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# 100 Years of Credit Unions: Impact of Tax Exempt Status The Case for Georgia

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Thomas G. Noland and Edward H. Sibbald

The year 2009 marked the 100<sup>th</sup> anniversary of credit unions in the United States. The first U. S. credit union was chartered in 1909 by the state of New Hampshire. Federal chartering began in 1934 upon passage of the Federal Credit Union Act, which provided that federal credit unions would be set up as taxable entities with a tax burden “not to exceed the rate imposed upon domestic banking

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corporations” (Pub. L. No. 73-467). In 1937, this act was amended to exempt both federally and state chartered credit unions from federal income taxation. The act also exempted all federally chartered credit unions from state corporate income taxes (Pub. L No. 75-416). The state of Georgia, the subject area of this study, also exempts state chartered credit unions from paying corporate income taxes at the state level. Currently, credit unions are the only depository institutions that are exempt from federal corporate income taxes.

Credit unions have grown and evolved over the past one hundred years. Some financial industry observers feel that the largest credit unions are now in direct competition with banks for not only individual depositors but also for business customers. Indeed, at the end of 2008, 145 U.S. credit unions exceeded \$1 billion in asset size with the largest being Navy Federal Credit Union

with an asset size of \$36 billion (NCUA 2008).

At the end of 2008, Georgia had 171 credit unions. Sixty-seven of these had state charters while the remainder held national charters. As reported in Table 1, these credit unions ranged in asset size from \$51,000 to nearly \$3 billion. Seventy-eight of Georgia’s credit unions had less than \$10 million in assets. Four credit unions exceeded \$1 billion in asset size (Online Credit Union Data Analytics System).

The purpose of this study is to examine credit unions’ tax exempt status by comparing credit unions headquartered in Georgia with their closest competitors, banks of similar asset sizes, within the same state. The authors analyzed quantitative metrics such as interest rates on loans and deposits and profitability ratios such as return on average assets. They also discuss qualitative measures that might justify or dispel the tax exemption that credit unions receive.

## Historical Background

The original justification for the tax exemption of credit unions was the idea that credit unions served lower income borrowers and depositors. Savings and loans were also given this tax exemption. In 1951, the tax exemption for savings and loans was repealed. One reason that the credit unions' tax exemption was not repealed at this time is that credit union membership was limited to those with a common bond while savings and loans membership was available to everyone.

Over time, the rationale that credit unions serve lower income customers and members with a common bond has been examined closely. While competing studies differ, it has been

shown that members of some credit unions have higher average incomes, have achieved higher education levels, and have higher rates of home ownership than non-members (Chamura 2004 & GAO 2006). As a result, it is often argued that credit unions no longer fulfill the original mission of serving lower income borrowers and depositors. To combat this charge, the National Credit Union Administration (NCUA) has been approving new credit unions that are specifically designed to serve "under-served" residents through a Low Income Credit Union program designed to assist credit unions that can demonstrate that a majority of their members have a median household income

that is less than 80 percent of the national household income.

One of the problems with the Low Income Credit Union program is that an existing community credit union serving a geographic area where a majority of residents are below the annual income standard is presumed to be serving predominantly low-income members. While this may be the case, the flaw in this categorization is that banks in that geographic area are also serving customers that do not meet the national income averages. As a result, credit unions in that market could still be serving individuals with higher incomes than banks in their trade area but could still be considered nationally as a low income credit union.

**Table 1**  
**Credit Unions in Georgia Based upon Asset Size**

<b>Asset Size</b>	<b># of Credit Unions</b>
< \$10 Million	78
\$10 Million < \$25 Million	34
\$25 Million < \$100 Million	39
\$100 Million < \$200 Million	11
\$200 Million < \$500 Million	3
\$500 Million - \$1 Billion	2
>\$1 Billion	4

Source: Online Credit Union Data Analytics System

The Chamura and GAO studies finding that some members of credit unions are more affluent than non-members is not surprising when one considers the member rules for a credit union. Credit unions must be formed by members with a common bond. Section 9 of the 1934 Federal Credit Union Act states,

Federal Credit Union memberships shall be limited to groups having a common bond of occupation, or association, or to groups within a well-defined neighborhood, community or rural district (*Federal Credit Union Act*, 1934).

The first common bond category allows individuals that work for one company or that have a common occupation to form a credit union. Another common bond is allowed for individuals in the same social or civic group. In the early 1980s, some credit unions failed and credit unions with multiple common bonds were allowed to combine. The fourth common bond is that of community, which allows members from a well-defined local geographic community to be members of a credit union. With these various membership classes, it is easy to see how members of credit unions

such as Pentagon Federal or American Airlines Credit Unions could have higher incomes, more education, and a higher rate of home ownership than the general public.

The two categories of multiple common bonds and geographic community essentially allow credit union membership to be available to almost anyone. The National Credit Union Administration web site states that credit unions have more than 82 million members. As an example of a large credit union, Delta Community Credit Union, headquartered in Atlanta has more than 180,000 members and has 16 branches in the metro Atlanta area. Delta Community membership is available to any resident of eleven metro Atlanta counties, any current or former employee of some 90 companies or governmental entities and any member of eight different associations. Delta Community is also actively seeking new companies to allow their employees to join the Delta Community Credit Union (Delta Community Credit Union, 2010).

Because of the multiple bond membership categories, the American Bankers Association, along with several small banks, filed a lawsuit challenging this membership category. In 1998, the U.S. Supreme Court ruled in favor of the

banking industry and stated that the 1934 Federal Credit Union Act did not allow membership to be based upon multiple common bond categories; however, six months later Congress passed legislation (Credit Union Membership Access Act (CUMAA)) that allowed credit unions to continue their multiple bond membership categories.

Chmura (2004) found that the fastest growing credit unions after Congress passed the CUMAA were community credit unions. Membership in federally chartered community credit unions more than doubled from 1998 to 2002 increasing from 3.5 million members to 8.4 million members. Tatom (2005) found that the asset size of credit unions grew at a higher rate than banks from 1993-2003 as credit unions grew at about a 6 percent rate while banks grew at an annual rate of about 5.2 percent. It is noted however, that the percentage growth rates reflect the much smaller asset bases for credit unions as compared to banks.

Bankers observe that the nearly unlimited membership categories place some credit unions in direct competition with banks. Their direct competition contention is supported by the deposit insurance structure. Deposit insurance, provided to credit union depositors, is

backed by the full faith and credit of the federal government in the same manner as bank deposit insurance. Similar to banks insured by the FDIC, credit union depositors are insured by the NCUA for deposits up to \$250,000. Both the FDIC and NCUA insurance funds are funded by premiums paid by member institutions. Credit unions observe that, since they operate on a non-profit basis, are organized without capital stock, and are cooperative organizations, they should not be taxed. Credit unions also maintain the regulatory limitation on business loans should justify their tax exempt status.

Many credit unions have always made commercial business loans. The current restriction on business loans is limited to 12.25 percent of a credit union's total assets. In 1992, the National Credit Union Administration (NCUA) limited member business loans in response to losses to credit unions, their members, and the National Credit Union Share Insurance Fund. NCUA established loan security requirements, limits on loans to one borrower, and an aggregate portfolio cap on construction and development loans. Credit unions have been lobbying to increase the business loan limit to 20 percent stating this would increase lending to small business. Credit unions also point out

that, historically, credit union commercial loan defaults are lower as a percentage than commercial banks. This legislation has been opposed by the banking industry because of the credit unions' tax exempt status.

Some larger credit unions are actively seeking additional business and commercial loans. Robins Federal Credit Union, a \$1.1 billion institution with more than 130,000 members located in Warner Robins, Georgia, states that it makes loans for commercial real estate, investment property, new building construction, commercial equipment, inventory, and business automobiles and offers both revolving lines of credit and a business VISA card.

Perhaps, another regulatory imbalance is credit unions are not subject to the compliance costs of the Community Reinvestment Act (CRA). This act requires banks to insure that qualified low and moderate income borrowers have credit made available to them. While differences exist between the CRA requirements for large and small banks, the CRA exemption allows credit unions to save money in two ways. Credit unions do not have the compliance costs associated with the CRA administration and they do not face the potential loan charge-offs that banks of more than \$250 million in assets have for their

community development loans.

## **Credit Union Business Model**

As financial intermediaries, both banks and credit union make loans and investments funded primarily by customer deposits; however, the business model of a credit union is fundamentally different than a commercial bank. Credit unions accept consumer deposits and primarily make consumer loans, whereas a bank accepts consumer and commercial deposits and primarily handles commercial loans. As such, the loan and deposit mix of a credit union is substantially different than a bank. A review of the loan mix of credit unions in three different asset size groups of credit unions is illustrated in Table 2.

While some minor variations exist between asset size ranges, approximately 40-44 percent of credit union loans are auto loans and more than 50 percent of these auto loans are used car loans. Real estate loans are primarily first mortgage residential loans with 5-7 year terms and a balloon payment due at maturity. Other real estate loans are consumer home equity loans. Any secured commercial loans would be included in the first mortgage loan real estate category. Overall, 90 percent

**Table 2**  
**Comparative Loan Mix: Credit Unions of Different Asset Size**

<b>Asset Range</b>	<b>25-50MM (%)</b>	<b>50-100MM (%)</b>	<b>100-200MM (%)</b>
Unsecured loans	12.65	14.00	8.27
Auto Loans-New	12.48	15.30	14.59
Auto Loans-Used	27.30	28.73	29.33
First Mortgage RE Loans	28.28	25.15	22.91
Other RE Loans	13.98	11.36	16.13
Other Misc. Loans	5.31	5.46	8.77
Total	100.00	100.00	100.00

**Table 3**  
**Average Bank (\$50-100MM in Assets) Loan Mix**

	<b>12-30-07 (%)</b>	<b>12-31-08 (%)</b>
Commercial real estate	41.93	45.58
Commercial & Industrial	14.38	14.24
Agribusiness	8.05	7.09
Municipal Loans and Other	1.23	0.69
First Mortgage RE Loans	23.75	23.19
Other RE Loans	1.29	1.84
Consumer loans	9.37	7.37
Total Loans	100.00	100.00

**Table 4**  
**Comparative Deposit Mix of Credit Unions and Banks**  
**\$50-100MM in Assets**

<b>Category of Deposits</b>	<b>Credit Unions (%)</b>	<b>Banks (%)</b>
Checking and savings	52.00	28.71
Money Market	8.36	12.88
CDs < \$100,000	29.81	24.30
CDs > \$100,000	.95	26.74
IRA/Keogh	8.88	7.37
(Note – some CDs > \$100,000 could be included)		
Total	100.00	100.00

Source for all three tables: Highline Financial Data

or more of the loans are consumer loans.

By comparison, the average \$50-100 million bank would have a loan mix heavily weighted towards commercial loans as illustrated for the 2007-2009 period in Table 3. Commercial loans represent 56-60 percent of total loans and non-real estate related. Consumer loans have been declining and account for only about 7 percent of a bank's loans. The different loan mix between credit unions and banks is not surprising given the historical mission of credit unions as consumer lenders. On the funding side, significant differences exist in the deposit mix of credit unions compared to banks as illustrated in Table 4.

Credit Unions have a significantly higher percentage of lower cost checking and savings deposits whereas higher rate certificates of deposit are a far greater percentage of a bank's funding sources. The average size certificate of deposit for a credit union is \$16,767 compared to 26.74 percent of a bank's deposits in certificates of deposit exceeding \$100,000 in size.

The credit union business model also differs from a bank in terms of its volume and average size per account. The credit union operating platform is designed and staffed to handle large volumes of

smaller accounts and smaller loans. Banks of similar asset size have fewer customers, larger average deposit balances and fewer loan customers, but with substantially higher loan balances.

To illustrate, the average credit union in the \$50-100MM asset range has the following average balance per account or loan.

Average checking and savings account	\$ 1,637
Average IRA/Keogh account	\$ 10,122
Average car loan	\$ 11,138
Average mortgage	\$ 77,501
Average home equity	\$ 26,988

As these data show banks generally choose not to manage large volumes of small accounts and tend to concentrate their loans in larger more profitable commercial loans instead of smaller dollar used car loans.

As a non-profit organization, service is the key objective for credit unions and more staff is needed to handle the volume of transactions and accounts relative to asset size than a bank. As a result, credit unions' head-count levels and efficiency ratios (overhead expense % assets, outstanding loans per employees and deposits per employees) often compare unfavorably to

banks of similar asset size.

## Tax Exemption Benefits

A government estimate by the Joint Committee on Taxation Estimates found that the 2006 tax expenditures (A tax expenditure is the tax revenue lost from a tax break.) from credit unions' federal tax exemption was \$1.4 billion (Congressional Research Service, 2005). Another study by Chmura found that, in 2002, the estimated tax loss was \$1.9 billion based upon a 33.3 percent tax rate. Given the clear benefit from being exempted from federal and state corporate income taxes, this benefit would be reasonably expected to accrue to its members in one of in four possible ways:

1. Credit unions would offer higher rates on deposits than banks;
2. Credit unions would offer lower rates on loans than banks;
3. Credit unions would extend consumer credit to a greater extent than banks and at a more reasonable rate than available through finance companies or credit cards; or
4. Credit unions would retain additional earnings as a primary source of capital to strengthen the company in view of limited

alternative equity funding sources.

A previous study using aggregate data does not appear to support the first two benefits afforded by the tax exemption. A 2005 study sponsored by the Tax Foundation found that the estimated federal tax losses due to the tax exemption of credit unions over a 10 year period were \$31.3 billion (Tatom, 2005). Tatom utilized an effective tax rate of 33.97 percent to estimate the tax losses. His study found that the primary beneficiaries were not the depositors or the borrowers but that the credit union itself was the recipient of what the author dubbed “unusual returns.” The extra income generated from being tax exempt was retained in the credit union and provided capital for the credit union to grow faster than other institutions. Tatom states that only a small fraction of the 50 basis points subsidy that the tax exemption provides goes to credit union members. The author states that 6 basis points accrue to borrowers in the form of lower interest rates, and 11 basis points are absorbed by higher labor costs with little or no effect on deposit rates. The other 33 basis points accrue to the owners in the form of larger equity allowing credit unions to expand faster.

The findings of Tatom’s study, while not supporting the benefits of significantly

lower loan rates, and higher deposit rates do support the benefit that the tax exemption provides credit unions with increased capital in the form of retained surplus. Unlike banks, credit union cannot rely on shareholders, privately placed preferred stock, or capital contributions from a parent holding company to obtain capital. An analysis of the loan mix of credit unions lends support to benefit that credit unions are extending credit to customers that might otherwise seek loans from credit cards or finance companies.

While previous studies differ on the amount of federal taxes lost, it is clear is that, in the future, this dollar amount will increase as credit unions continue to grow in size. If credit unions are allowed to increase their business lending to 20 percent of assets, the tax dollars lost will rise even further as credit unions begin to make more profitable business loans.

### **Research Design**

This study analyzed data for the year end periods from 2004-2008 using banking data provided by the Federal Deposit Insurance Corporations (FDIC) and credit union data provided by Highline Financial Corporation. The authors analyzed five years of data because this period of time includes both times of prosperity and turbulence

in the financial services industry. In June 2009, Camden Fine, head of the Independent Bankers of America, called Georgia the “Chernobyl of banking” since Georgia had more bank failures than any other state (Paletta, 2009). The five year analysis eliminates the potential for flawed conclusions based upon a one or two year snapshot of banks and credit unions.

The authors compared credit unions and banks with asset sizes between \$25 million and \$200 million with headquarters in the State of Georgia. Because only two banks in Georgia had less than \$25 million in assets at year end 2008 (FDIC, 2010), a comparison was not made for credit unions less than \$25 million in asset size. Since only nine credit unions had more than \$200 million in assets, this study did not include banks and credit unions with more than \$200 million in assets. At the end of 2008, 175 banks were in the requisite asset size group analyzed. The number of banks in the group fluctuated over time due to mergers, bank failures, and increases in asset size. The number of banks in the study also differed than the total number of banks between \$25-\$200 million dollars due to using trimmed average data. The Uniform Bank Performance Reports provided by the FDIC used peer group trimmed averages. The peer group trimmed average for a given

ratio is trimmed or adjusted to eliminate the effect of outliers. The outliers eliminate bank ratios above the 95<sup>th</sup> percentile and below the 5<sup>th</sup> percentile. The group of banks used on one ratio will differ from that used by other ratios because the top and bottom 5 percent of banks will change from ratio to ratio. The resulting average is thus closer to a median or midpoint. An analysis of these outliers found that the outliers tended to lower ratios such as return on average assets (ROA) in good economic times but raised the ROA during economic slowdowns when banks have to be shut down. The number of credit unions was held constant for all five years due to the availability of data. Fifty credit unions had an asset size between \$25-\$200 million at the end of 2008. The average asset size for the banks analyzed in 2008 was \$96.9 million. The average asset size for the credit unions analyzed was \$63.7 million.

## Results

The first ratio analyzed was asset growth. The study found that the assets of banks grew at a much faster rate than credit unions in our study (Table 5). Much of the banks' growth was fueled by commercial real estate loans. In 2008, credit unions' asset size increased by 8.96 percent, which was higher than the 7.74 percent national rate of increase for all credit unions but slightly below the 9 percent growth

rate for all Georgia credit unions (NCUA 2008).

The next ratio analyzed was the loan to asset ratio. The loan to asset ratio measures the net loans outstanding as percent of total assets. A low loan to asset ratio may mean that financial institutions are not serving the credit needs of the community. An extremely high loan to asset ratio may mean that an institution is taking on excessive risk by making loans to entities that have substandard credit quality. The analysis (Table 6) found that banks generally have a slightly higher loan to asset ratio than credit unions. The analysis also showed that banks received a higher yield on loans than credit unions from 2004-2007, but, in 2008, credit unions' loans had a higher yield than banks (Table 7). One possible explanation for this in 2008 is that banks may have stopped accruing interest on loans that were non-performing. For 2008, banks in the study reported 2.76 percent of all loans were non-current while only 1.40 percent of loans by credit unions were considered delinquent. At first glance, the finding that banks, for the most part, receive a higher yield on loans is not surprising given that banks make a large percentage of higher rate commercial and industrial loans and credit unions' business loans are

limited to 12.25 percent of assets; however, given the fact that credit unions make a large percentage of unsecured loans and used car loans, this finding may support the theory that credit unions do give favorable rates to borrowers.

The analysis shows that banks had a higher cost of funds than credit unions. This means that banks are paying a higher rate for deposits than credit unions (Table 8). One reason for this, as shown in the credit union business model section, is that banks have more large deposits than credit unions. Banks reported yields on time deposits more than \$100,000 that approximated .75 percent higher than the overall yield on all interest bearing deposits. Approximately 25 percent of all bank deposits for the banks analyzed exceeded \$100,000.

One ratio that both banks and credit unions reported was net interest income to average earning assets. Net interest income would include interest income on securities as well as loans. Interest expense would include not only interest on deposits but also on borrowed funds. These data show that, in three of the five years analyzed, credit unions had a higher net interest income than banks (Table 9). The main reason for this is the lower overall cost of funds credit

**Table 5**  
**Asset Growth Rates 2004-2008**

<b>Asset Growth %</b>	<b>2004-2005</b>	<b>2005-2006</b>	<b>2006-2007</b>	<b>2007-2008</b>
Banks	6.65	13.80	16.96	10.54
Credit Unions	1.42	1.88	6.77	8.96

**Table 6**  
**Loan to Asset Ratio**

<b>Loan to Asset Ratio</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Banks	63.56	64.49	66.23	67.59	68.51
Credit Unions	61.14	63.03	64.95	65.59	63.62

**Table 7**  
**Yield on Loans**

<b>Yield on Loans</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Banks	7.38	8.01	9.04	9.00	7.28
Credit Unions	7.30	7.14	7.43	7.61	7.49

**Table 8**  
**Cost of Funds to Interest Bearing Deposits**

<b>Interest Expense to Interest Bearing Deposits</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Banks	1.92	2.57	3.79	4.36	3.54
Credit Unions	1.41	1.64	2.25	2.77	2.52

**Table 9**  
**Net Interest Income to Average Earning Assets**

<b>Net Interest Income to Average Assets</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Banks	4.56	4.74	4.83	4.47	3.62
Credit Unions	4.70	4.62	4.76	4.65	4.35

Source for all five tables: Highline Financial Data

unions have. Another possible reason in 2008 as mentioned previously, is that banks have stopped accruing interest on their non-performing loans since credit unions had an overall loan yield was higher than banks. Another explanation as shown with the cost of funds analysis is that credit unions are paying a lower overall rate on deposits than commercial banks. Credit unions had higher overhead expenses to average assets than banks for all five years of the study. Banks' overhead expenses to average assets declined over the last four years while overhead expenses to average assets increased for credit unions every year until 2008 (Table 10). While some of the increasing expenses may be explained by economies of scale—the average credit union in this study is smaller in asset size than the average bank. The analysis of personnel expenses shows that credit unions in this study employed more personnel than banks.

Since banks and credit unions report office occupancy expenses differently, an overall comparison of just occupancy expense was not possible. For example, banks' Uniform Bank Performance Report (UBPR) requires the cost of operating leases for

equipment and furniture as well as utility expenses to be listed as occupancy expenses while the credit unions' performance report lists these expenses under office operations expenses instead of occupancy expenses.

The study found that banks as a whole paid better than credit unions. The average personnel expense per employee (including benefits) was \$65,150 for banks in 2008 while the average personnel expense per employee for credit unions was \$50,587 (Table 11); however, the authors also found that credit unions even though smaller in asset size, employed more personnel than banks for the past three years (Table 12).

Banks have reduced their staffing levels dramatically over the last five years while credit unions have increased theirs. The fact that credit unions employ more personnel than banks is not surprising since many credit unions pride themselves on customer service and many deal with large numbers of low dollar volume transactions on both the loan and deposit side.

The next ratio analyzed was net income to average assets (ROA- Return on Average Assets). ROA is considered the best

measure of a financial institution's profitability. The analysis shows that, in four of the five years analyzed, credit unions were more profitable than banks (Table 13). The major reason for this is that credit unions do not pay corporate income taxes. The study also analyzed banks pre-tax net operating income against credit unions ROA. With the exception of 2008, banks pre-tax operating income ratios were higher than credit unions net income ratios (Table 14). This is not surprising given the large provisions for loan losses that banks made in 2008.

The difference between the ROA of banks and their pre-tax net operating income consists primarily of corporate income taxes. Banks in this study paid, on average, between .26 and .36 percent of their average assets in taxes for years they were profitable. Since the average credit union size was \$63.7 million in assets and had a five year average ROA of .718 percent, the average size credit union in this study would have before tax income of \$457,366. At a combined federal and state tax rate of 40 percent (34% Federal and 6% Georgia), the average credit union in this study received a tax subsidy of \$182,946 or .287 percent of average assets.

**Table 10**  
**Overhead Expense to Average Assets**

<b>Overhead Expense to Average Assets</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Banks	3.83	3.94	4.02	3.64	3.47
Credit Unions	4.18	4.36	4.69	4.95	4.87

**Table 11**  
**Average Personnel Expense per Employee**

<b>Average Personnel Expense</b>	<b>2004 (\$)</b>	<b>2005 (\$)</b>	<b>2006 (\$)</b>	<b>2007 (\$)</b>	<b>2008 (\$)</b>
Banks	51,760	54,030	59,800	62,160	65,150
Credit Unions	44,231	45,534	47,010	49,092	50,587

**Table 12**  
**Average # of Employees**

<b>Average # of Employees</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Banks	30.7	29.5	27.5	27.2	24.6
Credit Unions	25.3	26.7	28.2	29.9	30.1

**Table 13**  
**Net Income to Average Assets (ROA)**

<b>Net Income to Average Assets</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Banks	.63	.66	.64	.68	(.61)
Credit Unions	.93	.85	.81	.68	.32

**Table 14**  
**Banks—Pre Tax Net Operating Income and Credit Unions Net Income to Average Assets**

<b>Pre-Tax Income to Average Assets</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Banks	.98	1.02	.95	.91	(.56)
Credit Unions	.93	.85	.81	.68	.32

Source for all five tables: Highline Financial Data

## Conclusion

This study shows the overall after tax net income as a percentage of assets (ROA) is higher for credit unions than banks, based upon asset size \$25-\$200 million (trimmed averages) for four of the past five years in Georgia. The five year time horizon is critical as it includes periods of economic prosperity and recession. The lower ROA for banks during good economic times is primarily due to the tax exemption of credit unions, based upon the average credit union, asset size of \$63.7 million, receiving a federal and state tax subsidy of approximately \$183,000 per year, according to the data. Pre-tax operating income was higher for banks than credit unions in each year except 2008. Banks are generally more profitable than credit unions, but, due to the credit unions tax exempt status, banks wind up earning less income as a percentage of assets.

The study demonstrates that the business model of credit unions is vastly different than banks. While credit unions do compete with banks for small deposits, banks generally have more than 26 percent of their deposits in CDs that exceed \$100,000 while credit unions have more than 90 percent of their deposits in non-IRA or deposit accounts less than \$100,000. The study also

found that banks had a slightly higher loan to asset ratio than credit unions. For the past five years banks had a loan to asset ratio of approximately 66 percent while credit unions had a loan to asset ratio of 63.6 percent.

This study revealed that banks had a higher cost of funds than credit unions primarily due to a larger volume of CDs more than \$100,000 and the higher rates of interest paid on these deposits. The authors report that banks paid better than credit unions but that the average credit union has been increasing its number of employees while banks have reduced their staffing level. The average credit union in the study now employs more personnel than the average bank in the study.

The study shows credit unions fulfill a critical role in consumer lending and have more than 50 percent of their loan portfolio in automobile or unsecured lending while the typical bank has less than 10 percent of their loans in this type of consumer lending product. The extent to which credit unions extend credit to lower income borrowers is still unclear and is an area that deserves further research.

The finding that credit unions have a higher after tax ROA than banks due to their tax exemption leads to several fundamental policy

questions, including how the federal government can justify backing the NCUA guarantee on deposits with the full faith and credit of taxpayers when these institutions do not pay federal taxes? Between January 1 and August 12, 2009, five federally insured credit unions had been liquidated. While not threatening the solvency of the National Credit Union Share Insurance Fund (NCUSIF), allowing an increase in the regulatory limits on business lending, as currently requested by some larger credit unions, could lead to a replay of the 1980s S&L crisis where taxpayer money had to be used to pay off insured depositors.

Perhaps, the larger policy question is should credit unions continue to receive tax exempt status? Credit unions' exemption from corporate income taxes provides them with an equity contribution each year that is equal to the amount of taxes they do not have to pay. This tax subsidy allows credit unions to grow larger, thus increasing the amount of potential tax revenue lost.

Another policy question that might be considered is whether all credit unions should be taxed regardless of asset size? The Reagan administration proposed taxing them but allowing credit unions with less than \$10 million in assets to

remain tax exempt. Some might argue that asset size does not matter because what is critical is the “profit” of a credit union, and, if an entity is profitable, it should pay taxes regardless of asset size. The current study only analyzed credit unions between \$25 and \$200 million in asset size, thus, no conclusions can be drawn about credit unions smaller than \$25 million or larger than \$200 million. Additional studies may be needed to analyze the optimal asset size and “profitability” levels of credit unions that might be subject to taxation.

The debate over the taxation of credit unions is similar to the debate over the taxation of not-for-profit hospitals. Just as non-profit hospitals were granted tax exemption because they were generally smaller and provided charitable care as a community benefit, credit unions were granted tax exemption because they had limited membership categories and served the lower and moderate income consumer. Some non-profit hospitals now directly compete with and have grown larger than hospitals in their trade area. Similarly, credit unions have been allowed to expand their membership categories, and have increased their asset size to such a level that the original rationalizations for their tax exempt status may have

been eliminated, especially for the largest credit unions.

Since the original justification for credit unions’ tax exempt status is always subject to review, new motivations for their tax exemption might also be considered. One motivation may be the void credit unions fill in both consumer lending and deposits being considered more important than the tax revenue lost. Another motivation may be that if not for credit unions, many consumers would have to obtain loans from finance companies, payday lenders and credit card companies. Others might contend that all other entities handling consumer finances are taxable and credit unions should be no different.

Regardless, once the immediate economic downturn stabilizes, a new strategy to reform the tax code and slow the growing national debt will need to be addressed. As part of this process, Congress and the administration may revisit the tax exemption of credit unions and debate whether the need to reduce the mounting deficits and provide revenue for other government programs outweighs the benefits credit unions provide to consumers. If Congress and the administration decide to tax credit unions, they will need to address whether all or only credit unions of a certain size will be taxable.

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