

HOUSE BILL REPORT

HB 2364

As Reported by House Committee On:
Financial Institutions & Insurance

Title: An act relating to use tax owed by converting or merging credit unions when converting or merging a federal, foreign, or out-of-state credit union into a state charter.

Brief Description: Creating a use tax exemption when converting or merging a federal, foreign, or out-of-state credit union into a state charter.

Sponsors: Representatives Santos, Orcutt, McIntire, Hunter, Armstrong, Morrell and Roach.

Brief History:

Committee Activity:

Financial Institutions & Insurance: 1/12/06, 1/24/06 [DP].

Brief Summary of Bill

- Personal property, services, and extended warranties that are acquired by a state credit union from a federal, out-of-state, or foreign credit union as a result of a conversion or merger are exempt from use tax.

HOUSE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: Do pass. Signed by 9 members: Representatives Kirby, Chair; Ericks, Vice Chair; Roach, Ranking Minority Member; Newhouse, O'Brien, Santos, Serben, Simpson and Williams.

Minority Report: Do not pass. Signed by 2 members: Representatives Tom, Assistant Ranking Minority Member and Strow.

Staff: Jon Hedegard (786-7127).

Background:

Credit unions. A credit union is a financial cooperative organization of individuals who have a common bond, such as a place of employment, residence, or membership in a labor union. Credit unions accept deposits from members, pay interest (in the form of dividends) on the deposits out of earnings, and use their funds mainly to provide consumer installment loans to members.

Credit unions doing business in Washington may be chartered by the state or federal government. Federally chartered credit unions are regulated by the National Credit Union

Administration (NCUA), under the Federal Credit Union Act. Their share accounts are insured by the National Credit Union Share Insurance Fund (NCUSIF), which is administered by the NCUA. Washington chartered credit unions are regulated primarily by the Division of Credit Unions of the Washington Department of Financial Institutions. Washington credit unions are organized and regulated under the Washington State Credit Union Act.

There are certain business reasons that a credit union may choose to operate as a state-chartered union or a federally chartered union in Washington. Federally chartered institutions are exempt from paying state taxes, for example, and such institutions that operate in multiple states are governed by a single set of regulations. On the other hand, Washington statutes and regulations allow for a broader field of membership and greater flexibility in business lending than do federal regulations.

As of January 2006, about 79 state credit unions and 61 federal credit unions were in operation in Washington.

Conversions and mergers of credit unions. Federally chartered credit unions may convert to state chartered credit unions or merge with state chartered credit unions under the state charter. When converting to or merging under the state charter, a credit union becomes subject to state regulation. Since 1990, 19 credit unions converted from the federal to the state charter, and 27 mergers between state and federal credit unions under the state charter have taken place.

Use tax. The use tax is imposed on items and certain services used in the state for which retail sales tax has not been paid. This includes purchases made in other states and purchases from sellers who do not collect Washington sales tax. The tax is levied at the same rate as the retail sales tax, a 6.5 percent rate by the state. Cities and counties also impose use taxes at the same rate as any local sales tax imposed. Currently, local rates imposed range from 0.5 percent to 2.4 percent. Use tax is paid directly to the Department of Revenue.

All items or services sold or acquired at retail are subject to the retail sales and use taxes unless specifically exempted otherwise. Such exemptions include purchases made by federally-owned entities, such as federally chartered credit unions.

In 2004, the Board of Tax Appeals issued a decision that found that a credit union that converts from the federal to the state charter loses its federal exemption and so owes use tax on property for which sales tax had not been paid.

Summary of Bill:

Personal property, services, and extended warranties that are acquired by a state credit union from a federal, out-of-state, or foreign credit union as a result of a conversion or merger are exempt from use tax.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: This bill is a modest proposal to exempt the mergers or conversions of federally chartered credit unions to state chartered credit unions from the use tax. The bill is limited in scope. There are only 61 federally chartered credit unions. The one-time use tax is more than offset by the ongoing sales tax that the state would receive if a federal credit union switched to a state charter.

The bill is good for the state budget and good for the consumer. Consumers would have state regulation and oversight of their institution. Federally chartered institutions are exempt from state sales and use tax. State chartered institutions pay both. State chartered institutions believe that the state charter is worth paying the taxes. This bill removes the penalty for converting to a state charter. In 2001, the Department of Revenue (DOR) developed a new interpretation of existing law requiring the payment of use taxes upon merger or conversion. The credit unions have worked with the DOR in the drafting of this bill. A single conversion may bring in \$45,000 in a one-time use tax but that same converted entity may pay \$300,000 in sales taxes a year. If the use tax deters a conversion or merger, the state loses money. A credit union based on the Kitsap peninsula put conversion to a vote. The members voted it down because of the impact of the use tax. Banks and credit unions are very different entities. Banks may oppose the bill; they may not want to improve the state charter for credit unions. If this bill does not pass, there will be credit unions that may not convert or merge which would result in a loss of money to the state. Credit unions should not pay a penalty for switching to state regulation. Banks say that they have fewer tax advantages than credit unions. Banks have made record profits over the last several years and none seem to want to convert to a credit union so the credit union charter must not be as advantageous as they would like the Legislature to believe. Credit unions may prefer a state charter because it has a broader field of membership and a responsive, modern state regulator. Current state chartered credit unions support the bill because it helps spread the cost of state regulation. The better the state charter, the more it will spur growth and economic development. Credit unions don't make business decisions in traditional methods, credit unions are member governed. Only a small subset of credit unions, perhaps six or 10 of all credit unions have the expanded business loan powers. The Department of Financial Institutions must review and approve of the expansion of lending authority. This bill also helps in situations where there is a troubled federally chartered credit union. If there is a tax penalty for conversion, a state chartered credit union may not want to merge with the troubled credit union. Converted credit unions will have to pay sales tax, additional taxes on credit unions is what the banks want, they should support the bill.

(Neutral) About 3.5 percent of credit union assets are in business lending today. Five credit unions have expanded lending powers. In order to get expanded lending power, a credit union must have onsite exams from three different regulators. The state charter is very good but

some state chartered institutions do convert to a federal charter. Eighteen have switched from a federal to a state charter. Nine have switched from a state to a federal charter. One of the strengths of the dual charter system is the ability to choose the regulatory system that works best.

Testimony Against: The banking industry opposes this bill. It primarily impacts the community banks. Community banks compete with credit unions. Credit unions used to be a niche institution, now they compete on all types of products. Today, the field of membership for credit unions is broader than ever. Credit unions have many tax advantages and do not have to comply with Community Reinvestment Act requirements. This gives credit unions competitive disadvantage. Why should they get another tax break? The state credit union charter gives institutions a broader membership and allows for a higher percentage of business loans. Community banks have lost market to credit unions. The more state chartered credit unions, the more competition for business loans for community banks. Community banks must pay a significantly higher tax burden than credit unions. Credit unions can convert to a state charter today. Banks are not asking to limit that, banks are saying if they want to convert let them pay the one-time use tax required today. That one-time cost may amount to as little as six days of the tax burden a bank must pay. The only real purpose for conversion is to expand business loans. Banks and credit unions work together on almost all issues. Banks will never agree on the expansion of the powers of credit unions or on the tax treatment of credit unions. There has been a tacit understanding that banks would not try to limit the powers or increase the taxes on credit unions; credit unions would not try to expand their powers or decrease their taxes. This bill would remove a tax and banks must oppose it. Banks would be happy to compare tax burdens with credit unions. Banks do have some structural competitive advantages, such as capitalization opportunities. Community banks need to be competitive on business loans. State charters can have about 20 percent of loans as business loans; federal charters can have about 12 percent. The use fee should be part of the cost of doing business.

Persons Testifying: (In support) Stacy Augustine, Washington Credit Union League; Susan Streifel, Woodstone Credit Union; Elliot Gregg, Kitsap Federal Credit Union; and Gary Gardner, Boeing Employee Credit Union.

(Neutral) Linda Jeckel, Department of Financial Institutions.

(Opposed) Denny Eliason, Washington Bankers Association; and Brad Tower, Washington Independent Community Bankers Association.

Persons Signed In To Testify But Not Testifying: None.