

October 23, 2017

SUBJECT: Staff Position Regarding the Availability of the Non-Profit Registration Exemption under Section 202(e) of the Pennsylvania Securities Act of 1972 for Business Entities Seeking to Receive Tax Credits Under the Pennsylvania Educational Improvement Tax Credit

RELEASE NO.: 17-CF-01

DATE OF RELEASE: October 18, 2017

TYPE: Staff Position

PRIOR REFERENCE: None

BACKGROUND

The Pennsylvania Educational Improvement Tax Credit (EITC) was established in 2001 to provide tax credits to business firms that make contributions to “Scholarship Organizations,” “Educational Improvement Organizations,” and/or “Pre-K Scholarship Organizations.” The tax credit is administered by the Pennsylvania Department of Community and Economic Development (DCED).

Act 194 of 2014, effective October 31, 2014, expanded the definition of “business firm” to include “Special Purpose Entities.” A Special Purpose Entity is a pass-through entity, the purpose of which is the making of contributions and whose shareholders, partners or members are composed of owners or employees of other business firms.

The definition of business firm does not include sole proprietorships or entities not subject to tax. As such, the owners or employees of sole proprietorships or entities not subject to tax cannot form a Special Purpose Entity.

To be eligible for the tax credit, a business firm must make contributions to organizations that are on the list of approved organizations published by DCED¹ and be subject to at least one of the listed taxes. Special Purpose Entities must be created for the sole purpose of making contributions under the EITC.

¹ An organization that desires to be included on the DCED list must meet the following criteria: 1) it must be a nonprofit entity; 2) it must be exempt from paying federal tax under Section 501(c)(3) of the Internal Revenue Code; and 3) it must contribute at least 80% of its annual EITC receipts to a scholarship program that meets the requirements of the EITC.

It has come to the attention of the Corporation Finance Office of the Department of Banking and Securities that schools are establishing Special Purpose Entities, specifically limited liability companies (LLC's), in order to utilize the EITC as an incentive to facilitate donations to scholarship funds and organizations.

This Staff Position addresses whether the issuance of interests in LLC's and other Special Purpose Entities are exempt from the registration provisions of the Pennsylvania Securities Act of 1972 (1972 Act).

DEPARTMENT LAWS AND REGULATIONS

Section 102(t) of the 1972 Act defines the term "security" and includes a membership interest in a limited liability company, unless all of the following conditions are satisfied:

- (v)(A) The membership interest is in a company that is not managed by managers;
- (B) The purchaser of the membership interest enters into a written commitment to be engaged actively and directly in the management of the company; and
- (C) The purchaser of the membership interest, in fact, does participate actively and directly in the management of the company.

Section 201 of the 1972 Act provides that, "[i]t is unlawful for any person to offer or sell any security in this State unless the security is registered under this act, the security or transaction is exempted under section 202 or 203 hereof or the security is a federally covered security."

Section 202(e) of the 1972 Act provides the following exemption from registration:

Any security (except evidences of indebtedness, whether interest bearing or not) of an issuer (i) organized exclusively for educational, benevolent, fraternal, religious, charitable, social, athletic or reformatory purposes and not for pecuniary profit, if no part of the net earnings of the issuer inures to the benefit of any private shareholder or individual, or (ii) organized as a chamber of commerce or trade or professional association. The fact that amounts received from memberships, or dues, or both will or may be used to construct or otherwise acquire facilities for use by members of the nonprofit organization does not disqualify the organization from this exemption. This exemption shall not apply to the securities of any nonprofit organization if any promoter thereof expects or intends to make a profit directly or indirectly from any business or activity associated with the organization or operation of such nonprofit organization.

RELATED PENNSYLVANIA LAWS

Under Pennsylvania's Nonprofit Corporation Law of 1988, 15 Pa.C.S.A. § 5101 et. seq., corporations may be incorporated under the law for any lawful purpose, including, but not limited to, educational purposes. *See* 15 Pa.C.S.A. § 5301(a). Importantly, an entity may be a nonprofit corporation under Pennsylvania law but not recognized as an exempt organization under Section 501(c)(3) of the Internal Revenue Code.

Similarly, Pennsylvania's recently enacted Limited Liability Corporation Act of 2016, 15 Pa.C.S.A. § 8811 et. seq., amended the previous law by, among other things, expanding permissible activities of nonprofit limited liability companies to be consistent with nonprofit corporations, including, receiving and holding real property in trust for the purpose or purposes set forth in its public filing. *See* 15 Pa.C.S.A. § 8818(d).

STAFF POSITION

It is the position of Office of Corporation staff that interests in Special Purpose Entities such as LLC's will be treated as exempt from the registration requirements of Section 201 of the 1972 Act under Section 202(e) of the 1972 Act if the entity complies with the requirements of the Pennsylvania Limited Liability Company Act of 2016 as nonprofit LLC's.²

Further, interests in for-profit LLC's will be treated as exempt from the registration requirements under Section 202(e) only if all of the following criteria are satisfied:

- The Special Purpose Entity is registered under Pennsylvania law;
- The Special Purpose Entity was created for the sole purpose of making contributions to educational institutions under the EITC and continues to maintain that purpose;
- That 100% of the proceeds from the sale of the units is used as a donation to an educational institution that is registered or qualifies as a charity under Section 501(c)(3) of the Internal Revenue Code and is included in the list of approved organizations published by DCED;
- That the only benefit members of the Special Purpose Entity receive in return for their investment is an opportunity to apply for and receive distributions of Educational Tax Credits that can be used on the members' personal income tax returns.

² It should be noted that only LLC interests that do not satisfy the exclusion from the definition of "security" in Section 102(t)(v)(A), (B), and (C) of the 1972 Act are subject to this Staff Position.

FURTHER ASSISTANCE

Any questions concerning this Release may be directed to staff of the Office of Corporation Finance at (717) 783-4223. Alternative formats of this document are available upon request.