BEFORETHE STATE BOARD OF EQUALIZATION.

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CALIFORNIA RIFLE AND PISTOL)
ASSOCIATION)

For Appellant: Earl C. Crouter
Attorney at Law

For Respondent: Carl G. Knopke
Counsel

OPINION

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of California Rifle and Pistol Association against proposed assessments of additional franchise tax in the amounts of $582.00, $1,290.00, $1,684.44, and $1,677.51 for the income years ended September 30, 1975, September 30, 1976, September 30, 1977, and September 30, 1978, respectively.

The only issue for decision is whether interest and dividend income received from the investment of appellant's Life Members Fund for the income years ended 1975 through 1978 is "unrelated business taxable income" within the meaning of Revenue and Taxation Code section 23732, subdivision (a) (2). A second issue relating to the status of income generated from the sale of membership lists to insurance companies as such "unrelated business taxable income" appears to have been conceded by appellant.

Appellant is organized and operated for nonprofit purposes as a "social club" within the provisions of Revenue and Taxation Code section 23701g. Members of appellant must pay dues to the association, usually on an annual basis. However, rather than paying dues annually, a member may purchase a lifetime membership in the association, the receipts from which are deposited in a special Life Members Fund. The principal of this fund is then invested and the interest and dividends derived are utilized by appellant for the same purposes as the annual dues. The taxability of these investment earnings to the appellant is the question presented in this appeal.

As such a "social club," Revenue and Taxation Code section 23701 exempts appellant "from taxes imposed under this part, except as provided in this article or in Article 2. . . ." In general, a "social club" is exempt from California franchise taxes except to the extent of its "unrelated business taxable income" as defined in Revenue and Taxation Code section 23732." (Rev. & Tax. Code, § 23731.) For a "social club," "unrelated business taxable income" means the gross income of the organization excluding any "exempt function income." (Rev. & Tax. Code, § 23732, subd. (a)(2)(A).) The subject investment earnings are clearly includable in appellant's gross income (Rev. & Tax. Code, § 24271) and, thus, would be considered taxable as "unrelated business taxable income," as noted above, unless such investment earnings are excluded as being "exempt function income." Accordingly, for this inquiry, the definition of "exempt function income" is critical. Revenue and Taxation Code section 23732, subdivision (a)(2)(B), states, in relevant part, that the term "exempt function income" means income from "dues, fees, charges, or similar amounts paid by members of the organization." Respondent argues that such investment income has not been "paid by the members" and, accordingly, it is not "exempt function income" within the meaning of the Revenue and Taxation Code as cited above. On the other hand, appellant argues that this investment income should be considered "similar [to] amounts paid by members" and, therefore, should be "exempt function income," not subject to taxation.

The fundamental rule of statutory construction is that the intent of the Legislature should be ascertained so as to effectuate the purpose of the law. (Select Base Materials v. Board of Equalization, 51 Cal.2d 640 [335 P. 2d 672] (1959) .) When there exists doubt as to the legislative intent of a statute that has been adopted, recourse may be made to the history or purpose underlying its enactment. (County of Alameda v. Carleson, 5 Cal.3d 730 [97 Cal.Rptr. 385] (1971); app. dism. 406 U.S. 913 [32 L.Ed.2d 112] (1972) ; Rocklite Products v. Municipal Court, 217.. Cal.App. 2d 638 [32 Cal.Rptr. 183] (1963) .) Revenue and Taxation Code section 23732, subdivision (a), was completely reworked in 1971 to conform with its federal counterpart, section 512(a) of the Internal Revenue Code, which had been amended in 1969. Accordingly, the legislative history with respect to the enactment of, section 512(a) is a relevant factor to be considered in determining the proper interpretation of section 23732, subdivision (a). (State v. Mitchell, 563 S.W.2d 18 (Mo. 1978).)

The legislative report of section 512(a) of the Internal Revenue Code which, as, indicated above, is relevant to the proper interpretation of the Revenue and Taxation Code section 23732, subdivision (a), is as follows:

> General reasons for change.--Since the tax exemption for social clubs and other groups is designed to allow individuals to join together to provide recreational or social facilities or other benefits on a mutual basis, without tax consequences, the tax exemption operates properly only when the sources of income of the organization are limited to receipts from the membership. Under such circumstances, the individual is in substantially the same position, as if he had spent his income on pleasure or recreation (or other benefits) without the intervening separate organization. However, where the organization receives income from sources outside the membership, such as income from investments (or in the case of employee benefit associations, from the employer), upon which no tax is paid, the membership receives a benefit not contemplated by the exemption in that untaxed dollars can be used, by the organization to provide pleasure or recreation (or other benefits) to its membership. For example, if a social club were to receive $10,000, of untaxed inaome from investment in securities, it could use that $10,000 to reduce the

> cost or increase the services it provides to its members. In such a case, the exemption is no longer simply allowing individuals to join together for recreation or pleasure without tax consequences. Rather, it is bestowing a substantial additional advantage to the members of the club by allowing tax-free dollars to be used for their personal recreational or pleasure purposes. The extension of the exemption, to such investment, income is, therefore, a distortion of its purpose. S. Rep. No. 91-552 91st Cong., 1st Sess., p. 71 (1969), [1969 U. S. Code Cong. & Ad. News 2100].

The key point in this excerpt from the legislative history appears to be that the tax exemption for "social clubs" operates "properly only when the sources of income of the organization are limited to receipts from the membership." When this happens, the report continues, "the individual is in substantially the same position as if he had spent his income ... on recreation . . . without the intervening separate organization." Payment of dues by a member to a "social club" is ordinarily not a deductible expense. (Rev. & Tax. Code, § 17282.) Therefore, a member must use after-tax dollars to pay his dues. Once tax is paid by the individual member, and these after-tax dollars are used to pay his dues, no further tax is due from the "social club" with respect to the receipt of such dues. To do so would place a double tax on the activities of the organization and place the individual member in a substantially unfavorable position vis-a-vis spending dollars directly on pleasure or recreation. It would appear that the purpose of the Revenue and Taxation Code section 23701 is to prevent this sort of double taxation. However, taxation at one level, either at the individual level or at the organization level as "unrelated business taxable income," appears to be required in order to place the individual in substantially the same position as if he had spent his money directly on pleasure or recreation. To treat the interest and dividend income derived by appellant from the investment of its Life Members Fund, as "exempt function income" within the meaning of the Revenue and Taxation Code section 23732, subdivision (a)(2)(B), would result in that income escaping tax entirely and, accordingly, would bestow a substantial benefit to the members. That is, the "social club" could use tax-free dollars rather than after-tax dollars for the pleasure or recreation of its members. Such an advantage is not within the contemplation of Revenue and Taxation Code section 23732. (Council of British Societies in Southern Calif. v. United

States, (D.C. Calif.) 42 Am.Fed.Tax R. 2d 78-6014 (1978):) Thus, we find here that the subject investment income generated from the Life Members Fund is not "exempt function income" within the meaning of Revenue and Taxation Code section 23732, subdivision (a)(2)(A). That investment income was not paid by the members and has not been subjected to tax. Accordingly, appellant realized "unrelated business taxable income" during the years at issue with respect to the subject investment income generated from the Life Members Fund.

Nevertheless, appellant argues that the earnings' derived from the Life Members Fund are beneficially those of the life members. Appellant contends that it *was* merely the trustee and/or fiduciary for its members, who should be deemed to have paid such investment income. Appellant, of course, bears the burden of showing that respondent's determination is erroneous. (Appeal of Harold G. Jindrich, Cal. St. Bd. of Equal., April 6, 1977.) Nothing in the record indicates that such a trust or fiduciary relationship existed between appellant and its members. Under *the* circumstances, we mast find that appellart has not met its burden of proof with respect to this contention. Furthermore, appellant's, reliance upon Revenue and Taxation Code section 23732, subdivision (a)(l), and upon authorities relying upon the pre-1969 federal statute is misplaced. Revenue and Taxatian Code section 23732, subdivision (a)(l), does not apply to "social clubs" such as appellant and, as indicated above, Internal 'Revenue 'Code section 512 (a) was completely revised in 1969 so as to make decisions based upon pre-1969 law inapplicable to the instant case.

Appeal of California Rifle and Pistol Association

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of California Rifle and Pistol Association against proposed assessments of additional franchise tax in the amounts of $582.00, $1,290.00, $1,684.44, and $1,677.51 for the income years ended September 30, 1975, September 30, 1976, September 30, 1977, and September 30, 1978, respectively, be and the same is hereby sustained.

Done at Sacramento, California this 3rd day of January, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

_____, Member

_____, Member