



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

LS/HMU:cch

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JUN 21 1985

Ms. Marian L. Perrin
President-Manager
Safeway Kansas City Employees
Federal Credit Union
4420 Madison Avenue
Kansas City, MO 64111

Dear Ms. Perrin:

This is in response to your letter of May 13, 1985, concerning the tax-exempt status of Federal credit unions.

As noted in one of the enclosures to your letter, you corresponded with Wil Theard of NCUA's Department of Supervision and Examination. Mr. Theard responded with a letter to you dated May 8, 1985, signed by D. Michael Riley. As Mr. Riley noted in his letter, Federal credit unions are exempt from certain taxes (for example, sales tax) pursuant to Section 122 of the Federal Credit Union Act (12 U.S.C. §1768). Case law has supported this exemption (see United States v. Maine, 524 F.Supp. 1056 (D.Me. 1981)). Mr. Riley also noted that Federal credit unions are exempt from Federal income taxes and that NCUA files a consolidated informational return for all Federal credit unions.

I have enclosed a copy of Mr. Riley's letter, as well as an explanation of the tax exemption for Federal credit unions found in Credit Union Law Service, a publication of Matthew Bender and the Credit Union National Association. These should help to explain this matter further.

I hope that we have been of assistance. If you have additional questions, please feel free to contact Hattie Ulan of this Office.

Sincerely,

STEVEN R. BISKER
Assistant General Counsel

Enclosures

FOIA file: Vol. V, B - Taxation



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MAY 8 1985

Ms. Marian L. Perrin, President-Manager
Safeway Kansas City Employees Federal
Credit Union
4420 Madison Avenue
Kansas City, Missouri 64111

Dear Ms. Perrin:

This is in response to your letter regarding your efforts to verify that federal credit unions are exempt from sales tax.

Federal credit unions have been held to be federal instrumentalities for tax purposes, United States v. Maine, 524 F. Supp 1056 (D. Me. 1981), and their Constitutional immunity from a state sales tax (where the legal incidence falls on them) has been confirmed by statute, 12 U.S.C. 1768.

Additionally, each year this office files with the Director, Internal Revenue Service, Philadelphia, Pennsylvania, a consolidated Form 990, Return of Organization Exempt from Income Tax, for all federal credit unions.

If you need further assistance, please contact us.

Sincerely,

A handwritten signature in dark ink, appearing to read 'D. Michael Riley'.

D. MICHAEL RILEY
Director, Office of Programs

cc: Regional Director
Region IV (Chicago)

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CHAPTER 7

Federal Taxation and Credit Unions

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§ 7.01 Background and Summary of Federal Tax Treatment of Credit Unions

Federal credit unions are exempt from federal and state income taxes and directly imposed excise taxes. State credit unions are exempt from federal income taxes and most states exempt them from state income tax. All credit unions are subject to federal social security and unemployment insurance taxes, are required to withhold 20 percent of dividends paid to member if social security number is incorrect, and may be custodians or trustees for IRA accounts.

Credit unions are a unique type of cooperative financial institution. They are formed by groups of people with a common bond. The tie that the credit union's members share may be the same employer or occupation, or it may be membership in the same union or religious institution. In any event, membership in the credit union is limited to the particular group or groups involved. A credit union gives its members a place to invest their funds and makes loans to members at below market interest rates. Member's savings are known as "shares" and are listed on the books of the credit union as "share accounts."

Due to this non-profit cooperative nature, federal credit unions are exempt from both federal and state income taxes by virtue of the Internal Revenue Code (IRC § 501(c)) and the Federal Credit Union Act. (FCUA § 122) Federal credit unions are also exempt from directly imposed excise taxes, such as those levied on telephone or telegraph services, but they are liable for retailers' or manufacturers' excise taxes. State credit unions are exempt from fed-

eral income taxes, in addition to whatever exemptions are accorded to them under state law. Most states exempt state credit unions from state income tax. However, all credit unions are subject to federal social security and unemployment insurance taxes. State chartered credit unions may also be subject to a tax on unrelated business income.

In order to be tax exempt, a credit union must come squarely within the terms of the statute and it must file a written application with the director of the Internal Revenue Service (Service) district in which its principal office or place of business is located.

Once a tax exemption is granted, it continues indefinitely. Credit unions are required to file an annual information return and must keep permanent books and records to justify their returns. These returns must show any items of gross income, receipts and disbursements, and are due on or before the 15th day of the fifth calendar month following the close of the period for which the return is filed. Failure to file may result in loss of the exemption. However, a group return may be filed on behalf of federal credit unions by the National Credit Union Administration (NCUA) and on behalf of state chartered credit unions by state credit union agencies.

In certain situations, credit unions may be required to withhold 20 percent of the dividends they pay to a member. This procedure, known as "backup withholding" is triggered when a member's account contains an incorrect social security number or if such a number is missing entirely. Credit unions are subject to a \$50 penalty each year for any missing or incorrect taxpayer identification number they use when dealing with the Service unless they exercise "due diligence" in trying to verify the number.

An Individual Retirement Account (IRA) is a savings device that allows members to accumulate money for their retirement. A credit union may serve as a custodian or trustee for such accounts. Credit unions that function in either of these capacities are entitled to reasonable compensation for their services. Payments to an IRA are tax deductible, while tax on its earnings is deferred until such earnings are distributed to the member, which typically occurs after the member has retired and is in a lower tax bracket. Members are eligible to set up IRAs whether or not they are active participants in any other retirement plan.

§ 7.02 Tax-Exempt Status of Credit Unions

Federal credit unions are exempt from federal and state income taxes and directly imposed excise taxes. State credit unions are exempt from federal income tax. Most states exempt them from state income tax. All credit unions are subject to social security, medicare, unemployment insurance and unrelated business income taxes. State, unlike federal, credit unions must file application for exemption. Ruling or determination letter is issued if criteria are met.

[1]—Scope and Rationale of the Exemption

Federal credit unions are exempt from federal and state income taxes. (IRC § 501; FCUA § 122) They are also exempt from directly imposed excise taxes such as those on telephones, telegraph, radio and cable services. Credit unions, however, are liable for retailer's or manufacturer's excise taxes as well as social security, medicare and unemployment insurance taxes. Although state credit unions are generally exempt from federal income tax, they are liable for federal social security, medicare and unemployment insurance taxes. Most state statutes exempt state credit unions from state income tax. (See Ch 8, *infra*, for a state-by-state summary of credit union taxation). An important exception to these federal taxation provisions is the tax on unrelated business income that may be imposed on state credit unions. (IRC § 511)

There are many reasons behind the exemption from taxes given to credit unions. They are afforded this treatment because of their cooperative nature. The members of a credit union truly own and control the credit union and they share in its distributed income as well as in any retained reserves at the credit union's dissolution. They share in the income of the credit union because it is their savings that make it possible to earn such income. In addition, credit unions are organized and operated on a nonprofit basis. All income after expenses and required reserves must be returned to the members whose savings made the income possible. Credit unions are generally small in size because of the restrictions on membership, so their total assets are frequently limited. The directors and committee members who manage the credit union generally serve without compensation. By statute, no officer, other than the treasurer may be compensated for his services. (FCUA § 112) Credit union members receive personal loans at interest rates that are often lower than the prevailing market rates, regardless of how small the loan is. As well as providing affordable credit, credit unions foster systematic savings, and aid members in the management of their own money.

Credit unions are self-supporting entities because the cost of government regulation is offset by annual operating fees imposed on the credit unions. The NCUA is totally supported by such fees. On the local level, credit unions pay real and personal property taxes that are used to support community ac-

tivities. The statutory concept of credit unions contemplates a common bond, voluntary service by management, limited expenses, and tax exemptions in order to extend low cost loans to the members. These characteristics also justify the tax-exempt status of credit unions. (Rev Rul 72-37, 1972-1 CB 152); (La Caisse Populaire Ste Marie (St Mary's Bank) v US, 563 F2 505 (1st Cir 1977) affg 425 F Supp 512)

[2]—How to Obtain the Exemption

Credit unions are tax exempt if they lack capital stock and are organized for mutual purposes and without profit. (IRC § 501(c)(14)(A)) Federal credit unions do not have to apply to the Service to receive tax exempt status. State credit unions that seek the exemption are required to file an application for exemption with the director for the Service district in which the credit union's principal office or place of business is located. Oral requests for an exemption will not be considered.

Although the Service does not mandate the use of a specific form, the application must list the state and date of the credit union's incorporation and must also show that the state's credit union law with respect to loans, investments and dividends is being obeyed. Conformed copies of the credit union's articles of incorporation, by-laws, and an annual statement of receipts and expenditures and balance sheet for the current year and the three most recent prior years must be included in the application.

The Service has agreed to the use of an exemption application by state credit unions, which, if properly completed, is acceptable without copies of the articles of incorporation, by-laws and financial statements. (Rev Proc 56-2, 1956-I CB 1017) This form appears as follows:

Date

CLAIM FOR EXEMPTION FROM FEDERAL INCOME TAX

The undersigned Credit Union, Inc.
(Complete name)

..... a credit union operating under
(Complete address, including street & number)

the credit union law of the State of claims exemption from Federal income tax and supplies the following information relative to its operation:

- (1) Date of incorporation
- (2) It was incorporated under the credit union law of the State of
....., and is being operated under uniform bylaws adopted by said State.
- (3) In making loans the State credit union law requirements including their purposes, security, and rate of interest charged thereon, are complied with.