

Date of Hearing: July 27, 2020

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Autumn R. Burke, Chairwoman

SB 934 (Bates) – As Amended June 18, 2020

Majority vote. Fiscal committee.

SENATE VOTE: 39-0

SUBJECT: Corporate taxes: exempt organizations: filing fees

SUMMARY: Eliminates, under the Corporation Tax Law (CTL), the \$25 filing fee to submit a tax-exempt application to the Franchise Tax Board (FTB) and the \$10 annual information return filing fee applicable to tax-exempt organizations. Specifically, **this bill:**

- 1) Eliminates a \$25 fee some organizations are required to submit when applying for California tax-exempt status with the FTB.
- 2) Eliminates a \$10 fee for those tax-exempt organizations that must file an annual information return with the FTB.
- 3) Makes conforming amendments and updates cross references in the Health and Safety Code and Vehicle Code.

EXISTING LAW:

- 1) Exempts the income of various types of nonprofit organizations from the corporation tax.
- 2) Requires nonprofit organizations to submit an application to the FTB to obtain California "tax-exempt status."
- 3) Requires the FTB to review the application and issue a determination.
- 4) Requires some types of organizations that apply for tax-exempt status to include a \$25 filing fee with their application.
- 5) Provides a streamlined method for specified nonprofit organizations that have obtained a ruling, determination, or specified letter from the Internal Revenue Service (IRS) regarding the organization's federal tax-exempt status to obtain state tax-exempt status by attaching their federal determination letter to their application to the FTB without the \$25 filing fee.
- 6) Allows the streamlined method without the \$25 fee only for organizations described in Section 501(c)(3), (c)(4), (c)(5), (c)(6), (c)(7) or (c)(19) of the Internal Revenue Code (IRC).
- 7) Requires nonprofit organizations organized under any other part in IRC Section 501(c) to file their application to the FTB with the \$25 filing fee.

- 8) Requires certain organizations that have been granted state tax-exempt status to file an annual information return to the FTB and pay a \$10 filing fee.

FISCAL EFFECT: The FTB estimates that this bill will result in a revenue loss of \$600,000 in fiscal year (FY) 2020-21, \$900,000 in FY 2021-22, and \$900,000 in FY 2022-23.

COMMENTS:

- 1) The author has provided the following statement in support of this bill:

SB 934 will 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) This bill is supported by the California Association of Nonprofits, which notes:

[T]he current fee structure for filing annual information returns requires tax-exempt, but not other, organizations to pay a fee with the required return. As a result, current law creates disparate treatment between tax-exempt and other entities with regard to this filing fee.

SB 934 will simplify, for nonprofits and the FTB, the tax-exemption application process, eliminate existing inequities in the fee structure for filing annual information returns, and help support a robust nonprofit sector in California.

Although the bill may seem to create state revenue losses, when one takes into account the administrative costs of processing the fees, the potential fee revenue and administrative costs of processing the fees cancel each other out, with no loss to the state. And there is a net gain to nonprofits of not having to pay the fees, which is particularly appreciated during these difficult economic times.

- 3) Committee Staff Comments:

- a) *Tax-exempt application filing fee background:* In California, nonprofit corporations are not necessarily tax-exempt ones, regardless of federal tax-exempt status. All nonprofits must apply to the FTB for tax-exempt status, but some nonprofits are allowed to use a simplified method by providing the FTB with a copy of the IRS's determination that the organization is tax-exempt under certain provisions of the IRC. The IRS charges a user

fee for its application to receive federal tax-exempt status, which is generally \$275 for IRC Section 501(c)(3) organizations and \$600 for others.

California requires a \$25 filing fee to be submitted with the state tax-exempt application (FTB Form 3500) to reimburse the state's general fund for the FTB's processing costs. However, nonprofits organized under the following IRC Section 501(c) provisions may submit a different application (Form 3500A) to the FTB without the \$25 fee to obtain state tax-exempt status under the simplified method:

- i) IRC Section 501(c)(3), governing organizations operated exclusively for religious, charitable, scientific, or other specified purposes;
- ii) IRC Section 501(c)(4), governing specified civic leagues and local employee associations;
- iii) IRC Section 501(c)(5), governing labor, agricultural, or horticultural organizations;
- iv) IRC Section 501(c)(6), governing business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues;
- v) IRC Section 501(c)(7), governing clubs organized for pleasure, recreation, and other non-profitable purposes; or,
- vi) IRC Section 501(c)(19), governing veterans organizations.

All other nonprofit organizations organized under any other part in IRC Section 501(c) must file an application to receive state tax-exempt status with the \$25 filing fee.

In addition to the simplified application filings, in FY 2018-19, the FTB received approximately 5,700 tax-exempt applications. The FTB states that some organizations fail to include the application fee, requiring additional correspondence and tracking. The \$25 fee paid with the tax-exempt application is not captured in, or cost effective to add to, the FTB's automated accounting systems and must be manually tracked. Moreover, the FTB states that general fund recovery fees require additional manual processing to credit the payments appropriately, which increases the department's costs to process the payments.

- b) *Annual information return filing fee background:* After receiving state tax-exempt status, nonprofit organizations are required to file an annual information return (Form 199) and pay a \$10 filing fee, unless specifically exempted. Smaller organizations with normal annual gross receipts of less than \$50,000 can provide their information electronically, and, if they do so, no filing fee applies (Form 199N). Federal law also requires a tax-exempt organization to file an annual information return or notice with the IRS, unless an exception applies, and no filing fee applies.

In the 2017 tax year, the FTB states that 60,000 entities were subject to the \$10 filing fee. No other entities, such as taxable corporations or individuals are required to pay a fee to file a state income tax return with the FTB.

- c) *What does this bill do?* This bill eliminates the \$25 filing fee to submit a tax-exempt application to the FTB and the \$10 annual information return filing fee applicable to tax-exempt organizations. Eliminating these fees, in turn, allows the FTB to discontinue its manual processing and tracking of the payments for accounting purposes.

REGISTERED SUPPORT / OPPOSITION:

Support

Franchise Tax Board (Sponsor)
California Association of Nonprofits

Opposition

None on file

Analysis Prepared by: Rose Marie Kinnee / REV. & TAX. / (916) 319-2098