Oregon Business

Credits Unions: To Tax or Not to Tax

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Credit unions' exemption from paying federal income tax has always been a bone of contention with banks that compete with the sector for customers. But lawmakers' efforts to reform the tax system have reignited the debate over the special tax status.

In April this year, Rob Nichols, president and CEO of the American Bankers Association (http://www.aba.com/Pages/default.aspx), sent a letter to Congressman Kevin Brady, chair of the House Ways and Means Committee, requesting that he consider removing the tax exemption for credit unions. Brady, a pro-small business conservative, is leading a campaign to close tax loopholes and limit deductions. "The "changing face" of the credit union industry should raise serious questions about whether the tax exemption continues to serve a legitimate policy goal," wrote Nichols. Credit unions should no longer be exempt because they look more like banks these days, he argued.

In a state like Oregon where credit union membership is growing and the sector competes directly with community banks for customers, tensions between the two types of financial institutions is growing more palpable. Competition from credit unions is becoming more of a pain especially for smaller local banks in Oregon, which are facing challenges in the low interest rate environment where their profit margins are under pressure and they are struggling to cope with the extra regulations from the Dodd-Frank Wall Street Reform and Consumer Protection Act (https://www.whitehouse.gov/economy/middle-class/dodd-frank-wall-street-reform).

"They [credit unions] are a threat to the local community bank," Terry Zink, CEO of Bend-based Bank of the Cascades, told Oregon Business magazine in February. "The biggest challenges community banks face today is not the competition from the really large banks; it is butting up against credit unions. They are banks that don't pay taxes. Banks are struggling to find out what the government is trying to do with credit unions and how far they are willing to let credit unions go. It makes it difficult for businesses that do pay taxes to continue to compete."

Credit unions argue that what distinguishes them from banks is their ownership structure. Because they are owned by members, they can provide lower fees and rates on loans compared with banks, which credit unions say have to charge more to make a profit for their shareholders.

"It is the not-for profit cooperative structure that distinguishes credit unions from banks and determines the difference in tax treatment; not the number of members served, asset size, or services provided," says Robert Corwin, CEO of Advantis Credit Union. It is this ownership structure that credit unions say is the reason for their growing membership and may account for why they say they are increasingly seeing customers open accounts who used to be members of banks.

The number of members at credit unions headquartered in Oregon grew 16% between 2011 and 2015.

2011 — 1,375,842

2012 — 1,415,230

2013 — 1,463,002

2014 — 1,536,065

2015 — 1,598,487

Source: Northwest Credit Union Association

As the larger banks charge higher fees to recoup costs from more cumbersome regulations and low interest rates, the consumer benefits to credit unions' member-owned status is increasingly becoming more compelling, say credit unions.

"We consistently hear directly from our members that belonging to a local, cooperative, not-for-profit credit union is important to them," says Laura Illig, vice president of marketing at Selco Community Credit Union. Consolidation in the banking sector has particularly hit communities outside of Portland where branch closures have been widespread. "Many banks in Oregon are consolidating, charging higher fees and leaving communities. Those communities have turned to credit unions — we have seen this at the coast and in the Willamette Valley," says Rick Hein, CEO of OSU Federal Credit Union, whose firm admittedly stands to benefit from the closure of bank branches.

OnPoint Community Credit Union, Oregon's largest credit union by shares and deposits, saw its membership increase 6.5% between 2014 and 2015. Kelly Schrader, chief operations and risk officer, attributes the population increase in the Portland metro area for the membership growth. Many of the new members are millennials, who have recently moved to the city. The credit union has anecdotal data that some of its new members were previously bank customers.

"As the city grows, consumers are viewing credit unions as true community institutions," she says. SELCO Community Credit Union has seen its membership grow 48% in the past four years. It is targeting younger consumers between 25 and 45 years of age – the highest users of financial services. It sponsors and participates in younger-skewing events like food truck festivals and summer concerts in the park to attract younger members, says Illig. The Oregon Community Credit Union is also focusing on attracting millennials. Its membership of the age group grew by 12.4% last year, says Mandy Jones, CEO.

The American Bankers Association frequently criticizes credit unions' special tax status, and the group's most recent letter is likely to be one of many it sends Congress in its campaign to nix the tax break. But as credit unions continue to grow their membership and smaller community banks come under pressure to consolidate, the issue is likely to grow in momentum. This is especially the case as credit unions increasingly compete head to head with banks by offering the same products and services. Both types of financial institutions provide savings and loan products and both face the same challenges building out their technology platforms to meet customers' demand for digital transactions. Credit unions' tax exemption will be the defining characteristic that distinguishes them from banks and one that will increasingly need to ensure their survival in the highly competitive financial services sector.