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STIFEL

Accounting and Tax Update

2020 What's New in New England Banking

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TODAY'S OBJECTIVES

**ACCOUNTING UPDATE – CECL AND LOAN
MODIFICATIONS**

TAX UPDATE

A photograph of a person working at a desk. The desk is white and round. On it, there is a silver laptop, a white coffee cup with a black lid, and a small green potted plant in a white pot. The person's hands are visible, typing on the laptop. The background shows a window with blinds. The text "CURRENT EXPECTED CREDIT LOSSES (CECL)" is overlaid on the bottom left of the image.

**CURRENT EXPECTED CREDIT
LOSSES (CECL)**



Polling question #1

EFFECTIVE DATES

SEC filers except for smaller reporting companies (SRCs) – fiscal years beginning after December 15, 2020

SRCs and all other banks – fiscal years beginning after December 15, 2022

CECL IMPLEMENTATION

- Approximately 75% of eligible SEC banks decided not to delay implementation (ABA Banking Journal)
- There are reasons to NOT postpone implementation
- Why delay implementation?

CECL ADOPTION



KEY CHALLENGES:

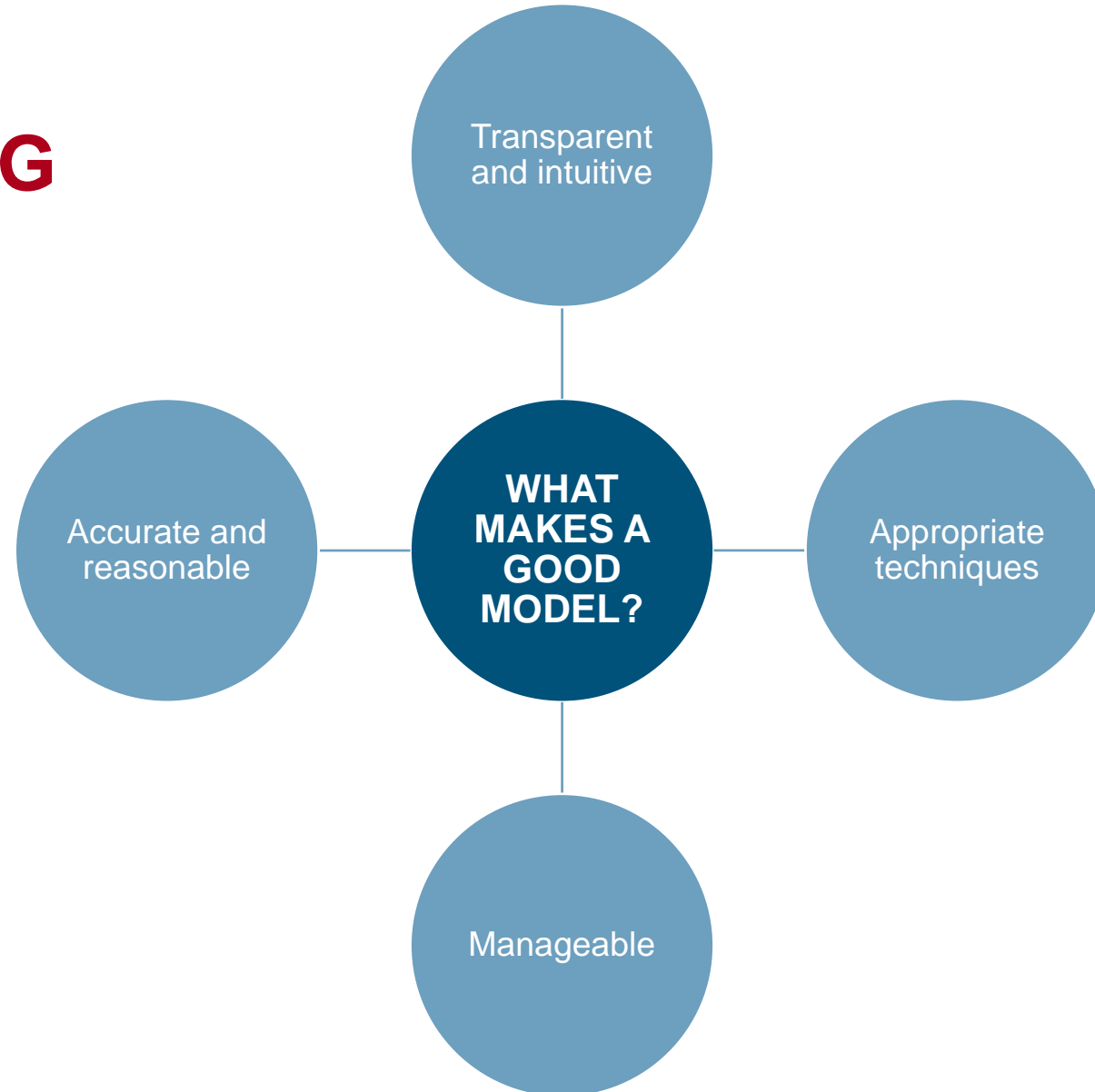
- Extreme economic circumstances challenged the effectiveness of many CECL models.
- Developing a reasonable and supportable forecast is the most challenging element of CECL.



LESSONS LEARNED:

- Parallel runs are very powerful.
- You will always have some level of qualitative reserves.
- Try to break your model. When do they show un-intuitive results?

NAVIGATING CECL



CECL ADOPTION TRENDS – BIG 4

Bank of America

32% increase in ACL upon adoption (\$3.3 billion)

JP Morgan Chase

30% increase in ACL upon adoption (\$4.3 billion)

Citi

29% increase in ACL upon adoption (\$4.1 billion)

Wells Fargo

12.4% decrease in ACL upon adoption (\$1.3 billion)



COVID-19 LOAN MODIFICATIONS

TYPES OF LOAN MODIFICATIONS

Section 4013 of the CARES Act Loan Modifications

- Option to temporarily suspend certain requirements under GAAP related to TDRs
- Loan modification must be related to COVID-19
- Loan cannot be greater than 30 days past due as of December 31, 2019
- Executed between March 1, 2020 and the EARLIER of (a) 60 days after the termination of the National Emergency or (b) December 31, 2020

TYPES OF LOAN MODIFICATIONS

Non-Section 4013 Loan Modifications – Additional Modifications

- Cumulative modifications short term in nature (e.g. six months or less combined)
- Borrower is contractually current at time of subsequent modification (less than 30 days past due on all contractual payments)
- Management may presume the borrower is not experiencing financial difficulty

TDR Designation and COVID-19 Loan Modifications:

Section 4013 of the CARES Act and OCC Bulletin 2020-35

Section 4013 of the CARES Act: On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law. Section 4013 of the CARES Act, “Temporary Relief From Troubled Debt Restructurings,” provides banks the option to temporarily suspend certain requirements under U.S. GAAP related to troubled debt restructurings (TDR) for a limited period of time to account for the effects of COVID-19.

Revised Statement: On April 7, 2020, the banking agencies issued a statement, “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working With Customers Affected by the Coronavirus (Revised)” (Revised Statement), to encourage banks to work prudently with borrowers and to describe the agencies’ interpretation of how accounting rules under ASC 310-40, “Troubled Debt Restructurings by Creditors,” apply to certain COVID-19-related modifications (see OCC Bulletin 2020-35).

Which Applies?

If a loan modification is eligible, a bank may elect to account for the loan under **section 4013 of the CARES Act**. If a loan modification is not eligible under section 4013, or if the bank elects not to account for the loan modification under section 4013, the **Revised Statement** includes criteria when a bank may presume a loan modification is not a TDR in accordance with ASC 310-40. **If the criteria are not met under either section 4013 of the CARES Act or the Revised Statement, the bank should follow its existing accounting policies to determine whether the modification should be accounted for as a TDR.** The chart below provides a summary of the respective criteria.

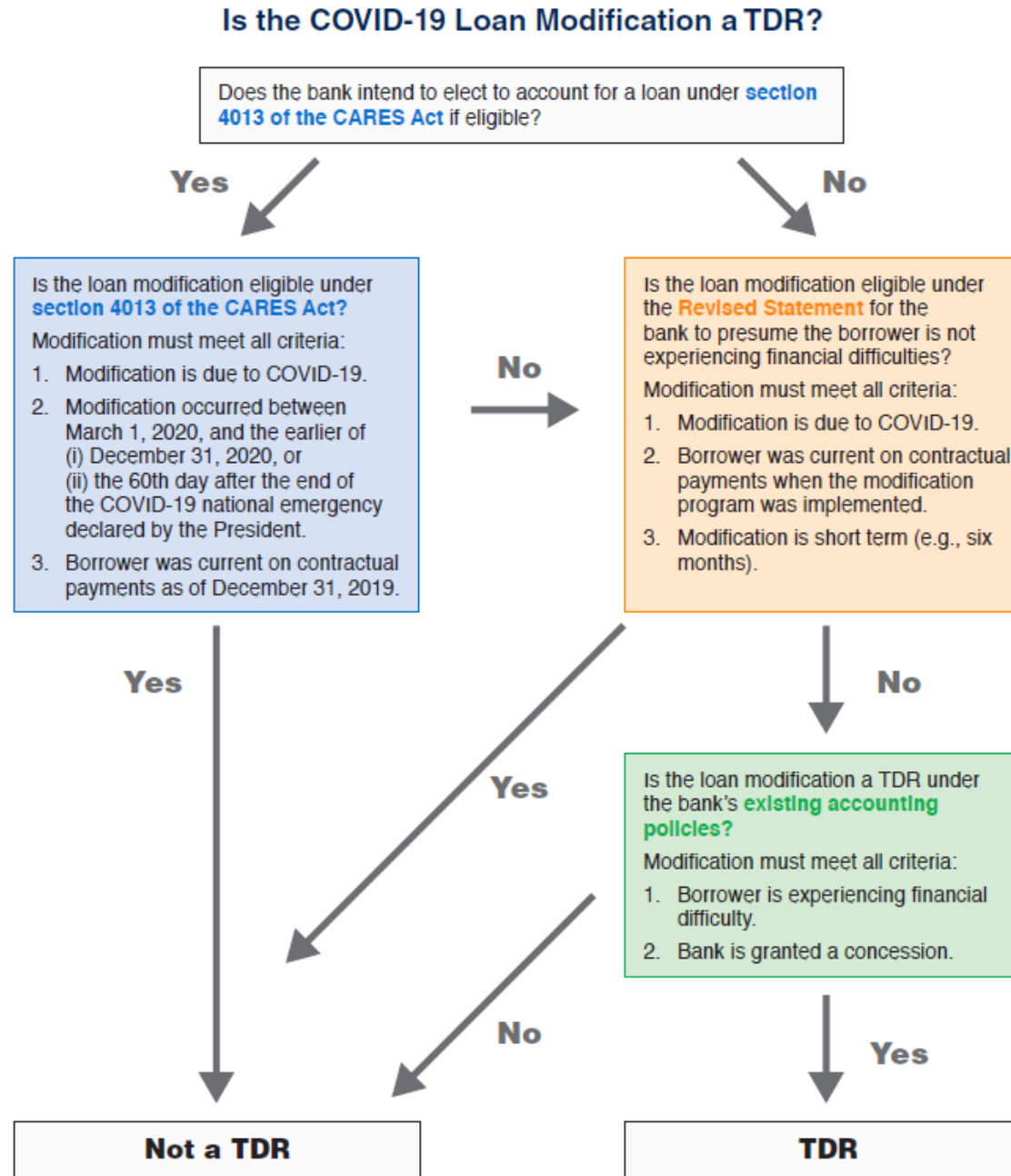
Refer also to the flowchart “Is the COVID-19 Loan Modification a TDR?” on page 2.

OCC REFERENCE GUIDE

	Section 4013 of the CARES Act	Non-Section 4013 Loan Modifications (Revised Statement)
Evaluation date of whether borrower was current (< 30 days past due)	December 31, 2019	No earlier than when the modification program is implemented
Modifications terms allowed (safety and soundness principles still apply)	Any modification	Short term (e.g., six months)
Time period of when the modification occurs	Between March 1, 2020, and the earlier of (i) December 31, 2020, or (ii) the 60th day after the end of the COVID-19 national emergency declared by the President.	Management should use judgment to determine if the modification is related to COVID-19.
Duration of non-TDR designation	Remaining life of the loan. Subsequent modifications must be evaluated if they are not also eligible under the criteria.	Remaining life of the loan. Subsequent modifications must be re-evaluated.
Why is it not a TDR?	By law, the bank is not required to designate the loan as a TDR.	The bank may presume that the borrower is not experiencing financial difficulty.

If neither section 4013 of the CARES Act nor the Revised Statement criteria are met, the bank should follow its existing accounting policies to determine whether the modification should be accounted for as a TDR.

OCC REFERENCE GUIDE





Polling question #2

TAX DISCUSSION TOPICS

1 TAX RATE STRUCTURE
AND IMPACT TO
PLANNING &
DEFERREDS

2 PPP FORGIVENESS IRS
AND STATE TAXATION –
SUMMARY TREATMENT

3 TAXATION OF PPP
LOAN FEES – CURRENT
OR DEFERRED
INCLUSION

4 REMOTE
EMPLOYEES AND
STATE NEXUS

5 DISASTER RELIEF
EMPLOYEE BENEFITS

6 CARES ACT TAX
CREDITS

FUTURE OF CORPORATE TAX RATE

	Current Tax Law (TCJA–present)	Biden’s Stated Goals	Trump’s Stated Goals
Corporate Tax Rates and AMT	<p>Corporations have a flat 21% tax rate and no corporate alternative minimum tax (AMT), which were both changed by the TCJA.</p> <p><i>These do not expire.</i></p>	<p>Biden would raise the flat rate to the pre-TCJA level of 28% and reinstate the corporate AMT on profits of \$100 million or more.</p>	<p>Trump has not announced changes and has no plans to reinstate a corporate AMT.</p>

TAX RATE CHANGE IMPACT ON TAX PROVISION

ASC 740 requires the effect of changes in tax rates and laws on deferred tax balances to be recognized in the period in which new legislations is enacted.

- Tax Cuts and Jobs Act of 2017 (reduced corporate rate from 34% to 21%)
- Financial reporting disclosure implications if rate increases to 28%
- Equity Section reclass – OCI versus Retained Earnings

PAYROLL PROTECTION PROGRAM LOAN AND FORGIVENESS

For federal purposes, PPP loan forgiveness may be excluded from gross income by an eligible recipient by the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

However, the IRS issued Notice 2020-32 in April 2020 stating that expenses associated with the tax-free income are non-deductible. This guidance was consistent with historic IRS guidance regarding non-taxable income and related expenses but has the net effect of essentially reversing the tax-free benefit of the exclusion on the loan forgiveness.



PAYROLL PROTECTION PROGRAM LOAN, STATES, AND NEW HAMPSHIRE

Example:

Generally, all federal-level COVID-19 relief distributed to taxpayers required to file a BPT return should be included as income for BPT purposes. However, any federal-level relief taking the form of a loan should not be included as income for BPT purposes, unless that loan is forgiven or otherwise discharged. Similar to the treatment of state-level relief, taxpayers are permitted a deduction for the expenses of operating a business, even if paid for with federal-level relief.



PAYROLL PROTECTION PROGRAM – SBA FEES PAID TO LENDERS

A Timing Dilemma

Income Deferral:

Treasury Regulation §1.1273-2(g) governs whether a payment collected at loan origination must be included in taxable income when received or deferred and recognized as interest income over the life of the loan. This regulation holds that fees collected from the borrower by the lender at loan closing are generally applied to reduce the issue price of the debt instrument, resulting in OID. Any payment treated as such would be recognized over the life of the loan as interest income using the constant yield method.



PAYROLL PROTECTION PROGRAM – SBA FEES PAID TO LENDERS

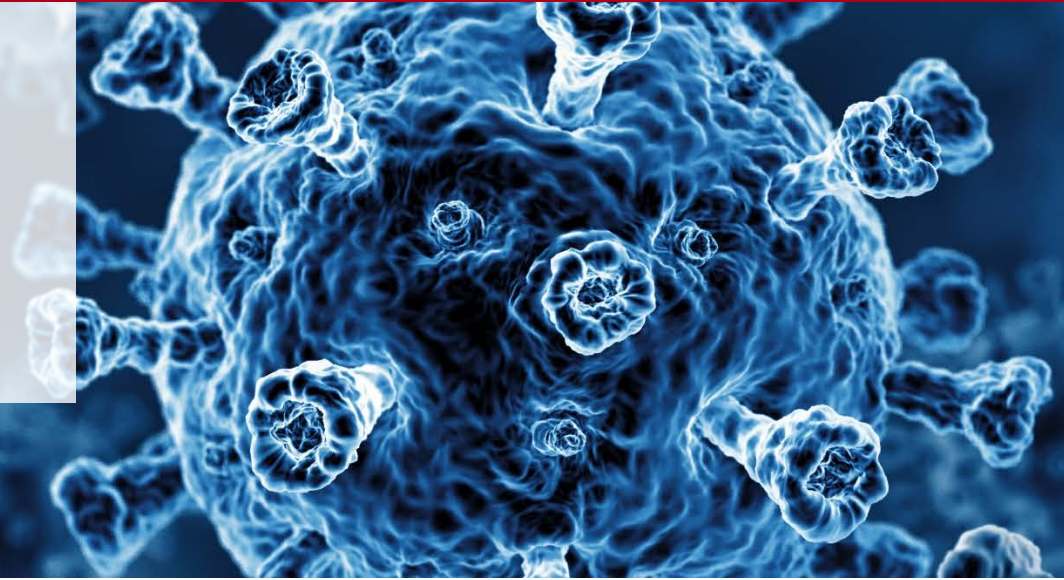
A Timing Dilemma

Current Inclusion:

The same Treasury Regulation (§1.1273-2(g)) explicitly prohibits this treatment from being applied to “payment for property or for services provided by the lender, such as commitment fees or loan processing costs”. Thus, in order to apply OID treatment, the amount collected must generally represent interest paid in the form of points. However, flat fee amounts charged as a “loan origination fee” or “loan processing fee” intended to compensate the lender for the service of processing the loan application and/or to cover the lender’s cost in making the loan do not qualify as points for this purpose.



COVID-19 RELATED ISSUES

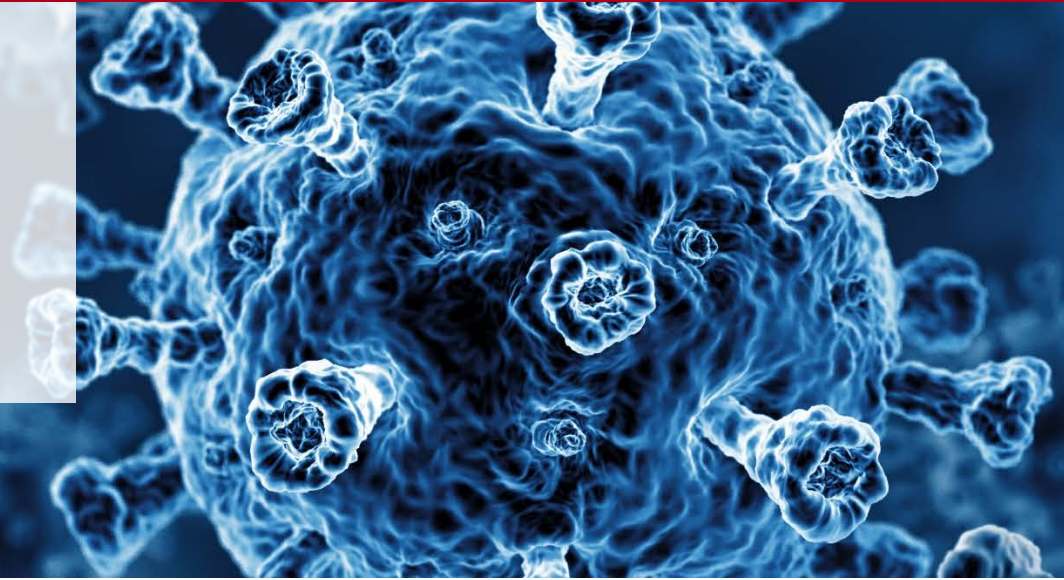


- Remote employees and state nexus implications
- Permanent vs. temporary work from home assignments
- Taxation on workers



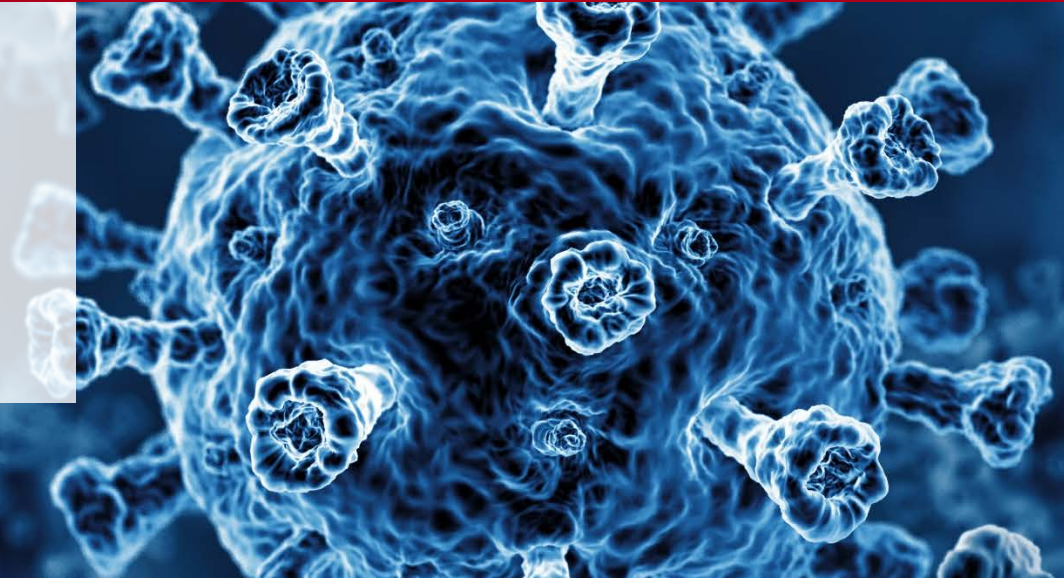
Polling question #3

DISASTER RELIEF PAYMENTS



- Federal employee benefits – Code Section 139
- Disaster relief payments
- Employees exempt from tax; not required to track/report expenses
- Employer may claim deduction for payment

COVID-19 PAYROLL TAX CREDITS

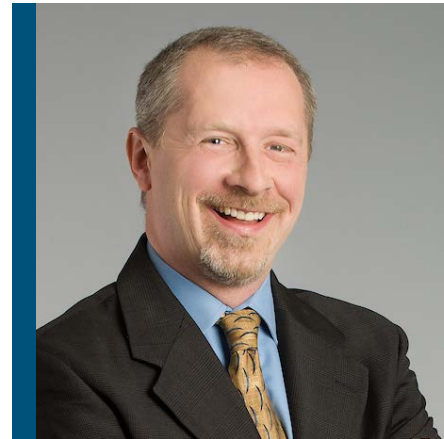


- **Families First Coronavirus Response Act Payroll Tax Credit**
 - Small employers – less than 500 employees
 - Paid sick/family leave due to COVID-19
- **Employee Retention Credit**
 - 100 FTE threshold
 - \$5,000 credit per employee

Questions



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