

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Lara, DeSaulnier, et al. Analyst: Diane Deatherage Bill Number: SB 323  
Related Bills: See Legislative History Telephone: 845-4783 Introduced Date: February 19, 2013  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Exempt Organizations/ Disallow Tax-Exempt Status to Discriminating Organizations

### SUMMARY

This bill would require that the Franchise Tax Board (FTB) disallow or revoke the tax-exempt status of public charity organizations that discriminate.

This analysis will not address the bill's changes to the Revenue and Taxation Code relating to sales tax, as they do not impact the department's programs or operations.

### RECOMMENDATION

No position.

### REASON FOR THE BILL

The reason for this bill is to eliminate eligibility for tax-exempt status for nonprofit youth organizations that are found to be discriminating.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2013.

### ANALYSIS

#### Federal Law

Organizations described in Internal Revenue Code (IRC) section 501(c)(3) are exempt from federal income taxation under IRC section 501(a). IRC section 501(c)(3) provides, in part, that an organization must be organized and operated exclusively for religious, charitable or educational purposes, 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, and which does not participate in any political campaign on behalf of (or in opposition to) any candidate for public office.

Board Position:

\_\_\_\_\_ S      \_\_\_\_\_ NA        X   NP  
\_\_\_\_\_ SA      \_\_\_\_\_ O      \_\_\_\_\_ NAR  
\_\_\_\_\_ N      \_\_\_\_\_ OUA

Executive Officer

Date

Selvi Stanislaus

04/03/13

In determining whether an organization qualifies for exemption under IRC section 501(c)(3), common law principles have been applied that, to be treated as a charitable entity, an organization may not operate illegally or contrary to public policy. Courts have consistently held that the benefits accorded charitable organizations ought not to be made available to an organization which functions in a manner that undermines important and recognized societal values.<sup>1</sup>

An organization seeking tax exemption must serve a public purpose and may not violate established public policy.<sup>2</sup> For example, since there's a national policy to discourage racial discrimination, a private school that lacks a racially nondiscriminatory policy would be considered to be operating contrary to public policy within the common law concept.<sup>3</sup> Thus, IRS tax-exempt status is unavailable to private schools that practice racial discrimination.

### State Law

Under California law, an organization must obtain state tax exempt status regardless of the organization's federal status. Generally, to obtain California tax-exempt status, an organization is required to file an exempt application<sup>4</sup> with the FTB. An organization obtains tax-exempt status upon receiving a letter from the FTB exempting the organization from tax.

An organization that is exempt from federal tax under IRC section 501(c)(3) may use a streamlined process by using a simplified form<sup>5</sup> when applying for tax-exempt status with the FTB by attaching a copy of their federal determination letter of exemption under IRC section 501(c)(3).<sup>6</sup>

California Revenue and Taxation Code (R&TC) section 23701d conforms with modifications to IRC section 501(c)(3). Revenue and Taxation Code Section 23701d sets forth the definition of a charitable organization for purposes of tax exemption.

Similar to federal tax law, state tax law lacks language that explicitly prohibits discrimination by charitable organizations.

### THIS BILL

This bill would bar tax exempt status for a public charity youth organization, as defined, that discriminates on the basis of gender identity, race, sexual orientation, nationality, religion, or religious affiliation.

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<sup>1</sup> Internal Revenue 1980 Exempt Organization CPE Text.

<sup>2</sup> Jones University (1980, CA4) 47 AFTR 2d 81-553.

<sup>3</sup> Rev Rul 71-447, 1971-2 CB 230.

<sup>4</sup> FTB Form 3500 – Exemption Application.

<sup>5</sup> FTB Form 3500A – Submission of Exemption Request.

<sup>6</sup> R&TC section 23701d.

Public charity youth organization would be defined as including, but would not be limited to, those organizations listed in R&TC section 6361(b)(3)(A): Little League, Bobby Sox, Boy Scouts, Cub Scouts, Girl Scouts, Campfire, Inc., Young Men's Christian Association, Young Women's Christian Association, Future Farmers of America, Future Homemakers of America, 4-H Clubs, Distributive Education Clubs of America, Future Business Leaders of America, Vocational Industrial Clubs of America, Collegiate Young Farmers, Boys' Clubs, Girls' Clubs, Special Olympics, Inc., American Youth Soccer Organization, California Youth Soccer Association, North, California Youth Soccer Association, South, and Pop Warner football.

### IMPLEMENTATION CONSIDERATIONS

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

Under this bill, a donor's charitable contribution deduction would be unaffected if an organization's California tax-exempt status was denied or revoked as the charitable contribution deduction is controlled by federal law.<sup>7</sup> If this is contrary to the author's intent, the author may wish to amend the bill.

If an organization obtains its tax-exempt status by using the streamlined process, an acknowledgement letter is sent. Currently, the FTB must provide an acknowledgement letter without being able to consider whether the organization is in compliance with these new rules. The author may consider revising the language to allow the FTB to check for compliance prior to sending an acknowledgement letter.

The bill lacks administrative details that must be determined to implement the bill and determine its impacts to the department's systems, forms, and processes. The bill is silent on the following issues:

- How would the FTB determine whether an organization discriminated? Would the FTB have the resources to audit and defend the FTB's determinations?
- If an organization eliminated its discriminatory practice(s), would it be ineligible for tax-exempt status forever?
- If an organization's California tax-exempt status is revoked based on the organization's discriminatory policy, what would be the effective date of the tax-exemption revocation? Would the revocation apply retroactively or only prospectively?

### **LEGISLATIVE HISTORY**

SB 559 (Padilla, Chapter 261, Statutes of 2011) added "genetic information" to the list of protected classes in existing law under which discrimination is prohibited and preserved the deduction for business expenses, e.g. entertainment, incurred in connection with a club or organization that discriminates on the basis of "genetic information".

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<sup>7</sup> IRC 170(c)(2)

## **OTHER STATES' INFORMATION**

*Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws do not have comparable provisions for disallowing or revoking an organization's corporation tax-exempt status as proposed by this bill. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

## **FISCAL IMPACT**

If this bill is amended to resolve the implementation considerations addressed in this analysis, the bill would not impact the department's costs.

## **ECONOMIC IMPACT**

### Revenue Estimate

While it is estimated that there are approximately 7,400 organizations that could potentially be affected by this bill, staff was unable to determine the number that discriminate upon the basis specified in this proposal. For each organization determined to discriminate, it is estimated the revenue generated per taxpayer would be approximately \$1,000 per open tax year. Taxpayers generally have one to four open tax years, depending on when they were organized and when they filed their returns.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

## **SUPPORT/OPPOSITION**

Support: None provided.

Opposition: None provided.

## **ARGUMENTS**

Proponents: Some taxpayers may say that this bill would encourage tax-exempt public charity youth organizations to eliminate discrimination within their organizations.

Opponents: Some may argue that if the FTB revokes the tax-exempt status of a public charity youth organization based on its discriminatory practices, the FTB may be challenged on the basis of violation of the freedom of religion and freedom of association clauses.

## **LEGISLATIVE STAFF CONTACT**

Diane Deatherage

Legislative Analyst, FTB

(916) 845-4783

[diane.deatherage@ftb.ca.gov](mailto:diane.deatherage@ftb.ca.gov)

Mandy Hayes

Revenue Manager, FTB

(916) 845-5125

[mandy.hayes@ftb.ca.gov](mailto:mandy.hayes@ftb.ca.gov)

Gail Hall

Legislative Director, FTB

(916) 845-6333

[gail.hall@ftb.ca.gov](mailto:gail.hall@ftb.ca.gov)