

October 1, 2013

The Honorable Dave Camp  
Chairman  
Committee on Ways and Means  
U.S. House of Representatives  
1102 Longworth House Office Building  
Washington, D.C. 20515

The Honorable Sander Levin  
Ranking Member  
Committee on Ways and Means  
U.S. House of Representatives  
1106 Longworth House Office Building  
Washington, D.C. 20515

Dear Chairman Camp and Ranking Member Levin:

As you start the process to reform the United States tax code, the American Bankers Association (ABA) strongly recommends that the tax-exempt status for credit unions – especially large, complex credit unions – be repealed. The credit union tax exemption has a significant cost. The Office of Management and Budget recently estimated the credit union tax exemption at almost \$10 billion over the next five years. With large annual federal deficits, our country can no longer afford to subsidize the \$1 trillion credit union industry, which increasingly operates like a tax-free banking system.

### **The Credit Union Tax Exemption Is Being Abused and No Longer Serves Its Original Purpose**

Credit unions were granted tax exempt status to provide subsidized financial services to individuals with low to moderate incomes. However, the evidence shows that this tax expenditure is going to wealthy individuals and businesses and 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 U.S. taxpayers are subsidizing financial services to individuals who clearly do not 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 In fact, the credit unions’ own surveys suggest that their image of serving moderate and lower income people is no longer valid.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 is more likely to own a home than non-credit union members.

Moreover, *credit unions have never had to document that this tax subsidy was actually used as intended and there is no examination by credit union supervisors to assure compliance.* With such a lack of oversight protecting taxpayer dollars, it is no surprise that the tax exclusion has grown and been directed to purposes Congress never intended.

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If the tax exemption is no longer conditioned upon the policy goal of serving low- and moderate-income individuals, it can no longer be justified and should be repealed.

### **Credit Unions Were Never Intended To Be Tax-Exempt Banks, but This Is the Reality Today**

Credit unions serve the same markets as banks – particularly community banks – and there is no practical limitation on who a credit union can serve. In fact, the public does not differentiate between banks and credit unions.

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

The tax code should not be picking winners and losers, but that is exactly what the credit union tax exemption does. It has a particularly harsh impact on Main Street community banks. If tax reform is about the principle of making the tax code fairer, then Congress should end the corporate tax exemption for credit unions.

### **The Credit Union Tax-Exemption Should Be Repealed**

As you and your colleagues in the House debate reform of the United States tax code, consider the fact that 208 credit unions have assets over \$1 billion. Each one of these credit unions is larger than 90 percent of taxpaying banks. More fundamentally to the tax debate, these 208 credit unions – three percent of the entire credit union industry – account for 62 percent of the tax expenditure. These large, fast-growing, and increasingly complex credit unions have diversified to the point that they bear no resemblance to the traditional credit unions that Congress envisioned to be worthy of preferred tax status. They often no longer use “credit union” in their names and advertise that they are just like banks.

This is not the first time that Congress has had to deal with different tax treatments in the financial services industry. 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.

Credit unions contend that their tax exemption is the same as the tax treatment for Subchapter S banks. That statement is patently false. A Subchapter S corporation is a corporation that has between one and 100 shareholders and that passes-through net income or losses to shareholders. Whether or not the Subchapter S corporation passes-through dividends to the shareholder, someone – in this case the shareholder – will be paying taxes on the profit. In contrast, credit

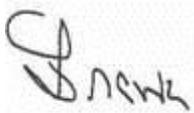
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unions do not pay taxes at the corporate level, nor do they have an outstanding tax liability that is passed through to their members.

In an economy based on free market principles, the tax system should not provide a competitive advantage for particular commercial enterprises. Credit unions should thus be subject to tax on the same basis as other financial institutions.

In conclusion, the credit union tax exemption is a Depression-era tax break that for many credit unions has outlived its purpose. It no longer supports the public policy of providing financial services to low- and moderate-income consumers. Previous administrations – both Democratic and Republican – have recommended ending the credit union industry’s tax exemption. The time has come for Congress to abolish this exemption. It would be a fiscally sound way to help reduce the U.S. debt and eliminate distortions in the financial services industry.

Sincerely,

A handwritten signature in black ink, appearing to read "F. Keating", is positioned above the typed name.

Frank Keating  
President and CEO

Cc: Members of the House of Representatives