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| MASSACHUSETTS TAX EXPENDITURES  EVALUATION SUMMARY |
| EVALUATION YEAR: 2020 |

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| **TAX EXPENDITURE TITLE** | Exemption of Credit Union Income |
| **TAX EXPENDITURE NUMBER** | 2.701 |
| **TAX EXPENDITURE CATEGORY** | Exemption against the income measure of the corporate excise |
| **TAX TYPE** | Corporate excise |
| **LEGAL REFERENCE** | IRC, §501(c)(14)(A); M.G.L. c. 63, § 30 |
| **YEAR ENACTED** | Massachusetts – 1909 (Chapter 419 of the Acts of 1909); Federal – 1934 (P.L. 86-354) |
| **REPEAL/EXPIRATION DATE** | None |
| **ANNUAL REVENUE IMPACT** | Tax loss of $21.5 - $26.8 million per year during FY18-FY22 |
| **NUMBER OF TAXPAYERS** | 157 (calendar year 2019) |
| **AVERAGE TAXPAYER BENEFIT** | About $151,600 (calendar year 2019) |

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| **Description of the Tax Expenditure:**  Credit unions are member-owned financial cooperatives. The income of credit unions is exempt from state and federal taxation. However, as with other non-profits, unrelated business income of credit unions is subject to the corporate excise. | **Is the purpose defined in the statute?**  The statute does not explicitly state the purpose of this tax expenditure. |
| **What are the policy goals of the expenditure?**  The expenditure encourages the operation of credit unions, which, unlike other financial institutions, are member-owned, democratically-operated, not-for-profit organizations, generally managed by a volunteer Board of Directors, and have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means. | **Are there other states with a similar Tax Expenditure?**  Income generated by credit unions is exempt from federal taxation and taxation in all states that impose an income tax. |

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| Conclusion/Recommendations: [To be Entered by TERC] |

**INTRODUCTION**

Credit unions, which are member-owned financial cooperatives, are considered tax-exempt organizations for both federal and state income tax purposes and therefore are generally exempt from the income measure of the corporate excise. However, like other nonprofit entities, unrelated business income of credit unions is subject to the income measure of the corporate excise.

In 1909, the enactment of the Massachusetts Credit Union Act (Chapter 419 of the Acts of 1909) authorized the creation of Massachusetts chartered credit unions as tax-exempt entities. In 1934, the enactment of the Federal Credit Union Act, 12 USC § 1751, et seq., authorized the creation of federally chartered credit unions, which are exempt from federal income tax pursuant to 26 USC § 501(c)(14)(a).

**POLICY GOALS**

While the statute does not explicitly state the purpose of this tax expenditure, the expenditure encourages the operation of credit unions, which, unlike other financial institutions, are member-owned, democratically-operated, not-for-profit organizations, generally managed by a volunteer Board of Directors, and have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.

**DIRECT COSTS**

The revenue loss resulting from this expenditure is estimated to be $21.5 - $26.8 million per year during FY18-FY22. See Table 1.

**Table 1. Tax Revenue Loss Estimates for Exemption of Credit Union Income**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Fiscal Year | 2018 | 2019 | 2020 | 2021 | 2022 |
| Estimated Revenue Loss ($Million) | $21.5 | $23.3 | $24.3 | $25.5 | $26.8 |

**DIRECT BENEFITS**

The direct beneficiaries of the incentive are credit unions. Tables 2 and 3 show that, as of the end of 2019, there were 157 credit unions (64 state-chartered credit unions and 93 federally chartered credit unions according to the same data source) in Massachusetts. Except one, all of the credit unions had less than 500 employees. About 69 of them had less than 5 employees. They also had $42.2 billion in total assets, $260 million in net income, 3.2 million in current member, and 6,757 full time employees in Massachusetts. (Custom Querry, n.d.) Table 3 shows that these key metrics have grown by more than 3% every year with a couple of exceptions.

**Table 2. Count of Credit Unions by Range of Employees in Massachusetts**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Number of Employees (2019) | Less than 5 | 5-9 | 10-49 | 50-99 | 100-199 | 200-499 | 500 and more | Total |
| Number of Credit unions | 69 | 18 | 36 | 14 | 12 | 7 | 1 | 157 |

Source: National Credit Union Administration.

**Table 3. Some Key Statistics for Credit Unions in Massachusetts**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Year | | 2015 | 2016 | 2017 | 2018 | 2019 |
| Total Assets | Amount ($Million) | $33,875 | $36,037 | $37,936 | $39,556 | $42,152 |
| Growth (%) |  | 6.4% | 5.3% | 4.3% | 6.6% |
| Net Income (Loss) | Amount ($Million) | $199 | $226 | $244 | $250 | $260 |
| Growth (%) |  | 13.7% | 7.7% | 2.3% | 4.2% |
| Number of Current Members | Count (Million) | 2.7 | 2.8 | $2.9 | 3.1 | 3.2 |
| Growth (%) |  | 4.1% | 4.3% | 4.9% | 3.1% |
| Number of Full Time Employees | Count | 5,893 | 6,004 | 6,260 | 6,538 | 6,757 |
| Growth (%) |  | 1.9% | 4.3% | 4.4% | 3.3% |

Source: National Credit Union Administration.

**EVALUATION: COMPARING COSTS AND BENEFITS**

In the previous sections, we reported the direct costs (to the Commonwealth, or to the residents and businesses who ultimately bear the costs when the Commonwealth cuts government spending or increases taxes to finance the exemption of credit union income) and the direct benefits and beneficiaries (credit unions) of this tax expenditure. However, when looking at the broader economy, there are, in addition to direct impacts, indirect and induced impacts on other residents and businesses in Massachusetts. To determine the total net impact of the tax expenditure, i.e., the total benefits (including direct, indirect and induced benefits) offset by the total costs (including direct, indirect and induced costs), we employed an economic model developed by Regional Economic Models Incorporated (“REMI”).[[1]](#footnote-1) See the appendix for details.

The net impacts of the tax expenditure are summarized in Tables 4 and 5. As shown, the exemption of credit union income, and the corresponding reduction in state government spending because of the balanced budget requirement, result in less economic activities, with real state GDP decreasing by about $20-21 million annually. The net impact on total employment is negative with total employment decreasing by 281 – 308 jobs annually. The impact on state revenues[[2]](#footnote-2) is also negative, resulting in a loss ranging from $0.4 million to $1.1 million annually.

Because the tax expenditure has its own specific purpose, the net negative impacts do not necessarily imply that the tax expenditure is not desirable.

**Table 4. Net Additional Revenue Impact of Exemption of Credit Union Income\***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Fiscal Year | 2018 | 2019 | 2020 | 2021 | 2022 |
| Net additional revenue impact ($000) | -$439 | -$934 | -$996 | -$1,044 | -$1,069 |

\* assuming state government spending is cut by the same amount as the revenue loss due to the credit union income exemption to balance budget.

**Table 5. Net Economic Impacts of Exemption of Credit Union Income**

**by Selected Economic Measure\***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Calendar Year | 2018 | 2019 | 2020 | 2021 | 2022 |
| Impact on total employment | -308 | -298 | -298 | -288 | -281 |
| Impact on private non-farm employment | -47 | -33 | -27 | -16 | -8 |
| Impact on GDP ($000), real dollars (2012) | -$21,000 | -$21,000 | -$21,000 | -$20,000 | -$20,000 |
| Impact on personal income ($000) | -$20,000 | -$21,000 | -$23,000 | -$24,000 | -$24,000 |

\* assuming state government spending is cut by the same amount as the revenue loss due to the credit union income exemption to balance budget.

**Similar Tax Expenditures Offered by Other States**

Section 122 of the *Federal Credit Union Act* (12 U.S.C. § 1768) provides that Federally chartered credit unions are exempt from all federal and state taxes except for local real property and personal property taxes. Furthermore, the overwhelming majority of states do not impose a tax on the income generated by state chartered credit unions. However, a small number of states do tax state chartered credit unions’ income. The following is a non-exhaustive list of states that, similar to Massachusetts, exempt state chartered credit union’s income from taxation: Arkansas, California, Colorado, Kansas, Louisiana, Maine, Mississippi, New Mexico, New York, Oregon, Rhode Island, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, West Virginia. However, most states (including Massachusetts) will tax the unrelated business income or non-income measure of credit unions.

In Maine sales to credit unions that are organized under the laws of that State are exempt from sales tax. This exemption remains in effect only for the time that federally chartered credit unions are, by reason of federal law, exempt from payment of state sales tax.

Vermont offers an exemption on deposits in Credit Unions. Deposits and shares in Vermont state-chartered credit unions are not subject to taxation.

New York offers an exemption from tax for New York State chartered credit unions if they had converted to a state charter from a federal charter on or after January 1, 2006.

California credit unions are exempt from state income and franchise taxes. Since credit unions are nonprofit, membership organizations, only their member income is generally exempt from tax. This provision also exempts their "nonmember" income (such as investment income on excess deposits or miscellaneous sources of income, such as ATM fees charged to nonmembers) from taxation.

Louisiana credit unions are exempt from all taxes except for taxes on immovable property owned. The shares of a credit union are not subject to a stock transfer tax when issued by the corporation or when transferred from one member to another. No fees, taxes, or any of the stipulations as to capital stock set forth in general statutes for corporations apply to credit unions. The purpose of this exemption is to minimize the tax burden on these nonprofit organizations.

**IS THE INCENTIVE AS DESIGNED ACCOMPLISHING ITS PURPOSE?**

[FOR TERC TO COMPLETE]

# References

*Custom Querry*. (n.d.). Retrieved from National Credit Union Administration: https://webapps2.ncua.gov/CustomQuery/CUSelect.aspx

Felix, R. A. (2009, Second Quarter). *Do State Corporate Income Taxes Reduce Wages?,* Economic Review, FEDERAL RESERVE BANK OF KANSAS CITY.

Keith R. Ihlanfeldt, David L. Sjoquist. (2001, August). Conducting an Analysis of Georgia’s Economic Development Tax Incentive Program. *ECONOMIC DEVELOPMENT QUARTERLY, 15*(3), 217-228.

York, E. (2019, October). *Repealing the Federal Tax Exemption for Credit Unions*. Retrieved from Tax Foundation: https://taxfoundation.org/repealing-credit-union-exemption/

**Appendix: Further Discussion on Costs and Benefits**

The text of the report discussed the direct costs (to the Commonwealth, or more specifically, to the Massachusetts residents or businesses who benefit from state expenditures[[3]](#footnote-3)) and direct benefits and beneficiaries (credit unions) of this tax expenditure. It also summarized the indirect and induced costs and benefits associated with this tax expenditure. This appendix will discuss the indirect and induced, as well as other costs and benefits in more detail.

**Other costs and benefits: Indirect and Induced**

*Indirect and Induced Costs*

Regardless of its size, the existence of a specific tax incentive means less revenue for other spending given the Commonwealth’s balanced budget requirement assuming no increase in state revenues. Reduced spending on other expenditure items means forgone benefits from those items. This is an **opportunity cost** to the Commonwealth. The opportunity cost to the state include not only the impact on the businesses and their employees that directly benefit from those expenditure items (this is called “direct impact”), but also the indirect impact on the chain of businesses that provide intermediate products and services to the directly impacted businesses (this is called “indirect impact”). In addition, there is the impact on the chain of businesses that benefit when the employees working for the directly impacted businesses spend their wages and salaries to buy goods and services (this is called “induced impact”). The total forgone benefits to the whole economy are larger than the initial forgone benefits. This phenomenon is called the “Multiplier Effect”.[[4]](#footnote-4)

To estimate the total forgone benefits of the reduced spending, we employed Tax-PI, an economic analysis tool for evaluating the total fiscal and economic effects of tax policy changes. Tax-PI is built on over 30 years of experience in modeling the economic effects of tax policy changes, according to MODELS: TAX-PI in the reference. The popularity of the model has grown substantially since it was introduced. Note that while the tax incentive is for a specific purpose, the reduced spending is assumed to be made according to the current composition of the Commonwealth’s expenditure.

*Quantifying total costs (direct, indirect and induced)*

The period of study is limited to the five years from 2018 through 2022, for which we prepared input data to run the model. Tables A1 and A2 report the model results. The figures for 2018 and 2019 are estimates of forgone benefits (opportunity costs) that the Massachusetts economy experienced due to having the expenditure, and those for 2020, 2021 and 2022 are projections of forgone benefits that the Massachusetts economy will experience going forward. The effects are displayed as negative numbers as reduced spending has a negative impact on the state economy.

Tables A1 and A2 show that, the reduction in state government spending results in lost economic activities, with real state GDP declining by $52 million-$59 million and total employment declining by 607 – 668 jobs annually. Lost economic activities result in further loss of state revenues, ranging from $1.1 million to $3.3 million annually. Note that the revenue impact reported in Table A1 does not include the estimated direct impact of the tax expenditure from Table 1, but only the additional indirect and induced impact.

**Table A1. Additional Revenue Impact due to Decreased Government Spending\***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Fiscal Year | 2018 | 2019 | 2020 | 2021 | 2022 |
| Additional revenue impact ($000) | -$1,118 | -$2,461 | -$2,810 | -$3,100 | -$3,272 |

\* This table reports the lost revenues from the foregone economic activities as the state reduced government spending to finance the exemption of credit union income.

**Table A2. Economic Impacts due to Decreased Government Spending by Selected Economic Measure\***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Calendar Year | 2018 | 2019 | 2020 | 2021 | 2022 |
| Impact on total employment | -607 | -630 | -668 | -661 | -647 |
| Impact on private non-farm employment | -335 | -347 | -369 | -360 | -345 |
| Impact on GDP ($000), real dollars (2012) | -$52,000 | -$55,000 | -$59,000 | -$59,000 | -$59,000 |
| Impact on personal income ($000) | -$44,000 | -$50,000 | -$58,000 | -$62,000 | -$64,000 |

\* This table reports the lost economic activities as the state reduced government spending to finance the exemption of credit union income.

*Indirect and Induced Benefits*

The incentive aims to reduce the costs of operating businesses, which in turn encourages the directly affected businesses to invest, expand, hire additional workers, etc. Such decisions would increase demand for goods and services provided by other individuals and businesses in the economy, or put another way, generate a “Multiplier Effect” (see discussion in the previous section) from the initial or direct benefits as reported in the text. As a result, the total benefits of the tax credit would be larger than the initial or direct benefits.

*Quantifying total benefits (direct, indirect and induced)*

To quantify the total benefits, including indirect and induced benefits, we again employed Tax-PI. A summary of the revenue impact of the exemption is reported in Table A3, and the economic benefit from the exemption is reflected in Table A4 below. The figures for 2018 and 2019 are estimates of benefits that the Massachusetts economy experienced and those for 2020, 2021 and 2022 are projections of the benefits that the Massachusetts economy will experience going forward.

Tables A3 and A4 show that the credit union income exemption results in more economic activities, with real state GDP increasing by $31 - $39 million and total employment increasing by 299 – 373 jobs annually. More economic activities result in more state revenues, ranging from $0.7 million to $2.2 million annually, which partially offsets the cost of this tax incentive.

**Table A3. Additional Revenue Impact of Exemption of Credit Union Income**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Fiscal Year | 2018 | 2019 | 2020 | 2021 | 2022 |
| Additional revenue impact ($000) | $679 | $1,527 | $1,814 | $2,056 | $2,203 |

**Table A4. Economic Impacts of Exemption of Credit Union Income**

**by Selected Economic Measure**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Calendar Year | 2018 | 2019 | 2020 | 2021 | 2022 |
| Impact on total employment | 299 | 332 | 370 | 373 | 366 |
| Impact on private non-farm employment | 288 | 314 | 342 | 344 | 337 |
| Impact on GDP ($000), real dollars (2012) | $31,000 | $34,000 | $38,000 | $39,000 | $39,000 |
| Impact on personal income ($000) | $24,000 | $29,000 | $35,000 | $38,000 | $40,000 |

**Comparison of costs and benefits**

If we don’t consider the opportunity cost of the tax incentive, total benefits are greater than costs. Considering the opportunity cost means asking what benefits would occur if the Commonwealth used the tax incentive for other purposes. There can be numerous other purposes and examining them is beyond the scope of the current evaluation report. Nonetheless, we reported net impacts of the tax incentive in Tables A5 and A6 below under the balanced budget requirement, which are the combined effects in Tables A1-A4.

Tables A5 and A6 show that the exemption of credit union income combined with a cut in state government spending results in less economic activities, with real state GDP decreasing by about $20-21 million annually. The net impact on total employment is negative with total employment decreasing by 281 – 308 jobs annually. The impact on state revenues is also negative, decreasing from $0.4 million to $1.1 million annually.

Because the tax expenditure has its own specific purpose, the net negative impacts do not necessarily imply that the tax expenditure is not desirable.

**Table A5. Net Additional Revenue Impact of Exemption of Credit Union Income \***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Fiscal Year | 2018 | 2019 | 2020 | 2021 | 2022 |
| Net additional revenue impact ($000) | -$439 | -$934 | -$996 | -$1,044 | -$1,069 |

\* assuming state government spending is cut by the same amount as the revenue loss due to the credit union income exemption to balance budget.

**Table A6. Net Economic Impacts of Exemption of Credit Union Income**

**by Selected Economic Measure\***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Calendar Year | 2018 | 2019 | 2020 | 2021 | 2022 |
| Impact on total employment | -308 | -298 | -298 | -288 | -281 |
| Impact on private non-farm employment | -47 | -33 | -27 | -16 | -8 |
| Impact on GDP ($000), real dollars (2012) | -$21,000 | -$21,000 | -$21,000 | -$20,000 | -$20,000 |
| Impact on personal income ($000) | -$20,000 | -$21,000 | -$23,000 | -$24,000 | -$24,000 |

\* assuming state government spending is cut by the same amount as the revenue loss due to the credit union income exemption to balance budget.

**Other unquantified costs and benefits**

Besides the additional costs and benefits quantified in the previous sections, there are other costs and benefits that are hard to quantify due to lack of data or other challenges. In this section we will enumerate some of these costs and benefits.

Ihlanfeldt and Sjoquist (2001), a published study for the state of Georgia summarizes some of other costs and benefits as follows:

*Loss of competitiveness.* Providing tax incentive such as credits to selected firms may diminish the competitiveness for existing similar firms. In this case, credit unions have a significant competitive advantage compared to other financial institutions because of the exemption.

*Compliance costs.* The authors think that the costs to the firm may be substantial in general. However, the exemption applies to the entire income of credit unions, and the compliance costs should be virtually none or very little.

*Improved business climate.* Tax incentive improves the perception of the business climate in the state and is used by site location specialists in screening alternative sites.

*Synergistic or clustering effects.* Tax incentive may attract a firm in an industry new to the state, which then serves as a magnet for attracting additional firms in the industry.

On the other hand, York (2018), an article from Tax Foundation, pointed out that while the exemption was justified on the grounds that credit unions would serve customers of moderate means, restrict their customer base to people with a common bond, and provide services that were difficult to obtain at banks, nowadays the common bond weakened, anyone can join a credit union, and many services now offered by credit unions resemble those offered by banks.

Another hard to quantify cost is the administrative cost. The administrative cost attributable to this incentive should be relatively small because the Department of Revenue administers the exemption with existing staff as part of its overall mission.

**Other issues related to costs and benefits**

The burden of a tax does not necessarily fall on those responsible for remitting the tax. It is known through economic theories that corporate taxes change the allocation of capital between corporations and noncorporate businesses and among states because capital would flee from states of higher corporate taxes if all other considerable factors are not significantly different.

Felix (2009) finds that labor bears a significant burden from the state corporate tax in the form of lower wages. Her study further suggests that a one-percentage-point increase in the marginal state corporate tax rate reduces wages by 0.14% to 0.36%, that labor’s burden from the state corporate tax has trended upward over time due to increased global competition and increased competition among states to attract businesses, and that state corporate taxes reduce the wages of highly educated workers more than that of less-educated workers.

The exemption of credit union income is significant to the direct beneficiaries. Hence, the findings imply that the incentive may have benefited workers who were employed by the unions in the form of higher wages. The incentive may have further benefited the members and clients of the credit unions due to the growth of businesses.

1. Regional Economic Models Inc. is a recognized leader in economic analysis at the state level. See their website for background information and further details: <https://www.remi.com/>. [↑](#footnote-ref-1)
2. Including both tax and non-tax revenues but excluding the revenue loss reported in Table 1. [↑](#footnote-ref-2)
3. Spending on a specific tax incentive means less spending on other expenditure items for the Commonwealth under balanced budget requirement if there is no increase in state revenues. Reduced spending on other expenditure items means forgone benefits from those items. This is an opportunity cost to the Commonwealth, which, more specifically, is borne by the Massachusetts residents or businesses who benefit from those expenditure items. [↑](#footnote-ref-3)
4. For an illustration of “Multiplier Effect”, see Slide 4 of: <https://www.ilw.com/seminars/JohnNeillCitation.pdf> [↑](#footnote-ref-4)