

L3C - Bridging the Gap between Nonprofits and For-Profits

	For-Profit	L3C	Nonprofit
Exempt from income tax	No	No	Yes, if 501(c) entity
Donor receives charitable deduction	No	No	Yes, if 503(c)(3) entity
Tap into private foundations PRIs	Only with difficulty	Likely easier	Easier; set up to access these funds
At wind down assets are distributed to	Owners	Owners	Other charitable organizations
Fiduciary duty to maximize profit for owners	Yes	No	No, there are no owners

Effective January 1, 2010, Illinois became the fifth state to recognize the low-profit limited liability company (L3C). As of this writing, 64 L3Cs have been formed in the state. An L3C is a hybrid business structure that combines the financial advantages of LLCs with the social advantages of nonprofit organizations with respect to funding, distributions to owners, return on investment and achievement of social goals. Like nonprofits, an L3C is organized to further one or more charitable or educational purposes. However, unlike nonprofits, the L3C has owners and may in fact have different classes of investors - individuals, nonprofits, for-profits, and even government agencies. As a variety of LLC, it generally shields owners and investors from liabilities of the enterprise.

The opportunity for L3Cs lies in PRIs (program-related investments). PRIs are loans or investments private foundations can make for charitable or educational projects, even if those projects are run by for-profit entities. Federal tax law requires that private foundations distribute at least 5% of their assets (estimated at more than \$23.5 billion only in Illinois) every year to social programs or PRIs. PRIs may involve high risk, low return, or both, but are nonetheless made by foundations because they are intended to achieve charitable purposes. The key to PRI funding is the foundation's motivation in making the investment. PRIs can be recovered, along with earnings, by the foundation and reinvested in qualifying PRIs.

However, for-profit's access to PRIs is restricted because investment in PRIs is complicated and the private foundation may be fined if IRS does not view the project as adequately charitable. L3Cs facilitate access to PRIs because, while the IRS does not automatically recognize L3Cs as eligible to receive PRI, the very structure of these entities may serve to facilitate the charitable nature of the investment. To ensure the L3C is properly structured, under Illinois law, specific language has to be included in the articles of organization. However, until PRIs in L3Cs are formally recognized, foundations will have to rely on private letter rulings by IRS or an opinion of counsel regarding the PRI treatments.

An L3C enjoys a flexible ownership structure and can have different classes of investors with distinct investment goals and affinity for financial risk. Unlike nonprofits, L3Cs are allowed to distribute profits to their owners/investors as long as the company continues to pursue its charitable purpose and production of income is secondary. Also, unlike nonprofits, at dissolution, the company is not required to distribute its assets to other nonprofits; there are no provisions that limit the sale of an L3Cs by the owners. If at any point the company ceases to satisfy the L3C requirements, it will be treated as an LLC and is required to amend its articles.

Even though similar to the tax-exempt nonprofits, an L3C is subject to taxation on its income. Just like an LLC, an L3C is taxed as a partnership if it has more than one member and as a disregarded entity if it has only one member. To reduce its tax burden when wholly owned by a nonprofit, the L3C may also opt in for corporate tax treatment.

The L3C will often be a great fit for social entrepreneurs, i.e., those seeking to do well while furthering social goals and seeking innovative solutions to pressing social problems.