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Bank Strategies

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Third Quarter 2012

THE POSSIBLE EXPIRATION OF BUSH-ERA TAX CUTS AND ITS EFFECT ON DEFERRED COMPENSATION

EXTENSION OF TAX CUTS THROUGH 2012

At the end of 2010, President Obama signed into law legislation that, among other things, temporarily extended Bush-era tax cuts until December 31, 2012.

The bill included provisions for:

- The temporary extension of the 10%, 25%, 28%, 33%, and 35% income tax brackets.
- The temporary repeal of the Personal Exemption Phase-out and itemized deduction limitation.
- The temporary extension of the 15% (and lower) capital gains and dividend rates.

TAX RATES IN 2013 AND BEYOND

We are now within three months of the end of the Bush-era tax cuts. There has been unending speculation as to what will happen to tax rates beyond 2012 and still no one knows. However, there is reason to believe that the large deficits projected now and into the future will lead to the expiration of all or some of the Bush-era tax cuts in 2013.

SOME TAXES AND CREDITS AFFECTED BY EXPIRATION OF TAX CUTS

- Federal marginal income tax brackets move up to 15%, 28%, 31%, 36%, and 39.6%
- Maximum capital gains rate increases from 15% to 20%
- Dividends tax rate moves from capital gains to ordinary income rates
- Value of itemized tax deductions is phased out at higher income levels
- Personal exemption reduced at higher income levels
- \$1,000 per child tax credit reduced to \$500 per child

THE EFFECT OF RISING TAX RATES ON DEFERRED COMPENSATION

Of course, any rise in rates in 2013 will make deferrals of compensation in 2013 more valuable, especially in consideration of the additional taxes other than the expiration of the

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Bush-era tax cuts scheduled to go into effect in 2013 and described below. This will be an area on which to keep a vigilant eye as the end of 2012 approaches and decisions regarding deferral of compensation for 2013 must be made.



UPCOMING EVENT

2012 ABA ANNUAL CONVENTION

OCTOBER 14–16, 2012

HILTON SAN DIEGO BAYFRONT,
SAN DIEGO, CA

M Benefit Solutions - Bank Strategies is once again proud to be an exhibitor at the 2012 ABA Annual Convention. Please join us at **Booth 804**:

- Enter to win an Amazon Kindle Fire
- Pick up your bank's customized BOLI Empowerment Page

For more information on the convention, please visit <http://www.aba.com/Training/Conferences/Pages/annual.aspx>

We look forward to seeing you in San Diego.

OTHER TAX INCREASES SCHEDULED TO BEGIN IN 2013

EMPLOYEE FICA TAXES

The FICA withholding tax rate for 2011 and 2012 was reduced to 4.2% of gross wages up to limits of \$106,800 in 2011 and \$110,100 for 2012. This rate is scheduled to return to its pre-2011 rate of 6.2% beginning in 2013.



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UNEARNED INCOME MEDICARE CONTRIBUTION TAX

In the case of an individual, estate, or trust, a new unearned income Medicare contribution tax will be imposed for taxable years beginning after December 31, 2012.

Individual Tax

In the case of an individual, the tax is 3.8% of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount.

- The threshold amount is \$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married individual filing a separate return, and \$200,000 in any other case.
- Modified adjusted gross income is adjusted gross income increased by the amount excluded from income as foreign earned income under Code Section 911(a)(1) (net of the deductions and exclusions disallowed with respect to the foreign earned income).

Estate or Trust Tax

In the case of an estate or trust, the tax is 3.8% of the lesser of undistributed net investment income or the excess of adjusted gross income over the dollar amount at which the highest income tax bracket applicable to an estate or trust begins.

- The tax does not apply to a nonresident alien or to a trust all the unexpired interests in which are devoted to charitable purposes.
- The tax also does not apply to a trust that is exempt from tax under Section 501 or a charitable remainder trust exempt from tax under Section 664.

ADDITIONAL HOSPITAL INSURANCE TAX ON HIGH INCOME TAXPAYERS

The employee portion of the Hospital Insurance (HI) tax is increased by an additional tax of 0.9% on wages received in excess of the threshold amount.

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However, unlike the general 1.45% HI tax on wages, this additional tax is on the combined wages of the employee and the employee's spouse. The threshold amount is \$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married individual filing a separate return, and \$200,000 in any other case.

Liability for the Additional HI Tax on Wages

The employer is required to withhold the additional HI tax on wages. However, in determining the employer's requirement to withhold and liability for the tax, only wages that the employee receives from the employer in excess of \$200,000 for a year are taken into account and the employer must disregard the amount of wages received by the employee's spouse. Thus, the employer is only required to withhold on wages in excess of \$200,000 for the year, even though the tax may apply to a portion of the employee's wages at or below \$200,000, if the employee's spouse also has wages for the year, they are filing a joint return, and their total combined wages for the year exceed \$250,000.

In contrast to the employee portion of the general HI tax of 1.45% of wages for which the employee generally has no direct liability to the IRS to pay the tax, the employee is also liable for this additional 0.9% HI tax to the extent the tax is not withheld by the employer. The amount of this tax not withheld by an employer must also be taken into account in determining a taxpayer's liability for estimated tax.

Additional HI for Self-employed Individuals

This same additional HI tax applies to the HI portion of SECA tax on self-employment income in excess of the threshold amount. Thus, an additional tax of 0.9% is imposed on every self-employed individual on self-employment income in excess of the threshold amount.

As in the case of the additional HI tax on wages, the threshold amount for the additional SECA HI tax is \$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married indi-

vidual filing a separate return, and \$200,000 in any other case. The threshold amount is reduced (but not below zero) by the amount of wages taken into account in determining the FICA tax with respect to the taxpayer. No deduction is allowed under Section 164(f) for the additional SECA tax, and the deduction under 1402(a)(12) is determined without regard to the additional SECA tax rate.

SECTION 409A

EMPLOYMENT, SEVERANCE, AND OTHER PLANS AND AGREEMENTS

As a reminder, IRS modified the rules and regulations under Code Sec. 409A in 2010 (IRS Notice 2010-80) which may require a minor change to any employment, severance or other plan or agreement that requires an employee to complete certain employment-related actions (such as the execution and submission of a noncompetition agreement, a nonsolicitation agreement, or a release of claims) before a payment is made to an employee. According to Notice 2010-80, employers and employees have until December 31, 2012 to make this change.

The IRS is concerned by the possibility that some employers and employees could delay the commencement (and taxation) of severance payments into the following calendar year by delaying completion of the required agreement or release or, conversely, could accelerate the commencement of payments into the current calendar year by speeding up the waiver process.

Many plans and agreements are drafted to be exempt from Code Sec. 409A, for example, by qualifying for the short-term deferral exception. These plans and agreements generally do not need to be amended. However, if a plan or agreement is not exempt, a simple amendment is recommended. An acceptable amendment could include the provision for payment on a fixed date or, where the agreement or release period spans two calendar years, payment in the later of the two calendar years.

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END OF THE YEAR CLEAN UP

It is time once again to review terminations of employees for the calendar year to ensure that deferred compensation payments, if applicable, have commenced in order to avoid Section 409A penalties and complications.



COMPENSATION COMMITTEE LISTING STANDARDS

The Securities and Exchange Commission (SEC) finalized a rule earlier this year that the national securities exchanges and associations prohibit the listing of any equity security of an issuer other than an issuer that is a “controlled company” (see below), limited partnership, company in bankruptcy proceedings, open-ended management investment company that is registered under the Investment Company Act of 1940, or a foreign private issuer that provides annual disclosures to shareholders of the reasons that the foreign private issuer does not have an independent compensation committee, that does not comply with the following compensation committee independence rules.

During the last week of September, the New York Stock Exchange and NASDAQ each released proposals, subject to approval by the SEC, to meet the “independence” requirements set forth in the Dodd-Frank Act for compensation committees and directors who make compensation decisions.

THE SEC RULES

Independence

- Each member of a company’s compensation committee must be a member of the Board and must be independent.
- To determine independence national securities exchanges and associations shall consider relevant factors including:

- The compensation committee member’s source of compensation, including consulting, advisory, or other compensatory fee paid by the company to the member, and
- Whether a member is affiliated with the company, subsidiary, or any affiliate.

The national securities exchanges and associations may provide for exemptions from this requirement based on consideration of the size of a company and any other relevant factor.

Selection of Compensation Consultants and Other Committee Advisors

The compensation committee may only select a compensation consultant, legal counsel, or other advisor after taking into account factors that are competitively neutral among categories of consultants, legal counsel, or other advisors and preserve the ability of compensation committees to retain the services of members of any such category. Factors shall include:

- The provision of other services to the company by the person that employs the consultant, counsel, or other advisor (Advisor’s Employer)
- The amount of fees received from the company by the Advisor’s Employer as a percentage of the total revenue of the Advisor’s Employer
- The policies and procedures of the Advisor’s Employer designed to prevent conflicts of interest
- Any business or personal relationship of the compensation consultant, legal counsel, or other advisor with a member of the compensation committee
- Any stock of the company owned by the compensation consultant, legal counsel, or other advisor
- Any business or personal relationship between the compensation consultant, legal counsel or other advisor and any executive officer of the company

Compensation Committee Authority to Retain Compensation Consultant

The compensation committee:

- May, in its sole discretion, retain a compensation consultant,

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- Must retain direct responsibility for the selection, compensation, and oversight of the work of a compensation consultant,
- May not be required to act consistently with the advice or recommendations of the compensation consultant, and
- Shall retain its ability and/or its obligation to exercise its own judgment in fulfillment of its duties.

In addition, in accordance with regulations to be issued by the SEC, in their proxy for their annual meeting (and any special meeting in lieu of an annual meeting), companies must disclose whether:

- The compensation committee retained or obtained the advice of a compensation consultant, and
- The work of the compensation committee has raised any conflict of interest and, if so, the nature of the conflict and how it was addressed.

Compensation Committee Authority to Retain Legal Counsel and Other Advice

The compensation committee:

- May, in its sole discretion, retain independent legal counsel and other advisors,
- Must retain direct responsibility for the selection, compensation, and oversight of the work of independent legal counsel and other advisors,
- May not be required to act consistently with the advice or recommendations of independent legal counsel and other advisors, and
- Shall retain its ability and/or its obligation to exercise its own judgment in fulfillment of its duties.

Compensation of Compensation Consultants, Independent Legal Counsel, and Other Advisors

Each company must provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to compensation consultants, independent legal counsel and other advisors.

Controlled Company. For purposes of the rules on compensation committee independence, the term “controlled company” means an issuer that:

- Is listed on a national securities exchange or by a national securities association; and
- Holds an election for the board of directors of the issuer in which more than 50% of the voting power is held by an individual, a group, or another issuer.

THE NYSE INDEPENDENCE REQUIREMENTS

In addition to the SEC’s mandated independence factors, the NYSE’s director independence standards will continue to provide that no director qualifies as “independent” unless the Board affirmatively determines that the director has no material relationship with the listed company. In addition, a director may not be deemed to be independent if the director has a relationship with the listed company that violates any one of five bright-line tests:

- The director is, or has been within the last three years, an employee of the listed company, or an immediate family member is, or has been (in the same time frame), an executive officer.
- The director (or an immediate family member) has received, during any twelve-month period within the last three years, more than \$120,000 in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided this compensation is not contingent in any way on continued service).
- The director is a current partner or employee of a firm that is the listed company’s internal or external auditor, has an immediate family member who is a current partner of such a firm, or if the director or family member was a partner or employee of such a firm and personally worked on the listed company’s audit within the last three years.
- The director, or family member, within the past three years has been employed as an executive officer of another company where any of the listed

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company's present executive officers at the same time served on that company's compensation committee.

- The director, or family member, is a current executive officer of a company that has made payments to, or received payments from, the listed company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$1 million, or 2% of the other company's consolidated gross revenues.

NYSE listed companies would have until their first annual meeting after January 15, 2014, or October 31, 2014, whichever is earlier, to comply with new compensation committees independence standards. Existing standards would continue to apply pending the transition to new independence standards.

NASDAQ PROPOSAL

NASDAQ is proposing to modify its compensation-related listing rules, to provide that:

- Companies must have a compensation committee consisting of at least two members, each of whom must be an Independent Director as defined under NASDAQ's current listing rules
- Compensation committee members must not accept directly or indirectly any consulting, advisory or other compensatory fee, other than for board service, from a Company or any subsidiary thereof
- In determining whether a director is eligible to serve on a compensation committee, a Company's board must consider whether the director is affiliated with the Company, a subsidiary of the Company or an affiliate of a subsidiary of the Company to determine whether such affiliation would impair the director's judgment as a member of the compensation committee
- Companies may continue to rely on NASDAQ's existing exception that allows certain non-Independent Directors to serve on a compensation committee under exceptional and limited circumstances

- If a Company fails to comply with the compensation committee composition requirements in certain circumstances, it may rely on a cure period
- Companies must adopt a formal, written compensation committee charter that must specify the compensation committee responsibilities and authority relating to the: (i) authority to retain compensation consultants, independent legal counsel and other compensation advisers; (ii) authority to fund such advisers; and (iii) responsibility to consider certain independence factors before selecting such advisers, other than in-house legal counsel
- Companies must review and reassess the adequacy of the compensation committee charter on an annual basis
- NASDAQ's existing exemptions from, and phase-in schedules for, the compensation-related listing rules remain generally unchanged; and
- Smaller Reporting Companies must have a compensation committee comprised of at least two Independent Directors and a formal written compensation committee charter or board resolution that specifies the committee's responsibilities and authority, but are not required to adhere to the compensation committee eligibility requirements relating to compensatory fees and affiliation, or the requirements relating to compensation consultants, independent legal counsel and other compensation advisers.



RECENT 2012 FMS EVENTS

THE FINANCE & ACCOUNTING FORUM

JUNE—LAS VEGAS, NV

Thank you to all who visited the M Benefit Solutions booth. We look forward to exhibiting again next year in Boston.

EAST COAST REGIONAL CONFERENCE

SEPTEMBER—PORTSMOUTH, NH

GW Financial was a proud sponsor of this regional event, and John Gagnon presented "What You Should be Asking Your BOLI Provider."



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Distributed throughout the country, these Advisors work interactively with M Benefit Solutions and bank clients to design programs which meet each bank's specific needs and to ensure high quality administrative and compliance services.

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ABOUT M BENEFIT SOLUTIONS - BANK STRATEGIES

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