WHITEPAPER:

LOW-PROFIT LIMITED LIABILITY COMPANY (L3C)

I. What is the L3C?

The Low-Profit Limited Liability Company (L3C) is a new type of LLC that is for-profit and organized to further a charitable purpose. It is a hybrid structure that combines the legal and tax flexibility of a traditional LLC, the social benefits of a nonprofit organization, and the branding and market positioning advantages of a social enterprise. By becoming a L3C, a business will be better positioned to receive investments from private foundations and will have a better chance of staying financially secure and successful.

A L3C may be organized to advance a number of charitable activities, including but not limited to a community development initiative, a charter school, a social service organization, a faith-based program, a child care center, and an educational or other workforce development training opportunity. Currently, nine states and two Indian Nations authorize L3Cs. Illinois, Louisiana, Maine, Michigan, North Carolina, Rhode Island, Utah, Vermont, and Wyoming and the federal jurisdictions of the Crow Indian Nation of Montana and the Oglala Sioux Tribe.

II. What are the advantages of the L3C?

The most significant advantage of the L3C is that it is specifically designed to facilitate Program-Related Investments ("PRIs") by private foundations. Private foundations are required under the Internal Revenue Code ("IRC") to invest 5% of their average net assets into for-profit business ventures for charitable purposes. They can fulfill this requirement by making grants, or by making PRIs. PRIs often are structured as below-market-rate loans, but can take other forms such as grants, lines of credit, linked deposits or equity investments.

Currently, it can be difficult and expensive for foundations to make PRIs because they often have to prove to the IRS that a proposed investment qualifies as a PRI. The L3C helps simply and streamline the IRS approval process because the language in its operating agreement is required by law to mirror the IRS rules for qualifying as a PRI. A L3C's operating agreement must contain the following three requirements:

1. The company's primary goal is to accomplish one or more charitable or educational purposes;

2. A significant purpose of the company is not the production of income or the appreciation of property; and

3. The company must not be organized to accomplish any political or legislative purposes.

III. Legal structure

The L3C is a type of LLC and possesses many characteristics of a traditional LLC. Like a traditional LLC, the L3C is a for-profit entity, offers a flexible ownership structure, its members enjoy limited liability for the actions and debts of the company, and is classified as a "pass-through" entity for federal tax purposes. The most important distinction between a L3C and a traditional LLC is that the primary purpose of a L3C is to achieve a socially beneficial objective, with earning a profit as a secondary goal.

IV. Capital structure

The L3C can have different classes of investors - individuals, non-profits, for-profits, and even government agencies that have distinct investment goals and are willing to assume different levels of financial risk. Because members of an L3C is not required to assume equal stakes in the venture, the structure of the L3C allows for tiered financing, known as tranching. Tranching permits unequal allocation of profit and risk among investors. There are 3 tranches of capital in an L3C.

1. The junior tier (or equity tranche) is the capital most at risk because they have the last claim on the assets upon dissolution and thus are willing to accept a below-market rate of return.
2. The intermediate or "mezzaine" tranche is designed for profit-seeking investors who also desire to achieve socially desirable ends. They are willing to forego market-rate financial returns and instead accept part of their return in the form of enhanced social welfare.
3. The most senior tranche of capital in the L3C is provided by investors that need to generate market rate of return, but would like to invest in projects providing tangible social benefits.

V. How is an L3C taxed?

L3Cs are created to advance charitable purposes, they are not charities and thus are not exempt from federal or state tax, and the investments in L3Cs are not tax-deductible. Like traditional LLCs, a L3C is a "pass-through entity", which means items of income, expenses, gain and loss "pass through" the L3C to its members and are reported on the members' individual tax returns. By default, L3Cs will be taxed as partnerships if there are more than two members, and a disregarded entity if it has only one member, unless it elects to be taxed as a corporation.