FINAL DRAFT

PHILANTHROPIC FACILITATION ACT OF 2010

Summary: The current economic recession has resulted in the coincidence of fewer philanthropic dollars with greater philanthropic need. Accordingly, private foundations are looking for a way to generate a return, however modest, on their funds available for distribution.[1] The exception for program-related investments (PRIs) under Section 4944 of the Internal Revenue Code of 1986, as amended (the "Code"), allows a non-profit to make a return on an investment which also qualifies as a qualifying distribution under Section 4942 of the Code. The Philanthropic Facilitation Act of 2010 would improve the ability of private foundations to use the PRI exception more efficiently and thereby would open up additional capital for investment in economically-distressed industries.[2]

I. OVERVIEW OF THE PROGRAM-RELATED INVESTMENT EXEMPTION

Section 4944 of the Code imposes an excise tax on private foundations for engaging in high-risk (*i.e.,* "jeopardy investments") investments, unless such investments further the foundation's exempt purposes (*i.e.,* PRIs).

- PRIs qualify as qualifying distributions under Section 4942 of the Code; however, unlike a grant the foundation has the potential to receive a return on its distribution, and then redistribute such funds in support of other charitable activities.
- Traditionally, PRIs have been structured as interest-free or below-market loans, loan participations or guarantees, letters of credit and equity investments.
- Although the favorable tax treatment of, and potential investment return on, should make them attractive to private foundations, survey of more than 72,000 private foundations showed that private foundations collectively made qualifying distributions in the aggregate amount of $43 billion; however, PRIs accounted for less than 1% of these qualifying distributions despite being a strong tool to advance charitable purposes.[3]
  - Currently, there is no process to confirm that a private foundation's proposed investment will comply, both initially and over time, with the PRI regulations under Reg. § 53.4944-3(a). Additionally, there is no uniform standard for forming entities to serve as recipients of PRIs.
  - Traditionally, many private foundations have refrained from investing in for-profit ventures due to the uncertainty of whether a specific investment would qualify as a PRI or because of the cost, time and resources to acquire a legal opinion from counsel or a private letter ruling from the IRS to verify that the particular venture is a valid PRI.

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[1] Shelly Banjo, *Consider It an Investment*, WALL ST. J., Nov. 9, 2009, *available at* http://online.wsj.com.

[2] Private foundations give away an estimated $40 billion annually. *See* Pablo Eisenberg, *What's Wrong With Charitable Giving—and How to Fix It*, WALL ST. J., Nov. 9, 2009, *available at* http://online.wsj.com.

[3] The Private Foundation Center, *Aggregate Data by Private Foundation Type, 2006* (released 2008). *available at* http://private foundationcenter.org.

Without clarification of the rules surrounding PRIs, the philanthropic community may continue to be unwilling to undertake PRIs, and, thereby, continue to diminish the resources available for philanthropy at a faster than necessary rate.

II. UTILIZING THE PRI EXEMPTION: THE LOW-PROFIT, LIMITED LIABILITY COMPANY

The low-profit, limited liability company (L^3C) format evolved from a desire to relieve economic distress caused by high unemployment occurring in areas such as newspaper publishing, automobile manufacturing and furniture manufacturers. However, L^3Cs are not limited to the foregoing; rather proposed L^3Cs also include food banks, health clinics, affordable housing, museums and many other entities with a social purpose.

- The L^3C is a new form of LLC formed specifically to further a charitable purpose. Although the entity is expected to be a profitable entity, profit-making is a secondary and insubstantial part of its mission.

- Pursuant to state statutes, an L^3C must be organized and operated at all times in a manner that investments therein satisfy the requirements under Reg. §53.4944-3(a), which state that a PRI must possess the following characteristics:

  - The primary purpose is to accomplish one or more of following purposes: "religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment) or for the prevention of cruelty to children or animals;"[4]

  - No significant purpose is the production of income or the appreciation of capital; and

  - No purpose is to influence legislation or to "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."[5]

- The L^3C was first introduced in the United States in April 2008 when Vermont adopted the L^3C as an official legal structure. In 2009, the following states followed suit: Illinois,[6] Michigan,[7] Utah[8] and Wyoming.[9] Additionally, the Oglala Sioux Tribe and the Crow Indian Nation of Montana have adopted L^3C legislation. Maine[10] and North Dakota[11] also enacted legislation authorizing feasibility studies of the L^3C. Similarly, the Arkansas Interim Study Proposal 2009-171 was adopted this summer.[12]

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4 Code §170(c)(2)(B).
5 Code §170(c)(2)(D).
6 805 ILCS 180/1-5, 805 ILCS 180/1-10, 805 ILCS 180/5-5.
7 Mich. Comp. Laws §450.4102.
8 Utah Code §§48-02c-412 and 48-02c-1411.
9 Wyo. Stat. §17-15-102(a)(ix), *et seq.*
10 L.D. 1265.
11 H.B. 1545.
12 H.B. 2102.

Bills have also been submitted to the state legislations in the following jurisdictions: Missouri,[13] Montana,[14] North Carolina,[15] Oregon[16]and Tennessee.[17] Additionally, in early 2010, bills will be introduced in the following jurisdictions: Colorado, Florida, Kentucky, Maryland, New York, Wisconsin and Virginia. Moreover, draft bills are currently being considered for introduction in the following jurisdictions: California, Georgia, Louisiana, Massachusetts, Nebraska, Ohio and Washington.

- As a type of LLC, the L^{3}C's flexible structure allows tranched investments by members, which have varying levels of risk. The highest-risk investments come from PRIs by private foundations. By absorbing excess risk, PRIs by private foundations provide position for the L^{3}C to attract non-charitable investors that may earn reasonable returns at acceptable levels of risk. Accordingly, the L^{3}C can bring new sources of funds for social problems traditionally addressed exclusively by non-profit funds.

Because an L^{3}C can tap into both private foundation and for-profit investors, an L^{3}C offers a more economically sustainable format than a non-profit. Additionally, because an L^{3}C must have a social purpose as its primary purpose, the L^{3}C format still realigns a company with its community.

III. AN INDUSTRY IN NEED: NEWS ORGANIZATIONS

The face of news in the United States has undergone a dramatic change in recent years as more and more consumers receive their news online rather than through traditional news sources, such as newspapers, weekly news magazines, broadcast news and AM/FM radio News. Recent statistic show the severity of the impact on traditional news sources:

Newspapers

- Figures released by the Audit Bureau of Circulations on October 26, 2009 show that average daily circulation dropped by 10.6% between April and September 2009.[18]

- Between 2006 and 2008, advertising revenues declined 23%. Of the $38 billion in advertising revenue raised in 2008, less than 3% was from online advertising.[19]

- Newspaper stocks, which declined 42% between the start of 2005 and the end of 2007, lost 83% of their remaining value during 2008. Moreover, for many

[13] H.B. 817.
[14] H.B. 235.
[15] S.B. 308.
[16] H.B. 2886.
[17] S.B. 0472/H.B. 0664.
[18] *Newspaper Circulation Declines*, WASH. POST, Oct. 27, 2008, , *available at* www.washingtonpost.com.
[19] The Pew Research Center's Project for Excellence in Journalism and Rick Edmonds of the Poynter Institute, The State of the News Media: An Annual Report on American Journalism (2009) (the "Pew Report").

newspapers, the value in the company comes from its outside investments, rather than the generation of sufficient profits by the newspaper activities themselves.[20]

- Since 2007, the following metropolitan dailies have ceased operations: Tucson Citizen, Rocky Mountain News, Baltimore Examiner, Kentucky Post, Cincinnati Post, King County Journal, Union City Register-Tribune, Halifax Daily News, Albuquerque Tribune, South Idaho Press, East Valley Tribune and San Juan Star.

- A number of major publications, including the Boston Globe, the Seattle Times and the San Francisco Chronicle, have reported that they are losing approximately $1 million a week.[21] While other publications, including newspapers owned by the Tribune Company and the Star Tribune of Minneapolis, filed for bankruptcy.[22]

- In order to continue to generate sufficient profits to service indebtedness or to sustain shareholders, and, in the case of publicly traded newspapers provide shareholders, newspapers have been implementing an array of cost cutting measures, including reductions in staff, decreasing the amount of news coverage in relation to advertising, reducing circulation and, in some cases—Valley Tribune in Phoenix, the Detroit Free Press, the Detroit News and the Christian Science Monitor—instituted severe cutbacks that have moved all or a part of the news coverage to the internet only.[23]

Weekly News Magazines

- Based on a study of eight news magazines, ad pages fell by 16% in 2008 compared to 2007 and ad dollars fell by almost 19%, including the following declines at the two largest news magazines:
  - *Time*: Ad pages declined 19.0% and ad dollars declined 27.1%; and
  - *Newsweek*: Ad pages declined 19.0% and ad dollars declined 14.1%.[24]
- Many niche news magazines saw similar declines. For example:
  - *The Atlantic*: Ad pages declined 17.0% and ad dollars declined 2.8% and
  - *The New Yorker*: Ad pages declined 26.8% and ad dollars declined 20.7%.[25]
- It is estimated that just fewer than 150,000 people worked in magazines in 2008, down from approximately 170,000 in 2000.[26] Moreover, the five largest magazine publishers—Time, Advance Publications (owner of the Condé Nast magazine

[20] Id.
[21] Id
[22] Id.
[23] Id.
[24] Id, citing Publishers Information Bureau.
[25] Id.
[26] Advertising Age, *The World is Flat*, Magazine 300 (Oct 6, 2008), *available at* http://adage.com/images/random/datacenter/2008/magtrend.pdf. The 2008 estimates were based on averages from January through July.

group), Hearst, Meredith and McGraw-Hill—each announced significant staff reductions in late 2008.[27] These staff reductions included 160 Newsweek employees and an 8% reduction in news staff at Time.[28]

Broadcast News

- The domestic bureaus of national broadcast news (*i.e.*, individuals not at the New York headquarters offices) saw a 6% staff reduction in 2008.[29]
- Industry-wide broadcast news staff was reduced by approximately 4.3% in 2008.[30]
- In the past year, the budgets for the majority of local affiliates were decreased (41.9%) or stayed the same (28.1%).[31]
- In 2009, the overall percentage of stations making a profit on news decreased by almost 3%, while the percentage losing money rose by 4%.[32] These decreases in profitability were more significant in smaller markets.[33]

AM/FM Radio News

- In 2009, the overall percentage of radio news stations making a profit decreased by almost 9.2% and the percentage breaking even increased by 4%.[34]

The newsroom cutbacks have shifted journalism away from investigative journalism and towards the pursuit of a bottom line. Accordingly, the "watchdog" functions of the media (*i.e.*, holding government and institutions accountable for their actions), are at risk of being lost. The news organizations have traditionally played a key role in making the government "of, by and for the people." This is never more true than with respect to small community newspapers. These papers provide a check on local government by reporting on city/county council or school board meetings, so that busy residents can stay informed. Additionally, small community newspapers provide residents with information regarding zoning proposals, tax issues, bond referendums and other legal issues that may impact their daily lives. A study conducted by Pew Research Center's Project for Excellence in Journalism in Baltimore, Maryland regarding how people get news about their communities showed that 48% of community news came from general interest newspapers and less than 4% came from all forms of new media, including blogs, Twitter and local websites.[35] Additionally, for the elderly who are not internet savvy and

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[27] Pew Report, *supra* n. 20.
[28] Id.
[29] Id.
[30] Robert Papper, *TV and Radio Staffing & News Profitability Survey*, The Association of RTNDA Electronic Journalists, *available at* http://www.rtdna.org/media/pdfs/research/TV%20and%20Radio%20Staffing%20and%20Profitability.pdf
[31] Id.
[32] Id.
[33] Id.
[34] Id.
[35] Pew Research Center's Project for Excellence in Journalism, *How News Happens--Still: A Study of the News Ecosystem of Baltimore* (Jan. 11, 2010), *available at* http://pewresearch.org/pubs/1458/news-changing-media-baltimore.

the poor who do not have in-home access to computers, these newspapers provide a low-cost, low-stress manner of staying informed.

The newsroom cutbacks have also increasingly shifted a greater portion of the news online. The move from the print and broadcast news to online news results in individuals having a more narrow exposure to information as they use search engines to pick and choose items of interest rather than being incidentally exposed to a broader range of topics.[36] A 2006 study by The Pew Center for People & the Press over a month-long period found that individuals who used the online sources for news spent significantly less time reading the news than the average number of minutes that newspaper readers, radio news listeners and TV news viewers spent with those sources.[37] Moreover, looking online for news increases the likelihood of misinformation because of the plethora of personal news sites.

In the search for new models, some news organizations have turned to a non-profit format. Some recent examples include:

- On October 1, 2009, The Texas Tribune, a newly formed non-profit public media organization, received a total of $750,000 in grants from Houston Endowment and The John S. and James L. Knight Foundation, to begin its operations as an online news source. Its website launched in November 2009.

- As of November 20, 2009, Chicago News Cooperative will commence operations providing local coverage to national papers (the New York Times has signed on as their first client). Chicago News Cooperative is operating under the umbrella of WTTW-Channel 11, a tax-exempt public television station, and funds for its operations have been provided by The John D. and Catherine T. MacArthur Foundation.

While the non-profit model is appealing, this model might ultimately prove to be a temporary solution as the pool of funds available to support non-profit news organizations is not unlimited. Moreover, many local communities do not have private foundations the size of The John S. and James L. Knight Foundation or The John D. and Catherine T. MacArthur Foundation to fund their local news; rather they would be reliant on small community foundations. The L^3C format makes use of the available private foundation funds, whether from large national foundations or small community foundations, without giving up access to for-profit dollars. However, before more entities will be willing to take advantage of the L^3C format the PRI rules must be clarified to provide a road map for how to ensure investments by private foundations qualify as PRIs. Although an investment in a L^3C will always require a pre-investment inquiry by the private foundation,[38] the amendments requested herein would establish a more

[36] Lee Rainie, Director of Pew Internet & American Life Project, Remarks at Journalism and the New Media Ecology: Who will Pay the Messenger? at Yale University School of Law (Nov. 13, 2009); Pablo Boczkowski, Associate Professor at Northwestern University School of Communications, Remarks at Journalism and the New Media Ecology: Who will Pay the Messenger? at Yale University School of Law (Nov. 14, 2009);

[37] The Pew Center for People & the Press, Online Papers Modestly Boost Newspaper Readership, Maturing Internet News Audience Broader Than Deep (July 30, 2006), *available at* http://people-press.org/report/282/online-papers-modestly-boost-newspaper-readership.

[38] Transcript of the September 25, 2009, ABA Tax Section Exempt Organizations Committee Meeting, 64 The Exempt Org. Tax Review, Dec. 2009, at 608-609.

streamlined procedure for making this inquiry along with protective provisions to facilitate continued compliance.

IV. AN INDUSTRY IN NEED: AUTO MANUFACTURERS

Michigan, Ohio, and Indiana combined account for almost half of all jobs in the auto industry.[39] These states, particularly Michigan, have built an infrastructure and an economic base oriented around that industry for more than a century. However, the auto industry is seeing decreased demand for its products, increased unemployment amongst autoworkers and excess capacity at facilities:

- The U.S. Bureau of Labor Statistics estimates that the already ailing industry will see a decrease in employment of 16.3% by 2018, compared to an estimated 11% percent growth for employment in all industries combined.[40] For the past four years, Michigan has held the nation's highest unemployment rate, at approximately 15%.[41]

- Auto sales for U.S. automakers began falling in the spring of 2008 as gas prices rose, and, in October 2008 when the current recession worsened, sales dropped to the lowest level recorded in 25 years.[42] As sales by automakers have declined this has had ripple effect on suppliers, increasing the economic recession in this region.[43]

- Despite approximately 100,000 workforce reductions since 2006 and closing factories nationwide, the automakers have been unable to cut their costs at a rate sufficient to keep up with the steadily declining market for new vehicles.[44] The auto industry currently has the capacity to produce approximately 90 million cars and light trucks a year; however, only approximately 60 million were actually sold worldwide in 2009.[45] Accordingly, the worldwide auto industry has a third more capacity than is necessary to meet worldwide demand.[46]

Despite the decline of the auto industry, the region still possesses two important resources—a large network of skilled laborers and existing manufacturing facilities. Many of the same people and factories that have made automobiles and automobile components can be adapted to manufacture wind turbines, batteries, electric transport vehicles, unique hydro power systems, solar energy systems and more. Moreover, with its extensive waterfront exposure there are numerous possible sites to implement these green energy concepts.

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[39] Bureau of Labor Statistics, Motor Vehicle and Parts Manufacturing in Career Guide to Industries (2010-2011 Ed.), *available at* http://www.bls.gov/oco/cg/cgs012.htm. Other states that account for significant numbers of jobs in the auto industry include Kentucky, Tennessee, and California. Id.
[40] Id.
[41] Associated Press, *Pelosi, LaHood Laud US Investment*, N.Y. Times (Jan. 11, 2010), *available at* http://www.nytimes.com/aponline/2010/01/11/business/AP-US-Auto-Show-Lawmakers.html.
[42] Times Topics, *Automotive Industry Crisis*, N.Y. Times (updated Jan. 12, 2010), *available at* http://topics.nytimes.com/top/reference/timestopics/subjects/c/credit_crisis/auto_industry/index.html.
[43] Id.
[44] Id.
[45] Marketplace, *Automakers Need to Face New Reality* (NPR broadcast on Jan. 13, 2010), transcript available at http://marketplace.publicradio.org/display/web/2010/01/13/pm-reich-commentary/.
[46] Id.

However, due to the crippling economic recession in this region there is currently not sufficient capital available to purchase and retool the facilities and retrain workers. The substantial start-up costs and period of irregular income at the start of operations makes such retooling too risky for many for-profit investors. By utilizing the L^3C format to access private foundation support, whether from large national foundations or small community foundations, the credit rating of the ventures can be substantially improved and attract greater interest from private investors. Additionally, once the facilities have been retooled and workers have begun to create the components necessary for green energy sources, new L^3Cs can be formed to set up and operate cites to implement these green energy businesses. As a result of these transactions, automakers and suppliers of auto parts would sell off their excess capacity and, thereby, resize their businesses to meet consumer demand and improve their balance sheets without additional governmental resources. Additionally, unemployed skilled workers would be reemployed in a growth industry, which will stimulate the economies in these regions. However, as noted above, the PRI rules must be clarified before a substantial number of entities will be willing to invest in L^3Cs.

V. NECESSARY AMENDMENTS TO THE INTERNAL REVENUE CODE AND TREASURY REGULATIONS

In order to implement the foregoing objectives, we respectfully request that Congress make the following amendments to the Internal Revenue Code of 1986, as amended (the "Code"):

- Amendment of Section 4944(c) of the Code must be amended to clarify that a PRI (i) is not an investment which jeopardizes the carrying out of exempt purposes; (ii) qualifies as a qualifying distribution under Section 4942 of the Code and (iii) is not a business holding within the meaning of section 4943 of the Code.

- Amendment of Section 4944(c) of the Code to clarify that the primary purpose of the investment is to accomplish one or more of the purposes described in Section 170(c)(2)(B) of the Code and no significant purpose of the investment is the production of income or the appreciation of property.

- Amendment of Section 4944(c) of the Code to provide a rebuttable presumption that investments in entities organized under state law, or the law of any federally-recognized tribe, as low-profit limited liability companies qualify as PRIs.

- Amendment of Section 4944(c) of the Code to provide a voluntary procedure for entities wishing to be the recipients of PRIs to receive a determination by the IRS that an investment in said entity qualifies as a PRI for private foundations with a common purpose and, if an investment is deemed to qualify, all private foundations may rely on this determination unless and until the Secretary publishes a notice of revocation of the determination. The time and cost of said determination should be equivalent to the average time and cost for the determination of 501(c)(3) tax-exempt status.

- Addition of a new section to Chapter 60 of the Code to require information returns for for-profit entities receiving PRIs requiring disclosure of:

  - Its gross income for the year;
  - Its expenses attributable to such income incurred within the year;
  - Its disbursements within the year for the exempt purposes of the organizations holding PRIs in the for-profit entity, together with a narrative statement describing the results obtained from the use of those assets for charitable purposes;
  - A balance sheet showing its assets, liabilities, and net worth as of the beginning of such year;
  - The names and addresses of all private foundations holding PRIs in the for-profit entity.
  - A statement of the portion of its liabilities and net worth that represent capitalization obtained by means of PRIs as of the beginning of such year;
  - A statement of any interest, dividends, or other distributions paid with respect to any PRIs during the year; and
  - Such other information as the Secretary may by forms or regulations prescribe.

- Addition of a new section to Chapter 61 of the Code to require publication of aforementioned information returns for for-profit entities receiving PRIs. Robert Ottenhoff, CEO of Guidestar, has stated that Guidestar would be willing to include such statements on its database.[47]

- Amendment of Section 7428(a)(1) of the Code to include determinations of whether an investment in an entity qualify as a PRI.

- Direction to amend the Treasury regulations as follows:

  - Amendment of Reg. Sec. 1.501(c)(3)-1 to provide that the dissemination of news furthers educational and literary purposes, including without limitation the inclusion of an example under Reg. Sec. 1.501(c)(3)-1(d)(3)(ii).
  - Amendment of Reg. Sec. 1.501(c)(3)-1 to provide that activities exempted from the definition of a "Lobbying Contact" under Section 1602(8)(B)[48] of the

[47] Telephone call between Robert Ottenhoff, CEO of Guidestar, and Robert Lang, CEO of L3C Advisors L3C.

[48] Section 1602(8)(B)(ii) of the Lobbying Act exempts communications "made by a representative of a media organization if the purpose of the communication is gathering and disseminating news and information to the public" from the definition of "Lobbying Contacts." Similarly, Section 1602(8)(B)(ii) of the Lobbying Act exempts communications "made in a speech, article, publication or other material that is distributed and made available to the public, or through radio, television, cable television, or other medium of mass communication" from the definition of "Lobbying Contacts." Section 1602(11) of the Lobbying Act defines a "media organization" as "a person or entity engaged in disseminating information to the general public through a newspaper, magazine, other publication, radio, television, cable television, or other medium of mass communication." Accordingly, the proposed amendment would clarify that the activities of news organizations are not attempts to influence legislation or to "participate in,

Lobbying Disclosure Act of 1995, as amended (the "Lobbying Act"), do not qualify as an attempt to influence legislation or to participate in, or intervene in political campaigns, since such activities are necessary to educate the public on public issues.

- Amendment of Reg. Sec. 53.4942(a)-3 to clarify that a PRI qualifies as a qualifying distribution.
- Amendment of Reg. Sec. 53.4943-3 to exclude a PRI from the definition of a business holding.
- Amendment of Reg. Sec. 53.4944-3 to reflect all of the changes to Section 4944 of the Code outlined above, including (without limitation) inclusion of:
  - Examples of the following: (i) an investment in a L^3C that would qualify as a PRI, (ii) an investment in a L^3C that would not qualify as a PRI at the outset and (iii) an investment that initially qualified as a PRI but due to a change in circumstance no longer so qualifies.
  - Procedures for a private foundation to divest itself of a PRI that no longer so qualifies within a specified time period without incurring excise tax.

- Such conforming changes as may be necessary to implement the foregoing provisions.

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or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."