

**L3C Legislation**  
**“Encouraging Socially Responsible Investment”**  
**By Representative Joe Miklosi**

**Summary and Benefits**

In today’s economic climate, it is important for public policy, business, and nonprofit leaders to think creatively and to implement innovative, responsible investment ideas that will empower entrepreneurs, and private sector investors to invest in socially responsible opportunities that also reduce risk. The L3C is an important tool to accomplish these socially responsible economic goals. The L3C or Low-Profit Limited Liability Company is law in five states and several other states are considering passing this legislation. The Low-profit Limited Liability Company operates in the space between a nonprofit organization and a for-profit entity. The L3C is designated as low-profit with charitable or educational purpose and can have multiple applications and benefits. The L3C has been called the “for-profit with a nonprofit soul” by its creator Robert Lang.

**What is an L3C?**

A low-profit limited liability company, also known as an L3C, is a new kind of limited liability company (LLC) that combines the financial advantages of the traditional LLC form of business with the social benefits of a non-profit entity. In addition, as a variety of LLC, the L3C generally shields its owners from the debts of the enterprise. On January 1, 2010, Illinois became the fifth state to authorize the creation of L3Cs.

An L3C is a for-profit limited liability company which is specifically organized to further one or more charitable or educational purposes within the meaning of the Internal Revenue Code (IRC).<sup>1</sup> L3Cs may be formed as free-standing businesses with social purposes. They may also be created by nonprofit organizations as for-profit subsidiaries with social welfare goals.

An L3C can earn income and see its property appreciate in value, but the production of income or the appreciation of property cannot be a significant purpose of the company. In addition, L3Cs are prohibited from pursuing political or legislative purposes within the meaning of the IRC.

<sup>1</sup> 26 U.S.C. § 170(c)(2)(E3).

**What are the advantages of an L3C?**

One major advantage of an L3C is that it is specifically designed to facilitate program- related investments (PRIs) by private foundations. Generally speaking, each year, private foundations are required under the IRC to distribute 5% of their average net assets for charitable purposes. Qualifying distributions, for this purpose, include not only grants, primarily to public charities, but also PRIs, which may be loans, loan guarantees, lines of credit, linked deposits or even equity investments.

Unlike grants, PRIs can be recovered, along with earnings, and redeployed, over and over again, for charitable purposes. The program-related investment's "multiplier effect" thus expands the foundation's programmatic impact.

Program-related investments have three characteristics: (1) their primary purpose must be to accomplish one of the foundation's charitable purposes; (2) a significant purpose of the investment must not be the production of income or the appreciation of property<sup>2</sup>; and (3) no purpose of the investment can be the accomplishment of political or legislative purposes.

A foundation's PRI to an L3C can catalyze a potent social-purpose strategy. By taking on higher risk and forgoing market-rate returns, the foundation affords the L3C the opportunity to attract private-sector investment which otherwise might never support a social venture. It also fosters the L3C's long-term sustainability.

<sup>2</sup> The L3C venture might never have been launched but for the private foundation's investment. IRS regulations establish a test: if investors "solely engaged in investment for profit would be likely to make the investment on the same terms as the private foundation," the investment is unlikely to qualify as a PRI. Treas. Reg. §53.4944-3(a).

#### **What kinds of activities can an L3C be formed to engage in?**

The possible uses for L3Cs are as varied as charity itself. The L3C might be a suitable business form for any of these activities, among others:

- A community development initiative
- A venture which provides employment opportunities for economically disadvantaged minority groups
- An arts group
- A venture organized to revitalize and stimulate economic growth in deteriorated areas where businesses are not providing adequate opportunities
- A charter school
- A social service organization
- A faith-based program
- A child care center
- An educational or other workforce development training opportunity
- A business that develops cutting-edge technology in rapidly changing environmental or health-related fields
- A land conservation or environmental mitigation effort
- A business that finances affordable housing for low-income and other disadvantaged members of society
- A historic preservation group
- A venture that provides low-interest loans and affordable credit to disadvantaged persons and business owners
- A business that provides services to nonprofit organizations in support of their missions
- A health clinic
- A cultural organization

## How is an L3C formed?

As of February 4, 2010, an L3C can be organized in Vermont, Michigan, Illinois, Wyoming, and Utah by filing Articles of Organization with appropriate Secretary of State.

The Crow Indian Nation and the Oglala Sioux Tribe have also passed L3C legislation.

The Articles of Organization generally require the following information:

1. The company's name. The name must contain the abbreviation "L3C."
2. The address of the company's principal place of business where its records will be kept.
3. The effective date of the Articles of Organization.
4. The name of the company's registered agent and the address of the registered office in the State where organizing.
5. The purpose for which the company is organized. The following statements may be required:
  - *The company intends to qualify as a low-profit limited liability company pursuant to the appropriate State Statute and shall at all times significantly further the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the internal Revenue Code of 1986, or its successor, and would not have been formed but for the relationship to the accomplishment of such charitable or educational purposes.*
  - *No significant purpose of the company is the production of income or the appreciation of property.*
  - *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 Internal Revenue Code of 1986."*
6. If the company is intended to dissolve by a certain date, the date of dissolution. (This should be left blank if no such date of dissolution is intended.)
7. Optionally, other provisions for the regulation of the company's internal affairs.
8. Whether the company is to be managed by the manager(s) or by the member(s), and in either case, their name(s) and business address(es).
9. The signature, name, and address of one or more organizers of the company, who may be, but are not required to be, members of the company.

The Articles of Organization must be submitted to the Secretary of State with the appropriate fee.

## Who manages an L3C and how is it governed?

Like other LLCs, an L3C is managed either by the "member" or "members" (owners) collectively, or by one or more "managers." The L3C's Articles of Organization must specify whether the company is to be member-managed or manager-managed. If the company is manager-managed, the managers may be members, but are not required to be.

An L3C is governed according to the terms of its "operating agreement." An operating agreement is an agreement signed by the members which regulates the affairs of the company, the conduct of its business, and the relationship among the members, the managers (if any), and the company. If the company has only one member, the sole member may establish an operating agreement in writing, or, if the company has a manager other than the sole member, by oral agreement with the manager.

An L3C's operating agreement sets forth the members' respective rights and obligations; the contributions they are expected to make to the company; the distributions they may be entitled to receive; their voting rights; the rights and responsibilities of managers (including certain obligations which program-related investors are required by Federal law to impose on L3C managers); conditions relating to the members' ability to transfer their membership interests; and other governance provisions.

The members are given broad latitude to determine the governance of the company by means of the operating agreement. The Limited Liability Company Act provides for "default" governance provisions, but most such provisions may be modified by the operating agreement.

The operating agreement establishes substantial rights and obligations. For that reason, legal counsel should be consulted in connection with its negotiation and drafting.

#### **How is an L3C taxed?**

Although L3Cs pursue the same purposes as tax-exempt non-profit organizations, an L3C is not considered a non-profit organization and is not itself eligible for exemption from income tax. Instead, L3Cs, like other LLCs, are treated for tax purposes as sole proprietorships, partnerships or corporations are.

The default status for any LLC, including an L3C, is to be taxed as a partnership if it has more than one member, and as a disregarded entity if it has only one member (in other words, its income and expenses are reported on its owner's tax return similar to a sole proprietorship). However, the company may choose, in either case, to elect to be taxed as a corporation rather than as a partnership or disregarded entity.

Although most LLCs choose to be taxed as partnerships or disregarded entities, it may be advantageous for some L3Cs to elect to be taxed as corporations instead. This is particularly true for L3Cs which are wholly owned by nonprofit corporations. If a nonprofit corporation wholly owns an L3C, and the L3C is treated as a disregarded entity, the L3C's profits (if any) may be taxed as "unrelated business taxable income." However, if the nonprofit wholly owns an L3C which elects to be taxed as a corporation, although the L3C's profits will be subject to tax, any dividends received by the nonprofit from the L3C will not be treated as unrelated business taxable income.

[Source: Attorney Marc J. Lane, The Law Offices of Marc J. Lane]

## Talking Points...

### *The L3C:*

- A type of LLC
- L3C = Low Profit Limited Liability Company
- The L3C is a for-profit entity –it is NOT a charity or nonprofit entity
- Treated as an LLC for legal and tax purposes
- The L3C is a flexible LLC designed to allow a mix of foundations, trusts, endowments, pension plans, individuals, corporations, and governmental entities to partner in order to achieve social objectives while operating in a for-profit business structure
- Just like any LLC, an L3C has the liability protection of a corporation and the flexibility of a partnership
- Unlike the standard LLC, it is explicitly formed to first, further a socially beneficial purpose and second, earn a profit
- This flexible structure allows for greater, more creative options to be utilized in structuring social ventures
- The L3C combines financial advantages of an LLC with social advantages of a non-profit

### *Purpose/Benefits of L3C:*

- Indicates a clear commitment to social objectives to investors, foundations and contractors
- Eligible for Program-Related Investment (PRI) from foundations, which typically focus on charitable grants
- By attracting a wider range of investment sources, L3Cs may be in a better position to achieve charitable purpose or social mission

[Sources: Attorney Marc J. Lane and Attorney Ray Dinning]

### *Examples of Program Related Investment (PRI):*

- Low-interest loans to students in the form of student loans
- Equity investment or loans for low-income housing projects
- Low-interest loans to minority or disadvantaged business owners
- Environmental cleanup and land conservation
- Direct investment in businesses, non-profits and property in distressed neighborhoods
- Job creation
- Relief of the poor and charitable, educational and other charitable purposes of social ventures

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## **Background Information**

The L3C was designed as a variant to the LLC structure in order to provide the flexibility of membership and organization needed to cover a wide variety of social enterprise situations. That leaves 15+ years of legislation and litigation that is behind the LLC intact behind the L3C. It also makes it very easy for lawyers and laymen alike to grasp since it does not create a new structure but merely amends the definition section of the LLC statutes in most states.

The L3C, as an LLC, allows the members of the L3C to make investments, have responsibilities, receive income, and have voting power in disproportionate relationships to one another. The LLC is effectively a partnership with corporate protection. That means that the operating agreement or contract among the members can within the framework of the law; essentially embody whatever the members agree upon. This makes the L3C very well suited to membership by a disparate group of organizations. The membership could include corporations, nonprofits, government organizations and individuals.

The L3C was created by Robert Lang, CEO of the Mary Elizabeth & Gordon B. Mannweiler Foundation, who has many years of corporate and nonprofit management experience. The L3C was carefully refined with the assistance of Marcus Owens, a partner in Caplin & Drysdale, the preeminent Washington DC tax law firm, and a former director of the exempt division of the IRS for 10 years and Arthur Wood, the Director of Social Financial Services for Ashoka, with over 20 years of financial experience at upper level management positions with leading UK financial institutions.

The L3C is not a nonprofit. It is a for profit enterprise that under its state charter must have a primary goal of performing a socially beneficial purpose not maximizing profit. The legislation to date has been specifically written to dovetail with the federal IRS regulations, enacted with the Tax Reform Act of 1969, relevant to PRIs by foundations.

The L3C may facilitate PRI investment without the need for IRS private letter rulings. There is nothing automatic about this and there is no guarantee that any L3C will receive PRI without the need for a private letter ruling. It also facilitates tranching investing with the PRI usually taking first risk position thereby taking much of the risk out of the venture for other investors in lower tranches. The rest of the investment levels or tranches become more attractive to commercial investment by improving the credit rating and thereby lowering the cost of capital. It is particularly favorable to equity investment because foundations can take the highest risk at little or no return thereby essentially turning the venture capital model on its head and giving many social enterprises a low enough cost of capital that they are able to be self-sustainable.

The L3C is now recognized in all 50 states as a result of legislation signed into law in Vermont in April 2008, Michigan in Jan. 2009, the Crow Indian Nation in Jan. 2009, Wyoming in Feb. 2009, Utah in March 2009, the Oglala Sioux Tribe in July 2009 and Illinois in August 2009. A Vermont, Michigan, Wyoming, Utah or Illinois L3C, like a Delaware or Nevada corporation, can be used anywhere. L3C legislation is pending in several states and additional states are considering how best to adopt the L3C.

## Examples of State Legislation

*See ATTACHMENT A for Vermont Legislation*

*See ATTACHMENT B for Wyoming Legislation*

*See ATTACHMENT C for Michigan Legislation*

*See ATTACHMENT D for Illinois Legislation*

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## Talking Points...

- The L3C is simple to form and simple to use
- It is virtually identical to a standard LLC
- The L3C must contain "L3C" in its company name
- The L3C's operating agreement specifically outlines the social purposes for which it's being formed
- The L3C has flexible membership rules that allow all the partners to structure the company in such a way as to satisfy their unique needs.
- The L3C can actively market memberships to market driven investors as well as other foundations, trusts, pensions, and individuals, making it easier for socially-motivated investors to locate the L3C that fits their needs

[Source: Attorney Ray Dinning]

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## Frequently Answered Questions

### 1. What is the L3C?

The L3C is a low-profit limited liability company -- a variant form of the popular Limited Liability Company (LLC). The LLC combines the best features of a partnership (flexibility, ease of organization, and simplified taxation) with the best features of a corporation (liability protection and easier transferability of ownership.)

The L3C is the brand name for a hybrid structure that links business methods with charitable purposes in a for-profit entity organized to engage in socially beneficial activities. Because L3Cs build on the LLC foundation, they offer a legal and commercial comfort level that stems from the successful experience investors, suppliers, and consumers have had with LLCs over the last generation.

## **2. Are any L3Cs already in operation?**

Yes. The first bill to make the L3C into law passed the Vermont Legislature on April 15, 2008 and was signed by the Governor of Vermont on April 30, 2008. Since then, Michigan, Utah, Wyoming and Illinois have passed an L3C law.

As of February 5, 2010 there were 113 L3Cs organized in the U.S.: [90] in Vermont, [28] in Michigan, [9] in Utah, [5] in Wyoming and [5] in Illinois.

## **3. How can I form an L3C?**

To organize your entity as an L3C, please visit the Secretary of State's Office in a state that has passed the L3C law for more information.

## **4. How does an L3C differ from a nonprofit charitable organization and how does it differ from a for-profit business?**

An L3C is run like a regular business and can be profitable. Unlike a for-profit business, however, the primary aim of the L3C is not to make a profit, but to achieve socially beneficial purpose(s). Profit is a secondary goal. The L3C thus occupies a unique niche in the space between the for-profit and charitable sectors.

## **5. Can you provide more examples of the sort of enterprise that might be organized as an L3C?**

L3Cs would typically involve businesses that serve socially beneficial purposes and have some economic viability -- but have difficulty attracting capital because of the high risk, low return, (or both) integral to their operation. A few examples:

1) A hotel in a deteriorating business district would have some ability to generate revenue, but not enough to attract sufficient capital to begin operations.

2) Historic buildings could perhaps be saved and turned into office and retail property, but the costs of renovation may be so steep that the projected rents cannot support market-rate debt incurred to finance those renovations.

3) A factory that has employed much of a town's work force may need to replace obsolete equipment at great cost, leading its owners to explore relocation of manufacturing operations to a lower-cost foreign jurisdiction.

In all of these situations, an L3C could undertake the low-return; high-risk business activity involved in these situations, with a view to combating economic deterioration, destruction of historic property, or job loss.



## **6. How will L3Cs attract the capital they need?**

Attracting capital is the key to this innovative business structure. Under the federal tax laws, private foundations must distribute five percent of their capital each year for charitable purposes. Usually, foundations do this by making grants. However, foundations are permitted to make program-related investments (PRI) instead, and to count funds so invested in determining compliance with the five-percent requirement.

The L3C vehicle is designed to facilitate PRI investments. In our model L3C operating agreement, the foundation investor would have the last claim on the assets of the enterprise upon dissolution while accepting a rate of return well below the market rate. By absorbing excess risk and accepting less than market rate returns, the foundation investment provides a base of capital that makes the subsequent senior tiers of capital less risky and more profitable.

The most senior tier would generate market rates of return. With the PRI capital in place, the model L3C can offer market rates of return at acceptable levels of risk to investors such as pension funds, community banks, etc.

The third tier in the capital structure of an L3C is a potential intermediate tier, between the high-risk, low-return PRI and the market risk-and-return senior tier. The investors participating in this mezzanine tier includes those investors willing to accept some of its return in the form of enhanced social welfare. This group of investors would be junior to the market-rate tier of capital, but senior to the private foundation PRI-generated capital.

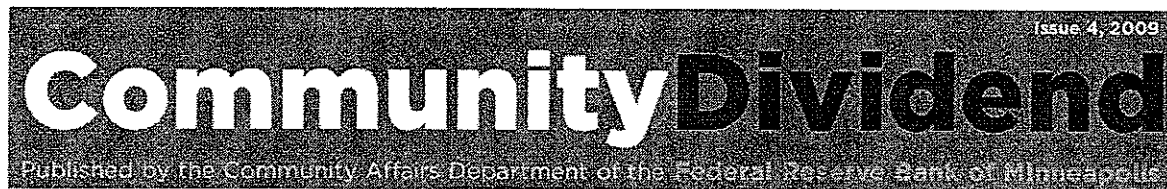
## **7. How would an L3C be taxed?**

In the same way as an LLC is taxed. No federal income tax is imposed on the entity itself. Instead, items of income and expense are allocated among the members of the L3C and reported on their returns as the income is earned. It is important to note that, although the L3C serves charitable ends, it is not exempt from taxation. Though L3Cs by their nature begin as enterprises that are expected to generate low overall profits, if those businesses generate profits, those profits would be subject to taxation at the rates of tax that apply to their investors.

## **8. Are investments in an L3C tax deductible?**

No. The L3C is a for-profit entity and investments in an L3C are not deductible. While the L3C is designed to facilitate Program Related Investments by foundations, these investments are governed by the rules governing PRIs rather than the rules governing charitable contributions.

[Source: [www.americansforcommunitydevelopment.com](http://www.americansforcommunitydevelopment.com)]



## **The L3C: A new business model for socially responsible investing**

**By Sue Woodrow and Steve Davis**

Peggy Grimes loves food. Specifically, she is passionate about food security and hunger alleviation. Grimes is the executive director of the Montana Food Bank Network (MFBN), a nonprofit organization that solicits donated food and transports it to charitable programs throughout Montana. The MFBN is the largest distributor of emergency food in the state.

Under an agreement with the Montana Department of Corrections, the MFBN operates a food cannery in Deer Lodge, Mont., that is staffed by inmates of the nearby state prison. The Montana Department of Corrections owns the cannery facility, and the department's Montana Correctional funds. The inmates provide labor as part of a job training and reentry program, while the MFBN provides donated produce from Montana food growers, cannery equipment and supplies, and day-to-day management of the operation. Cannery products are then distributed through the MFBN's network to families in need.

Grimes envisions expanding the cannery operation in order to increase the supply of emergency food and develop a retail line of Montana-grown canned goods. If realized, her vision would further MFBN's hunger alleviation mission, broaden the retail market for Montana food producers, and expand the inmate rehabilitation program. But acquiring funding to realize the vision is a significant barrier. For more than five years, Grimes has pursued—with limited success—grants and government funds to pay for capital investments, such as replacing the aging cannery facility, and operating expenses, such as supporting the day-to-day management of the cannery. Recently, Grimes learned about a new form of taxable business entity called a low-profit limited liability company, or L3C, designed specifically to integrate business savvy and social passion. She believes the L3C model holds real promise for bringing much-needed investment and operating funds “to the table.”

The L3C is one of several hybrid business organization models that have been developed in recent years, both in the U.S. and abroad, to help address the funding-related challenges experienced by a growing sector of charitable-purpose entities known as social enterprises.<sup>1</sup> A social enterprise is an organization that combines or supports a charitable mission with market-oriented methods. In other words, a social enterprise has a “double bottom line,” or double purpose of social benefit and financial gain. Dubbed the “Fourth Sector,” social enterprises are

increasingly seen as filling a void left unaddressed by the traditional public, private, and nonprofit sectors. In particular, social enterprises are seen as straddling the for-profit business sector, which is generally constrained by the duty to generate profits, and the nonprofit sector, which is generally constrained by tax laws and the duty to fulfill social objectives. At the heart of the social enterprise movement is the ongoing challenge of accessing investment capital for socially responsible purposes.<sup>2</sup> Acquiring start-up capital is a common issue for many nonprofits. It's exacerbated by federal tax laws that restrict nonprofits from accessing traditional forms of equity, such as venture capital and, sometimes, commercial debt. For the most part, nonprofits must rely on private foundation grants, government support, and, for some, earned income such as fees for services. To subsidize their earned income, some nonprofits have set up separate social enterprise business sidelines.<sup>3</sup> For example, an animal shelter in Minneapolis recently opened a full-service day care, grooming, and boarding facility for pets.

The for-profit sector faces its own challenges in funding charitable activities because federal tax laws generally restrict private business entities from accessing foundation grants and government assistance. In addition, for-profit investors expect market-rate returns and maximized profits. Their expectations don't align well with social mission-focused entities, which need "patient capital" and typically have slower, more modest growth.

There is a growing body of thought that new business models and possibly new tax incentives or structures are needed to effectively bridge the "sector" gap. These new models would eliminate the need for social entrepreneurs to either choose between the for-profit and nonprofit business models or create and manage both. One such model, the L3C, is a newly developed form of business that blends attributes of nonprofit and for-profit organizations in order to promote investment in socially responsible objectives.

The idea behind the L3C model grew out of a 2006 meeting convened by the Aspen Institute's Nonprofit Sector and Philanthropy Program and titled "Exploring New Legal Forms and Tax Structures for Social Enterprise Organizations." Legal, financial, and other experts gathered to discuss the myriad issues that the growing Fourth Sector faces. The key question that emerged was whether traditional business structures and nonprofit tax laws are hindering the growth of hybrid social enterprise models.<sup>4</sup>

It was at this meeting that Robert Lang, president of the Mary Elizabeth & Gordon B. Mannweiler Foundation; Marcus Owens, a partner with the Washington, D.C., law firm Caplin & Drysdale and former director of the Exempt Organizations Division of the Internal Revenue Service; and Arthur Wood, director of Social Financial Services for Ashoka, an international organization that promotes social entrepreneurship and socially responsible investing; met and began collaborating to create a business model that would address, among other things, two key challenges for social enterprise development: federal tax law and "patient capital." According to Lang, "There was a whole portion of the for-profit sector which, while self-sustaining, produced too low a profit to induce normal for-profit investors to engage on their own. Yet this area is where a lot of socially beneficial enterprises fit."

## **A hybrid of a hybrid**

The trio of Lang, Owens, and Wood developed the L3C as a self-sustaining means to achieve a social mission at the lowest possible cost and with the greatest efficiency. An L3C can make a low profit of 1 to 10 percent, but this is secondary to its social purpose. Unlike a traditional charity, however, an L3C may distribute its low profits to its investors.

As its name suggests, the L3C is a hybrid form of a for-profit limited liability company, or LLC. The LLC is an established form of business entity in most states and U.S. territories and on several Native American reservations. Basing the L3C on the LLC model was a strategic decision that ensured the L3C would have the LLC's flexible profit, loss, and taxation features. LLCs themselves are hybrids of corporations and partnerships. Like the liability of shareholders of a corporation, the liability of LLC owners, or members, is limited. The LLC is like a partnership, however, in that the organization can be structured to bear no direct tax consequences. For federal income tax purposes, the profit and loss tax liabilities may be passed through to the LLC's members unless the operating agreement specifies otherwise.

The L3C modifies the standard LLC in a couple of important respects. First, an L3C's organizing document, called articles of organization, must set forth as its primary business objective "one or more charitable or educational purposes," as defined by the Internal Revenue Code. In addition, the term "low profit" is embedded in the title of the business form to put investors and philanthropic funders on notice that the entity is motivated first and foremost by its expressed social mission, but not necessarily to the exclusion of making money.

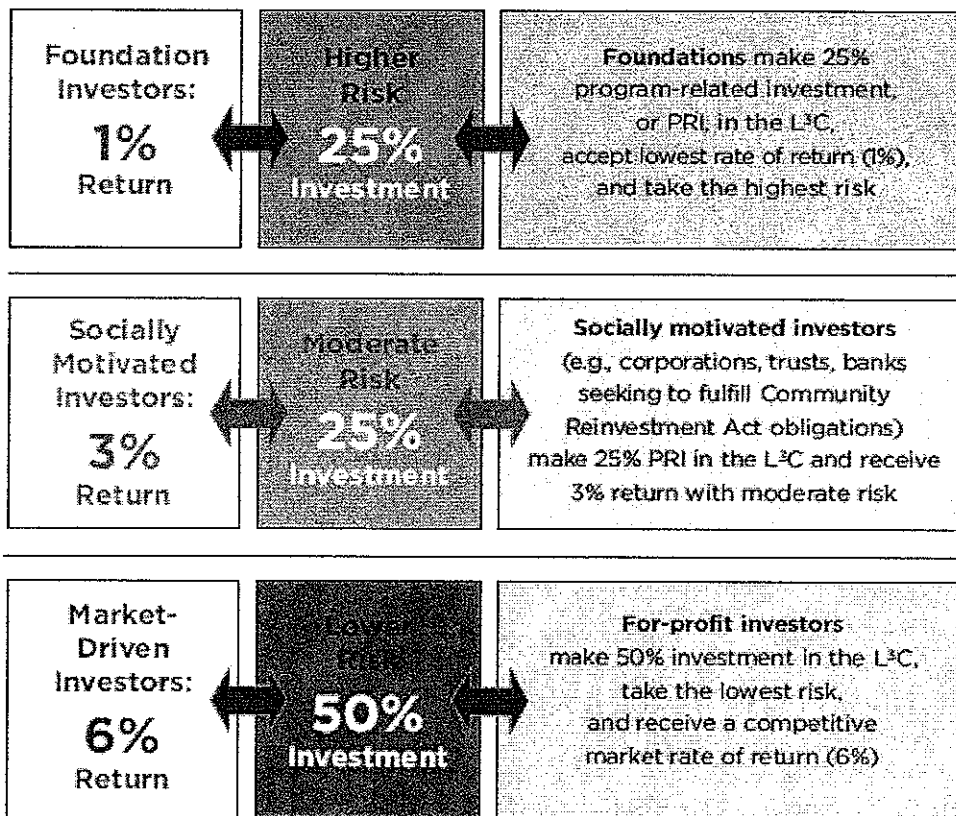
Second, the L3C's articles of organization must state that the operating agreement among its members contain specific language that mirrors IRS regulations regarding program-related investments, or PRIs. Facilitating the use of PRIs is at the heart of the L3C structural concept.

Authorized by Congress in the Tax Reform Act of 1969,<sup>5</sup> a PRI is an investment that a foundation makes in a nonprofit or for-profit venture to support a charitable project or activity, with the potential of a return on the foundation's capital over a period of time. A PRI can be any type of investment vehicle, such as a loan or loan guarantee, line of credit, asset purchase, recoverable grant, or equity investment. Notably, foundations can use PRIs to meet their federally mandated 5 percent minimum payout obligation.<sup>6</sup> To deter investments in speculative deals, an investment must meet three tests to qualify as a PRI: 1) its primary purpose must be to further the tax-exempt objectives of the foundation, 2) the production of income or the appreciation of property cannot be a significant purpose, and 3) it cannot be used for political lobbying or campaigning.<sup>7</sup> By nature, PRIs are intended to be high-risk and/or low-return.

## A layered investment approach

At the core of the L3C concept is the use of PRIs as part of a multiple-tiered, or layered, investment strategy that, theoretically, will help attract a wide range of both socially motivated and profit-oriented investments. Following this strategy, a foundation makes a PRI in an L3C and accepts a lower-than market rate of return as well as a disproportionately higher risk—or “first risk”— position, which in turn attracts other for-profit investors by lowering their risk and increasing their potential rate of return. The following diagram illustrates the mechanics of a sample L3C layered investment strategy and shows how different types of investors can formulate a plan that best suits the risk-to-reward ratios each is willing to accept.

### The L<sup>3</sup>C's Layered Investment Strategy\*



\*The percentages listed here are provided for illustration purposes and represent just one of many possible risk-return arrangements for L<sup>3</sup>Cs.

A for-profit entity does not need to organize as an L3C to utilize PRIs for charitable purposes. But Lang and Owens contend that PRIs are significantly underutilized. Of the nearly 80,000 private foundations operating in the U.S. today, only 5 percent make PRIs, and these are primarily loans to charities.<sup>8</sup> According to Lang and Owens, foundations typically don't engage in PRIs because of the perceived need to seek prior approval from the IRS to ensure compliance with PRI requirements. Upon request and for a fee, the IRS will issue a private letter ruling that

states whether a proposed investment will qualify as a PRI. A private letter ruling is not required by law, but the risks of a post-investment determination by the IRS that a foundation's investment does not qualify as a PRI may include financial penalties. In addition, when the investment is subsequently subtracted from the foundation's calculation of tax-exempt purpose expenditures, the foundation may face more penalties or even lose its nonprofit status if the subtraction results in falling short of the 5 percent payout requirement. However, obtaining a private letter ruling can be very costly and time-consuming. The costs and perceived risks of seeking or failing to seek private letter rulings deter some foundations from making PRIs. The L3C is structured to help address these barriers and thus facilitate among an L3C's members to include language that sets forth the federal legal requirements for PRIs. This is intended to provide assurance to foundations that their investments in L3Cs comply with federal tax requirements and thus qualify as PRIs without the added expense and time needed to obtain private letter rulings.

To further address the deterrents that keep foundations from making PRIs, Lang and Owens are lobbying for legislation that would amend the federal tax code so that a foundation's investment in an L3C is presumed to qualify as a PRI unless proven otherwise. This rebuttable presumption is not intended to do away with a foundation's need to exercise due diligence in its decision-making process, but it would arguably offer the added assurance foundations seek when considering investments in for-profit entities. In addition, Lang and Owens are advocating for L3C legislation at the state level through an informational organization called Americans for Community Development, L3C.

### **Possibilities vs. concerns**

The range of socially responsible purposes potentially suited to the L3C structure is broad, from affordable housing initiatives and mortgage assistance to historic building preservation and biotech development. For example, a recently chartered L3C in Vermont produces innovations in medical imaging technology. It has high research and development costs, but relatively low rates of return for its investors. An interesting L3C possibility in North Carolina involves plans to revive the flagging furniture industry. Many of the furniture manufacturing conglomerates in the state have moved production overseas, leaving behind struggling communities. Lang is working with parties in North Carolina to explore developing an L3C capitalized by foundations and for-profit investors that would buy the closed manufacturing plants, rehabilitate and re-equip them, and then rent them at low rates to local, start-up furniture manufacturers. Lang notes, "These would-be entrepreneurs are long on talent but short on cash." The proposed L3C would provide up-and-coming furniture companies in North Carolina with affordable access to manufacturing capacity. Efforts to pass L3C legislation in that state are under way.

Despite the possibilities, the L3C has its critics and skeptics. Some argue that existing business forms are sufficient for the purposes discussed above, and adding yet another legal entity as an option will "muddy the waters." Others express concern that the proposed legislation to amend federal tax law pertaining to PRIs in L3Cs entails a loosening of the tax laws for for-profit entities, and that it's too early to consider amendments because L3Cs are still a relative unknown. Some concern has also been expressed that without the supporting federal tax legislation, the L3C movement will die out.

Proponents of the L3C stand by the new model as a potentially powerful tool for social entrepreneurs and an evolutionary step in social enterprise development. Many believe that as more jurisdictions enact L3C laws, the L3C brand will increasingly attract foundation and for-profit investment. Their belief could soon be tested, because L3Cs are gaining traction across the country. To date, five states and two Native American tribes have enacted some form of L3C legislation. Vermont took the lead, signing L3C legislation into law in April 2008. Michigan, Wyoming, Utah, Illinois, the Crow Tribe in Montana, and the Oglala Sioux Tribe on the Pine Ridge reservation in South Dakota followed suit in 2009. According to L3C Advisors, L3C, the first L3C chartered for the purpose of advocating for and supporting the development of L3Cs, some form of L3C legislation is pending or under review in 20 other states. As a matter of comity, an L3C chartered in one U.S. jurisdiction will be recognized as a lawful business in all other U.S. jurisdictions, whether or not they have enacted L3C legislation.

### **Realizing the vision**

So how would the L3C model enable Peggy Grimes to realize her cannery vision? Grimes would charter the cannery as an L3C, removing it from day-to-day management of the MFBN and reliance on Montana Department of Corrections funding. She would continue to staff it with inmates from the Deer Lodge state prison, resulting in further growth of the inmate training and reentry program at no additional cost to the state. Her hope is that opportunities to invest in the L3C would open up and attract PRIs from foundations. The PRIs, in turn, would provide incentives for additional for-profit investors. The L3C would use the PRIs and additional investments to replace the current, aging cannery with a new facility. Then the L3C would buy food from Montana producers, thus expanding the market for local farmers, and use the food to produce a high-end line of retail canned goods. The proceeds of the retail goods would sustain the operating costs of the cannery, which would continue to supply the MFBN.

“The L3C model provides MFBN an opportunity to realize a vision that’s been in the making for more than ten years,” Grimes notes. “It offers a practical vehicle for raising the necessary capital to enable Montanans to have access to products that are grown and processed in Montana, to provide consistent access to healthy food for the emergency food system, and to offer an excellent means for inmates to acquire skills to help them succeed outside the prison system.”

The Montana Department of Corrections has given its initial approval for the initiative. Grimes sees the possibilities that an L3C, and the capital it could attract, can offer: a sustainable public-private partnership that would provide new markets for Montana food producers, enhanced rehabilitation training for prison inmates, and—most important—a significant tool to help alleviate hunger in Montana.

At the time of this writing, Steve Davis served as an AmeriCorps VISTA volunteer with Rural Dynamics, Inc., a community development organization in Great Falls, Mont.

For more information about the L3C, visit [www.americansforcommunitydevelopment.org](http://www.americansforcommunitydevelopment.org).

To learn more about the MFBN and its cannery project, call 800-809-4752 or e-mail [info@mfbn.org](mailto:info@mfbn.org).

1 Examples of hybrid business models in the U.S. include the Socially Responsible Corporation, introduced in Minnesota Senate Bill 3786 in 1986 (the bill failed), and the B-Corporation concept being developed by Jay Coen Gilbert and B-Lab. Examples from abroad include the “community interest company,” which was enacted into law in Great Britain in 2005.

2 A “socially responsible investment,” or SRI, is an investment made principally for a charitable, educational, environmental, community development, or ethical purpose and not primarily to maximize a return on the investment.

3 For more about nonprofits creating social enterprises, see “Earning income, serving the community: An introduction to social enterprises” in *Community Dividend Issue 1*, 2009. Available at [www.minneapolisfed.org](http://www.minneapolisfed.org).

4 Thomas J. Billitteri, *Mixing Mission and Business: Does Social Enterprise Need a New Legal Approach?* Highlights from an Aspen Institute Roundtable, The Aspen Institute, January 2007.

5 See USC § 4944(c) for the statutory provision regarding PRIs.

6 Private foundations are required by federal law to distribute each year at least 5 percent of their endowments—specifically, their net investment assets. This is known as the minimum payout obligation, or payout rule.

7 To read the full regulatory definition of PRIs, see 26 CFR § 53.4944-3(a).

8 IRS Business Master File system, January 2007.





interSector Partners, L<sup>3</sup>C  
What's *your* bottom line?

## How-to: An Insider's Look at the L3C and What it Could Mean For You and Your Social Enterprise

**First published: August 2009**

There's been a fair amount written about the L3C recently. We're seeing the gamut from people over-the-top excited about the possibilities of this innovative, hybrid business model to pundits dismissing the L3C as a mediocre solution to anything at best.

Some of what we hear and read is true, some partially true and some not true at all. Generally, we are seeing social entrepreneurs trying to harness the excitement while academics research and analyze. Not entirely unexpected!

We hear what we want to hear, believe what we want to believe and that becomes our reality. Much of what is being written, spoken and tweeted about is what people "want" to believe. The L3C is an exciting new concept bringing together two worlds that have long needed to collaborate and make big things and good things happen together! When new ideas are born that are believable and have the potential to create immediate, long-lasting change – sometimes our enthusiasm kicks into overdrive and we don't get all the facts just right.

All the intricacies and details of the L3C including business structure, tax and financial issues are beyond the scope of this brief introduction to the L3C. I'm here to provide a general overview of some of the important facts and issues to consider as you decide if the L3C is right for you. Please understand there are a potentially infinite number of scenarios where the L3C will not work, where the L3C is not the right business structure, where the L3C just doesn't make sense and therefore just won't fit.

**The bottom line:** We're interested in talking with, educating and working with social entrepreneurs, who want to research, brainstorm, create, nurture and grow scenarios that turn into enterprises where the L3C WILL work. Social entrepreneurs who are passionate about being agents for positive social change. We want to empower social purpose businesses, foundations and all others concerned with a focused pursuit of enhancements and improvements to our society.

### Why the L3C and why now?

There are many reasons but here are just a few: Experts are predicting that with the current economic environment eating away at nonprofit's primary sources of funding (charitable donations and foundation funding), that as many as 100,000 of the nations roughly one million nonprofit organizations will close their doors in 2009. This is a scary reality.

Current social purpose businesses are reeling from the crisis in the capital and credit markets. Traditional funding sources aren't quite sure what to make of a business that puts social purpose BEFORE profit.

Foundations are making fewer grants and smaller grants because their investment/endowment portfolios have not been able to withstand the current economic turmoil.

Nonprofits need to start behaving more like businesses. For-profits businesses need to start behaving more like nonprofits. Nonprofits and for-profits need to start working together.

**The bottom line:** All this is a fairly tenuous backdrop to what we feel is a very positive and uplifting opportunity that comes along with a complete and accurate understanding of the L3C.

### **What is an L3C?**

Very simply and according to its creator Robert Lang, the L3C is not a nonprofit. It is a for profit venture that under its state charter must have a primary goal of performing a socially beneficial purpose not maximizing income. The legislation was specifically written to dovetail with the federal IRS regulations relevant to Program Related Investments (PRIs) by foundations. The L3C facilitates PRI investment without the need for IRS private letter rulings. Further, because the foundations 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 that they are able to be self sustainable.

Mr. Lang goes on to state; the L3C 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. It also makes it very easy for lawyers and laymen alike to grasp since it does not create a new structure but merely amends the definition section of the LLC acts in most states. That leaves 15+ years of legislation and litigation that is behind the LLC intact behind the L3C.

**The bottom line:** We believe this to be one of the important, if not the most important consideration for the L3C business model – the potential for social entrepreneurs to gain access to new, creative, more available, more favorable sources of funding to launch and/or grow a social enterprise.

### **How do you form an L3C?**

As of August 7<sup>th</sup>, L3C legislation, basically amending a state's LLC statutes, has been signed into law in Vermont, Michigan, Wyoming, Utah, and Illinois (*effective 1-1-10*) as well as the Crow Indian Nation and the Oglala Sioux Tribe. Legislation is currently being discussed and pending in several other states.

The L3C is recognized in all 50 states as it is a variant form of LLC and every state must honor and recognize every other state's LLCs - just as you can form a Delaware corporation and do business in Idaho, Colorado, North Carolina or any state in the U.S.

Today, the process for forming an L3C is actually quite simple. While each state's requirements vary slightly, social entrepreneurs wishing to form an L3C will file Articles of Organization with the appropriate state regulatory authority in one of the six states listed above and pay the required fee. Our company, interSector Partners, L3C, filed Articles of Organization with the Vermont Secretary of State and paid a \$100 fee. We chose Vermont, first, because they were the first state to pass L3C legislation and second, because the Vermont LLC statutes are very similar to the LLC statutes in Colorado. But we could have organized in any state that has passed L3C legislation at that time.

Our next step, as we are based in Colorado, was to register as a foreign entity doing business in Colorado. It's a simple three page form and a \$125 fee. If we open offices in other states, we'll need to register as a foreign entity in those states as well, in accordance with those state's statutes and laws.

**The bottom line:** the process to form an L3C is generally quite simple and not at all time consuming.

#### **Other things to consider:**

- The L3C, just like the LLC, is a for-profit business structure. While some call it a "low profit limited liability company" you'll need to earn and retain profit to sustain your business over the long-term.
- Should you obtain PRI from a foundation, you'll need a viable and sustainable revenue model to pay back the PRI plus interest, if applicable.
- Right now, there is no "low profit" police. No one will be watching over your shoulder deciding how much profit is too much profit. Ultimately, social purpose is your guiding star and if you'll have to answer to anyone, regarding profit, it may be those that that your L3C serves.
- After organizing your L3C, you'll need to draft your operating agreement. Just like with an LLC, the operating agreement is the governing document of the business. While, as of this date, there are no official "filing" requirements, the L3C's operating agreement generally must be made available for inspection. We also believe, that in the interest of transparency, we should probably anticipate future filing requirements regarding some portion or all of an L3C's operating agreement.
- Before approaching a foundation for PRI or approaching other funding sources such as community financial institutions or angel investors, you'll need to prepare a business plan – just as you would if your business was an LLC, C or Sub S corporation.
- As you explore whether an L3C is the right business structure for your social enterprise – make certain to engage the services of qualified legal, accounting, tax, financial and other professional counsel as your particular situation dictates.

#### **So, which legal structure is right for your social enterprise?**

This can be a complicated question and will depend on your particular situation. We highly recommend you review *Effective Social Enterprise — A Menu of Legal Structures* by Robert A. Wexler for an in-depth discussion of the various different legal structures as they relate to social enterprise.

## The L3C in action:

The L3C is so new; there are no real illustrative case studies. As of this writing, there are 75 registered L3Cs in the US – some of which we are certain are not yet truly in business. There are a couple of very interesting L3Cs getting ready to hatch. You can read brief summaries here.

## Hurdles:

There are a few key hurdles you'll have to get over if you're seriously considering the L3C for your social enterprise:

- While nearly all foundations are aware of PRI, only very small percentages actually make PRI. The record shows us it's larger foundations making PRI in larger projects. This may affect your ability to attract PRI for your L3C. We're working diligently to shorten the foundation learning curve.
- The IRS has not "blessed" the L3C. This is not really so important for the L3C but rather for the foundations making PRI into an L3C. This may affect your ability to attract PRI for your L3C.
- While individual states are amending their LLC statutes to allow for the L3C, as of this writing, there is no Federal L3C legislation. The creator of the L3C, Robert Lang and his team, are introducing Federal legislation but it's much too early to tell its final outcome or effect. This may affect your ability to attract PRI for your L3C.

**The bottom line:** These are by no means all the hurdles. The L3C is new and basically untested. Everyone's on the learning curve. For some that learning curve will be steeper than for others.

Everything about the L3C brings to mind a saying our good friend and attorney Marc Lane reminds us of: *No one wants to be a pioneer, but no one wants to be left behind.* For those with a pioneering spirit, we believe the L3C experience will be fruitful and the rewards will be many.

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*This article contains information that was believed to be accurate at the time of publication and addresses legal, accounting and financial matters, but does not in any way provide or constitute legal, accounting or financial advice or opinion. It is strongly recommended that all readers consult their individual professional legal, accounting and financial advisors and take action only upon receipt of such advice. Neither the author nor interSector Partners, L3C endorse the L3C business structure and assume no responsibility or liability for actions taken or not taken as a result of the information contained herein.*



With nearly 30 years of business marketing and entrepreneurial experience under his belt, Rick knew there had to be a way to combine social good with profit motives. With a focus on market-based results, Rick is a co-founder and principal partner in the firm interSector Partners, L3C based in Boulder County, Colorado. The firm provides education and consulting services to help nonprofits become more sustainable, for-profits become more socially responsible and government agencies to better support both in their community. The firm also consults with social entrepreneurs interested in the L3C business model.

## ATTACHMENT A

### NO. 106. AN ACT RELATING TO LOW-PROFIT LIMITED LIABILITY COMPANIES.

(H.775)

It is hereby enacted by the General Assembly of the State of Vermont:

Sec. 1. 11 V.S.A. § 3001(23) is added to read:

(23) "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:

(i) significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code of 1986, 26 U.S.C. § 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 Internal Revenue Code of 1986, 26 U.S.C. § 170(c)(2)(D).

(D) If a company that met the definition of this subdivision (23) at its formation at any time ceases to satisfy any one of the requirements, it shall immediately cease to be a low-profit limited liability company, 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) of this title.

Sec. 2. 11 V.S.A. § 3005(a) is amended to read:

(a)(1) ~~The~~ Except for low-profit limited liability companies, the name of a limited liability company as set forth in its articles of organization shall contain the words “limited liability company” or “limited company” or the abbreviation “L.L.C.,” “LLC,” “L.C.,” or “LC.” The word “limited” may be abbreviated as “Ltd.” and “company” may be abbreviated as “Co.” in a limited liability company name.

(2) The name of a low-profit limited liability company as defined in subdivision 3001(23) of this chapter shall contain the abbreviation L3C or l3c.

Sec. 3. 11 V.S.A. § 3023(a) is amended to read:

(a) Articles of organization of a limited liability company shall set forth:

- (1) the name of the company;
- (2) the address of the initial designated office;
- (3) the name and street address of the initial agent for service of process;
- (4) the name and address of each organizer;
- (5) whether the company is a term limited liability company and, if so, the duration of the term;
- (6) whether the company is an L3C;
- (7) whether the company is to be manager-managed, and, if so, the name and address of each initial manager; and
- ~~(7)~~(8) whether the members of the company are to be liable for its debts and obligations under subsection ~~(b) of section 3043~~ 3043(b) of this title.

Sec. 4. EFFECTIVE DATE

This act shall take effect upon passage.

Approved: April 30, 2008

**ATTACHMENT B**

HOUSE BILL NO. HB0182

Low profit limited liability companies.

Sponsored by: Representative(s) Zwonitzer, Dn., Craft,  
Goggles, Lubnau and Mercer and Senator(s)  
Perkins

A BILL

for

1 AN ACT relating to limited liability companies; providing  
2 for creation of low profit limited liability companies;  
3 providing a definition; providing for use of abbreviations;  
4 providing for administrative dissolution; and providing for  
5 an effective date.

6

7 *Be It Enacted by the Legislature of the State of Wyoming:*

8

9       **Section 1.** W.S. 17-15-102(a) by creating a new  
10 paragraph (ix), 17-15-105(a) (intro) and (b) and 17-15-112  
11 by creating a new subsection (e) are amended to read:

12

13       **17-15-102. Definitions.**

14

15       (a) As used in this act:

1 (ix) "Low profit limited liability company"  
2 means a limited liability company that has set forth in its  
3 articles of organization a business purpose that satisfies,  
4 and which limited liability company is at all times  
5 operated to satisfy, each of the following requirements:

6

7 (A) The entity significantly furthers the  
8 accomplishment of one (1) or more charitable or educational  
9 purposes within the meaning of section 170(c) (2) (B) of the  
10 Internal Revenue Code and would not have been formed but  
11 for the entity's relationship to the accomplishment of  
12 charitable or educational purposes;

13

14 (B) No significant purpose of the entity is  
15 the production of income or the appreciation of property  
16 provided, however, that the fact that an entity produces  
17 significant income or capital appreciation shall not, in  
18 the absence of other factors, be conclusive evidence of a  
19 significant purpose involving the production of income or  
20 the appreciation of property; and

21

22 (C) No purpose of the entity is to  
23 accomplish one (1) or more political or legislative



1 purposes within the meaning of section 170(c) (2) (D) of the  
2 Internal Revenue Code.

3

4 **17-15-105. Name.**

5

6 (a) The words "limited liability company," or its  
7 abbreviations "LLC" or "L.L.C.," "limited company," or its  
8 abbreviations "LC" or "L.C.," "Ltd. liability company,"  
9 "Ltd. liability co." or "limited liability co." shall be  
10 included in the name of every limited liability company  
11 formed under the provisions of this act and, except the  
12 name of a low profit limited liability company, as defined  
13 in W.S. 17-15-102(a) (ix) shall contain the abbreviations  
14 "L3C," "l3c," "low profit ltd. liability company," "low  
15 profit ltd. liability co." or "low profit limited liability  
16 co.". In addition, the limited liability company name may  
17 not:

18

19 (b) Omission of the words "limited liability  
20 company," or its abbreviations "LLC" or "L.L.C.," "limited  
21 company," or its abbreviations "LC" or "L.C.," "Ltd.  
22 liability company," "Ltd. liability co." or "limited  
23 liability co.," or in the case of a low profit limited

24 liability company, as defined in W.S. 17-15-102(a)(ix),

1 omission of the words "low profit limited liability  
2 company" or its abbreviations "L3C," "l3c," "low profit  
3 ltd. liability company," "low profit ltd. liability co." or  
4 "low profit limited liability co.," in the use of the name  
5 of the limited liability company shall render any person  
6 who participates in the omission, or knowingly acquiesces  
7 in it, liable for indebtedness, damage or liability  
8 occasioned by the omission.

9

10 **17-15-112. Administrative forfeiture of authority and**  
11 **certificate of organization.**

12

13 (e) In addition to the other provisions of this  
14 section, if any low profit limited liability company has  
15 ceased to meet the definition of a low profit limited  
16 liability company as provided in W.S. 17-15-102(a) (ix) and  
17 has failed for thirty (30) days after ceasing to meet the  
18 definition to file an amendment to its articles of  
19 organization with the secretary of state amending its name  
20 to conform with the requirements of W.S. 17-15-105(a), it  
21 shall be deemed to be transacting business in this state  
22 without authority and to have forfeited any franchises,

23 rights or privileges acquired under the laws thereof and  
24 the forfeiture shall be made effective in the same manner  
1 as provided in subsection (a) of this section.      The  
2 reinstatement provisions and fees provided in subsection  
3 (a) of this section shall apply.

4

5        **Section 2.** This act is effective July 1, 2009.

6

7

(END)

ATTACHMENT C

STATE OF MICHIGAN  
94TH LEGISLATURE  
REGULAR SESSION OF 2008

Introduced by Senators Allen and Barcia

**ENROLLED SENATE BILL No.  
1445**

AN ACT to amend 1993 PA 23, entitled "An act to provide for the organization and regulation of limited liability companies; to prescribe their duties, rights, powers, immunities, and liabilities; to prescribe the powers and duties of certain state departments and agencies; and to provide for penalties and remedies," by amending section 102 (MCL 450.4102), as amended by 2002 PA 686.

*The People of the State of Michigan enact:*

Sec. 102. (1) Unless the context requires otherwise, the definitions in this section control the interpretation of this act.

(2) As used in this act:

(a) "Administrator" means the director of the department or his or her designated representative.

(b) "Articles of organization" means the original documents filed to organize a limited liability company, as amended or restated by certificates of correction, amendment, or merger, by restated articles, or by other instruments filed or issued under any statute.

(c) "Constituent" means a party to a plan of merger, including the survivor.

(d) "Contribution" means anything of value that a person contributes to the limited liability company as a prerequisite for, or in connection with, membership, including cash, property, services performed, or a promissory note or other binding obligation to contribute cash or property, or to perform services.

(e) "Corporation" or "domestic corporation" means any of the following:

(i) A corporation formed under the business corporation act, 1972 PA 284, MCL 450.1101 to 450.2098.

(ii) A corporation existing on January 1, 1973 and formed under another statute of this state for a purpose for which a corporation may be formed under the business corporation act, 1972 PA 284, MCL 450.1101 to 450.2098.

(iii) A corporation formed under the professional service corporation act, 1962 PA 192, MCL 450.221 to 450.235.

(f) "Department" means the department of labor and economic growth.

(g) "Distribution" means a direct or indirect transfer of money or other property or the incurrence of indebtedness by a limited liability company to or for the benefit of its members or assignees of its members in respect of the members' membership interests.

(h) "Electronic transmission" or "electronically transmitted" means any form of communication that meets all of the following:

(i) It does not directly involve the physical transmission of paper.

(ii) It creates a record that may be retained and retrieved by the recipient.

(iii) It may be directly reproduced in paper form by the recipient through an automated process. (i)

"Foreign limited liability company" means a limited liability company formed under laws other than the laws of this state.

(j) "Foreign limited partnership" means a limited partnership formed under laws other than the laws of this state.

(k) "Limited liability company" or "domestic limited liability company" means an entity that is an unincorporated membership organization formed under this act.

(l) "Limited partnership" or "domestic limited partnership" means a limited partnership formed under the Michigan revised uniform limited partnership act, 1982 PA 213, MCL 449.1101 to 449.2108.

(m) "Low-profit limited liability company" means a limited liability company that has included in its articles of organization a purpose that meets, and that at all times conducts its activities to meet, all of the following requirements:

(i) The limited liability company significantly furthers the accomplishment of 1 or more charitable or educational purposes described in section 170(c)(2)(B) of the internal revenue code, 26 USC 170, and would not have been formed except to accomplish those charitable or educational purposes.

(ii) The production of income or appreciation of property is not a significant purpose of the limited liability company. However, in the absence of other factors, the fact that a limited liability company produces significant income or capital appreciation is not conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

(iii) The purposes of the limited liability company do not include accomplishing 1 or more political or legislative purposes described in section 170(c)(2)(D) of the internal revenue code, 26 USC 170.

(n) "Majority in interest" means a majority of votes as allocated by an operating agreement, or by the statute in the absence of an allocation by operating agreement, and held by members entitled to vote on a matter submitted for a vote by members.

(o) "Manager" or "managers" means a person or persons designated to manage the limited liability company pursuant to a provision in the articles of organization stating that the business is to be managed by or under the authority of managers.

(p) "Member" means a person who has been admitted to a limited liability company as provided in section 501, or, in the case of a foreign limited liability company, a person that is a member of the foreign limited liability company in accordance with the laws under which the foreign limited liability company is organized.

(q) "Membership interest" or "interest" means a member's rights in the limited liability company, including, but not limited to, any right to receive distributions of the limited liability company's assets and any right to vote or participate in management.

(r) "Operating agreement" means a written agreement by the member of a limited liability company that has 1 member, or between all of the members of a limited liability company that has more than 1 member, pertaining to the affairs of the limited liability company and the conduct of its business. The term includes any provision in the articles of organization pertaining to the affairs of the limited liability company and the conduct of its business.

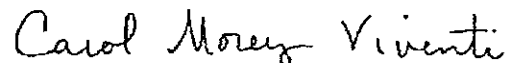
(s) "Person" means an individual, partnership, limited liability company, trust, custodian, estate, association, corporation, governmental entity, or any other legal entity.

(t) "Services in a learned profession" means services rendered by a dentist, an osteopathic physician, a physician, a surgeon, a doctor of divinity or other clergy, or an attorney-at-law.

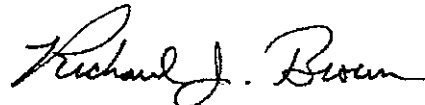
(u) "Surviving company", "surviving entity", or "survivor" means the constituent that survives a merger, as identified in the certificate of merger.

(v) "Vote" means an affirmative vote, approval, or consent.

This act is ordered to take immediate effect.



Secretary of the Senate



Clerk of the House of Representatives

Approved-----

-----  
Governor

## ATTACHMENT D

### Illinois Public Act 096-0126

SB0239 Enrolled

LRB096 07539 KTG 17634 b

AN ACT concerning business.

Be it enacted by the People of the State of Illinois,  
represented in the General Assembly:

Section 5. The Limited Liability Company Act is amended by changing Sections 1-5, 1-10, and 15-5 and adding Section 1-26 as follows:

(805 ILCS 180/1-5)

Sec. 1-5. Definitions. As used in this Act, unless the context otherwise requires:

"Anniversary" means that day every year exactly one or more years after: (i) the date the articles of organization filed under Section 5-5 of this Act were filed by the Office of the Secretary of State, in the case of a limited liability company; or (ii) the date the application for admission to transact business filed under Section 45-5 of this Act was filed by the Office of the Secretary of State, in the case of a foreign limited liability company.

"Anniversary month" means the month in which the anniversary of the limited liability company occurs.

"Articles of organization" means the articles of organization filed by the Secretary of State for the purpose of forming a limited liability company as specified in Article 5.

"Assumed limited liability company name" means any limited liability company name other than the true limited liability company name, except that the identification by a limited liability company of its business with a trademark or service mark of which it is the owner or licensed user shall not constitute the use of an assumed name under this Act.

"Bankruptcy" means bankruptcy under the Federal Bankruptcy Code of 1978, Title 11, Chapter 7 of the United States Code.

"Business" includes every trade, occupation, profession, and other lawful purpose, whether or not carried on for profit.

"Contribution" means any cash, property, or services rendered or a promissory note or other binding obligation to contribute cash or property or to perform services, that a

person contributes to the limited liability company in that person's capacity as a member.

"Court" includes every court and judge having jurisdiction in a case.

"Debtor in bankruptcy" means a person who is the subject of an order for relief under Title 11 of the United States Code, a comparable order under a successor statute of general application, or a comparable order under federal, state, or foreign law governing insolvency.

"Distribution" means a transfer of money, property, or other benefit from a limited liability company to a member in the member's capacity as a member or to a transferee of the member's distributional interest.

"Distributional interest" means all of a member's interest in distributions by the limited liability company.

"Entity" means a person other than an individual.

"Federal employer identification number" means either (i) the federal employer identification number assigned by the Internal Revenue Service to the limited liability company or foreign limited liability company or (ii) in the case of a limited liability company or foreign limited liability company not required to have a federal employer identification number, any other number that may be assigned by the Internal Revenue Service for purposes of identification.

"Foreign limited liability company" means an unincorporated entity organized under laws other than the laws of this State that afford limited liability to its owners comparable to the liability under Section 10-10 and is not required to register to transact business under any law of this State other than this Act.

"Insolvent" means that a limited liability company is unable to pay its debts as they become due in the usual course of its business.

"Limited liability company" means a limited liability company organized under this Act.

"L3C" or "low-profit limited liability company" means a for-profit limited liability company which satisfies the requirements of Section 1-26 of this Act and does not have as a significant purpose the production of income or the appreciation of property.

"Manager" means a person, whether or not a member of a manager-managed company, who is vested with authority under Section 13-5.

"Manager-managed company" means a limited liability

company which is so designated in its articles of organization.

"Member" means a person who becomes a member of the limited liability company upon formation of the company or in the manner and at the time provided in the operating agreement or, if the operating agreement does not so provide, in the manner and at the time provided in this Act.

"Member-managed company" means a limited liability company other than a manager-managed company.

"Membership interest" means a member's rights in the limited liability company, including the member's right to receive distributions of the limited liability company's assets.

"Operating agreement" means the agreement under Section 15-5 concerning the relations among the members, managers, and limited liability company. The term "operating agreement" includes amendments to the agreement.

"Organizer" means one of the signers of the original articles of organization.

"Person" means an individual, partnership, domestic or foreign limited partnership, limited liability company or foreign limited liability company, trust, estate, association, corporation, governmental body, or other juridical being.

"Registered office" means that office maintained by the limited liability company in this State, the address, including street, number, city and county, of which is on file in the office of the Secretary of State, at which, any process, notice, or demand required or permitted by law may be served upon the registered agent of the limited liability company.

"Registered agent" means a person who is an agent for service of process on the limited liability company who is appointed by the limited liability company and whose address is the registered office of the limited liability company.

"Restated articles of organization" means the articles of organization restated as provided in Section 5-30.

"State" means a state, territory, or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico.

"Transfer" includes an assignment, conveyance, deed, bill of sale, lease, mortgage, security interest, encumbrance, and gift.

(Source: P.A. 90-424, eff. 1-1-98.)

(805 ILCS 180/1-10)

Sec. 1-10. Limited liability company name.

(a) The name of each limited liability company as set forth



in its articles of organization:

(1) shall contain the terms "limited liability company", "L.L.C.", or "LLC", or, if organized as a

low-profit limited liability company under Section 1-26 of this Act, shall contain the term "L3C";

(2) may not contain a word or phrase, or an abbreviation or derivation thereof, the use of which is prohibited or restricted by any other statute of this State unless the restriction has been complied with;

(3) shall consist of letters of the English alphabet, Arabic or Roman numerals, or symbols capable of being readily reproduced by the Office of the Secretary of State;

(4) shall not contain any of the following terms: "Corporation," "Corp.," "Incorporated," "Inc.," "Ltd.," "Co.," "Limited Partnership" or "L.P.";

(5) shall be the name under which the limited liability company transacts business in this State unless the limited liability company also elects to adopt an assumed name or names as provided in this Act; provided, however, that the limited liability company may use any divisional designation or trade name without complying with the requirements of this Act, provided the limited liability company also clearly discloses its name;

(6) shall not contain any word or phrase that indicates or implies that the limited liability company is authorized or empowered to be in the business of a corporate fiduciary unless otherwise permitted by the Commissioner of the Office of Banks and Real Estate under Section 1-9 of the Corporate Fiduciary Act. The word "trust", "trustee", or

"fiduciary" may be used by a limited liability company only if it has first complied with Section 1-9 of the Corporate Fiduciary Act; and

(7) shall contain the word "trust", if it is a limited liability company organized for the purpose of accepting and executing trusts.

(b) Nothing in this Section or Section 1-20 shall abrogate or limit the common law or statutory law of unfair competition or unfair trade practices, nor derogate from the common law or principles of equity or the statutes of this State or of the

United States of America with respect to the right to acquire and protect copyrights, trade names, trademarks, service marks, service names, or any other right to the exclusive use of names or symbols.

(c) (Blank).

(d) The name shall be distinguishable upon the records in the Office of the Secretary of State from all of the following:

(1) Any limited liability company that has articles of organization filed with the Secretary of State under Section 5-5.

(2) Any foreign limited liability company admitted to transact business in this State.

(3) Any name for which an exclusive right has been reserved in the Office of the Secretary of State under Section 1-15.

(4) Any assumed name that is registered with the Secretary of State under Section 1-20.

(5) Any corporate name or assumed corporate name of a domestic or foreign corporation subject to the provisions of Section 4.05 of the Business Corporation Act of 1983 or Section 104.05 of the General Not For Profit Corporation Act of 1986.

(e) The provisions of subsection (d) of this Section shall not apply if the organizer files with the Secretary of State a certified copy of a final decree of a court of competent jurisdiction establishing the prior right of the applicant to the use of that name in this State.

(f) The Secretary of State shall determine whether a name is "distinguishable" from another name for the purposes of this Act. Without excluding other names that may not constitute distinguishable names in this State, a name is not considered distinguishable, for purposes of this Act, solely because it contains one or more of the following:

(1) The word "limited", "liability" or "company" or an abbreviation of one of those words.

(2) Articles, conjunctions, contractions, abbreviations, or different tenses or number of the same word.

(Source: P.A. 92-33, eff. 7-1-01; 93-59, eff. 7-1-03.)

(805 ILCS 180/1-26 new)

Sec. 1-26. Low-profit limited liability company.

(a) A low-profit limited liability company shall at all times significantly further the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code of 1986, 26 U.S.C. 170(c)(2)(B), or its successor, and would not have been formed but for the relationship to the accomplishment of such charitable or educational purposes.

(b) A limited liability company which intends to qualify as a low-profit limited liability company pursuant to the provisions of this Section shall so indicate in its articles of organization, and further state that:

(1) no significant purpose of the company is the production of income or the appreciation of property; however, 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; and

(2) 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 Internal Revenue Code of 1986, 26 U.S.C. 170(c)(2)(D), or its successor.

(c) A company that no longer satisfies the requirements of this Section 1-26 continues to exist as a limited liability company and shall promptly amend its articles of organization so that its name and purpose no longer identify it as a

low-profit limited liability company or L3C.

(d) Any company operating or holding itself out as a low-profit limited liability company in Illinois, any company formed as a low-profit limited liability company under this Act, and any chief operating officer, director, or manager of any such company is a "trustee" as defined in Section 3 of the Charitable Trust Act.

(e) Nothing in this Section 1-26 prevents a limited liability company that is not organized under it from electing a charitable or educational purpose in whole or in part for doing business under this Act.

(805 ILCS 180/15-5)

Sec. 15-5. Operating agreement.

(a) All members of a limited liability company may enter into an operating agreement to regulate the affairs of the

company and the conduct of its business and to govern relations among the members, managers, and company. To the extent the operating agreement does not otherwise provide, this Act governs relations among the members, managers, and company. Except as provided in subsection (b) of this Section, an operating agreement may modify any provision or provisions of this Act governing relations among the members, managers, and company.

(b) The operating agreement may not:

(1) unreasonably restrict a right to information or

access to records under Section 10-15;

(2) vary the right to expel a member in an event specified in subdivision (6) of Section 35-45;

(3) vary the requirement to wind up the limited liability company's business in a case specified in subdivisions (3) or (4) of Section 35-1;

(4) restrict rights of a person, other than a manager, member, and transferee of a member's distributional interest, under this Act;

(5) restrict the power of a member to dissociate under Section 35-50, although an operating agreement may determine whether a dissociation is wrongful under Section 35-50, and it may eliminate or vary the obligation of the limited liability company to purchase the dissociated member's distributional interest under Section 35-60;

(6) eliminate or reduce a member's fiduciary duties, but may;

(A) identify specific types or categories of activities that do not violate these duties, if not manifestly unreasonable; and

(B) specify the number or percentage of members or disinterested managers that may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate these duties; or

(6.5) eliminate or reduce the obligations or purposes a

low-profit limited liability company undertakes when organized under Section 1-26; or

(7) eliminate or reduce the obligation of good faith and fair dealing under subsection (d) of Section 15-3, but

the operating agreement may determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable.

(c) In a limited liability company with only one member, the operating agreement includes any of the following:

(1) Any writing, without regard to whether the writing otherwise constitutes an agreement, as to the company's affairs signed by the sole member.

(2) Any written agreement between the member and the company as to the company's affairs.

(3) Any agreement, which need not be in writing, between the member and the company as to a company's affairs, provided that the company is managed by a manager who is a person other than the member.

(Source: P.A. 92-33, eff. 7-1-01.)

**Effective Date: 1/1/2010**

