Low-Profit Limited Liability Company (L3C) Information Session

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PROGRAM-RELATED INVESTMENTS (PRIs)

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PRIs: A Brief History

- Pre-1969: A foundation may invest its principal assets in any legal transaction, however risky, without jeopardizing its exempt status.
- Congress' Goal: Deter investment in speculative deals; encourage socially-beneficial investments in organizations that carry out charitable programs.
- Tax Reform Act of 1969: Adds section 4944, which penalizes "jeopardizing investments," but encourages program-related investments ("PRIs").

What is a PRI?
3 Requirements

1. Primary Exempt Purpose
   - Significantly furthers foundation's exempt purposes, and
   - Would not have been made but for its relationship to the accomplishment of such purposes
2. No Significant Investment Purpose
   - Profit-seekers would not make this investment
   - Below-market returns (0-4%)
   - But production of income/appreciation not determinative
3. No Prohibited Political or Legislative Purpose
   - No earmarking, and
   - Deductible business expense

Common PRIs

- Loans (80+%)
- Equity investments
- Loan guarantees
- Lines of credit
- Asset purchases
- Recoverable grants

Examples of PRIs

- Examples from the Regulations
  - Low-interest loans to needy students.
  - Equity investment or loans for low-income housing
  - Low-interest loans to disadvantaged business owners
  - Direct investment in businesses, non-profits and property in distressed neighborhoods.
  - Jobs creation
- Recent examples
  - Investment in a venture capital fund that supports businesses in low-income communities
  - Investment in a limited partnership organized to exploit technology developed by local universities and support new companies in an economically-depressed area
  - Investment in joint initiative with a for-profit internet/cable company to conduct high-tech polling and research, the results of which would be distributed for free over the internet, concerning the opinions of women on wide-ranging issues
  - Capital contributions to a for-profit fund structured as an LLC dedicated to angel investing in low-income communities, as well as providing educational programs and technical training

Advantages to PRIs

- Benefits Under Chapter 42
  - Not "jeopardizing investments"
  - Treated as "qualifying distributions"
  - Excluded when computing foundation's annual distribution requirement
  - Exempt from "excess business holdings" limitations
- Practical Benefits
  - May be repaid and/or generate a small return
  - Useful for funding large projects
  - Foster recipient entities' management capacity and creditworthiness

PRIs by Michigan Foundations

- Historically underutilized
  - *the Foundation Center's "2003 PRI Directory" lists 255 foundations that make PRIs*
  - *6 are located in Michigan*
- Primarily loans to charities
  - *few loans to for-profit organizations*
  - *few equity investments*

LOW-PROFIT LIMITED LIABILITY COMPANIES (L3Cs)

What is an L3C?

- Type of limited liability company (LLC)
  - *a flexible, for-profit, taxable business*
- Primary purpose is charitable
  - *profit is a secondary goal*
- Must satisfy PRI requirements
  - *designed to qualify as a recipient of PRIs*

Mechanics of the L3C
3-Tiered Investment Structure

- Junior Tier (highest risk/lowest return)
  - *PRIs*
- Senior Tier (market risk and return)
  - *mix of individual, exempt, and nonexempt investors*
- Mezzanine Tier (in-between)
  - *socially-motivated investors*

Michigan L3C Act (enacted 1/16/09)

M.C.L. § 450.4102(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."

Examples of a Michigan L^3Cs

- Mortgage assistance entity
- Relief mechanism for auto suppliers
- Other possibilities

Forming the L^3C

- Articles of Organization
  - *file with Department of Labor & Economic Growth*
  - *name, purpose, address, registered agent*
- Operating Agreement
  - *defines each member's rights, powers, entitlements*
  - *flexible document with certain required clauses*

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(Charitable) Purpose Clause

"To assist low and middle-income families facing mortgage-related financial difficulties due to loss of employment."

"To provide relief to distressed small and mid-sized automotive suppliers through assistance with alternative financing, consolidation, or business counseling."

Other Required Clauses

- Classes of Members
- Public Reporting
- Transfer of Interests
- Dissolution

QUESTIONS?