Macon
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TALK BY M. MONROE KIMBREL

The subject assigned me today is a highly controversial matter in the financial community throughout the country. While prudence might suggest greater caution, for my part, I welcome the opportunity to discuss the legislative inequities between commercial banks and savings and loan associations. I believe it is a subject that needs a great deal of discussion. Moreover, it is a subject which, together with the related subjects of the duties, obligations and responsibilities of our different financial institutions, will be the focus of more and more attention as the work of the Monetary Commission recently established by the Committee for Economic Development progresses. The relationships among commercial banks, savings and loan associations and all other financial institutions will have to be carefully studied by that Commission in order to come to any conclusions about their respective roles in our national monetary and credit systems. Certainly, both commercial banks and savings and loan associations, as well as the financing industry as a whole stand to benefit from clearer public understanding of the problems that exist among them and how they can be corrected.

One of the principal existing inequities is to be found in the impact of the income tax law on commercial banks and savings and loan associations as a result of the differing treatment of reserves for bad debts.

In order to reduce this issue to manageable proportions, it is necessary to make certain basic observations.

First, savings and loan associations desire, as do commercial banks, to bear a fair share of the Federal tax burden. The good faith of either industry is not in question.

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Secondly, it is in the public interest and certainly in accord with the principles of our competitive enterprise system that neither type of institution realizes a competitive advantage as the result of tax treatment by the Federal Government.

Thirdly, the savings and loan industry by and large has attained a level of growth and stability at which it no longer needs a direct or indirect Federal subsidy.

I think everyone will acknowledge these as being reasonable assumptions. And yet, what does the record show in terms of Federal taxes actually paid?

The year 1956 is the latest year for which accurate figures are available. During that year, according to the annual report of the Federal Deposit Insurance Corporation, the Nation's insured commercial banks paid in Federal taxes $769,843,000 - or 38 per cent of their net income before taxes.

During the same year, according to the Federal Home Loan Bank Board, savings and loan associations which are members of the Federal Home Loan Bank system (representing 96 per cent of the industry's assets) paid in Federal taxes $5,070,000 - or 1.3 per cent of their net income after deduction of dividends paid on share accounts.

In other words, on the basis of net income before taxes, commercial banks paid at a rate 29 times greater than that paid by savings and loan associations.

So there is a disparity - of man-sized proportions. Let's examine, in layman's terms, how it comes about.

Savings and loan associations, like many other cooperative enterprises, were initially exempt from all Federal income taxation. In 1952 they were made subject to income taxation at the rates prescribed for all other corporations, but the deductions allowed were so liberal

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as to have the practical effect of requiring little or no Federal income tax payment by most of the associations.

Section 591 of the Internal Revenue Code of 1954 allows savings and loan associations to deduct earnings credited to the withdrawable accounts of shareholders as dividends. In addition, under Section 593, all transfers of earnings to reserves are deductible as long as the sum of surplus, reserves and undivided profits is less than 12 per cent of withdrawable accounts.

Savings and loan associations, together with mutual savings banks, are the only business organizations given a special statutory formula for determining reasonable additions to reserves for bad debts.

Commercial banks, on the other hand, like all other business corporations which adopt the reserve method of treating bad debts, are subject to the general regulations of the Internal Revenue Service. These regulations allow a deduction from gross income of a reasonable addition to a bad debt reserve in lieu of a deduction for specific bad debt items, with the reasonableness of the addition to be determined by the Internal Revenue Commissioner.

The Commissioner has approved two formulas for use by commercial banks in determining a reasonable addition to a reserve for bad debts. Both formulas are based on the average loss experience of the individual bank on loans, over a period of years. This average loss experience is then applied to the bank's loans outstanding at the end of the tax year to find the dollar amount which may be transferred to a reserve for bad debts and deducted from income for tax purposes. There is the further qualification imposed by both these formulas that no tax deduction will be allowed for any transfer which brings the total in the reserve to an amount in excess of three times the figure which would otherwise be allowable in that tax year.

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Under these formulas the average ceiling on the total amount of tax-free earnings which may be accumulated in bad debt reserves by commercial banks is 2.43 per cent of loans, whereas savings and loan associations may accumulate tax-free earnings in bad debt reserves until their reserves, surplus and undivided profits equal 12 per cent of withdrawable accounts. Both the percentage and the base to which that percentage is to be applied are larger for savings and loan associations, than for commercial banks.

Recognizing the unwarranted tax advantage given to savings and loan associations under existing law, Representative Thomas B. Curtis of Missouri has introduced a corrective measure.

Under this bill, Representative Curtis, who is himself a director of a savings and loan association, proposes to reduce the ceiling on the savings and loans' deductible reserves by in effect making retained earnings of such an association taxable when its surplus, reserves and undivided profits equal 5% (instead of the present 12%) of withdrawable accounts. His bill also proposes to limit the maximum amount of deductible dividends to 3% of share accounts.

The American Bankers Association recognized the merit of closing the tax gap between savings and loan associations and commercial banks, but believed that the Curtis bill failed to meet the basic problem; that is, the need for uniformity of tax treatment of bad debt reserves for both types of institution. Accordingly, last February I presented to the Ways and Means Committee of the House of Representatives the following recommendations for amendments to the Curtis bill on behalf of the American Bankers Association:

1. The maximum reserve percentage allowed should be the same for commercial banks and for savings and loan associations.

2. The base to which that percentage is applied should also

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be the same for both institutions and this base should be the amount of loans outstanding, which constitutes a realistic base to measure the extent of possible bad debt loss.

3. Any other tax limitations which Congress might impose such as the extent to which dividends on share accounts or interest on deposits would be deductible, should also be applied uniformly.

One further word on reserves for bad debts. We did not attempt to recommend a precise percentage but we did point out that the present average ceiling for banks of 2.43 per cent is grossly inadequate, that the economic welfare of the country demanded a measurably higher figure but that we did not believe that either the commercial banks or the savings and loan associations could justify a figure as high as 12 per cent.

Let me pass now to another legislative inequity. The commercial banks of the United States are justifiably proud of their dual banking system and the strength and vitality of both the State-chartered and the national banks. One of the principal reasons for this healthy situation is that the Federal laws recognize the sovereignty of the States in determining the extent to which a bank may establish branches. National bank branches may be authorized only to the extent that a State-chartered bank is expressly authorized by State law to establish branches. This desirable condition does not prevail, however, with respect to the branches of Federal savings and loan associations. The granting of branching privileges to those associations is now entirely ~~within the limitations in the State law as to branches of State savings~~

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within the discretion of the Federal Home Loan Bank Board. The Board need not observe the limitations in the State law as to branches of State savings and loan associations and in fact the Board does not observe such limitations. The present practice appears to be for the Board to authorize branches in any State that permits branches of State savings and loan associations or State banks and in any State which has holding company banks or chain banking. Some future Board might even, under the law, authorize branches across State lines as has been done in several instances in the past.

The correction of this situation is one of the many desirable amendments to the law contained in the proposed Financial Institutions Act. Under that Act the establishment of branches of federally-chartered savings and loan associations would be limited to the branching authority under State law for State-chartered savings and loan associations, mutual savings banks or commercial banks. Branching across State lines would be prohibited.

I do not want to leave the impression that the savings and loan industry has been opposing the Financial Institutions Act. To the contrary, their representatives have participated in the formulation of the bill and testified in its support. All financial institutions would be helped and the public would benefit by the enactment of this bill which prunes, rearranges and modernizes the present cumbersome Federal financial laws. After passage by the Senate, the Financial Institutions Act now awaits action in the House Banking and Currency Committee. We are still hopeful that action on this bill may be completed during this Congress.

In addition to our concern about inequities now on the statute booss, we must always be alert to forestall, if possible, the legislative

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enactment of new inequities. For example, the proposed Housing Act of 1958 now before the Senate as reported by a subcommittee of the Banking and Currency Committee contained a provision which would have established a new mortgage guaranty agency to guarantee the top 20 per cent of conventional home mortgages. This agency would have been authorized only to guarantee mortgages of institutions which are members of the Federal Home Loan Bank System. This discrimination in favor of savings and loan institutions and against most other mortgage lenders, including commercial banks, was brought to the attention of the Committee. I am gratified that the full committee has seen fit to delete this inequitable provision from the Housing bill pending more careful study.

I want to make it clear that what I have said today is not intended as a criticism of the savings and loan industry. These institutions constitute an important segment of the financial structure of this country, and commercial banks generally recognize the useful functions they perform in encouraging thrift and home ownership. At the same time, we believe that the statutory rules under which they operate should not give them competitive advantages. Fair and equitable competition between financial institutions, as between other classes of business, is in the public interest, but legislative inequities which result in preferential tax treatment or the contravention of State sovereignty are against public policy and should be eliminated.

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