Credit Unions and Tax Reform

The Senate Finance Committee leadership has begun the process for tax reform, seeking input from their colleagues and others on ways to create a tax code that is free of special-interest provisions in the form of exclusions, deductions, credits, and other preferences – special breaks often referred to as "tax expenditures" because they come at a cost to American taxpayers. We expect similar efforts to be undertaken in the House Ways and Means Committee.

Chairman Max Baucus (D-MT) and Ranking Member Orrin Hatch (R-UT) noted that such tax breaks should only be retained if they (1) help grow the economy, (2) make the tax code fairer, or (3) effectively promote other important policy objectives.

Based upon the evidence, the credit union tax exemption does not meet these policy objectives and can no longer be justified.

- **The Credit Union Tax Exemption Does Not Help the Economy Grow**

  - A loan to a creditworthy borrower made by a credit union is a loan that any bank would be happy to make.
  - The credit union tax exemption merely shifts the same business to tax-favored credit unions without adding to economic growth.
  - In fact, this shift distorts market forces, lowering productivity and harming economic growth.
  - As economic activity moves from the taxable sector of the economy to the tax-exempt sector, it will add to the federal deficit and reduce long-term economic growth.

- **The Credit Union Tax Exemption Does Not Make the Tax Code Fairer**

  - 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.
  - Credit unions compete head-to-head with community banks, with the added advantage of being tax-exempt.
  - The tax system should not provide a competitive advantage for particular commercial enterprises. Credit unions should be taxed on the same basis as other financial institutions.
  - Other cooperatively owned financial institutions pay taxes. Congress eliminated the tax exemption for mutual insurance companies in 1942 and for mutual savings banks in 1951.
  - More than 200 credit unions have assets over $1 billion, making each of them larger than 90 percent of taxpaying banks. These large credit unions are only 3 percent of the entire credit union industry, yet they account for 62 percent of the credit union

tax expenditure.

- A U.S. family of four pays *more* Federal income taxes than the *entire $1 Trillion Credit Union Industry*.

➢ **The Credit Union Tax Expenditure Is Being Abused and No Longer Serves An Important Policy Objective**

- The credit union tax exemption was originally intended as a way to subsidize financial services for individuals with low or moderate income.
- But a 2006 GAO study found that 14 percent of credit union customers were of low-income and 17 percent were of moderate-income, while 49 percent were of upper-income. Credit unions serve a wealthier and more educated customer base than taxable banks.
- The credit union tax exemption subsidizes financial services to those who clearly do not need it.
- 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.
- If the tax exemption is no longer conditioned upon the goal of serving low- and moderate-income individuals, it can no longer be justified and should be repealed.

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

- The credit union tax exemption is a Depression-era tax break that 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.