

Community Bank Tax Insights

2023 Financial Institutions Summit

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Agenda

- ▶ S Corporation vs. C Corporation
- ▶ Tax Credit Investments
- ▶ Current Tax Considerations



S Corporation vs C Corporation

Bank S Corporations

▶ As of August 2023

- Out of 4,657 Financial Institutions, there are 1,543 that are S Corporation Banks – 33%
- Asset size ranges from \$16 million to \$37 billion
 - ▶ However, only one is larger than \$10 billion
- Out of 214 Kentucky and Indiana Financial Institutions there are 58 S Corporation Banks – 27%
 - ▶ Kentucky 122 Financial Institutions, 43 S Corporation Banks – 35%
 - ▶ Indiana 92 Financial Institutions, 15 S Corporation Banks – 16%



Advantages/Disadvantages

- ▶ Primary Advantages –
 - Elimination of double taxation on distributed corporate earnings
 - Shareholder tax basis increase in stock
 - Tax advantages in sale transaction
- ▶ Primary Disadvantages –
 - Potential for reduced liquidity in corporation stock
 - Single class of stock requirement
 - Increased complexity to corporation and shareholder tax returns
- ▶ Much more detailed conversation to consider; none of these discussions are new so why a topic today???



Why a Current Topic

- ▶ Tax Cuts and Jobs Act (“TCJA”) – signed into law December 2017
 - Corporate tax rate reduced from a top rate of 35% to a flat rate of 21% beginning in 2018
 - Individual tax rate reduced from a top rate of 39.6% to a top rate of 37%
 - ▶ Individual TCJA changes sunset on December 31, 2025
 - Qualified Business Income (“QBI”) deduction
 - ▶ Allows a 20% deduction of QBI from individual taxable income
 - ▶ If 100% of S Corporation income is eligible effectively a 29.6% tax rate
 - SSTB activities can reduce QBI deduction
 - ▶ Sunsets on December 31, 2025



Why a Current Topic

- ▶ However, recent conversions are frequently occurring for primarily non-tax reasons
 - Ability to raise capital
 - ▷ Types of shareholders, second class of stock, number of shareholders
 - Need for increased capital retention in corporation
 - Impacts of exit strategy and/or transfer of share ownership
 - ▷ Sale of bank or shares transferred through inheritance
 - Initial Public Offering
 - ▷ S Corporation cannot be a publicly traded organization



Tax Credit Investments

Tax Credit Investments

- ▶ Low-Income Housing Tax Credit
 - Credit claimed over 10 years
 - Project must qualify for 15 years to prevent credit recapture
 - No tax basis reduction

- ▶ Historic Tax Credit
 - Credit claimed over 5 years
 - ▶ Pre-TCJA credit claimed in first year
 - 5-year investment period to prevent credit recapture
 - Basis of investment credit property (and partner's interest in partnership) reduced by 100% of ITC
 - Lessee structure – 50(d) income



Tax Credit Investments

- ▶ Renewable Energy Tax Credit
 - Credit claimed in first year
 - 5-year investment period to prevent credit recapture
 - Basis of investment credit property (and partner's interest in partnership) reduced by 50% of ITC
 - Lessee structure – 50(d) income

- ▶ New Market Tax Credit
 - Credit claimed over 7 years
 - ▷ 5% of QEI in first 3 years and 6% of QEI in last 4 years
 - 7-year investment period to prevent credit recapture
 - Basis of investment credit property (and partner's interest in partnership) reduced by 100% of credit



Tax Credit Investments

- ▶ Kentucky Rehabilitation Tax Credit
 - Elect to utilize or transfer
- ▶ Credit is refundable if elect to utilize but not refundable if transferred
- ▶ Election made on KHC Form TC-4, attached to Part 3 – Request for Certification of Completed Work
 - Irrevocable election



Structures

- ▶ Direct Ownership
- ▶ Partnership Investment
 - Equity Contribution
 - ▷ Direct Developer
 - ▷ Fund
 - NMTC – Leverage Loan Structure
- ▶ Transferability – some credits are transferable but not all



Tax Equity Investment Considerations

- ▶ Existing tax liability and expected future year of utilization of tax liability
 - Tax Rate
 - Economic Environment
- ▶ Structure of investor organization (S Corporation vs C Corporation)
 - Shareholder ability to utilize tax credits generated
- ▶ Partnership Exit – capital gains and losses
 - Ability to utilize capital loss and impact on projected benefit



Tax Equity Investment Considerations

- ▶ Expected yield of potential investment compared to other market investment opportunities
- ▶ Financial Statement Impact
 - Tax Credit – Flow-through or Deferral Method
 - Partnership Investment – Cost or Equity Method
 - ▷ Other than Temporary Impairment considerations
 - Proportional Amortization Method
 - ▷ ASU 2014-01 Low-Income Housing Tax Credits
 - ▷ ASU 2023-02 New Markets Tax Credits, Historic Tax Credits, Renewable Energy Tax Credits



Current Tax Considerations

Current Tax Considerations

- ▶ Banking as a service (“BAAS”)
 - Information Reporting
 - Economic Nexus
- ▶ Digital assets and cryptocurrencies
 - Intangible asset – gain or loss considerations
 - Information Reporting



Current Tax Considerations

- ▶ Interest expense disallowance (TEFRA)
 - Bank qualified and non-bank qualified tax-exempt investments
- ▶ AFS Securities unrealized losses
 - Deferred tax asset – tax rate utilized
 - Entity holding securities – ordinary or capital losses if realized
- ▶ Employee Retention Credits (“ERC”)
 - Continued IRS scrutiny
- ▶ Kentucky Pass Through Entity Tax
 - Effective January 1, 2022



Thank you!

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