

MEMORANDUM

To: Marc Smiley
From: William S. Manne, JD
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Gary McGee, CPA¹
Subject: Formation and Qualification of a Tax Exempt Entity to Accept Funds Under ORS 757.612(3)
Date: September 28, 2000

The purpose of this memorandum is to set out our recommendations concerning the formation, organization, and qualification of a Section 501(c)(3), tax exempt, charitable, public benefit, Oregon nonprofit corporation ("corporation") to accept funds collected under ORS 757.612(3), as specifically described in ORS 757.612(3)(d).

We believe the fundamental approach of utilizing this type of corporation to pursue the policy objectives contained in ORS 757.612(3) has great merit. Such a corporation, organized and operated in the manner described, should be able to work independently, efficiently, and in the best interests of the state of Oregon and its citizens to accomplish the goals of this important legislation.

Organizational Structure :

1. Purpose. The corporation's purpose will be narrowly defined as, "to support the development of cost-effective local energy conservation, market transformation energy conservation, and renewable energy resources for utility customers in Oregon."

¹ Gary McGee, CPA, is not a member of the lawfirm of Miller Nash LLP, but has contributed to the analysis of tax exemption and non-private foundation status in this memorandum.

2. Board of Directors. The board of directors may consist of a minimum of five members or a maximum of eleven members. The initial board will consist of seven Oregon residents (three serving one year terms, two serving two year terms, and two serving three year terms). Review and approval of the proposed initial board will be sought from the PUC. The board, once established, will be self-perpetuating. One ex-officio, non-voting seat on the board will be appointed by the PUC (this is in addition to the seven regular members). Directors will serve three year staggered terms which are renewable.

3. Governance.

(a) Most decisions will require approval by a majority of the directors. Amendments to the Articles of Incorporation or Bylaws will require the approval of 70 percent of the directors;

(b) Conflicts of interest will be strictly addressed by ORS 65.361. Directors will be required to disclose direct and indirect conflict of interest transactions as defined in ORS 65.361 and all conflicts will be approved by the board utilizing procedures set forth in that statute;

(c) Directors and officers will be indemnified to the full extent permitted under ORS 65.387 et. Seq;

(d) There will be no members;

(e) All board meetings will be held in compliance with ORS 192.610 (public meeting rules), except executive sessions.

4. Dissolution. On dissolution, other than funds controlled by the PUC (see paragraph 2(b), under "Funding," below), the board of directors will distribute any remaining assets to another 501(c)(3) entity which is doing work similar to that of the corporation.

Funding :

1. Authorizing Rule or Order. The PUC will issue appropriate rules or orders authorizing payment of monies to the corporation, as authorized under ORS 757.612(3)(d). Such orders will also authorize an appropriate party within the PUC to enter into a grant agreement with the corporation, which will detail the obligations and responsibilities of the parties.

2. Grant Agreement. The grant agreement will provide considerable detail governing the arrangement and can be terminated by either party with 60 days' advance written notice.

(a) The grant agreement will require the corporation to submit prospective annual budgets and periodic interim budget updates to the PUC for review. To the extent the PUC is notified through these procedures and does not inquire further or reserve approval, the organization will have the authority to proceed with the expenditures contained within that budget notification. Once such budgets are deemed approved, termination of the grant agreement by either party will require the reservation of full funding for any remaining amount of binding commitments contained within the budget.

(b) In the event of the corporation's dissolution, bankruptcy, or similar event, funds advanced to the corporation which have not been spent or otherwise committed (under the process described in (a) above) will be deemed to be held "in trust" by the corporation for the PUC. In such event, the funds will not be deemed to belong to the corporation until committed under the above process or otherwise expended. In the event of any termination of the agreement or dissolution of the corporation, the PUC will control the ultimate distribution of such "uncommitted" funds.

(c) Reporting requirements (from corporation to PUC) will be detailed in the grant agreement.

Qualification as a 501(c)(3) Organization:

Although several types of organizations qualify for exemption from tax under IRC § 501(c)(3), the corporation most closely fits into two categories of exempt organizations:

(a) an organization that lessens the burdens of government, and (b) an environmental organization.

1. Lessening the Burdens of Government. IRC § 501(c)(3) provides for an exemption from federal income tax for organizations organized and operated exclusively for charitable or educational purposes, no part of the earnings of which inures to the benefit of any private shareholder or individual. The term "charitable" includes the lessening of burdens of government. Treas Reg § 1.501(c)(3)-(1)(d)(2).

Revenue Rulings 85-1 and 85-2 set forth the two-part test for determining whether an organization's activities lessen the burdens of government. First, the organization must demonstrate that the activity is a burden of the government, and second, the activity must actually lessen that burden. An activity is a burden of the government if there is an objective manifestation by the governmental unit that it considers the activities of the organization to be its burden. The interrelationship between the governmental unit and the organization may provide evidence that the governmental unit considers the activity to be its burden. Whether the organization is actually lessening the burdens of government is determined by considering all of the relevant facts and circumstances. A favorable working relationship between the government and the organization is strong evidence that the organization is actually lessening the burdens of the government.

For example, in Private Letter Ruling 9411037, a city was charged with certain redevelopment obligations under a state statute, including providing moderate income housing. The city chose to meet that obligation by creating a separate entity to acquire and rent out low and moderate income housing. The IRS ruled that the organization qualified for exemption from tax because it lessened the burdens of government.

This corporation's relationship to the PUC is similar to the relationship between the city and the exempt organization in Private Letter Ruling 9411037, because its purpose is to perform a statutory obligation of the PUC. We believe the corporation should also qualify for exemption under this same analysis.

2. Environmental Organization. Although environmental conservancy is not expressly defined as a charitable function, the IRS has ruled that it is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public serve a charitable purpose. Revenue Ruling 76-204.

"The benefit to the public from environmental conservation derives not merely from current educational, scientific, and recreational uses that are made of our natural resources, but from their preservation as well." Id.

In Revenue Ruling 76-204, the IRS held that a non-profit organization that was formed for the purpose of preserving the natural environment by acquiring ecologically significant undeveloped land, and either maintaining the land itself with limited public access, or transferring the land to a government conservation agency qualified for exemption under IRC § 501(c)(3).

Since the principal purpose of the corporation is the development of energy conservation and renewable energy resources, it could also apply for exemption under 501(c)(3) as an environmental organization.

We recommend that the corporation apply for exemption from tax under IRC § 501(c)(3) as an organization that lessens the burdens of government, because the

relationship between the corporation and the PUC closely matches the situation in Private Letter Ruling 9411037. It is not necessary to analyze whether the corporation would also qualify for exemption as a governmental agency because the corporation likely already qualifies for exemption under IRC § 501(c)(3).

Non-Public Foundation:

501(c)(3) organizations are divided into two categories: private foundations, and organizations that are not private foundations ("public charities"). Private foundations must comply with complicated organizational rules and prohibitions on many activities, such as self-dealing and retaining excess business holdings, to qualify for exemption from tax. The corporation qualifies under two exceptions as a public charity and will likely be able to avoid application of the private foundation rules.

Under IRC § 509(a)(1), an organization that normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable function constituting the basis for its exemption) from the United States, or any state, or political subdivision, or from direct or indirect contributions from the general public, is treated as a public charity. An organization is "publicly supported" if it meets one of two tests. Under the first test, the organization must normally receive more than one-third of its financial support from governmental units, direct or indirect contributions from the general public, or a combination of both sources. Treas Reg § 1.170 A-9(e)(2). The corporation should qualify under this section because all of its financial support will be provided by authority granted to the PUC. Although there are no rulings that specifically hold that funds similar to the 3 percent public purpose charge, to be collected and spent at the direction of the PUC, constitute

"governmental support," it is likely that receipt of those funds would be considered to be a contribution from a governmental unit.

The organization could also qualify as a public charity under IRC § 509(a)(2). To qualify under this section, the organization must normally receive more than one-third of its support in each taxable year from:

- (a) Gifts, grants, contributions, and membership fees; and
- (b) Gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in an activity that is not an unrelated trade or business.

In addition, the organization must normally receive less than one-third of its support in each taxable year from:

- (a) Gross investment income; and
- (b) The excess of the amount of unrelated business taxable income over the amount of tax imposed on that income.

"Government" State Law Restrictions:

There is currently no legal precedent in Oregon regarding the issue of whether an Oregon, non-profit corporation that engages in activities benefiting the public interest on behalf of the PUC (or other State of Oregon agency) is subject to procurement and personnel restrictions that apply to other state agencies. We have reviewed Oregon law to determine whether state law restriction would apply to the corporation, including review of the following chapters in the Oregon Revised Statutes: The State Personnel Relations Law, Public Facilities, Public Contracts and Bidding, the state version of the Davis-Bacon Act, Public Printing, Interagency Services, Public Financial Administration, Salaries and Expenses of State Officers and Employees, Administration of Public Funds, and County and Municipal Financial

Administration. We have also requested, although not yet received, information on the legislative history (if any) of the use of the term "nongovernmental" in ORS 757.612(3)(d).

Although we do not believe the state law restrictions will apply to the corporation, the corporation should follow precautions to ensure that it does not engage in activities that would make it more susceptible to being classified as a public agency subject to these restrictions. For example, if the corporation forms a joint venture with a government agency on a project or a government agency lends employees to the corporation, the risk that the corporation will be subject to governmental restrictions is increased. Therefore, the corporation should obtain legal advice prior to engaging in these types of activities or whenever it is concerned that its involvement in an activity might provide further evidence that supports a legal argument that it is subject to these restrictions. There is no "bright line" test under current law for when or under what circumstances an organization such as this corporation becomes subject to these restrictions.

Based upon the definitions used in these statutory schemes, it is our opinion that the corporation should not be subject to these restrictions simply as a result of working with or being funded through the PUC in the manner described in this memorandum. However, we cannot provide you with certainty that a third party will not assert applicability and, if so, that the corporation would prevail. The result in any case which asserts applicability of these restrictions will be dependent upon the unique facts and circumstances of that case.