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North Carolina Law Life

Why the L3C?

By: Donna Ray Berkelhammer. *Thursday, November 8th, 2012*

Traditionally the United States had three economic sectors: private (for-profit), public (government) and non-profit. It was the job of private businesses to return the maximum profit to their owners; the non-profit and governmental sectors addressed social ills (hunger, poverty, care of the environment).

Many entrepreneurs, however, wish to accomplish a social or environmental mission that doesn't square with the existing sectors. They want to make some profit, but also want to make a difference. They may not qualify for non-profit status with the IRS or may not want to be bothered with the extensive auditing, reporting and filing involved with being a non-profit.

To try to shoehorn social missions into corporate structures, we have seen **corporate social responsibility** programs, **triple bottom line** business models, non-profit agencies with for-profit divisions, for-profit and non-profit partnerships . None of these is truly helpful in providing a meaningful and useful structure for **social entrepreneurship**.

Thus, the benefit corporation (B-corp or B-corporation) and low-profit limited liability company (**L3C**) structures emerged to govern social enterprise. In North Carolina, B-corps are not a recognized legal entity, but remain a certification that a company can earn from a third party—**B Lab**. To be certified as a B Corporation, an entity takes on additional corporate responsibilities, such as redefining the best interests of the corporation to include the consideration of employees, consumers, the community, and the environment.

L3Cs were enacted in North Carolina in August 2010. They are organized under the limited liability company (LLC) statute, but also require that a company have both a social purpose and a business purpose. An L3C can make a profit (even a substantial profit), but it must be formed to achieve a social or environmental purpose.

We are strong proponents of the L3C, even though some of their hoped-for tax benefits are still speculative.

- **Flexible.** LLCs are much more flexible than corporations for ownership, decentralized management, decision-making power, ability to allocate profits and losses, etc.
- **Credible**. Using the L3C structure signals to sources of charitable and social benefit capital that the entity is going to produce social benefit returns. It may make it easier to get grants, investors or other capital.
- **Easy**. L3Cs are pass-through entities for tax purposes, and just like LLCs, require very little ongoing administrative and corporate governance burdens.
- **Safe Harbor**. The authorizing language in the North Carolina L3C statute incorporates provisions directly from the Internal Revenue Code that authorize certain investments by private foundations. To maintain their charitable status, these foundations are required to disburse a certain percentage of their funds via program-related investments (PRIs). There is a lot of red tape and expense involved in determining whether a non-profit is a qualified recipient of such investments, and for-profit companies are ineligible completely. By placing the PRI authorizing language directly into the L3C statute, North Carolina legislators were hoping to pre-authorize L3Cs to receive program-related investments and thereby stimulate the local social entrepreneurship business model. Often times these investments can be initial equity funding or below-market loans that attract other investors. Unfortunately, there has been no official ruling from the IRS that L3Cs are, indeed, a safe harbor.
- **Marketing**. Even though the PRI safe harbor remains speculative, the “coolness” factor of being a cutting edge company with a stated social mission garners significant positive press. L3Cs are still new enough that simply forming one can be business news in a community.