BUSINESS LAW SECTION

NONPROFIT & UNINCORPORATED ORGANIZATIONS COMMITTEE

THE STATE BAR OF CALIFORNIA

TO: The State Bar Office of Governmental Affairs

RE: A.B. 897 (Houston)

Committee Position:

☒ Support if Amended

Date position recommended:	April 27, 2007
Nonprofit & Unincorporated Organizations Committee vote:	Unanimous of Members Attending (a quorum being present)
Executive Committee vote:	__-_
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I. STATEMENT OF POSITION

The Nonprofit & Unincorporated Organizations Committee (the "Committee") of the Business Law Section of the State Bar of California welcomes this opportunity to provide comments on Assembly Bill No. 897 ("AB 897"). This is the first statement of position that the Committee has submitted on AB 897. The Committee recommends that:

(1) the proposed bill should be clarified to clearly limit the automatic revocation of exemption contained in 23701d (c)(2)of the Revenue and Taxation Code (the "R&T Code") to those organizations relying on 23701d (c)(1);

(2) the proposed bill should clarify whether 23701d (c) may also be used for organizations that are exempt under a federal group exemption letter;

(3) the current section 23701d (c) should be renumbered to be 23701d (d), and the reference thereto in proposed 23701d (c)(1) line 14, page 3 should be similarly changed; and

(4) consideration should be given to including similar language now contained in 23801d (c) to apply to any organization that has established its exempt status with the Internal Revenue Service (the "IRS"), if a corresponding exemption is provided by the R&T Code.

A. Description of AB 897.

The proposed bill would add R&T Code Section 23701d (c). It provides an exception to the general rule that under current subdivisions (a), (b), and (c) of Section 23701, an organization must file an application for tax exemption with the Franchise Tax Board (the "FTB"). It states that notwithstanding subdivisions (a), (b), and (c) [(d)?] of Section 23701, an organization organized and operated for nonprofit purposes in accordance with the

provisions of Section 23701d shall be exempt from taxes "upon its submission to the Franchise Tax Board of 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."

B. The Committee's Position.

Proposed R&T Code Section 23701d (c)(1) allows nonprofit organizations to establish their exempt status under California law with the FTB, by furnishing it with a copy of the notice issued by the IRS establishing that the organization is exempt under Section 501(c)(3) of the Internal Revenue Code (the "IRC"), rather than making the separate filing now required by Section 23701d. It should be clarified that 23701d (c)(2) applies only to those organizations that have elected to comply with 23701d (c)(1). In other words, if the organization's exempt status is based on the IRS determination, then upon revocation of that determination, the exempt status in California will terminate. However, a separate determination by the FTB that an organization is exempt under the R&T Code should not be automatically overturned by a contrary IRS ruling as to tax-exempt status under the IRC. It would also be helpful if the Code would clarify that the date of the FTB exemption mirrors the date of the IRS exemption, so that if the IRS exemption is retroactive, the FTB exemption will be as well.

Secondly, it should be noted that many organizations are determined to be exempt under Section 501(c)(3) of the Internal Revenue Code by virtue of a federal group exemption. If the legislature agrees that a determination by the IRS is sufficient, this should extend to group exemptions as well as individual determinations.

Thirdly, as noted above, the current R&T Code Section 23701d (c) still exists; it should be renumbered to be 23701d (d), and the reference to (c) in (c)(1) corrected to reflect this renumbering.

It is also not clear to us why, as this is an optional provision, it has been limited only to organizations that have established their exempt status as an organization exempt under Section 501(c)(3) of the IRC. If an organization has filed and established its exempt status with the IRS under another section of the IRC that has a corresponding exempt status under California law, it seems appropriate to extend the same option to that organization. For example, organizations that are exempt under IRC Section 501(c)(6) would normally be found to be exempt under Section 23701e of the R&T Code, a Section 501(c)(4) organization is exempt under Section 23701f, and a Section 501(c)(7) organization is exempt under 23701g of the R&T Code.

C. Analysis.

1. Addition of new Section 23701d (c) to the R&T Code would clearly be an improvement in many ways. It does away with the requirement that a nonprofit organization exempt under IRC Section 501(c)(3) file applications to establish this exemption with both the IRS and the FTB. By eliminating these essentially duplicate filings, the load upon the government will also be reduced.

Of course, there are some IRC Section 501(c)(3) organizations that are not required to file with the IRS, such as churches, associations and conventions of churches, integrated auxiliaries of churches, and very small organizations; these organizations, if they choose not to file with the IRS, will still be required to file with the FTB to establish their exempt status under California law. To the extent an organization makes a filing under R&T Section 23701d, the determination of the FTB should be dispositive, unless the FTB itself affirmatively determines to the contrary. Thus, it should be clarified that the automatic rescission of Section 23701d (c)(2) only applies for organizations relying on Section 23701d (c)(1) to establish their exempt status.

We would also suggest that Section 23701d (c) be modified to make it clear that, by complying with its provisions, the organization will be treated as though it had also established its exempt status under Section 23701d, as of the effective date of the IRS determination.

2. A significant number of organizations are determined to be exempt under Section 501(c)(3) of the Internal Revenue Code by virtue of a federal group exemption. There does not appear to be any reason why, if the legislature agrees that a determination by the IRS is sufficient, that this should not extend to group exemptions as well as individual determinations.

3. The duplication of (c) in 23701d is simply a typo.

4. Although only organizations that are exempt under IRC Section 501(c)(3) are generally required to establish their exempt status with the IRS, other exempt organizations may, and in fact many do, choose to establish their exempt status by filing with the IRS under other provisions of the IRC. It is unclear to us why section 23701d (c) [previously 23701m] is limited only to IRC Section 501(c)(3) organizations. If an exemption in California corresponds to an exemption established with the IRS, it will lessen the burdens of government, as well as the burden on the nonprofit, to expand this bill to allow organizations to file an exempt determination notice with the FTB in lieu of an entirely separate filing. Of course, there will continue to be some organizations that are not required to file with the IRS and choose not to do so; these organizations will continue to be required to make the appropriate filing with the FTB.

II. GERMANENESS

The Committee believes that its members have the special knowledge, training, experience and technical expertise to provide helpful comments on the Bill and that the positions advocated herein are in the best interests of California nonprofit organizations and the constituents interests that they serve.

III. CAVEAT

This statement is that only of the Nonprofit & Unincorporated Organizations Committee of the Business Law Section of the State Bar of California. The positions expressed herein have not been adopted by the Business Law Section or its overall membership or by the State Bar's Board of Governors or its overall membership, and are not to be construed as representing the position of the State Bar of California. There are currently more than 8,800 members of the Business Law Section.

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