

Low-profit Limited Liability Corporation (L3C)

Executive Summary

Background

There is and always has been a need for social welfare philanthropy. Going as far back as the Biblical injunction to tithe and the Koranic requirement of alms giving, to the Dickensonian theme of cheerful giving in “A Christmas Carol,” philanthropy has been a part of our humanity. However, in the last two decades nonprofit social service has begun to lose ground to ever-increasing needs, and competition for funding. Simultaneously nonprofit and for-profit executives began to explore alternative ways to finance positive social change. Social enterprises began to take shape and notable foundations like the Ford Foundation and the John D. and Catherine T. MacArthur Foundation stepped up and made program-related investments in addition to their traditional grantmaking.ⁱ The PRI was born.

Program Related Investments (PRI)

A PRI is a provision in the IRS code that satisfies the prohibition against “jeopardizing investments” set forth in IRC Section 4944 (the exemption for program related investments, Section 4944(c)).

A program related investment has the following characteristics:

- The “primary purpose test” – to accomplish one or more charitable purposes.
- The “production of income test” – no substantial purpose of the investment is to produce income or capital appreciation.
- The “political purpose test” – no substantial purpose of the investment is to influence legislation or political campaigns.

Of interest to foundations is the fact that qualifying PRI’s can help satisfy their 5% minimum annual distribution requirements under IRC Sec. 4942. PRI’s can be in the form of loans, capital investment and equity share.

In order to protect themselves against investing in a non-qualifying program, most nonprofits and their trustees seek a Private Letter Ruling (PLR) from the IRS. Unfortunately, obtaining a PLR can be a lengthy and expensive process. To encourage PRI’s, Robert M. Lang, Jr., of the Mary Elizabeth & Gordon B. Mannweiler Foundation, Inc., sought a way to streamline the process and eliminate the high expense of time and money. His solution was the establishment of a new form of incorporation - the low-profit limited liability corporation (L3C).

L3C – Low-profit Limited Liability Corporation

The L3C acts as a conduit of investment for positive social change. According to David T. Leibell, “The purpose of the L3C is to bring together a mix of entities (foundations, other not-for-profits, trusts, endowments, pension plans, individuals, corporations and governmental bodies) – to achieve social objectives while operating in accordance with for-profit metrics. Like an LLC, an L3C has the liability protection of a corporation and the flexibility of a partnership. Unlike most LLCs, an L3C is *explicitly formed to qualify as a program-related investment for a foundation.*”ⁱⁱ

“The rationale for forming an L3C,” writes Lang, the originator of the L3C, “is to perform one or more social missions at the lowest cost possible with the most efficiency, and maximum leverage—and with as much revenue as possible being used to further the social good.”

By definition the L3C must have as it’s primary purpose a socially redeeming objective, over against profit. What differentiates an L3C from a nonprofit is this, it is a for-profit enterprise and as such does not fall under the IRS exempt status of 501(c)3. An L3C cannot accept tax-exempt gifts from individuals or corporations.



Simply put, by investing in an L3C a foundation can increase the dollars they have available for philanthropic purposes because the return on that investment must be reinvested or granted again to public charity.ⁱⁱⁱ

The good news for the L3C is the availability of capital investment that would normally not be accessible due to the high risk factor (e.g. a renewable energy project in rural Africa).

It is worth noting at this point, the Council on Foundations supports the establishment of L3C.^{iv} Also, the Bill and Melinda Gates Foundation recently used their website (www.gatesfoundation.org) to announce their intension to use PRI's to "leverage foundation resources and to encourage broader financial support for its mission."^v This announcement was followed by a similar announcement from the Susan Thompson Buffet Foundation (Warren Buffet).

Concerns

As with any innovation there are concerns from the stakeholders. Many of these concerns were raised by the National Association for State Charity Officials (NASCO) and addressed by Marcus Owens, Partner, Caplin & Drysdale (law firm, Washington DC). The concerns and their answers are extensive and due to the limited nature of this summary I would refer you to the pdf containing the entire text. That pdf can be accessed at: <http://americansforcommunitydevelopment.org/legal.html>

Resources

The L3C legislation has been passed or is being considered in thirteen states and two Native American tribes as of January 11, 2010 (including Tennessee Senate Bill 0472 and House Bill 0664).

Web site: Americans for Community Development <http://americansforcommunitydevelopment.org/>. This web site is a resource of first choice because it is kept current by the originator of the L3C concept.

Federal Reserve Bank of Minneapolis, web site publication, http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4305

Leibell, David T., Trusts & Estates pdf available at http://trustsandestates.com/wealth_watch/gates-foundation-venture-philanthropy1230/

Minnigh, Elizabeth Carrott, *Tax Management, Estates, Gifts and Trusts Journal*, September 2009.

ⁱ Social enterprise, also known as venture philanthropy, was introduced with purpose in the late 1990's with the publishing of "Virtuous Capital: What Foundations Can Learn From Venture Capitalists," by Christine W. Letts, William Ryan and Alan Grossman (Harvard Business Review, March-April 1997, at pp. 36-44), and "Philanthropy's New Agenda: Creating Value," was published in the November-December 1999 issue of the Harvard Business Review, at pp. 121-130, as noted by David T. Leibell, "Advising the Wealthy: It's a Whole New Game," (retrieved January 11, 2010 from http://trustsandestates.com/wealth_watch/gates-foundation-venture-philanthropy1230/).

ⁱⁱ *Ibid.*

ⁱⁱⁱ Lang, Robert M., "Presentation Workshop C-3 UBS Philanthropy Forum – July 5 – 7 2007, Lisbon, Portugal" (retrieved January 11, 2010 from <http://americansforcommunitydevelopment.org/>)

^{iv} Retrieved January 11, 2010 from <http://www.cof.org/searchresult.cfm?cx=011643639411809016742%3A7tpw1kiy0m&cof=FORID%3A10&q=L3C&submit.x=40&submit.y=14&submit=Submit+Form#944>

^v Retrieved January 11, 2010 from <http://gatesfoundation.org>