



The Family Foundation and the L3C

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The social sector is facing enormous challenges. Government support has dried up as staggering budgetary shortfalls divert federal and state resources toward basic services. The recession has taken its toll on philanthropy while philanthropic need is greater than it has been at any time since the Great Depression: The Chronicle of Philanthropy recently reported that charitable giving is down nine per cent this year. And the stock market's plunge has devastated endowments and the grants they fund.

In response, many charities are turning to earned-income strategies to help replace their lost revenue, and more and more social-purpose businesses are being organized every day. Social Enterprise Alliance, a public charity on whose board I sit, is collaborating with the Obama White House to foster private-sector solutions to drive positive social change and to ameliorate social problems.

Families of wealth are also giving serious thought to their role as agents of change. And an underutilized, 40-year-old economic opportunity to empower the family foundation is gaining new currency.

It's well known that, as a trade-off for the tax benefits they enjoy, foundations, including family foundations, are obliged to distribute five per cent of their assets every year for charitable purposes. That's what accounts for the feverish competition for grants in which charities engage.

What's less well known is that the same law, the Tax Reform Act of 1969, gives foundations an alternative. Rather than distributing grants totaling five per cent of assets annually, they may instead make "program-related investments," or "PRIs," of five per cent each year, or a combination of the two. PRIs can take the

form of interest-free or below-market loans, loan participations or guarantees, letters of credit, or even equity investments in for-profit businesses.

All things being equal, foundations would likely prefer to make investments, rather than grants, for the same reason any of us would favor an asset over an expense. When a foundation makes a grant, it does its due diligence, writes a check and hopes for the best. By contrast, an investment can be recovered with earnings and recycled for charitable purposes, again and again. It is this multiplier effect, more than anything else, which commends the PRI.

Yet PRIs have been tough to design, tough to implement and tough to monitor. And if a PRI fails to meet the technical legal requirements, both the foundation and its managers can be hit with an excise tax for jeopardizing the foundation's assets. For that reason, PRIs represent less than one per cent of qualifying distributions.

But all of that is changing. One notable foundation which is leading by example is the Bill & Melinda Gates Foundation. On October 8, 2009, the Foundation reported that ". . . it is] working with a range of partners to use PRIs to deepen the impact of. . . [its] work. . . [It] believe[s] that investments are the right instruments to use in situations in which. . . program strategies are best served by partnering with revenue-generating enterprises, such as NGOs, financial institutions or companies. These entities may not be able to access investment capital from the private markets because the markets or entities that serve the poor may be perceived as too risky or costly to serve, or investors don't have good information to assess the opportunities. By providing investment capital directly or by reducing risk to

investors, . . . [the Foundation] can help . . . [its] partners access the capital they need to grow and demonstrate to the market that financially viable opportunities exist that serve the needs of poor or otherwise disadvantaged persons.”

The “Low-profit Limited Liability Company” or “L3C” may embolden other foundations to invite social enterprises to leverage PRIs to access trillions of dollars of market-driven capital for a host of ventures with modest financial prospects, but the possibility of major social impact.

The L3C was signed into law in Vermont in April of last year. Since then, several other states have passed similar bills or are considering doing so.

The L3C is a special form of limited liability company whose articles of organization mirror the legal requirements for PRIs: (1) the entity must be organized for charitable purposes; (2) the production of income or the appreciation of capital can't be a significant purpose of the enterprise (although there is no cap on either); and (3) the entity may not influence legislation, or support or oppose a candidate for office. So a foundation can get comfortable with an

investment in an L3C, knowing that all the business can do is that which PRIs are authorized to fund.

Amendments to the Internal Revenue Code and Treasury Regulations are in the works but, even now, L3Cs are being organized all over the country as food banks, health clinics, museums, affordable housing ventures and other social enterprises. I have been proud to draft L3C bills in several states and help shepherd them through their legislatures; and to represent many foundations, social entrepreneurs and other stakeholders who already benefit from them.

Because foundations are patient investors which seek social returns more than financial returns, an L3C with only modest profits can skew economic benefits to private-sector investors who require reasonable returns at acceptable levels of risk. As a program-related investor, the family foundation can thus become a social venture capitalist and a catalytic philanthropist rolled into one.

The L3C may afford the family foundation a genuine opportunity to fully realize its promise.

Marc J. Lane, a nationally recognized attorney and financial advisor, is the Founder of Marc J. Lane Wealth Group (www.MarcLane.com). An innovator in helping social enterprises and social entrepreneurs leverage capital to maximize financial results while driving positive social change, he designed and teaches the Social Enterprise course at Northwestern University School of Law where he is an Adjunct Professor of Law. Marc is the pioneer behind the Advocacy Investing approach to mission-related investing (www.AdvocacyInvesting.com).



A Director of Social Enterprise Alliance, the national association of enterprising nonprofits and social-purpose businesses, he spearheaded the launch of its Chicago chapter, which he serves as President and a Director. And he is the force behind the Low-profit Limited Liability Company (L3) legislation in several states, authorizing the new hybrid business form which can leverage foundations' program-related investments to access trillions of dollars of market-driven capital for ventures with modest financial prospects, but the possibility of major social impact. Marc is the author of Profitable Socially Responsible Investing. An Institutional Investor's Guide, Euromoney Institutional Investor PLC, Advising Entrepreneurs: Dynamic Strategies for Financial Growth, John Wiley and Sons, Legal Handbook for Nonprofit Organizations, American Management Association, and Representing Corporate Officers and Directors, Aspen Publishing. His treatises Social Enterprise, American Bar Association, and Corporate Governance and Fiduciary Responsibilities: Representing Officers, Directors, Managers, and Trustees, Aspen Publishing, will be published in 2010.

FOA Newsletter Guest Columnist

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