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President & CEO

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President's Economic and Recovery Board (PERAB)

Members of the President's Economic and Recovery Advisory Board:

The "*Report on Tax Reform Options*" released last Friday provides a comprehensive view of ways the U.S. tax system might be simplified, while improving taxpayer compliance and reforming the corporate tax system. In the section on corporate tax reform, the report describes some of the inefficiencies with the current tax system and a number of possible remedies. Although the report makes no recommendations regarding changes in tax law, one of the potential changes mentioned is the tax exemption of credit union net income. Because of the well-documented value of the credit union tax exemption, both to the government and to the nation's 92 million credit union members, I would like to provide a few comments on three aspects of the report's analyses

INEFFICIENCIES AND DISTORTIONS. The report describes the inefficiencies and distortions that result from a corporate tax structure combining high statutory tax rates and numerous deductions and exclusions, suggesting that these distortions have deleterious consequences. In general, the report makes the case that broadening the tax base with a consequent reduction in corporate tax rates would improve economic efficiency by reducing the distortions.

In point of fact, many of the "distortions" of the current tax code are the **intended** consequences of wise economic policy. Indeed, as you well know, most tax preferences were enacted with the express purpose of fostering certain types of economic activity that Congress wished to encourage. A tax preference that advances public policy so that the benefits exceed the foregone tax revenue can be an extremely cost effective way of advancing important goals. As history has shown, this is certainly the case with the credit union tax exemption.

Once credit union net income returns to its pre-recessionary level, the credit union tax exemption will amount to up to $1.5 billion in lost federal revenue a year, less the reduction in tax payment by credit union members on their reduced dividends if credit unions were taxed. 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). They also receive access to a financial institution they own and which therefore keeps their interests ahead of stockholders' interest, providing exceptional and low-cost service to members at all income levels. Further, the tax exemption helps to ensure consumers have choices beyond commercial banks in the financial marketplace. It is appropriate to view these results not as an economic distortion, but as evidence of sound public policy. 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.

EROSION OF CORPORATE TAX BASE. The report documents how tax law evolution over the past three decades has reduced the proportion of total business net income subject to corporate income tax, from 80% in 1980 to 53% in 2007. This has occurred as changes at the state and federal level have allowed more businesses to operate in a pass-through form such as Subchapter S corporations and LLCs, where income is "passed through" to be taxed at the individual level rather than at the corporate level. More and more businesses have adopted the forms necessary to qualify for this pass-through status. The report goes on to suggest that a goal of tax reform would be that businesses of similar size and engaging in similar activities would be subject to a similar tax structure.

I would point out that much of the recent erosion of the corporate tax base has been due to changes in the tax law that granted special tax treatment to already existing firms based solely on their size or number of owners, and <u>not</u> because of changes in the operating characteristics of the business. Many firms that now receive pass-through tax treatment did not have to change their fundamental mission or structure to enjoy tax benefits. In sharp contrast, the credit union tax exemption precedes these changes by decades, going back to the 1930s. Also, the credit union tax exemption is based on a fundamental difference in organizational structure. Credit unions are not-for-profit cooperatives operated solely for the benefit of their member/owners. As a result of their organizational framework, credit unions are entirely different from for-profit corporations. Therefore, to group credit unions with Subchapter S corporations or LLCs, organizations that have tax benefits with little discernable public policy rationale, ignores the fundamental difference in credit unions' very nature.

SPECIAL TAX PROVISIONS. Third, the report lists a number of special tax provisions that narrow the business tax base, including an estimate of the 10-year revenue cost to the government of each provision. The report indicates that many of these provisions "violate principles that businesses with similar characteristics should be treated equally." Of the $1.3 trillion of total lost revenue over the 10 years for all these provisions, the exemption of credit union income is estimated to represent $19 billion, or 1.4%. With specific reference to credit unions, the report says:

> Unlike other financial institutions like banks and thrifts, credit unions do not pay corporate taxes on their income. This puts them at a competitive advantage relative to other financial institutions for tax reasons. Eliminating this exemption would raise revenue and level the playing field, but would clearly raise taxes on credit unions.

In response I note that the credit union tax exemption is tiny compared to either the current and expected level of federal deficits, or the total of the listed special tax provisions. Also, I strongly disagree that credit unions and banks are "businesses with similar characteristics", even though they do provide similar services. As mentioned previously, the cooperative, not-for profit structure of credit unions produces very different results for members than the for-profit, investor owned sector creates for its customers. Moreover, if the competitive advantage of being a credit union were so great, we wonder why banks have not *en masse* converted to credit union charters, or why the credit union share of depository institution assets has remained around 6% for the past two decades. Finally, eliminating the exemption would indeed raise taxes on credit unions' 92 million member owners.

I appreciate that the report states that "the PERAB is an outside advisory panel and is not part of the Obama Administration." Also, the report lists a multitude of options and does not make any recommendations, and as the report states, it "does not represent Administration policy." Nevertheless, on behalf of credit union members and credit unions, I am compelled to set the record straight on the importance of the public policy justification for the continuation of credit unions' federal tax exemption.

CUNA will continue our strongest efforts to ensure that policymakers understand the purpose and effects of the credit union tax exemption. In that connection, I would welcome an opportunity to meet with you to discuss the points I have raised in this letter.

Sincerely,

Bill Cheney
President & CEO

The Honorable Timothy Geithner, Secretary, U.S. Department of the Treasury
The Honorable Max Baucus, Chairman, Senate Committee on Finance
The Honorable Charles Grassley, Ranking Member, Senate Committee on Finance
The Honorable Christopher Dodd, Chairman, Senate Committee on Banking, Housing and Urban Affairs
The Honorable Richard Shelby, Ranking Member, Senate Committee on Banking, Housing and Urban Affairs
The Honorable Barney Frank, Chairman, House Committee on Financial Services
The Honorable Spencer Bachus, Ranking Member, House Committee on Financial Services
The Honorable Sander Levin, Chairman, House Committee on Ways and Means
The Honorable Dave Camp, Ranking Member, House Committee on Ways and Means
The Honorable Debbie Matz, Chairman, National Credit Union Administration Board
Treasury Assistant Secretary for Financial Institutions, Michael Barr
White House Deputy Director of the National Economic Council, Diana Farrell
National Commission on Fiscal Responsibility and Reform