



BUSINESS LAW SECTION

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

TAX EXEMPTION UNDER 23701d

LEGISLATIVE PROPOSAL (BLS-2009-04)

TO: Office of Governmental Affairs
FROM: Lisa A. Runquist, Chair
Business Law Section (the "Section") Nonprofit & Unincorporated Organizations
Committee (the "Committee")
DATE: July 9, 2008
RE: Proposal to amend Revenue & Taxation Code Section 23701d

SECTION ACTION AND CONTACTS

Date of Approval by Section Executive Committee (the "Executive Committee"): June 6, 2008
Approval Vote:

For: 16 Against: 0

Date of Approval by Legislative Subcommittee of the Executive Committee: July 9, 2008
Approval Vote:

For: 6 Against: 0

Date of Approval by the Committee: May 2, 2008
Approval Vote:

For: 9 Against: 0

Date of Approval by Legislative Subcommittee of the Committee: July 8, 2008
Approval Vote:

For: 7 Against: 0

Executive Committee Contact:¹	Committee Contact:¹
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¹ Contact information is as of the date submitted. Contact information for the 2008-09 State Bar year is contained in the Supplemental Contacts Information sheet at the end of this document.

HISTORY, DIGEST AND PURPOSE

The purpose of this Proposal is to clarify the process for applying for tax exemption as a charitable organization under Revenue and Taxation Code Section 23701d.

History

Revenue and Taxation Code Section 23701d was added by Stats 1949, ch 557 § 1, effective July 1, 1951. It was recently amended by AB 897, effective January 1, 2008. As explained in the following section, this amendment greatly simplified the tax exemption process in California but also left some questions unanswered that the Committee believes should be addressed in the interests of certainty and clarity.

Proposal and Reasons for the Proposal

Revenue and Taxation Code Section 23701d sets forth the definition of a charitable organization for purposes of tax exemption. AB 897 simplified the process of obtaining tax exemption from the Franchise Tax Board for charitable organizations by allowing 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 FTB in lieu of applying for tax exempt status in California using Form 3500.

This Proposal would address three issues that arose from the passage of AB 897. First, the Proposal requires the issuance of an acknowledgement letter by the FTB, which was not required by AB 897. Other agencies rely upon a determination of tax exemption by the FTB, but AB 897 does not allow the FTB to make a determination; the discretion required to issue a determination letter was removed by AB 897. That has caused confusion. The Proposal provides the mechanism for the FTB to issue an acknowledgement letter when the organization relies upon Section 23701d as modified by AB 897 (and current Form 3500A) and a determination letter when the organization relies upon the traditional application for tax-exempt status (current Form 3500). The FTB has issued FTB Notice 2008-3 that explains the purpose of the Exempt Acknowledgement Letter. Second, the Proposal clarifies that an organization that is part of a federal group exemption can apply for state recognition on the basis of the federal group exemption. Third, the Proposal clarifies that California tax exemption cannot merely be reinstated by submitting the IRS determination letter if California tax exemption has been revoked by the FTB.

As noted above, the effect of AB 897 was to do away with the requirement that an organization separately establish its exemption with the FTB if it had already established its exempt status with the IRS. However, it was not clear how this would impact organizations covered by a group exemption letter from the IRS. If they could not make use of the same process, it would leave these entities in an anomalous position of having to separately apply to establish their exempt status with the FTB, even though they had an applicable exemption letter

from the IRS. This Proposal clarifies that organizations covered by a federal group exemption may make use of the AB 897 process.

APPLICATION

If enacted, the proposed legislation would become effective in 2010.

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 23701d but have not taken any steps to assess the potential for such support, much less solicit it. We believe that these changes address concerns voiced by the Franchise Tax Board. We are unaware of any specific segments that might oppose this Proposal.

FISCAL IMPACT

None.

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.

TEXT OF PROPOSAL

SECTION 1. 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 involve 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, and 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:

(A) a copy of the notification issued by the Internal Revenue Service approving the organization’s tax-exempt status pursuant to Section 501(c)(3) of the Internal Revenue Code *or*

(B) (i) a copy of the group exemption notification issued by the Internal Revenue Service and (ii) substantiation that it is included in the federal group exemption as a subordinate organization.

(2) Upon receipt of the proof required in subparagraph (A) or (B) of paragraph (1) of this subdivision (c) of Section 23701d, the Franchise Tax Board shall issue an acknowledgement that the organization is exempt from tax by operation of law, which may include reference to the Internal Revenue Service approval under Section 501(c)(3) of the Internal Revenue Code and, if applicable, subordinate organization status under a federal group exemption. The effective date of an organization's tax-exempt status for state income tax purposes pursuant to this subdivision shall be no later than the effective date of the organization's tax-exempt status, under Section 501(c)(3) of the Internal Revenue Code, for federal income tax purposes.

(3)~~(2)~~ If, for federal income tax purposes, an organization's tax-exempt status under 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, an organization's tax-exempt status granted pursuant to paragraph (1) of this subdivision.

(4)~~(3)~~ 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 exemption pursuant to paragraph (3) or (4) of this subdivision (c) of Section 23701d, the exempt status of the organization will not be reinstated until it establishes exemption under Section 23701 regardless of whether the organization can establish exemption under paragraph (1) of this subdivision (c) of Section 23701d.

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

SUPPLEMENTAL CONTACTS INFORMATION
(2008-09 STATE BAR YEAR)

Executive Committee Contact:	Committee Contact:
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