Taxation and Representation for Community Banks

tax reform corporate tax cut

If you have wondered why politics is so crazy these days, consider an ICBA report that finds there are about 30 lobbyists for every 1 legislator. To visualize this, take a look out the door of your office or stretch out from your desk that is 30 people deep. Then, think about how you would deal with those people when they file in 1 by 1, asking you to do something to help them. Perhaps, all of these voices jockeying for time and providing singularly focused input could be a key reason Congress seems to move so slowly. Let's hope they can at least figure out the regulatory reduction or tax pieces soon, in order to give community bankers more breathing room.

On the subject of tax rates, bankers know this can have a major impact on how the bank or your commercial customers determine their next moves. Given tax reform for banks and businesses that is reportedly on the way, community banks are more carefully considering how these potential changes could impact bottom line performance, the attractiveness of certain investments, flexibility to innovate, and your customers.

No matter your politics, looking purely through the lens of what would help community bankers, it seems the discussed corporate tax cut down to somewhere around 25% or perhaps even 15% could help bottom line performance at many banks. Assuming it eventually happens, that is something bankers should be considering when discussing strategic matters at least.

In addition, such a change could arguably help your commercial customers, so that could be good too (particularly when it comes to servicing the debt on your loans or building out the business).

That said, it could also create some issues around deferred tax assets and liabilities. Here, some might be forced to "revalue" deferred tax assets and liabilities. That could hit capital to an unknown extent for some banks and perhaps even downstream customers that do business with you.

Another consideration is around investments in municipal bonds and bank-owned life insurance. These tax specific moves could be impacted by a reduction in the overall tax rate. Depending on the tax change, new reforms could render these investments less beneficial perhaps, as their tax adjusted yield would decline relative to the decline in tax rate. Hence, community banks should think about the potential tax impact here too.

Further, although most debates around banks and tax reform focus on corporate tax codes, more than 2,000 community banks are organized under Subchapter S of the tax code. Under that structure, income and losses are passed through to shareholders and included on their individual tax returns. This structure is also commonly used by many small businesses, so that too could be a good thing as such companies could see a pickup in after tax performance. On the bank front specifically, lower tax rates could allow community banks to raise additional capital and take other actions that could provide benefit down the road.

While it is unknown when or if any tax reform will occur, the best bet at this point is probably effective in 2018. This is clearly a complex matter that deserves careful consideration, so let's all hope Congress has its act together here. If this happens, the signs point to a beneficial outcome for community banks, so be sure to work a discussion into your processes as things continue to develop so you can take positive action.

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