FEDERAL AND STATE TAX UPDATE

FMS and NJ Bankers Half-Day Seminar
Stony Hill Inn

Glenn Richard James, JD, CPA
Partner, BDO USA, LLP

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Glenn Richard James, JD, CPA

Partner, Tax

Glenn is a partner in our Philadelphia office with more than 25 years of experience providing tax consultancy to financial institution clients as a tax partner in national and regional accounting firms. He serves as the practice leader for the financial institutions industry tax group.

Glenn lectures and writes widely in relation to financial institution taxation. He is a former member of the advisory board of the Bank Tax Institute and continues to serve that body periodically as a faculty member. He is a regular speaker at the annual PICPA Financial Institutions Conference.

His work includes counseling clients on accounting for income taxes under ASC 740; executive compensation; Pennsylvania, New Jersey, Delaware and New York state taxation of banks and thrifts; and financial transactions taxation. He also represents financial institution clients before the Internal Revenue Service, the New York State Department of Tax and Finance, the New York City Finance Department and the New Jersey Division of Revenue.

BDO USA, LLP

1700 Market Street, Suite 2900

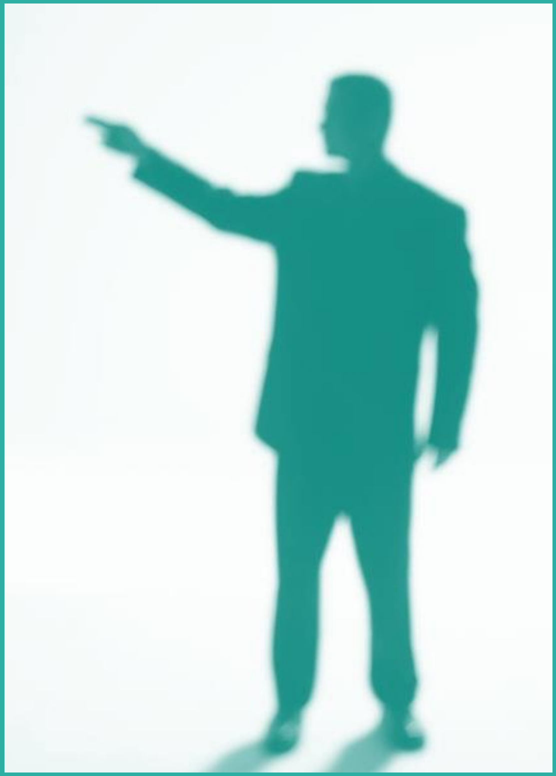
Philadelphia, PA 19103

Tel: 215-241-8959

Email: gjames@bdo.com

Agenda

- Regional SALT Trending
- Basel III – Deferred Taxes
- Recent Pennsylvania Tax Legislation
- New York Tax Reform



Regional SALT Trending

Regional SALT Trending

- Expansion of taxation of out-of-state banks by movement to:
  - Market-based nexus standard – location of the “customer”
  - Single-factor receipts-based apportionment
- Expansion of withholding against tax-pass-through non-resident owners
- Expansion of information reporting against owners of tax-pass-throughs
- Outcome: Decline of “no-where” income

Basel III – Deferred Taxes

Basel III - Deferred Taxes

Deferred tax accounting now

- Reversal assumption
- Deferred tax liability – fungible
- Twelve-month forward projection of utilization
- 10% of capital limitation

Basel III - Deferred Taxes - cont'd

Under Basel III Final rule

- Reversal assumption retained
- Deferred tax liabilities are allocated between:
  - temp diff DTA and
  - attribute carryover DTA
- DTA for attribute carry-forwards disallowed
- DTA for temp diff dependent on future income limited to
  - 10% Common Equity T1 Capital
- DTL related to other capital deduction items can be netted against item

Basel III - Deferred Taxes - cont'd

Transition – community banks

- First effective 1/1/15 at 40%
- Fully effective 1/1/18 at 100%

Basel III – Deferred Taxes – cont’d

Planning

- Project the 10 to 15% limitations
- Decline to elect accelerated deductions
- Decline income deferral opportunities
- Decline bad debt charge-offs

Pennsylvania Act No. 52

Approved by the Governor 9 July 2013

Pennsylvania Corporation Net Income Tax Changes

- No deduction for **intangible/interest expense** “in connection with” Affiliate transaction (Pg. 28, § 401(3) 1.(t)(1)) (Eff. tax years beg. > 2014)
- Take **credit for Affiliate tax** paid on related income (Pg. 29, § 401(3)1.(t)(1))
- If transaction at **arm’s length** and PA CNI tax avoidance not “the **Principal Purpose,”** deduction NOT disallowed (Pg. 29, § 401(3)1.(t)(1))
- If Affiliate is **foreign entity** in jurisdiction with Treaty, deduction NOT disallowed (Pg. 29, § 401(3)1.(t)(1))
- If Affiliate has **back-to-back expense** to unaffiliated entity, deduction NOT disallowed (Pg. 30, § 401(3)1.(t)(1))
- “Affiliate” = owning or owned direct or indirect **> 50%** (Pg. 34, § 401(3)4.(10))

Pennsylvania Corporation Net Income Tax Changes - cont'd

- **Single-factor apportionment** based on Receipts effective for tax years beg. > 2012 (Act 85 of 2012, § 401(3)2(a)(9)(A)(v))
- Services receipts sourced to PA if **"delivered to"** a PA location – if not clear, source to billing address (Pg. 31, § 401(3)2(a)(16.1)(c))

Pennsylvania Bank Shares Tax Changes

- Definition of taxable institution changed from "located in PA" to "doing business in PA" (Pg. 37, § 701(a) and Pg. 57 § 701.5 "Institution")
- Shares tax rate dropped to 0.89% effective 1/1/14 (36% reduction) (Pg. 37, § 701(b))
- No more 6-year moving average based on quarterly averages of shares value and exempt assets – use 12/31 value per last call report (Pg. 39, § 701.1(a))
- Still get deduction against share value for exempt assets ratio at 12/31 values per last call report (Pg. 39, § 701.1(b))
- Combination rule retained, but without history (Pg. 41, § 701.1(c)(2)

Pennsylvania Bank Shares Tax Changes – cont'd

- Apportionment now based solely on Receipts factor
  - Receipts located in PA / Receipts located in all states (Pg. 41, § 701.4(1)(ii))
- Throw back receipts sourced to states where not subject to tax (Pg. 53, § 701.4(3)(xvii))

Pennsylvania Bank Shares Tax Changes - cont'd

Doing business in PA (Page 56, § 701.5)

- Having gross receipts apportioned to PA > $100K **AND**
  - Office/branch in PA
  - People conducting business in PA
  - People soliciting business in PA
  - Using/Owning property in PA other than OREO/REO
  - Holding security interest in PA property
  - Any receipts apportioned to PA
  - More than 1 day physical presence in PA
  - If permitted to be taxed by US Constitution
- Does Not Include: (Pg. 57, § 701.5)
  - Engaging professional services in PA not significantly associated with marketing in PA
  - Use of a processor or transfer agent located in PA

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New York Tax Reform

New York Tax Reform

- Enacted 31 March 2014
- With general effect from 1 January 2015
- Article 32 Bank Franchise Tax is Repealed
- Article 9A General Corporation Tax is overhauled

New York Tax Reform

Nexus

- Changes from physical presence to an economic presence
- Did require physical location in New York
- Now requires $1,000,000 of NY-sourced receipts or 1,000 credit cards issued

New York Tax Reform

Tax base changes

- Entire net income changed to “Business Income”
- Alternative Entire Net Income gone
- Capital tax retained – but phasing out
- Fixed dollar minimum retained

New York Tax Reform

Apportionment

- 3-factor formula (Deposits, Receipts and Payroll) is gone
- Replaced with single robust receipts factor
- Applies to both Business Income and Capital

New York Tax Reform

New York Receipts

- Interest and fee income from loans with New York real estate as security
- Interest and fee income from other loans to New York located borrowers
- 8 percent of interest income from MBS
- Interest income from US, State and Municipal Debt is not sourced to NY but 50% of non-New York municipal income is excluded from receipts denominator

New York Tax Reform

The good news

- Rate reduction from 7.1 to 6.5% effective 1 January 2016
- Captive REITs of Banks with not more than $8.0 Bil assets in place at 1 April 2014 are grandfathered
- Two new subtraction modifications

New York Tax Reform

New "Bad Debt" Subtraction modification

- 32% of taxable income before the subtraction less the federal bad debt deduction already taken
- Applies to thrifts and Community Banks meeting the QTL assets test
- Community Banks = Not more than $8.0 Bil in assets

New York Tax Reform

New Qualifying Net Interest Income Exclusion

- Applies to small thrifts (not more than $8.0 Bil in assets) and Community Banks
- Net interest income from NY residential mortgage loans and NY small business loans – exclude 50%
- Small Business Loans – not defined but can’ exceed $5.0 Mil principal

Tax Planning Strategies

Tax Planning Strategies

Converting taxable interest income into excludible dividends

Re-situsing investment income to a tax friendly jurisdiction

Structuring apportionment factors to create “no-where” income

Tax Planning Strategies

Key **"factors"** for state tax planning

- Separate Company Reporting – limited forced combination
- Subsidiary dividends received exclusion
- Market receipts sourcing in home state
- Physical presence sourcing in friendly state

Tax Planning Strategies

Captive REIT (interest conversion)

- Key: a broad definition of “dividends” by State
- Bank owns 99% interest – common stock
- 110 Insiders together own 1% interest – preferred stock
- Bank capitalizes REIT with mortgage loans
- REIT distributes 100% of taxable income – pays no tax
- Bank gets state exclusion for subsidiary dividends
- Federal tax not effected

Tax Planning Strategies

Re-situsing investment income to tax friendly state

- Delaware and Nevada – zero tax
- Bank capitalizes Sub with securities
- Investment income shifted to Sub to force Bank to break-even
- Sub has zero tax or reduced tax on investment income
- Bank state tax goes to zero
- If Bank gets dividends exclusion Sub can dividend income back to Bank

Tax Planning Strategies

Structured Apportionment

- Bank creates an investment subsidiary
- Bank funds Sub with loans to create “out-of-state” revenue viz home state
- Structured receipts apportionment creates diluted receipts factor in home state
- Investment income not tax in friendly state

Tax Planning Federal

Tax deferral means nothing to a Bank

Credits offer the only meaningful tax planning opportunities

- BOLI
- Municipal Bond Interest
- Low Income Housing Credit
- Certified Historic Rehabilitation credit