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THE IMPACT OF THE 12% RESERVE INCOME TAX PROVISION UPON THE BANKING STRUCTURE

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ORDINARILY, it is difficult, if not almost impossible, to measure with any degree of accuracy the impact of a tax provision upon an industry. This is often so even after years of experience under it. Moreover, with few exceptions, it is an unusual tax provision that shapes the fundamental practices and competitive relationships within an industry, unless it is purposely directed to that end as a matter of policy, and, even then, it may (and frequently does) fail of its objective. Section 593 of the Internal Revenue Code of 1954[1] is unique in all these respects; on its face—a provision for a bad debt reserve—it does not appear extraordinary. Nonetheless, it has had a strong impact upon banking practices and the banking structure of the nation, and upon competitive relationships within that structure. However, its impact has *not* been the one contemplated by Congress: the section's greatest uniqueness lies in its success in achieving the opposite of the congressional objectives for its enactment.

Section 593 first appeared in the Revenue Act of 1951.[2] This act removed the tax exemption traditionally enjoyed by mutual banking institutions—mutual savings banks and savings and loan associations—and provided for their taxation on the same general basis as corporations. Provision also was made by language now appearing in section 593 for the deduction of "Additions to Reserve for Bad Debts" of these institutions. It provided that building and loan associations, and mutual savings banks and cooperative banks without capital stock might deduct for federal income tax purposes a reasonable addition to a reserve for bad debts up to the point it equals "12% of the total deposits or withdrawable accounts of its depositors." In effect, section 593 freed these various mutual institutions of federal income tax until their reserve for bad debts exceeded 12 percent of deposits.

Prior to the Revenue Act of 1951 the mutual institution

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1 68A Stat. 205, 26 U.S.C. (Supp. IV, 1957) §593.

2 65 Stat. 490-491 (1951).

historically had been exempt from federal income taxation, largely due to its semi-philanthropic purpose and its mutual form of organization. In the Act of 1863,[3] the Tariff Act of 1894,[4] and the Excise Tax Act of 1909,[5] the mutual institution had been tax exempt. Following the Sixteenth Amendment, the Revenue Act of 1913 provided that ". . . nothing in this section shall apply to . . . mutual savings banks not having a capital stock represented by shares. . . ."[6] This same language appeared in all subsequent revenue acts until that of 1951.[7]

The mutual savings bank had first been established in the early part of the nineteenth century. Its purpose was to encourage persons with low incomes to save and thereby to develop thrift habits in the hope that these persons then would less likely become objects of public charity during periods of economic depression. A mutual savings bank has no capital stock; theoretically the depositors are the owners of the bank. It is managed on their behalf by a self-perpetuating board of trustees. The depositors control neither the selection of the trustees nor the policies of the bank.

Today mutual savings banks are a very important part of the national banking structure. Mutual savings banks now operate in seventeen states.[8] At the end of 1956, the nation's 527 mutual savings banks had time deposits of $30,001 millions and total assets of $33,311 millions[9] and served over twenty million depositors.

The savings and loan association had equally humble beginnings. Originally formed by private individuals of moderate means under the name of building and loan associations, it was contemplated that periodic deposits by all members would permit a few at a time to borrow and thereby to purchase homes until eventually each member in the association would be able to own his own home. Typically the savings and loan association is a non-stock corporation. Deposits are known as shares to indicate the original proprietary interest of the depositor.

Like the mutual savings bank, the savings and loan associa-

3 12 Stat. 712 (1863).

4 28 Stat. 556 (1894).

5 36 Stat. 112, 113 (1909).

6 38 Stat. 172 (1913).

7 65 Stat. 490-491. It appeared in §101(2) of the Internal Revenue Code of 1939.

8 SAVINGS BANKS TRUST CO., SAVINGS BANKS FACT BOOK, 1956, p. 121.

9 FEDERAL RESERVE BUL. 667 (June 1957). For the states in which the banks operate and the amount of deposits in each state, see U.S. SAVINGS AND LOAN LEAGUE, SAVINGS AND LOAN FACT BOOK, 1957, p. 13.

tion has had an amazing growth, and, in fact, one which surpassed that of the savings bank. At year-end 1956, approximately twenty million persons held share accounts totalling $37,302 millions[10] in the nation's 6,100 savings and loan associations.[11]

Ordinarily, mutuals have somewhat less operating authority than commercial banks. In general, the mutual institution does not provide consumer credit, business loans, or checking accounts. On the other hand, mutual savings banks alone of these institutions may sell bank life insurance. A distinction also is often drawn between the size and types of loans the various institutions properly may make. In the past few decades periodic grants of operating authority have been made to mutual institutions, which, in the aggregate, have made a fundamental change in the original character and services of these institutions and which have intensified their competitive pressure upon other banking institutions.

Legislative Background of Section 593

The Revenue Act of 1951, which eliminated the tax exemption of the mutual institution, was a war measure. It was designed "to provide extraordinary increases in revenues to meet essential national defense expenditures" caused by "the military action in Korea, coupled with the general threat to world peace."[12] Income tax rates were increased and additional sources of revenue sought. One source was certain organizations then exempt from taxation under section 101 of the applicable Internal Revenue Code of 1939. Among these were the mutual banking institutions.

The original House bill contained no provision for their taxation;[13] the provision first appeared in the Senate. In its Report accompanying the House bill, the Senate Committee on Finance stated that the exemption of these institutions should be removed in view of their size, the need for revenue, and the tax discrimination between these institutions and the commercial banks and life insurance companies with whom they actively competed.[14]

10 FEDERAL RESERVE BUL. 677 (June 1957).

11 U.S. SAVINGS AND LOAN LEAGUE, SAVINGS AND LOAN FACT BOOK, 1957, p. 41. The average balance was $1,875 against one of $1,356 five years ago. Id. at 46.

12 H. Rep. 586, 82d Cong., 1st sess., 1, 1951-2 Cum. Bul. 357.

13 H.R. 4473, 82d Cong., 1st sess. (1951).

14 S. Rep. 781, 82d Cong., 1st sess., 1951-2 Cum. Bul. 458, 473-478.

> "At the present time, mutual savings banks are in active competition with commercial banks and life insurance companies for the public savings, and they compete with many types of taxable institutions in the security and real estate markets. As a result your committee believes that the continuance of the tax-free treatment now accorded mutual savings banks would be discriminatory. So long as they are exempt from income tax, mutual savings banks enjoy the advantage of being able to finance their growth out of earnings without incurring the tax liabilities paid by ordinary corporations when they undertake to expand through the use of their own reserves. The tax treatment provided by your committee would place mutual savings banks on a parity with their competitors."[15]

The Senate Report also referred to the tax exempt status of savings and loan associations under section 101(4) of the applicable Internal Revenue Code of 1939. It stated that, like the mutual savings bank, few savings and loan associations retained the true substance of their earlier mutuality.

> "The steady decline in the proportion of share-accumulation loans is evidence that the character of these organizations has changed. More and more, investing members are becoming simply depositors, while borrowing members find dealing with a savings and loan association only technically different from dealing with other mortgage lending institutions in which the lending group is distinct from the borrowing group. In fact, borrowers ordinarily have very little voice in the affairs of most savings and loan associations."[16]

The Senate Report provided for taxation of mutual banks "in the same manner as ordinary corporations."[17] It would also permit, "as in the case of other banks," the deduction of "amounts credited to a reasonable reserve for bad debts."[18] Suggestion had been made that, instead of the deduction of a "reasonable" reserve, mutuals should "be taxed only on their net income in excess of some 'specified reserve.'"[19] The Senate rejected the suggestion. Mutual institutions should be treated in the same general fashion as commercial banks.

[15] 1951-2 Cum. Bul. 476.

[16] Id. at 477. It further stated that the reasons for taxing these associations "after making a reasonable allowance for additions to reserves for bad debts, are the same as those on which mutual savings banks are taxed under the bill." Id. at 478.

[17] Id. at 474.

[18] Ibid.

[19] Id. at 476.

A commercial bank then deducted as a bad debt allowance an amount determined by its loss experience based upon a 20-year moving average. The Senate Report contemplated that this general type of formula should be applied to mutual savings banks after adopting it for their "historical loss experience."[20] This treatment, the report stated, would afford a deduction "at least as generous" as that accorded commercial banks.[21]

In conference, the managers on the part of the House agreed in principle with the Senate amendment to the original act eliminating the exempt status of the mutual institution. The House receded with an amendment, however. Instead of agreeing to the fluid test of a "reasonable" addition to a reserve for bad debts, as proposed by the Senate, the 12 percent reserve provision was substituted.[22] The move for a "specified" reserve, earlier rejected by the Senate Committee,[23] had carried in conference.

The Accomplishment of Legislative Purpose

One method of measuring the success or failure of an enactment is to determine whether it achieved the purposes for which it was enacted. Together with that of raising revenue, let us consider the factors which motivated the taxation of mutual institutions and passage of section 593 to determine whether in this sense it has succeeded.

20 Id. at 475: "The size of the bad-debt allowance provided in the case of commercial banks is determined under administrative rulings by the Commissioner of Internal Revenue. At present it is provided in the case of commercial banks that the amount which can be deducted from taxable income in any one year shall be determined by applying the ratio of losses to outstanding loans during the past 20 years, to the loans outstanding in the current year. These reserves are limited to three times the current 20-year loss ratio. In the case of mutual savings banks also, the formula permitted may be quite different from that now provided for commercial banks if the Commissioner after investigation finds that the historical loss experience of these institutions differs substantially from that of commercial banks. In fact, your committee believes that the loss experience of these banks should be based upon a period of at least 25 years if this, in the aggregate, would result in greater loss deductions for these banks than the 20-year period now provided in the case of commercial banks. Basing loss reserve deductions on the loss experience of the past 20 or 25 years will include a period in which the losses of the mutual savings banks were quite large, with the result that the loss reserve deductions permitted in the next several years will be relatively large."

21 Id. at 476. Again, savings and loan associations would be similarly treated. Id. at 478.

22 H. Rep. 1213, 82d Cong., 1st sess., 1951-2 Cum. Bul. 287, 300.

In 1951 the book surplus of savings banks in the nation was 11.7% of deposits. It had not exceeded 12% of deposits nationally since 1941 and has not exceeded it since that year. SAVINGS BANKS TRUST CO., SAVINGS BANKS FACT BOOK, 1956, p. 202.

23 Page 404 supra.

Revenue. One purpose was "to provide extraordinary increases in revenues to meet essential national defense expenditures."[24] It was estimated that the taxation of mutual institutions would bring $140 millions in revenue.[25]

Revenue actually raised has been relatively insignificant. For example, between 1952 and 1954, inclusive, insured mutual savings banks paid total federal income tax of approximately $7 millions on total net operating income before taxes and dividends of approximately $1,553 millions, or at an effective rate of 0.45 percent; between 1953 and 1955, inclusive, member savings and loan associations paid total federal income tax of $15.8 millions on total net income before federal income tax of $2,964 millions, or at an effective rate of 0.53 percent.[26] During the period 1952 to 1956, inclusive, those commercial banks which were members of the Federal Reserve System paid total federal income tax of $3,513 millions on total profits before income taxes of $8,315 millions, or at an effective rate of 42 percent.[27] If enactment of section 593 had resulted in tax parity and operating experience had been identical, the taxation of mutual institutions at the same effective rates as commercial banks would have increased federal income tax revenues by at least six hundreds of millions of dollars per year.

It is apparent that the taxation of mutual institutions failed to raise the amount contemplated or the far larger amount which would have been raised if tax parity had been achieved.

Tax Parity with Competitors. Increasing corporation tax rates to 52 percent in the Act of 1951 aggravated the discrimination in tax then existing between mutuals and their competitors. Accordingly, the Senate Report gave as a second purpose to "place mutual savings banks on a [tax] parity with their competitors."[28]

It has already been shown, however, that the effective rate of tax paid by mutuals is only a small fraction—roughly one-eightieth—of that paid by their competitors.[29]

The affected mutual institutions reacted with substantial uniformity to the Act of 1951. The anticipated effect of the 12 per-

24 Note 12 supra.

25 S. Rep. 781, 82d Cong., 1st sess., 1951-2 Cum. Bul. 471, 473.

26 SAVINGS BANKS TRUST CO., SAVINGS BANKS FACT BOOK, 1956, p. 198; FEDERAL HOME LOAN BANK BOARD, COMBINED FINANCIAL STATEMENTS, 1955, p. 49; FEDERAL HOME LOAN BANK BOARD, COMBINED FINANCIAL STATEMENTS, 1954, p. 49.

27 FEDERAL RESERVE BUL. 517 (May 1957).

28 1951-2 Cum. Bul. 476, 622-623.

29 Notes 26 and 27 supra.

cent reserve provision might be nullified simply through maintenance of reserves less than 12 percent of deposits. This could be accomplished both by reducing net income through tax deductible expenses and also by increasing the deposit base against which the 12 percent was to be applied. Income used for public relations purposes—advertising, free gifts, new or remodeled offices, and so on—were deductible business expenses. These expenditures not only reduced net income, but, in turn, attracted new deposits, thereby increasing the deposit base. Similarly, payment of increased dividends also was deductible[30] and attracted additional deposits as well. Here was a nearly ideal tax and business situation. The act had an effect opposite to the Senate intent[31] by both encouraging growth as a business practice and subsidizing it at the expense of tax dollars.

Enactment of the Act of 1951 has not prevented the growth of the mutual. Since then, these institutions have expanded with great rapidity. At the end of 1950, mutual savings banks had total assets of $22,385 millions[32] and savings and loan associations had total assets of $16,893 millions.[33] Between year-end 1950 and 1956, assets of savings and loan associations increased to $43,098 millions[34] and had surpassed the assets of the mutual savings banks which had increased to $33,311 millions.[35] Percentage growth of the savings bank and the loan association respectively was 49 percent and 255 percent. In terms of dollar growth, share accounts in savings and loan associations increased between 1950 and 1956 from $13,992 millions to $37,302 millions[36] and accounts in savings banks from $20,009 millions to $30,001 millions.[37] During this same period, time deposits in commercial banks increased from $36,503 millions to $50,908 millions, or 40 percent.[38] Deposit growth of mutual institutions

30 Revenue Act of 1951, §313(f).

31 "So long as they are exempt from income tax, mutual savings banks enjoy the advantage of being able to finance their growth out of earnings without incurring the tax liabilities paid by ordinary corporations when they undertake to expand through the use of their own reserves." 1951-2 Cum. Bul. 476.

32 FEDERAL RESERVE BUL. 667 (June 1957).

33 Id. at 677.

34 Ibid.

35 Id. at 667.

36 Id. at 677.

37 Id. at 667.

38 Ibid.

surpassed commercial banks both in percentage, and, more significantly, in dollar amount as well.

In a period as economically dynamic as this, many out-of-the-ordinary forces affected the various banking institutions. Inflation, unprecedented growth in the mortgage market, and high levels of consumption and industrial expansion—all have caused substantial growth in all institutions. Nonetheless, the asset growth of mutuals consists primarily of deposit growth, which was made possible largely by the payment of higher interest rates than other banking institutions. It seems inescapable that these rates would not have been feasible in the absence of the failure to achieve tax parity in the Act of 1951.

Other Criteria of the Public Interest

Apart from success or failure in the accomplishment of these congressional purposes, and looking away from the area of competitive impact, has section 593 succeeded from other perspectives of the public interest? Can it then be justified on another basis? In other words, apart from its apparent failure to achieve congressional purposes, have other benefits flowed in such a measure from its enactment as to outweigh its demonstrated defects?

Reserves. The importance of safe reserve levels in banking institutions can hardly be overstated: the reserves of a banking institution are the main source of protection to its depositors. Federal deposit insurance is long on public morale value, but it is funded only to the extent of 1.5 percent of deposits.[39] At the present time Federal Reserve Board jurisdiction fails to extend to mutual banking institutions.[40] No arbitrary acceptable percentage of reserves applicable to each institution can be established. Necessary reserve levels depend upon the individual institution's relation of cash and near cash to deposits, the form of other assets to deposits, the inflow and outflow of deposits, and the amount of mortgage anticipation payments, among others.

In any event, due to a number of factors—the absence of required reserves, the need of mutuals to invest almost all funds

[39] FEDERAL DEPOSIT INS. CORP., ANNUAL REPORT, Dec. 31, 1956, p. 16. The percentage of funds to insured deposits was 1.44%. On Dec. 31, 1956, the total assets of the Federal Deposit Insurance Corporation was $1,800 millions. Ibid.

[40] At the end of 1956, three mutual institutions were voluntary members of the Federal Reserve System. FEDERAL RESERVE BUL. 931, n. 1 (August 1957).

to maintain high interest payments, and the influence of section 593—the reserves and undivided profits of mutual institutions as a percentage of savings capital have diminished yearly. In the case of savings and loan associations, for example, reserves and undivided profits as a percentage of savings declined from 9.15 percent to 8.01 percent between 1950 and 1955.[41]

Today, there is neither requirement in the banking law nor incentive in the tax law to maintain higher reserve levels. In fact, under section 593, the accumulation of reserves to more desirable levels well might be penalized by the imposition of tax. A statute which penalizes safer reserve levels fails to advance the public interest.

Control over the National Economy. The Federal Reserve System helps counteract inflationary and deflationary movements in the economy, and assists in creating conditions favorable to high employment, stable values, national growth and a rising level of consumption. To accomplish these objectives, the board depends in large measure upon its power to affect the availability, cost and volume of reserves of its member banks and to fix rates for the discounting of commercial paper. By these means, together with the purchase and sale of government securities in the open market, it influences the flow of credit and thereby aids in fostering an orderly economic growth.

The tremendous growth of mutuals and the lack of jurisdiction over them by the Federal Reserve Board may have a far broader implication than those already mentioned. This lies in the steady decrease in control over the national economy by the Federal Reserve Board which has paralleled the steady increase in deposits of mutual institutions.

The Board has authority over its member institutions only. At the end of 1956, 6,462 of the nation's 13,640 commercial banks, or 47 percent, were members and these members held 85 percent of adjusted demand deposits, and 80 percent of time deposits in commercial banks, nationally.[42] Members held 84 percent of total demand and time deposits in commercial banks. These percentages permit the Federal Reserve System to control effectively the reserves and availability of credit of commercial banks.

It is true that the action of the System upon its member banks

41 FEDERAL HOME LOAN BANK BOARD, SOURCE BOOK, 1956, p. 10.
42 FEDERAL RESERVE BUL. 667 (June 1957).

has a peripheral regulatory effect upon mutual institutions which also are a part of the money market. Despite this, an important question is whether this peripheral control is adequate control today. More specifically, the impact of the mutual on the money market is becoming increasingly greater to the extent that direct control or jurisdiction may well be indicated.

Today, the argument would run, the commercial bank is but one of many important sources of credit, which now also includes the mutual institution, insurance company, credit union and even the large industrial corporation. Until the postwar years, the deposits of mutual institutions were small in a relative sense and the lack of Reserve Board control over them did not impair the working of the regulatory scheme. This is no longer true. If time deposits in mutual savings banks in 1956 of $30,001 millions[43] are taken into consideration as a credit source, and added to commercial bank demand and time deposits, instead of affecting 84 percent of the credit represented by all deposits, the board could affect only 71 percent. Adding share accounts in savings and loan associations in 1956 of $37,302 millions[44] as another credit source, the percentage affected drops to 60 percent. Add life insurance reserves of $79,738 millions[45] and the percentage drops to 42 percent. If funds in credit unions, postal savings, and the like also were considered, the percentage of available credit which the Federal Reserve Board can affect would be smaller.

Thus the Federal Reserve Board reaches only a fraction of the national credit market. To achieve a desired effect upon the economy as a whole, it necessarily must exert a greater pressure upon that particular portion than if it directly reached all or substantially all credit sources. As the participation of member banks in the national credit market decreases by virtue of the deposit growth of non-member mutual institutions, it seems inevitable that the system will have to "regulate" its members just that much harder in order to achieve a desired over-all result.

Benefits Under Section 593. A situation is hardly ever entirely black. A number of desirable consequences have flowed in the past few years from enactment of section 593. First, thrift *has*

43 Ibid.
44 Id. at 677.
45 LIFE INSURANCE FACT BOOK, 1957, p. 57.

been fostered. Mutual institutions have attracted new accounts and additional deposits in old accounts through active public relations efforts and the payment of high interest rates. This has been a mixed blessing, however, because one consequence of these efforts has been an inflated emphasis on dividend size as an investment factor. Second, mutuals have increased their assets to a point of greater over-all strength. Third, the success of mutuals in the savings field, together with the desire to attract deposits in a tight money market, has caused large numbers of commercial banks to reexamine their own policies and activities in respect to these deposits. Commercial banks have become more competitive for savings accounts. Unfortunately, this also is a mixed benefit, since some commercial banks may have set interest rates beyond sound and economic levels in an attempt to compete with the interest which can be paid by the more favored mutual institutions.

These are desirable consequences. But, these or similar ones can be had, and would follow, in the case of almost any organization which is exempt from tax. It is difficult to justify the existence of these benefits, which, after all, are obtained by depositors in mutual institutions at the expense of the remainder of the tax-paying public.

Other Problems Raised by the Growth of the Mutual Institution

These are only a few of the important criteria with which to test the efficacy and desirability of the section. The growth of the mutual has raised other areas of inquiry as well.

1. Over 97 percent of the deposits of savings and loan associations and substantial amounts of the deposits of savings banks have been placed in home mortgages with long terms of twenty to thirty years. Approximately 36 billion dollars are tied up in savings and loan associations alone.[46] To what extent has this practice of so narrowing its credit to one segment of the economy contributed to the current tight money situation in the economy generally? Does the rising cost for the use of money by both government and industry (which may be an embarrassingly high fixed charge against operations in any future period of economic depression) suggest that the placement of this money is a matter of grave public concern?

[46] U.S. SAVINGS AND LOAN LEAGUE, SAVINGS AND LOAN FACT BOOK, 1957, p. 45.

2. How has the growth of mutual institutions and their inability to create money affected the availability of funds for industrial expansion? Should action be taken to make it possible for mutual institutions to create money as commercial banks now do by means of fractional reserves upon demand deposits?

3. Liquid assets of a financial institution, which are needed to meet its cash requirements, consist of the United States Government securities, cash on hand, and cash in other banks. Savings and loan associations maintained a liquidity ratio of approximately 13 percent of deposits.[47] Is this liquidity sufficient in view of the fact that an important part of the deposit growth of mutual institutions seems to have been attracted mainly by their higher interest rates and, therefore, lacks the stability of a true savings account?

4. The area of competition between commercial institutions and mutual institutions in terms of size and services offered increases yearly. Is it possible to avoid a banking structure, which, in time, will consist of institutions of equal size and equal operating authority competing for identical business, but with the difference that one type of institution is freed of tax and control over reserves and the other not? Where, when, and by whom is the line to be drawn beyond which additional operating authority will not be granted mutual institutions?

5. Does a solution to the problem of increased competition possibly lie in the commercialization of mutual institutions or in the mutualization of commercial institutions, assuming either is possible? Should appropriate statutory amendments be made to permit a commercial institution to "purchase" or absorb a mutual institution by merger or otherwise?

6. Should commercial institutions be prevented by law from serving the small saver and this service reserved to the mutual institutions and, at the same time, the mutual institution prevented from serving the larger and business accounts and this service reserved to commercial institutions? How can such a distinction be drawn between the "small" saver and the "large" saver—by size of initial deposit, by size of later deposits, by the business or non-business character of the depositor?

[47] At the end of 1956, savings and loan associations had U.S. Government securities and cash on hand and in other banks of $4,960 millions against deposits of $37,300 millions, or 13%. U.S. SAVINGS AND LOAN LEAGUE, SAVINGS AND LOAN FACT BOOK, 1957, pp. 45, 47. Eliminating advances by the Federal Home Loan Bank the percentage is 9.7%. Ibid.

7. Should Federal Reserve Board control be imposed over all financial institutions, including mutual institutions, credit unions, large business corporation lending, and insurance companies? Is their regulation a categorical necessity to regulate our national economy effectively?

Conclusion

Whatever conclusions one may draw from these facts, the dark consequences predicted to follow upon taxation of mutuals in 1951 by opponents of the measure have not occurred. Taxation of mutual institutions has not destroyed the incentive to save, prevented the payment of reasonable dividends or the allocations of funds to reserves where management has desired it, impaired the financial soundness of these institutions, placed an undue burden on the thrifty, or increased the cost of home ownership in any manner other than it has already been increased by tight money and other causes.

Several conclusions may be drawn, however, from the experience under section 593 to help achieve the congressional objectives which are still sound today, but which have been so vastly unrealized since its enactment.

First, it would be foolish and wishful to think it possible to turn back the clock and to reshape mutual institutions into the small, ineffective and semi-philanthropic organizations of a century, or even three decades, ago. These institutions now must be accepted with their present size, influence, and powers, and must be given consideration and treatment as large, effective and semi-commercial banking organizations.

Second, the congressional purpose in 1951 to achieve tax parity among competing banking institutions is still sound today. In fact, due to the growth in size and powers of mutual institutions, the problems to be corrected are more critical today than six years ago. Mutual and commercial banking institutions are competitive both in terms of size of institution and services offered, and this competition has increased yearly. Discrimination in tax treatment between competing institutions which provide almost identical services ordinarily cannot be justified as a matter of simple justice. As between commercial banking institutions and mutual banking institutions, there is no reason sufficient to justify a tax discrimination under which one pays income tax at a rate 80 times greater than the other.

Third, ideally, both types of institutions should be taxed identically. Two alternatives are available. Commercial institutions might be taxed at the same effective rate as mutuals. This alternative is specious on its face; there would be an annual tax loss of between approximately $675 millions and $700 millions from member banks of the Federal Reserve System alone.[48] The other alternative is to repeal section 593 and, instead, to allow mutuals to receive the bad debt reserve treatment now given commercial institutions under the Internal Revenue Code. This alternative would increase federal tax revenues by almost the same amount annually. Obviously, the second alternative is the sounder.

Fourth, the activities of mutual institutions now make a substantial impact on the national credit market. It would seem, therefore, that the Federal Reserve Board should be given jurisdiction over them to enable it to carry out its functions equitably and more effectively. This action also would cause reserves of mutual institutions, and particularly savings and loan associations, to be increased to more desirable levels.

Fifth, the grant of additional operating rights to mutual institutions merely aggravates the existing critical competitive situation. Annual grants of authority have made a patchwork banking structure. Additional operating authority should be considered concurrently with measures to eliminate tax discrimination among institutions.

Sixth, following the establishment of substantial equality of obligation in income tax and reserve requirements among all banking institutions, it would follow then that the mutual institution should be given substantial equality of rights in other matters, perhaps additional branch banking authority and provision of consumer credit and checking accounts.

Undoubtedly the soundest conclusion of all would be that these data and questions show a critical need for a comprehensive and searching study of our national banking structure: a study that would show the way to a sound and equitable relationship between competing banking institutions and even between the regulatory schemes of the federal government and of the individual states. Such a study is essential, if we are to maintain the sound national economy so vital to our leadership of the free world.

48 Page 406 supra.