FINANCING THE AMERICAN NEWSPAPER IN THE TWENTY-FIRST CENTURY

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INTRODUCTION

It would be premature to write the obituary of the American newspaper. But the news about newspapers is surely sobering. Newspaper publishing suffers from a long-term secular decline in readership, due largely to increasing competition from other media that appear to be more appealing to the younger demographics coveted by advertisers. Laid on top of that has been a severe general recession that made many weak companies weaker still. And newspapers appear to be among the weakest industries in the economy, caught in something of a death spiral: declining readership leads to declining revenue, from both circulation and advertising, which leads to desperate cost-cutting, which leads to declining quantity and quality of content, which initiates a new cycle of losses of readership and revenue.

To many observers, the situation looks hopeless. And perhaps in the long run it is; this may simply be a medium that was well-suited to nineteenth and twentieth century life, but not to an age in which electronic media appear to enjoy strong competitive advantages. But they do, at least for the foreseeable future, fill a special niche in the public consciousness. Unlike books or magazines, newspapers have an immediacy that allows them better access to, and influence on, policy debates. Unlike television, newspapers can bring to their audiences a depth of analysis that extends beyond the thirty-second sound bite. Unlike blogs or talk radio, newspapers generally must present enough balance to achieve broad appeal, especially since most cities can support only a single daily newspaper at best. And unlike nearly all other media, newspapers' traditional coverage of topics of local interest provides a focus on their geographic communities that would be difficult to replace.

Because the core problem is a financial one—there being no shortage of talented people who wish to pursue careers in journalism—the solutions presumably must come in the form of new financial structures. And a starting point in the search for new financial structures is to recognize that newspapers continue to have some ability to generate revenue, if perhaps

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not enough revenue to earn profits reliably.[1] Many newspapers appear to be able to cover their operating costs; but nearly all newspapers are likely to have difficulty attracting capital to improve, or even maintain, their product when the future seems so gloomy.[2] Capitalists want future returns on their investments, and newspapers seem to be an industry with more of a past than a future.

Some capitalists, however, have enough public spirit that they may be willing to forego some or all of the financial returns that optimal deployment of their capital might provide. And newspapers have a strong claim to the loyalty of publicly-spirited individuals. But how is the impulse to support daily print journalism to be translated into concrete terms? More particularly, what financial structures can be used to provide necessary support to newspapers in the most effective and least costly ways? The following is a description of the several most prominent possibilities, along with brief assessments of their strengths, weaknesses, and viability.

I. EXISTING CORPORATE STRUCTURE

Today, virtually all large daily newspapers operate within the structure of the standard business corporation—either as a stand-alone entity, or as part of a conglomerate that may include other media outlets (such as television or radio stations) or unrelated businesses. This was a hugely successful model during the first half of the twentieth century, when ownership of a newspaper conveyed both wealth and personal power. And it continued to be successful enough until relatively recently. Now, however, this model is beginning to unravel. It is not unraveling so quickly, however, that it could not be sustained in many markets for some time to come, but probably at diminishing levels of profitability or increasing levels of operating losses. Owners who choose to do so could, of course, simply

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1. Total advertising revenue of American newspapers in 2008 was $34.7 billion. THE WORLD ALMANAC AND BOOK OF FACTS 252 (Sarah Jansen et al. eds., 2010). Average total daily circulation was 48.6 million copies, and Sunday circulation was 49.1 million. *Id.* If one assumes a daily price of $1, and a Sunday price of $2, this suggests that an amount in excess of $20 billion would be earned each year in subscription and newsstand revenue. The exact figures are not terribly important. The main point is that the hybrid business models discussed in this article will not work if the object is to finance a nonprofit business, such as a soup kitchen, that depends largely on donations for its revenue. With their substantial ability to generate advertising and circulation revenue, newspapers would not be such a case. As a consequence, newspapers appear to be plausible candidates for financing through some hybrid business model.

2. Average daily newspaper circulation was over 62 million in 1985, some 28% higher than it was in 2008. Similarly, annual newspaper advertising revenue was $48.7 billion in 2000, more than 40% greater than the comparable amounts in 2008. *Id.* These figures nicely encapsulate the diminishing prospects of the American daily newspaper.

tolerate this situation, satisfying their taste for public service and altruism in the form of personal absorption of lesser profits or greater losses, within the limits of their resources. And, of course, they can—as most actually do—try to minimize their losses by adapting to changing conditions: adding web-based editions, pooling reporting resources, and the like.

Still, it appears that this may not be a sustainable model. There may be a few financial angels who have the resources and the resolve to simply absorb losses indefinitely, and there may be a few markets that can support a daily newspaper indefinitely. But there are (or recently were) about 100 daily newspapers with a circulation of 100,000 copies per day or more.[3] There may not be enough publicly-spirited altruism of this form to go around, and many of these newspapers will fail if they are forced to depend on the willingness of their owners to absorb losses.

There is also a tax problem with the corporate model. Normally, publicly-spirited altruism is rewarded with tax deductions for charitable contributions.[4] But no such deductions would be allowed for newspaper philanthropists who do no more than absorb losses from continued publication of a failing daily newspaper within the context of a for-profit corporation. To the extent that their "contributions" go beyond mere foregone profit, and begin to involve actual losses, deductions of net operating losses may be available in some circumstances.[5] However, owners of a corporate enterprise are not entitled to deduct the enterprise's net losses in the year in which those losses are incurred; rather, the standard tax treatment is to carryback operating losses for up to two years, offsetting any income taxes paid in those years, and to carry any remaining (or new) losses forward for up to twenty years.[6] If no income appears within those years (or, in any case, insufficient income to absorb the losses), the loss carryovers will eventually expire unused, yielding no tax benefits to anyone.[7] Similarly, new infusions of capital would not produce deductions, but would be treated instead as either contributions to the capital of a corporation, or as subscription prices paid for the issuance of new stock,

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3. THE WORLD ALMANAC AND BOOK OF FACTS 286 (C. Alan Joyce et al. eds., 2009).

4. I.R.C. § 170 (2006). Section 170 of the Internal Revenue Code allows deductions for contributions to recognized charities, as defined in § 170(c)(2). There are, of course, altruistic acts that are not rewarded with a deduction, such as giving spare change to a homeless person, giving a lift to a hitchhiker, etc.

5. Corporations, and other taxpayers not relevant here, can deduct net operating losses incurred in one year against income earned in up to two preceding years and twenty subsequent years under the provisions of § 172(a). *Id.* § 172(a)–(b) (2006).

6. *Id.* § 172(b)(1)(A)(i).

7. Of course, if the newspaper business is lodged within a larger company, which perhaps also operates a television station or the like, it would be able to use the newspaper losses to absorb other income.

depending on how the contribution was structured.[8] In either case, the tax treatment would give the shareholder additional basis in the amount of the contribution, but no tax deduction.

II. LIMITED LIABILITY COMPANIES

Ordinary limited liability companies (LLCs) operate much like business corporations, but have different tax features.[9] LLCs pool the capital of investor–participants, marshal it for the use of the business, and operate the business pursuant to a written agreement specifying the terms under which operating responsibilities, profits, and losses will be shared (among other things).[10] Because a failing daily newspaper would not likely have a high market value, relatively small amounts of capital pooled in an LLC might be enough to purchase daily newspapers in many markets. If the LLCs subsequently sustained losses through their operations, these losses normally *would* be deductible by the owners of the newspaper—not as charitable contributions, but simply as business losses.[11] However, if an arrangement such as the one described were entered into, more or less consciously, with the idea of subsidizing publication of the newspaper out of publicly-spirited altruism, it is likely that the Internal Revenue Service (IRS) would challenge the deductions under § 183 of the Internal Revenue Code (the Code), which denies deductions of net losses of activities "not engaged in for profit."[12] It is also true that LLCs appear to be best suited as vehicles for enterprises of modest size, largely due to the difficulty of attracting large amounts of capital when the organization lacks the convenience of issuing ordinary stock. Many newspapers may find that

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8. The I.R.C. authorizes deductions for a variety of purposes, but these do not include buying more stock or contributing to the capital of a corporation. This Note raises the difficult problem of proving a negative. Income is taxed except to the degree it is offset by deductions, and there is no deduction for this sort of transaction.

9. Treas. Reg. § 301.7701-1–301.7701-3 (as amended in 2009). Being taxed like a regular corporation is generally unfavorable because it means that the income will be taxed to the corporation as it earns it, and then taxed again to the shareholders when distributed as a dividend. The whole point of the LLC is to enable business entities to obtain the limited liability of a corporation, without this double-tax feature. LLCs have an option to be treated for tax purposes like a corporation or an association. *Id*. Most LLCs decline this option, and the discussion here assumes that newspaper LLCs would usually decline this option as well.

10. *Id.* § 301.7701-3.

11. I.R.C. § 165(a) (2006).

12. I.R.C. § 183(a) (2006). If the newspaper has a recent history of profitability, it may be possible to take net-loss deductions for a few years, due to the favorable presumption of profit motive embodied in § 183(d) of the Code, which presumes that activities are engaged in for profit if they have in fact been profitable in three of the preceding five years. *Id*. § 183(d). But even if it qualifies initially, the organization would quickly age out of eligibility for this presumption.

their capital needs are too great to be comfortably met within the LLC framework.

III. NONPROFIT CORPORATIONS

If operating a newspaper is increasingly unprofitable, it seems natural to ask whether it might be better housed in an entity that is specifically intended to operate on a nonprofit basis. A few initial distinctions should be made before detailed consideration of this option. First, although nonprofit corporations, like any other entity form, are largely creatures of the law of the state in which they are incorporated, the most important distinctions among categories of nonprofit organizations are in the I.R.C.[13] One such distinction is between charitable nonprofits, those that qualify for exemption from federal income tax under § 501(c)(3) of the Code, and noncharitable nonprofits, which may qualify for exemption from income tax under any one of the other twenty eight paragraphs of § 501(c).[14] While it seems imaginable that a newspaper might be operated as a noncharitable nonprofit corporation—most plausibly as a § 501(c)(4) social welfare organization—it is difficult to see any advantages in doing so. Contributions to such organizations are not deductible, nor are losses from operations.[15] Furthermore, unlike business corporations or LLCs, any gains that might accrue could not be distributed to the participants because of the ban on "private inurement" contained in § 501(c)(4).[16]

It thus seems that a charitable nonprofit corporation, eligible for exemption under § 501(c)(3) of the Code, is more promising, largely because contributions to such organizations are ordinarily deductible[17]—a major incentive to those who might be willing to support such an organization out of altruistic impulses. A further subdivision within the charitable nonprofit category between so-called "public charities" and "private foundations" is also salient, largely because the latter subcategory

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13. I.R.C. § 501(c).

14. *Id.*

15. *Id.* § 501(c)(4). The description in § 170(c)(2) of the organizations to which deductible contributions can be made does not match the description of organizations covered by § 501(c)(4). *Compare id.* § 170(c)(2), *with id*. § 501(c)(4). In contrast, the § 170(c)(2) definition is almost perfectly congruent with the definition in § 501(c)(3). *Compare id*. § 170(c)(2), *with* § 501(c)(3). But, 501(c)(4) organizations are themselves exempt from taxation under that very provision (actually, under § 501(a), an earlier part of the same section), so deductions are not meaningful. *Id*. § 501(a), (c)(4). If income is not exposed to any tax, there is no need for deductions to reduce the income exposed to tax.

16. *Id*. § 501(c)(4)(B).

17. The deduction is authorized by § 170(c)(2) of the Code; however, the language of that provision regarding deductibility closely parallels the language of § 501(c)(3) governing the exemption of such organizations from income tax. *Id*. § 501(c)(3).

is subject to some special limitations that make them particularly problematic as owners of newspapers. It will be more convenient to note these difficulties at the conclusion of the next section, which will otherwise presume that the charitable corporation will qualify as a "public charity."

IV. PUBLIC CHARITIES DIRECTLY OPERATING NEWSPAPERS

A charitable nonprofit corporation might be able to operate a newspaper directly, by which I mean as a business owned by the nonprofit corporation rather than through a subsidiary business corporation owned by the nonprofit. But there are several concerns raised by this possibility. The first is whether operation of a newspaper serves a valid charitable purpose. Section 501(c)(3) organizations are allowed to pursue only purposes specifically described in that section, including those that are "religious, charitable,[18] scientific, literary, or educational."[19] Can publication of a daily newspaper be said to advance any of these purposes?

Possibly so. Newspapers may be considered to be educational. This is a category that is substantially elaborated in the Treasury Regulations,[20] and certainly goes far beyond formal education of the sort conducted by schools. The Treasury Regulations explaining this concept speak of purposes that include: "The instruction of the public on subjects useful to the individual and beneficial to the community."[21] Certainly some parts of a daily newspaper—such as those describing bills introduced in Congress, public safety improvements proposed by the city council or police chief, and the like—would easily meet this definition. Other parts—comic pages, bridge columns, horoscopes—might have more difficulty measuring up, in which case the *primary* purposes served by the newspaper might have to be assessed before concluding that it was within the definition of "educational" on an overall basis.

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18. *Id.* §§ 501(c)(3), 170(c)(2). The word "charitable" is, confusingly, used in two rather distinct senses in the nonprofit context. It is often used to describe the entire universe of organizations (or purposes) that qualify for favorable tax treatment under §§ 170(c)(2) and 501(c)(3) (as in the phrase "charitable contributions"). But it is also one of the specific purposes for which such organizations can be formed and operated. *Id.* § 170(c)(2). In the latter, more narrow sense, it refers, generally, to those organizations that serve to relieve the effects of poverty or other distress, such as soup kitchens, hospitals, disaster relief organizations, and the like. Treas. Reg. § 1.501(c)(3)–1(d)(2) (as amended in 2008).

19. I.R.C. § 170(c)(2). There are a few other approved purposes of less interest in the present context, such as fostering of amateur sports competition, testing for public safety, and the like. The reader may be assured that any purpose that could remotely include publication of a daily newspaper has been included in the quotation in the text. *Id.* §§ 170(c)(2), 501(c)(3).

20. Treas. Reg. § 1.501(c)(3)–1(d)(3).

21. *Id.*

It is fair to say that publication of a newspaper has not traditionally been thought to be educational, but that is quite possibly because such enterprises have ordinarily preferred commercial status, if only so that profits could be distributed to the entrepreneurs who have invested in them. In situations where such returns seem unlikely, educational status has sometimes been recognized. For example, in *Big Mama Rag, Inc. v. United States*, an organization was recognized as exempt[22]—albeit over the objection of the IRS[23]—where the primary activity of the organization was the publication of the eponymous "Rag," which was a monthly newspaper containing "articles, editorials, calendars of events, and other information of interest to women."[24] The IRS has also recognized that an organization whose purpose was to provide support to the then-emerging "free press" in former Soviet satellite countries in the early 1990s was qualified for exemption as an educational organization.[25] Similarly, it has recognized that a public affairs magazine could be operated as a qualified educational organization.[26]

Another possibility would be that newspapers could be "charitable" in the narrower sense of relieving poverty or distress. That does not sound very much like what newspapers ordinarily do, but the concept of "charitable" as defined in the Treasury Regulations contains some promising threads.[27] Among the examples mentioned in the regulations are "lessening of the burdens of Government;" "advancement of education or science;" and "promotion of social welfare."[28] Newspapers certainly serve important roles in explaining governmental programs and policies to readers, which might otherwise need to be done by government itself at its

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22. Big Mama Rag, Inc. v. United States, 631 F.2d 1030, 1032 (D.C. Cir., 1980).

23. *Id.* at 1033. The IRS objection was not based on the idea that a newspaper was inherently not educational, but rather that this particular journal offered primarily propaganda rather than information. Big Mama Rag, Inc. v. United States, 494 F. Supp. 473, 477 (D.D.C. 1979), *rev'd on other grounds*, 631 F.2d 1030 (D.C. Cir. 1980).

24. *Big Mama Rag*, 631 F.2d at 1032.

25. The finding that this was a valid charitable purpose is implicit in the finding that the purpose could be supported through a program-related investment (a concept explained in the text below), as stated in a private letter ruling issued following the collapse of the Soviet Union. *See* I.R.S. Priv. Ltr. Rul. 92-23-054 (Mar. 12, 1992), 1983 WL 197944, at *1–3 (finding that distribution of a private foundation's news service in Eastern European countries was an investment which qualified for tax exemption because the foundation's purpose was "to foster First Amendment freedoms, particularly freedom of speech and freedom of the press").

26. I.R.S. Gen. Couns. Mem. 38,845 (May 4, 1982), 1982 WL 204252, at *1–6.

27. Treas. Reg. § 1.501(c)(3)–1(d)(2) (as amended in 2008).

28. *Id.* Note that the last phrase quoted in the text—promotion of social welfare—adds "by organizations designed to accomplish any of the above purposes." *Id*. Thus, it would appear that an organization would need not merely to promote social welfare, but to also achieve one of the other purposes noted in the text.

own expense.[29] Assuring the integrity of public institutions is also an internal obligation of governmental bodies, and the "burden" of doing so is often greatly aided by a vigilant free press. Finally, providing information about the operation and integrity of government, and providing a medium of communication among merchants and potential customers, would seem to "advance education and promote social welfare."

A final possibility is that newspapers might serve "literary" purposes. While this seems in some ways a more natural category than "charitable," it is in fact probably less promising. First, the Treasury regulations offer no definition of the "literary" concept, and the case law is exceedingly sparse. More importantly, the word "literary" ordinarily connotes "writings . . . of an imaginative or critical character."[30] While newspapers often contain book reviews, and less commonly, works of fiction or poetry, these items would rarely constitute a substantial portion of a general-circulation daily newspaper.

But an organization need only have one purpose that qualifies, so whether the "literary" category applies or not, newspapers would seem to have a reasonably good claim to being either "educational" or "charitable," and thus should be able to satisfy the first of several hurdles to exempt status. The next hurdle on the course to exempt status is a doctrine that the IRS imposes—without compelling support in the Code—as something of a negative condition for exempt status under § 501(c)(3): the so-called "commerciality" doctrine.[31] The doctrine is quite vague, and has a tangled history, but reflects at its core an interpretation of the Code to the effect that an exempt organization must be organized and operated *exclusively* for exempt purposes.[32] If the organization also operates a business that is unrelated to its exempt purpose, and if that business is substantial in

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29. Examples abound: notices about days of operation of the public schools; trash collection; hearings on foreclosure actions; openings and closings of public offices, museums, municipal parks and stadiums; proceedings of city council meetings, etc.

30. WEBSTER'S NEW TWENTIETH CENTURY DICTIONARY 1056 (2d ed., 1979). This language is taken from the definition of "literature," the noun to which "literary" of course refers. *Id*. at 1055.

31. *See* Goldsboro Art League, Inc. v. Comm'r, 75 T.C. 337, 342 (1980) (describing IRS use of the doctrine in an unsuccessful attempt to deny exempt status to what it regarded as a commercial art gallery).

32. The Code is understood not to mean "exclusively" too literally, just as "ordinary and necessary" business expenses do not need to be strictly necessary to be deductible under § 162. I.R.C. § 162(a) (2006). As the regulations explain, "[a]n organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes." Treas. Reg. § 1.501(c)(3)–1(c)(1). Thus, the regulations baldly (but reasonably) substitute "primarily" for "exclusively."

comparison to the scope of the pursuit of its exempt purposes, then exempt status would be denied under this doctrine.[33]

One might think that this issue had already been addressed: if it can be concluded that operating a newspaper can be a legitimate exempt purpose, then surely all aspects of those operations are related to that purpose. Perhaps, but the law on unrelated business activities is not so straightforward, and unfortunately for newspapers, their principal source of revenue—advertising charges—has proven particularly problematic. In *United States v. American College of Physicians*, the Supreme Court found that even if a publication (in this case, the Annals of Internal Medicine) serves an exempt purpose—namely, publishing scholarly articles about developments in internal medicine—it does not mean that the business of soliciting and placing advertisements within the publication is a business that is related to that exempt purpose.[34] Rather, the advertising part of the publication was found to be an unrelated trade or business, subject to the tax, at the regular for-profit corporate tax rate, on unrelated business income enjoyed by a nonprofit organization under § 511 of the Code.[35]

The unrelated business income tax (or "UBIT")[36] may be a problem for some newspapers, but probably not for most. This is because it is, as an income tax, subject to deductions for the reasonable expenses of operating the business,[37] and the general background assumption of this Article is that a newspaper thinking about organizing as a nonprofit is one whose expenses will ordinarily equal or exceed its *total* revenue, and hence *a fortiori* must exceed its advertising revenue. But if the advertising business is unrelated to the educational aspects of publishing a newspaper that give rise to its claim for exempt status, and are substantial in relation to the pursuit of the educational mission, does this mean that the conduct of the newspaper as a whole is too tainted by commerciality to pass muster as an entity organized and operated exclusively for exempt purposes?

That is, unfortunately, the position that the IRS has taken in the one ruling most on point. In Revenue Ruling 77-4, a nonprofit organization's only activities were the publication of a weekly newspaper emphasizing items of interest to an unspecified "ethnic group."[38] The IRS found that the operations were "indistinguishable from ordinary commercial publishing practices. Accordingly, it is not operated exclusively for charitable and

33. Treas. Reg. § 1.501(c)(3)–1(c)(1).
34. United States v. Am. Coll. of Physicians, 475 U.S. 834, 840–49 (1986).
35. *Id.* at 849.
36. I.R.C. § 511(a) (2006).
37. *Id.* § 512(a)(1).
38. Rev. Rul. 77-4, 1977-1 C.B. 141.

educational purposes . . . ."[39] This passage suggests that the IRS's view is that operations that strongly resemble those of for-profit competitors are sufficient grounds in themselves to deny § 501(c)(3) status, but it is not clear why that should be so, nor that it is in fact so. It would not be difficult, for example, to find a pair of hospitals, one nonprofit and the other for-profit, whose operations were not distinguishable except by reference to whether their managers were seeking to make a profit.

Outside of the newspaper field, several cases have found that organizations whose operations resemble those of for-profit competitors in the same field could nevertheless qualify for § 501(c)(3) status if their purposes were charitable or educational. *Goldsboro Art League v. Commissioner* involved an organization (the League) whose activities included operation of two public art galleries displaying works of art that were for sale to the public.[40] The League took a twenty percent commission on sales, remitting the balance to the artists who created the works.[41] The League also conducted a number of educational programs, such as offering classes in drawing, sculpture, and the like.[42] But the IRS argued that the operation of public art galleries in a manner indistinguishable from the operation of commercial art galleries meant that the organization was "operated in furtherance of a substantial commercial purpose," and was therefore not qualified for exemption as a charitable organization.[43] The Tax Court found otherwise, however, due in part to the non-gallery activities of the organization, but also because the court found that the sales activities were "secondary and incidental to furthering [the League's] exempt purpose."[44]

Similarly, in the *Big Mama Rag* case noted previously, the IRS denied exemption for the organization on several separate grounds, one of which was that it was indistinguishable from an ordinary commercial publication.[45] This view was rejected by the district court that heard that case, and was not specifically addressed by the District of Columbia Circuit on appeal.[46] A cautionary note, however, is that the district court findings on this question were influenced by the fact that Big Mama Rag operated with substantial contributions of free labor, and also distributed most of its

39. *Id.*
40. Goldsboro Art League, Inc. v. Comm'r, 75 T.C. 337, 340 (1980).
41. *Id.* at 339.
42. *Id.*
43. *Id.* at 338.
44. *Id.* at 344– 45.
45. Big Mama Rag, Inc. v. United States, 631 F.2d 1030, 1033 (D.C. Cir. 1980).
46. *Id*.

copies without charge,[47] facts that would likely not routinely be true of daily newspapers that were seeking to convert to nonprofit status.

The IRS also initially resisted the participation of § 501(c)(3) organizations in joint ventures with profit-seeking firms, arguing that such participation furthered a substantial commercial purpose. After this position was rejected by the Tax Court in *Plumstead Theatre Society, Inc. v. Commissioner*,[48] the IRS relaxed its position, and now examines such joint ventures on a case-by-case basis, using a test that asks whether the joint venture furthers the exempt purposes of the participating charity, and whether the structure of the joint venture permits operation of the charity for its exempt purposes and not for the private benefit of one or more non-exempt parties.[49]

While the *Goldsboro Art League*, *Big Mama Rag*, and *Plumstead Theatre Society* cases do not directly overrule the IRS position expressed in Revenue Ruling 77-4, they do suggest that courts have been more willing than the IRS to allow nonprofit purposes of an organization to trump an operational pattern that in other respects might be thought to resemble patterns seen in the for-profit world. Nevertheless, the opposition of the IRS, which apparently continues, to the idea of qualifying newspaper operations as a charitable or educational activity,[50] is a substantial obstacle. It means that in all likelihood a newspaper seeking such status would have to be prepared to litigate the issue with the IRS, under circumstances where victory was far from certain.

Finally, it must be noted that § 501(c)(3) organizations are prohibited from "attempting[] to influence legislation," (except to an insubstantial degree) and barred completely from participation in political campaigns.[51] While balanced accounts of newsworthy events, such as congressional debates over pending legislation, would not be proscribed by this language, it would seem that much editorial commentary might well be regarded as grass-roots lobbying. Explicit endorsement of candidates for public office would likewise be considered participation in a campaign. If operation of a newspaper were to be conducted directly by an organization exempt under § 501(c)(3), it would probably need to incorporate some important modifications to its usual practices—modifications that, unfortunately,

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47. Big Mama Rag, Inc. v. United States, 494 F. Supp 473, 475 (D.D.C. 1979), *rev'd on other grounds*, 631 F.2d 1030 (D.C. Cir. 1980).

48. Plumstead Theatre Society, Inc. v. Comm'r, 74 T.C. 1324, 1333–34 (1980).

49. I.R.S. Gen. Couns. Mem. 39,005 (Dec. 17, 1983), 1983 WL 197944, at *1–3.

50. It is the practice of the IRS to revoke earlier rulings no longer consistent with its policy. Revenue Ruling 77-4 has not been revoked. Therefore, one may infer that the IRS continues to resist the idea of qualifying newspaper operations as charitable or educational.

51. I.R.C. § 501(c)(3) (2006).

might make it more difficult for the newspaper to serve its important function as a critic of governmental policies.

V. PUBLIC CHARITIES OPERATING A NEWSPAPER THROUGH A TAXABLE SUBSIDIARY

A charity wishing to operate a newspaper might consider an alternative approach: creating (or acquiring) a taxable subsidiary corporation, and operating the newspaper through the subsidiary. Any profits of the newspaper would be subject to the corporate income tax,[52] but, by the assumptions of this paper, few if any profits would be earned.[53] This is the model that has been adopted by the Poynter Institute, which owns the corporation that operates the *St. Petersburg Times*.[54] One might assume that the very existence of the Poynter Institute–St. Petersburg Times relationship would prove the viability, or at least the permissibility, of this structure. However, there are some special circumstances in this case that make it difficult to know whether their experience can be generalized.

The Poynter Institute is indeed an educational organization, but its educational purpose consists not of publishing a paper per se, but rather of instructing journalists (or would-be journalists) in their craft.[55] The purpose is *not* to educate the general public about public policy issues,[56] as it presumably would be in the usual case of a charity that exists to publish a daily newspaper. The Institute's most recent Form 990 explains that it is "a school dedicated to the teaching and inspiring of journalists and media leaders."[57] In addition to offering courses at its Florida campus, the Institute offers a number of on-line courses to journalists, and publishes various guides for the use of journalists.[58] The extent and range of the Institute's programs might be replicable in a few instances, but presumably would not

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52. *Id.* § 11.

53. Of course, there may be fluctuations in profitability that might lead to profits in some years and losses in others. However, if the overall tendency is to lose money, the net operating loss carry back and carryover provisions of § 172 of the Code should allow any temporary profits to be shielded from taxability in the long run.

54. Douglas McCollam, *Somewhere East of Eden: Why the St. Pete Times Model Can't Save Newspapers*, 46 COLUM. JOURNALISM REV. 50, 50–51 (Mar./Apr. 2008).

55. The Poynter Institute, *The Poynter Institute: What We Do*, POYNTER ONLINE (Jan. 1, 2009), http://www.poynter.org/content/content_view.asp?id=8090.

56. *See id.* ("The Poynter Institute is a school for journalists, future journalists, and teachers of journalism.").

57. The Poynter Institute 2007 Form 990, Pt. III, at 3.

58. The Poynter Institute, *Journalism Education*, POYNTER ONLINE, http://www.poynter.org/subject.asp?id=59 (last visited Sept. 21, 2010).

be undertaken by every organization that might wish to operate a daily newspaper.

If a charitable nonprofit organization were to exist solely to hold the stock of a for-profit corporation that operated a newspaper, two concerns might arise. The first was foreshadowed by the previous section: could this organization be said to be organized and operated exclusively for a charitable purpose if its only activity is to be a holding company of the stock of a business corporation? Second, if the stated purpose is to hold the stock of a failing business, so as to allow the charitable organization to subsidize that business and thereby keep it afloat, the charitable organization might be thought to be imprudently managing its assets. Under state laws, such as those imposed by the Uniform Management of Institutional Funds Act (UMIFA) model legislation, investments must be chosen with prudence, and with an eye toward preservation of the capital of the organization.[59] If the very reason for creating the charitable organization is to aid a dying business corporation, one wonders how the investment of the organization's funds in such a vehicle could be defended against charges that it is imprudent. The defense would have to be, I think, that despite the investment structure, the ownership of the stock of the corporation isn't really intended for investment purposes. Rather, the ownership is either for the charitable purpose of educating the public on current events of interest, or for the purpose of providing a community with the information exchange that it needs in order properly to function, thereby relieving government of the obligation it might otherwise have to bear. This argument, of course, leads back to some of the problems noted in the previous section about the ability to qualify such a purpose as charitable for purposes of § 501(c)(3).[60]

VI. ADDITIONAL CONCERNS FOR PRIVATE FOUNDATIONS

As noted above, the charitable nonprofit sector is divided between public charities and private foundations, with the latter being burdened by strictures—largely added by the Tax Reform Act of 1969[61]—that were

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59. UNIF. MGMT. OF INSTITUTIONAL FUNDS ACT § 6 (1972). UMIFA was adopted by the Commissioners on Uniform State Laws in 1972, and has been adopted in 47 states and the District of Columbia. Susan N. Gary, *UPMIFA: Coming Soon to a Legislature Near You*, 21 PROB. & PROP. 32, 32 (2007). A revised version, by the name of Uniform Prudent Management of Institutional Funds Act (UPMIFA), was proposed in 2006, and has been enacted in 46 states and the District of Columbia. Unif. Law Comm'r, *Enactment Status Map*, UNIF. PRUDENT MGMT. OF INSTITUTIONAL FUNDS ACT, http://www.upmifa.org/ (follow "enactment status" hyperlink) (last visited Sept. 2, 2010).

60. *See supra* Part IV.

61. *See* I.R.C. §§ 509, 4940–4946 (imposing excise taxes based on income, taxes on self-

thought by Congress to be necessary to constrain otherwise problematic behavior. For our purposes, it is sufficient to say that the Code now presumes private foundation status for each charitable nonprofit organization, unless it affirmatively qualifies as a public charity.[62] An organization can so qualify on the basis of the sort of organization it is. For example, the Code specifically excepts from private foundation status churches, schools, and hospitals.[63] Also excluded are other organizations that can meet a "public support" test, either because they receive donations from a broad range of donors,[64] or because they receive a substantial percentage of their support from gross receipts obtained in connection with performance of its exempt functions.[65]

The restrictions on private foundations take the form of punitive excise taxes imposed on specified types of foundation misbehavior. At least three of these excise taxes are problematic in this context. Each is individually powerful enough to make it difficult if not impossible for a private foundation to own and operate a newspaper business; collectively, they seem virtually prohibitive. The first is that a private foundation is generally required to distribute for charitable purposes an amount equal to five percent of its assets each year.[66] If it is receiving little or no income because it is operating a newspaper business at a loss, it would be difficult also to surrender five percent of its assets each year for other charitable grants.

A private foundation is also generally prohibited from holding more than "20 percent of the voting stock," or other similar interest, in a business organization.[67] These so-called "excess business holdings" rules are designed to prohibit foundations from exercising control over business organizations, and would effectively preclude ownership of a controlling interest in a business that operates a daily newspaper. Finally, a private foundation is prohibited from making investments that, because of their excessive risk, might jeopardize the ability of the foundation to discharge its charitable purposes.[68] As noted in the foregoing section, investment in a failing newspaper would be difficult to defend in the face of such a rule.[69]

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dealing, taxes on failure to distribute income, taxes on excess business holdings, taxes on investments jeopardizing charitable purposes, and taxes on taxable expenditures).

62. *Id.* § 509(a).

63. Section 509(a)(1) excepts from private foundation status those organizations that are described in § 170(b)(1)(A), which include the types of organizations mentioned in the text. *Id.* § 170(b)(1)(A).

64. *Id.* § 170(b)(1)(A)(vi).

65. *Id.* § 509(a)(2).

66. *Id.* § 4942(d)–(e).

67. *Id.* § 4943(c)(2)(A)(i).

68. *Id.* § 4944(a)(1).

69. *See supra* Part V; *see also* I.R.C.. § 4944 (prohibiting investments that might jeopardize the

There is one possible escape from these conclusions. If operation of the newspaper business were found to be "functionally related" to the exempt charitable purposes of the foundation, then it would be excepted from the excess business holdings rules.[70] Similarly, if the foundation conducts a functionally related business, its entire operation would be an "operating foundation,"[71] and as such exempt from the requirement to distribute five percent of its income.[72] Finally, if the newspaper business were operated by the foundation directly rather than held as an investment, the jeopardizing investment rules would presumably not apply.[73] This escape route depends on acceptance of the idea that operating a newspaper can constitute an exempt function, however, and so circles around to the set of considerations regarding such a purpose discussed above.[74]

As the foregoing discussion makes clear, there is a reasonable chance that publishing a newspaper could constitute a charitable purpose, and a more than reasonable policy argument that it should. There are risks, however, that a charitable organization whose primary activity is publishing a newspaper could be caught in a netherworld, with too much commercial taint to pass muster as a charitable purpose itself, and too little in the way of profitability to pass muster as a legitimate investment of a charitable organization that is charged—as all are—with fiduciary obligations to preserve the value of its assets.

VII. LOW-PROFIT LIMITED LIABILITY COMPANY

In the spring of 2008, Vermont passed the first legislation authorizing creation of a new form of limited liability company, the low-profit limited liability company (L3C),[75] following development and forceful advocacy of the idea by the Mannweiler Foundation, a small New York foundation.[76] Nine more states—Michigan, Wyoming, North Dakota, North Carolina,

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continued existence of a foundation).

70. *Id.* § 4943(d)(3)(A).

71. *Id.* § 4942(j)(3).

72. *Id.* § 4942(a)(1).

73. *See id.* § 4944. The rules regulating investments are ordinarily applied to passive business interests, such as stock in corporations. But even if the IRS were to say that the investments in the assets of running a newspaper were jeopardizing the foundation's existence, the foundation could presumably qualify the investment as a program-related investment under § 4944(c), which would exempt the investment from the § 4944(a) excise tax.

74. *See supra* Part IV.

75. VT. STAT. ANN. tit. 11, § 3001(27) (2008 & Supp. 2009).

76. HEATHER PEELER, CMTY. WEALTH VANGUARD, THE L3C: A NEW TOOL FOR SOCIAL ENTERPRISE 1 (Aug. 2007), *available at* http://www.communitywealth.com/Newsletter/August%202007/L3C.html.

Utah, Illinois, Maine, Lousiana, and New York—have joined Vermont in the months since,[77] and several other states are actively considering bills that would accomplish this purpose.[78] Of course, even a single state is enough, since an organization created under the laws of any state can legally conduct operations in any other as well.[79]

The Vermont legislation authorizes creation of companies that meet the following conditions:

> (A) The company:
> (i) significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code of 1986, 26 U.S.C. 170(c)(2)(B); and
> (ii) would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes.
> (B) No significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.[80]

The bill also provides that an L3C cannot engage in lobbying or political campaigns and, upon ceasing subsequently to qualify, will be considered to be an ordinary limited liability company.[81]

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77. MICH. COMP. LAWS § 450.4102(m) (2010); UTAH CODE ANN. §48-2c-412 (2010); WYO. STAT. ANN. §17-15-102(a)(ix) (2010); 805 ILL. COMP STAT. ANN. 180/1-26 (West 2010); ME. REV. STAT. tit. 31, §§ 1599, 1611 (2010); An Act to Provide for the Formation of a Limited Liability Company as a Low-Profit Limited Liability Company, S. 308, 2009 Sess. (N.C. 2009), http://www.ncga.state.nc.us/Sessions/2009/Bills/Senate/PDF/S308v5.pdf; Act of Aug. 15, 2010, H.B. 1421, 2010 Sess. (La. 2010), http://www.legis.state.la.us/billdata/streamdocument.asp?did=721792; L3C Act, A10414, 2010 Sess. (N.Y. 2010), http://open.nysenate.gov/legislation/api/1.0/html-print/bill/A10414; Act of Jan. 6, 2009, H-B. 1545, 61st Sess. (N.D. 2009).

78. H.B. 2102, 87th Gen. Assemb., Reg. Sess. (Ark. 2009); H.B. 10-1111, 67th Gen. Assemb., 2nd Reg. Sess. (Colo. 2010); H.B. 371, 2010 Gen. Assemb., 10 Reg. Sess. (Ky. 2010); H.B. 5, 2010 Gen. Assemb., Reg. Sess. (Md. 2010); H. 4589, 2009 H.R., 186th Sess. (Mass. 2009); H.B. 1890, 95th Gen. Assemb., 2nd Reg. Sess. (Mo. 2010), http://www.house.mo.gov/billtracking/bills101/biltxt/intro/HB1890I.htm; H.B. 235, 61st Leg., Reg. Sess. (Mont. 2009); S. 6726, 2010 Sess. (N.Y. 2010), http://open.nysenate.gov/legislation/api/1.0/html-print/bill/S6726; H.B. 2886, 75th Leg. Assemb., Reg. Sess. (Or. 2009), http://www.leg.state.or.us/09reg/measures/hb2800.dir/hb2886.intro.html; H.B. 0664, 2009 Gen. Assemb. (Tenn. 2009), http://wapp.capitol.tn.gov/apps/billinfo/BillSummaryArchive.aspx?BillNumber=HB0664&ga=106; H.B. 261, 2010 Gen. Assemb., 2010 Sess. (Va. 2010).

79. U.S. CONST. art. I, § 8, cl. 3.

80. VT. STAT. ANN. tit. 11, § 3001(27)(A)–(B).

81. *Id.* § 3001(23)(C) and (D) respectively.

The purpose of the L3C is not immediately apparent from this legislative language. However, the purpose is essentially to create a hybrid entity form that is positioned to accept investment both from foundations that seek to use the entity to further charitable purposes, and ordinary investors who may seek normal market returns on their investments (as well as those investors whose motives may fall between these two poles).

An investment in an L3C made by a foundation would be in the form of a "program-related investment," a special concept created as part of the jeopardizing investment rules of Code § 4944.[82] Essentially, a program-related investment (PRI) is an investment made to advance a charitable purpose of the organization rather than to produce income or gains.[83] The regulations promulgated pursuant to this rule offer ten examples of investments that may (or in one of the examples, will not) qualify as PRIs.[84] The first several examples involve small businesses located in a "deteriorated urban area," that are "owned by members of an economically disadvantaged minority group."[85] Later examples make it clear, however, that even larger enterprises that are "financially secure" and whose stock is traded on a national exchange can be vehicles for qualified PRIs.[86] The core idea is not to help small or minority-owned businesses, but to help any business make an investment that would serve a charitable interest, but which would not be (or might not be) economically viable without the provision of capital from an entity that was not seeking a market rate of return. The means adopted by Congress and the Treasury to assure that this condition is satisfied is the test stated in § 4944(c) of the Code. This test requires that the primary purpose of the investment must be "to accomplish one or more of the purposes described in § 170(c)(2)(B)"[87]—the section defining "charitable" for purposes of the rules permitting deduction of charitable contributions—and that neither "production of income [n]or the appreciation of property" be a significant purpose of the investment.[88] As may be noted, the Vermont legislative language quoted above closely (and quite consciously) parallels this language, so that an entity organized under

82. I.R.C. § 4944(c) specifically exempts program-related investments from the other rules of this section.

83. Treas. Reg. § 53.4944-3(a)(1) (1972).

84. *Id.* § 53.4944-3(b). Example seven is the negative example. *Id*. Example eight involves appropriate responses if a once-good PRI goes bad. *Id*. In total, there are eight affirmative examples of qualifying PRIs. *Id.*

85. See, *e.g.*, Treas. Reg. § 53.4944-3(b), examples 1–3.

86. *Id.* example 5.

87. Treas. Reg. § 53.4944-3(a) (1972).

88. I.R.C. § 170(c)(2)(B).

those Vermont provisions would presumptively qualify for receipt of program-related investments.

This is true conceptually: one would hope that since the L3C has been specifically designed to meet the standards of PRIs, investments in such entities would indeed qualify. But PRI qualification of investments in L3Cs is not automatic at the present time. That is, there has not yet been any amendment, regulation, or ruling by Congress, the Treasury, or the IRS assuring that investments made in an L3C by a private foundation would necessarily qualify as PRIs.[89] Until further developments take place, one must assume that the usual process for determining PRI qualification would be followed. That process involves evaluation by the investing foundation of the facts and circumstances surrounding the investment, and concluding by their own judgment, by opinion letter from counsel, or by private letter ruling from the IRS, that the conditions for a PRI are satisfied.

While § 4944 of the Code is the only private foundation excise tax provision to mention program-related investments specifically, the regulations make it clear that such investments are also exempt from the "excess business holdings" rules of § 4943,[90] and will count as "qualifying distributions" under the mandatory 5% distribution rules of § 4942 in the year in which the investment is made, and will thereafter be taken out of the denominator by which the 5% requirement is measured.[91]

The ideal financial structure of an L3C can be inferred from the idea of the hybrid entity, with foundations contributing a base layer of capital that would be the most junior in terms of the foundation's rights to distributions upon dissolution, and hence at most risk if the enterprise were to fail. However, while junior tiers of capital in most entity financial structures are compensated for accepting greater risk by receiving greater returns if the enterprise is successful, this would not be so in an L3C. While some participation in any upside gains would not be inappropriate, the idea of the foundation investment is to permit otherwise marginal enterprises to improve their balance sheets to a point where other capital can be attracted on more or less market terms and rates. Thus, if the market rate of return generally is 10%, and a socially beneficial enterprise projects that it can only pay a return of 6% on the capital it needs, it can be financially viable if it can attract half of its capital from a private foundation as a PRI, paying a 2% return, and the other half from market sources, paying the usual 10% market rate of return. The core idea is not unlike tax-exempt bond

89. Indeed, it has been observed that an L3C does not accomplish anything that could not be accomplished by an ordinary limited liability company, and this seems to be largely true.

90. Treas. Reg. § 53.4943-10(b)..

91. Treas. Reg. § 53.4942(a)-3(2) (as amended in 1986).

financing, which has long been available to charitable nonprofit organizations; but it is much more flexible, because it does not depend on the market rates for tax-exempt bond investments.[92]

Indeed, the financial structure seems flexible enough to allow a foundation to pour as much capital as it is willing to into an enterprise that has or develops financial needs. This makes it appealing as a structure in which one or more foundations could partner with a newspaper that would, if left on its own, have only marginal financial prospects. And one notes, significantly, that this structure provides indirect tax benefits to the foundation's donors: their contributions funding the foundation are generally tax-deductible.[93] Thus, unlike any of the purely business structures considered at the outset of this paper, individuals who wish altruistically to support continued publication of a newspaper would be able to enjoy the appropriate reward for their altruism: a charitable contribution deduction.

This hybrid profit/nonprofit structure also seems to provide a significant insulation against IRS concerns about commerciality. Because it is understood that the entity itself is not barred from earning a profit in a PRI situation, it would seem as though operations of a typically commercial sort would not be problematic.

CONCLUSION

This leaves only one major question—the question that runs through the analysis of this paper at every turn: can publishing a newspaper be a charitable purpose under §§ 170(c)(2) and 501(c)(3) of the Code? This is an essential question even under the L3C structure, because an L3C cannot be formed primarily to operate or hold a newspaper business unless doing so qualifies as a "charitable" or "educational" purpose.[94] Similarly, an investment from a foundation cannot be a program-related investment unless it advances some appropriate charitable purpose. So, finally, does it in fact do so?

There does not appear to be a definitive answer to this question. The IRS position, as explained above, is generally negative. The regulations under § 501(c)(3) offer some guidance, but the language that might be taken to support the idea that publishing a newspaper can be charitable is quite general—either that it is "educational," or that it achieves a "lessening of

92. *See* I.R.C. § 145 ("qualified 501(c)(3) bond[s]").

93. *Id.* § 501(c)(3). Private foundations are a subset of § 501(c)(3) organizations, and hence contributions to foundations are ordinarily deductible under § 170(a). *Id.* § 170(a)(1).

94. *Id.* § 501(c)(3).

the burdens of Government;" "advancement of education and science;" and "promotion of social welfare."[95] Publication of a newspaper at its best would do all of these things, but it is certainly true as well that many popular features of a daily newspaper would be hard put to defend their existence in these terms, leaving the difficult question of whether the charitable and educational aspects of a newspaper can truly and in general be said to be the primary purposes of publishing a daily newspaper.

The regulation that explains what "charitable" means does provide more detail, but when it does, its principal focus seems to be elsewhere, largely on relief of poverty or other malignant social conditions. The regulations speak of "[e]liminat[ing] prejudice and discrimination;" of "[l]essen[ing] neighborhood tensions;" and of "[c]ombat[ing] community deterioration and juvenile delinquency."[96] Some of these sound almost quaint ("neighborhood tensions" and "juvenile delinquency" are not phrases much in use in this century),[97] and all reflect the social concerns that were most on the minds of the writers of the regulations when they were developing them in the late 1950s. It is time, surely, for a reconceptualization of the "charitable" idea, and for a revision of these fusty regulations. But until that happens, what does charitable mean?

If an L3C is the vehicle used, another branch of the regulations come into play: those promulgated under § 4944 that explain what can qualify as a PRI,[98] and offer eight affirmative examples. One searches those in vain, however, for anything that sounds very much like publication of a newspaper. All, in fact, involve "economically disadvantaged minority group[s]";[99] employment of "low-income persons"[100] (or "low-income farmers");[101] "deteriorated urban area[s]"[102] and the like. Though they were written in 1972, more than a decade after the § 501(c)(3) regulations were promulgated, they echo the concerns that are palpable in the latter regulations.

So we are left saying, I think, simply that publication of a newspaper *should* qualify as a valid charitable objective. This is an activity that involves tremendous positive externalities that cannot be easily captured by the publisher, but which are essential to the political, economic, and social health of the community served by the particular newspaper. This is so clear

95. Treas. Regs. § 1.501(c)(3)-1(d)(2).
96. *Id.*
97. *Id.*
98. Treas. Reg. § 53.4944-3.
99. *Id.* § 53.4944-3(b) example 1.
100. *Id.* example 4.
101. *Id.* example 6.
102. *Id.* example 1.

to many individuals that they would be willing altruistically to support the publication of the newspaper with disinterested contributions. And newspaper publishing is perhaps the single best example of an activity that is in the public interest, but which should nevertheless not be conducted by the government, since criticism of government performance is one of its greatest services, and accomplishment of that goal would be compromised by government ownership and operation.

There are several means by which affirmation of these observations, and concomitant clarification of the law, could be obtained. Unilateral declaration by the IRS, in the form of a ruling, would almost certainly be enough: generally no one other than the IRS would have standing to challenge the exempt status of a newspaper that is published ostensibly for educational or charitable purposes. If the IRS announces that it wishes to make no such challenge, the controversy effectively ends at that point. If the IRS is unwilling to do this, a variety of legislative solutions are available, and some in Congress have already evidenced their intention to achieve clarification of this general sort. By one means or another, one hopes this will be done.