

# [Exemptions]

[Federal income tax exempt status issued by IRS &/or as declared by Taxpayers]

## 26 U.S. Code § 501 (c)(14)



### 501(c)(14) — State-Chartered Credit Unions, Mutual Reserve Funds



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#### Part 7. Rulings and Agreements

#### Chapter 25. Exempt Organizations Determinations Manual

#### Section 14. Credit Unions and Mutual Reserve Funds

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##### 7.25.14 Credit Unions and Mutual Reserve Funds

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##### 7.25.14.1 (12-20-2004)

###### Overview

1. This section discusses credit unions and mutual reserve funds under IRC 501(c)(14).

##### 7.25.14.1.1 (12-20-2004)

###### Credit Union Statute and Regulations

1. IRC 501(c)(14) provides exemption from federal income tax for credit unions without capital stock which are organized and operated for mutual purposes and without profit.
2. Federal credit unions organized and operated in accordance with the Federal Credit Union Act, as amended, have been held to be instrumentalities of the United States. The National Credit Union Administration (NCUA) (successor to the Bureau of Federal Credit Unions) is, pursuant to Rev. Rul. 89-94, 1989-2 C.B. 233, no longer required to annually file a group information return, Form 990, covering all of the exempt Federal Credit Unions under its supervision, because those federal credit unions are organizations described in IRC 501(c)(1). See Rev. Rul. 89-94, 1989-2 C.B. 233, that obsoletes Rev. Rul. 60-169, 1960-1 C.B. 621.

#### **7.25.14.1.2 (12-20-2004)**

##### **Legislative History**

1. The Revenue Act of 1951 was the first such Act to designate credit unions by name as being exempt from Federal income tax. Prior to this enactment the Attorney General of the United States ruled that credit unions were exempt from income tax because of their similarity to domestic building and loan associations and cooperative banks, which were specifically exempt by prior Revenue Acts, 31 Opinions of Attorneys General, 176 (1916–1919). The 1951 Act:
  - A. Repealed the provisions exempting building and loan associations and cooperative banks.
  - B. Specifically exempted credit unions by name in what is now IRC 501(c)(14).

#### **7.25.14.1.3 (12-20-2004)**

##### **Typical State Defined Characteristics of a Credit Union**

1. IRC 501(c)(14)(A) does not define "credit union" except that it is an organization without capital stock and must be organized for "mutual purposes and without profit." Reg. 1.501(c)(14)-1 merely adds that the credit unions contemplated by this section are other than Federal credit unions. However, based on a detailed analysis of the legislative history of IRC 501(c)(14)(A), the Service has concluded that it was the intention of Congress to exempt under this provision only those organizations chartered as credit unions under the laws of their home states. Thus, state law determines whether organizations are credit unions for purposes of exemption from federal income tax under IRC 501(c)(14)(A). See also Rev. Rul. 69-282, 1969-1 C.B. 155.
2. In one notable exception to this rule, the Service has held that an organization formed by a group at a United States military base in a foreign country, if it meets all but the territorial requirements of the Federal Credit Union Act (which would make it exempt under IRC 501(c)(1)), will also be regarded as a credit union for purposes of IRC 501(c)(14)(A).
  - Rev. Rul. 69-283, 1969-1 C.B. 156 held that the Federal Credit Union Act is limited by its provisions to the several States, District of Columbia, territories and possessions of the United States, Panama Canal Zone, and the Commonwealth of Puerto Rico. Since the organization in this revenue ruling was not governed by the law of any of the states, its status could not be determined under any state law.
3. Although the credit union statutes of no two states are precisely identical, many are patterned roughly after an early Act of the Massachusetts legislature, approved May 20, 1915, and all have certain characteristics in common.
4. The 1915 Massachusetts Act provides that the words "credit union" are reserved to associations organized in accordance with the provisions of the Act:
  - A. Provides that organizations incorporated under the laws dealing with credit unions are subject to the supervision of the State Banking Commissioner.

- B. Authorizes credit unions to receive the savings of members either as a deposit or as payment for shares.
- C. The bylaws prescribe the conditions of membership, the par value of shares of stock, and the maximum number of shares which may be held by one member. They also designate the conditions under which shares may be paid in, transferred, or withdrawn, and the conditions under which deposits may be received and withdrawn.

#### **7.25.14.1.4 (12-20-2004)**

##### **Additional Requirement Created by IRC 501(c)(14)**

1. To qualify as a credit union exempt from federal income tax under IRC 501(c)(14)(A) a credit union must, in addition to being chartered under a state credit union law, and thus have the above state defined characteristics, operate without profit and for the mutual benefit of its members. See Rev. Rul. 69-282, supra, clarified by Rev. Rul. 72-37, 1972-1 C.B. 152.

#### **7.25.14.1.5 (12-20-2004)**

##### **Other Common Characteristics of Credit Unions**

1. Only members may subscribe for shares of stock, yet a member might be merely a depositor instead of a shareholder, as shareholding is not an essential prerequisite for membership but simply an attribute of membership. Each shareholder is entitled to one vote, regardless of the number of shares he/she might own.
2. Loans are made only to members of the credit union. Applications for loans must be made in writing to the credit committee, and the member applying for a loan must state the purpose for which it is desired. No loan shall be made unless the credit committee is satisfied that it promises to benefit the borrower. Loans of small amounts are made and are repayable in installments. Prompt payment of obligations is a fundamental requirement of these associations.
3. While members may subscribe for shares of capital stock, no stock certificates are issued. The Attorney General of the United States has ruled that the term "capital stock" as used in connection with credit unions is in no sense similar to the accepted business meaning of that term, which Congress doubtless had in mind when it restricted exemption to organizations "without capital stock." While a credit union pays dividends on shares of stock, this is in reality the same as paying interest on deposits, 31 Opinions of Attorneys General, 176 (1916-1919).

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#### **7.25.14.2 (12-20-2004)**

##### **Mutual Reserve Funds**

1. IRC 501(c)(14) also exempts from federal income tax corporations or associations without capital stock organized before September 1, 1957, and operated for mutual purposes and without profit to provide reserve funds, for, and insurance of, shares or deposits in—
  - A. domestic building and loan associations,
  - B. cooperative banks without capital stock organized and operated for mutual purposes without profit,
  - C. mutual savings banks not having capital stock represented by shares, or
  - D. mutual savings banks described in IRC 591(b).
2. IRC 501(c)(14) further provides exemption for corporations or associations organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for associations or banks described in a., b., or c. of the preceding paragraph. These organizations are exempt, however, only if 85% or more of the income is attributable to providing such reserve funds and to investments.

- Organizations described in this paragraph are exempt only for years ending after February 2, 1966, Sec. 3, Public Law 89–352, 1966–1 C.B. 375.
3. The significant differences in paragraph (1) and paragraph (2) above are, paragraph (2) does not require an organization to insure shares or deposits in its member organizations and does not contain a specific restriction against issuance of capital stock. On the other hand, paragraph (2) contains an income percentage restriction clause not present in paragraph (1). To avoid conflicts, the Code provides that the provisions of paragraph (2) are not applicable to organizations meeting the requirements of paragraph (1), IRC 501(c)(14)(C).
  4. For taxable years beginning after February 2, 1966, organizations described in paragraphs (1) and (2), above, are subject to the tax imposed by IRC 511(a) on unrelated business income.
    - For example, if an organization described above receives income from furnishing data processing services, such income is taxed as unrelated business income, Senate Report No. 945, 89th Congress, 1966–1 C.B. 425.
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#### **7.25.14.3 (12-20-2004)**

##### **Unrelated Trade or Business Taxable Income**

1. A state chartered credit union may have unrelated business taxable. Typical sources of this income are credit life and disability insurance issued by the credit union as an added service to guarantee the payment of outstanding member loans.
  2. The Service position is that this income is not directly related to the exempt purposes of the credit union in making loans for provident purposes. Accordingly, such income is taxable as unrelated business taxable income.
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#### **7.25.14.4 (12-20-2004)**

##### **Applications for Recognition of Exemption**

1. The Service does not provide an application form for use in applying for exemption under IRC 501(c)(14). Any form of written application is acceptable as long as it shows the information indicated below. It must be submitted in duplicate.
2. The application of a state chartered credit union must show the state and date of incorporation, and that the state credit union law with respect to loans, investments, and dividends, if any, is being complied with, (Regs. 1.501(a)–1(a)(3)(i).) When properly filled out, the form titled Claim For Exemption From Federal Income Tax, supplied by the Credit Union National Association, is acceptable as an application. See Rev. Proc. 56–2, 1956–1 C.B. 1017.
3. The applications of every other organization claiming exemption under IRC 501(c)(14) must show:
  - A. the character of the organization,
  - B. its purposes and activities,
  - C. the source of its receipts and the disposition thereof,
  - D. whether any of its income may be credited to surplus or may inure to the benefit of any private shareholder or individual, and
  - E. any other information that may affect its right to exemption.

4. The organization must submit, in duplicate, copies of its articles of incorporation or other enabling instrument, its by-laws or other governing regulations, and its latest financial statements showing its assets, liabilities, and disbursements. See Reg. 1.501(a)-1(a)(3)(i).

#### **7.25.14.5 (12-20-2004)**

##### **Digests of Published Rulings and Procedures**

1. Federal Credit Unions—Federal Credit Unions organized and operated in accordance with the Federal Credit Union Act, as amended, have been held to be exempt as instrumentalities of the United States. The NCUA is, pursuant to Rev. Rul. 89-94, 1989-2 C.B. 233, no longer required to annually file a group information return, Form 990, covering all of the exempt Federal Credit Unions under its supervision, because those federal credit unions are organizations described in IRC 501(c)(1). See Rev. Rul. 89-94, 1989-2 C.B. 233, that obsoletes Rev. Rul. 60-169, 1960-1 C.B. 621.
2. State chartered; application requirements—A form of statement furnished to applicant credit unions by the Credit Union National Association is acceptable by the Revenue Service as meeting the requirements relating to the evidence to be filed by State chartered credit unions claiming exemption from Federal income tax. Rev. Proc. 56-2 1956-1 C.B. 1017.
3. State chartered; group returns—A group information return, Form 990, may be filed by a State agency for all exempt state-chartered credit unions under its control and supervision in lieu of separate returns by each credit union. Rev. Rul. 60-364 1960-2 C.B. 382.
4. State chartered; based in a foreign country—An organization formed by a group of individuals at a United States military base in a foreign country, which meets all but the territorial requirements of the Federal Credit Union Act, will be regarded as a "credit union" for purposes of IRC 501(c)(14)(A). Rev. Rul. 69-283 1969-1 C.B. 156.
5. State chartered; insuring deposits—An organization created after August 31, 1957, for the purpose of insuring individual's deposits in state-chartered credit unions does not qualify for exemption under either IRC 501(c)(6) or IRC 501(c)(14)(B). Rev. Rul. 83-166, 1983-2, C.B. 96.
6. State chartered; law governing formation—An organization must be formed and operated under the state law governing the formation of credit unions to qualify for exemption under IRC 501(c)(14)(A) as a state chartered credit union. Rev. Rul. 69-282, 1969-1 C.B. 155.
7. State chartered; nonprofit operation—To qualify as a credit union exempt from income tax under IRC 501(c)(14)(A) an organization must, in addition to being formed and operated under a state credit union law, operate without profit and for the mutual benefit of its members; Rev. Rul. 69-282 clarified, by Rev. Rul. 72-37, 1972-1 C.B. 152.

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