

WHAT IS A L3C (LOW-PROFIT LIMITED LIABILITY COMPANY): AN ENTITY FOR ENTREPRENEURS WHO VALUE PURPOSE AND PROFITS



“An L3C is formed by filing Articles of Organization (or whatever the formation document is called by the state) in one of the states that authorize L3Cs.”

Some people start a business to provide themselves with income; some to further a charitable or social mission. But a growing number of people want both — a business that benefits society and also generates profits for its owners.

The states have responded to the growing numbers of social entrepreneurs by authorizing the formation of new statutory business entities that combine the financial benefits of a traditional for-profit entity with the social benefits of a nonprofit.

One of the first of these new “hybrid” entities to be authorized was the low-profit limited liability company or L3C. The L3C has received less attention than some others — such as the [benefit corporation](#).

But an L3C may be an appropriate choice for some socially motivated businesses. Therefore, lawyers who advise entrepreneurs who value both purpose and profits should familiarize themselves with the L3C option. entrepreneurs who put purpose over profits, and the lawyers who advise clients on choice of entity, should familiarize themselves with the L3C option.

WHAT IS AN L3C (LOW-PROFIT LIMITED LIABILITY COMPANY)?

An L3C (low-profit limited liability company) is a for-profit LLC that satisfies three requirements:

1. It significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Sec. 170(c)(2)(b) of the Internal Revenue Code and would not have been formed but for the company’s relationship to the accomplishment of those charitable or educational purposes.
2. It does not have as a significant purpose the production of income or the appreciation of property.
3. It does not have as a purpose the accomplishment of one or more political or legislative purposes.

Those three requirements are imposed for a reason. They match the conditions imposed by the Internal Revenue Service on the type of businesses in which a charitable foundation can make a program-related investment (PRI).

WHAT IS A PROGRAM-RELATED INVESTMENT (PRI)?

A PRI investment is one of the ways a tax-exempt foundation can meet the IRS’ requirements that it pay at least 5% of its funds towards a charitable project or activity each year.

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Foundations generally meet this annual payment requirement by making grants to tax-exempt nonprofits. Few PRIs are made — mainly because it is difficult to determine which investments qualify, and the IRS levies significant fines on foundations violating the rules.

This uncertainty often requires the foundation to obtain a Private Letter Ruling from the IRS first. The process for obtaining a Private Letter Ruling is time-consuming and expensive. But by having L3Cs, by statute, meet the PRI definition, the creators of the L3C hoped that foundations would be able to make PRI investments without having to obtain a Private Letter Ruling.

HOW IS AN L3C FORMED?

An L3C is formed by filing Articles of Organization (or whatever the formation document is called by the state) in one of the states that authorize L3Cs. Vermont was the first state to provide for L3Cs in 2008. The laws of Illinois, Maine, Michigan, Louisiana, Rhode Island, Utah, and Wyoming also provide for L3Cs.

The L3C is subject to the same provisions of the state LLC Act as any other LLC. This means it will have to appoint and maintain a Registered Agent. It will also need an operating agreement. And if LLCs are required to file an annual report and pay an annual fee, the L3C will have to as well.

The L3C designation must be indicated in the Articles of Organization and the name must include the words “Low-Profit Limited Liability Company” or abbreviation “L3C”. Those requirements were intentionally included in the statutes. The L3C’s creators hope that will make it easier for foundations to find companies involved in activities that qualify for a PRI. They also hope to create a brand — that “L3C” will come to signify to the public that it is a company that puts its mission above profits.

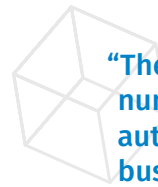
An L3C that is doing business in states other than the formation state will have to qualify to do business in those states and appoint and maintain a Registered Agent there.

HOW IS AN L3C MANAGED?

Like a traditional LLC, management of an L3C is vested by statute in the members.

However, the L3C may choose to be managed by managers instead. Details on how the L3C will be managed can be

set forth in the operating agreement. This includes such issues as whether meetings are required, how ordinary and extraordinary decisions are made, and the duties, obligations, and liabilities of members or managers — including the imposition of fiduciary duty to make sure the L3C meets the statutory requirements to retain its L3C status.



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HOW IS AN L3C TAXED?

An L3C is a for-profit entity. It is not tax-exempt.

An L3C is taxed the same as any other LLC for federal income tax purposes. By default, an L3C with two or more members is taxed as if it is a partnership. An L3C with one member, by default, is disregarded, and all income, credits, and deductions are reported on the member’s individual tax return. The L3C may elect to be taxed as a corporation instead.

HOW ARE L3CS FUNDED?

The L3C is designed to receive most of its funding from foundations through PRI investments. The L3C’s creators believe foundations will prefer making PRIs to L3Cs over making grants to nonprofits engaged in the same mission because the L3C can provide a return on the investment that can be used to fund other charitable missions.

However, as a for-profit entity, the L3C can also seek funding from banks, pension funds, or investors for whom the social purpose is more important than the return on their investment.

L3CS VS. BENEFIT CORPORATIONS

The benefit corporation is another social enterprise entity. It is authorized in more states than the L3C. A major difference between the benefit corporation and L3C is that one is a corporation and the other an LLC. Both provide their owners with limited liability.

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However, the L3C, as an LLC, provides greater flexibility in determining the financial and non-financial rights of its owners, allows for a more flexible management structure, and provides more options for taxation.

On the other hand, the benefit corporation does not have to meet the PRI-motivated requirements that an L3C does. And as the L3C's critics have pointed out, the IRS has not officially announced that an investment in an L3C automatically qualifies as a PRI — thereby making it risky for a foundation

to make a PRI investment in an L3C without a Private Letter Ruling. And that could possibly leave the L3C's founders without the funding they were counting on.

CONCLUSION

The L3C is not for everyone. But it may be a good fit for some socially motivated ventures. As such, anyone interested in creating a for-profit vehicle with a charitable or educational objective may wish to [consider the L3C](#).