

Executive Summary

The principal legislative purpose of AB 897, Stats. 2007, ch. 238, was to allow federal law under IRC section 501(c)(3) to control as to the exemption of organizations qualifying under that federal section for California purposes. As a result, to the extent that existing California regulations conflict with federal law under IRC section 501(c)(3), the Franchise Tax Board is amending existing regulations to effectuate the Legislature's intent in enacting AB 897.

Currently, both California and federal law recognize a group of organizations as tax-exempt if they are affiliated with a central organization (one which has one or more subordinates under its general supervision or control). The concept of a central organization applying for tax exemption for itself and its subordinates (i.e., chapter, local, post, or unit) is known as a "group exemption."

However, an important current distinction between federal and California law regarding "group exemptions" is that under federal law both incorporated and unincorporated subordinates can participate in group exemption. Conversely, under existing California regulations, only unincorporated subordinates are allowed to obtain tax exemption by virtue of being part of a group. (See Regulation sections 23701(i) and 23772(d).) Therefore, to effectuate the legislative purpose of AB 897, staff requests permission from the Board to hold an interested parties meeting to consider whether existing Regulation sections 23701(i) and 23772(d) should be amended to allow incorporated subordinates to be able to obtain tax exemption by virtue of being part of a group. This regulation project was not included in the 2008 Rulemaking Calendar approved by the Board in November of 2007.

REQUEST FOR PERMISSION TO HOLD AN INTERESTED PARTIES MEETING AND
PROCEED WITH REVISIONS TO EXISTING REGULATION SECTIONS 23701(i) AND
23772(d) TO ALLOW INCORPORATED SUBORDINATES OF IRC SECTION 501(c)(3)
ORGANIZATIONS TO OBTAIN TAX EXEMPTION BY VIRTUE OF BEING PART OF A
GROUP

AB 897, Stats. 2007, ch. 238, changed the rules for California income and franchise tax purposes for organizations that are exempt under Internal Revenue Code (IRC) section 501(c)(3). Specifically, AB 897 added a new subdivision to Revenue and Taxation Code (RTC) section 23701d that provides generally that IRC 501(c)(3) exempt organizations will be exempt for California purposes upon submission of a copy of the organization's IRC 501(c)(3) federal determination letter to the Franchise Tax Board. This change specifically applies to requests for tax-exempt status in California filed by organizations with the Franchise Tax Board on or after January 1, 2008. The Legislature's purpose for enacting AB 897 was specifically stated in Section 3 of the act as follows:

The Legislature finds and declares that the enactment of this act and the retroactive application provided by Section 1 of this act are necessary for the public purpose of providing relief under California law to certain nonprofit organizations that qualify as tax-exempt for federal income tax purposes and are seeking to obtain tax-exempt status in California by eliminating the requirement to file a separate application with the Franchise Tax Board for those organizations that have received a federal determination letter, and thus, streamlining the process of obtaining the tax-exempt status for state income tax purposes, and ensuring that every eligible organization qualifies for this new process regardless of whether the organization receives a federal determination letter before or after January 1, 2008.

As the legislative purpose of AB 897 is to allow federal law under IRC section 501(c)(3) to control, to the extent that existing California regulations conflict with federal law under IRC section 501(c)(3), consideration of any conflict in existing regulations is required to effectuate the Legislature's intent in AB 897.

Currently, both California and federal law recognize a group of organizations as tax-exempt if they are affiliated with a central organization (one which has one or more subordinates under its general supervision or control). The concept of a central organization applying for tax exemption for itself and its subordinates (i.e., chapter, local, post, or unit) is known as a "group exemption."

However, there is a distinction between federal and California law regarding "group exemption." This occurs because under federal law, both incorporated and unincorporated subordinates are eligible for a group exemption. Conversely, under existing California regulations, only unincorporated subordinates are allowed to obtain their tax exemption by virtue of being part of a group. (See Regulation sections 23701(i)

and 23772(d).) In California, incorporated subordinates must submit an individual application with fee to establish exempt status. (See Regulation sections 23701(i) and 23772(d).) Therefore, to effectuate the legislative purpose of AB 897, staff requests permission from the Board to hold an interested parties meeting to consider whether existing Regulation Sections 23701(i) and 23772(d) should be amended to allow incorporated subordinates to be able to obtain tax exemption by virtue of being part of a group. This regulation project was not included in the 2008 Rulemaking Calendar approved by the Board in November of 2007.

Since staff believes that these proposed amendments are likely to be non-controversial, in the event that no concerns are raised at the interested parties meeting, staff further requests permission to proceed immediately to the formal public hearing process under the Administrative Procedure Act. The text of the proposed amendments and a brief explanation of them are attached. If any concerns are raised at the interested parties meeting, staff will report back to the Board on the results of the interested parties meeting and request further direction as to how to proceed.

Section 23701 is amended to read:

§ 23701. Exemption from Taxation.

(a)(1) In General — ~~Section~~ Revenue and Taxation Code section 23701 provides an exemption from franchise or ~~corporation~~ corporate income tax for organizations organized and operated for nonprofit purposes within the provisions of a specific section of Article 1, Chapter 4, or are subject to ~~Section~~ Revenue and Taxation Code sections 23701h or 23701x (relating to certain title-holding companies), 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 June 30, 1983; and

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

(2) However, ~~t~~The exemption provided does not extend to the unrelated business taxable income of such organization (see ~~Section~~ Revenue and Taxation Code section 23731). Also the exemption is not applicable to an organization determined to be a feeder organization under ~~Section~~ Revenue and Taxation Code section 23702. An organization which has been determined to be exempt by the ~~department~~ Franchise Tax Board can rely upon such determination so long as there are no substantial changes in the law or the organization's charter, purposes or method of operation. However, to retain exempt status the organization must elect an annual accounting period, must submit an annual return or statement, and pay appropriate filing fees.

(3) Notwithstanding anything to the contrary in this regulation, for requests filed on or after January 1, 2008, an organization that is exempt from federal income tax under Internal Revenue Code section 501(c)(3) shall, upon submission of a copy of its federal determination letter to the Franchise Tax Board with the Form FTB 3500A, be exempt from franchise or corporate income tax under Part 11 of Division 2 of the Revenue and Taxation Code, except to the extent noted in the preceding paragraph, under the authority of Revenue and Taxation Code section 23701d, subdivision (c). The additional filing requirements specified in subsection (b) shall not apply to any organization described in this paragraph.

(b) **Proof of Exemption.** An organization must be organized (chartered, incorporated) and operated (conducting activities) primarily (in some cases exclusively) for one or more of the purposes specified in the particular section describing the exempt organization. If the organization fails to meet the organizational or operational test for the particular section describing the exempt organization, it is not entitled to exemption.

(1) ~~An~~ Except as provided in subsection (a)(3), an organization claiming exemption under ~~Section~~ Revenue and Taxation Code section 23701 and described in ~~Section~~ Revenue and Taxation Code sections 23701a through 23701z shall file with the Franchise Tax Board an exemption application (Form FTB 3500) filled out in accordance with the instructions on the form or issued therewith. The exemption application and the attachments thereto shall show the character of the organization, the purpose for which it was organized, its actual and proposed activities, the sources of its income and the receipts and disposition thereof, whether or not any of its income or receipts is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which may affect its right to exemption. To each application there shall be attached a copy of the articles of incorporation, declaration of trust or other organizational document, the bylaws or other code of regulations, and financial statements showing assets, liabilities, receipts and disbursements (actual or as proposed) of the organization. The organizational document must meet the organizational test set out below and the activities or proposed activities must meet the operational test.

(A) Inurement of Income to Member or Individual. Sufficient information must be furnished about benefits and compensation to be received by members, officers, directors and employees to insure that it can be said they will not receive personal or private inurement. An organization is not operated for one or more exempt purposes contained in ~~Section~~ Revenue and Taxation Code sections 23701a through 23701z of the ~~Revenue and Taxation Code~~ (with some exceptions discussed below) if net earnings inure directly or indirectly in whole or in part to the personal or private benefit of a member, officer, director, employee or individual.

Inurement means that an individual receives some special benefit which is unreasonable under the circumstances because of his membership or relationship to the organization. Where organizations, exempt under ~~Section~~ Revenue and Taxation Code sections 23701d or 23701n are involved, the activity that leads to inurement may also be a prohibited transaction under ~~Section~~ Revenue and Taxation Code section 23736.1 of the Code. If the organization is a private foundation, the violation of the prohibitions upon self-dealing set forth in the Internal Revenue Code would normally constitute inurement if not corrected.

1. Under ~~Sections~~ Revenue and Taxation Code sections 23701a, 23701b, 23701i, 23701j, 23701n and 23701s the payment of sick, accident, death, unemployment or retirement benefits out of employer, employee or member contributions does not result in personal or private inurement. In most cases, a limited amount of income, which may be taxable as unrelated business income, may be used for the payment of permitted benefits. Local associations of employees may receive contributions from employers that benefit employees without loss of exempt status. Payment of profits to participants of exempt diversified management corporations are also permissible benefits.

2. Inurement has been held to have occurred in many situations, including the following:

(I) Unreasonable compensation for services. The facts and circumstances of each case must be examined to determine if the compensation is unreasonable.

(II) Unreasonable rental charges.

(III) Unsecured loans of doubtful safety.

(IV) Deferred or retained interest in the assets of an organization claiming exemption under ~~Section~~ Revenue and Taxation Code sections 23701c, 23701d, 23701f, or 23701r.

(V) Operation of an organization to serve private interests.

(VI) Self-dealing with the organization; such as, making sales to or purchases from the organization which are not reasonable on their face.

(VII) Lack of a reasonable return on the capital of an organization exempt under ~~Section~~ Revenue and Taxation Code section 23701d.

(VIII) Use of the organization's property without adequate payment.

(IX) Reduction of dues, increase in assets, or provision of more services to members for the same dues which occurs as a result of a social and recreational organization's receiving income from the general public may be inurement to members. Use of limited income received from the general public for the above purposes may be permissible if it is taxable as unrelated business income.

(X) Reimbursement of founder for expenses incurred in connection with organization before it was exempt.

(XI) Payment of part of the general operating expenses of a membership organization out of income received from the general public normally results in inurement.

(B) Change of exempt classification.

1. An organization requesting a change of exempt status more than one year after exemption has been granted must submit a new exemption application, unless clause 2. is applicable. However, supporting information that is still current need not be resubmitted.

2. If an initial federal exemption application is timely filed and the exempt classification when received is different than that issued by the Franchise Tax

Board, a change of classification will be considered without a formal application if the request for reclassification is submitted within ninety days after issuance of the federal exemption letter. The request shall be accompanied by a copy of the federal determination letter and any supporting information not previously furnished the Franchise Tax Board.

(2) In addition to the information specifically required under this regulation, the Franchise Tax Board may require additional information as deemed necessary to determine whether an organization is entitled to exemption under Section Revenue and Taxation Code section 23701, including evidence that the organization has established exempt status with the Internal Revenue Service.

(3) An organization applying for exemption from tax or for a change (reclassification) of exempt status must pay an application fee of \$25 with the exemption application. However, exceptions to the payment of the fee may be made for ~~unincorporated chapters of groups~~ subordinates (processed on a group basis) and for unincorporated associations or trusts operating in California which were exempt from federal taxation prior to January 1, 1970. A copy of the Internal Revenue Service exempt determination letter should be furnished with the application.

(4) Retroactivity of Exemption. Exempt status may be granted for years prior to approval of the exemption application but only to the extent the organization establishes it satisfied the exemption requirements during each of such prior years. In no event shall a claim for refund be allowed unless timely filed under Section Revenue and Taxation Code section 19306. In the case of exemptions granted under subsection (a)(3), the effective date of an organization's tax-exempt status for California franchise or income tax purposes 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.

(c) Organizational Test.

(1) In General.

(A) An organization is organized primarily (in some cases exclusively) for one or more exempt purposes only if its articles of organization ("articles") as defined in paragraph (2) of this ~~subdivision~~ subsection:

1. Expressly set out an exempt purpose consistent with the purposes stated in the section which describes the exempt organization; and
2. Limit any other purposes or powers of the organization, except to an insubstantial degree, to those in furtherance of the purpose.
3. In the case of an unincorporated association (that is not a trust), expressly state that the organization is organized for nonprofit purposes and that individuals will not profit therefrom. However, associations described in

~~Section~~ Revenue and Taxation Code sections 23701h or 23701x (relating to certain title-holding companies) are not subject to this requirement.

4. In the case of a domestic corporation, incorporate the organization under Division 2, Parts 1, 2, 3, 4 or 6, of the California Corporations Code. However, incorporation under other provisions of the Corporations Code is permitted to the extent provided in ~~Sections~~ Revenue and Taxation Code sections 23701h and 23701x (relating to certain title-holding companies).

(B) In meeting the organizational test, the organization's specific purpose, may be as broad as, or more specific than, the purposes stated in the section which describes the exempt organization. The purpose should normally be accomplished by the primary activity of the organization.

(C) An organization is not organized primarily for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in a section describing an exempt organization. Thus, an organization that is empowered by its articles "to engage in a manufacturing business," or "to engage in the operation of a social club" does not meet the organizational test of an organization desiring exemption under ~~Section~~ Revenue and Taxation Code section 23701d regardless of the fact that its articles may state that such organization is created "for charitable purposes" within the meaning of ~~Section~~ Revenue and Taxation Code section 23701d.

(2) Articles of Organization. For the purposes of this section, the term "articles of organization" or "articles" includes the trust instrument, the corporate charter, the articles of association, or any other written instrument by which the organization is created.

(3) If before January 1, 1970, an organization has been determined to be an exempt organization by the Franchise Tax Board, the fact that such organization does not meet the organizational test prescribed by this paragraph shall not be a basis for revoking such determination.

(d) Operational Test.

(1) Primary Activities. An organization will be regarded as "operated primarily" or "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in the section (Revenue and Taxation Code sections 23701a through 23701z) which describes the exempt organization. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

(2) Exempt status will be recognized in advance of operations (or incorporation), where proposed operations are planned to begin within one year and can be described in sufficient

detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy these requirements. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned for carrying out the activities; the anticipated source of receipts, and the nature of contemplated expenditures. Where the Franchise Tax Board considers it warranted, a record of actual operations may be required before a determination letter will be issued.

(A) Where exempt operations do not actually begin within the year an attachment should be added to the annual report to explain the delay and to outline plans for conducting activities during the next year. Failure to explain such inactivity will be cause for revocation of the exempt status since an inactive organization is not operated for exempt purposes and therefore is not entitled to exemption from tax.

(B) Organizations that commence exempt operations and later become inactive are subject to loss of exempt status unless they include an attachment on their annual report to explain that their inactivity is temporary and to outline their plans for becoming active in the near future.

(e) The words "private shareholder or individual" in Sections Revenue and Taxation Code sections 23701a through 23701z refer to persons having a personal or private interest in the activities of the organization.

(f) Every organization which has established its right to exemption shall submit an annual report or statement as required by Sections Revenue and Taxation Code section 23772. Also, the organization shall maintain adequate operational and financial records to show that its operations are conducted in an exempt manner. Changes in the character, operations or purposes of an exempt organization shall be reported in writing to the Franchise Tax Board for evaluation as to whether the organization's exempt status is affected. In cases where the organization's exempt status is revoked, either by suspension of corporate powers, or for failure to elect an accounting period, or to file an annual return or statement, then (see Sections Revenue and Taxation Code sections 23776 and 23778 are applicable for reinstatement provisions).

(g) Every exempt organization shall make its records available or shall submit, in addition to its annual information return or statement, such additional information as may be required by the Franchise Tax Board for the purpose of enabling it to inquire further into the organization's exempt status and to administer the provisions of Chapter 4 of the ~~Bank and Corporation Tax~~ Law.

(h) **Withdrawal of Applications.** Applications for exemption may be withdrawn, upon the written request of one of the principal organizers or his/her attorney, at any time prior to the issuance of a determination letter. However, even though the application is withdrawn, the application, supporting documents and the application fee will be retained by the Franchise Tax Board and will not be returned to the organization.

(i) Group Exemptions for ~~Unincorporated~~Subordinates Chapters.

(1) A central organization (one which has one or more California subordinates under its general supervision or control) may apply for exemption for itself and ~~its unincorporated~~ subordinates (chapter, local, post or unit). A central organization may be a subordinate itself; for example, a state organization which has subordinate units and may itself be affiliated with a national organization or a district of a state organization. This procedure will relieve each of the subordinates ~~unincorporated chapters~~ from applying separately for exemption.

(2) The organization applying for a group exemption letter must establish its own exempt status. It must also establish that the ~~unincorporated~~ subordinates to be included in the group are:

- (A) Affiliated with it;
- (B) Subject to its general supervision and control; and
- (C) Exempt under the same lettered section under Section Revenue and Taxation Code section 23701, including organizations exempt under subsection (a)(3), although not necessarily exempt under the same section as the national, state or parent (central) organization.

(3) Each subordinate to be included in the exempt determination must be formed under a standard constitution, articles of association, articles of incorporation or bylaws, and must authorize the central organization in writing to include it in the group exemption letter.

(4) A central organization seeking a group exemption letter for its subordinates must establish its own exemption separately by filing an exemption application form. In addition to the information required to establish its own exemption or information not previously furnished, if it is already exempt, it must include in the application for group exemption:

- (A) Information verifying the existence of the relationships set out in ~~paragraph~~subsection (2)(A) and (B) above.
- (B) A description of the principal purposes and activities of subordinates.
- (C) A sample copy of the uniform governing instrument for subordinates.
- (D) An affirmation to the effect that, to the best of the central organization's knowledge, the subordinates are operating in accordance with the stated purposes.
- (E) A statement that each subordinate to be included in the group exemption letter has furnished written authorization to the parent organization.
- (F) A list of all California subordinates, mailing addresses and corporation numbers or Franchise Tax Board organization numbers if assigned. If an annual group report will be submitted, the organizations to be included in the report should be identified.

~~Each subordinate that cannot be included in the annual information group report or statement must be assigned an organization number by the Franchise Tax Board if it is not incorporated or qualified to do business in California.~~

(5) Information required annually to maintain a group exemption letter. The national, central or state organization must submit to the Franchise Tax Board annually within 45 days after the close of the annual accounting period of its ~~subordinates chapters~~, to the Franchise Tax Board, attention:

(A) Information regarding all changes in the purpose, character, or method of operation of subordinates included in the group exemption letter.

(B) A complete listing, with addresses, of all active California ~~chapters~~ subordinates, showing the corporation or organization number assigned by this department (when one has been assigned). If a group report will be submitted, the listings should indicate all subordinates that are authorized to and will be included in the group report. The list should be marked to indicate which subordinates have changed their names or addresses during the year. Any new subordinate formed during the year shall be clearly identified.

(C) A separate listing should show all subordinates that have ceased to exist since the last report and those that have disaffiliated from the central organization.

(D) Each subordinate must be included in an information return or statement submitted annually. Subordinates that meet the requirements may be included in a group report, while any subordinate not authorized and not included in the group return must submit an individual return or statement.

(E) Submission of the above information does not relieve the central organization or any of its subordinates of the duty to submit such additional information as the Franchise Tax Board may require to permit it to determine whether the conditions for continued exemption are met.

(6) Termination of a group exemption letter.

(A) Termination of a group exemption letter will result in nonrecognition of the exempt status of all included subordinates. To reestablish an exempt status in such cases, each subordinate must file an exemption application or a new group exemption must be applied for and secured.

(B) If a central or state organization covered by a group exemption letter ceases to exist, the group exemption letter will be terminated.

(C) Failure of the central or state organization to submit an annual listing or information return for itself (where required) and for its subordinates which are

included in the group letter and designated to be included in a group report may result in termination of the group exemption letter.

(D) If a subordinate which is covered by the group letter and which is required to report separately to the Franchise Tax Board does not submit an annual report, its exempt status may be terminated on an individual basis. The group exemption letter will no longer be applicable to such subordinate, but will otherwise remain in effect. Where a subordinate's exemption is terminated on an individual basis, it must reapply for exemption on an individual basis.

~~(7) Unincorporated associations that are covered by a group letter that later incorporate or new chapters of such groups that form corporations must submit an individual application with fee to establish exempt status. However, in such cases the exemption application can be abbreviated as indicated in the instructions to Form 3500.~~

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 23701, Revenue and Taxation Code.

Section 23772 is amended to read:

§ 23772. Information Returns and Statements Exempt Organizations.

(a) For income years ending December 31, 1971, and subsequent years, all exempt organizations or trusts and nonexempt trusts treated as a private foundation because of Internal Revenue Code Section 4947(a)(1) of the Internal Revenue Code (I.R.C.) must file a Form 199 (Exempt Organization Annual Information Return).

(1) A completed Form 199 is required from any organization, except:

(A) A church, an interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church such as a men's or women's organization, religious school, mission society, or youth group;

(B) An exclusively religious activity of any religious order;

(C) An organization (other than a private foundation) the gross receipts of which in each taxable year are normally not more than \$25,000 (as described in subdivision subsection (i) of this regulation);

(D) A mission society sponsored by or affiliated with one or more churches or church denominations, more than one-half of the activities of which society are conducted in, or directed at persons in, foreign countries;

(E) Nonprofit exempt quasi-governmental organizations formed to carry out a function of the State or a public body, that are carrying out that function and are controlled by the State or a public body. Such an organization must have been formed to support a function of the State, county, city or other political body, it must be operating for this purpose and the majority of the directors must be under the control of the State or appropriate political body. Upon dissolution, the assets must be turned over to the State, county, city, or other political body.

Note: A stock bonus, pension or profit-sharing trust exempt under Section Revenue and Taxation Code section 17631 is not required to file Form 199. However, unrelated business income of \$1,000 or more requires the filing of Form 109. (See Section Revenue and Taxation Code section 18506.)

(2)(A) The information required to be furnished by each organization required to file Form 199 is:

1. Its gross sales and receipts from all sources during the year, except dues and contributions set out in clauses 2. and 3. below. For this purpose, gross receipts includes tax exempt income. The cost of goods sold and the cost or other basis and sales expenses of assets will be shown and subtracted from the above to arrive at gross income.

2. Gross dues and assessments from members and affiliates for the year. Social or recreational clubs must furnish additional information on source of receipts.
3. The total of the contributions, gifts, grants and similar amounts received during the taxable year.
4. Gross receipts for filing requirements.
5. Its expenses incurred within the year attributable to gross income.
6. Its disbursements (including prior years' accumulations) made within the year for the purposes for which it is exempt.
7. Increase or decrease in net worth.
8. The total assets and liabilities at the beginning and end of the year.
9. Information on legislative and political activities.
10. Other information that may be found necessary to insure that the organization is operating in an exempt manner.
11. For additional information required to be furnished by private foundations, see subparagraphs (B) and (C) below.

(B) Alternative detailed reporting requirements.

1. Any organization, including a private foundation, that is required to complete Part II of Form 199 can comply fully with its reporting requirements by completing page 1 of the Form 199 and paying \$10.00 filing fee, if required, and:

(I) Attaching a completed copy of the current Registry of Charitable Trusts Report CT-2; or

(II) Attaching a completed copy of Federal Form 990 which includes Part I, II, and any required schedules. ~~Also~~In the case of Private Foundations with assets of \$5,000 or more, at any time during its accounting period, must furnish a copy of the annual report of Private Foundation (Federal Form 990A-R or substitute report) filed with the Internal Revenue Services; or

(III) In case of a labor organization, a copy of Labor Department Form LM-3 may be attached.

(C) Special rules for organizations which are required to complete Part II of Form 199 but which do not use alternative detailed reporting requirements permitted in subparagraph (B) above.

1. An itemized schedule must be attached to Form 199 if money, securities or other property of \$5,000 or more is received as a contribution gift or grant directly or indirectly from one person during the year showing name, address, date received and total amount received from such person. In the case of a private foundation (as defined in Internal Revenue Code Section 509(a)), the names and addresses of all persons who became substantial contributors (as defined in Internal Revenue Code Section 507(d)(2)) during the taxable year shall be furnished.

(I) An organization described in Section Revenue and Taxation Code section 23701d which meets the 33 1/3 percent-of-support test of the regulations under Internal Revenue Code Section 170(b)(1)(A)(vi) (without regard to whether such organization otherwise qualifies as an organization described in Internal Revenue Code Section 170(b)(1)(A) I.R.C.) is required to provide the name and address of a person who contributed, bequeathed or devised \$5,000 or more during the year only if this amount is in excess of 2 percent of the total contributions, bequests and devises received by the organization during the year.

(II) An organization other than a private foundation is required to report only the names and addresses of contributors of whom it has actual knowledge. For instance, an organization need not require an employer who withholds contributions from the compensation of employees and pays over to the organization periodically the total amounts withheld, to specify the amounts paid over with respect to a particular employee. In such case unless the organization has actual knowledge that a particular employee gave more than \$5,000 (and in excess of 2 percent if 1. of this subdivision is applicable), the organization need report only the name and address of the employer, and the total amount paid over by him.

(III) Separate and independent gifts made by one person in a particular year need be aggregated to determine if his contributions and bequests exceed \$5,000 (and in excess of 2 percent if 1. of this ~~subdivisions~~subsection is applicable), only if such gifts are of \$1,000 or more.

(IV) Organizations described in Section Revenue and Taxation Code sections 23701b or 23701i and organizations described in Section Revenue and Taxation Code section 23701g that receive contributions or bequests to be used exclusively for purposes described in Section Revenue and Taxation Code section 17214(d) must attach a schedule with respect to all gifts which aggregate more than \$1,000 from any one person, showing the

name of the donor, the amount of the contribution or bequest, the specific purpose for which such amount was received, and the specific use to which such amount was put. In the case of an amount set aside for such purposes, the organization shall indicate the manner in which such amount is held (for instance, whether such amount is commingled with amounts held for other purposes). If the contribution or bequest was transferred to another organization, the schedule must include the name of the transferee organization, a description of the nature of such organization, and a description of the relationship between the transferee and transferor organizations. Such organizations must also attach a statement showing the total dollar amount of contributions and bequests which are \$1,000 or less received for such purposes.

2. Attach a schedule detailing the gross amount received from the sale of assets, including inventory items.
3. Attach a schedule itemizing other income, except contributions, gifts and grants.
4. Attach a schedule showing amount of:
 - (I) Death, sickness, hospitalization or disability benefits;
 - (II) Unemployment compensation benefits; and
 - (III) Other benefits (state nature) paid out.
5. Attach schedule for officers, directors, trustees or individuals having similar responsibilities, showing name, address, social security number, compensation and time devoted to position, and in the case of a private foundation, all persons who are foundation managers, within the meaning of Internal Revenue Code Section 4946(b)(1). Organizations described in Section Revenue and Taxation Code section 23701d must also attach a schedule showing the names and addresses of the five employees (if any) who received the greatest amount of annual compensation in excess of \$30,000 and amounts received; the total number of other employees who received annual compensation in excess of \$30,000; the names and addresses of the five independent contractors (if any) who performed personal services of a professional nature for the organization (such as attorneys, accountants, and doctors, whether such services are performed by such persons in their individual capacity or as employees of a professional service corporation) and who received in excess of \$30,000, from the organization for the year for the performance of such services; and the total number of other such independent contractors who received in excess of \$30,000 for the year for the performance of such services.

6. Attach schedules to explain depreciation (or depletion), other expenses, and to explain items on balance sheet where requested in Part II of Form 199.

(b) Accounting Period for Filing Return or Statement. A return on Form 199 shall be filed on the basis of the established annual accounting period of the organization. If the organization has no established accounting period, the return shall be filed on the basis of the calendar year.

(c) Returns When Exempt Status not Established. Where an organization has a reasonable claim for exemption and submits an exemption application prior to the time a taxable return is due, if it does not appear that the exemption will be denied, an exempt return may be submitted within ten days of the due date even if the Franchise Tax Board has not yet issued an exempt determination letter. If the exemption should be denied at a later time, the above action should be reasonable grounds for filing a late taxable return. In other cases, a taxable return should be submitted on or before the due date with a payment for any tax that is due.

(d) Group Returns.

(1) A group return may be filed by a central organization (for the purposes of this subsection, this includes a parent, state, district, or similar type organization) for its subordinate organizations (for the purposes of this subsection, this includes a branch, local or similar organization) none of which are private foundations, provided the subordinate organizations:

(A) are affiliated with the central organization at the close of the central organization's annual accounting period;

(B) are subject to the general supervision and control of the central organization;
and

~~(C) have established their exempt status as may be required by the Franchise Tax Board; and~~

~~(D) do not have unrelated trade or business income in excess of \$1,000.~~

1. The group return shall consist of the following:

(I) a completed annual return or statement for the central organization;

(II) a list of names, current addresses and corporate or association numbers of the qualified subordinates which are to be included in the group return; and

(III) any additional information which may be required by the Franchise Tax Board.

2. After the initial group return is filed, Item 1.(II) above may be replaced by a list to include only:

- (I) subordinates that were added;
- (II) subordinates deleted; or;
- (III) a statement of no change from the previous year's report.

3. If the central organization has not been issued a group exemption letter, it must secure a group exemption determination from the Franchise Tax Board to cover its ~~unincorporated~~ subordinates before a group return may be filed. The Franchise Tax Board may determine the requirements for a group exemption.

4. If the central organization has previously been issued a group exemption letter, all new subordinate organizations formed during the year must be identified on the roster. ~~New subordinate organizations which are incorporated must establish their individual exempt status with the Franchise Tax Board before they may be included in a group return filed by the central organization.~~

5. A group return may be submitted by central church associations for subordinate churches or church associated groups that are permitted to file the exempt organization annual information statement. Schedules required in 1.(II) above must be attached to the information statement submitted by the parent church. Any subordinate having more than \$1,000 of unrelated trade or business may not be included in the group report.

(e) Time and Place for Filing. The annual return on Form 199 shall be filed on or before the 15th day of the fifth month (4 1/2 months) following the close of the annual accounting period for which the return is required to be filed. The annual return on Form 565 required to be filed by a religious or apostolic association or corporation shall be attached to Form 199. Each such return shall be filed in accordance with the instructions applicable thereto.

(f) Payment of Filing Fee. All organizations required to file Form 199 (including group returns), except those described below, must pay a \$10.00 filing fee with Form 199. If payment is not made on or before the due date (or extended due date), the fee is \$25.00 unless there is reasonable cause for late payment. Organizations required to file Form 199 but not required to pay the filing fee should check the appropriate box on Form 199. Organizations exempt under Section Revenue and Taxation Code section 23701d which are not required to pay a filing fee are described as follows:

(1) Exclusively religious organizations.

(2) An exclusively educational organization exempt under Section Revenue and Taxation Code section 23701d, if the organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on

(3) An exclusively charitable organization, or an organization for the prevention of cruelty to children or animals, exempt as provided under Section Revenue and Taxation Code section 23701d, if the organization is supported, in whole or in part, by funds contributed by the United States or any state or political subdivision thereof, or is primarily supported by contributions of the general public.

(4) An organization exempt under Section Revenue and Taxation Code section 23701d, if the organization is operated, supervised, or controlled by or in connection with a religious organization.

(g) Penalties for Failure to File a Return. If an organization or trust required to file a Form 199 fails to file the return on or before the due date, it will have to pay \$5.00 for each month, or part thereof, after the due date, not to exceed \$40.00, until the form is filed, unless it can be shown that the failure was due to reasonable cause. Also ~~in~~ In the case of a private foundation, the Franchise Tax Board may make written demand that such delinquent return or foundation report be filed within a reasonable time after notice of mailing such demand. The person failing to file (unless it can be shown to be due to reasonable cause) will have to pay \$5.00 for each month, or part thereof, (not to exceed \$25.00) after the period expires.

(h) Records, Statements, and Other Returns of Tax-Exempt Organizations. Every organization which is exempt from tax, whether or not it is required to file an annual information return or statement shall submit such additional information as may be required by the Franchise Tax Board for the purpose of inquiring into its exempt status and administering the provisions of Chapter 4 of the Bank and Corporation Tax Law. (See Section Revenue and Taxation Code section 23701 and the regulations thereunder with respect to the authority of the Franchise Tax Board, to require such additional information and with respect to the books of account or records to be kept by such organizations.)

(i) Definitions. For the purposes of this regulation, the following definitions are applicable:

(1) Gross receipts of an organization are normally not more than \$25,000 if -

(A) In the case of an organization which has been in existence for 1 year or less, the organization has received, or donors have pledged to give, gross receipts of \$37,500 or less during the first taxable year of the organization,

(B) In the case of an organization which has been in existence for more than one but less than 3 years, the average of the gross receipts received by the organization in its first 2 taxable years is \$30,000 or less, and

(C) In the case of an organization which has been in existence for 3 years or more, the average of the gross receipts received by the organization in the immediately preceding 3 taxable years, including the year for which the return would be required to be filed, is \$25,000 or less.

(2) "Gross Receipts" means the gross amount received by the organization during its annual accounting period from all sources, without reduction for any costs or expenses. Gross receipts include, for example, cost of goods or assets sold, cost of operations, and expenses of earning, raising, or collecting such amounts. Thus "gross receipts" includes but is not limited to:

(A) the gross amount received as contributions, gifts, grants, and similar amounts without reduction for the expenses of raising and collecting such amounts,

(B) the gross amount received as dues or assessments from members or affiliated organizations without reduction for expenses attributable to the receipt of such amounts,

(C) gross sales or receipts from business activities (including business activities unrelated to the purpose for which the organization qualified for exemption), the net income or less from which may be required to be reported on Form 109,

(D) the gross amount received from the sale of assets without reduction for cost or other basis and expenses of sale, and

(E) the gross amount received as investment income, such as interest, dividends, rents, and royalties.

Note: Gross receipts of local lodges do not include funds collected for insurance premiums of members by local lodges and thereafter remitted to the home or parent office in connection with benefit contracts issued by the home office.

(j) Unrelated Business Income Tax Returns. In addition to the foregoing requirements of this section, most organizations otherwise exempt from tax under Section Revenue and Taxation Code section 23701 are subject to tax on unrelated business taxable income and also required to file returns on Form 109 if they receive such income. (See Section Revenue and Taxation Code section 23731 and regulations thereunder.)

(k) This regulation shall be applied to income years beginning on or after January 1, 1986, except that paragraph (1) of subsection (i) and subparagraph (C) of paragraph (1) of subsection (a) shall be applied to income years beginning on or after January 1, 1982; subsection (f) and clause (i) of subparagraph (B) of paragraph (3) of subsection (a) shall be applied with respect to fees imposed on or after July 1, 1983; and subparagraph (A) of paragraph (1) of subsection (a) shall be applicable to filings made on or after January 1, 1984.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 23772, Revenue and Taxation Code.