



Financial Institutions Roundtable

A complimentary webinar series for financial institutions.

Recent Tax Developments in Banking M&A: Whether you're buying, selling or just want to be "in the know."

June 25, 2014

Presented by: **Pat Tuley, Partner, Porter Keadle Moore**
Abriel Davis, Manager, Porter Keadle Moore



Agenda



▲ M & A considerations

- Deferred tax asset valuation
 - IRC §382 limitations
 - *NOLs*
 - *Net unrealized built in losses*
 - *Recognized built in losses*
 - BASEL III and NOL carryforwards

- Other due diligence considerations
 - State tax nexus
 - Sales and use tax compliance
 - Golden Parachute considerations
 - Information reporting obligations
 - Unclaimed property

Agenda



▲ Other tax matters

- Tax-sharing agreements between tax consolidated group members



Deferred Tax Assets

- ▲ What is recorded currently?
 - Does a valuation allowance exist?
- ▲ Is the group subject to Net Unrealized Built In Loss / Gain restrictions?
 - What constitutes an unrealized gain or loss and why does it matter?
 - If subject to rules,
 - What is the recognition period for losses?
 - Generally - five years
 - IRC §1374 election for loan charge-offs
 - When are the losses triggered
 - What limitations apply
- ▲ Based upon all of this, do I have a mark for the DTA

Deferred taxes and regulatory capital – BASEL III



- ▲ Under the new BASEL III regulations, the DTA should be broken down into the following categories:
 - DTAs that could be realized through a hypothetical net operating loss (NOL) carryback
 - DTAs that arise from NOL and tax credit carryforwards
 - DTAs that arise from temporary differences that are subject to future taxable income
 - Deferred tax liabilities (DTLs)
 - Valuations allowances, if any



Deferred taxes and regulatory capital – BASEL III



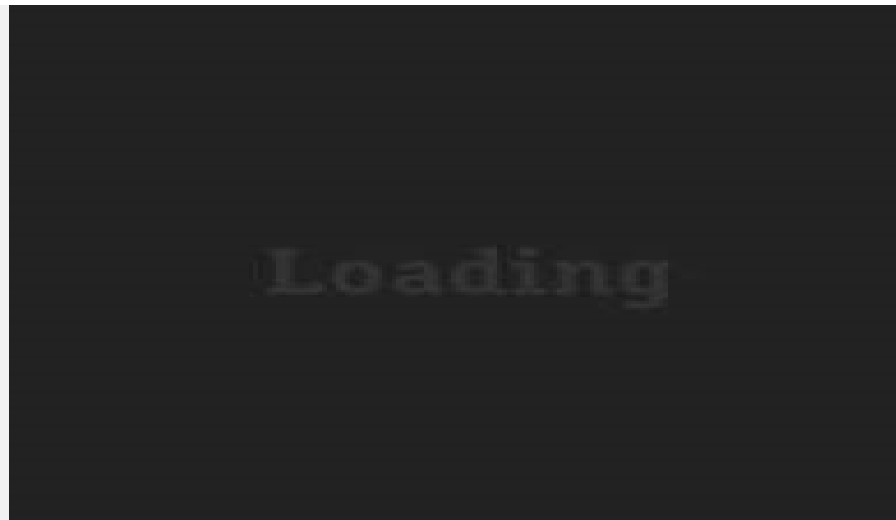
- ▲ Net DTAs arising from NOL and tax credit carryforwards reduces the bank's CET1
- ▲ DTAs that can not be realized through a hypothetical carryback and that exceed 10% of CET1 are deducted from CET1
- ▲ DTAs (net of DTL and VA), mortgage service assets (MSAs), investment in other financial institutions are subject to 15% of CET1

Deferred taxes and regulatory capital – BASEL III



▲ Phase-in of CET1 deductions.

- Phase-in: 40% of the disallowed DTA in 2015
- Phase-in: 60% of the disallowed DTA in 2016
- Phase-in: 80% of the disallowed DTA in 2017
- Phase-in: 100% of the disallowed DTA in 2018



Deferred taxes and regulatory capital – BASEL III



▲ Netting

- Unclear when the DTAs and DTLs should be netted
 - Before or after the hypothetical carryback?
 - Before or after the elimination of DTAs arising from NOLs and credits?

- Options for netting
 - Carry back gross temporary DTA, then allocate the DTL pro-rata
 - Carry back gross temporary DTA, net of DTL, then allocate the DTL pro-rata
 - Allocate the DTL pro-rata, then carry back the gross DTA
 - Allocate the DTL against gross DTA, then carry back the gross DTA

POLLING QUESTION #1



Has your bank modeled out its deferred tax asset under BASEL III?

- Yes
- No
- Not Sure





Due Diligence Considerations

- ▲ Asset acquisition transactions
- ▲ Stock acquisitions
- ▲ Deemed asset acquisitions



POLLING QUESTION #2



Do I inherit the unrecorded liabilities and obligations of the target?

- Yes
- No
- *It depends. . .*

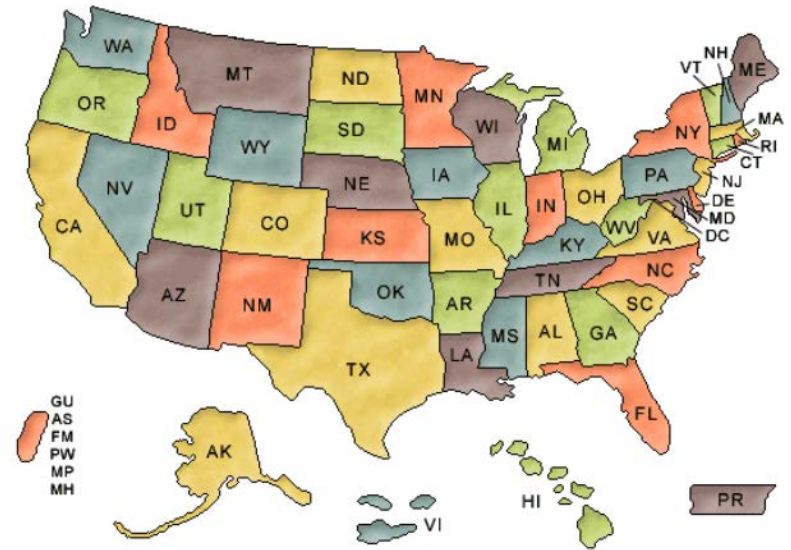


State Tax Nexus



For income / franchise tax and sales and use tax

- ▲ Physical presence
- ▲ Economic presence
- ▲ Other developing tests
 - Teleworking employees
 - Bright line tests based upon in-state sales, payroll, property
- ▲ If you have nexus, are you complying with your filing responsibilities (or collection and remittance obligations)?



Operational Due Diligence Considerations



- ▲ Golden parachute / severance agreements
 - Big tax exposure to
 - Employees in the form of excise taxes
 - Companies for non-deductible parachute payments
 - Test for applicability is based upon payments in excess of three times the base amount, but
 - Excess parachute payment is any amount in excess of ONE TIMES the base amount
 - Examples of benefits that fall under the rules
 - Acceleration of the vesting of a benefit
 - Acceleration of the timing of the payment of an otherwise vested benefit
 - Exceptions
 - Amounts paid for post change in control services that represent “reasonable compensation”

Operational Due Diligence Considerations



- ▲ Information reporting obligations
 - 1099-C for cancellation of debt
 - 1099-A for real estate transfers or abandonments
 - W-2 reporting
- ▲ Deferred compensation and IRC §409A may trigger a reporting and withholding obligation
 - Acceleration provisions
 - IRC 280G gross up provisions
 - *If subject to these rules, all amounts previously deferred are reportable to employee and require withholding...ANNUALLY*

POLLING QUESTION #3



Have you updated your deferred compensation plan agreements in the last 4 years for §409A?

- *Yes*
- *No*
- *Not Sure*



Operational Due Diligence Considerations



▲ Independent contractors vs. employee classification

▲ Unclaimed property



Other Tax Matters



- ▲ Tax-sharing agreements between members of a consolidated tax group

Tax Allocation Agreements



▲ Interagency Policy Statements

- In 1998, Agencies and Office of Thrift Supervision issued the “Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure” (Interagency Policy Statement) to provide guidance to insured IDI’s and their consolidated groups regarding the payment of taxes on a consolidated basis.
- Goal = protect the bank’s ownership rights in tax refunds while in a consolidated group



Tax Allocation Agreements



▲ Issuance of Addendum

- Many disputes over ownership of tax refunds developed between holding companies in bankruptcy and failed banks
- Courts ruled in favor of the holding companies, interpreting a creditor-debtor relationship



Tax Allocation Agreements



▲ Issuance of Addendum

- The HC receives any tax refunds for the consolidated group on behalf of the consolidated group as an agent
- The tax allocation agreement should not characterize refunds attributable to subsidiary depository institution the property of the parent

Tax Allocation Agreements



▲ Action Steps

- Consolidation Groups should
 - Acknowledge agency relationship exists between holding company and subsidiary bank's with respect to tax refunds
 - Do not contain other language that suggest a contrary intent
 - Include the sample paragraph or similar language



Sample Paragraph



“The [holding company] is an agent for the [IDI and its subsidiaries] with respect to all matters related to consolidated tax returns and refund claims, and nothing in this agreement shall be construed to alter or modify this agency relationship. If the [holding company] receives a tax refund from a taxing authority, these funds are obtained as agent for the Institution. Any tax refund attributable to income earned, taxes paid, and losses incurred by the Institution is the property of and owned by the Institution, and shall be held in trust by the [holding company] for the benefit of the Institution. The [holding company] shall forward promptly the amounts held in trust to the Institution. Nothing in this agreement is intended to be or should be construed to provide the [holding company] with an ownership interest in a tax refund that is attributable to income earned, taxes paid, and losses incurred by the Institution. The [holding company] hereby agrees that this tax sharing agreement does not give it an ownership interest in a tax refund generated by the tax attributes of the Institution.”

Tax Allocation Agreements



▲ Deadline for implementation is October 31, 2014

▲ For further information, contact:

- Office of the Comptroller of the Currency
 - Steven Key 202-649-5594 or steven.key@occ.trea.gov

- Board of Governors of the Federal Reserve System
 - Laurie Schaffer 202-452-2272

- FDIC
 - Robert Storch 202-898-8906

POLLING QUESTION #4



Has your bank revised its tax sharing agreement in accordance to the rules in the Final Addendum?

- Yes
- No
- Not sure



Questions?



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