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April 15, 2015

The Honorable John Thune  
Business Income Tax Working Group  
Committee on Finance  
U.S. Senate  
Washington, D.C. 20510

The Honorable Ben Cardin  
Business Income Tax Working Group  
Committee on Finance  
U.S. Senate  
Washington, D.C. 20510

Dear Senator Thune and Senator Cardin:

On behalf of the more than 6,000 community banks represented by ICBA, which are organized in a variety of forms, including mutuals and C and S corporations, I would like to express our strong support for tax reform and to thank you for your dedicated and persistent efforts in this regard. Done correctly, tax reform could help strengthen the economy and provide relief to the millions of individuals and small businesses served by community banks. We appreciate how very challenging it is to reform the tax code, and we are committed to continuing to work with you as the process unfolds. I would also like to use this opportunity to reiterate the principles we believe are essential components of any tax structure.

**Preservation of the Subchapter S Business Model.** More than 2,000 community banks, approximately one third of all banks, are organized under Subchapter S of the tax code. Any reforms to the tax code should not only preserve this model, but help strengthen it as well. Corporate and individual tax reform should be undertaken together, not separately. Decoupling individual and corporate tax reform is potentially harmful to Subchapter S community banks as well as the thousands of small businesses organized as pass through organizations that community banks serve.

Additionally, the top individual margin rate should be held in approximate parity with the top corporate rate so that the Subchapter S model is not disadvantaged relative to the C corporation model. Further, tax reform should be used to enhance the viability of the Subchapter S model by: raising the shareholder limit to 200, allowing Subchapter S banks to issue preferred shares, and allowing Subchapter S shares to be held in an IRA. These reforms would allow Subchapter S banks to meet regulators' persistent demands for higher capital levels.

**Business Interest Deduction.** The vast majority of small businesses do not have access to equity markets and rely on debt financing. Any change in the deductibility of interest on business debt would be extremely disruptive to these businesses which play a disproportionate role in job creation. Tax reform should preserve the ability of businesses to deduct interest expense.

*The Nation's Voice for Community Banks.®*

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**Opposition to New Commercial Bank Taxes.** ICBA has consistently opposed new taxes or fees specifically targeting the commercial banking sector or their customers. In our view, tax policy should be neutral and not target a specific industry sector. Sector-specific taxes distort the market and generate counterproductive outcomes. Even when such taxes exempt community banks, they set a troubling precedent: Once the tax code is opened up to target a specific sector it is difficult to contain the size, scope, and broader application of the tax.

**Promote Savings and Investment.** Tax reform should work to increase private savings and investment. The current tax code discourages or even punishes savings and investment with double or even triple taxation. A superior tax system would promote savings not punish it.

**Bank Qualified Bonds.** Community banks are invested in their local communities. One tool that allows them to effectively serve these communities is bank qualified municipal bonds. Created through the Tax Reform Act of 1986, bank qualified bonds allow local governments and municipalities to directly place their debt with community banks. The banks are then able to deduct a percentage of the carrying costs for purchasing these bonds. As a result, local governments save up to 50 basis points on borrowing costs that go to fund key infrastructure projects like building roads and schools. However, the 1986 legislation capped the annual issuer limitation at \$10 million and did not index it for inflation. The annual issuer limitation was briefly raised to \$30 million, but expired at the end of 2010. We advocate for the \$30 million limitation to be restored and made permanent.

**Credit Union and Farm Credit System Tax Exemptions.** Tax reform is a prime opportunity for review of the controversial tax exemption enjoyed by the credit unions and the Farm Credit System (FCS). Credit unions are becoming harder and harder to distinguish from the taxpaying banks with which they compete directly. Their efforts to raise the statutory cap on credit union commercial lending, if successful, would further blur that distinction. Most importantly, the credit union tax exemption comes at a significant cost to taxpayers. The most comprehensive estimate to date, done by the independent Tax Foundation, valued the tax subsidy at \$31.3 billion over 10 years<sup>1</sup>. The Debt Reduction Task Force of the Bipartisan Policy Center, chaired by former Senator Pete Domenici and former OMB Director Alice Rivlin, considered eliminating the tax exemption for credit unions. The Joint Committee on Taxation, the Office of Management and Budget, and the Congressional Budget Office (CBO) have all identified the credit union subsidy as a growing tax expenditure.

The FCS has continued to grow rapidly, doubling their loan volume in the past decade, and now has \$282 billion in assets. With over \$4.7 billion in net profits in 2014, the FCS paid only \$220 million in taxes, an effective tax rate of 4.5 percent. Many of the associations of the FCS are large, multi-billion dollar entities that compete with much smaller community banks. The FCS regulator, the Farm Credit Administration (FCA), recently issued guidance that allows FCS lenders to make non-farm loans provided they are labeled “investments.” The FCA has refused

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<sup>1</sup> “Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions.” Tax Foundation. February 28, 2005. URL: <http://taxfoundation.org/article/competitive-advantage-study-federal-tax-exemption-credit-unions>

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to answer basic questions about this guidance. The FCS's GSE status allows them to access funds from Wall Street at a subsidized rate only slightly above the Treasury's cost of borrowing. There is no policy rationale for continuing tax exemptions for mature, profitable multi-billion dollar entities that compete with community banks offering the same or similar products and services to the same customers.

Thank you again for your commitment to sensible, growth-oriented tax reform.

Sincerely,

/s/

Camden R. Fine  
President & CEO

CC: Members of the Senate Finance Committee Business Income Working Group

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