

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Lara Analyst: Jessica Deitchman Bill Number: AB 1564

Related Bills: See Legislative History Telephone: 845-6310 Introduced Date: January 30, 2012

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: FTB Revoke Tax-Exempt Status If Mandated Reporter Of Organization Is Found Guilty For Failure To Report Child Abuse Incident

SUMMARY

This bill would require the Franchise Tax Board (FTB) to revoke an organization’s tax-exempt status when a person associated with the nonprofit is convicted of a crime for failing to report child abuse.

This analysis only addresses the provisions of the bill as they impact the department.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

PURPOSE OF THE BILL

According to the language of the bill, the purpose is to deter nonprofit organizations from concealing, fostering, or failing to report the abuse of children.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective immediately upon enactment. Provisions that would require the FTB to revoke tax-exempt status would be specifically operative for convictions occurring in taxable years beginning on or after the operative date of the Revenue and Taxation Code section being added.

ANALYSIS

FEDERAL/STATE LAW

Federal Law

Under the Internal Revenue Code (IRC), certain entities are treated as tax-exempt organizations. A tax-exempt organization can be a trust, unincorporated association, or nonprofit corporation.

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The terms “nonprofit” and “tax-exempt” have different meanings. Nonprofit status is a matter of State law, which governs the organization and creation of the entity. All tax-exempt organizations are nonprofit, but not all nonprofits are tax-exempt.

IRC section 501(c)(3) organizations make up the largest category of tax-exempt entities. They are organized and operated for one or more of the following purposes:

- Religious
- Charitable
- Scientific
- Testing for Public Safety
- Literary
- Educational
- Fostering national or international amateur sports competition
- Preventing cruelty to children or animals

Churches, conventions, or associations of churches, and any organization (other than a private foundation) normally having annual gross receipts of less than \$5,000 annually are exempt automatically if they meet the requirements of IRC section 501(c)(3). Organizations that are not automatically exempt by federal law must apply for tax-exempt status for federal purposes by submitting an application to the Internal Revenue Service (IRS) with accompanying statements showing that all of the following are true:

- The organization is organized exclusively for, and will be operated exclusively for, one or more of the purposes (e.g., charitable, religious) specified above.
- No part of the organization’s net earnings will inure to the benefit of private shareholders or individuals.
- The organization will not, as a substantial part of its activities, attempt to influence legislation (unless it elects to come under the provisions allowing certain lobbying expenditures) or participate to any extent in a political campaign for or against any candidate for public office.

State Law

Although most California laws dealing with tax exemptions are patterned after the IRC, obtaining state tax exemption is a separate process from obtaining federal exemption. In order to obtain state exemption from tax, an organization must either: (1) submit a completed exemption application form to the FTB, pay a filing fee of \$25, and receive a letter issued by the FTB indicating the organization is exempt from tax, or (2) provide a copy of the federal letter indicating that the organization is exempt.¹

To be exempt from taxation, the organization must be organized and operated for one or more exempt purposes listed in the California Corporation Tax Law (CTL). The exempt purposes for California exemption mirror those listed in the federal law section of this analysis, except that churches and small charities are not automatically exempt under state law; they must apply for state tax exemption.

¹ This method is valid only for IRC section 501(c)(3) charities

Current federal and state laws allow for the revocation of the tax-exempt status of an organization when one of the following occurs:

- The tax-exempt organization fails to file a return.
- The tax-exempt organization fails to comply with FTB's and/or IRS's rights to examine records and subpoena witnesses.
- The tax-exempt organization fails to confine its activities to those permitted by its exempt status.

Additionally, current federal law automatically revokes tax-exempt status when an organization fails to file the required e-Postcard (or annual return) for three consecutive tax years.

THIS BILL

This bill would require the FTB to revoke the tax-exempt status of an organization organized for nonprofit purposes when an employee, volunteer, or other person of the organization (who is a mandated reporter²) is found guilty of a misdemeanor for failure to report an incident of known or reasonably suspected child sexual abuse in the scope of his or her duties in the organization.

This bill would specify that the FTB must reinstate the tax-exempt status of the organization if the organization notifies the FTB that the guilty verdict is overturned and the organization otherwise meets all the other requirements for exemption.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is working with the author's office to resolve these and other concerns that may be identified.

This bill uses terms that are undefined, i.e., "person of the organization," "volunteer," and "administrator." The absence of definitions to clarify these terms could lead to disputes between taxpayers and the department. It is recommended the bill be amended to clarify these terms.

The bill would require the FTB to revoke a nonprofit entity's tax-exempt status when a conviction has been made, as specified, and to reinstate the status when the conviction is overturned, but fails to detail how the department would be notified about the conviction or subsequent reversal of the conviction. To avoid confusion between the department and nonprofit entities, it is recommended that the bill be amended to specify how notification would be communicated to the FTB, who would provide the notification, and how often it would be reported.

Additionally, the bill fails to address when the FTB must revoke or reinstate the tax-exempt status. Lack of clarity could lead to disputes between the department and nonprofit entities. It is recommend that the bill be amended to clarify if the revocation would occur at the date of the failure to report or on the date of conviction; and if reinstatement is to be granted, whether the effective date should be retroactive to the date the exemption was revoked or upon notification from the nonprofit that the conviction has been overturned.

² As defined under Section 1165.7 of the Penal Code.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable law. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

Until the implementation concerns have been addressed, department staff is unable to determine the costs to administer this bill.

ECONOMIC IMPACT

Revenue Estimate

This bill requires the FTB to revoke the exempt status of nonprofit organizations that fail to report instances of child sexual abuse. Data relating to these failures to report is unknown. Therefore, the revenue impact of this bill is unable to be determined.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Pro: Some may say that this bill would encourage the reporting of child abuse.

Con: Some may say that an entire organization should not be penalized for one person's crime.

POLICY CONCERNS

The bill would specifically allow the FTB to reinstate the tax-exempt status of an organization if the conviction of the individual associated with the organization is overturned. This bill fails to provide for reinstatement if the individual that was convicted is no longer associated with the organization. If this is contrary to the author's intent, the language should be amended to expand the conditions for revocation and/or reinstatement.

LEGISLATIVE STAFF CONTACT

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