# The $1 Billion Bank Benefit

***The growing number of Subchapter S banks receive substantial tax breaks.***

BANKERS OFTEN COMPLAIN of unfair credit union competition, urge credit union taxation, and tout the federal government budgetary benefits of taxing credit unions.

Their messages are likely to become more frequent—and louder—in the coming months because Congress is beginning to explore a variety of tax-reform proposals.

Of course, substantial bank tax breaks won't be part of the bank lobby's rhetoric. So it might be necessary during the process to occasionally remind policymakers that banking institutions dramatically reduce their tax liabilities in a number of ways—including as Subchapter S corporations.

While the credit union tax status has been codified in law for nearly 100 years, bank Subchapter S corporations—investor-owned firms with no more than 100 shareholders—are a relatively new development.

Changes made to the Internal Revenue Code by the Small Business Job Protection Act of 1996 made it possible for closely held banks, thrifts, and parent holding companies to elect Subchapter S status.

The tax benefit Subchapter S banks enjoy is not the same as the credit union tax status. However, the foregone Treasury revenue from this election is substantial and growing rapidly.

Subchapter S status exempts banks from paying corporate income taxes. In exchange, all of the banks' net income becomes taxable personal income to banks' owners—regardless of whether the net income is paid in dividends.

Subchapter S eliminates the double taxation of stockholder dividends, not all taxation of bank profits. An individual bank's tax savings from Subchapter S conversion depends on the magnitude of its dividend payments and the tax rates of the bank and its shareholders.

But aggregate Federal Deposit Insurance Corp. statistics and some back-of-the-envelope calculations reveal that the total foregone revenue is equal to about one-third of the revenue that Treasury would receive if these institutions were not allowed to choose Subchapter S status.

> FOREGONE TREASURY REVENUE FROM SUBCHAPTER S STATUS IS SUBSTANTIAL AND GROWING RAPIDLY.

CUNA estimates that the banking sector's favorable Subchapter S tax treatment was responsible for a record $957 million in foregone U.S. Treasury revenue in 2016. That's up by more than $25 million compared with the 2015 total.

Moreover, since 1997, the cumulative total foregone Treasury revenue projects to roughly $13 billion. Given this substantial benefit, it shouldn't be surprising to discover that Subchapter S banks account for an ever-growing proportion of total banking institutions.

You also won't be shocked to learn that aggressive (and successful) lobbying on the part of bank trade groups has made it easier to qualify for the preferential status over the years.

After the first full year of availability, less than 6% of all banks had opted for Subchapter S status. But by the end of December 2006, more than one-quarter of banks had elected Subchapter S status, and by December 2016, 2,006 institutions—representing 34% of all banking institutions—had embraced the option ("Percent of U.S. banks with Subchapter S status").

What plays a big role in state-level Subchapter S election is the number of closely held banks in a state, the tax rates of the various owners, and whether each state follows the lead of the federal tax code.

Today, Texas (237), Minnesota (224), Iowa (183), Illinois (179), Oklahoma (143), Kansas (135), and Missouri (119) each are home to more than 100 Subchapter S banking institutions. As a group, these seven states account for nearly two-thirds (61%) of the number of Subchapter S banks in the U.S.

Tax policy has consistently recognized that the health of small, locally controlled businesses is vital to the country's economic health.

Bank Subchapter S status, like the credit union tax status, furthers the goal of supporting and encouraging local ownership and control. That's critical.

It's no secret that big banks don't always act in consumers' best interests. Policymakers know full well that the nation's smaller, community-based financial institutions—credit unions and community banks—didn't contribute to the causes of the financial crisis.

The big banks' near-exclusive focus on making ever-bigger profits and lining shareholder profits nearly wrecked the financial system and pushed the world economy dangerously close to a deep depression.

Is it any wonder that the Chicago Booth/Kellogg School Financial Trust Index reports that 60% of respondents said they find credit unions trustworthy, while only 30% said they trust big, national banks?

Having not-for-profit credit unions *and* community banks as vibrant and viable alternatives in the financial services marketplace is more significant today than ever. Policymakers who listen to bankers bash the credit union tax status should know the whole story: Banks benefit from tax policy. They enjoy large and growing tax advantages, and a big source is Subchapter S election.

As with credit unions, bank owners are the primary beneficiaries of that advantage. Unlike credit unions, however, banks are owned by stockholders.

Credit union owners, in contrast, are their member-depositors: Average, middle-class Americans who enjoy higher savings yields, lower loan interest rates, and fewer and lower fees than their counterparts who choose to do business with banks.

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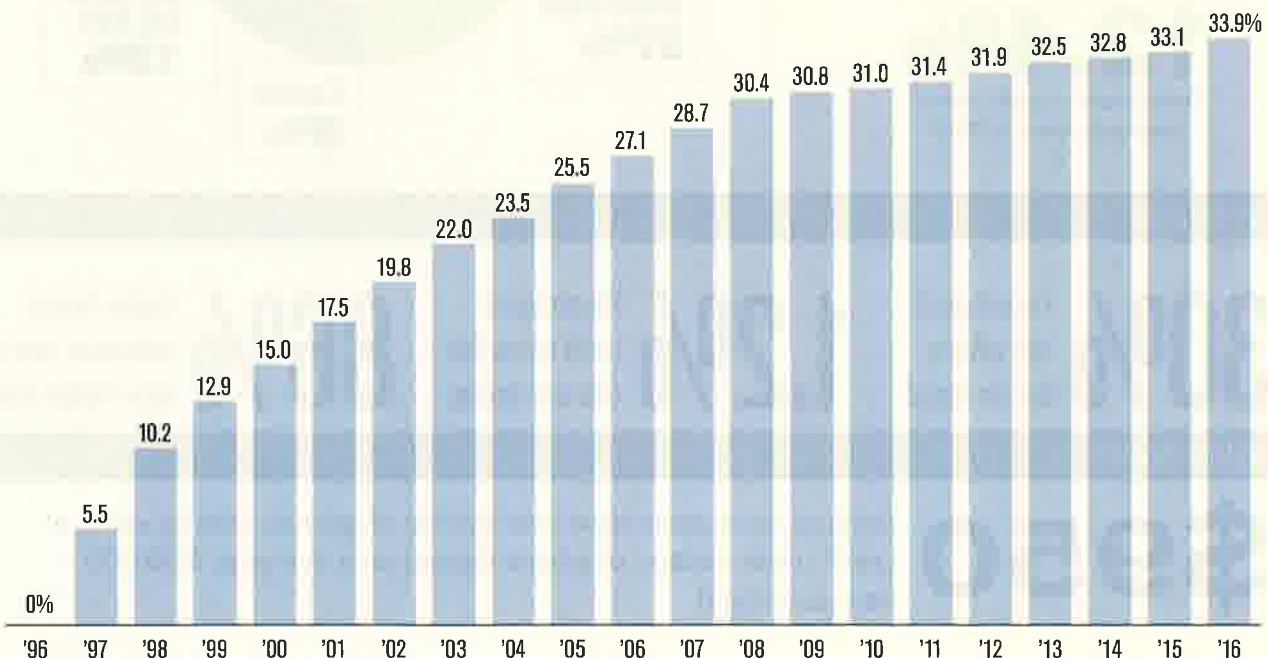
## Percent of U.S. Banks With Subchapter S Status




**Sources:** CUNA and Federal Deposit Insurance Corp.