STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**08/23/07**	Bill No:	**AB 538**
Tax:	**Sales and Use**	Author:	**Emmerson**
Related Bills:			

BILL SUMMARY

This bill would provide a sales and use tax exemption until January 1, 2014 for sales and purchases of new children's clothing sold to a nonprofit organization qualifying for exempt status under Section 23701f of the Revenue and Taxation Code for its distribution without charge to any individuals under the age of 18.

SUMMARY OF AMENDMENTS

The amendments to this bill since our last analysis incorporate an operative date of January 1, 2008 for the proposed exemption, and clarify that the exemption applies to distributions without charge to any individuals under the age of 18.

ANALYSIS

CURRENT LAW

Under existing law, the sales tax applies to the sale of tangible personal property in this state, unless specifically exempted. The Sales and Use Tax Law provides no general statutory exemption from the sales or use tax merely because the seller or the purchaser is engaged in charitable activities, is a nonprofit organization, or enjoys certain privileges under property tax statutes or income tax statutes. However, current law is sprinkled with several separate provisions designed to assist various kinds of nonprofit groups engaged in charitable activities. For example, currently under Section 6375.5 of the Revenue and Taxation Code, a sales and use tax exemption applies to sales and purchases of new children's clothing that are sold to a nonprofit organization that has exempt status under Section 23701d of the Revenue and Taxation Code for its distribution without charge to *elementary* school children.

Current law also provides an exemption for sales by charitable organizations qualifying for the "welfare exemption" under Section 214 of the Revenue and Taxation Code, provided the organization is engaged in the relief of poverty and distress, and the sales are made principally as a matter of assistance to purchasers in distressed financial condition. Also, the property sold must have been made, prepared, and assembled or manufactured by the organization.

Another exemption from use tax exists when any seller (whether a retailer or a wholesaler) donates property to any organization in this state described in Section 170(b)(1)(A) of the Internal Revenue Code (those entities for which a deduction is allowed for contributions to charitable organizations).

PROPOSED LAW

This bill would amend Section 6375.5 of the Sales and Use Tax Law to expand the current sales and use tax exemption applicable to sales and purchases of new children's clothing until January 1, 2014, to do the following:

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- Apply to the distribution to all individuals under the age of 18, rather than just elementary school children,
- Include nonprofit organizations that have exempt status under Section 23701f of the Revenue and Taxation Code, rather than just those qualifying for exempt status under 23701d, and
- Eliminate the requirement that the nonprofit organization be engaged in the relief of poverty and distress.

The bill would, operative January 1, 2014, reinstate the exemption in its original form.

As a tax levy, the bill would become effective upon enactment, but operative on January 1, 2008.

BACKGROUND

Section 6375.5 was added to the Sales and Use Tax Law in 1982 by AB 2619 (Ch. 708, Stats. 1982). At that time, the bill was sponsored by a volunteer association that operated a "Clothes Corner," the purpose of which was to distribute a minimum wardrobe to elementary school children who otherwise would be unable to attend school. The legislation sought to exempt purchases of children's clothing by organizations of this type, to enable them to purchase more clothing with a given level of funds. This statute has not been amended since it was added into law.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author to extend the current exemption for sales of new children's clothing to other nonprofit organizations that provide similar services, but that qualify for exempt status under Section 23701f of the Revenue and Taxation Code, rather than Section 23701d as the current statute requires.
2. **The August 23, 2007 amendments** incorporate an operative date of January 1, 2008 for the proposed exemption, and clarify that the exemption applies to distributions without charge to any individuals under the age of 18. **The April 19, 2007 amendments** incorporate a sunset date of January 1, 2014 for the proposed exemption, and reinstate the original exemption operative January 1, 2014. Also, the amendments make reference to the state income tax provisions for purposes of identifying the qualifying organizations rather than using the compatible federal income tax references.
3. **Would sales of all new clothing qualify?** The bill provides an exemption for the sale of new *children's* clothing. However, some children – especially teens – may actually wear adult sizes. Should the bill be amended to make it clear that sales of all new clothing distributed within the parameters of the exemption be included?
4. **A specific situation is being addressed.** According to the author's office, the bill is intended to apply to "ChildSpree" events held by Mervyn's Department Stores, and similarly constructed events. The Mervyn's events provide private $100 shopping sprees to local children in need. Selected by a nonprofit organization or school partner, and accompanied by a volunteer chaperone, participating children are able to shop for new clothes and shoes. The children also receive a discount on all purchases made during the event. According to Mervyn's website, since its 1992 inception, $18.6 million has been donated to Mervyns' ChildSpree and over 186,000

children have benefited from the program nationwide. The nonprofit organizations and schools in local communities coordinate the event and select the children. The organizations raise the money for each child, and Mervyn's matches a portion of the raised funds. Two gift cards are generated: one for the funds raised by the nonprofit organization, and one containing the funds that Mervyn's donates. The volunteer from the organization chaperones the child, and the gift cards are used to make the purchases of the items the child selects.

Some of the organizations that have participated in these events include the Salvation Army, United Way, the Jaycees, Kiwanis Club, local rotary clubs, Active 20/30 Club, Operation School Bell, various other charitable organizations, and local government social services agencies. Current law would allow the exemption for some of these organizations participating in these events, since they are 23701d organizations, but others, such as the Jaycees and Kiwanis Club, would not, since they are 23701f organizations.

3. **What are 23701d and 23701f organizations?** Section 23701d is one of California's state income tax provisions in the Revenue and Taxation Code granting an exemption from the state income tax to certain nonprofit organizations. The organizations described in these statutes are generally organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals. There are about 115,000 such organizations in California.

   Section 23701f organizations are also nonprofit, and include civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. These organizations differ from 23701d organizations in that they are permitted to lobby for legislation and endorse political parties and candidates. There are over 9,000 such organizations in California. Prominent 23701f organizations include AARP, Kiwanis, the Jaycees and National Rifle Association.

4. **Enactment of this bill would not materially affect the Board's administration of this exemption.** In addition, retailers making sales to qualifying organizations on an ongoing basis would no longer be required to make a distinction between a qualifying 23701d organization and a non-qualifying 23701f organization.

COST ESTIMATE

The Board would incur minor costs to administer this measure. These costs would be attributable to, among other things, notifying retailers and auditing claimed amounts. These costs are expected to be absorbable.

REVENUE ESTIMATE

This bill would to a small degree broaden the current exemption by 1) including all individuals under the age of 18, rather than just elementary school children, 2) including 23701f organizations as qualifying entities, and 3) eliminating the requirement that the nonprofit organization be engaged in the relief of poverty and distress. We do not anticipate the associated revenue losses to be significant – less than $10,000 annually, as computed below.

Mervyn's "Childspree" events result in $1 million sales of clothing annually to nonprofit groups (based on Mervyn's annual Internet releases about these events). Mervyn's requires that the nonprofit groups furnish an exemption certificate which certifies that the nonprofit organization is a qualifying organization in order to regard the sales as exempt from sales tax. Using the statewide average sales and use tax rate of 7.94%, the total sales tax attributable to these sales is $79,400 ($1 million x .0794).

There are about 9,000 23701f organizations and 115,000 23701d organizations in California. If we assume that the same ratio of 23701f organizations to 23701d in California would participate in these Childspree events, we would have 7.8% more organizations qualifying for the exemption (9,000/115,000 = 7.8%).

Applying the 7.8% to the $79,400 amounts to $6,193 annually. We do not have any information on the amount of new children's clothing that other retailers may sell to 23701f organizations that would qualify under the provisions of AB 538. But, if we assume that half of the amount attributable to Mervyns' sales would account for other retailers' sales, we would add an additional $3,096 ($6,193 x ½) in tax attributable to these sales.

Therefore, the total estimated sales tax associated with sales of new children's clothing to 23701f organizations would amount to $9,289 ($6,193 + $3,096).

Analysis prepared by:	Sheila T. Waters	916-445-6579	08/24/07
Contact:	Margaret S. Shedd	916-322-2376	

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