



PAYING A BONUS ON DEPOSIT ACCOUNTS

Someone in marketing said, “We want to pay \$20 to everyone that refers our bank to another customer. What do you think?” Your mind starts wheeling. You think of Regulation Q and its prohibition to paying interest on deposit accounts. Some fuzzy thoughts of the IRS reporting requirements come to mind. But did you think of Regulation D and DD? Several regulations come into play when deciding whether you can pay a bonus on an account. Regulation D, Q, DD and the IRS 1099 reporting requirements all have something to say about this topic. Here’s a summary of each of these rules.

Regulation D & Q – Interest?

Regulation Q states, interest shall **not** be paid on any demand deposit account directly or indirectly by any device whatsoever [§217.3 of Regulation Q]. However, before you feel defeated, there are several things to look at in this regulation. What is the definition of interest? Is a premium or bonus the same as interest? So let’s get started.

Interest is defined in §217.2(d) of Regulation Q:

Interest means any payment to or for the account of any depositor as compensation for the use of funds constituting a deposit. A member bank’s absorption of expenses incident to providing a normal banking function or its forbearance from charging a fee in connection with such a service is not considered a payment of interest.

Regulation D defines a demand deposit account in §204.2(b) as:

. . . a deposit that is payable on demand, or a deposit issued with an original maturity or required notice period of less than seven days, or a deposit representing funds for which the depository institution does not reserve the right to require at least seven days’ written notice of an intended withdrawal.

From this we learn that you cannot pay interest on checking accounts; however, you could offer a free safe deposit box for one year as the waiving of a fee or absorption of an expense is not considered to be interest. You might be asking “What about our NOW accounts?” That’s another story, but in short NOW accounts are not due on demand. NOW accounts must reserve the right to require seven days’ notice of intent to withdraw funds. This requirement must be disclosed in the account agreement and is usually found on the bank’s signature cards.

Now let’s look specifically at Regulation Q and what it has to say about paying a bonus on an account. In fact, §217.101 is specifically titled “Premiums on Deposits.”

*(a) Section 19(i) of the Federal Reserve Act and 217.3 of Regulation Q prohibits a member bank from paying interest on a demand deposit. **Premiums, whether in the form of merchandise, credit, or cash, given by a member bank to a depositor will be regarded as an advertising or promotional expense rather than a payment of interest if:***

- (1) The premium is given to a depositor only at the time of the opening of a new account or an addition to an existing account;*
- (2) No more than two premiums per account are given within a 12-month period; and*
- (3) The value of the premium or, in the case, of articles of merchandise, the total cost (including taxes, shipping, warehousing, packaging, and handling costs) does not exceed \$10 for deposits of less than \$5,000 or \$20 for deposits of \$5,000 or more.*

The costs of premiums may not be averaged. The member bank should retain sufficient supporting documentation showing that the total cost of a premium, including shipping, warehousing, packaging, and handling costs, does not exceed the applicable \$10/\$20 limitations and that no portion of the total cost of any premium has been attributed to development, advertising, promotional, or other expenses. A member bank is not permitted directly or indirectly to solicit or promote deposits from customers on the basis that the funds will be divided into more than one account by the institution for the purpose of providing more than two premiums per deposit within a 12-month period.

Therefore, a bank can give a \$10 gift certificate when someone opens a new account. Don't forget, if you give merchandise instead of cash, you must determine the "total cost" including shipping, taxes, etc. to the value of the item. But, there's more. The next section allows for an even bigger exception:

(b) Notwithstanding paragraph (a) of this section, any premium that is not, directly or indirectly, related to or dependent on the balance in a demand deposit account and the duration of the account balance shall not be considered the payment of interest on a demand deposit account and shall not be subject to the limitations in paragraph (a) of this section.

This exemption allows the bank to pay an even bigger bonus (more than \$10) to open an account but, there cannot be any minimum balance requirement on the account and you cannot require the customer to maintain the account for any specified time. Some financial institutions charge a "closing fee" to offset any potential losses when providing a bonus.

Truth in Savings Act – Account Disclosures:

OK. You decide that you have a bonus to offer. Now you have to design a Truth in Savings Act disclosure to offer consumers that open an account at your bank. We must look at Regulation DD or the Truth in Savings Act for guidance. First, let's define the term "bonus" under this regulation. Section 230.2(f) states:

Bonus means a premium, gift, award, or other consideration worth more than \$10 (whether in the form of cash, credit, merchandise, or any equivalent) given or offered to a consumer during a year in exchange for opening, maintaining, renewing, or increasing an account balance. The term does not include interest, other consideration worth \$10 or less given during a year, the waiver or reduction of a fee, or the absorption of expenses.

The Commentary to this section provides further guidance. It states:

1. Examples. Bonuses include items of value, other than interest, offered as incentives to consumers, such as an offer to pay the final installment deposit for a holiday club account. Items that are not a bonus include discount coupons for goods or services at restaurants or stores.

2. De minimis rule. Items with a de minimis value of \$10 or less are not bonuses. Institutions may rely on the valuation standard used by the Internal Revenue Service to determine if the value of the item is de minimis. Examples of items of de minimis value are:

- i. Disability insurance premiums valued at an amount of \$10 or less per year*
- ii. Coffee mugs, T-shirts or other merchandise with a market value of \$10 or less*

3. Aggregation. In determining if an item valued at \$10 or less is a bonus, institutions must aggregate per account per calendar year items that may be given to consumers. In making this determination, institutions aggregate per account only the market value of items that may be given for a specific promotion. To illustrate, assume an institution offers in January to give consumers an item valued at \$7 for each calendar quarter during the year that the average account balance in a negotiable order of withdrawal (NOW) account exceeds \$10,000. The bonus rules are triggered, since consumers are eligible under the promotion to receive up to \$28 during the year. However, the bonus rules are not triggered if an item valued at \$7 is offered to consumers opening a NOW account during the month of January, even though in November the institution introduces a new promotion that includes, for example, an offer to existing NOW account holders for an item valued at \$8 for maintaining an average balance of \$5,000 for the month.

4. Waiver or reduction of a fee or absorption of expenses. Bonuses do not include value that consumers receive through the waiver or reduction of fees (even if the fees waived exceed \$10) for banking-related services such as the following:

- i. A safe deposit box rental fee for consumers who open a new account*
- ii. Fees for travelers checks for account holders*
- iii. Discounts on interest rates charged for loans at the institution*

When a consumer customer opens an account that has a bonus attached to it, the Truth in Savings Act disclosures must contain specific language. The disclosure must state [§230.4(b)(7)]:

- 1. The amount or type of any bonus,
- 2. when the bonus will be provided, and
- 3. any minimum balance and time requirements to obtain the bonus.

Truth in Savings Act – Advertising:

If you're going to give something away, you want to tell people about it. Section 230.8(d) of Regulation DD offers some specific guidelines about advertising a bonus. If a bonus is stated in an advertisement, the advertisement must include the following, as applicable:

1. The "annual percentage yield," using that term;
2. The time requirement to obtain the bonus;
3. The minimum balance required to obtain the bonus;
4. The minimum balance required to open the account, if it is greater than the minimum balance necessary to obtain the bonus; and
5. When the bonus will be provided.

As you can see, if you mention a bonus on an interest bearing account, you trigger the annual percentage yield (as well as other things) for the account. In case you didn't know, stating the annual percentage yield, triggers even more things (listed below). Therefore, your advertisement will need to contain a lot of small print.

1. For variable rate accounts, a statement that the rate may change.
2. The time period the APY will be offered or a statement that the APY is accurate as of a specific date. Do not state "for a limited time only," or "this offer may be withdrawn at any time."
3. The minimum balance required to obtain the APY (for tiered-rate accounts, the minimum balance for each tier must be stated with the APY).
4. The minimum deposit required to open the account (only if greater than the minimum balance required to obtain the APY).
5. The statement that fees could reduce earnings (not applicable for CDs).
6. For time accounts:
 - a. The term of the account; and
 - b. A statement that a penalty may be imposed for early withdrawal.

1099-INT – IRS Reporting:

Although we don't claim to be IRS experts (we do get out once in a while), we have gathered the following from our secret sources. However, we must provide the following disclaimer: "Please consult your tax advisers concerning the reporting to Internal Revenue Service of bonus payments as interest on Accounts."

The general rule is that a bank must file a 1099-INT for every person to whom it paid \$10 or more of reportable interest (not the same definition as Regulation Q) during the year. The \$10 level is determined by customer, not account. For example, if a customer has three accounts and all received \$4 each a 1099-INT is required showing \$12 of interest paid. You are allowed to file separate 1099-INTs for each account of a customer who has been paid \$10 or more, however.

If a bonus is offered to a customer for opening, adding to, or maintaining an account, the IRS defines this as interest. If you give an item, other than money, you must determine the fair market value.

Form 1099-INT is only used for interest that has been credited to the account. For accounts with a term of more than one year, if interest is accrued but not credited to the account, it is reported to the IRS on Form 1099-OID rather than Form 1099-INT. Either way, interest is still reported and the customer still may owe taxes on the earned interest.

There are some entities that are exempt from reporting. These include corporations, tax-exempt entities, IRAs and registered securities or commodities brokers. Although you do not report interest paid to corporations, you must report on other businesses that are not incorporated (such as partnerships, dba's, associations and sole proprietors). Once again, this is a brief summary of the IRS report requirements. You should consult a tax adviser for expertise on this topic.

Bonus on Account Flowchart

