




<p>HORNE BANKERS' FORUM 2011</p>	
<p> HORNE CPAs & Business Advisors</p>	<p>Tax Planning in an Uncertain Recovery</p> <p>ALLEN POOLE, CPA/ Partner</p>

<p>Agenda</p> <ul style="list-style-type: none">▪ Reporting Uncertain Tax Positions (Schedule UTP)▪ Bad Debt Conformity/Non-Accrual Interest▪ Legislative, Compliance and IRS Issues▪ Regulatory Restrictions on Deferred Tax Assets▪ Information Reporting Considerations <p> </p>
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Reporting Uncertain Tax Positions (Schedule UTP)

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Schedule UTP – Uncertain Tax Positions Disclosure

- New tax return schedule requiring the disclosure of uncertain tax positions
- Treasury issued final regulations in December 2010 requiring the disclosure requirement on tax returns for tax years beginning on or after 01/01/2010
- Not all taxpayers are required to file in 2010, but eventually it is likely that most if not all taxpayers will be required to file
- Announcements 2010-9 and 2010-75 contain specific guidance including form instructions and Q&A

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Schedule UTP – Uncertain Tax Positions

- Who is required to file and when?
- For 2010 and 2011, Corporations that file Form 1120, 1120-F, 1120-L or 1120-PC and:
 - Have consolidated total assets equal to, or in excess of \$100 million, and:
 - Issue audited financial statements (or are included in the audited financial statements of a related entity) covering any portion of the corporation's 2010 or 2011 tax year, and:
 - Have one or more reportable uncertain tax positions

Schedule UTP – Uncertain Tax Positions

- For future years:
- The applicable total asset threshold is reduced as follows:

Year	Total Assets
▪ 2012	\$50 million
▪ 2014	\$10 million
- There is also consideration to expanding the application of Schedule UTP to S Corporations and other pass-through entities
- Due to balance sheet components, banks will be impacted by these reporting requirements if they have uncertain tax positions

Schedule UTP – Uncertain Tax Positions

- What is an Uncertain Tax Position?
- A “tax position” is any item of deduction, exclusion, credit, etc. taken on a federal tax return that would result in an adjustment to a line item on that tax return if the position is not sustained
- An “uncertain tax position” is a position that the taxpayer knows or should know may be challenged by the IRS assuming that all facts surrounding the transaction are known
- The disclosure requirement present in Schedule UTP leans heavily upon the financial statement requirement under ASC 740

Schedule UTP – Uncertain Tax Positions

- Uncertain Tax Positions do not include the following tax positions, provided that no financial statement reserve is recorded with respect to these positions:
 - 1) tax positions that are sufficiently certain, such that no reserve is required under applicable financial accounting standards; and
 - 2) tax positions that are immaterial for audited financial statement purposes

Schedule UTP – Uncertain Tax Positions

- Uncertain Tax Positions are required to be disclosed when two conditions are satisfied:
 - 1) an uncertain tax position is taken on the tax return for the current year or a prior year:
 - And either
 - 2a) a financial statement reserve is recorded with respect to that position; or
 - 2b) a decision not to record a reserve is reached even though the position is uncertain due to the taxpayer expecting to successfully defend the position in litigation

Schedule UTP – Uncertain Tax Positions

- When must an Uncertain Tax Position be Disclosed?
 - A reserve is typically recorded in the year an uncertain tax position is taken on a tax return
 - Once disclosed, changes to a recorded tax reserve in subsequent tax years does not trigger additional disclosure requirements
 - Financial statement reserves initially recorded for tax positions taken in prior years are disclosed in the year the reserve is first established
 - However, uncertain tax positions taken in tax years beginning before 01/01/2010 are not required to be disclosed regardless of when the related tax reserve is recorded

Schedule UTP – Uncertain Tax Positions

- What information is required to be disclosed?
 - A concise description of each uncertain tax position
 - The primary code section to which the position relates
 - Whether the tax benefit resulting from the position is permanent or temporary
 - The year to which the position relates, if disclosing a position related to a prior year (not applicable for 2010)
 - A numeric ranking of the positions based upon the relative size of the related reserves
 - An indication of which positions comprise 10% or more of the overall tax reserves

Schedule UTP – Uncertain Tax Positions

- What information is required to be disclosed?
 - The taxpayer is not required to disclose the amount of the financial statement tax reserve related to any particular uncertain position or the analysis behind the calculation of that amount
 - The IRS is currently considering alternatives for a penalty structure for non-compliance

Schedule UTP – Uncertain Tax Positions

- What is the purpose of this disclosure requirement?
 - Since the adoption of ASC 740-10, Accounting for Uncertainty in Income Taxes, the IRS has been very interested in bridging the financial statement tax reserve information to the IRS exam process
 - The IRS continues to protect its asserted right to examine taxpayers' tax accrual workpapers, including tax reserve calculation workpapers (U.S. v. Textron, Inc.)
 - The IRS asserts this will improve transparency and streamline the exam process

Schedule UTP – Uncertain Tax Positions

- Impact on the IRS “Policy of Restraint”?
 - The IRS currently has in place a self-imposed “policy of restraint” under which it will not seek to obtain tax accrual workpapers in the absence of listed transaction (i.e. tax shelters)
 - In Announcement 2010-76, the IRS expanded the policy of restraint to Schedule UTP

Bad Debt Conformity/Non-Accrual Interest

- Should Banks reassess the historical reluctance to make the conformity election?
 - If bank is examined, the conformity election can shortcut probably the most difficult part of the exam
 - If an accrual basis taxpayer, Revenue Ruling 2007-32 shortcuts the difficult nonaccrual interest issue
 - For S Corp. electing banks with numerous shareholders, the conformity election serves as “examination insurance” against having to amend all of the shareholder returns for examination adjustments

Bad Debt Conformity/Non-Accrual Interest

- Making the conformity election (Reg. 1.166-2(d)(3))
 - The election is an automatic change of accounting method (However, the change is not pursuant to Revenue Procedure 2008-52; it is controlled by Regulation 1.166-2(d)(3))
 - The first Express Determination Letter (“EDL”) is required for the latest federal examination before the beginning of the election year
 - The EDL must be “refreshed” for each exam. If the bank does not get an EDL for the most recent exam before the beginning of the tax year, the election is not valid

Bad Debt Conformity/Non-Accrual Interest

- It has been our experience that banks rarely have success in obtaining an EDL after the exam is finished
 - We have been told by regional accountants for the FDIC that their procedures manual prohibits field examiners from providing an EDL after the examination has been finished

- The standard wording of the EDL is in Revenue Procedure 92-84 and reads in relevant part:
 - “In connection with the most recent examination of {name of bank}, by {name of supervisory authority}, as of {examination date}, we reviewed the institution’s loan review process as it relates to loan charge-offs. Based on our review, we concluded that the bank, as of that date, maintained and applied loan loss classification standards that were consistent with regulatory standards regarding loan charge-offs”

Bad Debt Conformity/Non-Accrual Interest

- Banks that have made the conformity election:

- Revenue Ruling 2007-32 applies and resolves the knotty non-accrual problems very favorably for the Bank

- The Ruling appears from its terms to be mandatory for banks that make the conformity election

- The Ruling broke new ground by extending the conformity election to accrued interest for the first time

Bad Debt Conformity/Non-Accrual Interest

- Loans become non-accrual for tax purposes when they are placed on non-accrual for financial reporting purposes
 - All accrued interest, including the current year accrual, is charged to the reserve for losses; or is a charge-off if the bank is on the specific charge-off method for tax purposes
 - Different from books – There is no reversal against income
 - Interest on non-accrual loans is both:
 - a) Included in gross income; and
 - b) Charged-off as a bad debt

Bad Debt Conformity/Non-Accrual Interest

- The tax treatment of subsequent loan payments depends upon the reason that the loan is non-accrual:
 - a) If there is a reasonable expectation that the principal and interest will be collected, then subsequent payments are first recoveries of non-accrued interest up to the accumulated, charged-off income, and then applied to principal
 - b) If there is no reasonable probability that the non-accrued interest will be collected, then the normal rules apply

Legislative, Compliance and IRS Issues

- Income Tax Rates
 - The “Bush-era tax rates” have been extended for two years – 2011 and 2012 – for all individual taxpayers, regardless of income levels
 - Top marginal rate on ordinary income = 35% through 2012
 - The top federal tax rate on long-term capital gains and dividend income =15% through 2012
 - For corporations, the top federal tax rate remains unchanged at 35%, with no rate difference for long-term capital gains

Legislative, Compliance and IRS Issues

- Income Tax Rates
 - If these individual rates are not changed upon before 2013:
 - The top marginal federal tax rate on ordinary taxable income will revert back to 39.6% in 2013
 - Remember, the effective rate will be higher than 39.6% due to the limitation on itemized deductions
 - The maximum federal tax rate on long-term capital gains will revert back to 20% (18% for certain capital assets held more than 5 years)
 - The top marginal rate on dividend income will move from 15% to a rate in excess of 43%

Legislative, Compliance and IRS Issues

- Income Tax Rates
- There has been a lot of discussion about reducing the corporate tax rate from 35% to a lower rate while eliminating certain corporate deductions and tax benefits

Legislative, Compliance and IRS Issues

- Fixed Asset Depreciation
 - The 50% bonus depreciation provisions have been extended for qualified property placed in service before 01/01/2013
 - However, the bonus depreciation amount is increased to 100% for qualified property acquired after 09/08/2010 and placed in service before 01/01/2012
 - Guidance is provided in Revenue Procedure 2011-26
 - The Section 179 expensing limitation is increased to \$500,000 for qualified property placed in service during tax years beginning in 2010 and 2011
 - Phase out begins at \$2 million of qualified purchases

Legislative, Compliance and IRS Issues

- Fixed Asset Depreciation
 - Qualified property for both provisions generally includes all depreciable fixed assets and software, but does not include buildings and their structural components
 - However, certain leasehold improvements made to the interior of a leased building may qualify if the building is more than 3 years old
 - Bonus depreciation only applies to new property (not used), but Section 179 applies to both new and used property
 - Cost segregation opportunities (especially before 2012)

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Legislative, Compliance and IRS Issues

- IRS Audit Issues
 - Deducting Success-Based Fees to Facilitate Various Merger and Acquisition Transactions
 - Has been source of significant disagreement for many years

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Legislative, Compliance and IRS Issues

- **Deducting Success-Based Fees to Facilitate Various Merger and Acquisition Transactions**
 - To eliminate much of the disagreement in this area, the IRS issued Revenue Procedure 2011-29
 - Provides an elective safe harbor to treat 70% of the success-based fee as non-facilitative (deductible) and 30% as facilitative (capitalized) without the need to gather any supporting documentation
 - Election is available for success-based fees paid or incurred in taxable years ending on or after April 8, 2011
 - Election is irrevocable and is made by attaching a statement to the original federal tax return in which the fee is paid

Legislative, Compliance and IRS Issues

- **Deducting Success-Based Fees to Facilitate Various Merger and Acquisition Transactions**
 - On July 28, 2011, IRS issued a field directive (LB&I-04-0511-012) indicating that the IRS will not challenge a taxpayer's deduction for success-based fees claimed on returns for tax years prior to the effective date of the safe harbor, provided:
 - The deduction would have qualified for the safe harbor
 - The capitalized portion of the fee is at least 30%
 - The deduction was claimed on an original return

Legislative, Compliance and IRS Issues

- IRS Audit Issues
- Deducting OREO Carrying Costs
 - There have been a growing number of examinations in which the IRS has sought to capitalize OREO carrying costs

Legislative, Compliance and IRS Issues

- IRS Audit Issues
 - Mark to Market Valuations
 - On April 6, 2011, IRS issued a field directive (LB&I-4-1110-033) indicating the IRS will not challenge a taxpayer's use of financial statement market values for purposes of the MTM calculations required by Section 475, provided the taxpayer is required to file public financial statements
 - Treatment of Credit Card Interchange Income
 - IRS Chief Counsel Notice CC-2010-018
 - IRS announced they will no longer challenge the treatment of credit card interchange income as OID
 - Enables taxpayers to defer recognition of this income as OID over term of the outstanding credit card receivables

Legislative, Compliance and IRS Issues

- IRS Audit Issues
 - S Corporation Issues
 - IRS has formally announced that it will follow the decision in *Vainisi v. Commissioner*, thereby holding that the TEFRA interest expense disallowance formula applies to an S Corporation bank only if it was a C Corporation for any of the three immediately preceding tax years
 - For tax years beginning in 2011, a 5 year built-in gain ("BIG") tax period is substituted in place of the normal 10 year period
 - Thus, for sales of affected assets in 2011, the BIG tax will not apply if the corporation has been an S Corporation for at least 5 years
 - For tax years beginning in 2012, the 10 year BIG tax period is reinstated

Regulatory Restrictions on DTAs

- Deferred Tax Asset Valuation Allowance
 - Becoming more common among financial institutions for both GAAP and regulatory purposes
 - Deferred tax asset recognition thresholds:
 - GAAP – recognized if it is more likely than not (>50%) that the deferred tax asset will be realized
 - Regulatory – recognized in Tier I Capital
 - 1) to the extent the net deferred tax asset could be realized upon carryback to prior tax years; plus
 - 2) to the extent that any remaining net deferred tax asset (after carryback) is projected to be utilized within 12 months based on projected future taxable income

Information Reporting Update

- Expanded Form 1099 Provisions Repealed
 - The new health care law had provided for a significant expansion of information reporting requirements for payments of >\$600 per payee made after 12/31/2011
 - Expanded the reportable payments to include purchase of property
 - Eliminated the existing reporting exemption for payments made to corporations

- These expansive provisions have been repealed

Information Reporting Update

- Basis Reporting on Form 1099-B
 - Form 1099-B has historically required those acting in the capacity of a broker to report the gross proceeds from sales of stock or securities to the seller
 - New laws now require the broker to report the tax basis of certain covered securities and indicate whether the resulting gain/loss is short-term or long-term
 - The basis reporting requirement only applies to the following covered securities, provided they are held in a brokerage or similar custodial account:
 - Shares of stock on or after 01/01/2011
 - Mutual fund shares on or after 01/01/2012
 - Debt securities on or after 01/01/2013
 - Other securities as Treasury may designate in future years

Information Reporting Update

- Transfer Statement Requirements – Section 6045A
 - Enacted in tandem with the new Form 1099-B basis reporting requirement
 - Generally requires that brokers and professional custodians who effect transfers of stock to other brokers/custodians issue a “transfer statement” to the receiving broker/custodian within 15 days of the transfer

Information Reporting Update

- Transfer Statement Requirements – Section 6045A
 - However, IRS Notice 2010-67 suspended all penalties for failure to issue transfer statements related to 2011 transfers between broker/custodians that are “not incidental” to a sale/purchase of the transferred securities

Information Reporting Update

- Reporting Organizational Actions – Section 6045B
 - Enacted in tandem with the new Form 1099-B basis reporting and transfer statement requirements
 - Requires issuers of stock and securities to report actions undertaken by the issuer that affect a holder's per-share basis in such securities
 - Reporting is made to the owners of the applicable securities and to the IRS
 - The ultimate goal is to provide owners of such securities with information needed to calculate the impact of the action on the basis of their securities

Information Reporting Update

- How Will Banks be Impacted by These Provisions?
 - Unless the bank acts as a broker/custodian of its own stock, it is not likely required to file Form 1099-B
 - However, if the bank acts as its own transfer agent, it will likely be required to comply with the transfer statement provisions of Section 6045A
 - Those banks who do not act as it's own transfer agent to handle transfers of their stock will not likely be impacted by the transfer statement or basis reporting requirements
 - However, all banks could be potentially subject to the organizational action reporting requirements of Section 6045B if they undertake an action that affects their shareholders' stock basis

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Allen is a partner in the tax services practice at HORNE and has more than 15 years of public accounting experience providing income tax planning and compliance to clients. He has extensive experience regarding income tax issues of financial institutions ranging from independent community banks to large publicly traded financial institutions. His experience in serving financial institutions includes FIN 48 and FAS 109 income tax accounting, IRS and state examination assistance, Sarbanes-Oxley issues as well as federal and multi-state compliance and planning. Prior to joining HORNE, Allen served as senior vice president-federal taxes for a large publicly traded regional financial institution and also worked for an international professional services firm.

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