



## **Comments from NASCUS**

### **President's Advisory Panel on Federal Tax Reform**

**April 29, 2005**

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concerning particular aspects or elements of the current tax code

## **I. Description of Proposal**

The NASCUS proposal clarifies the different tax structure for state and federal credit unions.

## **II. Impact of Proposal Relative to Current System**

The impact of the suggested change applies to both fairness of the tax system and its impact on competitiveness between state and federal credit unions.

## **III. Transition, Tradeoffs and Special Issues**

There are no transition concerns, special tradeoffs or special issues presented in this proposal. It is worth noting that the proposal suggests favorable treatment of state and federally chartered credit unions.

## ***About NASCUS***

The National Association of State Credit Union Supervisors (NASCUS) is a professional association representing the forty-eight (48) state and territorial regulatory agencies that supervise the nation's more than 4,000 state-chartered credit unions. NASCUS has been committed to enhancing state credit union supervision and advocating for a safe and sound state credit union system since its inception in 1965. NASCUS is the sole organization dedicated exclusively to the promotion of the dual chartering system and advancing the autonomy and expertise of state credit union regulatory agencies.

NASCUS appreciates the opportunity to submit comments to the President's Advisory Panel on Federal Tax Reform.

NASCUS understands and respects that it is not the position of state regulators to set tax policy. Tax policy is rightfully a concern for our elected officials, both state and federal. Stating the NASCUS position, it is imperative that our elected officials have access to accurate information to develop policy.

## ***State and federally chartered credit union taxation explained***

NASCUS wants to clarify the different tax structure for state-chartered and federally chartered credit unions. Under our current tax system, state-chartered credit unions are taxed differently than federal credit unions. Taken together, the Federal Credit Union Act, the Internal Revenue Code and case law grant federal credit unions a broad tax exemption as instrumentalities of the federal government. Section 501(c)(1) of the

Internal Revenue Code grants federal credit unions this tax exemption. The various state statutes mandate when and whether state-chartered credit unions are taxed. For example, in many states, state-chartered credit unions pay sales tax and, in some cases, even franchise or income-based taxes. They are not subject to federal corporate income tax due to their non-profit structure. State credit unions are exempted under Section 501 (c)(14) of the Internal Revenue Code.

Federally chartered credit unions are not taxed because they have been exempted by Congress. State-chartered credit unions are taxed according to state law and do not enjoy the totally exempt status as their likewise non-profit federally chartered credit unions. For tax purposes, it is preferable for credit unions to be designated as Section 501 (c)(1) organizations.

***Current tax policy is a threat to the credit union dual chartering system***

Several tax policies illustrate how our current tax structure threatens the credit union dual chartering system. Some state credit unions are subject to federal taxation through the Unrelated Business Income Tax (UBIT). Explained simply, UBIT is tax policy that requires state-chartered credit unions to pay taxes on the net income generated from services determined to be unsubstantially related to accomplishing a credit union's exempt purpose.

Statutory assumptions in our current tax law presuppose that there are no activities in a federally chartered credit union that are deemed unrelated business income. Therefore, when offered by a federal credit union, the same services are exempt from income tax.

In addition to potential tax exposure, there is current debate about products that are substantially related and should be included for UBIT purposes. The IRS has previously audited state-chartered credit unions in several states to determine compliance with UBIT. State-chartered credit unions face the possibility of an audit. Further, state credit unions must file Form 990, detailing the returns of an organization exempt from income tax. Filing an IRS Form 990 each year is a regulatory burden for state credit unions and demands extra time in the tax filing process.

NASCUS does not want to see the tax burden on any credit unions increased. But treating credit unions differently for tax purposes solely based on their charter is simply wrong, and continues to threaten the dual chartering system we so highly value in America.

***NASCUS advocates fairness in the tax system***

NASCUS does not advocate any new taxes for credit unions—whether they are state or federally chartered. However, they should receive the same tax treatment; both state and federally chartered credit unions should be tax-exempt.

NASCUS does not believe that it was ever the intent of Congress to benefit, via preferential tax treatment, one charter over another charter for like institutions. Congress recognized the cooperative nature of credit unions and approved their tax-exempt status in 1934 when it voted to approve the Federal Credit Union Act. President Roosevelt signed the Act and it became law. Congress has never wavered in its position that credit unions should be tax exempt. Further, President Bush's administration has publicly acknowledged its support of credit unions' tax-exempt status.

NASCUS supports equal treatment of the state and federal credit union charter regarding federal tax policy. State credit unions should be granted the same tax exemptions as their federal counterparts. Both state and federal credit unions provide the same not-for-profit services and should not be accorded disparate tax treatment due to their choice of charter.

NASCUS is pleased the President appointed an Advisory Panel to study Federal Tax Reform. We appreciate your time studying our concerns; we are available for dialogue or to answer questions.