July 23, 2013

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
Washington, D. C. 20510

The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate
Washington, D. C. 20510

Subject: Reconsideration of the Tax Exemption for Large Credit Unions: An Opportunity to Broaden the Tax Base, Raise Revenue, and Improve the Marketplace for Financial Services

Dear Chairman Baucus and Ranking Member Hatch:

On behalf of the more than 7,000 community banks represented by ICBA, we strongly support reform that will simplify our tax code, reduce tax rates, restore confidence in tax administration, and promote economic growth. Further, we applaud the "blank slate" approach outlined in your June 27 letter to your Senate colleagues. Tax expenditures in the code should be closely reexamined, scrutinized, and subject to rigorous justification. A simplified, efficient and effective tax code should not include any costly expenditures by default.

The Joint Committee on Taxation's annual list of "Estimates of Federal Tax Expenditures," which you attached to your letter, includes the credit union tax exemption which the JCT estimates at $3.9 billion over five years. According to the JCT, "the tax exemption for noncharitable organizations that have a direct business analogue or compete with for-profit organizations organized for similar purposes is a tax expenditure."[1] The credit union tax exemption clearly meets this definition.

In the 70 years since credit unions were granted a tax exemption, the financial services marketplace has evolved dramatically and the original credit union charter has been fundamentally expanded and transformed. Moreover, credit unions are currently advocating for legislation that would further expand their commercial lending powers. ICBA believes tax reform offers an excellent opportunity to ask the question: **What legitimate policy objective does the credit union exemption serve today, especially for the largest, most complex credit unions that are virtually indistinguishable from taxpaying banks?** We believe that no legitimate objective can be specified and supported by data. We urge the Senate Finance Committee to reexamine the credit union tax exemption. Preserving the exemption in tax reform would come at the expense of higher rates for taxpaying entities, a higher deficit, or both.

[1] "Estimates of Federal Tax Expenditures for Tax Years 2012-2017." Prepared by the Staff of the Joint Committee on Taxation. February 1, 2013. Page 8.

Today's Credit Unions Fail to Satisfy the Criteria of the Federal Credit Union Act

Let's review the original rationale for the credit union tax exemption.

Serving "People of Small Means"

According to the 1934 Federal Credit Union Act, credit unions were intended "to make more available to people of small means credit for provident purposes."[2] Despite the credit union sector's tax exemption, a number of independent studies have shown that banks do a better job than credit unions in meeting this purpose:

- A 2003 Government Accountability Office study found that credit unions serve a more affluent clientele than banks. This GAO study concluded that "credit unions overall served a lower percentage of households of modest means than banks." Traditional banks serve more households of modest means (41 percent of customers) than do credit unions (31 percent).[3]
- A 2009 study by the National Community Reinvestment Coalition determined that banks do a better job of fulfilling the credit unions' mission than the credit unions. The study highlighted how banks "consistently exceed credit unions' performance in lending to women, minorities, and low and moderate-income borrowers and communities." [4]
- A study by the Woodstock Institute concluded that credit unions serve a higher percentage of middle and upper-income customers than lower-income households. [5]
- A study by the Virginia Commonwealth University concluded that credit unions tend to serve a higher proportion of wealthier households in their customer base.[6]

In short, credit unions have failed to satisfy the first fundamental justification for their tax exemption.

Common Bond Requirement

The Federal Credit Union Act limited credit union membership to "groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district." However, in 1998, in response to a Supreme Court decision that invalidated the liberalized membership criteria allowed by the National Credit Union Administration, Congress passed the Credit Union Membership Access Act, which allowed multi-bond credit unions, completely undermining the original "common bond" requirement. Today, with few practical limitations on their membership, credit unions grow by appeals to general communities-at-large.

Credit Unions, as "Stealth Banks," Should Be Taxed Like Banks

Credit unions clearly fail to meet two of the original criteria set forth in the Federal Credit Union Act. Further, in the 70 years since that Act was enacted, credit unions have evolved to the point where they are the functional equivalent of banks. Today's credit unions offer many of the same products and services

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[2] Pub. L. No. 73-467, 48 Stat.
[3] "Credit Unions: Financial Condition Has Improved But Opportunities Exist for Enhanced Oversight and Share Insurance Management." Government Accountability Office (GAO-04-91).
[4] "Credit Unions: True to their Mission? Part II." National Community Reinvestment Coalition. September 8, 2009. http://bit.ly/13eaCiF
[5] "Rhetoric and Reality: An Analysis of Mainstream Credit Unions' Record of Serving Low Income People." Woodstock Institute. (Chicago: February 2002). http://bit.ly/19IhDZ2
[6] "A Study on the Comparative Growth of Banks and Credit Unions in Virginia: 1985 - 1995." School of Business, Virginia Commonwealth University. August 1997.

and market to the same clientele as taxpaying banks. Many credit unions are multi-billion dollar institutions with aggressive promotional campaigns. There are 183 credit unions that have assets of more than $1 billion, an asset size greater than 91 percent of all banks.[7] The largest credit union has assets of $54 billion. They are "stealth banks," a description used in a recent article in Bloomberg Businessweek,[8] and should be taxed in the same way as banks.

Legislative Precedent Supports Repeal of Tax Exemption

There is precedent for repealing a tax exemption in the financial services sector that has become outmoded. Savings & Loans and mutual savings associations were once tax-exempt. Congress revoked their tax-exemption in 1951 because they were in active competition with commercial banks and life insurance companies and their tax status was deemed discriminatory.[9]

Credit Union Lending Comes at a Significant Cost to Taxpayers

The neglect of credit unions' original mission is unfair to the people credit unions were intended to serve; it's unfair to taxpaying community banks, but it's also unfair to all taxpayers. The most comprehensive analysis of the credit union's federal tax exemption was undertaken by the non-partisan Tax Foundation in 2005.[10] This analysis considered not only the cost of the tax subsidy, but what happens to the tax subsidy – i.e., whether and to what extent it is passed on to customers – and the effect of the subsidy on the marketplace for financial services. The Tax Foundation found that:

- The subsidy would cost the taxpayer over $32 billion over a ten-year budget window. This included not only the direct tax expenditure that resulted from not taxing the net revenue of credit unions, but the indirect effect on tax revenues of a less competitive marketplace for financial services. This is a more comprehensive analysis of the tax subsidy than is provided by the Joint Committee on Taxation and the Office of Management and Budget, which consider only the static tax expenditure and exclude behavioral changes in the marketplace.
- The subsidy boosted the return on assets for the average credit union by 50 basis points.
- Of those 50 basis points, only a meager 6 basis points are passed onto customers in the form of preferential interest rates on loans. There is little to no effect on deposit rates. Eleven basis points are absorbed by higher labor costs at a credit union than at a comparable bank (due to inefficiencies).
- The remaining 33 to 44 basis points of subsidy accrue to the credit union owners in the form of higher equity and larger assets they use to expand rapidly.

In summary, the Tax Foundation study shows credit unions generally do not pass on their subsidy to customers and instead use it to finance expansion. According to Bloomberg Businessweek, "Ten years ago there were only 70 credit unions with assets of more than $1 billion. Now there are 195."[11]

[7] "Oregon's Credit Unions: Growing, Consolidating, and Often Indistinguishable from Commercial Banks." Marvin Umholtz. January 2013.
[8] "Have Credit Unions Become Stealth Banks." Brendan Greely, Bloomberg Businessweek. May 16, 2013. http://buswk.co/10TctrS
[9] Senate Report No. 781
[10] "Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions." Tax Foundation. February 28, 2005. http://bit.ly/SKj8NP
[11] Bloomberg Businessweek. Ibid.

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In addition to the Tax Foundation, in recent years, government and independent non-government entities – including the Congressional Budget Office, the Joint Committee on Taxation, and the Treasury Department – have produced eight separate estimates of the taxpayer cost of the credit union tax exemption. The average cost estimate is $15.9 billion over ten years.[12]

No Justification for the Credit Union Subsidy Exists

ICBA urges the Senate Finance Committee to give due consideration to the data, independent studies, arguments, legislative precedents and legislative history noted above. Comprehensive tax reform presents an historic opportunity to reevaluate a tax exemption that has outlived its original purpose and can no longer be justified. This is particularly true in light of the credit union industry's current legislative effort to expand their commercial lending powers. Repeal of the credit union tax exemption for the largest credit unions would raise significant revenue for tax rate reduction or deficit reduction and result in fairer and less distorted market for financial services.

Thank you for your consideration.

Sincerely,

/s/

Camden R. Fine
President and CEO

CC: Members of the United States Senate

[12] "An Analysis of the Impact of Expanding the Ability of Credit Unions to Increase Commercial Loans." Ike Brannon, Capital Policy Analytics Group. http://www.icba.org/advocacy/stopthecugrab.cfm The Tax Foundation estimate is included in this average.