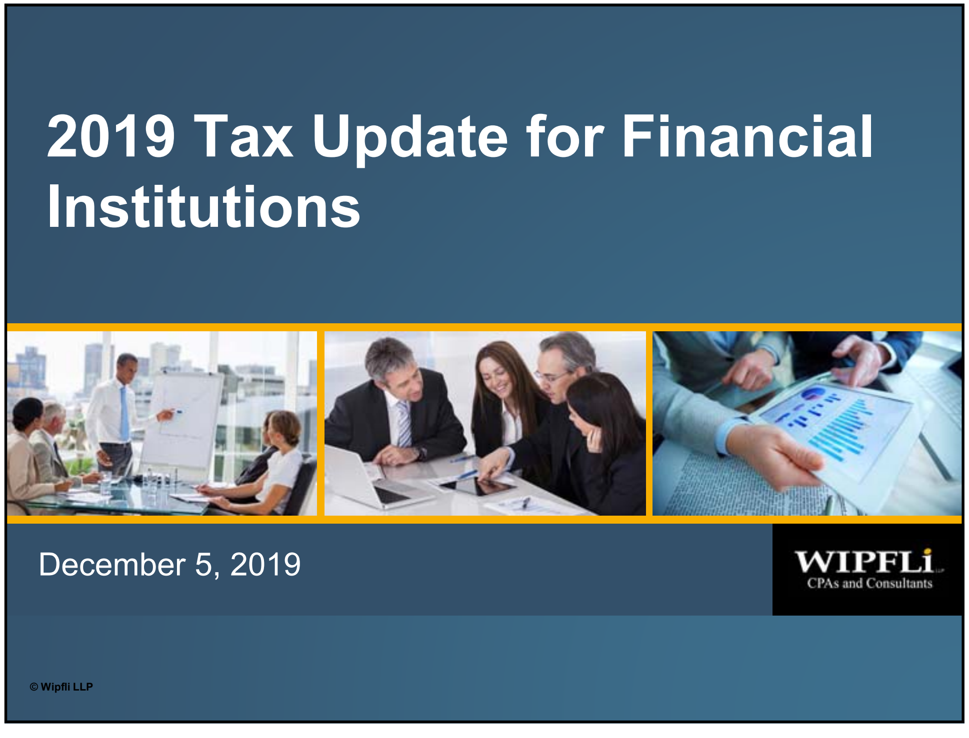
2019 Tax Update for Financial Institutions
December 5, 2019
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2

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Federal Tax Update

- Overview
  - Tax Issues Impacting All Banks
  - Tax Issues Impacting C-Corporation Banks
  - Tax Issues Impacting S-Corporation Banks
  - Federal IRS Audit Update

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Tax Issues Impacting All Banks

- Depreciation and Expensing (Bonus/179/LKE)
- Application of Section 451(b)
- Nondeductible Expenses (M&E and Parking)
- BOLI Issues With M&A
- Business Interest Limitation – Section 163(j)
- Opportunity Zones

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Depreciation and Expensing

- The TCJA increases the 50% bonus depreciation under current law to 100% through 2022 (through 2023 for longer production period property and certain aircraft).
- First year additional bonus depreciation is also extended through 2026 (2027 for longer production period property and certain aircraft) with a phase down beginning in 2023.
- The TCJA removes the requirement that the original use of qualified property must commence with the taxpayer. **As a result, the TCJA allows the additional first-year depreciation deduction for new <u>and</u> used property.**

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Bonus Depreciation

Period	Applicable Percentage
9/27/2017 - 2022	100%
2023	80%
2024	60%
2025	40%
2026	20%

179 Expensing

- The TCJA increases the 179 expensing limit to $1 million.
- Both expensing limitation and phase amounts will be indexed for inflation for tax years beginning after 2018.
- It also increases the 179 expensing for SUVs to $25,000.
- The TCJA expands the definition of qualified property to include improvements to nonresidential real property placed in service after the date the property was first placed in service:
  - Roofs
  - Heating, ventilation, and air-conditioning
  - Fire protection and alarm systems and security systems

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179 Expensing

Year	Section 179 Expense Limitation	Phase Out Starts At
2017	$510,000	$2,030,000
2018	$1,000,000	$2,500,000
2019	$1,020,000	$2,550,000

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Like-Kind Exchanges

- Like-kind exchanges are now only available for real property transactions.
- Like-kind exchanges are no longer allowed on personal property (such as vehicles).

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Application of Section 451(b)

- The TCJA has a new rule for accrual basis taxpayers, which generally prohibits the deferral of income (for tax purposes) to be beyond the timing of recognition in the applicable financial statement ("AFS").
- Note that call reports constitute an AFS.
- Exceptions apply to certain types of income:
  - Taxable income subject to special tax accounting methods
    - For example, installment sale contracts (IRC 453), hedging transactions, mark to market accounting (IRC 475), etc.
  - Any item of gross income in connection with a mortgage servicing contract

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Application of Section 451(b)

- Fortunately, most banks do not have many taxable income deferral items (aside from mortgage servicing arrangements, which is eligible for an exception).
- Those deferral items that do arise likely pertain to original issue discount or market discount, and these are both addressed favorably by proposed regulations (i.e., allowing for a deferral for tax purposes).
- The proposed regulations generally disallow taxable income deferral on credit card late fees, cash advance fees, and interchange fees (these remain the primary area of focus in applying this tax law change to banks).

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Nondeductible Expenses – M&E

- The TCJA repeals deductions allowed under current law for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the trade or business (and the related rule applying a 50% limit to such deductions) and for facilities used in connection with entertainment, amusement, or recreation.
  - Accordingly, no deduction is allowed for items such as tickets to the theatre or a sporting event, golf green fees, cost of skybox/luxury box, license fees paid to a sporting arena, etc.
  - Membership dues with respect to any club organized for business, pleasure, recreation, or other social purposes continue to be 100% nondeductible.

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Nondeductible Expenses – M&E

- IRS Notice 2018-76 provides additional guidance on when a business meal is a deductible expense and what constitutes entertainment.
  - Food and beverages provided during or at an entertainment activity will be deductible at 50% if the food and beverages are stated separately.
  - The rules cannot be circumvented by inflating the cost of the food and beverages.
  - Still need to meet the business purpose tests to receive the 50% tax deduction.

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Nondeductible Expenses – M&E

- The TCJA applies a 50% limit from December 31, 2017, through December 31, 2025, to expenses for food and beverages provided to employees through an eating facility operating for the convenience of the employer, and those expenses are nondeductible after December 31, 2025.
- A similar provision applies to meals provided on the business premises for the convenience of the employer—50% deduction through 2025 and no deduction after.
- De minimis fringe benefits (e.g., staff working lunches, pizza and soda when working overtime) are only 50% deductible.

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Nondeductible Expenses – Parking

- The TCJA disallows a deduction for the employer's cost of providing transportation fringe benefits to employees, including certain parking expenses.
- IRS Notice 2018-99 provides detailed guidance on how the nondeductible amount of employer-provided parking is determined in a variety of situations.

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Nondeductible Expenses – Parking

- IRS Notice 2018-99 provides the following:
  - Any amounts paid for, or reimbursed by, the employer for parking at third-party parking facilities is disallowed, unless reported to the employee as taxable compensation
  - Leased or owned parking lots with designated “employee-only” parking spots require an allocation of annual parking lot expenses to those spots (disallowed tax deduction)
  - The remainder of all parking spots (i.e., those not reserved) require an allocation of annual parking lot expenses only if the employees occupy 50% or more of the remainder spots (if more than 50% are used by customers, then no additional analysis is required)

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BOLI Issues With M&A

- The general rule is proceeds from a life insurance contract payable by reason of death are not taxable.
- If a policy is *transferred for value*, then the death benefits are taxable (less the consideration paid and premiums paid), unless an exception applies.
- Prior to TCJA, an exception applied to most tax-free mergers and stock acquisitions (i.e., carryover tax basis transactions).
- TCJA removed the carryover basis rules for BOLI policies when it created the “reportable policy sale” rules.

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BOLI Issues With M&A

- The new reportable policy sale rules have an exception if there is a “substantial family, business, or financial relationship with the insured.”
- These changes appeared to mean that BOLI policies acquired through an M&A transaction were now taxable, thus requiring the recording of a DTL at the closing date (on acquired BOLI policies for the future taxable income related to the taxable death benefit).

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BOLI Issues With M&A

- In March of 2019, the Treasury published proposed regulations that would exempt some corporation acquisition scenarios, and these regulations were finalized in October of 2019.
- The tax-exempt status of all BOLI policies owned by an acquired C corporation is preserved under the final regulations provided that:
  - The transfer results in the acquisition of a beneficial ownership interest in the C corporation’s stock, and
  - At the time of acquisition, not more than 50% of the fair market value of the acquired C corporation’s gross assets is comprised of BOLI.
- The exception above does NOT apply to S-corporation acquisitions or to certain tax-free mergers.

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BOLI Issues With M&A

- The regulations clarify what is meant by a "substantial family, business, or financial relationship with the insured":
  - Includes policies on the lives of individuals who were officers, directors, or highly compensated employees of the target immediately preceding the acquisition.
  - Also includes policies on the lives of individuals who were formerly directors or highly compensated employees of the target if immediately after the acquisition, the acquiror has an ongoing financial obligation to the insured individual related to his/her employment with the target.
    - Example provided is a life insurance contract held to fund various retirement obligations to the insured.

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BOLI Issues With M&A

- The regulations clarify what is meant by a "substantial family, business, or financial relationship with the insured" (continued):
  - Thus, most BOLI policies are likely to meet the requirements for having a substantial family, business, or financial relationship with the insured and should retain their tax-exempt status.
  - This is even the case in S-corporation acquisitions or certain tax-free mergers, assuming the substantial family, business, or financial relationship test is satisfied.

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Business Interest Limitation – Section 163(j)

- The TCJA limits a taxpayer's interest expense deduction to the sum of **interest income** plus 30% of the adjusted taxable income for the year.
- Businesses with average gross receipts of under $25 million (measured based on average over a three-year period) are exempt from the limitation.
  - Aggregation rules will apply to combine related entities in testing the $25 million gross receipts limit.

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Business Interest Limitation – Section 163(j)

- Adjusted taxable income means the taxable income of the taxpayer computed without regard to: (1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (2) any business interest income or expense; (3) the 20% deduction (199A) for certain pass-through income; and (4) the amount of any net operating loss deduction.
- For taxable years beginning before January 1, 2022, adjusted taxable income is further computed without regard to deductions allowable for depreciation, amortization, or depletion.
- In basic terms, EBITDA through 2021 and EBIT thereafter.

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Business Interest Limitation – Section 163(j)

- Applies on a consolidated tax return basis.
- The amount of any business interest not allowed as a deduction may be carried forward and used as a deduction in a subsequent year.
- Virtually every bank will be exempt from the limitation; however, it may impact a bank in two ways:
  - Limitation may apply to bank-owned partnership investments (for example, investments in low-income housing tax credit partnerships and other forms of real estate partnerships).
  - Limitation may apply to some separately filed state tax returns of non-bank affiliates in the same consolidated group (for example, some states require each affiliate in a consolidated group to file separate state tax returns and apply the tax law as if each affiliate was a standalone corporation).

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Business Interest Limitation – Section 163(j)

- Virtually every bank will be exempt from the limitation; however, it will definitely impact bank customers.
  - For this reason, it is very important that the commercial lending function considers the impact of Section 163(j) for not only credit evaluation, but also for the assessment of the best funding solution for a particular customer's needs.
  - Note that the change in 2022, from EBITDA to EBIT, could cause many more bank customers to be subject to the Section 163(j) interest expense limitation.

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Opportunity Zones

- New tax incentive resulting from TCJA, for steering investments into economically depressed areas
- Taxpayers can elect to defer, and potentially exempt from taxation (in part), eligible capital gains
- Must invest the capital gain into a Qualified Opportunity Fund ("QOF") within 180 days of the sale or exchange
- A QOF is a certified corporation or partnership organized for the purpose of investing in qualified businesses or business property located within a Qualified Opportunity Zone

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Opportunity Zones

- How does it work?
  - The original capital gain is deferred until the earlier of:
    - The date the QOF investment is sold or exchanged, or
    - December 31, 2026.
  - The original capital gain is exempt from taxation (in part), as follows:
    - A portion of the original deferred gain is exempt from taxation if certain holding period requirements are satisfied:
      - 10% if the QOF investment is held for 5 years.
      - 15% if the QOF investment is held for 7 years.
    - 100% of the gain resulting from appreciation in the QOF investment is exempt from tax if the QOF investment is held for 10 years.

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Opportunity Zones

- Full participation in the tax benefits may be limited for banks.
  - Requires an initial capital gain to participate, which is a rare occurrence for a bank (difficult for bank to have a capital gain).
  - Requires equity investment in a new or substantially improved tangible property (typically real estate) located in a designated low-income area or equity venture capital investment in businesses that operate within these areas.
- Banks can still play a role, most likely in the context of lending relationships with a QOF or investors in a QOF.
  - Potential for Community Reinvestment Act credit.
  - FDIC commented that investments in QOF do not automatically receive CRA consideration.

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Tax Issues Impacting C Corporations

- Corporate Tax Rate Reduction
- Limitations on Net Operating Losses
- Repeal of Corporate AMT
- Corporate Dividends Received Deduction
- Accounting Methods and Cash Basis Reporting

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Corporate Tax Rate Reduction

C-Corporation Tax Rates:

Taxable Income	2017	2018
$0 - $50,000	15%	21%
$50,001 - $75,000	25%	21%
$75,001 - $10,000,000	34%	21%
Over $10,000,000	35%	21%

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Corporate Tax Rate Reduction

- Will the 21% federal tax rate survive?
  - Depends on what happens in the 2020 presidential and congressional elections
  - Many of the Democratic presidential candidates have indicated that they are interested in repealing TCJA
  - The Democratic party platform has indicated that they are interested in increasing the corporate tax rate
  - Only time will tell

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Corporate Tax Rate Reduction

- What if the 21% federal tax rate increases?
  - Similar to the prior tax law change (TCJA), the deferred tax asset or deferred tax liability will need to be restated in the quarter of enactment.
  - The impact for most banks (with a deferred tax asset) will be additional book income (i.e., a debit to DTA and a credit to tax benefit/income).
  - Will want to revisit various tax planning strategies (it is generally better to accelerate income and defer deductions when tax rates are increasing).

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Limitations on Net Operating Losses

- The TCJA limits the NOL deduction to 80% of taxable income. This change applies to losses arising in taxable years beginning after December 31, 2017.
- The TCJA repeals the two-year carryback and the special carryback provisions, but provides an exception for certain farming losses.
- The TCJA removes the 20-year carryover limitation and provides for an indefinite carryover.
- These changes apply to net operating losses arising in taxable years beginning after December 31, 2017.

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Repeal of Corporate AMT

- Alternative Minimum Tax (AMT) repealed.
- AMT credits are refundable from 2018 – 2021.
  - Any AMT credit carryover can offset 100% of current year tax liability.
  - Any excess AMT credit (over current year tax liability) is refundable 50% from 2018 -2020.
  - Any remaining credit carryforward after 2020 is 100% refundable in 2021.

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Repeal of Corporate AMT

- No budget sequestration of AMT credits.
  - On January 14, 2019, the IRS issued guidance indicating that the refunded AMT credits would NOT be subject to federal budget sequestration.

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Corporation Dividends Received Deduction

- The general 70% limitation is reduced to 50%.
- The 80% limitation for “20% owned corporations” is reduced to 65%.
- Effective for tax years beginning after December 31, 2017.

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Accounting Methods and Cash Basis Reporting

- The TCJA increased the gross receipts threshold for cash basis accounting (tax purposes) from $5 million to $25 million.
  - The $25 million limit is indexed for inflation.
  - Applies to tax years beginning after December 31, 2017.
- This change in accounting method requires filing a Form 3115 with the Internal Revenue Service, and it results in a favorable Section 481 adjustment in the year of change (i.e., reduction to taxable income).
- Great candidates are banks below the $25 million gross receipts threshold that do not have a large muni portfolio.

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Tax Issues Impacting S Corporations

- Changes to Individual Tax Rates
- 199A Deduction for Non-Corporate Taxpayers
- Impact on Tax Distribution Methodology and Shareholder Agreements
- S Corp vs C Corp Analysis
- Disclosure Requirements Relating to Tax Basis

Individuals – Ordinary Income Rates

Tax rate	2017 Single	Tax rate	2019 Single
10%	Up to $9,325	10%	Up to $9,700
15%	$9,326 to $37,950	12%	$9,701 to $39,475
25%	$37,951 to $91,900	22%	$39,476 to $84,200
28%	$91,901 to $191,650	24%	$84,201 to $160,725
33%	$191,651 to $**416,700**	32%	$160,726 to $204,100
35%	$416,701 to $418,400	35%	$204,101 to $510,300
39.6%	$418,401 or more	37%	$510,301 or more

Watch the brackets for single individuals with income over $204,100

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Individuals – Ordinary Income Rates

Tax rate	2017 Married filing jointly	Tax rate	2019 Married filing jointly
10%	Up to $18,650	10%	Up to $19,400
15%	$18,651 to $75,900	12%	$19,401 to $78,950
25%	$75,901 to $153,100	22%	$78,951 to $168,400
28%	$153,101 to $233,350	24%	$168,401 to $321,450
33%	$233,351 to $416,700	32%	$321,451 to $408,200
35%	$416,701 to $470,000	35%	$408,201 to $612,350
39.6%	$470,001 or more	37%	$612,351 or more

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199A Deduction – Overview

High-Level Overview

- Generally applies to income from S corporations, partnerships (including LLCs), and sole proprietorships. Available to individuals, trusts, and estates.
- If fully applicable, the deduction will be 20% of business income.
- Calculated at the individual (or trust and estate) level.
- Intended to provide parity with C-corp tax rate reduction (21%).
- If applicable, brings the top individual tax rate on business income down to 29.6% (37% X 80%).
- Expires December 31, 2025.

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199A Deduction – Overview

High-Level Overview: How To Calculate

- Deduction generally equal to 20% of the taxpayer's combined qualified business income (QBI) for the year.
- QBI is the sum of:
  - Taxable income or loss for each qualified "trade or business" carried on by the taxpayer, and
  - Aggregate of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income.
- Qualified trade or business income deduction is limited by a "W-2 wage limitation" (this is generally not an issue for banks, given their high level of employee wage income).
- The deduction is further limited by 20% of the taxpayer's taxable income (after reduction for qualified capital gain).

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199A Deduction – Qualified Business Income

Qualified Business Income Defined

- QBI generally includes all net income from a business other than investment income.
  - Does not include dividends, investment interest income, capital gains and losses, commodities gains, and foreign currency gains.
  - QBI includes only income that is effectively connected with the conduct of a U.S. trade or business.

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199A Deduction – Qualified Business Income

Qualified Business Income Defined (Continued)

- QBI does not include any amount paid to the taxpayer:
  - Treated as reasonable compensation (as determined under current law)
  - By a partnership that is a guaranteed payment (for services under section 707(c) or section 707(a))
- "Specified Service Business" income is generally not QBI.
  - Exception provided for taxpayers under taxable income thresholds - $315,000 MFJ, $157,500 for all other taxpayers
  - Deduction relating to service business income completely phased out for taxpayers with taxable incomes of $415,000 MFJ, $207,500 for all other taxpayers
  - Amounts adjusted annually for inflation

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199A Deduction – Specified Service Business

A "Specified Service Business" includes any trade or business involving performance of services by owners or employees in:

Health	Law	Accounting
Actuarial Science	Performing Arts	Consulting
Athletics	Financial Services	Brokerage Services

OR

Any trade or business performing services as an employee.

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199A Deduction – Specified Service Business

- In August 2018, the IRS issued proposed regulations on 199A that were finalized in January of 2019. The regulations confirm that banks are not a Specified Service Business.
- However, the issue is that the regulations define banks as "taking deposits and making loans."
  - What about other non-core banking activities?
    - Dealers (loans sold on the secondary market) – Under the final regulations, this is okay if it relates to normal lending activities (i.e., bank originating loans for resale)
    - Wealth management/Trust departments

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199A Deduction – Specified Service Business

- The final regulations do allow a de minimis rule when determining whether the business is a specified service business or not.
  - *If the gross receipts are < $25 million, then no more than 10% of business can be a specified service business.*
  - *If the gross receipts are > $25 million, then no more than 5% of business can be a specified service business.*

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199A Deduction – Multiple Businesses

- If the de minimis rules are exceeded, is the entire business ineligible to take the Section 199A deduction?
  - No, assuming proper tax planning happens.
  - Trap for the unwary (seek professional tax advice).
  - If a bank is conducting SSTB activities that are above the de minimis thresholds, the final regulations acknowledge that the bank may still segregate those SSTB activities so as to not disqualify all of the core banking activities from the 199A deduction.

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199A Deduction – Multiple Businesses

- Example:
  - Gross receipts from an S-corporation bank are $50 million.
  - Gross receipts from a trust department are $5 million.
  - As a single business, none of the bank's income would be eligible for the 199A deduction, because the $5 million of trust department receipts is 10% of total gross receipts, thus failing the 5% de minimis test.
  - However, if the trust department is segregated as a separate business, then only the income of the trust department becomes ineligible for the 199A deduction. The core banking activities continue to qualify for the 199A deduction.

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199A Deduction – Multiple Businesses

- Multiple trades and businesses are not automatic.
  - Separate books and records must be maintained.
    - No clear definition is provided in the final regulations on what constitutes separate books and records.
    - Contains a provision that items of QBI properly attributable to more than one trade or business can be allocated using a "reasonable method" based on all of the facts and circumstances.
  - Is there a consistency requirement?
    - Can a bank report as a single business one year and multiple businesses the next year (i.e., if the de minimis threshold is exceeded in subsequent years)?
    - The regulations do not specifically address. Pending further guidance, we recommend breaking out in year one if there is a possibility in future years that the de minimis threshold will be exceeded.

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199A Deduction – Miscellaneous

- Deduction does not reduce adjusted gross income.
- Can be taken by taxpayers, regardless of whether they itemize or take the standard deduction.
- The deduction is not added back in computing individual level Alternative Minimum Tax.
- If the combined QBI of the taxpayer for any taxable year is less than zero, that amount is treated as a loss from a qualified trade or business in the succeeding taxable year.

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199A Deduction – Simple Example

Simple Example:

Facts:

Married Couple Filing Jointly	
Wage Income	$200,000
S-Corp Income From Bank – All QBI	$700,000
Share of S Corp's Wages = $800,000	
Standard Deduction	(24,000)
Taxable Income (Pre-199A Deduction)	$876,000

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199A Deduction – Simple Example

Simple Example (continued):

199A Deduction Calculation:

Lesser of:

1) QBI	$700,000	
X Deduction rate	20%	
	$140,000	
OR		Lesser = $140,000
2) Share of Business Wages	$800,000	(then limited to 20%
X	50%	of taxable income)
	$400,000	

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199A Deduction – Simple Example

Simple Example (continued):

Wage Income	$200,000
S-Corp Income From Bank – All QBI	$700,000
Share of S Corp's Wages = $800,000	
Standard Deduction	($24,000)
Taxable Income (Pre 199A)	$876,000
IRC 199A Deduction	($140,000)
Taxable Income (Post 199A)	$736,000
IRC 199A Deduction	$140,000
Top Marginal Tax Rate	X 37%
Tax Savings	$51,800

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Rate Comparison

Regular Pass Through	Service Pass Through	C Corp With Dividends - New	C Corp With Dividends - Old
$100 $(20) 199A $80		$100 X .21 $ 21	$100 X .35 $35
$80 X.37 $29.6	$100 X .37 $37.0	$79 Dividend X .238 $18.802	$65 Dividend X .238 $15.47
29.6%	37.0%	39.802%	50.47%

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Impact on Tax Distribution Methodology

- Lower tax rates will cause an "effective" marginal tax rate of 29.6% for most (but not all) S-corporation shareholders.
- Shareholder agreements should be reviewed, and potentially adjusted, in light of the new tax legislation and lower income tax rates. The verbiage within the shareholder agreement will control the tax distribution methodology.
  - Some shareholder agreements call for tax distributions to cover tax liabilities, "net" of any tax benefits resulting from bank losses, deductions, and credits passed through to the shareholder (presumably 29.6% ignoring state taxes).
  - Other shareholder agreements call for tax distributions at the highest individual tax rate (now 37% ignoring state taxes).
  - Each shareholder agreement is different. You should consult with legal counsel to ensure your verbiage accomplishes your desired objectives.

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S-Corporation Conversions

- With the highest C-corporation tax rate being 21% and the highest individual tax rate being 37% (or 29.6% after 199A), does S-corporation status still make sense for your bank?
  - Tax rates do not tell the entire story.
- Why did you become an S corporation in the first place?
  - Avoid double tax on dividends.
  - Stock basis increase for undistributed earnings.
- What are your strategic plans for the future?
  - Are you considering a bank sale?
  - Do you want to increase the amount of your capital (e.g., acquisition)?
  - What are your shareholders' expectations regarding dividends?
- Your tax advisor can assist with this analysis.

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Disclosure Requirements - Tax Basis

- Beginning in 2018, the IRS made several revisions to individual income tax returns (Form 1040), including a new requirement for S-corporation shareholders to attach a tax basis schedule to their tax return if any of the following occur:
  - A loss is reported on the Schedule K1.
  - A distribution is received from an S corporation.
  - Stock is disposed of.
  - A loan repayment is made from an S corporation.
- Since most S corporations pay quarterly tax distributions (to cover quarterly estimated tax payments), these new requirements will impact most S-corporation shareholders.

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Disclosure Requirements - Tax Basis

- The requirements to maintain tax basis schedules is ultimately the responsibility of the S-corporation shareholder.
- There is no requirement for the bank to maintain tax basis schedules for its shareholders.
- Despite this fact, it may be advantageous for tax basis to be maintained at the entity level for the following reasons:
  - Tax basis will be more uniform across the shareholder group and will likely be more accurate if maintained by the entity's tax preparer.
  - The cost of maintaining ad hoc (i.e., by each shareholder) is likely greater than it would be for the entity to maintain for all shareholders at once.
  - Maintaining at the entity level will facilitate a more formalized due diligence process (regarding ownership changes, etc.).
  - Professional fees are tax deductible at the entity level.

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Federal IRS Audit Update

- Overview
  - Taxpayer First Act
  - What You Can Do
    - LB&I directive on bad debts
    - Bad debt conformity election

Federal IRS Audit Update

- Taxpayer First Act
  - On July 1, 2019, President Trump signed the Taxpayer First Act of 2019 into law
  - Amends the Internal Revenue Code to modernize the Internal Revenue Service, improve customer service operations, strengthen taxpayer rights, and help bring the IRS technology systems into the 21st century
  - Most significant (potential) organizational and procedural changes within the IRS that we have seen in more than two decades. The true impact is still to be determined.

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Federal IRS Audit Update

- What You Can Do
  - IRS directive on charge-offs
    - Auditors are to accept charge-off amounts reported by banks and bank subsidiaries for GAAP or regulatory purposes as sufficient evidence of worthlessness
    - Directive does not apply to small banks (less than $500 million) that use the reserve method of accounting for loan losses under Code Section 585
    - Cannot be relied upon as law, but gives us insight into what the IRS is thinking

Federal IRS Audit Update

- What You Can Do
  - What about the conformity election?
    - Still recommended (note that IRS directive is not law)
      - If election has been made, then maintain it
      - If election has not been made, then consider making it
    - Continues IRS “protection” on the following:
      - Charge-offs
      - Nonaccrual interest
      - ORE initial write-downs to FMV (including potential issue of estimated selling costs)

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Federal IRS Audit Update

- What You Can Do
  - What about the conformity election?
    - Reminder to obtain Express Determination Letter (EDL) from federal regulators
      - EDL must be from most current exam.
      - EDL must be dated prior to 1st day of year election is made.
      - EDL must be obtained on every subsequent federal exam. If not obtained, conformity election is terminated.

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Questions?

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