FINANCIAL INSTITUTIONS
ACCOUNTING AND TAX UPDATE

Key 2019 year-end accounting and tax issues for financial institutions

December 18, 2019
Your presenter

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Chicago, IL
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ACCOUNTING UPDATE
ACCOUNTING UPDATE

Effective Date Deferrals
Effective date deferrals

- In October 2019, FASB decided to move forward with finalizing its proposals to defer the effective dates for certain ASUs and entities:

<table>
<thead>
<tr>
<th>Leasing</th>
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</thead>
<tbody>
<tr>
<td>Public business entities and certain NFPs and employee benefit plans that file with the SEC</td>
<td>No change – effective for 2019 CYE</td>
</tr>
<tr>
<td>All other entities</td>
<td>Revised - Fiscal years beginning after December 15, 2020 (2021 CYE), and interim periods within fiscal years beginning after December 15, 2021 (2022 CYE)</td>
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# Effective date deferrals

## Amendments to ASC 815, *Derivatives and Hedging*

<table>
<thead>
<tr>
<th>Entity Type</th>
<th>Effective Date</th>
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## CECL

<table>
<thead>
<tr>
<th>Entity Type</th>
<th>Effective Date</th>
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<tr>
<td>Public business entities that are SEC filers, except for smaller reporting companies (SRCs) as defined by the SEC</td>
<td>No change – effective for 2020 CYE</td>
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<tr>
<td>All other entities</td>
<td>Revised - Fiscal years beginning after December 15, 2022 (2023 CYE), and interim periods within those fiscal years</td>
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## Effective date deferrals

<table>
<thead>
<tr>
<th>Amendments to ASC 350, <em>Intangibles- Goodwill and Other</em></th>
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<td>Public business entities that are SEC filers, except for SRCs as defined by the SEC</td>
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<th>Amendments to ASC 944, <em>Financial Services - Insurance</em></th>
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</table>
ASU 2016-13


- Includes significant changes to the determination of the allowance for credit losses (ASC 326-20)
  - Supersedes many of the provisions in ASC 310 and 450

- Revises guidance on available for sale debt securities and the accounting for other-than-temporary-impairment (ASC 326-30)
ASU 2019-04

• ASU 2019-04, Codification Improvements to Topic 326, Financial Instruments – Credit Losses, Topic 815, Derivatives and Hedging and Topic 825, Financial Instruments, was issued in April 2019

• Provides certain policy elections and practical expedients with respect to the application of Topic 326 to the accrued interest component of the amortized cost basis

• Discusses treatment of the allowance when financial assets are transferred between classifications or categories (i.e., from held-for-sale to held-to-maturity)

• Clarifies the treatment of recoveries in the calculation of expected credit losses
Accrued interest – policy elections

- Policy election 1 – allowance for accrued interest receivable
  - If an entity writes off accrued interest receivable in a timely manner and makes certain disclosures, the entity may elect to not measure an allowance for credit losses on accrued interest receivable
    - Election made at the class of financing receivable or major security-type level
  - If no policy election is taken, will need to reflect the allowance for accrued interest receivable either as a separate calculation or as a component of the calculation of the allowance covering the total amortized cost
Accrued interest – policy elections

• Policy election 2 – write-offs of accrued interest receivable
  – By class of financing receivable or major security type, may make an election to write-off accrued interest by:
    1. Reversing interest income
    2. Recognizing credit loss expense
    3. Combination of both
  – Certain disclosures are required based on the policy elected
Accrued interest – policy elections

• Policy election 3 – disclosure of accrued interest receivable and associated allowance (as applicable)
  – Present net accrued interest receivable as either:
    • A separate line item in the balance sheet, or
    • Included in another line item with other balances, with separate note disclosure of where it is disclosed and the amount
  – If not elected, have to include in the line item that includes the remaining elements of amortized cost basis
Accrued interest – practical expedient

• May exclude applicable accrued interest included in the amortized cost basis for disclosures required under ASC 326
  – If applied, should disclose the total of accrued interest excluded from disclosed amortized cost basis as a single balance within the financials/notes
ASU 2019-05

• ASU 2019-05, *Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief*, was issued in May 2019

• Provides an option for entities with certain financial instruments to irrevocably elect the fair value option (ASC 825-10) upon adoption of CECL
  – Does not apply for held-to-maturity debt securities
  – Can be elected on an instrument by instrument basis
Effective Dates (Based on Calendar Year End)

2020
- PBES that are SEC filers, except SRCs as defined by the SEC
- All interim periods within the calendar year
- For call reports, beginning with Q1 2020

2023
- All others (PBES that are SEC filers and SRCs, PBES that are not SEC filers, Non-PBESs)
- All interim periods within the calendar year
- For call reports, beginning with Q1 2023
Planning for implementation

DO NOT DELAY SIMPLY BECAUSE THE EFFECTIVE DATE HAS BEEN DELAYED FOR CERTAIN FINANCIAL INSTITUTIONS!

Use the additional time to get started or remain on track to implementation.
Planning for implementation

• Analyze standard/understand where you are versus where you need to be
• Identify a multidisciplinary implementation team
• Weigh benefits of modifications to existing approaches/systems/applications/personnel versus investing in new
• Begin gathering data by asset type such as:
  – Lifetime historical loss information
  – Vintage data
  – Contractual life and prepayment information
  – Correlation of historical losses to various economic environments, underwriting conditions, etc.
Planning for implementation

• Identify resource needs (internal or external personnel/solutions)
• Develop detailed implementation plan/timeline
• Decide how to obtain or develop reasonable and supportable forecasts and how to adjust historical information as a result of forecasts
• Discuss plans with auditors and regulators
• Consider running a parallel model for a year or two to see impact and to fine-tune the model
Planning for implementation

• Develop new processes and internal controls, particularly as they relate to elements not previously subject to internal controls (e.g., forecasts, data points)

• Monitor regulatory and other developments in how the ASU is interpreted and applied, including implementation/disclosures for public companies

• Manage expectations and prepare to disclose the impact of adoption to investors/users

• Consider if any changes to credit extension or investment philosophy are warranted

• Consider impact on forecasting, budgeting and capital planning
AICPA CECL Practice Aid

• In September 2019, the AICPA issued nonauthoritative guidance in the form of a Practice Aid

• While primarily written for auditors, expected to be directly beneficial to lenders preparing to implement the new standard as well

• [https://www.aicpa.org/creditlosses](https://www.aicpa.org/creditlosses)
Subgroup vendor meetings were held in April and June 2019

Key Takeaways
- Role of management
- Internal controls
- Model evaluation
- Qualitative adjustment factors
- Retrospective reviews
- Forecasting/reversion
- Data used in models

https://www.aicpa.org/creditlosses
Resources

• RSM Thought Leadership
  – Financial Reporting Resource Center: Financial Institutions
    • Includes links to white papers and other resources
ACCOUNTING UPDATE

LIBOR Transition
Background

• LIBOR has been one of the most common reference rates used in the industry since its inception in the 1980s

• Criticisms of LIBOR
  - Hypothetical vs. actual transactions (i.e., may lack objective, market-driven inputs necessary to serve as a benchmark rate)
  - Dependent on banks responding and thus daily variability in volume and quality of responses
Alternative reference rates

• Groups around the world have been working to identify alternative reference rates to replace LIBOR and global IBOR counterparts

• United States’ Alternative Reference Rate Committee (ARRC) concluded in 2017 that it would:
  1. No longer compel banks to submit reference quotes for LIBOR after 2021, thereby effectively phasing out LIBOR as of the beginning of 2022
  2. Officially endorse the Secured Overnight Financing Rate (SOFR) as the preferred alternative to LIBOR

• Other reference rates such as Ameribor and other global rates are also available, SOFR is just the ARRC’s recommendation
Operational challenges

- Many variable rate loans, debt agreements and derivative contracts include references to LIBOR
  - Not only does it need to be phased out completely by 2022, but there is an expectation that it will be less reliable moving toward that date as fewer banks start to provide voluntary data
  - May need to consider phasing out prior to 2022

- **Fallback language** in current contracts and standard future contracts likely needs to be adjusted
  - Legal provisions that dictate what to do when the stated reference rate is no longer available
  - AARC has recommendations for revised common fallback language for a variety of products on its website

- May impact underwriting, contract negotiation and accounting
Accounting for LIBOR transition

- FASB and GASB both currently have proposals out to clarify the accounting treatment at the time of transition to LIBOR
  - Would generally allow that the contract’s terms could be modified without having to consider for a troubled debt restructuring and without losing certain accounting treatment (e.g., hedge accounting)
Accounting for LIBOR transition

• Refer also to RSM’s whitepaper on the topic for further discussion
ACCOUNTING UPDATE

Regulatory Matters

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May be able to remove entirely since not really accounting - may suggest keeping appraisals though

Sarb, Amber, 11/8/2019
Community Bank Leverage Ratio (CBLR) Framework

- Final rule issued September 17, 2019 to create the CBLR Framework
  - Effective January 1, 2020 and would be reflected in the March 31, 2020 call report
- Optional framework designed to reduce certain operational and reporting requirements related to regulatory capital
- Considered to be well-capitalized if meet the following criteria:
  1. Opt in to the Framework
  2. Maintain a leverage ratio of greater than 9 percent
  3. Have less than $10 billion in average total consolidated assets
  4. Have off-balance-sheet exposures of 25 percent or less of total consolidated assets
  5. Not be an advanced approaches banking organization
Credit Union Risk-Based Capital

• Final rule issued in 2015 to amend Part 702 to require credit unions that take certain defined risks to hold capital commensurate with those risks
  - Effective January 1, 2020
  - Proposal is out there to delay based on new changes with CBLR framework and other changes being made on the banking end

• Applies only to complex credit unions
  - As of January 1, 2020, a credit union is defined as complex and a risk-based capital ratio is applicable only if the credit union has quarter-end total assets exceeding $500 million as of its most recent call report

• Replaces the risk based net worth ratio (RBNWR) with the risk-based capital ratio for complex credit unions (similar to what is in place for banks)
Appraisal Guidelines

• Federal banking agencies (FDIC, FRB and OCC)
  - Issued amended rule in September 2019
  - Increased appraisal requirements for residential real estate from $250,000 to $400,000
    • Certain rural residential properties are exempt
  - Requires appraisals for federally related transactions to be subject to appropriate review for compliance with the Uniform Standards of Professional Appraisal Practice (USPAP)
  - Threshold for commercial real estate transactions remains at $500,000
  - Refer to FIL 53-2019 for further discussion
Appraisal Guidelines

• Credit unions
  - Issued final rule in July 2019
  - Increased appraisal requirements for commercial real estate from $250,000 to $1,000,000
    • Certain rural transactions are exempt
  - Threshold for residential real estate transactions remains at $250,000
  - Refer to the final rule on the NCUA’s website for further discussion
TAX UPDATE
Executive Summary

• Tax Reform Update
• Compensation Expense Limitation - Sec. 162(m)
• Revenue Recognition
• Business Interest Expense Limitation – Sec. 163(j)
• Bank Owned Life Insurance
• Bonus Depreciation
• Dividend Received Deduction (DRD)
• Non-Deductible Parking Expenses

• Meals and Entertainment
• FDIC Premium Payments
• Federal NOL
• AMT Credits
• Qualified Opportunity Fund Investments
• R&D Credit
• Sec. 382 Limitation
• Tax Disclosure Update
• S Corporation – Sec. 199A
• State and Local (SALT) Update
Executive Summary – Tax Developments Impacting Banks

• Tax Reform (TCJA) reduction in corporate tax rates to 21% provided significant improvement in bank earnings – lower effective tax rate

• TCJA (Tax Reform Act of 2017) created significant areas of uncertainty and Treasury has been active in issuing guidance during 2019 for Sub S banks and other key areas impacting banks

• No significant Federal tax legislation during 2019 and none expected prior to the November 2020 elections

• There continues to be significant state and city tax legislation impacting the banking industry
Executive Summary – Federal Tax Developments

• Possible future tax legislation – will the 21% tax rate survive?
• Continued discussions regarding some form of “financial transaction tax”
• Recent IRS guidance regarding Section 382 regulations for acquired NOL and built-in loss utilization
• No noticeable increase in IRS examination activity during 2019
Executive Summary – State/Local Tax Developments Impacting Banks

• Significant increase in tax legislation impacting multi-state banking companies at state, city, and county levels

• State effective tax rates are increasing for most banking companies

• The US Supreme Court sales tax case, South Dakota vs Wayfair, Inc., in June 2018, has many states looking to expand their “Nexus” reach to income and other non sales taxes

• State tax compliance requirements are increasing the tax department burden for almost all of our banking clients.
TAX REFORM - 2019 UPDATE
Federal Provisions
Corporate tax rate was permanently reduced from 35/34% to a flat 21% and the graduated rates were removed (i.e. all income now taxed at 21%).

Introduced new 20% pass-through deduction (Section 199A) for Subchapter S Banks (to sunset in 2025.)

ABA and various trade organizations are supporting H.R. 216 to make Section 199A pass-through deduction permanent for Sub S Banks.

Individual tax rates were temporarily reduced with the highest marginal rate decreased from 39.6% to 37% (to sunset in 2025).

Individual capital gains & dividend rates left unchanged.

3.8% tax on net investment income and 0.9% Medicare tax on compensation left unchanged.
• The Section 162(m) limitation applicable to public companies only limits the individuals compensation deduction for certain covered employees to $1M per year.

• The TCJA eliminates the exception under section 162(m) for all performance based compensation, including bonuses, stock options, deferred compensation and restricted stock.

• The TCJA did provide a transition rule for payments that are made pursuant to a binding written contract in effect on Nov. 2, 2017.
• Section 162(m) will now apply to companies that issue public debt securities, in addition to public equity filers (section 15(d) filers.)

• The CFO/Principal Financial Officer is added to the group of covered employees.

• Once an individual is a covered employee in 2017 or later, they are always a covered employee, even if no longer one of the five officers or have separated form the company.

• The TCJA extends covered employee status whether or not a proxy is filed, in situations where a proxy would have otherwise been required (for example, sale of a business during a period when the company was a public entity.)

• Transition rules cover payment pursuant to binding contracts in existence at Nov. 2, 2017- this should cover most stock option and stock grants, but bonus plans could be a challenge—will need more guidance in this area.

• Compensation amounts in excess of $1 million which are disallowed reflect a permanent difference.

• The new provisions require an analysis of deferred tax assets related to stock compensation, deferred compensation and bonuses to determine whether those assets are more likely than not to be realized, or whether they need to be written off.
New IRC 451(b) provisions generally prohibit accrual basis taxpayers from recognizing income for tax purposes later than the timing of the financial statement recognition with some exceptions (i.e. special tax accounting methods, mortgage servicing, etc.)

Revenue would be recognized for tax in the earliest period of when “fixed” (earned/due/received) or when recognized for GAAP purposes.

Generally interchange income, credit card late fees, for example, may no longer be deferred for tax purposes. TCJA legislation was focused primarily on credit card fees in banks.
• IRS Treasury issued proposed regulations in September, 2019, providing further guidance and clarification.

• For banks the proposed regulations exempt the following:
  - Market Discount
  - De minimis OID – which generally covers most deferred loan fees charged for interest, such as points
  - Income related to debt investments, accounted for as a discount or otherwise taken into income as an adjustment to the yield of the debt instrument over the life of that debt instrument on the taxpayers financial statements (such as non-de minimis OID/points)
• Proposed regulations clarify that the following types of “specified credit card fees” are subject to the new rule and taxpayers cannot rely on prior IRS guidance or case law (e.g. Capital One case)
  – Credit card late fees
  – Credit card cash advance fees
  – Credit card interchange fees/merchant discount

• Tax accounting method changes resulting from the new rules for specified credit card fees will be considered a 2019 automatic change with a 6-year spread adjustment period
The TCJA generally limits the deduction by corporations for net business interest expense (i.e.: interest expense in excess of interest income) to an annual limitation of 30% of EBITDA (will adjust to EBIT after 2021).

The interest expense limitation is applied on a consolidated tax return basis.

Any disallowed interest will be carried forward indefinitely and used in future computations, and reflected as deferred tax assets by C corporations.

Most banks will be unaffected since a bank’s net interest income generally exceeds net interest expense but we are seeing banks impacted in two ways:

1. The limitation could impact bank owned partnership investments as the disallowance is applied at the partnership level, then allocated to the individual partners who are not able to offset interest income or adjusted taxable income from other sources against the disallowed amount.
   - The basis in partnership should be reduced by the passed-through disallowed loss even though the deduction is not allowed.
LIHTC partnership can avoid this limitation by making one-time election (irrevocable) to be treated as an electing real property trade or business.

If the election is made, Alternative Depreciation System (ADS) method should be used (usually MACRS) for real property meaning the life of the real estate assets are depreciated over 30-40 years instead of 27.5 years.

(2) It can also impact separately-filed state tax returns of non-bank affiliates in the same consolidated group.

Some states require each separate company affiliate in a consolidated group to file separate state tax returns and apply this federal limitation as if each affiliate was a separate company.
• The 2017 TCJA provides that life insurance policies “transferred for value” lose their tax-exempt status upon transfer and therefore produce taxable death benefits UNLESS an exception applies.

• Prior to the TCJA legislation, the law exempted transfers under most tax free mergers and stock purchase transactions banks used to effect an acquisition where the tax basis or tax attributes of the target bank carried over to the acquirer.

• However, the TCJA legislation as executed, removed this historical exemption under prior law causing concern for many bank acquisitions.

• For pending acquisition transactions, the proposed regulations do not address certain typical acquisition structures involving mergers, where the target bank holding the BOLI contracts is merged out of existence either inadvertently or after the initial transaction is completed.
On March 29, 2019, Treasury released proposed regulations which addressed concerns in the industry regarding TCJA and the “transfer for value” rules.

Included in the regulations is a favorable rule important to the banking industry—a carve-out permitting a company acquiring a corporation that owns life insurance policies to avoid losing the tax exempt status and death benefits becoming taxable on payouts under those policies. This favorable rule does not apply to S-Corporation acquisitions.

The proposed regulations would exclude from the TCJA’s unfavorable rule an acquisition of a C corporation, provided that life insurance contracts do not constitute more than 50 percent of the gross value of the C corporation’s assets AND the acquisition results in the acquisition of a beneficial ownership in the corporations stock (i.e.: the target corporations existence survives in the acquisition structure). Under this proposed rule, the pre-TCJA exceptions to the transfer for value rule could apply after a corporate acquisition.

It is important to note that this favorable provision of the proposed regulations would be effective for transactions occurring after the date the proposed regulations are finalized. As things stand today, an exception in TCJA has been provided for acquired BOLI if the insured individuals have a substantial family, business, or financial relationship with the acquirer.

Banks which have already completed an acquisition in 2018 and recorded a deferred tax liability for acquired BOLI may need to re-evaluate in 2019 whether such deferred tax liability is still appropriate under ASC 740.
TCJA - Bonus Depreciation

• 100 percent bonus depreciation expensing for “qualified” assets which generally includes personal property, land improvements, and software

• Applies to new and used property acquired

• $1 million permanent expensing under section 179, subject to limitations and phase-outs

• Note – most states do not follow the new federal bonus depreciation rules and either limit or do not recognize the new 179 expensing rules

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<tr>
<th>Placed-in Service Date</th>
<th>Bonus Depreciation</th>
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<tr>
<td>9/28/2017 – 2022</td>
<td>100%</td>
</tr>
<tr>
<td>2023</td>
<td>80%</td>
</tr>
<tr>
<td>2024</td>
<td>60%</td>
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<tr>
<td>2025</td>
<td>40%</td>
</tr>
<tr>
<td>2026</td>
<td>20%</td>
</tr>
<tr>
<td>After 2026</td>
<td>0%</td>
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</tbody>
</table>
• Note:
  - New “Qualified Improvement Property” categorization added by TCJA intended to consolidate various types of improvement property into one category with a 15 year life, eligible for bonus depreciation.
  - However, TCJA as currently drafted, QIP will have a 39 year life and does NOT meet the eligibility requirements for new 100% bonus depreciation.
  - Congress must pass a technical correction to fix
  - QIP does qualify for Section 179 expensing. However, application may be limited for Sub S Banks with significant passive or trust shareholders.
• Dividends received deductions (DRD) for corporation-to-corporation dividends adjusted accordingly
  – Reduces 80 percent DRD to 65 percent and 70 percent DRD to 50 percent to preserve current effective rates
  – Effective for tax years beginning after 12/31/17

• Securities or investments which are treated as “equity” for tax purposes held at the bank or bank holding company are subject to the DTD reduction
• This TCJA change essentially disallows a deduction for the employers cost of providing transportation fringe benefits to employees.

• Any parking spaces reserved for employees are nondeductible (IRS Notice 2018-99) unless the amount is reported to employees as taxable income.

• Employer parking expenses (leased or owned) include, but are not limited to:
  – Repairs and maintenance
  – Utility costs, insurance, property taxes, and interest
  – Snow and ice removal, leaf removal, trash removal, cleaning, and landscape costs
  – Parking lot attendant expenses and security
  – Rent or lease payments or, if it’s not specified in the agreement, a portion or a rent or lease payment

• Depreciation is not included in the definition of parking expenses (fully deductible)

• Spaces not reserved for employees require allocation only if employees occupy 50% or more of the available spaces on average.
Meals & Entertainment

• New rules for meals
  – No more de minimis fringe benefit exception to 50 percent limitation for employee group working meals and meals on-site for the convenience of the employer
  – Section 274(e) exceptions to 50 percent limitation for meals that still apply (i.e. 100% deductible meals):
    • Expenses treated as employee compensation
    • Reimbursed expenses
    • Expenses for recreational, social or similar activities primarily for the benefit of employees
    • Expenses for goods, services and facilities made available by the taxpayer to the general public
    • Expenses for goods or services that are sold by the taxpayer in a bona fide transaction for an adequate and full consideration
    • Expenses includible in income of persons who are not employees
• New rules for entertainment
  - Most entertainment is now nondeductible
    • General rule is entertainment that is exclusively for the benefit of the employee is potentially 100% deductible (e.g. employee team building, award dinners, employee recognition, year end parties)
    • Entertainment of existing/potential customers or clients, such as sporting events, playing golf, theatrical events, etc. are now nondeductible.
  - Section 274(e) exceptions to disallowance for entertainment that still apply
    • All of the meals exceptions on the previous slide, plus:
    • Meetings of employees, stockholders, agents and directors
    • Meetings of business leagues (e.g. Chambers of Commerce)
Meals – At Entertainment Venue?

• Business meals between business owner or employee and client or potential client are 50 percent deductible, IF
  • Furnished at a restaurant and not an entertainment venue
  • Not lavish or extravagant under the circumstances
  • Taxpayer has reasonable expectation of deriving income or other business benefit

• Otherwise, it is nondeductible entertainment
  – UPDATE: Notice 2018-76 – recently clarified that meals/food/drink at/during an entertainment event (e.g. sports game) may still qualify for the 50% deduction provided the taxpayer is present, the cost of the meal/food/drink is separately invoiced (or separately stated on the invoice), and the cost is not extravagant, assuming the event is for business purposes
TCJA - FDIC premium payments

• TCJA imposes a limit on the deductibility of FDIC premium payments if “total consolidated assets” exceed $10 billion

• Limitation equal to the ratio that:
  - “total consolidated assets” in excess of $10 billion bears to
  - $40 billion
  - deduction phases out completely when “total consolidated assets” exceed $50 billion

• Effective for tax years beginning after December 31, 2017
The TCJA makes several changes to net operating loss carry-forwards.

First, for net operating losses arising in taxable years beginning after Dec. 31, 2017, such losses may only offset 80 percent of current year taxable income.

Secondly, for net operating losses arising in taxable years ending after Dec. 31, 2017, these losses may not be carried back, and can be carried forward indefinitely.

The enacted law does not change the pre-2018 loss usage, carryover or carryback periods.
• Frequently Asked Question
  - How does the 80% income limitation work?

• Example:
  - XYZ Bank has $100MM in NOL generated through 12/31/2017 and incurs a $20MM NOL in tax year ended 12/31/2018
  - If XYZ Bank generated $100MM in 2019 taxable income, it would appear that all of the pre-2018 NOL would be available
  - What if XYZ Bank generated $110MM in 2019 taxable income?
    • XYZ would likely offset $8MM of the additional $10MM in income with the 2018 loss
    • Or... would XYZ Bank’s utilization of the 2018 loss be zero because 80% of $110MM is $88MM, which is less than the $100MM of NOL applied to the 2019 taxable income?
The TCJA repeals the corporate alternative minimum tax, effective for taxable years beginning after Dec. 31, 2017.

The enacted law will continue to allow existing AMT credits to offset regular tax liability, after other credits.

ATM credits rendered refundable by TCJA

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Portion Refundable</th>
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<tbody>
<tr>
<td>2018</td>
<td>50% of AMT credit &gt; tax liability</td>
</tr>
<tr>
<td>2019</td>
<td>50% of AMT credit &gt; tax liability</td>
</tr>
<tr>
<td>2020</td>
<td>50% of AMT credit &gt; tax liability</td>
</tr>
<tr>
<td>2021</td>
<td>100% of AMT credit &gt; tax liability</td>
</tr>
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No Sequestration – On 1/14/2019, the IRS issued guidance indicating that the refunded AMT credits would not be subject to federal budget sequestration.
Alternative Minimum Tax (Cont’d)

• For tax accounting purposes, this likely results in a release of any existing valuation allowance against any AMT credit’s since those credits are now ultimately realizable, either as a reduction of future regular tax liability or as a refund.

• AMT credits should now be recorded as a current tax receivable since 100% of the credits will ultimately be refundable or be utilized as credits against current taxable income.

• However, any AMT credits suspended under Section IRC 383 beyond 2021 generally will not be released.
TCJA - Qualified Opportunity Fund Investments

- The TCJA is designed to create a tax incentive program for encouraging investments into economically depressed areas.

- Some banks are considering investing in these QOFs which in some instances provide Community Reinvestment Act credit.

- Capital gains may be deferred or exempted from taxation by reinvesting those gains through a Qualified Opportunity Fund (“QOF”) within 180 days of the sale or exchange.

- Tax savings:
  - Held more than 5 years – 10% permanent exclusion of the deferred gain
  - Held more than 7 years – 15% permanent exclusion of the deferred gain
  - 85% remaining gain recognized in 2026
  - Held more than 10 years – tax exempted on post-2026 appreciation up to 2048

- QOF is a corporation or a partnership that was formed for investing in “Qualified Opportunity Zone Property.”

- Opportunity Zone is a specially designated census tract including many commercial, industrial and residential areas.
TCJA - Qualified Opportunity Fund Investments (Cont’d)

- Applies to capital gain realized on or before December 31, 2026.
- The original gain is deferred until the earlier of:
  - The date the QOF investments is sold or exchanged, or
  - December 31, 2026.
- For capital gains that are invested in an Opportunity Zone fund, money must be equity not debt.
- Generally, property in which the QOF fund invests must be substantially improved within 30 months or have their original use commence with the Opportunity Fund in the Opportunity Zone.
- The trade or business is NOT engaged in certain business including
  - Golf courses; Country clubs; Massage Parlors; Hot tub facilities; Suntan facilities; Racetracks or other facilities used for gambling; or any store that primarily sells alcohol for consumption off premises
• Taxpayers who perform qualifying research and development ("R&D") activities within the U.S. could get dollar-for-dollar tax credit against their tax liabilities.

• Qualifying activities include:
  - New or Improved: The design and development of a new or enhanced product or process, including software
  - The development of new or enhanced: Software and Technology, Proprietary development, Customization of off-the-shelf software, and Complex Integrations
  - Software development life cycle: Ideate/Create, Requirements Design, Prototyping, Build/Develop, and Test (Test & Learn)
Research Credit (Cont’d)

• Qualifying Expenditures include:
  - **W-2 Wages**: Any wages paid or incurred to an employee in the performance of qualified research activities. It’s same as the amount reported on “Box 1” of the Form W-2.
  - **Computer Lease Costs**: Expenses paid or incurred to another person for the right to use computers performing qualified research activities if computers owned by the third party.
  - **Contracted Research**: Expenses related to third parties (excluding employees of the taxpayer) directly performing or supporting R&D activities on behalf of the taxpayer.
  - **Supplies**: Supplies and materials (not subject to depreciation) directly used in the performance of qualified research.
Research Credit (Cont’d)

• Special Tasks Qualified as R&D includes:
  - Self-service web applications and mobile apps
  - Point of sale solutions
  - Big data initiatives leveraging predictive and strategic analytics
  - Payment solutions
  - Automated underwriting systems
  - B2B software applications
  - Developing complex algorithms and business logic
  - Vendor package software implementations (e.g., proprietary modifications, customization, integrations, additional features, etc.)
  - Merchant applications that interface with business partners
  - Internal-use software resulting in a reduction to cost or improvement to speed
Sec. 382 NOL Limitation – Proposed IRS Regulations

- Proposed September 2019, and will become effective only for ownership changes occurring after the REGS are finalized.
- If finalized without modification, be taxpayer unfavorable in virtually all aspects.
  - 338 approach - Favorable to companies with NUBIG because of depreciable and amortizable assets with high book basis / no net unrealized built-in-gains tax basis (i.e., goodwill) which resulted in an increase in the Section 382 annual limitation for hypothetical/foregone deductions treated as RBIG.
  - 1374 approach: Favorable to companies with NUBIL as certain deductions (i.e., contingent liabilities, deferred revenue) were not captured as RBIL.
  - 1374 approach: Also eliminates the presumption that only bad debt charge –offs deducted within first 12 months of an ownership change constitute realized built-in losses.
SALT TAX UPDATE
States incorporate provisions of the Federal tax law in varying degrees – each state must be examined separately to conclude as to impact of Tax Reform

- Several states have “rolling” conformity provisions in their statute, meaning that they will automatically conform with the new Federal law (e.g. IL, MO, TN)
- Several other states must update their “fixed date” conformity statutes to adopt the new provisions, if they have not already (e.g. IA, MN, WI, MI, IN, KY). Some who have already updated their conformity are decoupling from specific provisions (e.g. bonus depreciation)
- The remaining states only conform selectively

Generally, most states will experience a revenue increase.

State income taxes generally has become more material to financial statement ETR reporting due to a reduction in Federal tax rate
FI Tax Update – Tax Reform – State Conformity

• Banks with national lending/leasing platforms should consider the following:
  - IRC conformity date
  - State decoupling from Federal provisions
  - Treatment of disregarded entities
  - Flow-through conformity to 20% deduction
  - Separate / Combined / Consolidated returns
  - Tax elections & Accounting Methods
  - NOL carry-back / carry-forward rules
  - Financial statement impact
  - Regulatory filing / Call Report impact
South Dakota v. Wayfair - recap

- South Dakota v. Wayfair, Inc.
  - A history of the case:
    - South Dakota Senate Bill 106 imposed a sales tax collection and remittance obligation on remote sellers without physical presence in South Dakota when gross revenue from sales of TPP or services exceeds:
      - $100,000, or
      - Sales occur in 200 or more separate transactions
    - South Dakota Supreme Court overturned the law under Quill
    - U.S. Supreme Court agreed to hear the case
  - On June 21, 2018, SCOTUS overrules Quill in a 5-4 decision
    - “Flawed on its own terms”
    - Physical presence no longer required to establish SUT nexus
Post-Wayfair to-do list

- Post-Wayfair to-do related to Income Tax/Other non sales tax type taxes
  - **Understand current nexus footprint:** When was the last nexus analysis conducted? Consider voluntary disclosure agreements (VDA) and amnesties for significant noncompliance to catch-up with new nexus framework. Understand which states have factor presence standards or other economic nexus laws.
  - **Review apportionment methodology regularly:** Once nexus is established, the next important step is to understand how you assign income to the various states. Every year, more states enact single-sales factor sourcing sales based on the location of the taxpayer’s customer. New nexus standards coupled with market-based sourcing (currently in more than 26 states and even more states for specialized industries such as broker/dealers, financial institutions and certain investment advisors) may result in lenders and/or service providers having potentially material apportionment or exposure in new states.
  - **Maintain state legislative tracking** of nexus expansion. Anticipate a wave of new economic nexus laws.
## State Income/Franchise Tax – 2019 Rate Considerations

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>2019 Rate</th>
<th>2018 Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Florida</td>
<td>4.458% (temporary – refunds provided if FL net tax collections exceed forecasts)</td>
<td>5.5%</td>
</tr>
<tr>
<td>Georgia</td>
<td>5.75%</td>
<td>6%</td>
</tr>
<tr>
<td>Indiana (Financial Institution Rate)</td>
<td>6.25%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Mississippi</td>
<td>Graduated: First $2,000 exempt</td>
<td>Graduated: First $1,000 exempt</td>
</tr>
<tr>
<td>North Carolina</td>
<td>2.5%</td>
<td>3%</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>7.7%</td>
<td>7.9%</td>
</tr>
<tr>
<td>New York – MTA Surcharge</td>
<td>28.9%</td>
<td>28.6%</td>
</tr>
<tr>
<td>Jurisdiction</td>
<td>Future Considerations</td>
<td>2019 Rate</td>
</tr>
<tr>
<td>---------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Arkansas</td>
<td>2021 – Graduated rate ranging from 1% to 6.2%</td>
<td>Graduated rate ranging from 1% to 6.5%</td>
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<tr>
<td></td>
<td>2022 – Graduated rate ranging from 1% to 5.9%</td>
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</tr>
<tr>
<td>Connecticut</td>
<td>10% surcharge extended through 2020</td>
<td>7.5% (plus 10% surcharge)</td>
</tr>
<tr>
<td>Florida</td>
<td>2022 – 5.5%</td>
<td>4.458%</td>
</tr>
<tr>
<td>Indiana</td>
<td>2020 – 6%</td>
<td>6.5%</td>
</tr>
<tr>
<td></td>
<td>2021 – 5.5%</td>
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</tr>
<tr>
<td></td>
<td>2022 – 5%</td>
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</tr>
<tr>
<td></td>
<td>2023 – 4.9%</td>
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</tr>
<tr>
<td>Illinois</td>
<td>2021 – 10.49%* (Income Tax – 7.99%<em>; Replacement Tax – 2.5%)</em></td>
<td>9.5% (Income Tax – 7%; Replacement Tax – 2.5%)</td>
</tr>
<tr>
<td></td>
<td>* CONTINGENT – Requires 3/5th approval in November 2020 Voter Referendum</td>
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<tr>
<td>Mississippi</td>
<td>2020 – Graduated: First $3,000 exempt</td>
<td>Graduated: First $2,000 exempt</td>
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<tr>
<td></td>
<td>2021 – Graduated: First $4,000 exempt</td>
<td></td>
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<tr>
<td></td>
<td>2022 – Graduated: First $5,000 exempt</td>
<td></td>
</tr>
<tr>
<td>Missouri</td>
<td>4%</td>
<td>6.25%</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>2020 – BPT: 7.7%, BET: 0.6%</td>
<td>BPT: 7.9%, BET: 0.675%</td>
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<tr>
<td></td>
<td>2022 – Ranges depending on revenue collections*</td>
<td></td>
</tr>
<tr>
<td></td>
<td>*BPT – 7.5% to 7.9%, BET – 0.5% to 0.675%</td>
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<tr>
<td>New Jersey</td>
<td>2020 – 1.5% temporary surcharge on allocated income great than $1 million</td>
<td>9% plus 2.5% temporary surcharge on allocated income greater than $1 million</td>
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<tr>
<td></td>
<td>2022 – No temporary surcharge currently in place</td>
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</tbody>
</table>
### State and Local Developments – Income/Franchise Tax Considerations

<table>
<thead>
<tr>
<th>Filing by Category</th>
<th>Future Considerations (2019 onwards)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Alabama</strong></td>
<td>• Quarterly estimated Financial Institution Excise Tax payments are now required for tax years beginning on or after January 1, 2020</td>
</tr>
</tbody>
</table>
| **California**     | • Taxpayers in “good standing” that file corporate income/franchise returns will be granted an automatic seven-month extension for filing Form 100 and Form 100W tax returns for tax years beginning on or after January 1, 2020 (previously granted an automatic six-month extension)  
• NOLs generated after December 31, 2018 can no longer be carried back  
• Taxpayers are no longer permitted to make separate state IRC Section 338 elections |
| **Colorado**       | • Market-based sourcing apportionment standard for tax years beginning on or after January 1, 2019 |
| **Florida**        | • The temporary tax rate decrease in 2019 to 4.458% will automatically be reduced and/or refunds issues if net tax collections exceed forecasts in the 2018-2019 fiscal year and 2020-2021 fiscal year |
| **Kentucky**       | • Mandatory combined reporting for unitary groups subject to corporate income tax for tax years beginning on or after January 1, 2019  
• Bank franchise tax is eliminated beginning on January 1, 2021  
• Prior to 2021, taxpayers subject to the bank franchise tax will continue to file separate bank franchise tax returns  
• After bank franchise tax is repealed, these taxpayers with nexus will file corporate income tax returns and will be included in the combined unitary group (if applicable) |
| **Michigan**       | • For tax years beginning on or after January 1, 2021, financial institutions will determine their net capital tax base as of the end of the tax year (previously used five-year average) |
| **Minnesota**      | • The MN NOL deduction cannot exceed 80% of taxable net income for a given year  
• MN AMT has NOT yet been repealed |
| **New Hampshire**  | • Market-based sourcing standard for tax years beginning on or after January 1, 2021 |
| **New Jersey**     | For tax years ending on or after July 31, 2019:  
• Combined reporting is mandatory for unitary groups. A combined group must determine its managerial member, who then reports the combined group to the New Jersey Division of Revenue and Enterprise Services (DORES). This registration can be completed online.  
• The minimum tax for each member of the combined group will be $2,000  
• Net operating losses are computed post-apportionment; all prior pre-apportionment NOLs will be converted to post-apportionment  
• DRD for deemed or paid dividends from greater than 80% owned subsidiaries has been reduced to 95%  
• Market-based sourcing for services based on where the benefit of the service is received |

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