TAX ALERT

THE TAX CUTS & JOBS ACT: IMPLICATIONS FOR BANKING

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As 2018 gets underway, taxpayers are grappling with the provisions of the sweeping tax reform signed into law on December 22, 2017. Many of those provisions will have a significant impact on the banking industry, and while some banks are anticipated to face large charges in the short-term, in the long-term, the industry is expected to be a net beneficiary.

Both domestic banks and U.S. branches of foreign banks will be affected by provisions related to the reduction in corporate rate, net operating loss limitations, increased expensing, limitations on excess interest, repeal of the alternative minimum tax, changes to deductibility of certain business expenses, and limitations on the deductibility of FDIC premiums.

Reduction in Corporate Rate to 21% for Taxable Years after December 31, 2017

For taxable years beginning after December 31, 2017, the applicable federal corporate rate is reduced to a flat 21% from 35%.

Mazars' Insight: *The reduced rate significantly reduces the value of a bank's deferred tax assets, triggering an immediate write-down for financial statement purposes. In the long-term, however, banks will certainly benefit from this reduction.*

Limitations to the Net Operating Loss Deduction

Losses that arise in taxable years beginning after December 31, 2017 will no longer be eligible for the two year carryback that is available for losses arising in prior years. Additionally, a taxpayer will only be eligible to deduct a net operating loss generated after December 31, 2017 to the extent of 80% of its taxable income. The law generally allows for the indefinite *carryforward* of such losses. Losses generated in tax years beginning before January 1, 2018 will not be subject to the taxable income limitation, and will continue to have a two year carryback and 20 year carryforward period.

Mazars' Insight: Where applicable, there may be an adverse impact to a bank's regulatory capital from the loss of the carryback provision. In some instances, the indefinite carryforward of net operating losses may require a revaluation of deferred tax assets and valuation allowances.

Increased Expensing of Qualified Property

Replacing the current rules relating to bonus depreciation, taxpayers will be able to immediately expense 100% of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023. Notably, the definition of qualified property is expanded, making this expensing available for both original and acquired property if it is the taxpayer's first use.

Mazars' Insight: For some banks, the increased expensing may be used to offset the limitations imposed on the deductibility of net operating losses. Additionally, the ability to immediately expense acquired property is anticipated to boost acquisition activity.

Limitations on Interest Expense

The deductibility of interest expense incurred in taxable years beginning after December 31, 2017 will be subject to additional limitations, capping the deduction at 30% of adjusted taxable income. The interest expense limitation provision does not provide for grandfathering.

Mazars' Insight: The interest expense limitations are only applicable for banks with net interest expense, blunting the impact on the industry as a whole.

Alternative Minimum Tax

The corporate alternative minimum tax is repealed for taxable years beginning after December 31, 2017. Banks with AMT credits carryforward will be able to utilize it to offset taxable income, and claim a refund of up to 50% of the credits, to the extent they exceed regular tax for the year, in tax years prior to 2022. Any remaining credits can be claimed as a refund in 2021.

Deductibility of Meals and Entertainment

Entertainment expenses, even where directly related to the active conduct of a taxpayer's business, are no longer deductible. A 50% limitation on food/beverages and qualifying business meals, such as meals consumed by employees while traveling for work is retained.

Additionally, the deduction for meals provided through employer-operated facilities on an employer's business premises is limited to 50% until 2025 and disallowed thereafter.

FDIC Premium Limitations

The deductibility of FDIC premiums will be limited for banks and other financial institutions with over $10 billion in consolidated assets. Further, banks and other financial institutions with consolidated assets in excess of $50 billion will be ineligible to deduct FDIC premiums in their entirety.

State and Local Tax

It is important to note that there may be varying State and Local tax impacts in connection with the above-listed tax reform provisions, depending upon whether a particular jurisdiction opts for conformity with federal rules.

International Tax

In addition to the aforementioned provisions, banks with overseas activity (inbound or outbound) may also be impacted by the substantial tax reform provisions targeting foreign investment and activity. Among those provisions are a new Base Erosion Anti-Abuse Tax ("BEAT"), loss-recapture rules for foreign branches being later incorporated, and mandatory repatriation of deferred foreign income/foreign tax credit changes triggered by the move to a participation exemption regime.

While tax reform provisions generally look to be favorable for the banking industry, the ultimate impact may be more difficult to determine, as tax reform contains several provisions with the potential to alter the demand for loans and the value of collateral (i.e., mortgage interest limitations and state and local tax deduction limitations). The specific impact, as always, will largely be dependent upon the facts and circumstances applicable to the individual taxpayer.

For additional information relating to the tax reform legislation, please refer to our December 22, 2017 alert. Please contact your Mazars USA LLP professional for additional information.

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