

Birth Announcement for Innovative Structure Combining Charitable Mission and Business –“L3C”

A new legal entity has been born and nicknamed ‘L3C’ because “low-profit limited liability company” is a mouthful for even the most adoring parent. Affectionately christening this new entity “for-profit with the nonprofit soul,” several states have already adopted legislation that provides for this specialized kind of a limited liability company. Vermont, Illinois, Michigan, Utah, Wyoming, Oglala Sioux Nation, and the Crow Indian Nation have adopted legislation allowing the formation of L3Cs. Several other states have similar pending legislation. The full faith and credit clause of the United States Constitution, however, leads observers to anticipate that an L3C formed under currently enacted state law should be recognized and able to operate in other states.

The L3C builds on the LLC model and thus is a new variety of LLC. Like LLCs, L3Cs enjoy the liability protection of a corporation, but may choose pass-through tax treatment to its members. The L3C is *not* a nonprofit. It is not designed to pursue tax exempt status. An L3C is a for-profit entity, but its organizing documents must limit its purposes to those that are primarily charitable or educational. In fact, the states that currently have L3C statutes require the L3C to be organized and operated to satisfy the following requirements:

1. The L3 must significantly further the accomplishment of one or more charitable or educational purposes; it may not be formed but for its relationship to the accomplishment of such purpose(s);
2. No significant purpose of the L3C may be the production of income or the appreciation of property (though the company is permitted to earn a profit); and,
3. The L3C must not be organized to accomplish any political or legislative purposes.

The impetus for the creation of the L3C vehicle was the desire for an ideal structure for “program-related investments” made by private foundations. The L3C legislation was written to fit hand in glove with the federal IRS regulations applicable to program-related investments. It is anticipated that solid investment from a private foundation will both attract other commercial investors (because of a low cost of investment) and provide greater financial security and self-sustainability for social enterprises.

Since the L3C is a for-profit vehicle, it can generate income and return on investment for the various owners of the business. Like an LLC, the L3C has flexible ownership and can support a variety and combination of investors with social objectives and plans for financial gain. Such investors may include individuals, nonprofits, for-profits, trusts, endowment funds, pension funds, and government entities.

Creators of the L3C envision an effective legal structure for bookstores, museums, charter schools, newspapers, conference facilities, music venues, and recreational facilities. Additionally, they hope L3Cs will be utilized to finance low-income housing projects, provide credit to disadvantaged business owners, and address other social needs in a new way. For example, Community Wealth Ventures reports that plans are underway for the National Cancer Coalition to “operate a clinic offering low-cost early-detection and cancer treatment services for women in Paraguay, generating revenue from patient fees while providing health services to a population in need.”

The possible scope and effect of L3Cs pose a number of tax and legal questions that are in the process of being worked out. Thus, some messes are to be anticipated. But while care and feeding are essential, the L3C’s birth announcement is being greeted with much optimism and high hopes for her bright future as a facilitator of charitable purposes and social enterprise in self-sustainable ways.

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