

# Explanation of The L<sup>3</sup>C



The creator of the L<sup>3</sup>C, Robert Lang, calls it the “for profit with the nonprofit soul.” It is a for profit organized to perform a social mission which must come before making a profit. A type of LLC, the L<sup>3</sup>C (**L**ow-profit **L**imited **L**iability **C**ompany), is able to bring together a mix of foundations, trusts, DAFs (Donor Advised Funds), endowments, pension plans, individuals, corporations, nonprofits, governmental entities and others in order to achieve social objectives while operating according to for-profit metrics. Just like any LLC, an L<sup>3</sup>C has the liability protection of a corporation and the flexibility of a partnership.

## Elements of the L<sup>3</sup>C:

- **Definition.** It is a for profit venture that under its state charter must have a primary goal of performing a charitable mission not maximization of income or appreciation of capital. The L<sup>3</sup>C legislation was specifically written to mirror IRS regulations relevant to PRIs (Program Related Investments) by foundations. These regulations also define the IRS position as to what constitutes a charitable activity. The L<sup>3</sup>C streamlines the process for foundations and other philanthropic Investors looking to determine the appropriateness of a possible PRI investment or PRI type investment.
- **Mission.** The L<sup>3</sup>C can have one or more charitable missions as defined by the IRS Section 170(c)(2)(B) and may also be organized to consider the needs and desires of other stakeholders such as the oft mentioned people and planet.
- **Eligibility.** Any activity, which fits within the IRS definition of charitable, has a revenue stream, has adequate capitalization, and can achieve a revenue level that exceeds costs, is a potential L<sup>3</sup>C.
- **Structure/LLC Advantage.** The L<sup>3</sup>C is a variant form of LLC so has all the advantages of an LLC. The L<sup>3</sup>C was built on the LLC structure in order to provide the flexibility of membership and organization needed to cover a wide variety of social enterprise situations while providing the simplicity of the organization of a partnership with the protection of a corporation.
- **Elimination of Fund Raising.** After initial capital has been raised L<sup>3</sup>Cs should function without an on going fund raising program. Management is able to focus on the business and the skill set required for management need not include the ability to raise donated dollars.
- **Stakeholders.** Both the Certificate of Organization and the Operating Agreement may contain language which protects all stakeholders.
- **Tranched Investing.** Structure facilitates tranched investing. The L<sup>3</sup>C model allows foundations and other philanthropic investors to take first loss position at a low rate of return thereby taking much of the risk out of the venture. The rest of the investment levels become more attractive to commercial investment by improving the credit rating and thereby lowering the blended cost of capital. It is particularly favorable to equity investment. Because the philanthropic

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investors take the highest risk at little or no return, it essentially turns the venture capital model on its head and gives many social enterprises a low enough cost of capital to be self sustainable.

- **Eliminates Many Nonprofit Challenges.** UBIT laws and charitable regulations often make it difficult for nonprofits to maximize the possibilities from their revenue streams. As a for profit the L<sup>3</sup>C eliminates many of these concerns. Nonprofit regulations also often run counter to good business practices. The L<sup>3</sup>C is protected from these regulations.
- **Ownership/End Game.** Like any for profit the assets and business of an L<sup>3</sup>C can be both and sold as good business dictates. Various stakeholders may be owners (members) and may share in profits as long as earning a profit is secondary to the mission.
- **Uses.** It is the perfect vehicle for economic development, medical research, operation of social service agencies, museums, concert venues, housing and any other activity with both a charitable purpose and a revenue stream. It can be used to consolidate a group of activities, some of which will earn significant revenue, with some that will earn very little and/or even lose significant amounts of money, and use the total revenue to keep the overall L<sup>3</sup>C revenue stream positive and achieve the social benefits because of elimination of ROI focus.
- **Branding.** The L<sup>3</sup>C identification after the name of the entity creates a brand which tells the world that this company has a charitable mission which it puts before profit yet is self sustaining. As a brand it makes these concepts easy to grasp.
- **Legal Responsibility.** Since the L<sup>3</sup>C law requires that the entity put its charitable mission first, a fiduciary responsibility is created which makes management legally responsible for carrying out the charitable mission as articulated in the operating agreement, possibly the Certificate of Organization, and the L<sup>3</sup>C laws of the state of organization.
- **Template.** The L<sup>3</sup>C laws also create a template for the structure.
- **Ease of Organization.** The clarity of purpose specified in the L<sup>3</sup>C law simplifies the process and reduces the cost of creation. Fewer precious dollars and creator time has to be spent on creating an operating agreement which embodies the charitable purpose since this is built in. Further the public can be sure that certain basic principles are consistent across all L<sup>3</sup>Cs.
- **Clarity for Legal Practitioners.** It is difficult given the differences between nonprofit law and for profit law for many practitioners to bridge the gap and bring clarity to the issue. The templated L<sup>3</sup>C creates a starting point for conversations among clients and attorneys.
- **Management/Employee Compensation & Incentives.** Like any for profit the L<sup>3</sup>C is free to pay salaries and bonuses appropriate for employee motivation.
- **States of Operation.** It is now legal to operate an L<sup>3</sup>C in all 50 states because the L<sup>3</sup>C is law in 9 states and two Indian tribes. An L<sup>3</sup>C can be formed in one state and registered to do business in another just as Delaware corporations are used everywhere.

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