Title: The L3C: A Boon to Illinois' Social-Purpose Businesses
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The Low-profit Limited Liability Company, or "L3C," is a new, for-profit business form available to social entrepreneurs who seek the legal and tax flexibility of a traditional LLC, the social benefits of a non-profit organization, and the branding and market positioning advantages of a social enterprise. Moreover, the L3C presents a unique opportunity to attract private capital to ventures with modest financial prospects, but the possibility of significant social impact.

The opportunity turns on a little known feature of the Tax Reform Act of 1969, which mandated that private foundations distribute at least 5% of their assets every year for charitable purposes. This legal requirement explains the feverish competition for grants among charities.

But the '69 law also created an alternative way for foundations to satisfy their 5% payout obligation - - the "program-related investment," or "PRI." A PRI can take any form - - a loan, a loan guarantee, a line of credit, a linked deposit, or even an equity investment - - as long as the investment is primarily made for a charitable, religious, scientific, literary, educational or other purpose for which charities are organized. And, although there is no cap on the venture's eventual profits or the appreciation of its assets, the production of income or the appreciation of property may not be a significant purpose of the investment. As long as these criteria are met and other technical requirements are satisfied, a program-related investment will count against the foundation's 5% distribution requirement.

All things considered, one would assume that foundations would prefer to make an investment (which can eventually be recovered, along with earnings, and recycled over and over again for charitable purposes), rather than a grant (which is an expense, never to be seen again). Yet, for a variety of reasons, grants have historically been favored over PRIs.

Enter the Illinois L3C, a new limited liability company form which, like any other LLC, shields its owners from the debts of their enterprise and affords them flexibility in governance and tax planning. But with one striking difference: the L3C's Articles of Organization are required by law to mirror the standards for program-related investing imposed on foundations by the Tax Reform Act of 1969. So the business form itself gives the foundation comfort that the target company is specifically organized to accept PRIs, thus satisfying a significant item on any foundation investor's due-diligence checklist.

A foundation seeking social impact over economic rewards can invest in an L3C (whether an affiliate of a charity or a stand-alone venture) and forgoing market-rate returns. The foundation's financial give-up can thus catalyze a potent social-purpose strategy. By taking on higher risk in exchange for lower financial returns, the foundation affords the L3C the opportunity to attract private-sector investment which otherwise might never be tapped to support a social venture. Together, the foundation and the L3C's private-sector funders can help ensure its long-term sustainability. Not only can the foundation's financial commitment to the venture's mission draw urgently needed private investment into the social sector. As important, the foundation's support may actually reduce the social enterprise's entrepreneurial risk: the talent, expertise and experience of a foundation's management will often elevate the foundation's role to that of a social venture capitalist which has a stake in both the viability of the venture and the social impact it delivers.

Since Illinois' L3C law took effect in January 2010, those of us instrumental in its enactment and development have already witnessed the L3C's power to leverage foundations' PRIs to entice private investment in education, economic development, affordable housing, workforce development, and other promising and impactful endeavors. We couldn't be more optimistic about the L3C's future.

Chicago attorney and financial advisor Marc J. Lane is a director of Social Enterprise Alliance (www.sea-alliance.org) and chairs the Host Committee for its upcoming Summit, which will be held in Chicago between October 31 and November 2 (www.sealliance.org/annual-summit). His latest book is Social Enterprise: Empowering Mission- Driven Entrepreneurs, American Bar Association, 2011 (http://bit.ly/mjl_socent).

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