



July 22, 1983

This is in response to your June 17, 1983, letter wherein you seek "a rationale" for a corporation being eligible for the welfare exemption if its shareholders are qualifying organizations, notwithstanding that all its assets could be distributed to the shareholders upon dissolution, but being ineligible for the exemption if income from its assets were to be distributed to its shareholders.

Applicable Revenue and Taxation Code Section 214, added by Stats. 1945, Ch. 241, provided and continues to provide that qualifying property is exempt from taxation if:

* * *

"(2) No part of the net earning of the owner inures to the benefit of any private shareholder or individual;

* * *

"(6) ...upon the liquidation, dissolution or abandonment of the owner will not inure to the benefit of any private person except a fund, foundation or corporation organized and operated for religious, hospital, scientific, or charitable purposes;

* * *

Accordingly, for qualifying property to be eligible for exemption, all the requirements of Section 214 must be met, including that of (2), above, which pertains to an organization's use of its earnings during its existence to the disposition of an organization's assets upon termination of its existence.

In enacting Section 214 and, particularly, subsections (2) through (5) and (6) thereof, presumably, the Legislature considered the use of an organization's property and earnings during its existence as an organization ((2) through (5)) to be separate and apart from the disposition of its assets upon termination of its existence (6). Presumably, also, in 1945 either applicable code provisions did not permit other qualifying organizations to be shareholders of qualifying organizations, in which case property of qualifying corporations would not be distributed to related qualifying corporations upon dissolution; or if they did, such an occurrence was an uncommon one which the Legislature did not deem necessary to address specifically in Section 214; or if applicable code provisions did permit other qualifying organizations to be shareholders of qualifying organizations and if such was a common occurrence, the Legislature did not deem it necessary to differentiate between qualifying organizations and qualifying organizations having other qualifying organizations as shareholders for purposes of Section 214.

Whatever the reason for the specific language of subsections (2) and (6) which, as indicated above, has remained unchanged since their enactment, constitutional provisions and case law amply support the proposition that no part of the net earnings of a qualifying organization may inure to the benefit of any private shareholder or individual:

- 1. Former Article XIII, Section 1c of the California Constitution, adopted November 7, 1944, and providing, in part, that:

“... the Legislature may exempt from taxation all or any portion of property used exclusively for religious, hospital, or charitable purposes... and no part of the net earnings of which inures to the benefit of any private shareholder or individual...”

2. “No part of the net earnings of which inures to the benefit of any private shareholder or individual” (1935 California Unemployment Act) had been narrowly construed by the District court of appeal only one year earlier in La Societe Francaise v. California Employment Commission or dividends could be distributed, but also that net earnings arising from hospital services, and services to “nonmembers” at rates in excess of those generally charged members could not inure to the benefit of the members in augmented service and privileges which would not otherwise be available to them.
3. Article XIII, Section 4 (b) of the California Constitution, adopted November 5, 1974, and continuing to provide, in part, that:

“(a) The Legislature may exempt from property taxation in whole or in part:

* * *

“(b) Property used exclusively for religious, hospital, or charitable purposes... and (3) no part of whose net earnings inures to the benefit of any private shareholder or individual.”

Very truly yours,

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