INDEPENDENT COMMUNITY BANKERS *of* AMERICA®

November 16, 2017

The Honorable Paul D. Ryan
Speaker
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Nancy Pelosi
Democratic Leader
U.S. House of Representatives
Washington, D.C. 20515

Dear Speaker Ryan and Democratic Leader Pelosi:

On behalf of the more than 5,700 community banks represented by ICBA, I write to thank you for undertaking the critical and ambitious policy challenge of comprehensive tax reform. ICBA and community banks strongly support your efforts to craft pro-growth tax reform. We are encouraged by many provisions of the Tax Cuts and Jobs Act (H.R. 1), including the permanent 20 percent corporate rate, estate tax relief, repeal of the alternative minimum tax for both individuals and corporations, permanent extension of Section 179, and preservation of non-qualified deferred compensation which are widely used by community banks to supplement the pension income of key employees. In particular, we are pleased that H.R. 1 does not repeal the deduction for business interest but provides a workable safe harbor that will allow small business to continue to deduct their interest in full. This has always been a high priority for ICBA and community banks, and we are grateful that you have accommodated America's small business borrowers.

However, we are disappointed that H.R. 1 does not eliminate or curtail the generous taxpayer subsidies given to credit unions and Farm Credit System lenders. While we won't reiterate our arguments here in full, we will note that many of today's credit unions and FCS lenders are multi-billion-dollar entities that compete against much smaller taxpaying community banks. Credit unions are the equivalent of banks and should be taxed equivalently. FCS lenders seek unconstrained lending authorities to siphon away community banks' best consumer and commercial customers in any market. We hope you will revisit this tax inequality before the bill is enacted.

As you begin consideration of H.R. 1 on the floor of the House, we take this opportunity to note our significant concerns with certain provisions of the bill.

Limits on FDIC Premium Deductibility

H.R. 1 would remove the deduction for FDIC premiums paid banks over $50 billion in assets and phase out the deduction for banks between $10 and $50 billion. FDIC premiums are clearly a business expense as is any other form of insurance premium. No sufficient rationale has been offered for limiting their deductibility. ICBA opposes this assault on FDIC insurance.

Application of Business Income Rate

ICBA is very pleased that community banking would not be classified as a "specified service activity" (Section 4(e)(3)) and that passive shareholders of Subchapter S community bank would be taxed at a maximum rate of 25 percent rate on their share of the bank's net income. However, we must note our very serious concerns about the application of the 25 percent rate to active shareholders in Subchapter S community banks. The formulas proposed in the legislation simply do not work for Subchapter S community banks.

Under H.R. 1, 70 percent of an active shareholder's pro rata share of net business income would be taxed at the individual rate, which is as high as 39.6 percent. We are pleased that they would not also owe SECA taxes on this amount, as provided in Chairman Brady's mark. The remaining 30 percent of the active shareholder's share of net business income would be taxed at the 25 percent rate.

In our view, the individual rate should be applied strictly to compensation for services rendered. Active shareholders in a Subchapter S community bank are required to be paid reasonable compensation as defined in IRS regulation, guidance and substantial body of caselaw designed to prevent payroll tax avoidance. Community banks have no history of abusing the reasonable compensation standard to under compensate active shareholders. An analysis of FFIEC call report data clearly demonstrates that banks pay a significant portion of their gross income in wages. Moreover, in a firm with both active and passive shareholders, dividends must be paid on an equivalent, pro-rata basis to all shareholders, active and passive. This requirement thwarts any scheme to avoid payroll taxes by depressing an active shareholder's wages and inflating his or her dividends, just as it would prevent abuse of the special rate for qualified business income.

The formula set forth in H.R. 1 is based on an unwarranted assumption that 70 percent of any given firm's earning are attributable to labor and 30 percent to capital. Returns on labor vary widely among industries and among firms within an industry, reflecting many economic factors, and there is no cause for reducing this variation to a formula. The wage tax rate should not be determined by a one-size-fits-all formula.

In addition, the alternative standard for "capital intensive businesses" (Section 4(e)(2)) and Section 4(f)) would not increase the "capital percentage" for community banks, unless an alternative definition can be found to measure return on capital. If a community bank's capital for the purposes of applying this standard is limited to its adjusted basis in the land, real estate, and other fixed assets used to conduct its business, the alternative standard will yield a capital percentage much lower than 30 percent. This is true for all community banks but particularly for

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the many community banks that lease their branches and other real estate. ICBA seeks clarity on the application and workability of the alternative standard for Subchapter S banks.

ICBA strongly recommends that you resolve this concern by allowing community banks to continue to use the "reasonable compensation" standard, as they do today, to divide wage income from business income. Banks are complex organizations structured with holding companies and often several subsidiary banks. There are numerous examples in the tax code where special rules are provided for banks because of their unique business structure. We believe that such rules for Subchapter S community banks remain warranted for the application of the business rate.

Preserve the New Markets Tax Credit

ICBA urges you to repeal Section 3406 of H.R. 1 which would terminate the new markets tax credit (NMTC). NMTC is a critical tool for ensuring that economic growth reaches low-income urban and rural communities. Between 2003 and 2015, $42 billion in NMTC financing leveraged over $80 billion in total project investments, creating nearly 750,000 jobs. The NMTC is the most flexible, cost-efficient way to ensure these struggling communities have access to private sector capital. We urge its restoration.

Thank you for your consideration. We look forward to working with you on growth-oriented tax reform in the coming weeks.

Sincerely,

/s/

Camden R. Fine
President & CEO

CC: Members of the U.S. House of Representatives

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