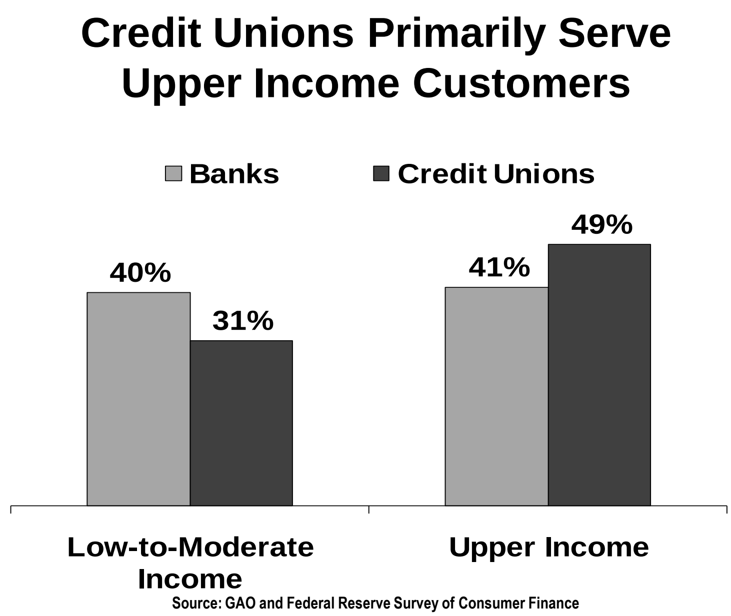
Eliminating the Credit Union Tax Expenditure Will Lower U.S. Debt Levels

As Congress examines the affordability of tax expenditures in the face of rising debt levels, it should target the credit union tax expenditure. The credit union tax expenditure is an anachronism whose need has long since disappeared. Since 2001, credit unions have added to our nation's debt by not paying an estimated $20.5 billion in federal income taxes. It is among the largest corporate tax expenditure at almost $9.5 billion over the next five fiscal years with the bulk of the tax expenditure favoring large bank-like credit unions.

Credit Union Tax Expenditure Subsidizing Upper Income Consumers

This tax expenditure was originally provided to credit unions as a way to subsidize financial services for individuals with low and moderate income. However, the evidence indicates that this tax expenditure is poorly targeted, as it is not going to people of modest means.

A 2006 study by the U.S. Government Accountability Office (GAO) found that "14 percent of credit union customers were of low-income and 17 percent were of moderate-income, compared with 24 percent and 16 percent for banks." Moreover, GAO found that 49 percent of credit union customers were of upper-income compared to 41 percent for banks.

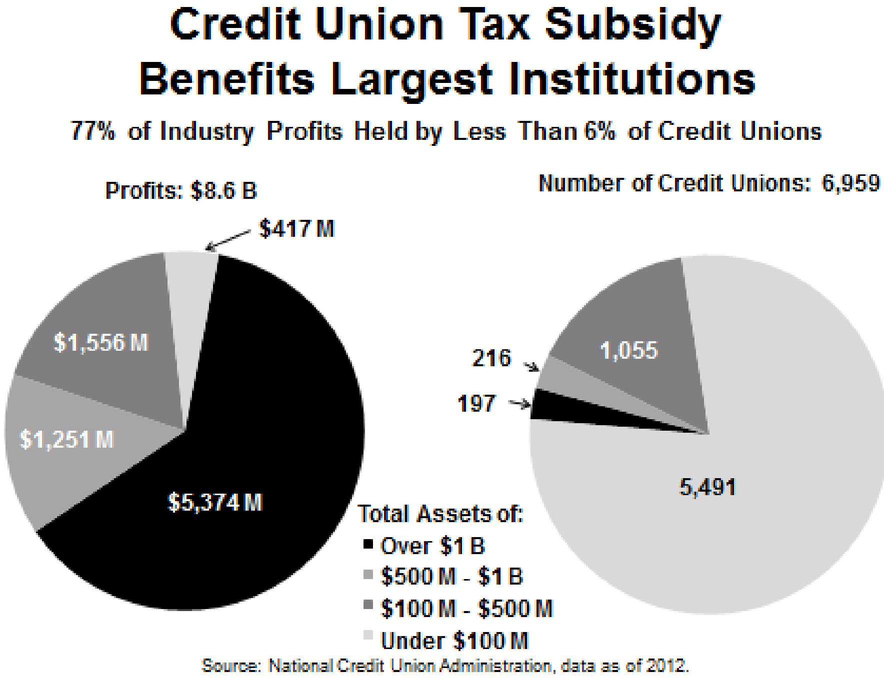


Thus, the tax expenditure is subsidizing financial services to individuals who clearly don't need it. In fact, the credit unions' own surveys suggest that their image of serving moderate and lower income people is no longer valid. The typical credit union member has higher than average income, more years of education and more likely to own a home than non-credit union members.

If the tax expenditure is no longer conditioned upon the policy goal of serving low- and moderate-income individuals, can it be justified?

Benefits of Tax Expenditures Going to Large Credit Unions

This tax expenditure favors large bank-like credit unions. In 2012, the credit union industry reported a profit of $8.6 billion. However, more than three-fourths of the industry profits were concentrated in credit unions with over $500 million in assets, which represent slightly less than 6 percent of all credit unions. On the other hand, credit unions with less than $100 million, which account for just fewer than 80 percent of all credit unions, had less than 5 percent of the industry's profits.



Also the size of the credit union "tax expenditure" is big – nearly $20.5 billion since 2001. This will be among the largest corporate tax expenditure over the next five years, using a conservative projection found in the Office of Management and Budget's *Analytical Perspectives*.

Basic economics tells us that this tax expenditure puts credit unions at a competitive advantage relative to other financial institutions providing identical services, as it distorts economic behavior and the allocation of resources within the financial services sector. Over time, these large bank-like credit unions will grow at the expense of taxpaying financial institutions and so will the tax expenditure.

In the 1940s and early 1950s, Congress faced a similar situation of tax-exempt financial institutions — mutual insurance companies and mutual savings banks — that had outgrown their original purpose and competed head-to-head with taxpaying institutions. What public policy decision did Congress make? It eliminated the tax exemption for mutual insurance companies in 1942 and for mutual savings banks in 1951. ***Importantly, removing this tax exemption did not drive mutual savings institutions out of business or even hinder their growth.*** These institutions are healthy, well-capitalized and profitable. Since 2000, mutual savings institutions have paid approximately $5.5 billion in corporate income taxes.

The credit union tax expenditure no longer supports the public policy of providing financial services to low- and moderate-income consumers, especially among most of the largest credit unions. Abolishing the credit union tax expenditure would help reduce the U.S. debt and eliminate distortions in the financial services industry. In conclusion, the United States can no longer afford to provide the credit union with this tax expenditure whose purpose can no longer be justified.