

An Introduction to the Low-Profit Limited Liability Company (a/k/a the L³C)

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A new form of business entity has emerged that could revolutionize the way in which the for-profit and nonprofit communities interact. Referred to as the low-profit limited liability company or L³C for short, this concept combines the basic features of a limited liability company—limited liability protection, pass-through tax treatment, flexibility—with the charitable purpose of a nonprofit organization. In other words, an L³C is business entity pursuing profits and a socially beneficial mission. Here are some things to know about the L³C:

1. L³Cs are Creatures of State Law. Like corporations, limited liability companies, business trusts, and limited partnerships, the L³C exists because states have started passing laws formally approving the L³C structure. Vermont was the first state to adopt an L³C law in 2008. Illinois, Michigan, Utah, and Wyoming followed suit in 2009, and other states have introduced legislation that would recognize L³Cs as a new form of business entity. Such legislation was introduced in Virginia in January 2010. The bill stalled in committee, but perhaps will be reintroduced in 2011. Regardless, an L³C legally formed in Vermont or another state can do business in Virginia or other states by simply following the process in a given state for qualifying to do business as a foreign limited liability company.

2. L³Cs are NOT Tax-Exempt Organizations. While L³Cs must be formed for the purpose of pursuing a charitable or educational purpose within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code, they are not tax-exempt organizations. They are business entities subject to income tax just like LLCs. Contributions to L³Cs are not considered tax deductible gifts.

3. L³Cs are Similar to LLCs. The L³C offers the limited liability protection of an LLC or corporation and the flexibility of LLCs and partnerships. The statutory nomenclature and framework for L³Cs is similar to that which applies to LLCs. In fact, expect to see states incorporate the L³C concept into their existing LLC statutes; thus, the L³C will be able to effectively piggy back on the 15-20 years of legislative and judicial history of LLCs. But unlike LLCs, an L³C is expressly formed to pursue a socially beneficial purpose.

4. L³Cs Should Be Eligible for Private Foundation Grants. L³C laws are specifically drafted to comply with IRS regulations concerning what are known as Program Related Investments (“PRIs”). A PRI is a special type of permissible investment made by a private foundation to support a charitable activity consistent with the foundation’s mission, and also one that is made to a for-profit business venture and may involve a positive return on capital. It is

permissible for a PRI to be profitable, but profit cannot be the primary motivation for the investment. PRIs count toward a foundation's five percent annual payout requirement.

More definitive guidance has been requested from the IRS to bolster everyone's comfort level that foundations may invest with L³Cs without violating the PRI rules, but foundations should be able to independently manage any discomfort through proper due diligence and assistance from legal counsel. A foundation could also apply to the IRS for a private letter ruling regarding a specific transaction, although the time and expense involved with that process might not be feasible depending upon the circumstances of the underlying transaction.

5. An Endless List of Potential Applications and Uses. The possibilities for the L³C concept are limited only by one's imagination. In light of the current financial condition of our federal government and many states, could there be a better opportunity for these hybrid entities to step in and fill the void to provide the socially beneficial products and services that no one else is willing or able to provide? Here are a few examples of projects that could be pursued through the L³C structure:

- Auto manufacturing facilities
- Community tennis centers
- Museums
- Performing arts centers
- Recycling plants
- Metropolitan newspapers
- Biotechnology facilities
- Transportation businesses
- Health care facilities
- Low-interest lending to needy families facing foreclosure, distressed small business owners or commercial property owners

The L³C offers charitable foundations a powerful mechanism to further their charitable objectives while at the same time providing for-profit businesses, venture capitalists, and entrepreneurs a new vehicle through which to pursue socially responsible investment opportunities. At a time when investment capital remains relatively scarce, the L³C could be a catalyst for a new era of economic growth.