City of Culver City, California

City Council Agenda Item Report

Meeting Date: 09/12/05	Item Number: A-3
AGENDA ITEM: Discussion of City Policies and Practices – Definition of a "Bonafide Non-Profit Organization".	
Contact Person/Dept.: Nagam Rao/City Treasurer's Office	Phone Number: (310) 253-5889
Fiscal Impact: Yes [x] No []	General Fund: Yes [x] No []
Public Hearing: [] Action Item: [x]	Attachments: []
Public Notification: Master Notification List on 9/7/05	
Department Approval: Crystal C. Alexander 9/1/05	CAO Approval: Jerry Fulwood 9/7/05
City Controller Approval: Marlee Chang 9/6/05	

RECOMMENDATION:

That the City Council approve a policy regarding the treatment of bonafide Non-Profit Organizations, and direct the City Treasurer to draft for the City Council's adoption a policy on the manner in which such organizations are to be treated with respect to business tax.

BACKGROUND:

According to the Culver City Municipal Code of the various possible non-profit organizations, only charitable organizations and homeowners associations are mentioned under the list of exempted businesses and organizations. Charitable organizations are required to obtain a business tax certificate but not required to pay any business tax. Homeowners associations are neither required to obtain a business tax certificate nor pay any business tax.

Under Section 11.01.230 of the City of Culver City's Municipal Code, Charitable Organizations are defined as:

"Any organization conducting a business or activity for charitable purposes; which presents proof of its designation as a tax-exempt organization for charitable purposes, in a form which is satisfactory to the City Treasurer. For purposes of this Section, the Committee may also make a determination that an organization or business is conducting an activity which has a charitable purpose".

The Committee referred to in the previous paragraph is the Committee on Licenses and Permits.

A Non-Profit Organization, (also referred to as a not-for-profit organization), is an organization whose primary objective is to support an issue or matter of private interest or public concern for non-commercial purposes.

In order for the organization to be a Non-Profit Organization, the organization's charter, trust instrument, or articles of association must specify that no part of it's assets shall benefit any persons who are members, directors, officers or agents for it to qualify for tax exempt status. The organization must also have a legal charitable purpose, created to support educational, religious or charitable activities. As long as the organization operates within its exempt purposes and it maintains an endowment or uses any excess revenue to further develop its activities, it will not be taxed by the Internal Revenue Service. However any income from a trade or business that does not conform with the organization's exempt purpose, even though the profits are used for an exempt purpose are subject to taxation.

An activity is an unrelated business (and therefore subject to tax) if it meets the following three criteria:

(1) It is a trade or business,
(2) it is regularly carried on, and
(3) it is not substantially related to the furtherance of the exempt purpose of the organization.

Both the Internal Revenue Service and the Franchise Tax Board require all cases of unrelated business income to be reported and taxes paid at the applicable rates.

If the purpose of the organization is one of those described in Section 501(c)(3) of the Internal Revenue Code, then donations to it are tax deductible to the persons or businesses who make them.

Due to differing requirements by the states, and the federal government, it is possible to be recognized as a non-profit organization by the state but not by the federal government. Similarly, the fact that an organization is exempt from federal income tax does not automatically exempt it from California tax.

To qualify for tax exemption in California, an organization must be organized and operated for purposes described in one of the following California Revenue and Tax Codes (R & TC) sections corresponding to the Internal Revenue Code (IRC) sections shown below.

R & TC	IRC	Purpose
23701 h	501(c)(2)	Title holding corporations.
23701 d	501(c)(3)	Religious, charitable, scientific, literary, or educational organizations.

23701 f	501(c)(4)	Civic leagues or social welfare and local associations of employees.
23701 a	501(c)(5)	Labor, agricultural, or horticultural organizations.
23701 e	501(c)(6)	Business leagues, chambers of commerce, etc.
23701 g	501(c)(7)	Social and recreational organizations.
23701 b	501(c)(8)	Fraternal beneficiary societies.
23701 i	501(c)(9)	Voluntary employees' beneficiary organizations.
23701 l	501(c)(10)	Fraternal Societies.
23701 j	501(c)(11)	Teachers' Retirement Funds
23701 c	501(c)(13)	Cemeteries, crematoriums.
23701 y	501(c)(14)	Credit unions.
23701 n	501(c)(17)	Supplemental unemployment compensation trusts.
23701 w	501(c)(6)	War veterans' organizations.
23701 x	501(c)(25)	Title holding organizations.
23701 k	501(d)	Religious and Apostolic organizations.
23701 r	527	Political organizations.
23701 t	528	Homeowners' association.
23701 u	none	Public facility financial corporations
23701 v	none	Mobile home park association.

Charitable Trusts / Organizations: Effective January 1, 2005, charities in California are required to register with the Attorney General's Registry of Charitable Trusts within 30 days of receiving assets. An initial registration fee of $25 has also been introduced this year for charities operating within California. The annual registration renewal fee is on a sliding scale.

Renewal Fee	Charity Revenue
$0	less than $25,000
$25	between $25,000 - $100,000
$50	between $100,000 - $250,000
$75	between $250,000 - $1 million
$150	between $1 million - $10 million
$225	between $10 million - $50 million
$300	greater than $50 million

In order to meet the definition of a Charitable Organization, under Section 501(C)(3), they are required to meet the (1) operational test, and (2) the publicly supported test. For the operational test, the organization's purpose as established by its articles, or organization and carried out by its operations, must be exclusively charitable. For the publicly supported test, the organization must either receive:

(i) any part of its fund as contributions (unrestricted gifts) from the United States Government, a State Government, or a political subdivision,

(ii) be primarily supported by voluntary contributions (unrestricted gifts) of the general public. An organization is "primarily supported by contributions of the general public" if more than 50% of its receipts or income received in the accounting period is derived from voluntary contributions of the general public, as distinguished from a few contributions or donors or from related or associated persons or ticketed sales.

In addition to the annual renewal fee, charitable organizations whose revenues are more than $25,000 a year are also required to file Form 199, along with a filing fee of $10 or $25 depending upon whether they file on time or not.

On the basis of the manner in which they are treated by the IRS and the Franchise Tax Board, we can categorize the gamut of Non-Profit Organizations as those determined to operating as

(1) Section 501(c)3 organizations, whose do not have to file IRS Form 199 i.e. whose revenues are less than $25,000 during that year.
(2) Section 501(c)3 organizations, required to file Form 199.
(3) Non-Profit Organizations recognized by either the Internal Service or the Franchise Tax Board,
(4) any of the above with unrelated business income, as declared to, or determined by the taxing authorities.

Non-profit Organizations operating in our City are required to pay only the first time application fee. They are, however, exempt from payment of the annual renewal fee and the business tax.

DISCUSSION:

In the light of the above discussion the following are being suggested for your consideration.

Section 501(c)3 organizations: With a view to supporting their purpose, the Section 501(c)3 organizations who do not file Form 199, should be required to pay only the first time application fee. However if they are required to file Form 199, they should be required to file the business tax renewal fee for each year. However the business tax could be waived as long as they provide evidence that they are operating under this Section.

Other Non-Profit Organizations: These organizations though exempt from payment of taxes, are still subject to applicable application fees and determination charges by both the Internal Revenue Service and the Franchise Tax Board. Consequently, while payment of the annual business tax could be waived, they should be required to pay the initial application fee and the annual renewal fee.

Unrelated Business Income: In those years where the organization has unrelated business income, income that they are required to declare and pay income tax on, they should also be required to pay the business tax renewal and the business tax. With a view to reducing penalties due to any timing differences between the City's business tax deadlines and the income tax authorities, we could waive any applicable penalties if their amended Business Tax payment is received within 15 days of their payment to the Internal Revenue Service or the Franchise Tax Board.

FISCAL ANALYSIS:

We currently have 252 accounts (an organization may have more than one account), under the Non-Profit category. Of these 70 are listed as Section 501(C)3 accounts and another 10 are either Federal or State government agencies. If we were able to collect the $45 renewal fee from the remaining 172 accounts, the additional revenue to the General Fund would be $7,740 per year.

MOTION:

That the City Council:

Direct the City Treasurer to Draft a Policy for Adoption by the City Council on the treatment of bonafide non-profit organizations operating in the City for the purpose of business tax.