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Taxation Fear Leads to Business Lending Prohibition

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In an effort to balance state budgets, legislators in at least five states are looking at taxing large credit unions. The Utah legislature recently introduced a measure to tax the profits of credit unions with assets over $100 million. Credit unions leaders fear the Utah tax legislation will become a model for other states and the US Congress, and divide the credit union movement thus weakening its resolve against taxation. Already, elements of the bill are on the drawing board in other states.

In an ironic twist to the Utah bill, a last minute compromise shut down the business lending programs of the large credit unions targeted by the tax bill, thus adding to the precedent of connecting credit union powers to taxation. Credit union negotiators apparently opted for a lending prohibition versus taxation, putting these large credit unions at a significant competitive disadvantage. The Utah lending restriction could be more costly and have a more profound impact on members than simply paying a tax. Ultimately, a weaker economy (and a desperate legislature concerned about the risks of business lending and tax revenues) could lead to compromises that both tax credit unions and limit powers.

The Utah action is indeed an indicator of what is to come on the National level, as multiple states act to mandate Congressional action on credit union taxation and powers. In short, to avoid taxes, large credit unions will likely face compromises that could lead to further restrictions on powers. Other items on the radar include requiring that "excess" reserves be distributed, dramatic grants of power to influence credit union activities for dissident groups and social organizations, and public disclosure of director and officers financial and travel benefits. Because of the stampede these measure might cause from NCUSIF, it’s a good bet the compromises would come with a moratorium on exiting the fund - a move that would find support at both NCUA and at least one large credit union trade association.

The US Congress in 1998 voted a compromise that put capital and business lending limits on all federally insured credit unions. For those credit unions that found these limits restrictive, Congress provided a streamlined path to the mutual bank charter and FDIC insurance of accounts - a path that is easier to implement than conversion to private insurance.

Converting to a bank charter does require a commitment to pay taxes, but because of the significantly expanded powers and better consumer awareness, credit unions with growth opportunities and the management to seize these opportunities are confident the conversion can be made without compromising member services, independence, and a strong commitment to employees and the community. They reasoned that taxes, like any other business expense, are manageable.

Finally, in some credit union boardrooms, patriotic values, ethical principles, and the negative public relations impact of remaining a credit union and avoiding taxation are being evaluated during the deliberations about converting. Concern has surfaced regarding the public outcry about Enron’s and Ingersoll-Rand’s effort to avoid taxes by setting up offshore corporations. The public relations "nightmare" created by these events was significant.

In conclusion, if taxation or some combination of events would lead your credit union to a bank charter, keep in mind the experience of the large credit unions in Utah. Compromise can lead to some unintended results - like the prohibition on business lending - as trade association negotiators and politicians set on keeping everybody happy bargain away your future. Today, the path for a federal credit union to a mutual bank charter is clear and well tested, but a last minute compromise could close the door.

For more information about the mutual bank charter, the stock bank charter, raising regulatory capital, bank holding companies, and other progressive growth strategies contact the author: Alan D. Theriault, President, CU

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