



# ***CUNA Issue Summary***

## **LIMITED LIABILITY COMPANY (LLC) BANKS**

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**ISSUE:** A Limited Liability Company (LLC) is a government authorized company that combines protection from individual liability like a corporation with the pass-through tax treatment of a partnership. That is, “members” are taxed individually on the company’s income.

An LLC bank is subject to fewer restrictions than a traditional corporate bank or a Subchapter S bank. For example, a Subchapter S corporation may have no more than 100 shareholders, only one class of stock, and no nonresident alien shareholders. An LLC has no such restrictions and allows for increased flexibility to allocate income or losses to different investors. In addition, LLC membership is unlimited and may include not only individuals, but also corporations and other LLCs. In 2003, the Federal Deposit Insurance Corporation (FDIC) ruled that state-chartered LLC banks were eligible for federal deposit insurance if they met the Corporation’s safety and soundness criteria.

Some banks have organized as LLCs as the regulation and potential tax status is more preferable than other forms of corporate organization. Many states have enacted laws to allow banks to organize as LLCs. That number can be expected to increase if the Internal Revenue Service (IRS) approves pass-through federal taxation status for state-chartered LLC banks.

The number of LLC banks would explode if Congress passes legislation that would allow national banks to organize as LLCs. In 2006, the House of Representatives passed the *Financial Services Regulatory Relief Act* (H.R. 3505), that would have allowed banks to organize as LLCs. The bill was supported by CUNA because it included regulatory relief not only for banks, but also credit unions and thrifts. The final version of the bill that was enacted into law did not include the provision that would have allowed national LLC banks (Sec. 109 of the House-passed bill).

**CUNA POSITION:** CUNA does not oppose the efforts of the banking industry to expand its tax benefits. CUNA does point out, however, the hypocrisy of the banking industry that on one hand seeks to impose additional taxes on credit unions while, on the other hand, aggressively lobbies to increase tax advantages for banks.

**STATUS/OUTLOOK:** It is expected that the banking industry will continue to pursue expansion of the Limited Liability Company rules to allow banks to organize as LLCs. In fact, on December 21, 2005, Senators Mike Crapo (R-ID), Orrin Hatch (R-UT), Jim Bunning (R-KY), and Blanche Lincoln (D-AR) signed a joint letter to former Treasury Secretary John Snow urging him to call on the IRS to recognize LLC banks. That letter was similar to one authored by Hatch and former Senators Gordon Smith (R-OR) and John Breaux (D-LA) in July of 2004. This demonstrates bipartisan Congressional interest in advancing this issue for the banking industry.

Also, the banker-backed *Communities First Act* (H.R. 1869 and S. 1405) was reintroduced in Congress on April 17, 2007 and in the Senate on May 16, 2007. It proposed giving FDIC-insured LLC banks pass-through entity federal tax treatment. On April 17, 2008, Rep. Dennis Moore (D-KS) introduced legislation titled the *Bank and Thrift Regulatory Relief Act of 2008* (H.R. 5841). Two major provisions of the bill would have allowed national banks and federal savings associations to organize as LLCs.

On December 8, 2005, the Congressional Budget Office (CBO) estimated that this proposal, included in H.R. 3505, the *Financial Services Regulatory Relief Act of 2005*, would reduce federal revenue by \$18 million over 10 years. At the time, CBO stated, “*Income earned by banks taxed as C corporations is subject to the corporate income tax, and post-tax income distributed to shareholders is taxed again at individual income tax rates. Income earned by partnerships—like that earned by S corporations—is taxed only at the personal income-tax rates of the partners and is not subject to the corporate income tax. The average effective tax rate on partnerships is lower than the average effective tax rate on C-corporation income but is similar to the average effective tax rate on S-corporation income.*”

On July 11, 2008, Senators Blanche Lincoln (D-AR) and Orrin Hatch (R-UT) introduced the *Small Bank Tax Equity Act*. It would allow pass-through federal tax status for state chartered LLC banks. No similar legislation has been introduced in the 111<sup>th</sup> Congress.

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