

Introducing the Low-Profit Limited Liability Company (L³C): The New Kid on the Block

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There is an old Chinese proverb that some donors have used to distinguish the difference between charity and philanthropy: "Give a man a fish and you feed him for a day. Teach a man to fish and you feed him for a lifetime."² Many generous and altruistic people donate gifts to those that need them, but do not realize those gifts often provide only a short term solution – giving a fish.

Others look beyond the present and seek to provide sustainable solutions that continue to support the donee – teaching one to fish. Yet philanthropists are fundamentally constrained by the rules and regulations that govern charitable-based organizations, whether they are: foundations, nonprofit corporations, for-profit corporations, hybrid limited liability companies (LLCs), charities, or others. While these socially-minded business organizations aim to teach their constituents how to fish they are often undercapitalized, improperly incentivized, overly regulated, and/or face other daunting challenges. The low-profit limited liability company (L³C) was designed with these challenges in mind. L³Cs are the proverbial equivalent of a fishing boat designed to supplement the fishing lessons. As a legally recognized entity, L³Cs account for the best aspects of the for-profit and nonprofit worlds by balancing a charitable purpose with an adequate capitalization structure. This article analyzes the emergence of this new corporate form.

This article is broken into five sections. Part I provides the general background of the L³C by analyzing how philanthropists have traditionally worked with nonprofit and for-profit companies. Part II discusses the structural makeup of L³Cs by focusing on

their: legal structure, status as a "program related investment," capital structure, and tax implications. Part III discusses state passage and the legislative creation of L³Cs. Part IV discusses the different ways to form L³Cs, giving current and prospective examples. And finally, Part V will provide future insight regarding L³Cs and expose potential uncertainties.

I. PAVING THE WAY FOR THE L³C

A brief analysis of nonprofit and for-profit companies is essential to understand the evolution of the L³C. In 2008, the Internal Revenue Service (IRS) estimated that the U.S. had roughly 1.8 million domestic nonprofit corporations in existence.³ Such corporations are exempt from federal income taxation if organized and operated exclusively for one or more of the following purposes: religious, charitable, scientific, public safety testing, literary, educational, certain amateur sporting competitions, and the prevention of cruelty to children or animals.⁴ Although nonprofit corporations can earn money, they are limited as to how these profits can be made and spent.⁵

For example, nonprofit corporations cannot distribute profit to the organization's shareholders or members.⁶ However, nonprofits are often involved in a business that generates very little, if any, profit. For all intensive purposes a nonprofit corporation earns an annual rate of return of 0 to negative 100%.⁷ As a result of a nonprofit corporation's total lack of investment return, they seek donations and grants from the philanthropic marketplace by appealing to donors' emotions.⁸ Consequently, many nonprofits have created for-profit subsidiaries tied to a

different industry⁹ and an estimated one-third of all nonprofits fail within their first five years and another one-third operate in a zone of insolvency.¹⁰ Finally, nonprofits are extremely bogged down by strict regulations.¹¹ Thus, while nonprofits promote high social value they operate in an overly saturated and regulated marketplace resulting in constant funding shortages.

Conversely, for-profit companies must earn an acceptable market rate of return – generally 5% or more per annum to attract investors.¹² Within such corporations, shareholder interest must be the top priority because managers are legally obligated to run the business in a manner that maximizes profits in the form of shareholder returns.¹³ Therefore, for-profit companies cannot easily pursue many charitable purposes due to their lack of profitability, attract program related investments (PRIs),¹⁴ and are unlikely to receive philanthropically-based grants.

Similarly, LLCs, except under special circumstances, are organized as for-profit companies and must earn a normal rate of return. LLCs offer the protection of a corporation¹⁵ (the members of the LLC are not personally liable for the debts of the company)¹⁶ and the flexibility of a partnership¹⁷ (members can elect to be taxed together as a corporation or individually according to their own personal tax status).¹⁸ However, LLCs are fundamentally distinguishable from corporations insofar that they can be organized for any lawful *purpose*, whereas a corporation must be organized for any lawful *business purpose*.¹⁹ The significance of this distinction is considerable and is detailed below.

LLCs can be organized for charitable purposes, circumventing the member interest priority inherent in corporations, by altering their operating agreements to stipulate as much, but as with a nonprofit corporation, LLCs that elect to be organized this way may face reoccurring capitalization issues.²⁰ To withstand the possibility of under capitalization, LLCs can have multiple classes

of members; each with a different vested interest in the company and each with a different form of capital return and tax consequence.²¹ In fact, the IRS has recognized defacto L³Cs disguised as complex subsidiary LLCs for some time.²² An example of this type of legal structure typically consists of a joint venture between a nonprofit company and a for-profit company each owning a share in an LLC. The LLC is provided capital by both parent companies and the LLC is designed to promote a charitable purpose not favored by the market and usually under the design and intent of the nonprofit. The for-profit parent company then manages the LLC and returns a small profit to itself only (to avoid forfeiting the nonprofit's tax exemption status).²³

Theoretically, business organizations like the one just described can accomplish the same goals of an L³C, but are often too complex to organize and manage effectively. Not only is it difficult to create a company that pursues a charitable purpose efficiently in the zone between nonprofits and for-profit companies (0 to 5% returns on investment per annum) there is no forward outside public recognition of such companies. Therefore, there is no effective way to attract outside investment from other nonprofit corporations, foundations, charities, companies, or other entities. Essentially, this type of business structure suffers from a branding problem on the outside and an efficiency problem on the inside. Thus, the stage was set to create a business organization that had the heart of a nonprofit corporation, but the vitality of a for-profit corporation.

II. THE STRUCTURAL MAKEUP OF THE L³C

A. Legal Structure

L³Cs are, in fact, a specialized form of a traditional LLC. They offer the protection of a corporation and the flexibility of a partnership, but are explicitly formed to “further a socially beneficial mission and [to] qualify as a Program Related Investment for foundation partners.”²⁴ Like a traditional LLC, L³C's may operate with a board of directors, officers, and members.²⁵ Additionally, L³Cs

can (must) differentiate and layer their owners or members to create separate vested interests in the L³C and thereby disseminate the proper market rate of return. Thus, “each operating agreement can be tailored to meet each member’s own particular needs – profits [and losses] may be allocated in proportions that are different from capital contributions.”²⁶

Finally, L³Cs as a form of LLC, once organized in an allowing state, will be recognized in all fifty states, US Territories, and many foreign countries.²⁷ Vermont, the first state to enact L³C legislation,²⁸ provides in its statute:

"L³C" or "Low-profit limited liability company" means a person organized under this chapter that is organized for a business purpose that satisfies and is at all times operated to satisfy each of the following requirements.

(A) The Company significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the IRS Code of 1986, 26 U.S.C. Section 170 (c)(2)(B); and (ii) would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes.

(B) No significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

(C) No purpose of the company is to accomplish one or more political or legislative purposes within the meaning of Section 170(c)(2)(D) of the IRS code of 1986, 26 U.S.C. Section 170(c)(2)(D).

(D) If a company that met the definition of this subdivision (27) at its formation at any time ceases to satisfy any one of the requirements, it shall immediately cease to be a low-profit LLC, but by continuing to meet all the other

requirements of this chapter, will continue to exist as a limited liability company. The name of the company must be changed to be in conformance with subsection 3005(a).²⁹

Summarily, L³Cs have three main pillars: (1) they must be organized to accomplish a charitable purpose; (2) they must not be created primarily to accumulate property or earn a profit; and (3) they must not be created to further any political or legislative objective. The legal structure of L³Cs is actually modeled after Section 4944(c) of the IRS Code and intended to provide foundations with a business entity that they can safely make Program Related Investments (PRIs) to without jeopardizing their exempt status.³⁰

B. Program Related Investments (PRIs)

PRIs are defined in Section 4944(c) of the IRS Code and are a hybrid between investments and grants.³¹ They are made with the primary purpose of accomplishing a charitable goal.³² Section 4942 of the IRS Code requires private foundations to pay out at least 5% of their net investment income annually in “qualifying distributions” in order to maintain their exempt status.³³ Failing to make qualifying distributions in excess of 5% of the foundation’s net investment income will subject the foundation to a penalty tax.³⁴ Like grants, PRIs are qualifying distributions and therefore fulfill the foundation’s 5% goal when made.³⁵ PRIs also have the potential to reduce a foundation’s excise tax rate.³⁶ Thus, foundations are incentivized to distribute PRIs whenever possible.

Because PRIs and L³Cs are composed of the same statutory requirements, L³Cs are immediately attractive to foundations that need to make PRIs.³⁷ In fact, an influential reason to create the L³C was that it would externally and conspicuously help identify companies that have social missions that also qualify as PRIs (this is known as “branding”).³⁸ Traditionally, PRIs have been used for economic development, housing, environmental causes, and microfinance.³⁹ PRIs in L³Cs can be: below-market-rate loans,

loan guarantees, low-cost leases, letters of credit, deposits in a community development bank that lends to a specific class, or an equity investment.⁴⁰ Moreover, PRIs allow a foundation to recover its investments, potentially with a profit, and to recycle its assets to make future grants and investments.⁴¹ Rather than giving a grant as a gift, foundations can invest wholeheartedly in an L³C in the form of a PRI and maintain a relationship with the investment – nurturing it and potentially receiving their money and a little profit back – only to perpetuate the process again while still maintaining their primary charitable purpose.⁴² Thus, PRIs are very beneficial to both the foundation and the recipient.

C. Capital Structure

L³Cs occupy a niche, between for-profit and nonprofit corporations, averaging profits from 0 to 5%.⁴³ In order for an L³C to become financially successful it must attract a sufficient amount of investors or members who are willing to forego normal profit returns in lieu of a social return – that is, investors who will derive a measurable marginal benefit by investing in a company that accomplishes a charitable purpose. It is this concept that allows L³Cs to operate a business that, under normal market influences, would fail. Secondly, L³Cs can attract regular for-profit investors if the company has its members' investments layered or "tranching."

Tranched investments are essentially layered vested ownership interests within the L³C by its members or, put more simply, different classes of investors.⁴⁴ An L³C's investors can include individuals, nonprofit corporations, for-profit corporations, government agencies, and foundations and they can be structured anyway its members want.⁴⁵

To illustrate, an L³C may have three tranches: (1) an Equity Tranche composed primarily of foundation investors via grants or PRIs carrying the most risk, paid last (subordinated to all other tranches), and returning the lowest rate of return (i.e. 1%); (2) the Mezzanine Tranche reserved for socially minded investors

composed of corporations, trusts, banks seeking to fulfill their Community Reinvestment Act obligations, or other individual investors seeking to fulfill good will by carrying the middle amount of risk, paid second (subordinate only to the Senior Tranche), and returning between 0 and 5% returns (i.e. 3%); and (3) the Senior Tranche composed of market driven investors and pension funds, or others, requiring a safe and average investment carrying the least amount of risk, paid first (AAA rating), and returning the largest annual return (i.e. 6%).⁴⁶ For example, if the Equity Tranche makes up 25% of this particular L³C structure, the Mezzanine Tranche another 25%, and the Senior Tranche the remaining 50%, then the blended rate of return is 4% and well within the initial target range of 0-5%.

Another possible way to layer an L³C's capital structure would be to maintain the 25-25-50% tranche ratios and compose the Equity Tranche with development agencies and other governmental partners who will accept a 0% return, essentially making a grant; foundation PRIs will occupy the Mezzanine Tranche receiving a 2% annual return; and finally, the market driven investors will receive a 7% return.⁴⁷ Again, here the L³C has a blended rate of 4%, but the foundation investors receive a slightly higher rate of return.

Lastly, an L³C with a 15-35-50% (Equity-Mezzanine-Senior Tranches respectively) split may provide the Equity Tranche with 15% ownership rights and the potential to get an annual return if the L³C's profits exceed 6% of total capital; the Mezzanine Tranche will be composed of foundation investors receiving a 3% return; and the Senior Tranche will secure a 6% return releasing all excess profits to the Equity Tranche investors.⁴⁸

This latter model provides foundation investors with even a higher rate of return while still maintaining market rates of return for the average investor. This type of member ownership structure ensures that those investing in the L³C will have a chance to take control of their funds and manage

accordingly.⁴⁹ No longer will donors escape adverse publicity if the company strays away from its charter by pleading ignorance.⁵⁰ Owners will have an incentive to manage effectively and achieve the company's charitable goals without risking the chance of a complacent perpetual board of directors.⁵¹ These examples highlight just a few of the nearly endless ways capital structures can be formed within L³Cs.

From a macro perspective, L³Cs will yield even larger gains by securitizing their PRI interests. Currently, PRIs are made on a one-on-one basis between the donor and the company.⁵² By securitizing the PRI interests in L³Cs the costs of procuring ownership shares would be greatly diminished. Marketing L³C securities on a primary and secondary market supported by brokerage houses and supplemented by prospectuses could revolutionize the way PRIs are bought and sold.⁵³ L³C securities could be packaged with other bonds, options, loans, convertibles, or placed in a group of similar themed investments and made into a mutual fund.⁵⁴ Not only would this allow small foundations to become involved in projects that would normally be too big for them, but all involved may generate a small rate of return.⁵⁵ The marketability and transactional ease of L³C securities would reduce barriers to entry and transaction costs for all investor types.

D. Tax Implications

L³Cs are technically for-profit ventures and will have to pay both property and state/federal income taxes⁵⁶ unless it meets the IRS's requirements to qualify as tax exempt.⁵⁷ As a form of LLC⁵⁸ an L³C can elect to be taxed as a corporation and file Form 1120, or be taxed as a partnership and file Form 1065.⁵⁹ L³Cs are normally conduit entities like a partnership, meaning as far as tax consequences go, the income distributed to each member will be taxed the same way that member is usually taxed on its individual income tax return.⁶⁰ Because L³C members may receive a rate of return different from the ratio of their capital contribution, members avoid forfeiting their current tax exempt status

when investing in an L³C. In order to retain such benefits, "[t]he L³C's operating agreement specifically outlines the PRI-qualified purpose for which it's being formed, helping ensure that the nonprofit partner's tax exempt status is secure."⁶¹ However, due to the low-profit nature of the L³C the income tax consequences that materialize are unlikely to be significant.

It should be noted that in the event the L³C's organization is improper, then it will cease to exist as an L³C and continue to exist as a traditional LLC.⁶² Alarming, an L³C with an improper charter that fails to meet the PRI requirements may be considered a jeopardizing investment by a foundation and may forfeit the foundation's tax exempt status.⁶³ This process is looked at in the context of the foundation's entire portfolio and requires the foundation managers to have failed to exercise ordinary business care.⁶⁴ Consequently, "absent connivance or gross dereliction of responsibility by a foundation board, a failed PRI would not be expected to jeopardize the overall tax-exempt status of a foundation."⁶⁵

Property taxes will depend on the location of the L³C.⁶⁶ In some cases a nonprofit corporation can make contributions in the place of taxes and in other localities property taxes may be waived or reduced in recognition of the public benefits that the L³C will generate.⁶⁷ At any rate, the property tax consequences will likely not deter any L³C from forming.

III. LEGISLATIVE ENACTMENT OF THE L³C

As stated above, in April of 2008, Vermont became the first state to adopt L³C authorizing legislation.⁶⁸ At the time of this article Illinois was the latest state to enact L³C authorizing legislation.⁶⁹ Illinois became the fifth state to enact the legislation, joining Vermont,⁷⁰ Michigan,⁷¹ Utah,⁷² and Wyoming.⁷³ Additionally, the Crow Indian Nation and the Oglala Sioux Tribe allow for the creation of L³Cs.⁷⁴

Several other states have also introduced, but not yet passed, L³C authorizing legislation. Arkansas,⁷⁵ North Carolina,⁷⁶ Oregon,⁷⁷ and Tennessee⁷⁸ are among this group. For those entities who want to form an L³C in a state that has not yet passed the legislation, the process is simple: the entity must choose a state that allows for the formation of an L³C then register as a foreign entity in the state where the entity wishes to operate.⁷⁹

IV. L³CS IN ACTION

By August 20, 2009 over sixty L³Cs had been formed in Vermont alone.⁸⁰ L³Cs can be created a variety of different ways, but four stand out: (1) newly created L³Cs, (2) existing entities that reorganize and convert to L³Cs, (3) L³Cs that are created as a subsidiary of an existing entity, and (4) the creation of social and charitable-centered investment vehicles or private equity funds.⁸¹

Newly created L³Cs are likely to be created by many existing organizations as their operations expand.⁸² For example, the National Cancer Coalition is planning on operating a clinic in Paraguay to offer low-cost early-detection cancer treatment for women.⁸³ Similarly, the Montana Food Bank is in the process of forming an L³C that offers training to Montana prisoners and access to food processing plants for Montana farmers to deliver fresh, local food to Montana grocery stores.⁸⁴ If either of these proposed L³Cs makes a profit they can funnel the money back into the mission or donate it as a grant back to the foundations that originally provided the capital.⁸⁵

Converting an existing business into an L³C is predicted to be less common, but viable for existing for-profit or nonprofit corporations that think they can attract more capital as an L³C.⁸⁶ A conversion can be accomplished by merging the existing entity into an L³C.⁸⁷ This process is simplest when an existing LLC becomes an L³C by, after a member vote, changing its charter and filing status.⁸⁸ Similarly, a partnership wishing to convert into an L³C must first convert into an LLC and

then complete the process by amending its charter.⁸⁹ Converting an S-Corporation or C-Corporation into an L³C is likely to be time consuming and costly.⁹⁰ Thus, to avoid liquidating the corporation and accruing complex tax liabilities, it is probably more beneficial for an S-Corporation and a C-Corporation to create a new L³C.⁹¹ Finally, converting a nonprofit public charity or private foundation into an L³C will require the entity either to pay over the net value of its assets to another nonprofit (public charity), or to liquidate and pay a termination tax (private foundation).⁹² Again, this process may be time consuming and costly and would not be preferable to just creating a new L³C.⁹³

Existing entities creating a spin off or subsidiary L³C will probably become the most popular method of creation.⁹⁴ Nonprofit corporations that have identified a profitable arm of their operation or for-profit corporations that have recognized a valuable, but unprofitable, arm of their company may wish to form a subsidiary L³C. Nonprofit corporations, under this model, will be able to maintain their current stream of donors and for-profit corporations will maintain a regular rate of return while benefiting their local community.⁹⁵ Some examples might include: a recycling company that wants to expand its revenue by selling certain metals that it receives,⁹⁶ or a news corporation that wants to maintain their newspaper presence in a local community but cannot afford their subscription's market revenue.⁹⁷ Other examples may include museums that lose money, but benefit the community by providing local access and finance companies that want to supply low-income financing, student loans, or micro financing in third-world nations. The possibilities are endless for cities like Detroit that have seen an outsourcing of their local industry or large cities that have severely underfunded and neglected neighborhoods.⁹⁸

Investment equity funds are also an attractive option for creating an L³C.⁹⁹ These funds can be managed to satisfy the objectives of its participants for the purpose of making

PRIs.¹⁰⁰ The investors of these equity funds would be members of the L³C benefiting from the limited liability and pass-through tax treatment accorded to traditional LLCs.¹⁰¹ The L³C, in all ordinary aspects, would function like any other private equity fund, but would make investments that would normally go unfunded for their lack of an adequate market rate of return.¹⁰² “A socially-oriented L³C venture investment fund would serve the very useful function of creating a pool of PRI capital to be deployed for the benefit of important social and charitable causes.”¹⁰³ This form of L³C can easily provide below-market interest rate loans and equity investments to companies that are within the L³C’s mission.¹⁰⁴

These are just four possible structures that are likely to be used by L³Cs. There are many other possible structures an L³C could take to allow it to mold and adapt to the capital market in which it seeks to participate in without compromising its social mission and purpose.

V. ALL THAT GLITTERS IS NOT GOLD

L³Cs are not flawless and have some uncertainties that have not yet been formally and conclusively addressed. Among the most notable is whether L³Cs will undeniably qualify as a PRI. Until the IRS conclusively addresses the status of L³Cs as a PRI, foundations risk penalties imposed by the IRS for “jeopardizing investments” and failing to distribute income.¹⁰⁵ Currently, the IRS has not explicitly ruled on this issue; and thus, foundations may be exposed to a 10% excise tax on both itself and its managers for investing in an L³C.¹⁰⁶ Moreover, the foundation’s investment in the L³C may be subjected to a 30% excise tax if it were intended as a qualifying distribution and the L³C was ruled to not qualify as a PRI.¹⁰⁷ In fact, Ron Schultz, an IRS senior technical advisor in the Tax Exempt Entities Division, warned foundations from prematurely embracing L³Cs as PRIs.¹⁰⁸ He stated:

The point I want to make today is that, at the federal level, no one has really

signed off on this yet. . . . So if you are out there hearing about L³Cs and you have a private foundation that wants to invest in it, and you think the jeopardy investment issue is a slam dunk and you don’t need to concern yourself with it, that would be premature.¹⁰⁹

Schultz gave his warning on June 11, 2009 at the American Institute of Certified Public Accountants national not-for-profit industry conference¹¹⁰ and concluded by stating, “The IRS is in the process of studying the issue to determine the tax consequences of L³Cs.”¹¹¹

However, Marcus Owens, a former director of the IRS’s Exempt Organizations Division and now an attorney with Caplin & Drysdale in Washington, D.C., advised the creation of Vermont’s L³C founding legislation and wrote an extensive letter to Schultz that refutes his warning and counters that the IRS “has issued considerable guidance addressing the federal tax consequences . . . for a private foundation . . . that invests in a limited liability company . . . that is organized and operated for a primary charitable purpose.”¹¹² Owens’ five page letter proceeds to exemplify two IRS Revenue Rulings¹¹³ allowing a foundation and other tax exempt organization to invest in a for-profit LLC having a charitable purpose for its primary goal without forfeiting its tax exempt status, or without making a jeopardizing investment.¹¹⁴ Owens continues by citing Example 5 § 53.4944-3(b) of the Treasury Regulations, which demonstrates a hypothetical for-profit LLC qualifying as a PRI.¹¹⁵ Finally, Owens cites four private letter rulings to demonstrate the IRS has, numerous times, allowed for-profit companies to qualify as PRIs.¹¹⁶ Owens concludes in his letter to Schultz “Thus, your assertion that the Service has not yet considered the federal tax implications of foundation investments in L³Cs is not entirely accurate and, in fact, may be misleading.”¹¹⁷

As discussed earlier, L³Cs are merely the branding of an existing form of LLC that is currently available in every state so foundations and other entities wishing to

make a PRI in a charitable company can easily identify which companies are available for such a purpose.¹¹⁸ In an effort to simplify the issue regarding L³Cs qualifying as PRIs, Owens included a draft of federal legislations entitled, *The Program-Related Investment Promotion Act of 2009* in his letter.¹¹⁹ The Act would streamline the private letter ruling process for PRIs by allowing the L³C, as the recipient, to get a private letter ruling qualifying them as a PRI rather than every single donor who wishes to make a PRI.¹²⁰ The proposed federal legislation would also create a mandatory filing requirement for for-profits that receive PRIs.¹²¹ Thus, the legislation would increase efficiency and transparency where none currently exists.¹²²

Others are concerned that L³Cs will have unintended negative consequences. Most widely recognized is the potential for L³Cs to effectively compete with nonprofits for donations.¹²³ Some worry that foundations will be more willing to make a PRI to an L³C rather than making a grant to a nonprofit.¹²⁴ Although theoretically possible, the N.C. Center for Nonprofits does not think this is a realistic concern.¹²⁵ Finally, it is recognized that L³Cs will connote mixed terms to the public and the nonprofit sector and therefore public education is important.¹²⁶ While there are uncertainties that lay ahead for L³Cs, they are not insurmountable and should not deter the creation of L³Cs.

CONCLUSION

The advent of L³Cs – to occupy a niche market between nonprofit and for-profit corporations, to qualify as PRIs, and to sustainably further a social purpose – advances a new generation of philanthropy. L³Cs provide philanthropists, charities, and other altruistic entities a brand that attracts and perpetuates their very existence. Blending for-profit motives and adequate capitalization with a legally binding nonprofit soul has the potential to beneficially impact a number of communities. Moreover, L³Cs are simply another form of LLC; and as such, are easy to form, convert, and predict. While there is some pause that the primary

funding source of L³Cs, PRIs, are not “conclusively” determined, there is adequate precedential evidence to suggest this concern is not a serious threat. After five states have relatively recently adopted L³C authorizing legislation more states are sure to follow. The resulting benefits that L³Cs welcome to their communities may take years to materialize; until then, all we can do is wait.

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² James P. Joseph & Andras Kosaras, *New Strategies for Leveraging Foundation Assets*, 20 TAX’N OF EXEMPTS, July/Aug. (2008), at 22, 29.

³ Gene Takagi & Emily Chan, *Alternatives to Forming a Charitable Nonprofit: A Start-Up May Not Be in Your Client’s Best Interests*, 18-AUG. BUS. L. TODAY 15, 16 (2009).

⁴ I.R.S., TAX-EXEMPT STATUS FOR YOUR ORGANIZATION (PUBLICATION 557) 19 (Dep’t of the Treas.) (2008) available at <http://apps3.irs.gov/pub/irs-pdf/p557.pdf>.

⁵ I.R.S., *supra* note 4, at 19; Americans, *infra* note 6 at 2.

⁶ AM. FOR CMTY. DEV., THE L³C: THE FOR PROFIT WITH THE NONPROFIT SOUL 2 (2008) [hereinafter Americans] available at http://americansforcommunitydevelopment.org/supportingdownloads/Introducing_the_L3C.ppt.

⁷ *Id.*

⁸ James E. Austin et al., *Capitalizing on Convergence*, STAN. SOC. INNOVATION R., Winter 2007, at 24, 30 available at http://www.ssireview.org/images/articles/2007WI_feature_austinetal.pdf.

⁹ *Id.* at 29.

¹⁰ Takagi, *supra* note 3, at 15. Insolvent means the companies liabilities, or indebted loans, exceed its assets; and thus, if forced to liquidate the organization will not be able to pay all of its creditors.

¹¹ *Id.* at 15-16.

¹² Americans, *supra* note 6, at 2.

¹³ Robert M. Lang, Jr., *The L3C: The New Way to Organize Socially Responsible and Mission Driven Organizations*, SN036 ALI-ABA 251, 255 (2007).

¹⁴ An IRS stipulation forbids the recipients of PRIs to have a significant purpose the production of income or the appreciation of property. Moody, *infra* note 42, at 2.

¹⁵ Lang, *supra* note 13, at 255.

¹⁶ In actuality there are situations when members of an LLC, just as certain owners of corporations, may be held liable for the debts of the company. This process is referred to as “piercing the LLC/corporate veil” and is beyond the scope this article.

¹⁷ Lang, *supra* note 13, at 255.

¹⁸ *Id.*; Rev. Rul. 2004-51, 2004-22 I.R.B. 974, 2004-1 C.B. 974.

¹⁹ LARRY E. RIBSTEIN, *Formation of Limited Liability Company*, in RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 4:10 (2009).

²⁰ Note that an LLC that is organized to further a charitable purpose does not create a nonprofit corporation that is eligible for 501(c)(3) tax exempt status. These types of LLCs are also typically economically unviable and do not generate subsisting income.

²¹ Lang, *supra* note 13, at 256.

²² See Rev. Rul. 2004-51, 2004-22 I.R.B. 974, 2004-1 C.B. 974.

²³ Keep in mind the reason this form of LLC can return a profit is because the company is subsidized by the nonprofit parent company. The profit that is generated is not enough to provide a normal rate of return to both parent companies.

²⁴ Americans, *supra* note 6, at 4.

²⁵ *Id.* at 21. For more information regarding the legal structure of an L3C refer to one of two L3C operating agreements on the Americans for Community Development website *available at* <http://americansforcommunitydevelopment.org/supportingdownloads/L3COperatingAgreement.pdf>, *see also* http://americansforcommunitydevelopment.org/supportingdownloads/L3C_Prototype_Operating_Agreement.pdf.

²⁶ Americans, *supra* note 6, at 10.

²⁷ Lang, *supra* note 13, at 256. “L³Cs can file in any of the . . . states that have passed legislation to establish the entity, and then can file as a foreign corporate entity in the state in which they are based, similar to Delaware corporations.” Mark Hrywna, *The L3C Status: Groups Explore Structure that Limits Liability for Program – Related Investing*, THE NONPROFIT TIMES, Sept. 1, 2009, at 2 *available at* http://www.intersectorl3c.com/goopages/pages_downloadgallery/download.php?filename=8139_8859156.pdf&orig_name=20090901_Nonprofit_Times_Article.pdf.

²⁸ VT. SEC’Y OF STATE, *Low-Profit Limited Liability Company* (2008), http://www.sec.state.vt.us/corps/dobiz/llc/llc_l3c.htm.

²⁹ *Id.*

³⁰ See I.R.C. § 4944(c), 26 U.S.C.A. § 4944(c).

³¹ Joseph, *supra* note 2, at 22.

³² *Id.*

³³ *Id.* at 23; *see* I.R.C. § 4942, 26 U.S.C.A. § 4944.

³⁴ Joseph, *supra* note 2, at 23.

³⁵ *Id.* at 22.

³⁶ *Id.* at 23.

³⁷ In fact, Robert Lang, the CEO of the Mary Elizabeth & Gordon Mannweiler Foundation first conjugated the idea of the L³C by envisioning a legal entity that

automatically qualified as a PRI. *Id.* at 29. Lang was the driving force behind Vermont to pass the first L³C legislation and continues to be a big promoter in helping more L3Cs get off the ground. COMTY. WEALTH VENTURES, INC., THE L3C: LOW-PROFIT LIMITED LIABILITY COMPANY RESEARCH BRIEF 2 (2008)

available at

<http://www.americansforcommunitydevelopment.org/supportingdownloads/CWVBrief-Updated.pdf>.

³⁸ Doug Batey, *Low-Profit LLCs – The Newest Limited Liability Company Structure*, LLC LAW MONITOR, Aug. 21, 2009,

<http://www.llclawmonitor.com/2009/08/articles/lowprofit-llcs/lowprofit-llcs-the-newest-limited-liability-company-structure/>.

³⁹ Joseph, *supra* note 2, at 23.

⁴⁰ *Id.*; Lang, *supra* note 13, at 254.

⁴¹ *Id.* at 24.

⁴² Tom Moody, *The L3C – Facilitating Socially Beneficial Investing 2* (2008) *available at*

<http://www.proctorconsulting.org/documents/L3CArticle-Moody.pdf>.

⁴³ WEALTH, *supra* note 37, at 1.

⁴⁴ Americans, *supra* note 6, at 11.

⁴⁵ Heather Peeler, *The L3C: A New Tool For Social Enterprise*, CMTY. WEALTH VANGUARD, Aug. 2007, <http://www.communitywealth.com/Newsletter/August%202007/L3C.html>.

⁴⁶ Americans, *supra* note 6, at 14.

⁴⁷ *Id.* at 15.

⁴⁸ *Id.* at 16.

⁴⁹ Lang, *supra* note 13, at 257.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.* at 258.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.* at 262.

⁵⁷ Letter from Marcus S. Owens, Partner, Caplin & Drysdale, Chartered, to Nat’l Ass’n for State Charity Officials (NASCO) 12 (April 17, 2009) [hereinafter NASCO] *available at*

<http://americansforcommunitydevelopment.org/downloads/nascoQ-A.pdf>.

⁵⁸ Minnigh, *infra* note 74, at 7.

⁵⁹ NASCO, *supra* note 57, at 12.

⁶⁰ Lang, *supra* note 13, at 262.

⁶¹ Americans, *supra* note 6, at 8.

⁶² NASCO, *supra* note 57, at 9-10.

⁶³ *Id.*

⁶⁴ See Treas. Reg. § 53.4944-1(a)(2)(i).

⁶⁵ NASCO, *supra* note 57, at 9-10.

⁶⁶ Lang, *supra* note 13, at 262.

⁶⁷ *Id.*

⁶⁸ Batey, *supra* note 38.

⁶⁹ See Vermont SB 0239 available at <http://www.ilga.gov/legislation/BillStatus.asp?DocNum=239&GAID=10&DocTypeID=SB&LegId=40822&SessionID=76&GA=96>.

⁷⁰ See Illinois HB 0775 available at <http://www.leg.state.vt.us/docs/legdoc.cfm?URL=/docs/2008/acts/ACT106.HTM>.

⁷¹ See Michigan SB 1445 available at <http://americansforcommunitydevelopment.org/downloads/Michigan2008-SNB-1445.pdf>.

⁷² See Utah SB 148 available at <http://le.utah.gov/~2009/bills/sbillamd/sb0148.htm>.

⁷³ See Wyoming HB 0182 available at <http://legisweb.state.wy.us/2009/Enroll/HB0182.pdf>.

⁷⁴ Elizabeth C. Minnigh, *Low-Profit Limited Liability Companies: An Unlikely Marriage of For-Profit Entities and Private Foundations*, TAX MGM'T ESTATES, GIFTS AND TRUSTS J., 1 n.3 (2009) available at <http://americansforcommunitydevelopment.org/downloads/MinnighPDFArtic.pdf>.

⁷⁵ See HB2102 available at <http://staging.arkleg.state.ar.us/ftproot/bills/2009/public/HB2102.pdf>.

⁷⁶ See SB 308 available at <http://www.ncga.state.nc.us/gascripts/BillLookup/BillLookup.pl?Session=2009&BillID=S308>.

⁷⁷ See HB 2886 available at <http://americansforcommunitydevelopment.org/downloads/oregonhb2886.intro.pdf>.

⁷⁸ See SB0472/HB0664 available at <http://wapp.capitol.tn.gov/apps/BillInfo/default.aspx?BillNumber=HB0664>.

⁷⁹ Hrywna, *supra* note 27, at 2; Lang, *supra* note 13, at 256.

⁸⁰ Batey, *supra* note 38.

⁸¹ Moody, *supra* note 42, at 3.

⁸² *Id.*

⁸³ WEALTH, *supra* note 37, at 2.

⁸⁴ *Id.* at 3.

⁸⁵ Mark Hrywna, *Montana Foodbank Uses L3C Status*, THE NONPROFIT TIMES, Sept. 1, 2009. "When an L3C makes profit from its operating business, the funds can be funneled to the mission, or back to the organization, in the form of a grant from the business to the nonprofit. It's not considered unrelated business income and therefore not taxable for nonprofits." *Id.*

⁸⁶ Moody, *supra* note 42, at 3.

⁸⁷ *Id.*

⁸⁸ Minnigh, *supra* note 74, at 3.

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.* at 3-4.

⁹² *Id.* at 4.

⁹³ *Id.*

⁹⁴ Moody, *supra* note 42, at 3.

⁹⁵ *Id.* A for-profit that opts to form a subsidiary L³C, rather than closing down or moving to a new territory, will benefit the local community by maintaining the jobs the company has created and the supporting industry around it.

⁹⁶ *Id.*

⁹⁷ Jim Barnett, *What's Keeping News Organizations from Trying the "Low-Profit" Model?*, NIEMAN JOURNALISM LAB, Aug. 20, 2009 available at <http://www.niemanlab.org/2009/08/whats-keeping-news-organizations-from-trying-the-low-profit-model/>.

⁹⁸ See Americans, *supra* note 6, at 12-13 (for a more detailed example of this type of L³C).

⁹⁹ Moody, *supra* note 42, at 3.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 4.

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ Minnigh, *supra* note 74, at 5.

¹⁰⁶ *Id.* at 5-6. See §§ 4942 and 4944 of the I.R.S. Code.

¹⁰⁷ Minnigh, *supra* note 74, at 6.

¹⁰⁸ Diane Freda, *IRS Tax-Exempt Official Urges Caution for Groups Eying Low-Profit LLC Investment*, No. 126 DAILY TAX REPORT, July 6, 2009, at G-3 available at http://news.bna.com/dtln/DTLNWB/split_display.adp?fedfid=13741364&vname=dtrnot&fn=13741364&jd=a0b8y7k7z7&split=0.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ Hrywna, *supra* note 27, at 1.

¹¹² Letter from Marcus S. Owens, Partner, Caplin & Drysdale, Chartered, to Ronald Schultz, Senior Technical Advisor, Tax Exempt and Gov't Entities, IRS, 1-2 (July 8, 2009) [hereinafter Letter] available at http://www.americansforcommunitydevelopment.org/downloads/im4511_20090708_164517.pdf.

¹¹³ See Rev. Rul. 2004-51, 2004-1 C.B. 974. See also Rev. Rul. 98-15, 1998-1 C.B. 718.

¹¹⁴ Letter, *supra* note 112, at 2.

¹¹⁵ *Id.* at 1-2.

¹¹⁶ *Id.* at 3. See I.R.S. Priv. Ltr. Rul. 199943044 (July 26, 1999); I.R.S. Priv. Ltr. Rul. 199910066 (Mar. 12, 1999); I.R.S. Priv. Ltr. Rul. 8807048 (Nov. 23, 1987); and I.R.S. Priv. Ltr. Rul. 200610020 (Dec. 13, 2005).

¹¹⁷ Letter, *supra* note 112, at 3.

¹¹⁸ *Id.* at 4.

¹¹⁹ *Id.* at 5.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ David Heinen, *Summary of Low-Profit Limited Liability Company (L3C) Legislation*, N.C. CENTER FOR

NONPROFITS, Aug. 2009, at 3 *available at*
<http://www.ncnonprofits.org/advocacy/l3csummary.pdf>.

¹²⁴ *Id.* at 3-4.

¹²⁵ *Id.* at 4.

¹²⁶ *Id.*