GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Illinois, Iowa, Wisconsin, Montana, Tennessee, Minnesota and Florida!

DID YOU HEAR THE ONE ABOUT?

A couple weeks ago I saw a brief article about a Vietnamese entrepreneur acquiring a small Texas bank. I thought to myself "that really can't be happening." I cannot believe the federal regulators would allow a foreign national with apparently no banking experience to acquire a bank charter. It turns out I was right. A recent detailed article in SNL Securities (the daily scandal sheet for those of us in banking) detailed how this Vietnamese concern reported on its website and other places that it obtained a banking charter in order to guarantee certain individuals the right to obtain a visa to work in the United States. The whole thing was bogus and has now been taken down. The article refers to it as "bank identity theft." If anybody wants a copy of it, let me know.

SUBCHAPTER S UNDER THE NEW TAX LAW

President Trump has now signed the "New Tax Law" into effect. A summary of all the various provisions of the New Tax Law is beyond the scope of *Musings*. However, one question that we have been asked a number of times lately is whether Subchapter S still makes sense in light of the New Tax Law. In short, the answer to the question is yes. The New Tax Law taxes Subchapter S corporations in such a way that it is ultimately a more beneficial tax structure for the shareholders than the alternative of being taxed as a C Corporation.

From a 30,000 foot perspective, the Subchapter S tax structure yields a slightly less than 30% total tax on corporate income when taking into account all taxes paid in the process of

ultimately getting the corporate profits to the shareholders. For C Corporations, the total tax is between 36% and 39%, depending on whether the dividends paid to the shareholders are subject to the 3.8% Medicare surtax.

The changes to the tax code as a result of the recent legislation are significant. What has not changed is the fact that an S Corporation is ultimately a more beneficial tax structure than a C Corporation. Please let us know if you have questions or would like to further discuss how the New Tax Law will affect your S or C Corporation specifically.

MORE SUBCHAPTER S TAX ISSUES

As virtually all of you know, the new tax bill contains some very favorable Subchapter S tax reforms. The bottom line is that 2018 forward, only 80% of Subchapter S community bank income will be included in the individual shareholder's taxable income (for the most part - these are complicated issues). That income will then be taxed at a maximum rate of 37%. This should provide a significant tax reduction for the shareholders. Many of the Subchapter S's I have visited with recently are contemplating whether to continue the same distribution to their shareholders or to reduce it to reflect a reduction in the taxes. We are also in the process of "running the numbers" on this for a number of individual community bank Subchapter S clients. If we can assist your bank in analyzing this strategic decision, please let us know.

CEO AGENDA

I was with a bank recently discussing some specific matters regarding their future planning. It was pretty clear that that particular organization's CEO's sole interest was in advancing his own agenda. It really did not seem to matter whether that agenda was consistent with the Board's agenda. During executive session at the end of the meeting it became pretty clear that the Board was well aware of the CEO's agenda and was not unduly influenced or taking their eyes "off the ball." A little subtlety probably would have helped this particular individual in moving toward the goals he desired.

EXCESS CAPITAL

We talk often in *Musings* about what to do with excess capital. I suppose all our community bank clients will have a little bit more excess capital, whether they are in a C Corporation or an S Corporation, under the new tax bill. If your community bank holding company is a C Corporation, your tax rate will go down, and the Corporation will pay less taxes,

resulting in less expense. If your community bank holding company is an S Corporation, the Board may determine that it wants to reduce the distribution because of the reduction in shareholder taxes. Either one of those will reduce expenses and generate additional capital which the Board will then need to appropriately allocate. It appears many of our clients are going to utilize that capital to redeem their own shares. This is generally a good use of excess capital in any circumstance.

THE EXPENSIVE BANK FAILURE

On Friday, December 15th, an approximately $166 million community bank in Chicago failed. This was the eighth failure of 2017. In reading the FDIC's notice related to the failure, the thing that struck me is that I consider this to be a very expensive bank failure given the size of the bank. The FDIC's press release indicated the cost to the Deposit Insurance Fund for the failure of this $166 million bank would be approximately $60 million. That is a very expensive failure relative to the size of the bank.

We looked into this failure a little bit because it seemed so strange. It turns out the bank was putting up very good numbers as reflected in their Call Report for the third quarter of 2017. Shortly before the bank failed, as we understand it, the CEO, who is the patriarch of the family that controlled the bank, committed suicide. Any connection? Probably, but the friendly federal regulators are not talking.

DO WE REALLY HAVE TO DO THIS?

We are currently working to reorganize a very closely held bank into a bank holding company structure. This particular bank has six shareholders - five of whom are family members, and one of whom is a bank employee. The bank holding company reorganization will occur through a simple share exchange transaction (tax-free) where each of the six bank shareholders will exchange their bank stock for an identical number of shares of holding company stock. This is the same as all other bank holding company reorganization structures.

Normally, these types of share exchange transactions are structured pursuant to each state's share exchange laws in the particular state's corporate statutes. This typically happens to ensure that any shareholders that do not want to go along with the transaction are either forced to go along or receive cash for their stock. In other words, using the share exchange statutes does not give the shareholders an option to opt out and continue to hold their bank stock.

In this transaction we are attempting to forego using the share exchange statutes. We are doing this primarily because it is less expensive and foregoes the requirement of a shareholder meeting. We are also trying to avoid having a shareholders meeting because such a meeting is completely unnecessary due to the fact that each of the six shareholders has agreed to exchange their bank stock for holding company stock and is in favor of the reorganization.

This all seems good in theory and makes perfect sense in reality. The problem is that the applicable federal statute requires a bank holding company reorganization to be approved by the shareholders at a shareholder meeting. The statute does not contemplate allowing the shareholders to do it in writing (i.e., hold their meeting by consent). What is more frustrating is that this statute requires notice of the meeting to be run in a public newspaper for four consecutive weeks prior to the meeting.

Arguably, each of these requirements could make sense. However, in this circumstance they do not. We are currently working with the appropriate friendly federal regulator to see if we can get some relief from these unnecessary statutory provision requirements. It will make the overall transaction easier to complete, more cost-efficient, and quicker. We will let you know whether the regulator agrees to waive these unnecessary requirements or whether they are going to require strict adherence to the statute and the holding of a meeting of these six shareholders. If they are required to hold a meeting, I hope it is someplace warm and sunny.

THE QUICK SUBCHAPTER S REORGANIZATION

As was mentioned in *Musings* about a month ago, towards the end of November we had a community bank ask us whether we could complete a Subchapter S reorganization for them prior to year-end so the holding company and bank could elect to be taxed as a Subchapter S Corporation beginning January 1, 2018. We told the Board we would put in the work necessary to make it happen on our end. The company agreed to do the same. Last night I attended the Special Meeting of Shareholders to approve the Subchapter S reorganization. The Plan of Merger that is necessary to effect the Subchapter S reorganization became effective today. In short, the transaction was completed in what is tied for record time (we completed one similar transaction in approximately six weeks a couple years ago).

The holding company and bank board members, who are *Musings* readers, are to be congratulated on their hard work in getting this transaction completed in this short amount of time. It took a lot of hard work by a good number of people, but it will provide benefits for the shareholders beginning Monday.

CONCLUSION

Musings is prepared to ring in the New Year. We hope you are too. It has been a wonderful 2017 for which we are very thankful to all of you who are loyal *Musings* readers and clients. We hope everyone has a safe and happy New Year and a good 2018.

Have a safe and Happy New Year. See you in 2018.

Jeff Gerrish *and* *Greyson Tuck*