



BUSINESS LAW SECTION

NONPROFIT ORGANIZATIONS COMMITTEE
THE STATE BAR OF CALIFORNIA
180 Howard Street
San Francisco, CA 94105-1639
<http://www.calbar.org/buslaw/nonprofits/>

TAX EXEMPTION UNDER REVENUE AND TAXATION CODE SECTION 23701

LEGISLATIVE PROPOSAL (BLS-2013-05)

TO: Office of Governmental Affairs
FROM: Gary L. Wollberg, Chair
Business Law Section (the “Section”) Nonprofit Organizations Committee (the “Committee”)
DATE: May 31, 2012
RE: Proposal to Amend Revenue and Taxation Code Sections 23701 and 23701d

SECTION ACTION AND CONTACTS

Date of Approval by Section Executive Committee (the “Executive Committee”): June 1, 2012
Approval Vote: For: 14 Against: 0

| Executive Committee Contact: | Committee Contacts: |
|---|---|
| Ellen A. Friedman Vice Chair, Legislation Friedman Dumas et al. LLP 33 New Montgomery St., Suite 290 San Francisco, CA 94105 Tel: (415) 834-3800 efriedman@friedumspring.com | Joel S. Corwin Law Offices of Joel S. Corwin 11661 San Vicente Blvd, Suite 500 Los Angeles, California 90049 Tel. (310) 721-7320 jcorwin@corwinlaw.us Gary L. Wollberg Musick, Peeler & Garrett 225 Broadway, Suite 1900 San Diego , CA 92101 Tel: (619) 525-2500 g.wollberg@mpglaw.com |

HISTORY, DIGEST AND PURPOSE

The purpose of this Proposal is to simplify the process for applying for a California tax exemption as an Internal Revenue Code (IRC) Section 501(c)(4), (5), (6) or (7) nonprofit organization under Revenue and Taxation Code Section 23701, just as such process has been simplified for IRC Section 501(c)(3) charitable organizations under Revenue and Taxation Code Section 23701d.

History

Revenue and Taxation Code Sections 23701 and 23701a through 23701z set forth the tax exemption requirements for certain organizations which are organized and operated for nonprofit purposes or which relate to certain title-holding companies. Effective January 1, 2008, Section 23701d was amended to allow an organization that had received a determination letter from the IRS stating that it qualified as an Internal Revenue Code Section 501(c)(3) charitable organization to submit that letter to the Franchise Tax Board (FTB) in lieu of applying for tax exempt status in California using Form 3500. While this amendment greatly simplified the tax exemption process in California for 501(c)(3) charities, it also left some questions unanswered.

Subsequently, Code Section 23701d was amended to deal with the unanswered questions from the original amendment. The Section now (i) provides a mechanism for the FTB to issue an acknowledgment letter when the organization relies upon the simplified exemption process; (ii) clarifies that an organization that is part of a federal group exemption can utilize the simplified exemption process; and (iii) clarifies that a California tax exemption achieved with the simplified exemption process cannot be reinstated merely by submitting the IRS determination letter if the California tax exemption has been revoked by the FTB.

Proposal and Reasons for the Proposal

Since the amendments to Section 23701d, it has become apparent to both practitioners as well as the FTB that the exemption process for a number of other nonprofit organizations could be simplified in the same way as was accomplished for 501(c)(3) organizations. It was agreed that such a process could be utilized for IRC Section 501(c)(4), (5), (6) and (7) nonprofit organizations. It is felt that such use would provide a more efficient and cost-effective process for both the applicant organizations as well as the FTB. Further, since the "bugs" have already been worked out with respect to the original amendment regarding 501(c)(3) organizations, the resulting refined amendment to be used for the other organizations will be amenable to a smooth transition in administration of applications for such organizations.

The amendments applicable to 501(c)(3) organizations were placed in Section 23701d which described such organizations. The proposed amendment applicable to the 501(c)(4), (5), (6) and (7) nonprofit organizations will be placed in Section 23701 which refers to exemptions for multiple types of nonprofit organizations. At the same time, it will also include 501(c)(3) nonprofit organizations so that what would be duplicative language may be deleted from the current Section 23701d. The new amendment, almost identical to the prior amendments to Section 23701d, fits conveniently into Section 23701 and avoids the duplication which would be required if it were included in the individual sections describing the five types of nonprofit organizations.

APPLICATION

If enacted, the proposed legislation would become effective in 2014.

PENDING LITIGATION

We are not aware of any specific pending litigation that would be affected by this Proposal.

LIKELY SUPPORT AND OPPOSITION

We anticipate support from organizations that are tax exempt in California under Section 23701. We are not aware of any opposition.

FISCAL IMPACT

No fiscal impact is anticipated.

GERMANENESS

The matters addressed in this Proposal require the special knowledge, training, experience or technical expertise of the Section and of members of the Committee. The position advanced would promote clarity, consistency, and comprehensiveness in the law.

DISCLAIMER

This position is only that of the Nonprofit Organizations Committee of the Business Law Section of the State Bar of California. This position has not been adopted by the State Bar's Board of Trustees or overall membership, and is not to be construed as representing the position of the State Bar of California.

Membership in the Nonprofit Organizations Committee and in the Business Law Section is voluntary and funding for section activities, including all legislative activities, is obtained entirely from voluntary sources.

Text of Proposal

SECTION 1. Section 23701 of the Revenue and Taxation Code is amended to read:

§ 23701. Organizations which are organized and operated for nonprofit purposes within the provisions of a specific section of this article, or are defined in Section 23701h (relating to certain title-holding companies) or Section 23701x (relating to certain title-holding companies), are exempt from taxes imposed under this part, except as provided in this article or in Article 2 (commencing with Section 23731) of this chapter, if:

(a) An application for exemption is submitted in the form prescribed by the Franchise Tax Board; and

(b) A filing fee of twenty-five dollars (\$25) is paid with each application for exemption filed with the Franchise Tax Board after December 31, 1969; and

(c) The Franchise Tax Board issues a determination exempting the organization from tax.

(d) (1) Notwithstanding subdivisions (a), (b), and (c) of this Section 23701, an organization organized and operated for nonprofit purposes in accordance with Section 23701a, Section 23701d, Section 23701e, Section 23701f or Section 23701g shall be exempt from taxes imposed by this part, except as provided in this article or in Article 2 (commencing with Section 23731), upon its submission to the Franchise Tax Board of one of the following:

(A) A copy of the determination letter or ruling issued by the Internal Revenue Service recognizing the organization's exemption from federal income tax under Section 501(a) of the Internal Revenue Code, as an organization described in Section 501(c)(3), (4), (5), (6) or (7) of the Internal Revenue Code.

(B) A copy of the group exemption letter issued by the Internal Revenue Service that states that both the central organization and all of its subordinates are tax-exempt under Section 501(c)(3), (4), (5), (6) or (7) of the Internal Revenue Code and substantiation that the organization is included in the federal group exemption letter as a subordinate organization.

(2) Upon receipt of the documents required in subparagraph (A) or (B) of paragraph (1), the Franchise Tax Board shall issue an acknowledgment that the organization is exempt from taxes imposed by this part, except as provided in this article or in Article 2 (commencing with Section 23731). The acknowledgment may refer to the organization's recognition by the Internal Revenue Service of exemption from federal income tax as an organization described in Section 501(c)(3), (4), (5), (6) or (7) of the Internal Revenue Code and, if applicable, the organization's subordinate organization status under a federal group exemption letter. The effective date of an organization's exemption from state income tax pursuant to this subdivision shall be no later than the effective date of the organization's recognition of exemption from federal income tax as an organization described in Section 501(c)(3), (4), (5), (6) or (7) of the Internal Revenue Code, or its status as a subordinate organization under a federal group exemption letter, as applicable.

(3) If, for federal income tax purposes, an organization's exemption from tax as an organization described in Section 501(c)(3), (4), (5), (6) or (7) of the Internal Revenue Code is suspended or revoked, the organization shall notify the Franchise Tax Board of the suspension or revocation, in the form and manner prescribed by the Franchise Tax Board. Upon notification, the board

shall suspend or revoke, whichever is applicable, for state income tax purposes, the organization's exemption under paragraph (1) of this subdivision.

(4) This subdivision shall not be construed to prevent the Franchise Tax Board from revoking the exemption of an organization that is not organized or operated in accordance with this chapter or Section 501(c)(3), (4), (5), (6) or (7) of the Internal Revenue Code.

(5) If the Franchise Tax Board suspends or revokes the exemption of an organization pursuant to paragraph (3) or (4), the exemption shall be reinstated only upon compliance with this Section 23701, regardless of whether the organization can establish exemption under paragraph (1).

This section shall not prevent a determination from having retroactive effect and does not prevent the issuance of a determination with respect to a domestic organization which was in existence prior to January 1, 1970, and exempt under prior law without the submission of a formal application or payment of a filing fee. For the purpose of this section, the term "domestic" means created or organized under the laws of this state.

The Franchise Tax Board may ~~issue rulings~~ prescribe rules and regulations ~~as are necessary and reasonable to carry out~~ to implement the provisions of this article.

SEC. 2. Section 23701d of the Revenue and Taxation Code is amended to read:

§ 23701d. (a) A corporation, community chest or trust, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involved the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation, (except as otherwise provided in Section 23704.5), and which does not participate in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. An organization is not organized exclusively for exempt purposes listed above unless its assets are irrevocably dedicated to one or more purposes listed in this section. Dedication of assets requires that in the event of dissolution of an organization or the impossibility of performing the specific organizational purposes the assets would continue to be devoted to exempt purposes. Assets shall be deemed irrevocably dedicated to exempt purposes if the articles of organization provide that upon dissolution the assets will be distributed to an organization which is exempt under this section or Section 501(c)(3) of the Internal Revenue Code or to the federal government, or to a state or local government for public purposes; or by a provision in the articles of organization, satisfactory to the Franchise Tax Board; that the property will be distributed in trust for exempt purposes; or by establishing that the assets are irrevocably dedicated to exempt purposes by operation of law. The irrevocable dedication requirement shall not be a sole basis for revocation of an exempt determination made by the Franchise Tax Board prior to the effective date of this amendment.

(b) (1) In the case of a qualified amateur sports organization--

(A) The requirement of subdivision (a) that no part of its activities involves the provision of athletic facilities or equipment shall not apply.

(B) That organization shall not fail to meet the requirements of subdivision (a) merely because its membership is local or regional in nature.

(2) For purposes of this subdivision, "qualified amateur sports organization" means any organization organized and operated exclusively to foster national or international amateur sports competition if that organization is also organized and operated primarily to conduct national or international competition in sports or to support and develop amateur athletes for national or international competition in sports.

~~—(c) (1) Notwithstanding subdivisions (a), (b), and (c) of Section 23701, an organization organized and operated for nonprofit purposes in accordance with this section shall be exempt from taxes imposed by this part, except as provided in this article or in Article 2 (commencing with Section 23731), upon its submission to the Franchise Tax Board of one of the following:~~

~~—(A) A copy of the determination letter or ruling issued by the Internal Revenue Service recognizing the organization's exemption from federal income tax under Section 501(a) of the Internal Revenue Code, as an organization described in Section 501(c)(3) of the Internal Revenue Code.~~

~~—(B) A copy of the group exemption letter issued by the Internal Revenue Service that states that both the central organization and all of its subordinates are tax exempt under Section 501(c)(3) of the Internal Revenue Code and substantiation that the organization is included in the federal group exemption letter as a subordinate organization.~~

~~—(2) Upon receipt of the documents required in subparagraph (A) or (B) of paragraph (1), the Franchise Tax Board shall issue an acknowledgment that the organization is exempt from taxes imposed by this part, except as provided in this article or in Article 2 (commencing with Section 23731). The acknowledgment may refer to the organization's recognition by the Internal Revenue Service of exemption from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code and, if applicable, the organization's subordinate organization status under a federal group exemption letter. The effective date of an organization's exemption from state income tax pursuant to this subdivision shall be no later than the effective date of the organization's recognition of exemption from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue Code, or its status as a subordinate organization under a federal group exemption letter, as applicable.~~

~~—(3) If, for federal income tax purposes, an organization's exemption from tax as an organization described in Section 501(c)(3) of the Internal Revenue Code is suspended or revoked, the organization shall notify the Franchise Tax Board of the suspension or revocation, in the form and manner prescribed by the Franchise Tax Board. Upon notification, the board shall suspend or revoke, whichever is applicable, for state income tax purposes, the organization's exemption under paragraph (1) of this subdivision.~~

~~—(4) This subdivision shall not be construed to prevent the Franchise Tax Board from revoking the exemption of an organization that is not organized or operated in accordance with this chapter or Section 501(c)(3) of the Internal Revenue Code.~~

~~—(5) If the Franchise Tax Board suspends or revokes the exemption of an organization pursuant to paragraph (3) or (4), the exemption shall be reinstated only upon compliance with Section 23701, regardless of whether the organization can establish exemption under paragraph (1).~~

~~—(d) The Franchise Tax Board may prescribe rules and regulations to implement this section.~~