POSSIBILITIES

INSIGHTS FOR FINANCIAL INSTITUTIONS

FALL 2017

2017 Tax Planning Strategies & Considerations

With Donald Trump in the White House and Republicans maintaining a majority in Congress, there are high expectations for sweeping tax reform. Taxpayers anticipate passage of corporate and individual tax rate decreases and elimination of certain taxes, such as the Alternative Minimum Tax (AMT) and the estate tax.

Although no significant tax legislation has been enacted as of the date of this publication, there is still potential for legislative action during 2017. Legislation could be signed into law later this year, but those provisions could be effective for the 2017 tax year, the 2018 tax year, or even later. However, that does not mean these anticipated changes shouldn't have a significant impact on 2017 tax planning.

With anticipated drops in effective corporate and individual tax rates, there could be major incentives to defer income to 2018 and accelerate deductions to 2017. You'll need to follow current tax law for 2017 with an eye on what could happen with tax legislation and be able to react and adjust your 2017 tax plan (and longer-term tax planning) quickly if the changes should warrant it.

Year-End Planning Opportunities

Taking all of this into consideration, in order to maximize the effect of potential 2018 tax rate decreases, some strategies to consider for deferring income and accelerating deductions for the 2017 tax year include, but are not limited to, the following:

- Review your bank's loan watch list and classified loans to determine if any additional charge-offs would be appropriate.
- For "other real estate" or "other personal property" repossessed during the year, make sure the property has been written down to fair market value. Keep in mind, the initial write-down should be booked to the loan loss reserve and is deductible as a loan charge-off. Subsequent write-downs to the property due to the decrease in value are non-deductible for tax purposes until the property is eventually sold.
- Currently, the expensing threshold for qualified furniture, equipment and other assets is $510,000 per entity, with phase-outs beginning at $2,030,000 of items placed in service for the year. If not fully expensed, 50 percent bonus depreciation on qualified new assets is available for 2017. If new equipment or furniture is needed, placing them in service during 2017 could yield permanent tax savings.
- Cost segregation studies could provide significant current-year (2017) deductions on buildings that may have been in service for several years. This study could take future tax depreciation deductions and place them in 2017, where a higher tax rate could likely be in effect than in future years.
- For cash basis banks, consider payment of accrued liabilities and paying certain short-term prepaid expenses that are qualified for accelerated deduction before year-end.
- Accrual basis banks may also prepay and deduct in 2017 some prepaid expenses, but the types available for deduction are more limited. Items such as taxes, insurance, and warranty contracts would qualify for this deduction.

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INSIDE

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THE DIRECTORS' CORNER

Director 101—Introduction to the Role of a Community Bank Director

In today's world, commercial banks are fighting hard to maintain their historic role as leaders of the financial community. They are faced with increasing pressures from competitive institutions which are eager to offer services that have heretofore been restricted to banks; … A bank director, particularly a non-management director, has a greater opportunity and a greater responsibility today than at any period in recent history …

An appropriate statement for bank leadership in the 21st century right? Yet these words were written 43 years ago in 1974! How ironic that banks continue to be challenged by this type of competition, although they wear different camouflage now. And front and center to those pressures is the increasing responsibilities of the community bank director.

Bank directors serve a critical role in the leadership and oversight of the institutions they govern. Fulfilling that role requires diligence and can be challenging. Studies show banks that are well-run with few problems have engaged and well-informed board members. Conversely, many failed banks were discovered to be supervised by directors who received insufficient or untimely information or were simply disengaged, which impaired their ability to identify and correct problems.

Take Your Seat

Serving as an outside director probably means you have never worked for a bank or had any training to be a banker. Yet you are legally obligated to supervise both the bank and bank management who have much more expertise. That's okay. Knowing how to manage the bank on a daily basis isn't your role. But overseeing the implementation of bank policies, understanding the bank's balance sheet and income statement, questioning management when necessary, and maintaining an independent approach is. Ongoing board training is also expected as a way of staying informed on changes taking place in the industry.

The regulatory expectation of a director is to exercise loyalty and care in fulfilling their responsibilities.

- **Loyalty** is administering the affairs of the bank with candor, honesty and integrity, and not advancing one's own personal or business interests at the expense of the bank.
- **Care** means to exercise sound business judgment. Employ the same degree of care as a prudent individual. Act in good faith and in the best interest of the bank.

Duties of a Director

So what is the job of a bank director? It boils down to decision-making and oversight, with risk management integrated throughout.

Decision-making includes hiring and setting compensation for the CEO, strategic planning that includes growth strategies such as acquisitions or expansion to new markets, approving new product offerings and approving written policies and procedures.

Oversight includes reviewing bank financial statements, board reports and evaluating the CEO's and the board's performances. In the event the board or bank regulators have identified weaknesses, it also requires addressing and correcting those issues.

Taking risk has always been fundamental to banking. Forty years ago the board's focus was centered on approving loans and expenses, along with marketing the bank. Sound risk management processes and internal controls is critical to ensuring compliance with banking laws and regulations. Today, risk management has taken on a different meaning as new technologies, innovation of services, and cyber security are changing the landscape of banking and the role of the community bank director.

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The Stay Interview: Retaining Your Top Talent

You likely conducted interviews on your employees when you first hired them. If you've had employees leave, maybe you've conducted exit interviews. But there's another type of interview that often gets overlooked: the stay interview.

While exit interviews are conducted when an employee leaves to help management get a better understanding of what went wrong or why the employee left, stay interviews give management an idea of how they can help their employees stay with their organization.

Stay interviews can help management gain a good understanding of what the organization is doing right that makes employees want to stay, but it can also help determine what it is that would cause an employee to leave. This gives management a chance to identify strengths and weaknesses, and to work on improving those before it's too late.

On top of that, stay interviews can help build stronger relationships within an organization, which can ultimately lead to more trust throughout. When employees realize their thoughts and needs are being considered, they are often more likely to have positive attitudes and relationships. Following up on information learned in the interviews can help solidify this.

Types of Questions

Common questions that can create a worthwhile interview include:

- What keeps you coming back to work here every day?
- What do you look forward to here?
- If you could change something about your job, what would it be and why?
- What would make your job more satisfying?
- What do you want to see from upper level management/staff?
- What might cause you to leave the organization?
- What can the organization do more of for you?
- What do I do next?

Stay interviews can be a powerful tool to help you improve work-life for your employees, and to keep them around for years to come. When stay interviews and the information obtained in them are acted on properly, you're more likely to retain your employees and avoid those exit interviews.

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Essential Cyber Security: Best Practices for Financial Institutions

This is part one of a two-part series on cyber security.

October is National Cyber Security Awareness Month, but it seems that the topic of cyber security needs no official help to be in the news. The recent Equifax breach proved once again that no organization is safe from cyber threats. Banks and other businesses that hold people's most sensitive personal information are and will always be prime targets for these attackers. A proactive approach is the best way to ensure your customers' data remains secure.

Of course, that's easier said than done. A proactive approach is truly a team effort that involves virtually everyone in your organization. However, there are best practices that you can start today to help increase your organization's defenses.

Email and Internet Best Practices

Email and the Internet are fundamental to how we work. Here are five tips to help make these areas more secure from cyber threats.

1. Think Before You Click

You just received your 50th email of the day! In your eagerness to get it out of your inbox, did you take a second to investigate the link before clicking? Once a link has been clicked there's no going back—malicious software can now install itself on your computer. Don't click on any link unless you know you can trust the source and you are certain of where the link will send you. If you are unsure about a link, the best thing to do is call the sender prior to clicking on the link or send it to your organization's helpdesk for them to investigate.

2. Secure Web Browsing

This message is brought to you by the letter "S." That simple letter makes a difference when it comes to secure online communication. "Http" stands for hypertext transfer protocol, while the "s" at the end stands for security. It is important to make sure that "https" is displayed as part of a URL you visit, as it shows the authenticity of the security certificate on that webpage. If you access a webpage without a certificate or one that is expired, there is a chance you are accessing a website that could be loaded with malware, viruses, Trojan horses, or eavesdroppers.

3. Be a Cautious Surfer

It is important that you do not surf the web if you are on an account that has administrator privileges. If you pick up malware using a computer with administrator privileges, you have successfully given the malware the same administrator rights that you have on your user account.

4. Be Smart with Your Smartphone

Smartphones are everywhere, and hackers know that, making it another avenue for them to access sensitive data.

- Don't open email if you don't know the sender
- Don't answer text messages asking for personal information
- Use the guest Wi-Fi network at the workplace
- Use strong phone passwords
- Turn off Bluetooth when you aren't using it or when entering sensitive data

5. Create Strong Passwords

Two of the most common passwords are "123456" and "password." Having more complex passwords can help protect you and your data.

Strong passwords should:

- Contain at least 12 characters and include upper and lower case letters, numbers and special characters
- Be unique to one person—that means they should never be shared
- Not be reused on multiple account logins
- Change every 60 to 90 days

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- Generally, an accrual basis bank is allowed a current deduction for accrued bonuses if they are paid within the first 2 ½ months of the following tax year. However, there are tax deduction limitations if the bonus plan allows the bank to retain any amounts forfeited by employees.
- With significant differences in state rates of taxation, make sure state identification of loans, deposits and loan interest income is properly identified in bank records for apportionment calculations to the appropriate states, and be certain that all state tax filing requirements are being satisfied. If a state tax balance due is projected, payment of that balance due prior to December 31, 2017, would provide a federal tax deduction for 2017.
- Review your bank's tax depreciation schedule for assets that are no longer in service and may have been disposed by the bank. If any tax basis remains in these assets, it can be deducted as a loss on disposal.
- Many luxury autos, due to depreciation limitations, have high tax bases in comparison to their trade values. Thus, a sale of the vehicle could generate a deductible loss, while a trade would defer that loss until the next vehicle was ultimately sold.
- It would be a good practice prior to year-end to review the dollar expensing threshold included in the banks capitalization policy and determine if that amount still makes sense for your bank. In addition, review your repairs and maintenance expense accounts and your current-year fixed asset additions to ensure all items are

HMDA Reporting Changes: 2018 and Beyond

The Home Mortgage Disclosure Act is dramatically changing next year. This will impact the way you determine if your institution is subject to the reporting requirements, which loans are reported, as well as the data that is collected. Here are some of the challenges we will tackle while complying with the updates to the HMDA rules.

Exemptions

Is your financial institution in or out? One change is the elimination of some banks from the reporting requirements. If the bank originates fewer than 25 closed-end loans or 500 open-end lines of credit secured by a dwelling in either of the previous two calendar years, the bank will not be subject to reporting. These exemptions are exclusive and could result in a bank reporting only one or the other. If a bank meets both of these exemptions it will not be subject to HMDA reporting for that year. Banks should ensure they are tracking these loan types if their loan volume is near either threshold to ensure data collection and reporting is completed when required.

New Loan Categories

Another change will be the loans subject to reporting. We currently report loans for the purchase, home improvement, or refinance of a dwelling secured loan. However starting in 2018 dwelling secured loans will fall into three categories: Consumer, Agricultural, and Business or Commercial.

Consumer purpose loans are defined as those loans primarily for personal, family, or household purposes that are secured by a dwelling. All loans within this category will need to be reported regardless of the loan purpose. This change now includes loans previously exempt by purpose, such as a debt consolidation loan secured by a dwelling. However, loans for temporary financing do remain exempt from the reporting requirements. In order to meet the definition of "temporary finance" the loan must be originated with the intent to be replaced by permanent financing at a later date.

A loan that is made primarily for a business or commercial purpose will be a covered loan if the transaction is a home improvement, home purchase or a refinance. The business and commercial loans take into consideration the purpose, unlike the consumer and agricultural loans for transactional coverage. An example of a reportable loan would be credit extended for investment purpose to purchase or improve a multi-unit apartment complex or rental home. A loan for the purpose of purchasing a warehouse would not be reportable.

Ag Loans

Agricultural loans are exempt from the reporting requirements in 2018. Loans that are for any purpose such as; purchase, improvement or refinance of a dwelling on land used primarily for agricultural purpose are excluded from HMDA regardless of the purpose of the loan. The number of acreage does not matter. The bank may use a reasonable standard to determine the primary use of the real property. A loan included in this category would be a loan to purchase a dwelling that is located on land that the purchaser currently is or will be primarily using for farming.

As we all incorporate policies and procedures in response to the changes, remember that we have made it through regulatory change together before and can do it again!

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2017 Tax Planning Strategies & Considerations

in compliance with the bank's capitalization policy.

- A review of the bank's available-for-sale security investment portfolio should be made and securities with unrealized losses should be considered for a sale in order to recognize the ordinary loss before year-end.
- For executives considering whether or not to exercise non-qualified stock options (NQSOs), it may be advantageous to defer exercise until 2018 when lower rates may be in place.
- For S corporation banks and holding companies, year-end tax planning time is a good time to perform some S corporation due diligence functions, to ensure that all S corporation eligibility requirements are still being met by the corporation and its shareholders. If shares were transferred during the year or new shareholders were added, it is important to make sure that all compliance with S corporation requirements is still in place, particularly if shares were transferred into trusts during the year. Care must be taken to be sure that IRS requirements, as well as Federal Reserve Bank rules, are being complied with.

Make sure to contact your Eide Bailly tax advisor to discuss year-end, and long-term, tax planning strategies and considerations.

Compliance Corner

COMPLIANCE HELPLINE AVAILABLE TO CLIENTS

Clients appreciate our Compliance Helpline, which is staffed by compliance professionals who have an average of 18 years of industry experience. These professionals respond to questions immediately, or within 24 hours if research is needed.

The Compliance Helpline can be reached Monday through Friday 8 a.m. – 5 p.m. at:

855.239.8676
compliancehelp@eidebailly.com

COMPLIANCE HELPLINE Q&A

Q: What were the changes effective October 3, 2017, regarding the Military Lending Act and credit cards?

A: Institutions that issue credit extended in a credit card account under an open-end (not home-secured) consumer credit card plan to service members or their dependents will need to prepare compliant oral and written disclosures. Institutions will need to have a system in place, both to identify when the MLA applies, and to ensure that a covered borrower is not charged an MAPR greater than 36 percent for any credit card billing cycle. Imposing the 36 percent MAPR rate cap on credit card products means that, in transactions with covered borrowers, institutions will be required to calculate and comply with the MAPR limit every billing cycle. Under an exemption for credit card products, institutions may exclude certain fees from the MAPR if the fees are "bona fide" and "reasonable for that type of fee." To determine whether a fee is "reasonable," the Department of Defense permits institutions to compare a specific fee to fees typically imposed by other creditors for the same or a substantially similar product or service. Institutions are permitted to rely upon commercially compiled information to determine whether a fee satisfies the "reasonableness" safe-harbor requirements. ■

We recommend you refer to your specific state's statutes for requirements in your state.

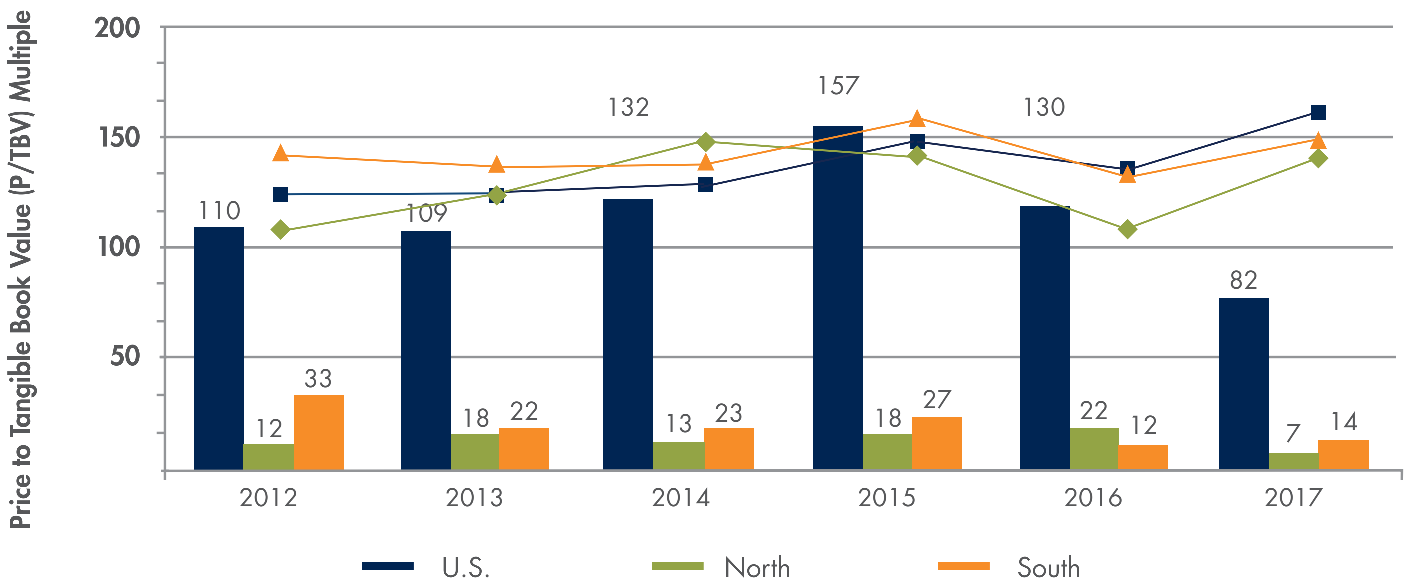
COMPLIANCE REMINDERS/DUE DATES

	Regulation	Description
Oct. 3, 2017	Military Lending Act	October 3, 2017, is the mandatory Military Lending Act compliance date for credit extended in a credit card account under an open-end (not home-secured) consumer credit plan.

M&A Corner

The following data were compiled from information provided by S&P Global Market Intelligence. The data include all completed transactions reported with pricing information available for the time period January 1, 2012, through August 31, 2017. The data for the North category include all completed transactions reported with pricing information available in Idaho, Iowa, Minnesota, Montana, Nebraska, North Dakota, Oregon, South Dakota, Washington, Wisconsin and Wyoming. The data for the South category include all completed transactions reported with pricing information available in Arizona, Colorado, Kansas, Nevada, New Mexico, Oklahoma, Texas and Utah. The data did not include any government assisted transactions, branch acquisitions, or savings banks/thrift transactions.

Bank Transaction Data
U.S., North and South Regions
1/1/2012 – 8/31/2017



The bar graphs represent the number of transactions for which we have pricing data. In addition to the transactions summarized in the chart, there were 419 transactions in the U.S. since the beginning of 2012 for which pricing data was not included. Of those, 149 transactions were in the North region and 94 were in the South region.

	North	South
Geography	The transactions completed in 2017 were headquartered in Iowa, Minnesota, Nebraska, North Dakota, Oregon, South Dakota, and Wisconsin.*	12 of the 24 banks sold in 2017 were from Texas. Nine of the remaining banks were headquartered in Kansas.*
Target Size	10 of the 20 banks sold through August 2017 had assets less than $100 million.*	10 of the 24 banks sold through August 2017 had assets less than $100 million.*
Multiples	The average tangible book multiple through August 2017 was approximately 1.39, compared to 1.22 a year prior.	The average multiple through August 2017 is considerably greater than the average multiples from 2012 through 2016.

**includes transactions for which pricing data was not available.*

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37th Annual Eide Bailly Bankers Seminar

REVOLUTIONARY LEADERSHIP

NEW WAYS TO THINK ABOUT BANKING

WEDNESDAY, NOVEMBER 1, 2017

Hilton Garden Inn, Fargo | Registration at 11:00 a.m. | Meeting at 12:00 p.m. (CDT)

Live Streaming Available in: Bismarck, Billings, Denver, Norman, Salt Lake City, Spokane, and Tulsa

THURSDAY, NOVEMBER 2, 2017

Verizon Wireless Center, Mankato | Registration at 12:30 p.m. | Meeting at 1:00 p.m. (CDT)

WEDNESDAY, NOVEMBER 8, 2017

Hilton Garden Inn, Sioux Falls | Registration at 12:30 p.m. | Meeting at 1:00 p.m. (CST)