Renewed hope for the low-profit limited liability company

Sonia J. Toson
Kennesaw State University, Kennesaw, Georgia, USA

Abstract

Purpose – The purpose of this paper is to challenge the notion that low-profit limited liability companies (L3Cs) are an ineffective or flawed choice of entity for social entrepreneurs. Most of the literature surrounding L3Cs has been critical of the form; however, a detailed analysis shows that the form is not only still viable but also, in fact, experiencing growth.

Design/methodology/approach – This paper utilizes key literature and an analysis of current L3C activity in the USA to provide a unique viewpoint on the utility and viability of L3Cs in the USA.

Findings – Analysis demonstrates that despite criticisms throughout the legal community, the L3C is experiencing recent growth and continues to be a viable choice of entity for social entrepreneurs.

Practical implications – This piece fills a significant gap in the literature surrounding L3Cs. Much has been written about L3Cs in the legal academy, but analysis is scarce when reviewing management and entrepreneurship literature.

Originality/value – This piece furthers the literature by providing the business academy with an in-depth analysis of the legal components of L3Cs and draws research-based conclusions about the state of the form and its viability for social entrepreneurs. It is unique in that it challenges the prevailing legal opinion that the L3C form is useless and unnecessary.

Keywords Social enterprise, Corporate social responsibility, Social entrepreneurship, Entity types, L3C, Low-profit limited liability company

Paper type Viewpoint

History of low-profit limited liability companies

Social entrepreneurship is a concept that has been on the rise in recent years in the USA (Cooney et al., 2014). While there are a vast number of definitions that attempt to describe the nature and characteristics of social entrepreneurship, social entrepreneurship can generally be defined as entrepreneurship that “aims for value in the form of a large-scale, transformational benefit that accrues either to a significant segment of society or to society at large” (Martin and Osberg, 2007). Owners of these entities are known as social entrepreneurs, and the entities themselves are known as social enterprises. According to Bayona and Milani (2011):

While a business entrepreneur is more concerned with financial performance and profits, a social entrepreneur is one, who in addition to profits and other financial performance measures success based on the impact he or she has been able to make on society.

Because social enterprises have the dual mission of generating a profit while simultaneously accomplishing some form of societal benefit, these entities have traditionally had difficulty in selecting the most appropriate form of business entity (Kelly, 2009). Traditionally, there were only a limited number of entity choices available to entrepreneurs. These included:
- non-profit corporations;
- for-profit corporations; and
- partnerships and limited liability companies (LLCs).

And while these entity types contained a number of variations within each type, they ultimately were divided into two broad categories: non-profit and for-profit entities. The basic premise was that the entity either gained revenue and distributed it as profit (for-profit model) or you gained revenue but only for operational purposes and never as profit (non-profit model). Businesses fell squarely into one camp or the other. Traditional businesses typically fit into one of the categories below (Table I).

<table>
<thead>
<tr>
<th>Entity type</th>
<th>Non-profit Description</th>
<th>Entity type</th>
<th>For-profit Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public charitable</td>
<td>Charitable, religious, scientific, literary, and other organizations exempt under</td>
<td>Traditional</td>
<td>Shareholders own shares and realize profit through dividends; both entity and individual</td>
</tr>
<tr>
<td>organizations</td>
<td>Internal Revenue Code (“IRC”) section 501(c)(3)</td>
<td>corporation</td>
<td>shareholders are taxed; limited personal liability</td>
</tr>
<tr>
<td>Private foundations</td>
<td>Private organizations charitable trusts operating through private donations and</td>
<td>S-Corporation</td>
<td>Shareholders meeting certain IRS-imposed restrictions own shares and realize profit</td>
</tr>
<tr>
<td></td>
<td>managed by trustees and directors pursuant to IRC section 501(c)(3)</td>
<td></td>
<td>through dividends; entity is not taxed, individual shareholder taxation only; limited</td>
</tr>
<tr>
<td>Social Welfare</td>
<td>Civic leagues and organizations operating exclusively to promote social welfare</td>
<td>General partnership</td>
<td>Partners own partnership interests and realize profit through distributions; entity is</td>
</tr>
<tr>
<td>organizations</td>
<td>pursuant to IRC section 501(c)(4)</td>
<td></td>
<td>not taxed, individual partner taxation only; unlimited personal liability</td>
</tr>
<tr>
<td>Professional/Trade</td>
<td>Professional and trade organizations such as chambers of commerce, trade associations</td>
<td>Limited</td>
<td>Partnership is comprised of at least one general and one limited partner who realize</td>
</tr>
<tr>
<td>organizations</td>
<td>and professional sports leagues pursuant to IRC section 501(c)(6)</td>
<td>partnership</td>
<td>profit through distributions; entity is not taxed, individual shareholder taxation only;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>limited personal liability for limited partner only</td>
</tr>
<tr>
<td>Political organizations</td>
<td>Political parties; campaign committees for candidates for federal, state or local</td>
<td>Limited liability</td>
<td>Partners own partnership interests and realize profit through distributions; entity is</td>
</tr>
<tr>
<td></td>
<td>office; and political action committees pursuant to IRC section 527</td>
<td>liability</td>
<td>not taxed, individual partner taxation only; all partners have limited personal</td>
</tr>
<tr>
<td>Veterans organizations</td>
<td>Organizations that benefit veterans of the United States Armed Forces pursuant to</td>
<td>Limited Liability</td>
<td>Members own membership interests and realize profit through distributions; entity is</td>
</tr>
<tr>
<td></td>
<td>IRC 501(c)(19) and 501(c)(23)</td>
<td>Company (LLC)</td>
<td>not taxed, individual member taxation only; limited personal liability</td>
</tr>
<tr>
<td>Labor organizations</td>
<td>Labor, agricultural and horticultural organizations pursuant to IRC section 501(c)(5)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table I. Traditional choices of entity
This line of demarcation between non-profit and for-profit entities remained the status quo for many years. However, in recent years, for-profit entities have increasingly begun to incorporate social missions into their business models spawning the rise of social entrepreneurship. The increase in social entrepreneurship was largely due to the lack of fit for these types of businesses with traditional entity choices. Non-profit organizations failed to meet their needs because social entrepreneurs are, in fact, seeking a profit. For-profit entities were also not appropriate because there is at least some evidence that these entities are required to maximize profit on behalf of their owners. The perception was that owners of these traditional entities did not have the flexibility to consider the interests of other stakeholders such as the local community, society or the environment as a whole (Boatwright, 2017, p. 52). The professional belief of many in the legal community was that sacrificing profit to serve a socially responsible mission, or even a socially responsible initiative could subject the management of a company to potential litigation for breach of fiduciary duty (Boatwright, 2017, p. 61).

Many believe the solution is found in hybrid entities, which blend social objectives with the for-profit business model (Kelly, 2009; Kelley, 2014). Among these hybrid companies, the most popular are benefit corporations and low-profit limited liability companies (L3Cs). Other hybrid forms such as social purpose corporations and the newly created benefit LLC exist as well but have not experienced growth at the same rate as benefit corporations or L3Cs (Ho, 2015, Cooney et al., 2014). Hybrid entities were created specifically to address the needs of social entrepreneurs who not only want to pursue socially responsible missions but also seek to gain a profit without having to maximize said profit.

Hybrid entities are attractive to social entrepreneurs because they directly address double bottom line (social and financial) or triple bottom line (social, environmental and financial) business models. Of the two most common socially responsible hybrid entities, this paper will specifically focus on L3Cs.

**Features and characteristics of low-profit limited liability companies**

L3Cs are owned by members who desire to both realize a profit and create positive social impact. The entity type was specifically created to further social enterprise by creating an entity tailor-made to attract private foundation program-related investment dollars (Thompson, 2012, p. 141).

L3Cs are similar in structure to LLCs in that they feature pass-through taxation and limited personal liability for their owners (Bayona and Milani, 2011). Pass-through taxation occurs when the entity itself is not taxed, rather tax liability is passed through to the individual owners via their individual tax returns (Internal Revenue Service, 2013). Limited personal liability indicates that the personal liability of individual owners of the L3C is limited to their capital contribution in the business (Easterbrook and Fischel, 1985). The most salient feature of L3Cs, however, is that they are designed specifically to qualify as program-related investments (Mayer and Ganahl, 2014).

Program-related investments occur when a non-profit entity, typically a private foundation, makes an investment related to its mission. If IRS guidelines are carefully followed, this type of investment does not sacrifice the non-profit’s tax-exempt status (Internal Revenue Service, 2016a, 2016b). This attribute is particularly attractive to private foundations as they are required to disburse at least 5 per cent of their assets annually (Bishop, 2010). Instead of simply giving funds away as grants or through similar funding initiatives that do not provide a return on the investment, foundations are permitted to invest foundation funds, provided that said investment is “program-related”. The IRS defines program-related investments as those in which:
The primary purpose is to accomplish one or more of the foundation’s exempt purposes.
Production of income or appreciation of property is not a significant purpose.
Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose (Internal Revenue Service, 2016a, 2016b).

To be considered “program-related”, the investments must “significantly further the foundation’s exempt activities. Further, the investments are such that they would not have been made except for their relationship to the exempt purposes” (Internal Revenue Service, 2016a, 2016b).

The IRS provides examples of potential forms or program-related investments, including:
- Low-interest or interest-free loans to needy students.
- High-risk investments in non-profit low-income housing projects.
- Low-interest loans to small businesses owned by members of economically disadvantaged groups, where commercial funds at reasonable interest rates are not readily available.
- Investments in businesses in deteriorated urban areas under a plan to improve the economy of the area by providing employment or training for unemployed residents.
- Investments in non-profit organizations combating community deterioration (Internal Revenue Service, 2016a, 2016b).

The language of most L3C-enabling statutes mirror IRS regulations regarding program-related investments and as a result, each state with active L3C legislation requires an L3C to meet at least four conditions.

First, the entity must significantly further the accomplishment of one of more charitable or educational purposes as defined in Section 501(c)(3) of the Internal Revenue Code. Those include religious, charitable, scientific, literary or educational purposes; fostering national or international amateur sports competitions; or preventing cruelty to animals (Reinhart, 2011).

Second, the entity would not have been formed but for its relationship to the charitable or educational purpose. Specifically, no part of the business should operate independently of the charitable or educational purpose (Hopkins, 2014).

Third, no significant purpose of the company can be the production of income or the appreciation of property. While the entity is permitted to realize a profit according to this requirement, the language of most L3C statutes clearly indicate that profit-generation must be a secondary goal, subordinate to the organization’s charitable or educational purpose (Reiser, 2010).

Finally, the business must not be organized to accomplish any political or legislative purpose, including influencing legislation or taking part in a political campaign on behalf of a candidate.

L3C statutes are not merely “symbolic” of social impact. Entities who choose to avail themselves of this form must comply with these requirements to maintain their status as L3Cs. In all 8 states with active L3C legislation, there is at least some mechanism to address L3Cs who are not in compliance with statutory requirements (Richman, 2010). In fact, in Illinois, ME, WY, LA, Rhode Island, UT and Vermont, an L3C that is not compliant with statutory requirements is automatically converted to a traditional LLC.
and must change its name, articles of organization or both to reflect that change (Hopkins, 2014).

Wyoming is particularly strict about this requirement in that if the non-compliant L3C does not change its name within 30 days, the L3C is deemed to be transacting business without authority and is subject to penalties (Wyoming Statutes Annotated, 2009). Michigan, also one of the stricter L3C states, goes even further by allowing the attorney general to sue to dissolve an L3C that no longer meets statutory regulations should it fail to amend its articles within 60 days of noncompliance (Michigan Compiled Laws, 2009).

Criticisms of low-profit limited liability companies

While L3Cs have been touted as an ideal choice of entity for social enterprises by proponents, the form has been heavily criticized by many in the business and particularly the legal community. Opponents note several key faults within the form.

One of the criticisms of L3Cs as a form is that they are specifically identified as “low-profit” entities. The implication is that “high-profit” is prohibited. This is problematic for two reasons. First, both the title of the form and the language of enabling statutes indicate that the form is reserved for “low-profit” companies, which begs the question, what exactly is “low”? How much profit is too much? If social entrepreneurs don’t know how much profit is too much they are left to “guesstimate” and risk both violating the statute and potentially compromising the tax-exempt status of any private foundation making an investment in the L3C.

Second, this low-profit requirement excludes social enterprises that wish to maximize profit while simultaneously serving a social mission. It should be noted that social entrepreneurship is not synonymous with subpar profits (Bugg-Levine et al., 2012). The high-profit social enterprise model does, in fact exist. This is evident in several examples, such as TOMS shoes, which is estimated to have impacted over 51 million lives by providing shoes, clean water, vision services and safe births, all while realizing a significant estimated $400m in profit (Buchanan, 2016). The indication of a low-profit requirement is a critical distinction of L3Cs and possibly a deterrent when compared with benefit corporations, where maximized profit is not prohibited.

Additional criticism of the form lies in its nomenclature. Critics argue that the name, “L3C” is a misnomer. Designation as a “L3C” implies that the organization is committed to keeping profit low. This is technically inaccurate, however. There is no statutory cap in any state with L3C legislation on the amount of profit that may be obtained. As it stands, there is nothing legally preventing L3Cs from seeking and realizing a significant amount of profit. However, an investor looking to invest in a company that will generate a significant amount of profit might shy away from an L3C, having been misled by a name that indicates only a low level of profit will be gained.

One of the most widespread criticisms of the L3C concerns the assumption that they would automatically qualify as program-related investments. L3Cs were designed to be tailor-made program-related investments according to IRS guidelines. However, to date, the IRS has not made an official determination that L3Cs will qualify by default as valid PRIs (Mayer and Ganahl, 2014). Merely organizing as an L3C, therefore, does not guarantee that the entity will meet the IRS definition of a program-related investment. The implication is that entities and the private foundations that invest in them, must go through the process of having the IRS make a determination as to whether each individual L3C qualifies as a PRI on a case-by-case basis. This process is complicated, expensive and time-consuming (Pearce and Hopkins, 2014). Therefore, claims made by proponents of the L3C that the form is a “ready-made” or “out of the box” program-related investment do not ring true. The current
status quo runs counter to the entire point of L3Cs, which is to take the currently arduous and costly process of designation as a PRI, and simplify it with a ready-made form that meets IRS requirements.

There have been attempts to force the IRS to validate L3Cs as automatic PRIs, such as the Program-Related Investment Promotion Act (2008) and the Philanthropic Facilitation Act (2010) (reintroduced in 2011, 2013, 2015 and 2016). However, these efforts have gained little or no traction. While the IRS has provided several examples of investments that would qualify as program-related investments, they have officially declined to provide an example of using an L3C as a PRI (Pearce and Hopkins, 2014). The language of this refusal indicates that the IRS views L3Cs as the same as LLCs and other traditional for-profit entities (Internal Revenue Service, 2016a, 2016b). Consequently, until the IRS makes an official determination that an L3C is by definition a valid PRI, the primary purpose of the form seems to be defeated.

An additional criticism is that even if L3Cs do qualify as program-related investments, an investment in an L3C would need constant monitoring by the private foundation to ensure it remains in pursuit of its charitable or educational goals. Failure to abide by the original charitable goals could subject the private foundation to the severe IRS penalties that result from making a jeopardy investment (I.R.C. § 4944). These penalties include an initial excise tax of 10 per cent of the amount of the jeopardizing investment. The foundation manager may also be assessed an additional 10 per cent excise tax if the IRS determines that he/she has “knowingly, willfully and without reasonable cause participated in making the jeopardizing investment” (I.R.C. § 4944(1)(a)(2)). Should the private foundation fail to remove the investment from jeopardy within the applicable taxable period, an additional excise tax of 25 per cent is assessed to the foundation (I.R.C. § 4944(1)(a)(2)). This poses a significant risk for the investing foundation.

A further argument against L3Cs is that the dual missions of an L3C pose an inherent conflict within the organization (Tyler, 2010). The question that plagues all socially responsible companies, L3Cs being no exception, is, can you ever truly serve two masters? The L3C construct contains inherent conflicts of interest and confusion for an L3C manager. Because the L3C by definition has a twofold mission, social responsibility and profit, the potential end result is a constant tug-of-war that exists in the mind of the L3C manager when making decisions on behalf of the entity.

Even if one concedes that social responsibility is the primary mission of the L3C and the financial mission is subordinate, an organization having two missions is a situation that is ripe for conflict of interest. It is entirely possible that these two missions will not just compete but at times may cause a head-on collision of fiduciary duties. The profit-driven investors will at some point want to sacrifice the social mission to maximize or at least increase profits. Likewise, the socially motivated investors will at some point advocate for the sacrifice of at least some level of profit to further the company’s social mission. There will undoubtedly come a point when the manager is faced with a decision that requires her to sacrifice, at least in part, one mission for the other. It is a well-stated legal principle that the duty of an L3C manager is to generate profit and increase the value of the investment on behalf of investors. (Rushton, 2014). How can an L3C manager satisfy both types of interests without compromising fiduciary duties?

Furthermore, L3Cs are a relatively new choice of entity. Though they are the oldest of the new socially responsible hybrid entities, they have still only been in existence since 2008. Because the form is still in its infancy, it has not yet been tested in court. This means there is a great deal of uncertainty as to whether it will perform in the manner in which it was designed (Tyler, 2010). In theory, an L3C manager is protected from litigation in a situation
where he or she sacrifices profits to further the company’s charitable or educational goals, however, this has not yet been proven in court. Until a court of law rules that such a decision is not a breach of fiduciary duties, uncertainty will loom over L3Cs like a dark cloud. This uncertainty may be more of a risk than investors and managers are willing to take (Rushton, 2014).

An additional criticism of L3Cs is that not only can they do no more than LLCs, they actually do less. In fact, L3Cs are by definition, narrower in scope than LLCs. To comply with statutory requirements, an L3C may not change its mission to anything that falls outside of charitable or educational purposes. This is particularly true if the L3C wants to attract private foundations seeking a program-related investment (Kleinberger, 2010). This narrow mission and lack of flexibility in changing it could be a deterrent to potential investors. The counter argument, however, is that the narrow mission and inability to change it is actually a benefit. It prevents an entity from straying from its state mission or simply using the designation for branding purposes and essentially greenwashing. Increasingly common, greenwashing is defined as misleading consumers about firm environmental performance or the environmental benefits of a product or service (Delmas and Burbano, 2011).

A final criticism of L3Cs involves their classification by the Securities and Exchange Commission (SEC) as securities. L3C ownership interests may qualify as securities for purposes of federal securities regulations. The Securities Act (1933) defines a security as any “investment contract” (48 Stat. 74, 15 USAC. §§77(a)). The definition of investment contract was litigated in the landmark Supreme Court case, SEC v. Howey Co (1946) (328 USA 293), which established an investment contract as any contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party (398 USA 293, 298-99).

Under this rule, L3C membership interests are likely to be considered investment contracts. On its face, this is not problematic. However, in an entity with a complicated tranching structure, this determination could vary with each level of investors, making compliance with securities law both complicated and unpredictable.

The current state of low-profit limited liability companies
After being the first hybrid entity created for social entrepreneurs in 2008, the L3C enjoyed a short burst of popularity. Within just four years, legislation enabling the formation of L3Cs had been enacted in nine states, including Illinois, LA, ME, MI, North Carolina, VT and Wyoming.

However, the next several years began to show what appeared to be a decrease in L3C activity. Critics pointed to two primary factors as indicators of decline. First, there seemed to be an overall decline in legislative activity. Following the enactment of Rhode Island’s L3C law in 2012, there was a decrease in the number of states with enacted legislation as well as those with L3C legislation under consideration. At the same time, there was an increase in failed legislation across the USA (Figure 1).

The second factor touted by critics as a marker of decline for L3Cs occurred in 2014 with the repeal of previously enacted L3C legislation in the state of North Carolina (N.C. Gen. Stat. §§ 57D-2-01, 57D-2-21, 55D-20(a) (2013) as repealed by S.B. 439). The repeal came just four years after the legislation was passed in 2010. By 2014, however, the state felt that the form was no longer necessary nor useful. According to representatives from the North Carolina Bar Association joint task force responsible for drafting a new LLC act, the L3C was unnecessary and was removed to streamline the new LLC act (Field, 2014). Drafters of the new LLC act felt that the LLC form was sufficient to meet the needs of business owners in
the state based on the theory that anything that could be done with an L3C could also be accomplished using an LLC. Drafters even went so far as to refer to the L3C-enabling language as “deadwood” (Dana and Prosser, 2016).

This left critics and even proponents wondering if this was the first in a trend of repealed L3C and the beginning of the end of the L3C. This lead to a notable decrease in the discussion of L3Cs as a topic of interest. A review of literature demonstrates very few academic articles discussing L3Cs. Moreover, what little that has been written about L3Cs has been largely critical of the form. (Blair et al., 2015; Dana and Prosser, 2016; Pearce and Hopkins, 2014). The same can be said of L3C discourse in news outlets, trade journals, business publications and law firm bulletins.

Renewed hope for the low-profit limited liability company

In light of the widespread criticism and the alleged current decline of L3Cs, the overwhelming sentiment in the academic community is that the L3C should be done away with. However, this viewpoint overlooks one critical fact. The number of L3Cs is actually increasing. If the form is so flawed, why are businesses still using it? The answer is that there is still value in the form for many social enterprises. In fact, the number of L3Cs in the USA has increased steadily over the past 4 years. In 2013, there were over 850 L3Cs in existence (Pearce and Hopkins, 2014). By 2015, the number of L3Cs formed had grown to 1,187 (Dana and Prosser, 2016). By August 2017, the number had grown to 1,266.


![L3C Legislative Activity 2009-2017](image-url)
Furthermore, over the past two years, there has been an increase in both enacted legislation, with new laws in Missouri and Puerto Rico, as well as an increase in states with L3C legislation under consideration. This indicates that while L3Cs may have appeared to be declining from a political perspective, the fact is that they continue to be utilized by business owners across the USA.

Saving the low-profit limited liability company

There has been a great deal written about how flawed the L3C is, yet very little has been written about how to fix it. Critics have, for the most part, inappropriately written off the form as useless instead of providing useful solutions to improve the form. The author contends that the L3C is still a relevant and valuable choice of entity for social entrepreneurs. This is evident in the recent increase in L3C activity. However, for the form to truly flourish, there are several improvements that must be made to the L3C.

The author proposes that instead of eliminating L3Cs, I overhaul the form by implementing critical improvements. To survive as a credible choice of entity for social enterprises, L3Cs must:

- improve attractiveness to investors;
- clearly distinguish itself from LLCs;
- improve accountability measures; and
- be recognized by the IRS as a valid program-related investment.

One of the primary ways that L3Cs can be reinvigorated as a choice of entity is to improve its attractiveness to investors. Several key changes could be implemented to increase the attractiveness of L3Cs to investors. One viable tactic would be shifting focus to attracting "non-traditional" investors. Traditional investors may be more focused on high levels of profit, whereas there is a new era of investment that seeks a different type of return. While profit is still important to this class of investors, they also seek more than just profit. This expanded definition of return often involves positive social impact. Investment companies such as Good Capital are examples of this new class of investor. The L3C model is a perfect fit for this class of investors. Another method of improving attractiveness would be to incorporate crowdfunding models into L3Cs (Murray and Hwang, 2011). Another strong incentive for investors would be to provide tax incentives similar to those received by non-profit organizations. Regardless of the method, it is critical that L3Cs find a way to increase their attractiveness to investors.

Another critical need for L3Cs is the need to distinguish the form from LLCs. Often the argument that L3Cs are unnecessary lies in its similarities with LLCs. Therefore, L3Cs must be intentional about providing clarity regarding the unique characteristics of L3Cs in the language of enabling statutes. Legal scholars have suggested that one way to accomplish this is through free transferability of L3Cs interests. Freely transferable L3C interests would stand in contrast with LLC interests, the transferability of which is typically restricted by default. (Brewer, 2013).

In addition, L3Cs must improve accountability if they are to remain a viable choice of entity. As noted by critics, L3Cs are lacking accountability to both the public and to its investors. Unlike benefit corporations, an L3C has no requirement to publicly report its progress related to its charitable mission. There is therefore no way for the public to truly hold the company accountable. Further, if operating as designed, an L3C is often funded by
private foundations seeking a program-related investment. These foundations have a vested interest in ensuring that the company is meeting its charitable purpose, as not doing so compromises the foundation’s tax-exempt status. Therefore, L3C members, particularly those with tax-exempt status should be allowed (and possibly required) to bring a derivative suit based on breach of fiduciary duty against L3C managers who deviate from the company’s charitable purpose (Pearce and Hopkins, 2014; Murray and Hwang, 2011). This would provide accountability to investors as well as the public by ensuring strict adherence to the company’s charitable purpose.

Finally, the most critical need for L3Cs is recognition as a legitimate program-related investment by the IRS. This single change would significantly increase the effectiveness and therefore the popularity of L3Cs. There are two primary tactics that would accomplish this goal. The first is, passing legislation such as the Philanthropic Facilitation Act (2011, 2013, 2015) and the Rebuilding and Renewing Rural America Act (2016), both of which would clearly establish L3Cs as a valid program-related investment. While unsuccessful in the past, enacting these types of laws would effectively legislate L3Cs as a valid program-related investment. The other and arguably more preferable action needed to accomplish this goal is a clear determination of the part of the IRS that L3Cs are, by default, a recognized program-related investment. However, as critical as this may be for the ultimate success of L3Cs, it must be noted that based on past history, the IRS appears unwilling to definitively make this determination.

In conclusion, while there are have been many criticisms of L3Cs, there is still hope for this choice of entity. The L3C does in fact serve its purpose of allowing for-profit non-corporation entities to both realize a profit and pursue a social mission. The form is currently experiencing growth both in number of states with enabling legislation and an increasing amount of L3Cs currently in business. While the recommended improvements could certainly strengthen the form, there is no need to abandon the form. To the contrary, L3Cs remain a vital part of the social enterprise landscape.

References


Wyoming Statutes Annotated (2009), Wyoming Limited Liability Company Act, §17-29-705(e).

Further reading


Rhode Island General Laws (2012), §7-16-76.


About the author

Sonia J. Toson has been teaching in higher education at both the undergraduate and graduate level for over 10 years. She is an experienced Professor of Business Law, Business Ethics, Real Estate Law, Employment Law, Construction Law and Negotiations. She received both her Juris Doctorate and her Master of Business Administration from American University in Washington, DC. She is a Licensed Attorney in the State of Georgia. Before beginning a career in academia, she spent eight years in private practice specializing in Corporate, Real Estate and Construction Law while also serving as the Human Resources Partner for the firm. Her research interests include the intersection between the law and corporate social responsibility, social entrepreneurship and sustainability and the scholarship of teaching and learning legal studies. Sonia J. Toson can be contacted at: toson@kennesaw.edu

For instructions on how to order reprints of this article, please visit our website: www.emeraldgrouppublishing.com/licensing/reprints.htm
Or contact us for further details: permissions@emeraldinsight.com