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As a member of the RSM US Alliance, we would like to share the following with you.

Financial services accounting and tax update

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FINANCIAL SERVICES ACCOUNTING AND TAX UPDATE

Key 2021 year-end accounting and tax issues for financial services

December 8, 2021

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Agenda

- Introduction and overview
- Economic update
- Accounting update
- Tax update
- Q&A

ECONOMIC UPDATE

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U.S. economy: Recap and look ahead

US growth picture

- Q1’21: Actual 6.3%
- Q2’21: Actual 6.7%
- Q3’21: Actual 2.1%
- Q4’21: RSM Forecast 7.2%

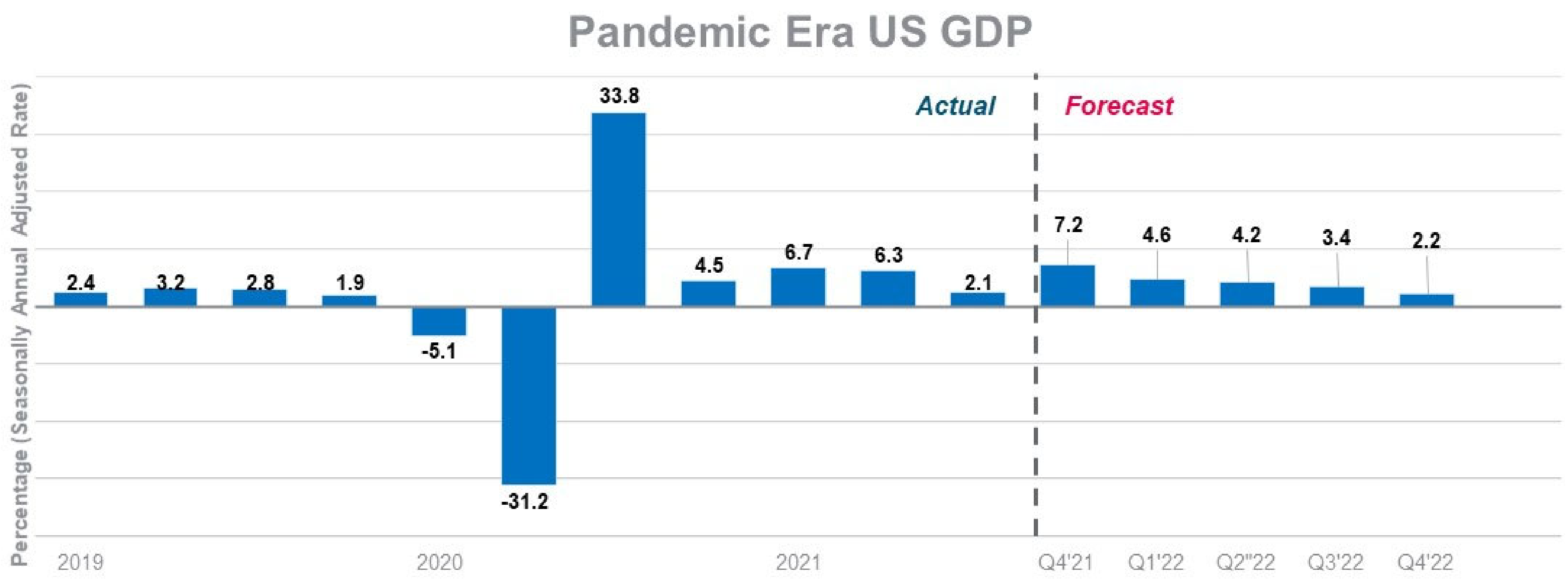
Inflation and risk to the economic outlook

- Supply chain constraints will last into 2H’2022, creating volatility, then easing near year-end
- Currently inflation highly concentrated in energy, transportation and lodging
- Worth noting that 62% of increase in inflation is clustered in 30% of CPI index
- Lack of velocity implies little pass through to inflation expectations that determine actual inflation

Interest rate outlook

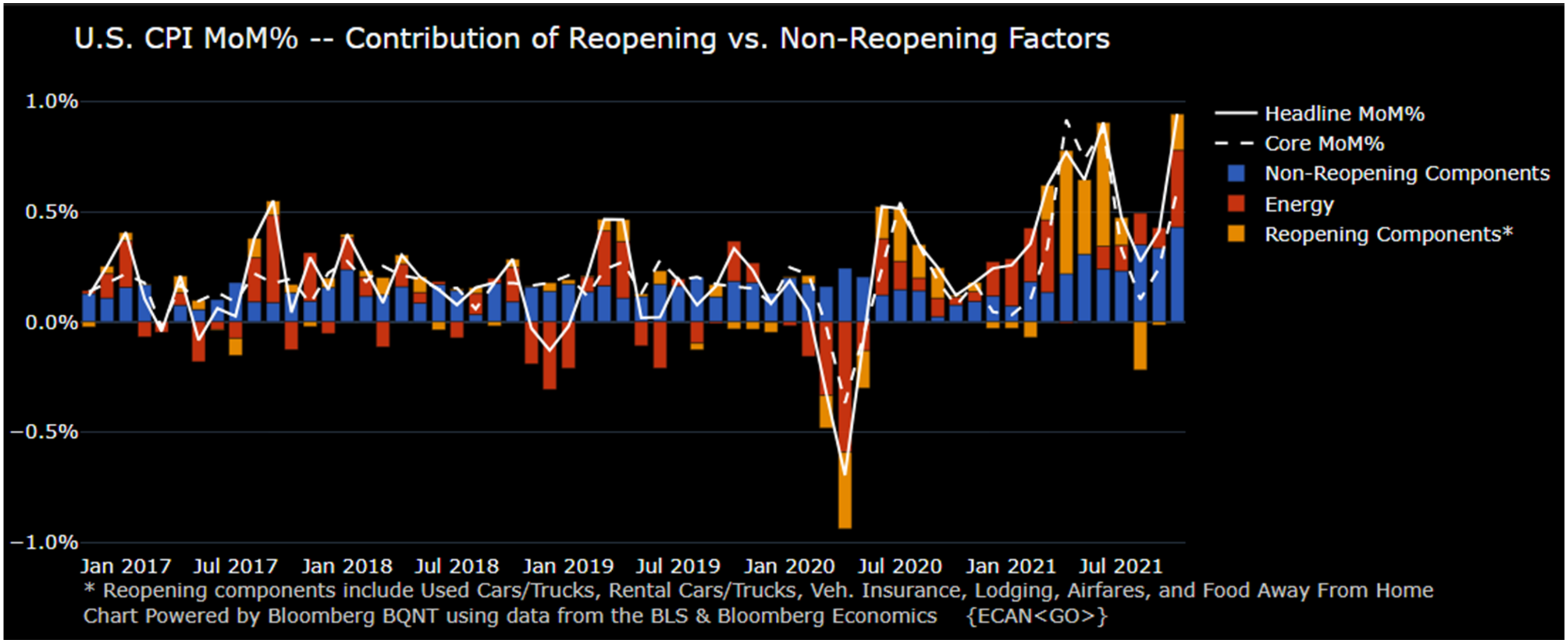
- Steeper yield curve with the 10-year yield rising to 2.25 by end of 2022 with risk of higher yields
- End of pandemic era policies as Fed prepares to hike rates during 2022
- Fed Taper Operations: Pace of taper picks up with end of repurchases likely in late Q1 2022

Growth outlook: Pandemic era U.S. GDP



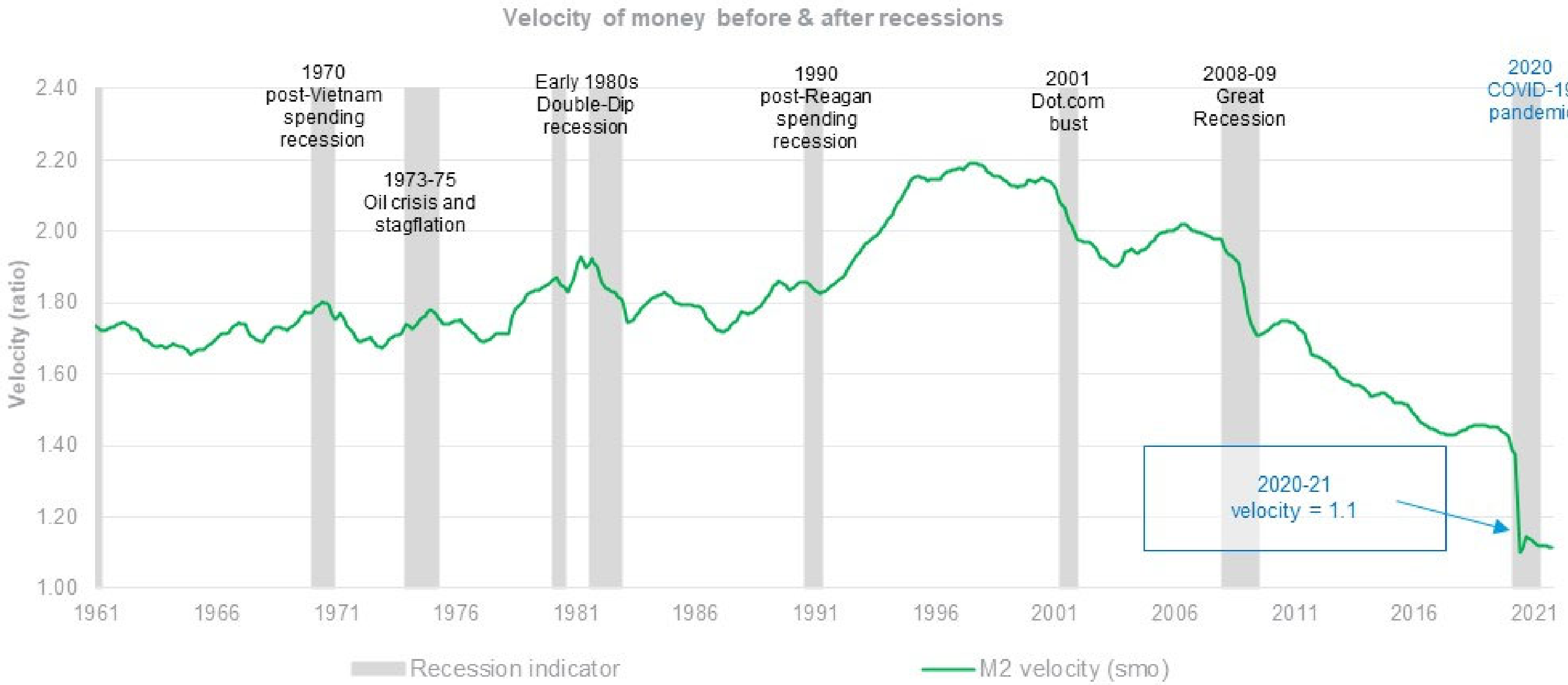
Source: RSM US, Bloomberg

Inflation outlook: What's driving inflation



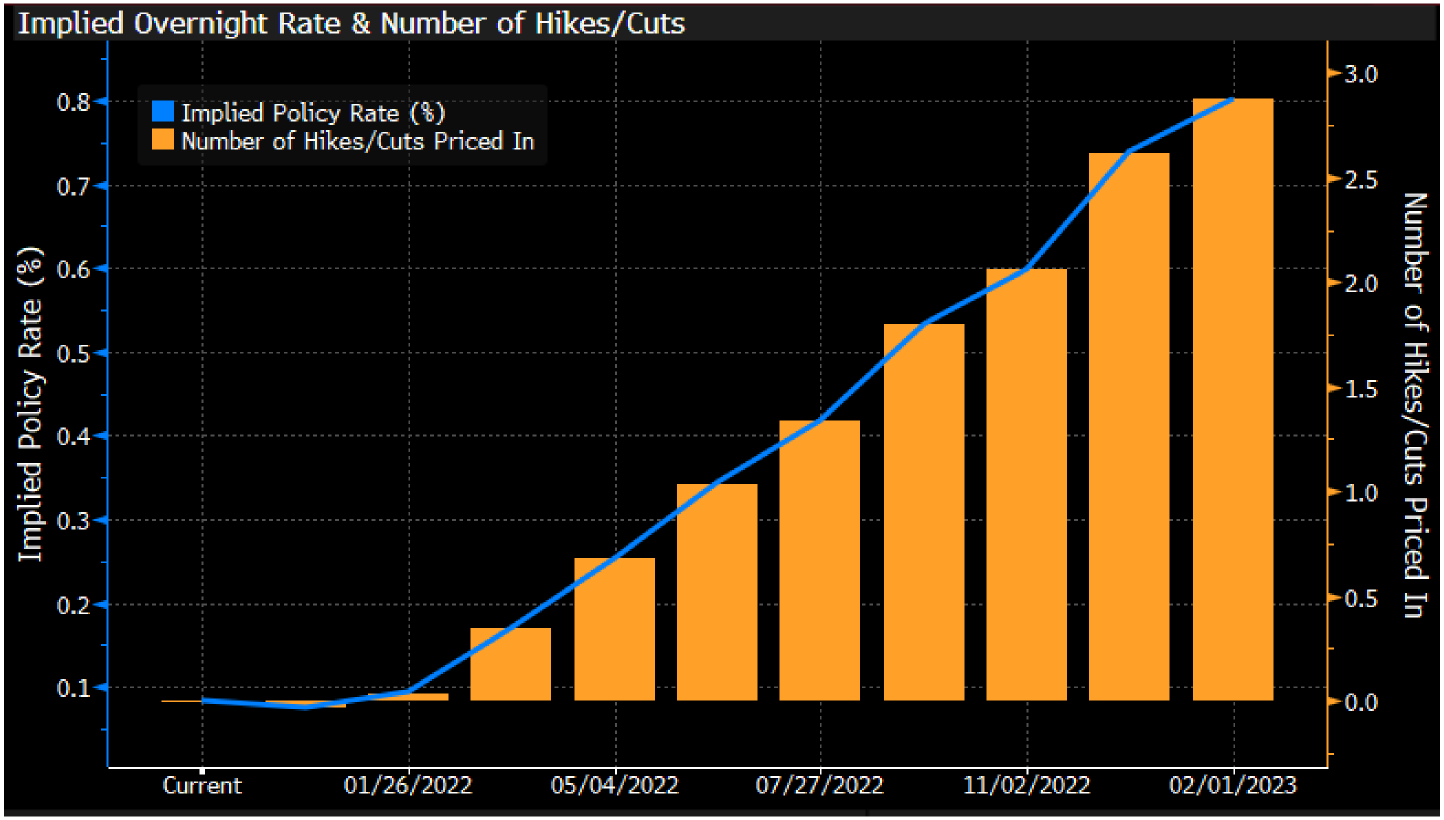
Source: Bloomberg

Inflation outlook: Review of velocity

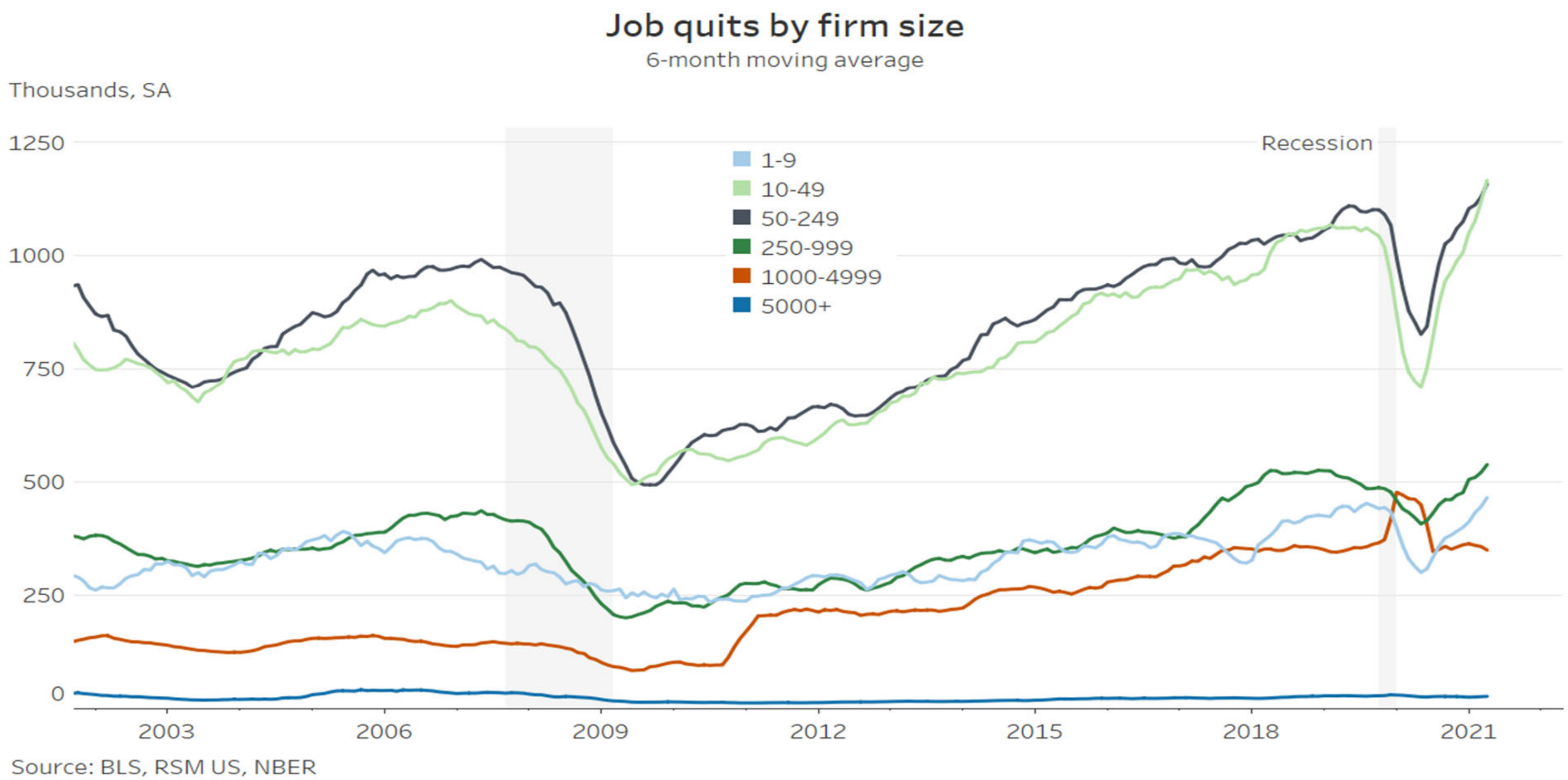


Source: Federal Reserve of St. Louis; BLS; NBER; RSM US

Interest rate outlook: Market pricing in multiple 2022 hikes



U.S. workforce: Transformation underway



U.S. workforce: What's driving the transformation

1. **Acceleration in retirement of the boomers**: Due to health effects linked to the pandemic and rise in demand for technological skills to remain on job that cohort does not possess.
2. **Delta Variant and the Pandemic**: Last wave of the pandemic resulted in a delayed reopening of schools and day care which prevented the cohort that bore the brunt of the burden – prime aged women 25-54 – from returning to work in large numbers through the end of summer. This will improve over the next 3-6 months.
3. **Ghosting**: Workers walking away with no notice given. This is a function of immediate signing bonuses paid by firms in a panic to compete for workers. This will abate soon enough, but it will wreak havoc across our food and beverage and leisure and hospitality ecosystems.
4. **Inter-generational wealth transfers**: The not talked about enough impact of roughly 787,000 deaths caused by the pandemic, which is creating a windfall among younger cohorts that is likely financing the walking away of those workers from employment and is a source of the labor shortage that is impacting firms across industry ecosystems and the economy.
5. **You Only Live Once:** The shock of the pandemic appears to have elicited a behavior change among younger workers that are taking time to reassess their lives and professional career arcs.

ACCOUNTING UPDATE

Accounting update

LIBOR

LIBOR transition

Lenders need to “pick up the pace” to be ready for the year-end change away from Libor to alternative reference rates.

Randal Quarles, Federal Reserve Vice Chairman for Supervision and Chairman of the Financial Stability Board

LIBOR transition – publication cessation dates

1/1/21

- All tenors (durations/terms) EUR and CHF LIBOR
- Overnight, one week, 2 month and 12 month JPY and GBP LIBOR
- Overnight and 2 month USD LIBOR

12/31/22

- *Synthetic* LIBOR for 1 month and 6 month GBP and JPY LIBOR

6/30/23

- Overnight, 1 month, 3 month, 6 month and 12 month USD LIBOR

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LIBOR transition – replacement reference rates

- All new contracts and modifications to existing contracts should not reference U.S. LIBOR starting in January 2022
- Replacement reference rates available
  - Overnight rates
    - Secured Overnight Financing Rate (SOFR; officially endorsed by ARRC)
    - American Interbank Offered Rate (AMERIBOR)
    - Bloomberg Short Term Bank Yield Index (BSBY)
    - Euro short-term rate (ESTR)
    - Sterling Overnight Index Average (SONIA)
    - Swiss Average Rate Overnight (SARON)
    - Tokyo Overnight Average Rate (TONAR)
  - Term rates
    - CME Term SOFR (officially endorsed by ARRC)

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LIBOR transition

- Expected to be an area of regulatory scrutiny in upcoming examinations to ensure that regulated insured depository institutions are on track with transition plans
- The Alternative Reference Rates Committee has been publishing guidance and tools for a number of years
- Consider where you are with respect to inventorying impacted contracts, identifying new reference rate(s), implementing the new reference rate(s), assessing potential accounting implications and modifying/adding fallback language to contracts
  - OCC Self-Assessment Tool was updated in October 2021
- RSM FI-specific whitepaper, *Financial institutions: Fundamentals of LIBOR phase out and transition* (recently updated)

Implementation steps to address LIBOR transition[1]

Establish Program Governance	Implement a robust governance framework with accountable senior executives to oversee the delivery and coordination of the firm's enterprise-wide LIBOR transition program.
Develop Transition Management Program	Establish an enterprise-wide program across functions and businesses to evaluate and mitigate the risks associated with transition with specific considerations for unique product and client exposures.
Implement Communication Strategy	Develop and implement an enterprise-wide strategy with clear objectives to proactively engage, consistently communicate, and increase levels of education with impacted internal and external stakeholders.
Identify and Validate Exposure	Quantify and develop a flexible approach to monitor LIBOR-linked exposures through the transition period. Obtain or develop capabilities to value products as part of transition to using those products.
Develop Product Strategy	Develop strategy for redesigning or transitioning the existing portfolio of LIBOR products, including creating or using new products based on new reference rates.
Risk Management	Identify, measure, monitor and control financial and non-financial risks of transition, establishing processes and oversight routines for ongoing management.
Assess Contractual Remediation Impact and Design Plan	Understand the financial, customer, and legal impacts resulting from transitioning from LIBOR to new reference rates via fallbacks, and plan mechanisms for implementing.
Develop Operational and Technology Readiness Plan	Develop a plan to address the largescale operating model, data and technology implications required for LIBOR transition.
Accounting and Reporting	Determine accounting considerations along with related reporting considerations.
Taxation and Regulation	Determine the tax and regulatory reporting considerations.

1. Based on guidance from ARRC at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC-SOFR-Checklist-20190919.pdf

Accounting update

Leases

Leases (ASC 842)

- ASC 842 is effective for periods ending on or after December 15, 2021 for private companies (2022 calendar year end)
- Impacts both lessee and lessor accounting
  - FI-specific RSM whitepaper contains guidance on lessor accounting and operational considerations
- Please refer to the Leases Implementation Center for links to relevant thought leadership and resources

Primary lessor changes

Topic	ASC 842	ASC 840
Existence of a lease	Arrangement must convey the right to control use of an identified asset	Lease could exist without control if customer takes substantially all output
Lessor classification	Less bright line/rules-based (i.e., no specified percentages in criteria) Similar criteria as for lessees Additional criterion to assess collectability in determining classification when not sales-type Control, not upfront profit, determines classification	Fairly bright line/rules-based (i.e., 90% and 75% specified in criteria) Presence of upfront profit a determinant in lease classification

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Primary lessor changes

Topic	ASC 842	ASC 840
Components	Taxes and insurance are not components Right to use land is a separate lease component (unless insignificant)	Taxes and insurance are executory costs Land is separate if it is 25% or more of the fair value
Initial direct costs	Incremental costs that would not have been incurred if the lease had not been obtained (more limited definition)	Includes costs incurred before lease was obtained, including internal costs

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Primary lessor changes

Topic	ASC 842	ASC 840
Sale lease-back	Applies to lessees and lessors Must meet sales guidance in ASC 606 Leaseback cannot be a finance lease Repurchase options No specialized guidance for real estate	Applies only to lessees Specific guidance for real estate
Lease term renewal options	Consider more than economics/bargain renewal options alone (e.g. intent, history with lessee, etc.)	Bargain renewal options generally dictate any extensions to term

Primary lessor changes

Topic	ASC 842	ASC 840
Lease start	Initial measurement, classification and recognition all at commencement	Initial measurement and classification at inception; recognition at commencement
Substitution rights	Must be "substantive" in nature Lessor should economically benefit	Lessor does not need to economically benefit
Leveraged leases	Eliminated prospectively (existing can be grandfathered unless a modification and re-measurement event takes place)	Accounted for separately

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Implementation considerations - lessors

- Changes for lessees are more major, but there are still changes for lessors that will impact operations and accounting (including internal controls)
- Potential needs for changes to systems or processes as a result of changes in lease classification. Items to consider include:
  - Does a system automatically classify leases? If so, how will it address the new criteria with no “bright lines”?
  - Can the system disaggregate between agreement/inception date and commencement date for proper recording?
  - Have individuals been properly trained in changes to definitions to know that classification and initial measurement may be impacted?
  - How does the entity assess collectability and is that information readily available to those classifying the leases and then initially measuring? Is collectability subject to controls over accuracy of the conclusions?
  - Do policies and procedure manuals need to change to reflect new guidance?

Accounting update

Credit losses (ASC 326)

ASU 2016-13 (ASC 326)

2022**

- 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 2022 (or period of adoption)

2023

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

***The CARES Act and Consolidated Appropriations Act deferred the original implementation dates for certain regulated financial institutions; however, regulators still allowed entities to adopt as of 1/1/2020, 1/1/2021, 12/31/2021 or 1/1/2022, if desired*

FASB project updates

- Two project updates were proposed after the October 11, 2021 FASB meeting with respect to ASC 326 and the results of post-implementation review
  1. Removal of TDR recognition and measurement guidance and enhancements to loan modification-related disclosures
     - All loan modifications would be accounted for in accordance with ASC 310-20, requiring determination at modification if the modification represents a new loan or continuation of an existing loan
     - Would be applied on a prospective basis, with an option for modified retrospective transition through a cumulative effect adjustment to opening retained earnings at the date of adoption
     - Disclosure-related amendments would be applied on a prospective basis

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FASB project updates

- Two project updates were proposed after the October 11, 2021 FASB meeting with respect to ASC 326 and the results of post-implementation review
  2. Requirement to disclosure current-year gross charge-offs by year of origination on a prospective basis
     - Gross recoveries omitted from proposed adjustment
- 30-day comment period ends 12/23/2021

SCALE

- Federal Reserve Bank published tool / methodology
- Targeted to smaller financial institutions
  - Must be < $1 billion in total assets
- Uses publicly available peer group data
  - Peer group made up of larger institutions (> $1 billion)
  - Use peer group allowance for credit losses as a proxy for the subject institution's allowance for credit losses
    - Not peer group loss data, but rather peer group allowance for credit losses
    - Includes peer group adjustments, qualitative factors, forecasts and other assumptions
  - **MUST** adjust peer group allowance for credit losses for the subject institution's specific conditions
- Performed on a one quarter lag

SCALE: Adjustments

- Consider the following when arriving at subject institution adjustments
  - Own loss experience as compared to peer loss experience
    - If peer loss experience is higher than own loss, should consider reducing peer allowance comparatively
  - Economic impact on own portfolio different than peer
    - May have higher or lower unemployment
    - Members concentrated in a certain industry, etc.
  - Lending expertise
    - Own turnover different than peer turnover
  - Other adjustments as deemed necessary

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Accounting update – credit losses (ASC 326)

Planning for implementation

CECL adoption impact (2020)

Figure 4 Percentage change in allowance – Regional banks

BANK NAME	DAY 1 ALLOWANCE CHANGE
Wintrust	27.12%
BBVA	20.14%
Santander Consumer Bank, USA	67.00%
Comerica	(2.36%)
Zions	1.96%
SVB	7.69%
New York Community	2.86%
People's United	31.58%
Signature	18.75%
Synovus	38.16%
Average of Regional Banks	44.35%

Average of Sub-Regional Banks	28.29%	Average of Small Banks	51.37%

- Moody's Analytics, *CECL Adoption and Q1 Results Amid COVID-19*
- Displays day one allowance change as of 1/1/2020 from incurred loss model to CECL

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Planning for implementation – initial considerations

- Analyze standard/understand where you are versus where you need to be
- Identify a multidisciplinary implementation team and develop a detailed implementation plan
- Weigh benefits of modifications to existing approaches, systems, applications versus investing in new
- Identify resource needs (internal or external personnel / solutions)
- Decide how to obtain or develop reasonable and supportable forecasts and how to adjust historical information as a result
- Begin considering and 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.

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Planning for implementation - documentation

- Prepare or modify existing allowance policy to document how the entity complies with the provisions of ASC 326
- Prepare or modify existing allowance procedures to document the approach for calculating and reviewing the allowance
- Prepare or enhance documentation surrounding adjustments to historical losses, including those for current conditions and reasonable and supportable forecasts
  - Documentation should focus on establishing the correlation between data points and expected losses and how the adjustments are established (i.e., how magnitude is determined)
  - If adjustments are not deemed necessary, provide documentation as to why
  - Note that this documentation should be prepared each time the allowance is calculated and should be part of the review process/controls
- Discuss plans with auditors and share documentation discussed above for initial reviews and feedback
  - The audit approach for CECL will generally involve getting behind management's estimate, so clear documentation supporting all decisions / assumptions made and compliance with ASC 326-20 will be critical

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Planning for implementation - other

- Develop new processes and internal controls, particularly as they relate to elements not previously subject to internal controls (e.g., implementation specific matters, forecasts, certain data points)
- Consider running a parallel model for as many quarters as possible to see impact and to fine-tune the model
- Monitor regulatory and other developments in how the ASU is interpreted and applied, including implementation/disclosures of 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 covenant compliance
  - Particularly relevant if electing the fair value option, which may increase income volatility

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Resources

- RSM thought leadership
  - Financial Reporting Resource Center: Financial Institutions
    - http://rsmus.com/what-we-do/services/assurance/financial-reporting-resource-center/financial-reporting-resource-center-financial-institutions.html
  - *A guide to accounting for investments, loans and other receivables*
    - https://rsmus.com/what-we-do/services/assurance/a-guide-to-accounting-for-investments-loans-and-other-receivable.html
  - *Loan loss allowance for specialty lenders is a key due diligence issue*
    - https://rsmus.com/our-insights/newsletters/financial-reporting-insights/loan-loss-allowance-for-specialty-lenders-is-a-key-due-diligence.html

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TAX UPDATE

Taxpayer Certainty and Disaster Tax Relief Act – tax update

Signed into law on December 28, 2020:

- Extended the Work Opportunity Tax Credit for five years (through 12/31/25)
  - The WOTC is a federal income tax credit ranging from $2,400 to $9,600 for each qualified newly hired employee. Qualified employees generally include members of families receiving benefits under the Temporary Assistance to Needy Families program, designated community residents, vocational rehabilitation referrals, qualified ex-felons, qualified summer youth employees, qualified food and nutrition recipients, qualified Supplemental Security Income recipients, long-term family assistance recipients, qualified veterans, and qualified long term unemployment benefit recipients.
- Extended the New Markets Tax Credit for five years (through 12/31/25)
  - The NMTC program was created to encourage investment in low-income communities (LICs) and grow businesses, create jobs and sustain healthy local economies through federal tax incentives. The New Markets Tax Credit (NMTC) program was extended through 2025 with a $5 billion annual appropriation as part of the Consolidated Appropriations Act, 2021, signed by President Trump on December 28, 2020. Before the extension, the NMTC was set to expire at the end of 2020.
- Congress provided a temporary exception to the 50% the business deduction for certain business meals under the Taxpayer Certainty and Disaster Relief Act of 2020 (the Act)
  - The temporary exception under the Act allows a 100% deduction for business meals if the food or beverages are provided by restaurants after Dec. 31, 2020 and before Jan. 1, 2023.

American Rescue Plan Act – tax update

Signed into law on March 11, 2021:

- Changed and expanded the definition of “covered employees” under IRC 162(m)
  - Section 162(m) generally limits the deductibility of compensation paid by a publicly held corporation to "Covered Employees" to $1 million per year
  - Under ARPA, the term "Covered Employees" has been expanded from at least five officers to at least 10 officers and employees (seemingly whether officers or not). This expands the current group of the three highest paid officers and the CEO and CFO
  - The new group of five will be covered employees for the years they are in the highly compensated group, but the law does not include them in the forever-covered provision that applies to the other officers
  - This provision takes effect for tax years beginning after Dec. 31, 2026
- Extended the excess business loss limitations (under IRC 461(l)) through 2026
- Other updates to be discussed later in this presentation:
  - Changes to the Employee Retention Credits
  - Changes to the FFCRA family and sick leave credits

Infrastructure Investment and Jobs Act – tax update

Signed into law on November 15, 2021:

- $1.2 trillion spending package that will provide funding to repair roads, bridges and address climate change
- Limited Tax provisions
- Cryptocurrency Reporting
- Expansion of the reporting requirements available to cryptocurrency
  - It is believed that a significant amount of gains that escapes taxation

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Infrastructure Investment and Jobs Act – tax update (cont.)

Signed into law on November 15, 2021: Continued

- Ends the employee retention credit early – only wages paid before October 1, 2021 will apply (previously applied to wages through 12/31/21)
- Crypto provisions added:
  - Includes a new definition of “digital assets” as “any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.” This may expand the current IRS definition of “virtual currency” to include items such as airline miles and loyalty points
  - Modified section 6045 to clarify that brokers of digital assets, such as centralized exchanges and possibly decentralized finance (“DeFi”) platforms, will need to report trades to their customers on some sort of Form 1099. Sec. 6045(c)(1) definition of "broker" is expanded to include anyone who for consideration effectuates "transfers of digital assets on behalf of another person."
  - Includes an amendment to treat a digital asset in the same way as cash payments under section 6050I. This means that a person engaging in a trade or business receiving a digital asset payment in excess of $10,000 must report the transaction on Form 8300 for those receiving digital asset payments during the course of their trade or business

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Pending – Build Back Better – proposed legislation

- Build Back Better Plan – General Principle

Spending = Taxes

Pending – Build Back Better – proposed legislation (cont.)

Budget reconciliation process

- Majority vote in House and Senate

Pending – Build Back Better – proposed legislation (cont.)

Status – 11/22/2021

- Build Back Better Bill (H.R. 5376) has passed the House on November 19, 2021.
- Next step is for the Senate to take this bill under consideration with a goal of getting this passed by Christmas. If the Senate makes changes, then the bill must go back to the house for consideration.
- With slim majority in the house and a 50/50 split in the Senate will result in a challenging road to passage.

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Pending – Build Back Better – proposed legislation (cont.)

- Further changes are expected to the House bill in the Senate – the following slides discuss the House bill as of 11/23/2021
- There are significant tax provisions in the House bill of interest to the banking and fintech industries

Build Back Better legislation – what's NOT in the House bill

- Passed the House on November 19, 2021 –Here's what's NOT in the current House bill:
  - Corporate tax rate increase to 26.5%
  - Top individual rate increase to 39.6%
  - Capital gains rate increase to 25%
  - IRC 199A deduction limitations
  - Making the new market tax credit (NMTC) permanent
  - Expansion of the rehabilitation tax credit
  - The $600 / $10,000 bank account reporting requirement for banks
  - The mark-to-market tax on unrealized gains for high-net-worth individuals
  - Reduction in the overall estate exemption from $12 million to $6 million
    - Changes in grantor trust rules

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Build Back Better legislation – what's IN in the House bill

- New 15% minimum tax on adjusted financial statement income of certain large corporations with three-year average pre-tax net income in excess of $1B (on the consolidated financial statement).
  - Consistent with a global agreement, it would adopt a 15% country-by-country minimum tax on foreign profits of U.S. corporations.
- The proposed legislation includes a new surtax on the income of multi-millionaires and billionaires. It would apply a 5 percent rate above income of $10 million or $200,000 in modified adjusted gross income of an estate or trust. In addition, an additional 3 percent surtax on income above $25 million or $500,000 modified adjusted gross income of an estate or trust.
- The Net investment income (NII) would include specified income for high-income taxpayers which would subject certain active trade or business income to the 3.8% tax that was previously excluded. The high-income threshold for this expanded threshold would be MAGI of $400,000 for single and $500,000 for married filing jointly.

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Build Back Better legislation – what's IN in the House bill (cont.)

- Delay of required R&D credit cost capitalization by 4 years (to tax years beginning after 12/31/25 instead of 12/31/21)
- Increase in the individual deduction for state & local taxes (on individual 1040s) from $10,000 to $80,000 for the 2021-2030 period, $10,000 for 2031, after which it would expire
- Modifications to IRC 163(j) interest expense limitations for partnerships and S Corporations – a new "aggregation" approach
- Retirement Changes
  - Distributions required if IRA and defined contribution plan balance > $10 million
  - Limitations on Roth conversions
  - Limitations on contributions for high income taxpayers
- The framework will create a tax system through new investments in the IRS: hiring enforcement agents who are trained to pursue affluent taxpayers that are in noncompliance with tax laws, modernizing outdated IRS technology, and investing in improved taxpayer service. Additional enforcement resources will be focused on pursuing those with the highest incomes; not Americans with income less than $400,000

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Build Back Better legislation – stock repurchases

- 1% excise tax on the value of stock repurchased by publicly-traded US corporations
  - Buyback excise tax is based on the total value of the buyback. However, there are a few exceptions to this tax as follows:
    - The repurchase is part of a tax-free reorganization.
    - The repurchased stock or its value is contributed to an employee purchase plan, ESOP, or similar plan.
    - The total amount of stock repurchased is less than $1 million.
    - The repurchase is treated as a dividend.
- "Stock" is not defined currently in the bill. Thus, for now we must assume that this includes all stock (i.e. common, preferred, etc.).
- "Established Securities Market" is broadly defined and generally includes:
  - A national securities exchange (under section 6 of the Securities Exchange Act of 1934)
  - A national securities exchange exempt from registration due to low volume of trades
  - A foreign securities exchange which satisfies regulatory requirements in the local jurisdiction similar to the 1934 Act
  - A regional or local exchange
  - An interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers

Build Back Better legislation – stock repurchases (cont.)

- “Repurchase” may include leveraged buyout transactions and / or other constructive redemptions.
- The tax is assessed on the “Fair Market Value” of the stock repurchased. However, no guidance has been provided as to when such FMV should be determined.
  - Note – the bill does not address IRC 83(b) transactions when the amount paid for stock is different than FMV; how to treat “boot” in an IRC 368(a) transaction, or provide for an exception for acquisition of stock in a “split-off” under IRC 355

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Build Back Better legislation – IRC 163(j) - aggregation

- The current approach for both partnerships & S Corporations allows for a computation of the limitation on interest expense deductions at the entity level. Once interest expense is limited, only excess interest income in future years from such respective K-1 would be netted with the interest expense limited in prior years.
- The build back better bill proposes significant changes to IRC 163(j) limitations – the limitation would now be aggregated at the individual level. Thus, all interest expense, interest income, and ATI information would flow through to the individual and would be netted together to compute the interest expense limitation on an individual's return.
- The small business exception is presumed to apply at the partner / individual level, but the rules as currently proposed are not clear.
- It is unclear how the various states would apply these new rules.
- Further guidance was provided on transition rules with respect to partners / individuals who have previously been allocated excess business interest expense – this interest would be treated as paid or accrued in tax years beginning after December 31, 2022.

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Build Back Better legislation – other provisions

- R&D expenditures – currently, R&D costs must be capitalized and amortized over a five-year period (using the midpoint of the tax year in which the R&D costs were paid or incurred as a starting point) for tax years beginning after December 31, 2021. This bill proposes to delay this by four years.
- IRC 1411 tax on net investment income ("NII") of 3.8% - currently, there is an additional tax on individuals, estates, and trust invested in a trade or business which is a passive activity which generates "net investment income". For individuals, the 3.8% tax is assessed on the lesser of net investment income or the excess of modified AGI over $250K (joint) or $200K (separate). The proposed changes would:
  - Assess the additional 3.8% tax on individuals regardless of whether they materially participate in the trade or business (where such income is not already subject to FICA or SECA tax)
  - The tax would apply to the greater of "specified net income" or net investment income. Specified income is the sum of gross income from interest, dividends, annuities, royalties, rents, other gross income derived from a trade or business and the net gain from the disposal of property
  - The income threshold would be increased to $500K (joint) and $400K (separate), subject to a phase in approach
  - Provides clarification on determining net investment income
  - Would be effective for tax years after December 31, 2021

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Build Back Better legislation – other provisions (cont.)

- IRC 461(l) excess loss limitations –
  - Under the TCJA (2017), noncorporate taxpayers (partnerships/S Corporations) could only deduct a maximum $250,000 of excess business losses ($500,000 for joint returns) on their individual tax returns, with limits subject to inflation.
  - Section 2304(a) of the CARES Act retroactively suspended this rule for tax years beginning in 2018 through 2020. Form 461 will not exist for the 2020 tax year but will be used again starting in the 2021 tax year.
  - For any tax years beginning after Dec. 31, 2020, and before Jan. 1, 2027, excess business losses will not be allowed (Sec. 461(l)(1)(B)). Note – this was previously extended one year under the American Rescue Plan Act of 2021.
  - The proposed "Build Back Better" legislation would make the limitation permanent and would also provide for a "retesting" of the losses each year which could significantly limit the utilization of such losses prospectively.
- New surcharge on high-net-worth individuals
  - The proposed "Build Back Better" legislation would impose a new 5% income tax surcharge on individuals, estates, and non-grantor trusts with modified AGI over $10MM (single, head or household, or married) and $200,000 for estates and trusts.
  - An additional (new) 3% income tax on modified AGI in excess of $25MM (single, head or household, or married) and $500,000 for estates and trusts.
  - Modified AGI is AGI adjusted for deductions for investment interest or business interest.
  - This proposal would be effective for tax years beginning after December 31, 2021.
  - This may create issues for S Corporations making proportionate tax distributions for quarterly tax estimate purposes.

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UPDATES ON OLDER TAX LEGISLATION

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CAREs and FFCRA Acts – executive summary – refresher

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and the Families First Coronavirus Response Act (FFCRA), both enacted in March, 2020, provided for several benefits to financial institutions. For the **2021** tax compliance season, we'd like to continue to highlight the following:

- The 80% NOL carry-forward limitation is back for 2021
- Charitable contribution "25%" rule extended
- IRC 163(j) TCJA "30%" of ATI rule is back
- The Qualified Improvement Property "Retail Glitch" fix – still in play
- Payroll tax credit opportunities are still available
- Payroll tax deferral – deduction timing

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CAREs Act – net operating losses

- The CARES Act:
  - Allowed for any net operating losses (NOLs) arising in calendar tax years 2018, 2019, and 2020 to be carried back to each of the previous five years.
  - Repealed the 80% limitation on losses incurred in calendar years 2018, 2019, and 2020
  - Provided for an election to waive the carry-back for NOLs incurred in calendar tax years 2018 or 2019
- Individuals (e.g. S Corporation shareholders) were not provided with a 5 year carry-back on their individual returns.
- **Update for 2021:**
  - The 80% limitation on utilization of NOL carry-forwards, temporarily suspended by the Cares Act, was reinstated for 2021

CAREs Act – other tax provisions

- Temporary increase in charitable contribution limitation percentages
  - Donations made in 2020 would be limited to 25% of taxable income (instead of 10%)
- Favorable changes made to interest expense limitations under IRC 163(j)
  - Favorable increase to the inclusion of Adjusted Taxable Income (“ATI”) from 30 to 50% in the computation of interest expense limitations
  - Favorable changes to the definition of “interest expense”
  - Generally not applicable to the banking industry
- **Update for 2021**:
  - Charitable contribution limitation at 25% extended to 2021 (if election made)
  - IRC 163(j) temporary “50% of ATI” rule reverts to 30% of ATI (under the TCJA) for 2021

Employee Retention Credit (Cares Act)

- It is a refundable payroll tax credit claimed quarterly on Form 941.
- The partial or total government-ordered shutdown or the applicable decline in gross receipts tests still appl.y
- The definition of a “large employer” changed from 100 to 500 employees in 2021.
- For wages paid between March 13 and December 31, 2020, employers who qualify may claim a credit for 50% of wages paid, capped at $10,000 per employee annually. The limitation on PPP wages was retroactively removed.
- For wages paid between January 1, 2021 and June 30, 2021, this was increased to 70% of wages paid, generally capped at $7,000 per employee per quarter. This was original extend to Q3 & Q4 of ’21.
- As mentioned previously, the “Infrastructure Investment and Jobs Act” eliminated the credit on wages paid in Q4 of 2021.
- The statute of limitations was extended from 3 to 5 years for any credits claimed in Q3 of ’21. Wages used in Q3 of ‘21 for (i) PPP loan forgiveness, (ii) the shuttered venue operators grant or (iii) the restaurant revitalization grant cannot also be used for ERTC purposes.

Family & Sick Leave Credits (FFCRA)

- The FFCRA was passed in March of 2020 and imposed paid leave requirements on employers with fewer than 500 employees. Employees impacted by certain COVID-19 events were eligible for paid sick leave and paid family leave from April 1, 2020 through Dec. 31, 2020. Employers providing this paid leave were entitled to payroll tax credits on their 2020 Forms 941
- The Consolidated Appropriations Act passed in December of 2020 allowed employers to voluntarily provide paid sick leave and paid family leave to employees from Jan. 1, 2021 to March 31, 2021, under the same terms as applied to 2020. Under the new Act, paid leave can be provided on a voluntary basis from April 1, 2021 through Sept. 30, 2021. Eligible employers can claim payroll tax credits on their 2021 Forms 941 for the applicable quarters.
- Although the new Act incorporates many provisions from the FFCRA, there are some differences. For example, employees can receive paid leave if they are seeking or awaiting the results of a COVID-19 medical diagnosis or test due to exposure to the virus or because their employer has requested the diagnosis or test. In addition, paid leave can be provided to employees obtaining immunizations related to COVID-19 or recovering from any injury, disability, illness or condition related to such immunizations.

Payroll tax deferral (Cares Act)

- Due to the CARES Act, all employers can defer for up to two years the deposit and payment of their share of the social security tax on employee wages. Amounts normally due between March 27, 2020 and Dec. 31, 2020, can be deferred with 50 percent required to be paid by Dec. 31, 2021, and the remaining 50 percent by Dec. 31, 2022. The deferral only applies to employer social security taxes and does not apply to employer Medicare taxes or tax withholdings from employees. Self-employed individuals are also eligible to defer 50 percent of the social security tax imposed on their net earnings from self-employment.
- Generally, for tax purposes this deferred payroll would be deductible in the year paid – 50% in 2021 and 50% in 2022. The Bank should have a deferred tax asset for the deferred payroll if it took advantage of this program.

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STATE ISSUES

State Nexus – work from home during COVID-19 pandemic

Employee temporarily working from home can create tax nexus for a business with no other nexus-creating presence?

- In response to COVID-19, a number of states have been addressing whether income/franchise tax nexus is created for a business by its employees temporarily teleworking in a state during the pandemic, in situations where the business has no other nexus-creating presence or activities within the state.
- Without official state guidance to the contrary, the presence of an employee working in a state is typically sufficient presence to create corporate income tax nexus in that state.
- Several states have issued high-level guidance where they indicated they will NOT seek to impose income/franchise tax nexus due solely to its employees temporary presence in the state while teleworking during the pandemic.
- Other states may issue similar guidance in the near future.
- Please consult an RSM SALT professional for more information on these updates. Depending on the particular states that are involved, the continuing move toward remote working may have a significant impact on a company's state tax apportionment and overall state tax rate.

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State update – state Pass Through Entity (“PTE”) changes

- Several states (20+) have adopted PTE provisions to address the $10,000 limitation of state & local tax deductions at the shareholder/partner level
- The IRS issued Notice 2020-75 which confirmed that an S Corporation bank may deduct state taxes paid on behalf of the owners on the corporate return
- Currently, the SALT cap is in effect through 2025, but could be modified/extended through 2031 under the proposed “Build Back Better” bill
- Various provisions exist at the state level to either allow the tax as a credit for the owners or as a subtraction from the income taxed at the entity level
- S Corporation banks should consider whether the new entity level tax is material enough to record income tax expense and/or tax effect deferred taxes
- Most states provide for an annual election

YEAR END TAX CONSIDERATIONS

2021 year-end tax considerations

- DTA Considerations if there is a rate increase
  - DTA would need to be adjusted in the quarter of the date of enactment
  - If the company is in a net DTA position , there would be an initial benefit with an increase in the company's run rate
- Accounting method review if there is a possible rate increase
  - Accelerate income and defer expenses
- State tax issues if the company's workforce has been remote and out of what one would consider the company's normal footprint
- Consideration if the employee retention credit could apply
  - Did government orders impact your company during 2020 or 2021?

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THANK YOU FOR YOUR TIME AND ATTENTION

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QUESTIONS AND ANSWERS

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