



Bill Analysis

Author: Wiener, et al.

Sponsor:

Bill Number: SB 834

Related Bills: See Legislative
History

Amended: March 9, 2022,
April 6, 2022, April 18, 2022,
and May 2, 2022

SUBJECT

Suspension of Tax Exempt-Status for Nonprofit Organizations Supporting or Engaging in Illegal Activities

SUMMARY

This bill would, under the Corporation Tax Law (CTL), require the Attorney General to notify the Franchise Tax Board (FTB) of a finding that a tax-exempt organization has actively engaged in, or incited the active engagement in, illegal activities, as defined, and would require the FTB to revoke the tax-exempt status of the organization found to be in violation. The bill would restate the FTB's existing revocation authority.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 9, 2022, amendments removed the findings and declarations language and replaced it with provisions, under the CTL, requiring the Attorney General to notify the FTB of a finding that a tax-exempt organization has actively engaged in, or incited the active engagement in, illegal activities, as defined, and requiring the FTB to revoke the tax-exempt status of the tax-exempt organization found to be in violation or any tax-exempt organization who has as a director or officer a person who was a director or officer of any organization found to be in violation.

The April 6, 2022, amendments removed the provision requiring the FTB to revoke the tax-exempt status of any tax-exempt organization that has as a director or officer a person who was a director or officer of any organization that had its exemption revoked for engaging in or inciting the active engagement in illegal activities. In addition, the amendments removed the provision requiring the directors of a nonprofit organization that has its exemption from tax revoked to provide written notification of the revocation to all known donors, the Internal Revenue Service (IRS), and the taxation authority of every state in which the organization operates or raises funds.

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The April 18, 2022, amendments do not constitute a change in, but is declaratory of, existing law and removed the tax levy provision.

The May 2, 2022, amendments made changes to Legislative intent.

This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for this bill is to revoke the California tax-exempt status of a tax-exempt organization actively engaged in or supporting insurrection and other illegal actions.

ANALYSIS

The bill contains a declaration from the Legislature explaining the purpose of the bill.

This bill would, under the CTL, provide that if the Attorney General determines that an organization exempt from tax has actively engaged in, or incited the active engagement in, specific crimes, the Attorney General would be required to notify the FTB of that determination. The bill identifies the following specific crimes under Title 18 of the United States Code:

- Treason (Section 2381);
- Misprision of treason (Section 2382);
- Insurrection (Section 2383);
- Seditious conspiracy (Section 2384);
- Advocating overthrow of the government (Section 2385); and
- Advocating mutiny by members of the United States military (Section 2387).

The bill would provide that upon receiving notification from the Attorney General, the FTB has authority under state law to revoke the exemption from tax for the organization.

The bill would allow the Attorney General and the FTB to prescribe rules, guidelines, procedures, or other guidance to carry out the purposes of the bill.

The bill would also provide that the authority of the FTB to revoke an exemption from tax does not constitute a change in, but is declaratory of, existing law.

Effective/Operative Date

This bill would be effective and operative January 1, 2023.

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Federal/State Law

Upon application, the IRS grants certain organizations tax-exempt status. California law treats federally tax-exempt IRC section 501(c)(3), 501(c)(4), 501(c)(5), 501(c)(6), 501(c)(7), or 501(c)(19) organizations as tax-exempt under state income tax law if the organization submits form FTB 3500A, Submission of Exemption Request, and a copy of its federal determination letter to the FTB.

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

California grants special status to nonprofit charitable organizations so that they may be exempt from paying state taxes. In addition, for certain nonprofit organizations, contributors may make donations that they may deduct for income tax purposes. To be exempt from state tax, an organization must be organized and operated for one or more exempt purposes listed in California's Corporation Tax Law.

Federal and State law allows for the suspension of the tax-exempt status, and requires suspension of tax-exempt status of an organization supporting or engaging in illegal international terrorist activity (IRC § 501(p), Cal. Rev & Tax Code § 23703.5).

Current California law prohibits an organization formed as a California corporation or qualified to do business in California that is listed by the Secretary of State (SOS) or the FTB as "suspended" or "forfeited" from establishing its exemption from state income taxes and provides that the organization will not receive an acknowledgement from the FTB of the organization's exemption until that corporation is listed by the SOS and the FTB as an "active" corporation.

Implementation Considerations

The department has identified the following implementation consideration, and is available to work with the author's office to resolve this and other considerations that may be identified.

The bill language is silent with regards to whether an organization that has its tax-exempt status revoked is barred from applying for reinstatement of the tax-exempt status in subsequent tax years. The author may wish to amend the bill to specify if an organization can or cannot apply for tax-exempt status in subsequent tax years.

Technical Considerations

None noted.

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Policy Considerations

This bill would create differences between federal and California tax treatment of the entity, as an entity could be considered exempt at the federal level but not at the state level. Such a difference could cause uncertainty for the organization and potential donors.

LEGISLATIVE HISTORY

SB 934 (Bates, Chapter 59, Statutes of 2020) eliminated the \$25 filing fee as of January 1, 2021, for organizations applying for tax-exempt status.

AB 94 (Rodriguez & Cervantes, Chapter 104, Statutes of 2017) allows federally tax-exempt veterans' organizations under IRC section 501(c)(19) to use the streamlined method of applying for tax-exemption for state purposes.

SB 1713 (Machado, Chapter 552, Statutes of 2004) in specified conformity to federal laws, modified the membership requirement for exemption from taxation for a veteran's organization, suspended the tax-exempt status of terrorist organizations, and expanded the use of Coverdell education savings accounts with respect to distributions made on account of attendance at specified military academies.

PROGRAM BACKGROUND

Currently, in order to obtain state exemption from tax under CTL section 23701, an organization must submit a completed exemption application form to the FTB. The exemption application is required to include the organization's Articles of Incorporation, bylaws, and financial statements showing assets, liabilities, receipts, and disbursements.

Beginning in 2008, organizations that received a federal determination of tax-exempt status under IRC section 501(c)(3) could obtain state tax-exempt status using a streamlined process by submitting only a copy of the federal determination to the FTB (RTC section 23701d(c)(1)). Beginning in 2013, the streamlined application process was extended to include organizations that received a federal determination of tax-exempt status under IRC sections 501(c)(4), 501(c)(5), 501(c)(6), or 501(c)(7).

Under the streamlined process, the FTB is allowed to revoke tax-exempt status if the organization fails to meet certain California provisions governing exempt organizations.

Also, an organization must inform the FTB of the suspension or revocation of the federal tax-exempt status and, upon receipt of the IRS notice of suspension or revocation, the FTB is allowed to suspend or revoke the organization's state tax-exempt status.

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FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill as amended May 2, 2022, would allow the FTB to revoke the tax-exempt status of a nonprofit organization that the Attorney General determines to have engaged in, or incited the active engagement in, an act of conspiracy. Because of the uncertainty inherent in such an event, it is not possible to accurately forecast when such an event would occur. However, under the bill's provisions, additional revenues would likely be generated because revoked nonprofits would become subject to the corporate income and franchise tax provisions and taxed at the applicable corporate tax rate. It is estimated that each additional \$1 million dollars of taxable income resulting from the revocation of tax exempt status would result in a revenue gain of approximately \$90,000.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

Support

As per the Senate Floor analysis of SB 834, dated May 21, 2022, the following organizations are in support of the bill:

All Rise Alameda
Anti-Defamation League
Building the Base Face to Face
Change Begins With Me Indivisible Group
Cloverdale Indivisible
Contra Costa MoveOn
Defending Our Future: Indivisible in CA
East Valley Indivisibles

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El Cerrito Progressives
Feminists in Action
Hillcrest Indivisible
Indi Squared
Indivisible 30/Keep Sherman Accountable
Indivisible 36
Indivisible 41
Indivisible Auburn CA
Indivisible Beach Cities
Indivisible CA: StateStrong
Indivisible CA-25 Simi Valley Porter Ranch
Indivisible CA-29
Indivisible CA-3
Indivisible CA-33
Indivisible CA-37
Indivisible CA-39
Indivisible CA-43
Indivisible CA-7
Indivisible Claremont/Inland Valley
Indivisible Colusa County
Indivisible East Bay
Indivisible El Dorado Hills
Indivisible Elmwood
Indivisible Euclid
Indivisible Lorin
Indivisible Los Angeles
Indivisible Manteca
Indivisible Marin
Indivisible Media City Burbank
Indivisible Mendocino
Indivisible Normal Heights
Indivisible North Oakland Resistance
Indivisible North San Diego County
Indivisible OC 46
Indivisible OC 48
Indivisible Peninsula and CA-14
Indivisible Petaluma
Indivisible Sacramento
Indivisible San Bernardino
Indivisible San Francisco
Indivisible San Jose
Indivisible San Pedro
Indivisible Santa Barbara

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Indivisible Santa Cruz County
Indivisible Sausalito
Indivisible Sebastopol
Indivisible SF
Indivisible Sonoma County
Indivisible South Bay LA
Indivisible Stanislaus
Indivisible Suffragists
Indivisible Ventura
Indivisible Windsor
Indivisible Yolo
Indivisible: San Diego Central
Indivisibles-Sherman Oaks
Livermore Indivisible
Mill Valley Community Action Network
Mountain Progressives
Nothing Rhymes With Orange
Orchard City Indivisible
Orinda Progressive Action Alliance
Our Revolution Long Beach
Riseup
Rooted in Resistance
San Diego Indivisible Downtown
SFV Indivisible
Tehama Indivisible
The Resistance Northridge-Indivisible
Together We Will Contra Costa
Together We Will/Indivisible - Los Gatos
Vallejo-Benicia Indivisible
Venice Resistance
Women's Alliance Los Angeles
Yalla Indivisible
Two individuals

Opposition

Per the Senate Floor analysis of SB 834, dated May 21, 2022, two individuals are in opposition to SB 834.

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ARGUMENTS

As per the Senate Floor analysis of SB 834, dated May 21, 2022, the following support and opposition arguments were presented and are included below:

Support

According to the author, "SB 834 revokes the California tax-exempt status of a nonprofit organization if the Attorney General determines that the nonprofit has actively engaged in or incited treason, misprision of treason, insurrection, seditious conspiracy, advocating overthrow of the government or the government of any State, or advocating mutiny by members of the military or naval forces of the United States. If the Attorney General finds that a nonprofit organization has incited or actively engaged in an act that is directed and likely to imminently violate one or more of these crimes, they shall notify the FTB, who shall revoke the nonprofit's tax-exempt status.

"On January 6, 2021, pro-Trump extremists and insurrectionists – incited by the 'Big Lie' (the fraudulent notion that the 2020 election was stolen) and then President Donald Trump – breached the United States Capitol. Five people were killed and hundreds were injured as a result of this insurrection. A variety of individuals and organizations – including nonprofits participated in the events on January 6th. Nonprofits raised millions of tax-free dollars off the 'Big Lie' that the 2020 presidential election was stolen.

"SB 834 fills an important gap. While the FTB is currently directed to suspend the tax-exemption of a nonprofit supporting international terrorism, there is no clear authority concerning nonprofits that support insurrection. SB 834 will ensure that nonprofit organizations engaged in insurrection-related offenses will be held to the same standard as those that engage in or support international terrorist activity, and also have their exemption revoked.

"As the United States Supreme Court held in *Bob Jones University v. United States* (1983), it is permissible for the IRS to deny tax-exempt status to a private school with explicitly racist policies. The Court held that entitlement to tax exemption depends on meeting certain common-law standards of charity, namely, that a nonprofit organization seeking tax-exempt status must serve a public purpose and not be contrary to established public policy.

"Tax-exempt status is a privilege, not a right. Organizations that engage in, or incite the active engagement of insurrection-related offenses – both of which are illegal – should not be given this special status to help them fundraiser."

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Opposition

According to an email message received by an individual, "the cancel culture is carried away with silencing freedom of expression and stretching the meaning of insurrection to advance their agenda. I see no benefit from the proposed bill. The bill provides that the state FTB can deny or suspend the tax-exempt status of any non-profit wherein the state has determined that the non-profit is (or has) engaged in some form of insurrection (certain organizations, e.g. NRA, CRPA, etc.) might be considered part of this group and thus denied their California rightful tax-exempt status."

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov