
SENATE COMMITTEE ON GOVERNANCE AND FINANCE

Senator Mike McGuire, Chair
2019 - 2020 Regular

Bill No: SB 934
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Consultant: Deitchman

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Tax Levy: No
Fiscal: Yes

CORPORATE TAXES: EXEMPT ORGANIZATIONS: FILING FEES

Eliminates the \$25 filing fee for the application for tax-exempt status and the annual information return filing fee of \$10 for Exempt Organizations.

Background

Tax law has treated organizations that serve charitable purposes and exist to serve its members differently from businesses seeking a profit since Congress enacted the Tariff Act of 1894. That Act levied a corporate income tax, but excluded “corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes, including fraternal beneficiary associations.” Congress believed that these agencies filled a gap in social welfare programs that the government did not yet provide, and taxing these entities would divert needed resources away from them.

IRS laws. Internal Revenue Code (IRC) section 501(c) describes the various forms of organizations that are exempt from the federal income tax. Most charities, churches, and other tax-exempt organizations operate under section 501(c)(3). However, IRC section 501(c) includes other kinds of groups that are similarly tax-exempt, such as:

- 501(c)(4) - Civic leagues, social welfare organizations (including certain war veterans’ organizations), or local associations of employees;
- 501(c)(5) – Labor, agricultural, or horticultural organizations;
- 501(c)(6) – Business leagues, chambers of commerce, etc;
- 501(c)(7) – Social Clubs; and
- 501(c)(19) – Veteran Organizations.

Internal Revenue Service (IRS) Fees. The IRS charges a user fee for submitting a federal application for tax exemption. The amount of the user fee for an organization that applies to obtain tax-exempt status is between \$275 and \$600, depending on the type of organization applying. The IRS does not currently charge taxpayers to file their annual returns.

Conformity. California law does not automatically conform to changes to federal tax law, except for specific retirement provisions. Instead, the Legislature must affirmatively conform to federal changes. Conformity legislation is introduced either as individual bills to conform to specific federal tax changes, like the Regulated Investment Company Modernization Act (AB 1423, Perea, 2011), or as one omnibus bill that provides that state law conforms to federal law as of a specified date, currently January 1, 2015 (AB 154, Ting, 2015).

Nonprofits. In California, nonprofit corporations are not necessarily tax-exempt ones, regardless of federal tax-exempt status. All nonprofits must apply to the Franchise Tax Board (FTB) for tax-exempt status, or provide FTB with a copy of the Internal Revenue Service's (IRS's) determination that the organization is tax-exempt under the Internal Revenue Code (AB 897, Houston, 2008). After FTB's determination or acknowledgement, all non-church charities must annually file a simple form with FTB, known as the E-Postcard (Form 199N) with basic information about the organization. Tax-exempt organizations with average gross receipts over \$50,000 per year must file a more comprehensive annual return (Form 199). Churches do not have to complete either form. Nonprofits that do not obtain approval from FTB for their tax-exempt application are subject to tax. Corporations incorporated, registered or doing business in California must pay the \$800 minimum franchise tax, or the measured franchise tax of 8.84% of apportioned net income, if the measured tax exceeds \$800.

State Fees. The Franchise Tax Board (FTB) currently imposes a \$25 fee on entities filing a tax-exempt application. However, this fee is not applicable to organizations that are organized under IRC 501(c)(3), (4), (5), (6), (7), or (19) and attach their federal determination letter to their application to the FTB. However, those organized under any other part in IRC 501(c) are subject to the \$25 fee.

Additionally, non-profit organizations must pay a \$10 fee when filing their annual information return (Form 199) with FTB, unless specifically exempted. State law exempts entities with normal annual gross receipts of \$50,000 or less that are not a private foundation or a charitable trust. Currently, the FTB does not charge other entity types to file a return.

Not all entities applying for tax-exempt status are treated the same for California purposes. The author wants to allow those seeking tax-exempt status, regardless of entity type and gross receipts, to apply for tax exempt status and file returns with no fees, thereby providing equal treatment.

Proposed Law

SB 934 eliminates the fee payable to the FTB for both the tax-exempt application and the annual filing fee for all tax-exempt entities.

State Revenue Impact

According to FTB, SB 934 results in revenue losses of \$600,000 in 2020-21, \$900,000 in 2021-22, and \$900,000 in 2022-23.

Comments

1. Purpose of the bill: “I’m pleased to work with the Franchise Tax Board (FTB) to help non-profits save money, reduce paperwork, and make more efficient use of state resources. According to the FTB, it costs more for them to collect these fees from nonprofit organizations than the amount of revenue they bring in to the state. Due to their small cost, application filing fees for state tax exemptions are not captured in, or cost effective to be added to, FTB automated accounting systems and must be manually tracked, thereby increasing the department’s costs. These fees are both insignificant to the general fund and unnecessarily time-consuming for the FTB. My legislation will enable the FTB to devote additional resources on more urgent matters, such as processing tax refunds for families. Elimination of the annual information return Form 199 filing fee would result in equitable and fair tax administration for exempt organizations and be consistent with federal and other state tax laws. We must ensure that our tax-dollars are being used equitably and efficiently, and this bill provides a simple way to do just that.”

2. Fair share? Current state law provides an exemption from the fee for certain types of exempt entities (discussed above) based on the type of exempt organization and the amount of annual gross receipts. By eliminating the fees, SB 934 treats similarly situated exempt organizations equally. However, there are multiple ways of ensuring equitable treatment: for example, the \$25 fee could be extended to those entities that don’t currently pay it. Opponents argue that \$25 is a reasonable fee for an exempt entity to pay when applying for tax-exempt status with the FTB, given its benefits. Additionally, the IRS currently charges a fee between \$275 and \$600 to exempt organizations when applying for tax-exempt status. The committee may wish to consider whether the fee should be eliminated, or if the fee should be increased to more closely match the federal fees.

3. Administrative burden. If an organization that is required to pay either fee fails to include the \$25 or \$10 fee with their filing, FTB staff must contact the organization and collect the fee. This is an additional task for both the FTB and the exempt organization. While the exact administrative cost to collect the fee is uncertain, it is likely close to \$25. Thus, the elimination of this fee would streamline the procedures for both the FTB and the exempt entities.

Support and Opposition (5/18/20)

Support: Franchise Tax Board (sponsor), California Association of Nonprofits and The Howard Jarvis Taxpayer Association.

Opposition: California Tax Reform Association.

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