Statement for the Record

On behalf of the

American Bankers Association

before the

Oversight Subcommittee

of the

Committee on Ways and Means

United States House of Representatives

Statement for the Record

On behalf of the

American Bankers Association

before the

Oversight Subcommittee

of the

Committee on Ways and Means

United States House of Representatives

July 25, 2012

Chairman Boustany, Ranking Member Lewis and members of the Subcommittee, the American Bankers Association (ABA) appreciates the opportunity to submit a statement for the record for this hearing on tax-exempt organizations' compliance with unrelated business income tax (UBIT). ABA represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees.

Over the last two decades, tax exempt organizations of all types have grown increasingly more complex in their organizational structures and operations. Contributing to this complexity is the prevalence of profit-generating arms within the tax-exempt organizational structure. We commend the Subcommittee for holding this oversight hearing with regard to tax-exempt organizations' compliance with Federal tax law, including rules that subject business income from for-profit activities to UBIT and the disclosure of information about sources of income and expenditure on the Form 990.

Just like other tax exempt institutions, all credit unions should be subject to UBIT on income earned from activities outside of the scope of their tax-exempt purpose. Currently, only state credit unions are subject to UBIT; federal credit unions should also be required to comply. Similarly, state credit unions are required to disclose information about income and expenditures, such as executive compensation and charitable donations, on IRS Form 990. Federal credit unions should also be required to comply.

Credit unions were originally created for the purpose of promoting thrift and providing credit to members of the credit union and were granted their tax exemption to serve people of modest means.

However, many of these credit unions have now morphed from serving "people of small means" to become full service, financially sophisticated institutions that compete head-to-head with local taxpaying banks. In many cases, these morphed credit unions offer products and services that are outside of their tax-exempt purpose and should be subject to UBIT, just like what is applied to other tax-exempt entities.

Our statement will make several points:

- Credit unions are becoming increasingly complex organizations, virtually indistinguishable from taxpaying banks.
- Federal Credit Unions Should Disclose Activities on Form 990
- Activities outside of the scope of the credit union tax-exempt purpose should be subject to UBIT.
- Federal credit unions should be subject to UBIT, just like state chartered credit unions.

We will discuss these items in detail below.

I. Credit Unions Are Becoming Increasingly Complex

Many of today's credit unions are a far cry from the small, traditional credit unions that served distinct groups of "people of small means," which Congress sought to assist when it provided tax subsidies to credit unions in the 1930s. Today, the credit union industry has surpassed the $1 trillion asset threshold and will soon hold more assets than the savings association industry.

There are now 194 credit unions that have more ***than $1 billion in assets*** each; these credit unions hold 50.3 percent of all credit union assets but represent only 2.8 percent of the total number of credit unions. These 194 large credit unions are larger than 91 percent of all banks. For consumers, credit unions are indistinguishable from taxpaying community banks. Indeed, these credit unions compete for the same loans as their community bank counterparts, but pay no taxes. Credit unions were not intended to be simply tax exempt banks.

Moreover, many credit unions are exhibiting increased organizational complexity, including operating for-profit affiliates known as credit union service organizations (CUSOs). According to

the National Credit Union Administration, approximately 33 percent of all credit unions reported using CUSO services in 2010.

These for-profit affiliates can be wholly or jointly owned. Many are organized as limited liability companies. Limited liability companies are pass-through entities, where the shareholders pay the taxes on the profits of the company. However, since credit unions are tax exempt, ***the earnings of CUSOs structured as LLCs go untaxed***. Additionally, CUSOs have the authority to offer products and services that credit unions cannot offer and CUSO's can serve nonmembers. National Credit Union Administration regulations only require that the majority of a CUSOs business must come from credit unions or credit union members.

Alaska USA Federal Credit Union in Anchorage, Alaska is illustrative of this growing complexity. The credit union owns a mortgage company, insurance agency, trust company, and title agency and ***pays no UBIT on income earned from these activities***.

II. Federal Credit Unions Should Disclose Activities on Form 990

As credit unions become more complex, it is important to increase credit union transparency. Credit unions should be required to reveal information about sources of income and expenditures, such as executive compensation and charitable donations. Most tax-exempt organizations, including universities and hospitals, must disclose the compensation of senior officials to the Internal Revenue Service on the Form 990—a form that has become an important tool for determining the transparency and accountability of tax-exempt organizations. By publicly disclosing this information, the Form 990 fosters good corporate governance as it attempts to ensure that the tax expenditure is being appropriately employed.

State-chartered credit unions are already required to file a Form 990, but federal credit unions are not. Since federal credit unions are cooperatives, the member-owners have a right to know the total compensation paid to senior officials. For example, if Public Service Credit Union of Denver had been a federal credit union (rather than state-chartered), information regarding the $9.8 million base compensation of its CEO and President would not have been disclosed. His 2010 pay package was almost 20 times the average for comparable sized credit unions according to press reports.

Federal credit unions should be required to file Form 990 information just like state-chartered credit unions and most other tax-exempt institutions. Expanding the public's opportunities to review executive salaries would promote improved corporate governance and greater credit union

accountability. It would inform Congress, taxpayers, and credit union members about whether this valuable tax subsidy is going towards the credit union mission or is subsidizing credit union management.

III. Numerous Credit Union Products and Services Should Qualify for UBIT

ABA believes that income derived from non-members and from activities unrelated to the credit union's tax-exempt purpose should be subject to taxation. In general, a tax exempt organization is subject to UBIT if income is derived from an activity that is (1) a trade or business, (2) regularly carried on, and (3) not substantially related to the exempt purposes of the organization. An activity is related to the exempt purpose only where the conduct of the activity has a causal relationship to the achievement of the exempt purpose.

Today, credit unions and their subsidiaries offer numerous financial products and services that are not substantially related to their tax-exempt purpose and should be subject to UBIT.

Consider the following examples:

- La Capitol FCU in 2004 built a new six-story building in downtown Baton Rouge. The credit union occupied 30,000 feet of the 80,000 square-foot development and leased out the rest. The income from the 50,000 square feet of leased out office space ***should be taxed***.
- Another credit union, First FAA FCU located in Los Angeles, leased its unused portion of its office at above-market rates to the "CSI: Miami" production company. Space on the main floor of the building is set up to look like a police interrogation room. The income from the "CSI: Miami" set ***should be taxed***.
- Forum Credit Union in Indianapolis operates a conference and events center. It can be used for special occasions like weddings or corporate events. If you want to rent the entire facility during the weekend for a corporate event, the price would be $1,700 plus $4 per person. The income from the convention center rentals ***should be taxed***.

- Lake Michigan Credit Union in Grand Rapids, Michigan operates an auto dealership, called Lake Michigan Auto Center. The credit union also operates a car wash. It is hard to fathom what a car dealership and a car wash has to do with a credit union's tax-exempt purpose. The income from the Lake Michigan Auto Center ***should be taxed***.

- Many credit unions are surcharging nonmembers for using their automatic teller machines. The income from the ***nonmember fees should be taxed***.
- A number of the largest credit unions are now offering real estate brokerage services. Digital Credit Union of Marlborough, Massachusetts offers real estate brokerage services through its DCU Realty affiliate. The income from the real estate brokerage ***should be taxed***.

Furthermore, UBIT should also be applied to a credit union when it purchases or participates in a business loan to nonmembers. Since the first quarter of 2004, the NCUA has collected information on the number and the dollar volume of nonmember business loan purchases and participations. According to NCUA, 820 credit unions held $6.4 billion in nonmember business loan purchases and participations at the end of the first quarter of 2012. ABA believes this activity is outside the scope of a credit union's tax-exempt purpose and ***should be taxed***.

IV. UBIT Should Be Extended to Federal Credit Unions

Currently, state-chartered credit unions must pay UBIT. However, federally-chartered credit unions are statutorily exempted from paying UBIT. In fact, the tax exemption for federal credit unions is so broad that these organizations are excluded from all forms of federal and state taxation, other than state property taxes.[1] This statutory exemption from UBIT is no longer warranted. The only significant difference between state and federal credit unions is that federal credit unions are chartered by a federal agency, the National Credit Union Administration, while state-chartered credit unions are chartered by state regulators.

Tax policy should not differ between federal and state credit unions that offer virtually the same business services and compete for the same customers. The same competitive pressures between taxable businesses and tax-exempt organizations that motivated Congress to enact the unrelated business income tax also exists between federal credit unions and the nation's community banks. Disparity in the application of UBIT between state and federal credit unions also creates the potential for tax arbitrage and creates an incentive for credit unions to obtain federal charters.

[1] "The federal credit unions organized hereunder, their property, their franchises, capital, reserves, surpluses, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any state, territorial, or local taxing authority; except that any real property and any tangible personal property of such federal credit unions shall be subject to federal, state, territorial, and local taxation to the same extent as other similar property is taxed…" (12 U.S.C. 1768).

ABA encourages the Committee to examine repealing the federal credit union UBIT exemption. There is no public policy reason to exempt federal credit unions from UBIT, especially when the activities have no connection with their tax-exempt purpose.

Conclusion

As credit unions become more complex and expand the breadth of their product and service offerings beyond their tax-exempt purpose, ABA believes that it is incumbent on Congress to limit the growth of this tax exemption. A starting point for limiting the expansion would be to subject all credit unions to UBIT and to narrowly define the scope of activities that are related to the tax-exempt purpose of credit unions.

Also, as we stated in our May 16, 2012 Statement for the Record, ABA encourages the Committee to hold a hearing specifically on credit unions as tax-exempt entities. Credit unions represent a significant tax expenditure. Since 2001 they have enjoyed the privilege of not paying an estimated $20.5 billion in federal corporate income taxes. The size and taxpayer contribution conferred certainly make them worthy of careful Congressional investigation to ensure that their tax exemption is being used as Congress intended.