

Bank & Capital Markets

Tax Institute

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Washington National Tax



AGENDA

- Deducting Success Based Fees
- Section 118 Issues in State/Local Grants
- The Trouble with Mergers
- Hidden Continuity Issue in a Qualified Stock Purchase
- Using Leverage in Bank Holding Companies
- Boot in a Reorganization; Whose E&P Gets Taxed
- Partially Tax Free Bank Acquisition
- Rev Rul 80-58: A Federal Income Tax Do-Over

Deductibility of Success Based Fee

- General Rule
 - Treas. Reg. 1.263(a)-5(f)
 - Exception for detailed documentation

- Rev. Proc. 2011-29
 - Forego documentation
 - Elect 70% deductible; 30% capitalized
 - Irrevocable transaction based election
 - Attach election to original return
 - Effective for Tax Years ending April 8, 2011 or after

Deductibility of Success Based Fee

- LB&I Directive 04-0511-012 (July 28, 2011)
 - Applies to Tax Years ended before April 8, 2011
 - Allows application of Principles of Rev. Proc. 2011-29
 - Exam Should Not Challenge 70/30 Allocation
 - Original Timely-Filed Returns Only

Deductibility of Success Based Fee

Rev. Proc. 2011-29 or LB&I Directive

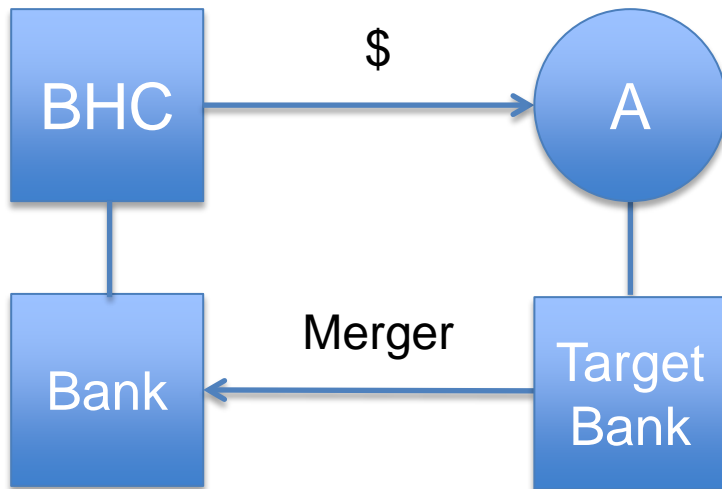
- Covered Transactions; Treas. Reg. 1.263(a)-5(e)(3)
 - Taxable Asset Acquisition – Trade or Business
 - Taxable Acquisition of Equity – At Least 50%
 - Reorganizations
 - 368(a)(1)(A)
 - 368(a)(1)(B)
 - 368(a)(1)(C)
 - 368(a)(1)(D) – Acquisitive Only

Section 118 Issues on State/Local Grants

- City A offers Reduction of Real Estate Tax
 - Minimum Capital Investment
 - Minimum Payroll
 - Potential Claw-back
- Taxpayer Desired View
 - Deduct 100% of Real Estate Tax
 - View Spread as Nontaxable Capital Contribution
 - Reduce Tax Basis of Real Estate
- IRS View
 - Mere abatement
 - Payroll Subsidy
 - Non-permanent Capital

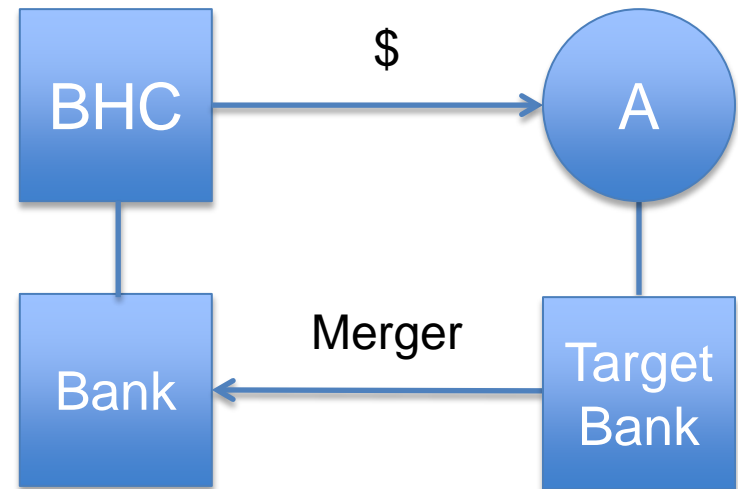
The Trouble with Bank Mergers

WRONG



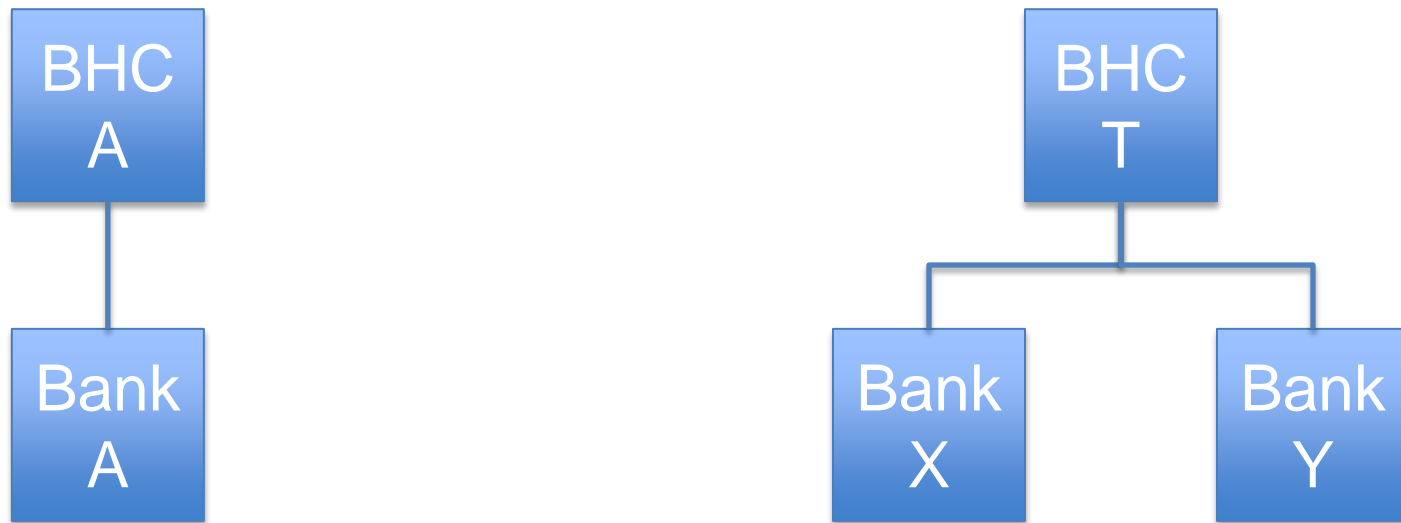
Target Bank merges into Bank and A is paid in cash.

RIGHT



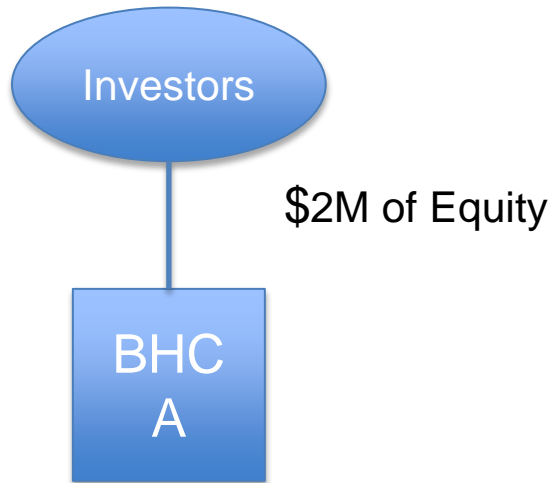
Step 1: A sells Target Bank's stock to BHC for cash.
Step 2: Target Bank, wholly-owned by BHC, merges into Bank.

Hidden Continuity of Interest Issue in a Qualified Stock Purchase

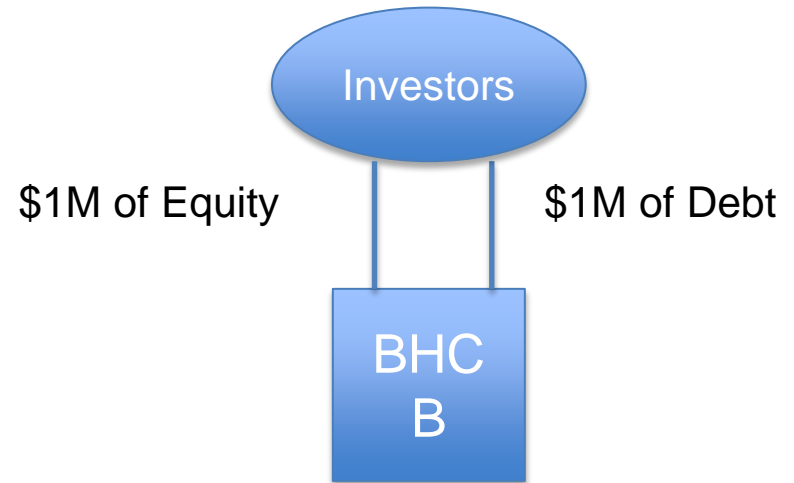


1. BHC A would like to purchase the stock of Bank X and Bank Y for cash.
2. BHC A believes synergies can be achieved by combining Bank X and Bank Y.
3. To facilitate the transaction, BHC T causes Bank Y to merge into Bank X.
4. BHC A then buys the stock of Bank X from BHC T.

Using Leverage in a Bank Holding Company



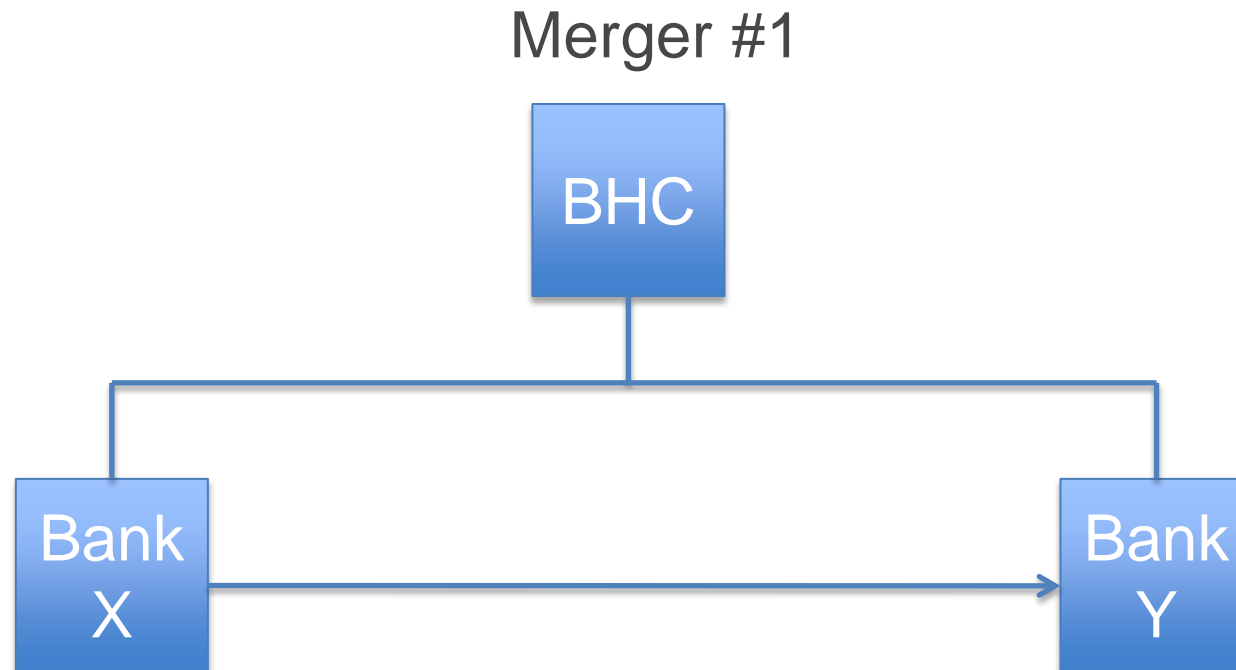
1. Any distribution to Investors taxed first as a dividend-taxable.
2. Paying dividends is not tax deductible.



1. Distributions consistent with debt terms are interest/principle- principle return is not taxable.
2. Paying interest is tax deductible.

ECONOMIC SUBSTANCE/PENALTIES IN EITHER SCENARIO???

PLR 201032035: Whose E&P Gets Taxed?



1. Bank X and Bank Y each have \$250 of E&P.
2. FMV of X stock = \$1,000; FMV of Y stock = \$1,500
3. Bank X merges into Bank Y
4. BHC receives \$500 of Bank Y stock and \$500 in cash

PLR 201032035: Whose E&P Gets Taxed?

Merger #2

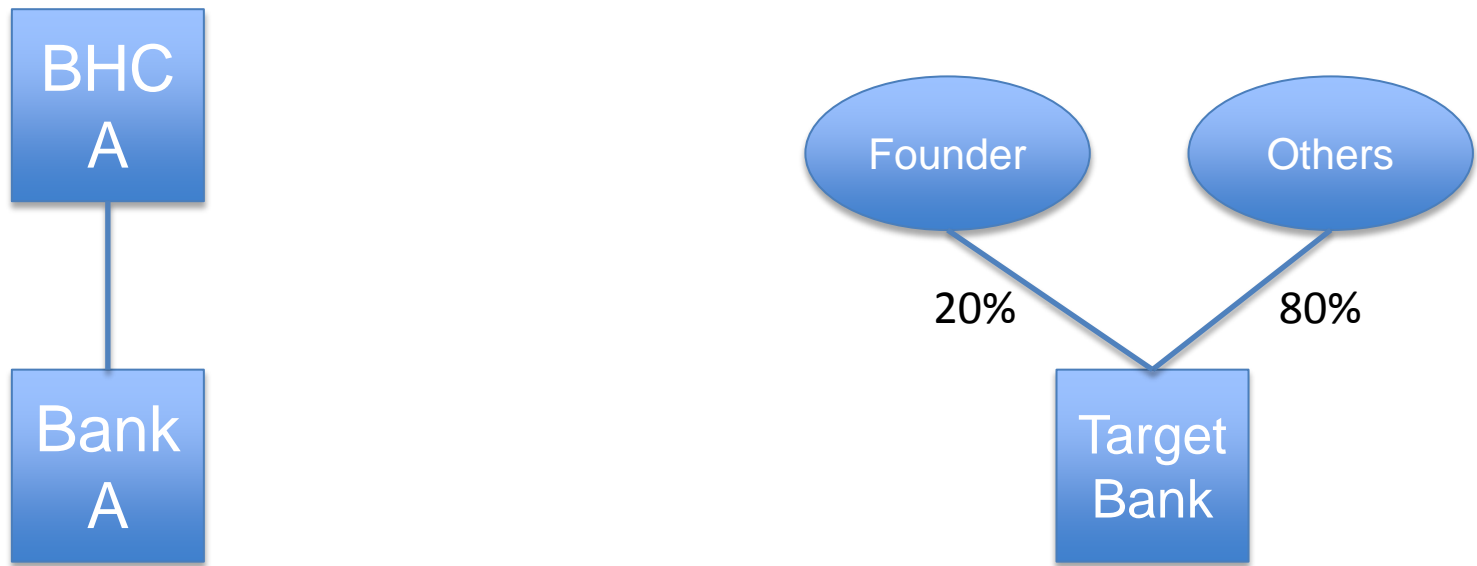


1. P Financial and Bank T each have \$250 of E&P.
2. FMV of P Financial stock = \$1,000; FMV of Bank T stock = \$2,000
3. Bank T merges into Bank P
4. C receives \$1,500 of P Financial stock and \$500 in cash

PLR 201032035: Whose E&P Gets Taxed?

- In PLR, IRS Applied Post Reorganization Test based on Comm. v. Clark, 489 U.S. 726
- Commonly Controlled – Merger #1
- Not Commonly Controlled – Merger #2

Partially Tax Free Bank Acquisition



1. BHC A desires to purchase Target Bank
2. Founder is unwilling to incur current taxation

Partially Tax Free Bank Acquisition



1. BHC A forms New BHC by transferring cash in exchange for 100% of the common stock of New BHC.
2. Founder transfers Target Bank stock to New BHC for “pure preferred stock.”
3. New BHC uses cash to purchase Target Bank stock from Others.

RESCISSION: A Federal Income Tax Do-Over

- Revenue Ruling 80-58
 - Applies Case Law
 - Single Tax Year
 - Status Quo Ante

- Liberal Application by IRS
 - Time Value of Money
 - Undo Statutory Merger—PLR 200710019
 - Reform Taxable Exchange—PLR 200752025

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- Thank you.
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