



Credit Union National Association

# *CUNA Issue Summary*

## **CREDIT UNION TAX EXEMPTION**

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**ISSUE:** In 1937 Congress granted credit unions with a federal tax-exempt status based upon their cooperative structure—that they are operated entirely by and for their members. Despite the evolution of products and services and expanded fields of membership, credit unions continue to operate as democratically controlled cooperative institutions, serving only their members, on a not-for-profit basis. Congress ratified the federal tax-exemption on several occasions, most recently in 1998 with the enactment of H.R. 1151, the *Credit Union Membership Access Act*.

The banking lobby is vigorously opposed to credit unions' federal tax-exempt status, and has listed the elimination of the credit unions' tax "advantage" as a higher priority than enacting legislative initiatives to benefit their own industry. Contrary to the bankers' arguments, credit unions do pay taxes - payroll taxes, real estate taxes, and some other property taxes. In addition, dividends paid to credit union members are taxed as ordinary income.

**CUNA POSITION:** The credit union federal tax-exemption is bound by the not-for-profit, cooperative nature of credit unions, not by the size of the credit union or the products and services that are offered. Credit unions' boards of directors are generally unpaid volunteers elected by the membership, and credit unions are restricted in who they can serve. CUNA continues to highlight the "Credit Union Difference," which reinforces the uniqueness of credit unions, in structure *and* service, from other financial institutions.

The banks have aggressively challenged the credit unions' tax exemption. The bankers also have had little difficulty in demanding taxation of credit unions while simultaneously advocating further tax relief for banks. The bankers have been very successful in lobbying Congress for tax changes that greatly enhance the attractiveness and tax position of banks that choose to elect Subchapter S status under the Internal Revenue Code. Bankers are also aggressively pursuing legislative action to allow national banks to organize as Limited Liability Corporations (LLCs). Both LLCs and Subchapter S corporations provide significant tax benefits by eliminating corporate-level taxation. Taxation occurs when these "pass-through entities" pay dividends to their shareholders. CUNA does not oppose efforts by the banking industry to decrease its tax liability, but objects to their hypocrisy in trying to limit the tax benefits of competing institutions.

**IMPACT ON CREDIT UNIONS:** The federal tax-exempt status is the crux of the credit union movement, and remains the priority issue for all credit unions, regardless of asset size, field of membership, and products and services offered. Many in the credit union movement believe credit unions would not be able to survive as cooperatives if the federal tax status were reversed, which could potentially lead to a sharp decline or elimination of credit unions. Credit unions also provide a market alternative that helps moderate increases in bank fees and charges for all consumers. Without credit unions, consumers would be greatly disadvantaged, and in some cases, be forced out of the financial mainstream.

**STATUS/OUTLOOK:** The Ways and Means Committee held a hearing on November 3, 2005, to further review the tax-exempt status of credit unions, with then-Chairman Bill Thomas (R-CA) closing the hearing by stating that he would not try to subject credit unions to federal taxation. Click [here](#) for a complete analysis of the hearing.

The IRS and the Treasury Department have taken action in the past that brings into question their commitment to the federal credit union tax exemption. On June 28, 2007, Kevin Brown, the former IRS Commissioner, wrote a letter to the Senate Finance Committee detailing numerous abuses by tax-exempt entities. Shockingly, he stated that, "... many tax-exempt credit unions may be hard to distinguish from for-profit banks ...". This drew a swift response from the credit union community and a [response letter](#) from former CUNA President and CEO Dan Mica. The CUNA letter detailed the difference between credit unions and banks and goes further by reminding the IRS that then President Bush in 2004 reaffirmed his commitment to preserving the federal tax exemption for credit unions.

On July 23, 2007, former Treasury Deputy Assistant Secretary for Tax Analysis Robert Carroll released a departmental background paper for the July 26, 2007 Conference on Business Taxation and Global Competitiveness. The paper cited several items in the federal tax code that could be eliminated to pay for a decrease in the top corporate tax rate to 27% as well as increased business expensing for American corporations. One of the items suggested for elimination was the federal tax exemption for credit unions. The report estimated that the Treasury would recoup \$19 billion over the next ten years if the tax exemption for credit unions was eliminated. This report also drew a quick and firm response from former CUNA President and CEO Dan Mica. In a July 25, 2007 [letter](#) to Treasury Secretary Hank Paulson, Mica pointed out that this policy proposal from Treasury was inconsistent with past statements and letters from the Bush Administration in support of the current tax status of credit unions.

On February 24, 2010, Federal Reserve Chairman Ben Bernanke testified before the House Financial Services Committee and was asked a question about legislation to raise the credit union member business lending limit. Bernanke replied, "The banks would complain, obviously, that if credit unions are allowed to do everything banks can do, why are they tax favored? I think that's the trade off Congress has to consider." Chairman Bernanke is gravely misinformed. Credit unions have been making member business loans (MBLs) since their inception in the early 1900's. In the first 90 years of credit unions' existence in the United States, there was no MBL cap at credit unions. The current 12.25% of assets cap was an arbitrary limit imposed by Congress in the *Credit Union Membership Access Act in 1998* (CUMAA). As for the credit union tax exemption: It arises from credit unions' structure as not-for-profit, democratically-controlled cooperatives – and that structure is unchanged over the past 100 years. The tax exemption has nothing to do with the breadth or volume of credit union product and service offerings – a fact clearly spelled-out by Congress in the CUMAA.

The credit union federal income tax exemption again came under scrutiny on August 27, 2010, when the Tax Reform Subcommittee of the President's Economic Recovery Advisory Board (PERAB) released its report called, "[The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation](#)".

As stated in the report, the three goals of the report's recommendations were to simplify the tax code, improve compliance, and reform corporate taxation. This Board was created by the President in early 2009 and the report stressed that the tax policy recommendations were not

official Administration policy. Nevertheless, the report listed the option of eliminating tax expenditures like the credit union federal income tax exemption as an option for reforming corporate taxation. The report also suggested that credit union size may be a factor in deciding if and when a credit union becomes subject to federal corporate taxation. The report was submitted to the National Commission on Fiscal Responsibility and Reform, the federal commission tasked with issuing a report by December 1<sup>st</sup> and outlining measures that could be taken to reduce the federal deficit.

Credit Union National Association President and CEO Bill Cheney replied in a [letter](#) to the PERAB, stating, "It may be the case that not all tax preferences have lived up to expectations, but the credit union tax exemption is one of the highest-yielding investments the federal government has made." CUNA figures show that America's 92 million credit union members receive substantial benefits in the form of better pricing on services, saving them about \$7.5 billion a year. The \$7.5 billion savings to consumers is especially significant when measured against the \$1.5 billion in lost federal revenue a year that the government says is represented by the credit union tax exemption. NOTE: On December 21, 2010, the Joint Committee on Taxation revised the "cost" of the credit union tax expenditure to \$0.3 billion for fiscal year 2011.

It is interesting to note in the report that S corporations, and S corporation banks, are discussed as distortions to the federal corporate tax code. The report mentions how S corporation employee-shareholders are able to avoid the full brunt of FICA payroll taxes through a loophole in the law. The report also states, "About half of business income now accrues to 'pass-through' entities like S corporations and partnerships; although the income of such pass-through entities is subject to tax at the individual level, it is excluded from the corporate tax." One-third of all US banks avoid corporate taxation by electing Subchapter S tax status. Credit unions are not opposed to banks seeking to lower their federal tax liability. However, this report neutralizes banker arguments that, because of the credit union tax status, they are at a competitive disadvantage in the marketplace. Finally, any bank can switch its charter to become a credit union. No bank has done so and thus illustrates the empty banker argument that credit unions should be subject to federal taxation.

On November 10, 2010, the National Commission on Fiscal Responsibility and Reform released its [draft report](#) on deficit reduction options. The report did not mention eliminating the credit union tax exemption but this Presidentially-commissioned report included an option to eliminate ALL federal tax expenditures as a way to reduce the federal budget deficit and simply the federal income tax code.

In a [letter](#), CUNA President and CEO Bill Cheney told Alan Simpson and Erskine Bowles, co-chairs of the National Commission on Fiscal Responsibility and Reform, that credit unions provide significant financial benefits to their 92 million members, saving them about \$7.5 billion a year, and that credit unions' favorable pricing also helps to improve bank rates and moderate their fees. On December 1, 2010, the Commission released its [final report](#) that largely mirrored the recommendations in the draft report. On December 3<sup>rd</sup>, the members of the panel voted 11 to 7 in favor of passing the report. This was three votes less than the 14 votes necessary to pass the proposal and send it to Congress for an up or down vote. Even though the report did not receive a vote in Congress, several lawmakers have suggested they will introduce legislation to implement all or part of the Commission's report. The "Gang of Six", a bipartisan group of six U.S. Senators, is expected to release a deficit reduction plan in May that mirrors the Commission's report.

The Chairwoman of the National Credit Union Administration, the regulator for all federally-insured credit unions, wrote a [letter](#) dated November 22<sup>nd</sup> to CUNA Chairman and CEO Bill Cheney expressing her concerns that a repeal of the federal tax exemption would threaten the very existence of credit unions as they are known today.

As a result of a contentious debate in Congress last year about how or whether to raise the federal debt ceiling, an agreement was reached and legislation signed into law that created a Congressional Joint Select Committee (JSC) that was charged with producing debt reduction legislation by November 23, 2011. The agreement as enshrined in the Budget Control Act of 2011 required that JSC cut at least \$1.5 trillion over ten years and would have to be passed by Congress by December 23, 2011. The law specified that if Congress failed to produce a deficit reduction bill with at least \$1.2 trillion in cuts, across-the-board cuts ("sequestration") of spending would automatically be triggered starting in 2013.

CUNA visited JSC members and staff to promote the credit union tax status and its value to America's financial services marketplace. In the end, the JSC failed to produce a report garnering the necessary supermajority to pass. Nevertheless, Congress still faces a very significant deficit problem; efforts to address this will continue and may, in the future, involve renewed calls for the elimination of all tax expenditures. And, we know the bankers will continue to lobby aggressively for the taxation of credit unions. We must not let our guard down and we will not. Preserving the credit union tax status is CUNA's top priority and we will continue to monitor the threat to the tax status that could develop should Congress engage in comprehensive tax reform efforts in 2012 or 2013.

On February 2, 2012, the White House and Treasury released a proposed framework for corporate tax reform. The plan calls for making a wide range of corporate tax law changes in order to lower the overall corporate tax rate across the board to 28% from 35%. Nothing in the 25-page framework released specifically targets credit unions but this is the beginning of a process expected to run at least through the November elections and probably well past. While credit unions are not mentioned specifically, the Administration's plan does speak broadly of starting "from a presumption that we should eliminate all tax expenditures for specific industries, with the few exceptions that are critical to broader growth or fairness."

During the 112<sup>th</sup> Congress, several committees have held hearings on reforming the federal income tax code. The credit union tax exemption has not been mentioned in any of these hearings. However, both Congress and the Administration seem to be in agreement that tax expenditures, in general, must be reduced in order to lower corporate tax rates and/or achieve deficit reduction targets.

Credit union members are encouraged by past statements from the top Republican and Democrat on the tax-writing House Ways and Means Committee Chairman Dave Camp (R-MI) stated, "Like you, I believe revoking the tax-exempt status of credit unions could impose additional tax burdens on millions of Americans who belong to credit unions. Please be assured that I will not support policies that disadvantage credit unions." Ranking Member Sander Levin (D-MI) stated, "I strongly support credit unions and the vital services they provide to millions of American consumers. I am concerned that some in Congress have suggested re-examining the tax-exempt status of credit unions. I believe such a re-evaluation is unnecessary and unwise."

CUNA continues to meet with Members of the House and Senate, as well as their staff, regarding the importance of the credit union federal income tax exemption.

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**RELATED DOCUMENTS:**

[Bank Attacks: Credit Unions Fight Back!](#)

[The Credit Union Difference](#)

[Why Credit Unions are Tax-Exempt](#)

[March 29, 2005: Comments to the President's Advisory Panel on Federal Tax Reform](#)

**LAST UPDATED:** March 8, 2012

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