The L³C A to Z

The L³C Legal Structure;  
A For-profit LLC With A Non-Profit Purpose

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by

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I. INTRODUCTION*

Our clients make charitable gifts for a variety of reasons and to, or for, a variety of causes. The form our clients’ philanthropy can take starts with simple outright gifts or pledges to their local church or synagogue, or their favorite public charity and often proceeds to more sophisticated charitable initiatives, such as split interest charitable trusts, sanctioned by the Internal Revenue Code and supporting regulations. For very wealthy families, these initiatives can include the formation and management of a private foundation, perhaps even coupled with sophisticated charitable split interest trust strategies. Regardless of the reason or the strategy, all these donors desire to make a difference in their community.

Increasingly, clients wish to use active, or what this author has come to call “hands on philanthropy” to bridge intergenerational family gaps and convey important values to their children and grandchildren. Conveniently, federal tax law provides significant incentives for those in the senior generation who are so inclined. These clients’ contributions, and their corresponding deductions under federal tax law, can be significant if properly structured and provide attractive gift and estate tax benefits. Assisting our client families with such planning strategies can help them achieve significant personal and estate planning goals, while at the same time leaving a strong and lasting benefit in their respective communities.

A goal of this outline is to teach the reader how to bridge the non-profit/for-profit gap with a special type of limited liability company known as a Low-profit Limited Liability Company (or the “L3C”). An L3C is a for-profit LLC, designed to comply with the Code’s Chapter 42 rules. In addition, another goal is to examine the judicious coupling of non-profit resources (from private foundations, commonly known as “program related investments” or “PRIs”) with for-profit investments in LLCs and L3Cs, in ways that greatly expand a client’s capability to have a significant philanthropic impact on his or her community.

By being able to identify these types of opportunities and learning to use these advanced charitable planning strategies for wealthy clients (many of whom are business owners and/or corporate executives, who oversee private foundations for their respective companies), it is this author’s hope that the reader will be able to multiply the positive impact of his or her clients’ philanthropic dollars (particularly in a difficult and unpredictable economy), while having a positive economic impact on their estates, businesses and the wealth they desire to preserve for younger generations. In addition, the family lawyer, estate planner and tax advisor who becomes familiar with the tax and psychological benefits, as well as the active philanthropic experience, that an advanced planning strategies like an L3C can provide, will be able to help expand the field of “social enterprise” investing or “social entrepreneurship”.

[Author’s Note: The author believes that it is important to define what he means when he is using the foregoing terms. Mr. Robert A. Wexler, in his excellent article, Effective Social Enterprise-A Menu of Legal Structures, in The Tax Organization Tax Review, Vol. 63, No. 6, June 2009, at p 565, points out “...there is no legal definition of social enterprise (or social entrepreneur), and there is not even a uniformly recognized non-legal definition. The Social Enterprise Alliance (http://www.se-alliance.org) defines social enterprise as ‘an organization or venture that achieves its primary social or environmental mission using business methods’. The Skoll Foundation (http://www.skollfoundation.org) defines social entrepreneur, as one who forms and leads a social enterprise, as ‘society’s change agent: a pioneer of innovations that benefit humanity’”. Id. Mr. Wexler streamlines the definition, identifying “a social enterprise as a businesslike activity that is designed, at least in part, to do good and not simply generate profits”, essentially identifying it as a socially motivated revenue generating activity. Id. As used in this outline, the terms social enterprise, social enterprise investing and social entrepreneurship will have the foregoing meanings].

This outline introduces the Low-profit, Limited Liability Company, or L3C and how it may be formed and used to expand social enterprise investing. It also examines the benefits and risks associated with this type of entity and what the critics have to say, as well as a response.

This outline also contains the following Exhibits:

Exhibit A- A pro forma draft of a Form 205, creating an L3C.
Exhibit B- A pro forma draft of a Company Agreement for an L3C.
Exhibit C- A compendium of authors and articles who have taken formal positions opposing the L3C
Exhibit D- Summary of the Private Foundation Excise Tax Rules.

In preparing this outline, the author has reviewed numerous excellent articles, treatises and sources on the L3C and related topics, as well as interviewed and consulted key individuals who are involved, and have been involved, with the charitable planning, PRIs and
L3C strategies from its inception in 2008. The key articles, treatises and sources consulted are cited in the bibliography. The author would particularly like to acknowledge the contributions and/or assistance of Elizabeth Minnigh, Mark J. Weinberg, Jeffrey D. Haskell, Kathleen Ford Bay and Robert Lang. Their assistance has been invaluable.

II. THE LOW-PROFIT LIMITED LIABILITY COMPANY (or “L3C”); EXPANDING “SOCIAL ENTERPRISE” INVESTING [Author’s Note: Combining non-profit, program related investments with for profit entities is not for the faint of heart, the uninformed or the ill advised. While the author’s bias is clearly toward finding creative ways to expand social enterprise investing to improve our communities, this Section is not presented as “the solution!” It is offered simply as another tool to seriously consider, in making our world a better place (see examples, discussed infra). In the final analysis, who is going to do it? Our neighbor? The government? Frankly, the ultimate success of the Low-profit Limited Liability Company will turn on several factors: (i) federal recognition of the structure and/or safe harbor provisions (see discussion of proposed federal legislation infra); (ii) the development of the L3C as a “brand name”, signaling to state and federal regulators (as well as to for-profit investors) that the entity holds PRI investments and can easily be identified for oversight (as opposed to a regular LLC); and (iii) for foundation managers and directors, the designation L3C will alert them to a structure that is specifically designed to hold PRI investments and has met minimum state and federal standards. While this will NOT eliminate the need for due diligence on the part of the foundation managers and directors, it should help stream line the process significantly by removing much of the complexity involved in making these types of investments, with the goal of making the world a better place to live. There are critics, as discussed (and responded to) in this Section. Some have points well taken, while others caution against a mass rush by do-it-yourself. For those who would embark on social enterprise investing, the author would simply refer them to the first sentence in this paragraph above.

A. What is it?

1. Introduction and Background

The Low-profit Limited Liability Company, or L3C, is yet the newest tool that has been developed in the effort to expand “social enterprise investing”. From this author’s perspective, the partnering of non-profits with LLCs has occurred, to a large degree, in the arena of community development and social enterprise, with the utilization of a financial institution’s Community Reinvestment Act (“CRA”) funds, in conjunction with a faith based organization’s community development initiatives. Such initiatives have included low-cost, affordable housing, day care facilities, senior centers and facilities housing “essential services” for low income residential areas typically affiliated with the faith based organization. The financial institution’s participation has taken a number of different forms, including low cost loans, tax credit financing and equity participation. When the financial organization has taken a “stakeholder” position, the partnering of for-profit, social enterprise dollars with these non-profit community development initiatives, weaving the two together has been tricky at best and fraught with tax and economic traps for the unwary.

The LLC as the entity of choice for partnering with a non-profit is difficult at best, and typically requires a non-profit to obtain a Private Letter Ruling (“PLR”) from the Internal Revenue Service (the “Service”) or a lengthy legal opinion; either or both can be a costly and time consuming process. As such, the corporate structure of the typical LLC, under state law, as a vehicle for social enterprise, is not always practical or adequate. This is true because this type of entity structure (organized for-profit and designed for the attraction of capital to be placed at risk) does not satisfactorily recognize the public (tax exempt) benefits that are the core of social enterprise (i.e., there is no sufficient, economic incentive to pursue social investing, which typically offers little or low-profit return on contributed capital). By contrast, the non-profit’s tax-exempt status provides very limited avenues to access capital, and a strong profit orientation may jeopardize its tax exempt status, as noted in the discussion of private foundation excise rules, in Exhibit D. While linking a for-profit LLC with a private foundation can be done, it requires (based on this author’s experience) significant due diligence, careful and precise restructuring of the LLC and careful, ongoing oversight, to assure program related investments are used for the intended charitable purposes. For those willing to dig beneath the surface, the Service and the Courts have provided significant, precedential guidance. “For those that have eyes, let them see!”

2. Necessity, the Mother of Invention

It is said that “necessity is the mother of invention” and the need created by this dilemma is no different. The Low-Profile Limited Liability Company is the result of an economist’s frustration, an economist who “inherited” the operation of a family foundation no one else wanted. His plan was to use the foundation’s
resources for social enterprise activities, but he very quickly found himself struggling with the constraints, restrictions and frustrations generated by the above dilemma. After consulting with tax advisors and attorneys, the practical solution was his development of the Low-Profit Limited Liability Company format, which he came to call the L3C. Working with these tax advisors and attorneys, turned colleagues, his efforts have lead to state legislation for the Low-Profit Limited Liability Company (or the “L3C”, as he has now branded it) that has been considered and/or adopted by numerous legislatures across the country (see Section C, below for a tracking reference, that follows and tracks state L3C Legislation.) [Author's Note: From personal interview 3-12-10 with Robert Lang (the above referenced economist), CEO of the Mary Elizabeth and Gordon B. Mannweiler Foundation].

3. Distinguished from a Traditional LLC

An LLC is a for-profit entity organized under state law, to engage in any legal purpose, typically as articulated in its Certificate of Formation or Articles of Organization. One such legal purpose may be socially beneficial activities. The traditional LLC provides a flexible ownership structure whereby different owners of a single company can receive different economic benefits. The Low-Profit Limited Liability Company, or L3C, takes the concept one step further. The L3C’s unique structure would encourage foundations to invest their program-related investments (or “PRIs”), in addition to or as an alternative to grants. This would be particularly true in the wake of a federal sanction and broad state acceptance of the L3C brand. The L3C can have different classes of investors—such as individuals, government agencies, nonprofits, and for-profits—with foundations or the other investors sharing different tranches of the risk, based on the particular project involved and the agreements made among the parties, subject however to the limitations proscribed by the rules of Chapter 42 of the Code and the regulations thereunder. Since a foundation’s PRI investment is a high risk proposition and generates a low return, it makes sense for the foundation to take an equity position in an L3C. This paradigm turns the normal venture capital model on its head. Theoretically, the L3C’s investment structure then could be designed to encourage new pools of funds, such as pension and endowment investments, to bear on problems normally treatable only by nonprofit dollars or government funded welfare programs. Structured in this way, the L3C could function as a hybrid legal structure combining the financial advantages of an LLC, with the social advantages of a private foundation. An L3C runs like a regular business and can make a profit. It does so, however, not without complex tax and financial issues to overcome, and certainly not without its critics, as will be observed later in this outline.

4. L3Cs: Bridging the Gap between the For-Profit and Non-profit Sectors

The L3C, as noted, is a form of LLC and possesses many characteristics of a typical LLC. Like a traditional LLC, the L3C can make a profit and is organized as a for-profit entity. Like a traditional LLC, the L3C offers a flexible ownership structure, wherein each member’s management responsibility and financial stake may vary according to individual needs and agreements of the parties. [Author’s Note and Observation: Conceivably it could even be structured using a “series” LLC (first originating in Delaware and now recently adopted in Texas). In addition, L3Cs can be organized in Utah or Illinois and registered in Texas as foreign L3Cs. There are still many unanswered questions about series LLCs (whether organized as a regular LLC or an L3C). Caution, however, would dictate that the new series LLC in Texas be thoroughly “road tested” before organizing it to also accommodate L3C type purposes]. Like a traditional LLC, the L3C’s members enjoy limited liability for the actions and debts of the company. And, like a traditional LLC, the L3C is classified, for the most part, as a “pass-through entity” for federal tax purposes. However, there is one important distinction between the L3C and the LLC. Although both are for-profit entities, the primary purpose of the L3C is not to earn a profit, but to achieve a socially beneficial objective (like a private foundation), with profit a secondary goal, and is structured to comply with the Code’s rules set out in Chapter 42, whereas a traditional LLC is typically organized and operated for any lawful business purpose, with profit as its primary objective. The L3C thus occupies a special niche between the for-profit and charitable sectors.

B. What are the Technical Requirements?

1. The Origins of the L3C

The L3C is a creature of statute, formed under state law, where a state has adopted a specific L3C statute. [Author’s Note: It should be noted, however, that an L3C can be formed in any state that has adopted L3C legislation and then admitted to a state that has not adopted such legislation. In this sense, the L3C is legal in every state. As to what L3C jurisdiction is most suitable, this decision will be up to the principal stake holders and their advisors. In states where no specific L3C statute exists, it is legally possible to form a Low-profit Limited Liability Company under such a state’s LLC rules, since in most every jurisdiction an LLC can be formed for “any legal purpose”. For any one of a number of reasons, the stakeholders may choose this
option as a workable “Work-around”. The obvious drawback is the loss of branding as an L3C. This is true because all state LLC statutes require that an LLC formed under that state’s rules must carry LLC or Limited Liability Company in the name designation. For example, a Low-profit Limited Liability Company can be formed under Texas law, which does not have L3C enabling legislation. Under the Texas Business Organizations Code (“TBOC”), it is without question that a Texas limited liability company is a domestic filing entity, governed as such under Title 3, of the TBOC (see TBOC Sec. 1.002. Definitions). Moreover, TBOC Sec. 2.001, General Scope of Permissible Purposes, provides an LLC, as “[a] domestic entity [that] has any lawful purpose or purposes, unless otherwise provided by this code”. Finally, under TBOC Sec. 2.003. General Prohibited Purposes, there is no prohibition against adopting a provision that requires the entity to be a “low-profit” entity. Accordingly, it is this author’s opinion that whether or not Texas adopts specific state law L3C provisions, there is no prohibition against the organization of a regular LLC, under Texas law, that is a Low-profit Limited Liability Company, and virtually identical to an L3C organized in another jurisdiction (as to its purpose) under specifically adopted L3C statutes in that state. As noted, however, the downside is that such an entity cannot bear the brand “L3C”. Notwithstanding, the examples in the Certificate of Formation – Exhibit A – and in the sample Company Agreement – Exhibit B – are precisely the same type terms and provisions that would be required in similar organizational documents for an L3C organized under a state that has adopted L3C legislation.

The L3C legislation originated in Vermont, in April of 2008. Since then, a number of other states have adopted and/or considered similar legislation (see Section C., below). The primary purpose of an L3C, under a typical state statute (Vermont’s, for example), must be for “charitable or educational purposes”. Wealth accumulation cannot be “a significant purpose”; however, it is not a violation of most state statutory rules for an L3C to have even “significant income.” Strictly speaking, a Low-profit Limited Liability Company is a limited liability company that, pursuant to state statute (in those states that have adopted formal L3C statutes), has included in its Certificate of Formation or Articles of Organization a very specific set of purposes. See for example the purposes set out in Vermont’s statute (at the following URL: http://www.leg.state.vt.us/docs/legdoc.cfm?url=/docs/2008/acts/ACT106.HTM), which has become the model for all state statutes adopting the L3C format. Accordingly, an entity will be a Low-Profit Limited Liability Company, or L3C, if its formation document contains a purpose that states that the entity will meet, and will at all times conduct its activities to meet, all of the following requirements:

a. Formed for Exempt Purposes

The limited liability company significantly furthers the accomplishment of one or more exempt purposes described in I.R.C. §170(c)(2)(B) and would not have been formed except to accomplish those charitable or educational purposes.

b. Income and Appreciation is not a Significant Purpose

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.

c. Not formed for Political or Legislative Purposes

The purposes of the limited liability company do not include accomplishing one or more political or legislative purposes described in I.R.C. §170(c)(2)(D). (see the pro forma Certificate of Formation at Exhibit A, for an LLC organized as a Low-profit Limited Liability Company under the TBOC). Note that the above language, in (a) through (c), comes directly out of the U.S. Treasury regulations defining the principal characteristics of program-related investments (see Treas. Regs. §53.4944-3(a)(1)(i), (ii) and (iii)).

2. Other than its Specific Purpose; Similar to other State-law LLCs

Except for the requirement that an L3C meet the foregoing statutory requirements, the L3C is similar to any other state law-formed limited liability company. It has members (owners), can be managed by the members or by one or more managers, and can have multiple classes of members. An L3C, therefore, is simply a limited liability company organized for a purpose that is aligned with the “program-related investment” Regulations. In all other respects it is governed by the state statutes under which it is organized. There is no special tax status associated with the L3C. An L3C is a taxable entity which can elect pass-through or corporate tax treatment by using IRS Form 8832. And, while the L3C does not have any special tax status, it signals to prospective charitable investors that the purposes for which the L3C were formed are consistent with the PRI regulations. Because the typical L3C statute is simply a modification to a state’s overall Limited Liability Company statute or act, the tremendous flexibility that is available to a limited liability company under such provisions is also...
available when forming an L3C (see generally the pro forma Company Agreement, at Exhibit B).

A note of caution, however. Simply “saying it’s so, don’t make it so.” While having a tool that is precision built for a very specific job is an immense help (and saves cost, since the traditional LLC format, under state law would need to be carefully reworked or custom drafted from the inception and still might require an IRS ruling), the tool still needs to be carefully used for the job for which it was intended, to achieve the desired result. Stated simply, the private foundation governing personnel cannot simply invest its PRI dollars in the L3C and await the results, like a limited partner in a business limited partnership. The investment of PRI dollars will require careful due diligence from the beginning, by the foundation managers and directors and ongoing oversight to assure the private foundation’s funds are invested and deployed in accordance with its charitable purposes. [Author’s Note: Based on the author’s experience, this would suggest an L3C governance structure which includes personnel representing both the foundation’s management as well the for-profit members and their stake in the venture (see proposed management structure at Section III, paragraph (1) in the pro forma Company Agreement in Exhibit B)].

C. Where has L3C Legislation been Enacted or Proposed?

1. Enacted Legislation
   Some eight or so jurisdictions have enacted L3C legislation; including (in alphabetical order) the Crow Indian Nation, Illinois, Louisiana, Maine Michigan, North Carolina, Oglala Sioux Tribe, Utah, Vermont, and Wyoming.

2. Proposed Legislation
   Some ten or so states have proposed L3C legislation pending, including (in alphabetical order); Arkansas, Colorado, Kentucky, Maryland, Missouri, New York, North Carolina, North Dakota, Oregon, and Virginia.

3. States under consideration
   Draft Bills (at the time this outline was being prepared) are currently being considered for introduction in the following jurisdictions: California, Florida, Georgia, Massachusetts, Nebraska, Ohio, Texas, Washington and Wisconsin.

4. Proposed Federal Legislation
   Federal legislation has been drafted for introduction in Congress, later in 2011, to help clarify some of the questions related to state L3C legislation and Program Related Investments. The purpose of this legislation would be to make it easier for private foundations to partner with for-profit investors and expand the reach of their PRI dollars and charitable purposes. See detailed discussion in Section D. 1. c. below.

D. Why were the L3C Statutes enacted?

1. Overcoming Historical Roadblocks
   The L3C statutes were apparently enacted to spur investments by private foundations into for-profit ventures. Historically, there were two roadblocks to such ventures:

   a. A For-Profit’s Goal of Maximizing Wealth for Stakeholders
      Those managing the affairs of for-profit entities have fiduciary duties requiring the maximization of wealth for the business owners. If the manager neglects this duty and instead seeks charitable or educational purposes over wealth accumulation, it can lead to disputes over the direction of the company and possible lawsuits.

   b. A Private Foundation’s Limitation to Program Related Investments
      The IRS requires private foundations to avoid investments which have substantial risk, unless the investment is considered a “program-related investment” (a “PRI”). The IRS has defined PRIs as investments in which: (i) the primary purpose is to accomplish one or more goals of the foundation’s exempt purpose; (ii) the production of income or appreciation of property is not a significant purpose; and (c) influencing legislation or taking part in political campaigns is not a purpose (hence the purpose structure developed for an L3C under the foregoing state statutes). Previously, private foundations were hesitant to make PRI investments because the only way it could be sure that the investment was qualified as a PRI; was to seek a private letter ruling from the Internal Revenue Service. These rulings cost money and take a significant amount of time to obtain.

   c. The Philanthropic Facilitation Act; a Federal solution?
      Since any IRS ruling on the L3C, as it relates to Program Related Investments, is limited to the “facts and circumstances” of a specific investment, and is controlling only as to the entity that requested it, such published private letter rulings provide little more guidance than the existing private letter rulings authorizing program related investments in regular LLCs. As a response to this quandary, a draft proposal for federal legislation has been prepared, entitled the Philanthropic Facilitation Act, for introduction into Congress sometime later this year. If enacted, it will provide a more streamlined process for the approval of
PRI exceptions more efficiently, thereby opening up additional capital for investment in economically-distressed industries or community based needs. (Private foundations give away an estimated $40 billion annually. See Pablo Eisenberg, What’s Wrong With Charitable Giving—and How to Fix It, Wall Street Journal, November 9, 2009, available at http://online.wsj.com).

d. Why Federal Legislation may be needed to dislodge Program Related Investments and clarify their use with L3Cs

I.R.C. §4944 imposes an excise tax on private foundations for engaging in high-risk investments (i.e., "jeopardy investments", see Paragraph E, in Exhibit D), unless such investments further the foundation's exempt purposes, i.e., PRIs. Note that PRIs qualify as qualifying distributions under I.R.C. §4942; however, unlike a grant, the foundation has the potential to receive a return on its distribution, and then redistribute such funds in support of other charitable activities. Traditionally, PRIs have been structured as interest-free or below-market loans, loan participations or guarantees, letters of credit and equity investments, as the author noted at the beginning of Part III of this outline. Favorable tax treatment of L3Cs, however, would make them attractive to private foundations.

A survey of more than 72,000 private foundations in 2006 showed that private foundations collectively made qualifying distributions in the aggregate amount of $43 billion; however, PRIs accounted for less than 1% of these qualifying distributions, despite being a strong tool to advance charitable purposes (see The Private Foundation Center, Aggregate Data by Private Foundation Type, 2006 [released 2008], available at http://privatefoundationcenter.org). Currently, there is no process to confirm that a private foundation's proposed investment will comply, both initially and over time, with the PRI regulations under Treas. Reg. §53.4944-3(a). Additionally, there is no uniform standard for form ing entities to serve as recipients of PRIs. [Author’s Note: The transactional costs related to the above factors provided a huge stumbling block to many of the transactions the author has worked on]. Traditionally, many private foundations have refrained from investing in for-profit ventures due to the uncertainty of whether a specific investment would qualify as a PRI or because of the cost, time and resources to acquire a legal opinion from counsel or a private letter ruling from the IRS to verify that the particular venture is a valid PRI. Both create formidable blocks to the flow of PRIs for social enterprise investing, in an economy that is desperate for relief and weary of government “bailouts” at the expense of already overburdened taxpayers.

2. Can the L3C Overcome these Roadblocks?

The L3C format attempts to address each of these concerns (i.e., a for-profit’s goal of maximizing wealth and the foundation’s limitation to program related investments). First, as to the for-profit entity, the L3C statutes that have been enacted specifically provide that production of income is not the primary purpose of the entity. This provides its managers with the right to promote charitable or educational purposes. If the L3C ceases to operate according to its purposes, it terminates, by operation of law, unless it converts to a traditional LLC within 60 days. Secondly, for the private foundation, the typical L3C statute is intended to give the foundation peace of mind that the L3C is designed and structured so that it will meet the definition of a PRI. A typical statute’s language authorizes the creation of an entity which, in accordance with the terms of the statute, mimics the IRS’ requirements for a PRI. This structure then provides the incentive for private foundations to invest in for-profit ventures that coincide with its charitable purposes. This will be particularly true when this format has a federal sanction.

E. The interface between the L3C and the Private Foundation; The benefits and risks (responding to the Critics)

1. What the Critics Say

To be fair, the L3C does have it critics. The author has attempted to gather, as far as possible, a compendium of commentators who are critical of the proposed L3C format and has listed, in Exhibit C, the predominant commentators, in alphabetical order, together with URLs or citations to their articles and/or comments, so that readers may pursue these sources in more depth. The points they raise are valid and include the types of criticisms one might anticipate (especially when a “new kid” moves into an “established”
neighbouhood). The author has enumerated below what appears to be the most critical views, ascertained from a review of this literature, and the author's responses to them. Those opposed to the L3C format, assert that the proponents believe that:

**Assertion-L3Cs make PRIs simple.** The L3C format complies with the IRS promulgated Program Investment Rules, simply allowing the private foundation to make its investment in a qualifying business enterprise (see Kleinberger and Callison paper; March 2010).

**Response**-This assertion suggests that the private foundation making such an investment in an L3C is akin to a limited partner who simply makes an investment in a limited partnership because it appears to be a “good investment” and then walks away, to await its (hopefully) favorable and positive return for depositing its funds into “the deal”. Private foundations are first and foremost creatures of statute, created under state law. Most state statutes authorizing the creation of non-profit corporations impose certain standards of care on foundation managers and directors. Texas is no different. The Texas Business Organizations Code requires a director of a nonprofit corporation to discharge the director’s duties “in good faith, with ordinary care, and in a manner the manager/director reasonably believes to be in the best interest of the corporation.” TBOC, Sec. 22.221(a). Additionally, federal tax law does not relieve a corporation to discharge the director’s duties “in good faith, with ordinary care, and in a manner the manager/director reasonably believes to be in the best interest of the corporation.”

It should be observed at this point, that the IRS has already approved LLCs for many years and since an L3C is merely another form of LLC, any IRS statement, a priori, would merely be on whether investments in a particular L3C qualify as a PRI (see Marcus Owens, “Response to June 2009 Remarks of IRSTE/GE Advisor Ronald Schultz on Low-Profit LLC Investment,” BNA Daily Tax Rep. (June 13, 2009)).

Private foundations are required to pay out annually at least five percent (5%) of their assets as grants to charities, or face an excise tax on the amount that remains undistributed. However, through PRIs, they could make investments in for-profit or nonprofit ventures. Through the exemption for PRIs from the jeopardy investment rules under I.R.C. §4944(c) (see discussion at Paragraph E, in Exhibit D), a private foundation can make an investment in a for-profit entity without incurring excise tax if: (i) a return on investment is not a significant purpose of the investment; and (ii) it will not jeopardize the carrying out of the private foundation’s exempt purposes. Additionally, if the investment qualifies as a PRI, then it will also be a qualifying distribution under I.R.C. §4942 (see I.R.C. §§4940 and 4944).

Qualifying the L3C as a PRI is a prerequisite to any benefits for a private foundation invested (making a “qualifying distribution”) in an L3C. PRIs include, without limitation, financing methods commonly associated with banks or other private investors, such as loans, loan guarantees, linked deposits, even equity investments in charitable organizations or in commercial ventures for charitable purposes, or other investments that will further the foundation’s charitable and philanthropic purposes.

It should be observed at this point, that the IRS has already approved LLCs for many years and since an L3C is merely another form of LLC, any IRS statement, a priori, would merely be on whether investments in a particular L3C qualify as a PRI (see Marcus Owens, “Response to June 2009 Remarks of IRSTE/GE Advisor Ronald Schultz on Low-Profit LLC Investment,” BNA Daily Tax Rep. (June 13, 2009)).

In addition, the author discussed this issue at length with Mr. Owens, in a conversation on February 24, 2010.
Mr. Owens observed that “even if the IRS rules that L3Cs are not per se PRIs, it seems obvious that an individual L3C could still qualify on a “facts-and-circumstances basis.”

**Assertion-The L3C structure will create a vehicle for “Private Inurement”.** The private foundation can make high-risk, low return investments, allowing the for-profit investors to make low-risk, high return investments (see the Bishop paper; February 2010 and the Kleinberger and Callison paper; March 2010).

**Response.** Under I.R.C. §501(c)(3) and Treas. Reg. §1.501(c)(3)-1(c)(2), no part of foundation’s net earnings may inure to the benefit of any private shareholder or individual. While the critics rightly raise the private inurement concern, it is of no more a concern for an L3C than it would be for an LLC or other for-profit entity that a private foundation might consider making an investment in. As noted above, a foundation’s investment in an L3C is subject to the same oversight mechanisms as other entities (including traditional LLCs and corporations). Once the PRI has been made, the foundation is required to exercise "expenditure responsibility" (due diligence) over the investment. This includes obtaining annual financial reports from the PRI recipient, which account for the foundation’s investment, and a statement that the PRI recipient complied with all appropriate regulations, which would include private inurement risks.

In addition, most L3C statutes provide that if there were a change of circumstances whereby an L3C began to serve an illegal purpose or the private purpose of its managers, such entity would cease, under the terms of the state's L3C statute, to qualify as an L3C and cease, by operation of the federal tax law, to qualify as a PRI (see Section VII, paragraph (1) of the pro forma Company Agreement, in Exhibit B). In addition, it is important to remember that any foundation or charity investment in an L3C or other PRI is still governed by the restrictions in I.R.C. §4941, addressing self-dealing, and in I.R.C. §4958, addressing excess benefit transactions.

The suggestion has also been made that, to avoid such a situation (i.e., the private foundation making high-risk, low return investments and allowing the for-profit investors to make low-risk, high return investments), why not limit the L3C’s participation to nonprofits or entities that are willing to accept a lower rate of financial return in exchange for accomplishing important socially beneficial purposes (i.e., not encouraging foundations to begin their PRI efforts with capital-intensive, high risk joint ventures with for-profit partners, but take a more conservative approach and raise less potential for abuse) (posed by National Association of State Charity Regulators ("NASCO") in a Letter Dated March 19, 2009 to Mr. Marcus Owens. Mr. Owens’ response to the questions posed in the letter is included in Mr. Owens’ response to Mr. Ronald J. Schultz’s summary of his remarks to the American Institute of Certified Public Accountants ("AICPA"), in the July 6 edition of the Bureau of National Affairs’ Daily Tax Report, [regarding the "ambiguities [and] ... unresolved tax questions" associated with the low-profit limited liability company ("L3C")]. Mr. Schultz is Senior Technical Advisor, Tax Exempt and Government Entities Division of the Service (see Marcus Owens, “Response to June 2009 Remarks of IRSTE/GE Advisor Ronald Schultz, on Low-Profit LLC Investment,” BNA Daily Tax Rep. (June 13, 2009)). When describing approved PRIs, the examples in the regulations use phrases such as:

- "conventional sources of funds are unwilling or unable to provide funds..." Treas. Reg. §53.4944-3(b), Example (1);
- "conventional sources of funds are unwilling to provide funds ...at reasonable rates..." Treas. Reg. §53.4944-3(b), Example (3);
- "conventional sources of funds are unwilling or unable to provide funds...at reasonable rates..." Treas. Reg. §53.4944-3(b), Example (4);
- "Y, a private foundation, makes a loan to X [a business enterprise] at an interest rate below the market rate for commercial loans of comparable risk." Treas. Reg. §53.49443(b), Example (4);
- "Y, a private foundation, makes a high-risk investment in low-income housing..." Treas. Reg. §53.4944-3(b), Example (10)."

In fact, all of the examples of approved PRIs in the Treasury Regulations involve risk levels that are unacceptable to normal financial investors, and all of the examples involve highly capital intensive projects such as the construction of manufacturing plants and low-income housing. By recommending a restriction on the long-standing rules for PRIs, which were intended to facilitate joint investments by foundations and commercial interests in a way that accomplished charitable purposes, this suggestion proposes a dramatic
retrenchment of policy decisions made by Congress in 1969 to encourage foundations to use socially-beneficial investments as one of the tools for accomplishing charitable purposes (Marcus Owens, “Response to June 2009 Remarks of IRSTE/GE Advisor Ronald Schultz on Low-Profit LLC Investment,” Id.).

**Assertion-The L3C brand=PRI.** The L3C is nothing more than a brand name, suggesting easy comprehension and use of PRIs (see Kleinberger and Callison paper; March 2010).

**Response.** The L3C is not a PRI, however it is anticipated that most, if not virtually all, L3Cs will be structured to qualify as recipients of PRIs, with both taxable and tax-exempt ownership interests. Such organizations would, themselves, be taxable entities. In every version of the state L3C legislation that has been enacted, the definition of an L3C was carefully drafted to encompass the PRI requirements set out in the Treasury Regulations (see Part II, Section C., above). Also, as noted above, the fact that an entity is designated as an L3C does not relieve the foundation managers and directors of their state and federal due diligence requirements. The incorporation of the L3C concept into LLC statutes at the state level will provide a consistent legal structure for socially-beneficial enterprises and a means, through the "L3C" designation, for the public, regulators and grant-makers to identify them. Without such statutes in place, regulators would have no ability to identify such enterprises and determine whether or not they should register under state charitable solicitation rules or other regulatory regimes. In addition, by having a consistent statutory structure, transaction costs associated with the formation of L3Cs to receive PRIs will be greatly reduced.

2. **Benefits for the L3C**

The Limited Liability Company or LLC is a for-profit entity organized under state law. By being a defined entity, organized under state law, the L3C would usually minimize legal fees and organizational costs associated with a private foundation’s PRIs, as well as the time and expense of a PLR, assuming proper due diligence is conducted and an ongoing oversight mechanism is in place. It would allow the use of the more efficient free enterprise system unburdened by private foundation regulation.

3. **Benefits for the Private Foundation**

Qualifying the L3C as a PRI is a prerequisite to any benefits for a private foundation invested in an L3C; however, PRIs can be legally complex and expensive for private foundations to administer. Having a consistent statutory structure for this type of PRI investment permits the private foundation to invest in an L3C (a for-profit entity) with a socially beneficial purpose that is consistent with and furthers the private foundation’s charitable purposes. The L3C would have much lower transactional costs (thus allowing more dollars to go for socially beneficial purposes) and allow the foundation to satisfy its philanthropic mandate and possibly generate a return on its PRI dollars, while allowing the L3C to attract additional investors to the entity.

4. **Risks to the Private Foundation**

Unlike public charities, which are not subject to the tax on investment income, private foundations are subject to the excise taxes imposed by provisions of Chapter 42 of the Code, including the tax on the failure to distribute income under I.R.C. §4942, the tax on “jeopardy investments” under I.R.C. §4944 and a ten percent (10%) excise tax would be imposed on both the private foundations and its managers (I.R.C. §4944 may generally be viewed as a restatement of the state law duty of care imposed on directors, without being shielded from liability). Moreover, under I.R.C. §4942 if the investment were intended as a qualifying distribution then there could also be an excise tax of 30% on the amount distributed to the L3C. Even though state laws have been written to be compliant with PRI requirements, there is always a risk that the IRS will deem L3Cs not to comply with the Code’s PRI rules.

The IRS has publically cautioned against use of the L3C format until the Treasury Department and/or the IRS affirmatively recognizes that the L3C format will qualify as a PRI (“IRS Tax-Exempt Official Urges Caution for Groups Eyeing Low-Profit LLC Investment,” Daily Tax Rep. (BNA), No. 126, atG-3 (July 9, 2009)). To date, the IRS has not had the occasion to examine an L3C arrangement. As noted below, however, the Service has approved the use of LLCs in many private rulings but there are no “blanket” approvals. This is the impetus then for federal legislation. In preparation of this outline, the author became aware that there are presently numerous initiatives, by professional groups and individuals, lobbying the IRS for such recognition. At the time this outline was being prepared, the IRS has not formally recognized the L3C format. Accordingly, private foundations should not generally assume that an L3C will be considered a PRI by the IRS, even though L3Cs were created to minimize risk to both the for-profit entity and the private foundation. As a consequence, private foundations may be slow to make investments in L3Cs in an effort to “play it safe” and avoid being the subject of IRS challenges. If, for example, a foundation invests in an entity that does not qualify as a PRI, it could lead to punitive excise taxes, sanctions and/or fines against both the foundation and the foundation managers (see Exhibit D), or even the “death penalty”.

9
Private foundations are well-advised to closely evaluate each and every proposed L3C to make an informed judgment about whether it constitutes a PRI related to its charitable purpose. This point is not raised to deter the use of L3Cs, but simply to advise the for-profit entity that foundations may be hesitant and may need additional information to determine that a proposed L3C will be considered a PRI. This type of due diligence, from the author’s experience, would normally be required anyway, when considering partnering the private foundation’s PRI dollars with an LLC not characterized as an L3C. Stated simply, “look carefully (and sometimes twice and with some help) before you leap”.

So, private foundations interested in L3Cs may lessen the chance that the investment will be treated as a jeopardy investment by ensuring that the managers and directors: (i) have retained competent legal and tax counsel; (ii) have done their due diligence, such as reviewing the L3C’s organizational documents and business plan and determining that the L3C is fully compliant with any state law requirements and any investment by the foundation will not violate the self dealing and private benefit rules; and (iii) both the organizational documents and business plan clearly document that the investment into a particular L3C complies with Treas. Regs. §53.4944-3(a)(1)(i), §53.4944-3(a)(2)(iii) and §53.4944-3(a)(1)(ii).

5. Benefits to the For-Profit

Investment in an L3C by a for-profit entity may be attractive because the L3C operating agreement can be drafted to allow for layered interests, delivering returns according to the needs or agreements of the parties. Many philanthropic for-profits may be interested in being involved in charity work that may actually generate a profit for them. Private foundations will be taking on more financial risk in exchange for a high social return by furthering their own charitable purposes. Further, if private foundations invest early, their funding will attract more market-driven investments in the L3C.

6. Risks to the For-Profits by Investing in L3Cs

For many for-profit investors, it is their philanthropic intent that enables them to bear the potential risk of a low return. Additionally, to comply with their duties as directors, members or partners, such directors, members or partners should do due diligence on the L3C and keep a clear record of the reason for their decision to invest, especially where the company is publicly held. This will help demonstrate that the investors in the L3C have complied with their fiduciary responsibility when receiving and deploying a PRI investment.

F. When is an L3C indicated?

[Author’s Note: This section was adapted from an article by Tom Moody, Attorney at Downs, Rachlin & Martin PLLC, Burlington, Vermont; "The L3C – Facilitating Socially Beneficial Investing", Vermont Business Roundtable, Burlington, Vermont (July 2008)].

1. L3C as a Startup Company

The L3C is intended to allow private foundations to make investments without requiring a private letter ruling from the IRS, providing that the investment is a PRI. The L3C’s Articles of Organization and Operating or Company Agreement minimize the risk to foundations by specifically detailing the purposes for the L3C. A startup company could use this entity to its advantage in seeking funding from foundations. To do so, the startup company should create an L3C and work with a foundation willing to provide capital to the entity. An L3C, like any other limited liability company, can have different classes of owners. L3Cs are flexible and can be structured to allocate risks according to the parties’ goals. For example an L3C can be organized to move most of the risk of the entity to the foundation and away from the for-profit investors. The capital from the foundation could come in the form of a loan, a loan guaranty, an equity purchase, or another investment, so long as it significantly furthers the non-profit foundation’s purposes.

a. Two member L3C

One option would be to form an L3C with two owners. One owner would be a for-profit entity and the other owner would be a private foundation. The ownership rights between the two members could be allocated in any way agreeable to both parties and the two members could actually own different classes of the membership interests in the company and thus, by agreement, shift and/or vary the risk. The L3C would then pursue the charitable or educational purpose. If the venture is profitable, income would be distributed to the members as outlined in the company’s operating agreement. If the venture is unprofitable, it could be wound up and dissolved as any other limited liability company, without a negative effect on the private foundation.

b. L3C as private foundation subsidiary

Another option would be to form an L3C with only one member: the for-profit entity. The L3C would then receive a loan from the charitable foundation. The loan would provide for a reasonable rate of interest but the foundation would acknowledge that it is a risky venture and that it may not receive any returns whatsoever. The L3C would then seek to accomplish its charitable or educational purposes. If it is successful, the loan would
be repaid. If it is not successful, the loan would remain unpaid.

2. When the Private Foundation desires to expand its PRI and get a better return on its capital

Private foundations are constantly looking for ways to maximize the value of their contributions. They are less concerned about return on investment than with the accomplishment of the social and charitable programs they are funding. The L3C is a compelling model because the foundation’s contribution is likely to be part of a broader financing strategy designed to build and expand the L3C’s social mission. Recipients of program-related investments will be operating with a secondary purpose of generating income to repay debt and/or a return for investors. This is likely to lead to more business-minded management, and, ultimately, an organization that is financially self-sustaining.

3. When the Private Foundation desires better business operations and oversight

Another significant difference between a charitable gift and an investment in an L3C (in the form of a low interest loan or equity investment), is that, in the latter case, the foundation’s loan or equity investment creates an on-going relationship with the charitable organization. A foundation seeking some measure of influence over the activities of the charitable organization would be able to exercise such influence in a variety of ways, including having a representative on the board, providing periodic input on the organization’s operating plan, and/or retaining approval rights with respect to certain activities that are outside the normal course of the organization’s operations (see Section III, of the pro forma Company Agreement at Exhibit B).

4. When the Private Foundation desires to expand its Financial Resources

Perhaps the most compelling case for the use of L3Cs lies in the prospect that the foundation’s funding will help attract angel and venture capital investment, and even bank loans, on market terms. Used in this way, a foundation’s investment is not simply applied to operating expenses. Instead, the nonprofit foundation’s investment helps create an equity cushion enabling the L3C to bring in additional capital from more conventional lending and equity sources. In such instances, the foundation investment could be in the form of a subordinated loan or junior equity investment. Commercial lenders or venture investors would then come in on market terms. There are many possible capital structures that could be devised to accommodate differing levels of risk and differing levels of expected financial return.

The kind of outside capital that would be attracted to a low-profit company would in part be a function of the industry and possible exit scenarios. For example, a company doing R&D on a groundbreaking drug would be a candidate for venture investment – by virtue of the possibility of a significant liquidity event in the future. By contrast, a low-profit company in the recycling industry would more likely be a candidate for a below-market-rate loan from a foundation which is used to leverage commercial bank debt – because its revenue stream is likely to be from operations, not from a future sale of the entity.

G. What are the tax implications; How will L3Cs and their investors be taxed? [Author’s Note: This Section was adapted from Elizabeth C. Minnigh’s article, “Low-Profit Limited Liability Companies: An Unlikely Marriage of For-Profit Entities and Private Foundations Tax Management,” BNA/Tax Management Estates, Gifts, and Trusts Journal, 9/10/2009]

1. The L3C

Because the L3C is merely a new form of limited liability company it will be taxed in the same manner as a traditional LLC. An LLC is generally treated as a partnership for tax purposes either by default if it has two or more members or by checking the box on IRS Form 8832. Treas. Regs. §301.7701-3. Unlike a corporation, an LLC is not taxed as an entity in itself. Instead, all gains and losses of the LLC “pass-through” to the members, who pay income tax at their respective marginal rates. The L3C taxes as a partnership should file IRS Form 1065, U.S. Return of Partnership Income, with the IRS, unless the IRS issues a new form for the L3C.

2. Private Foundation Investors

Assuming the L3C qualifies as a PRI, the private foundation will pay no tax on any gains on the distribution from the L3C. The foundation will need to show its investments in the PRI on IRS Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation, filed with the IRS annually, and may also have to disclose it in state filings. If the L3C does not qualify as a PRI, then the private foundation may be liable for excise taxes (and potential interest and penalties) if the investment is deemed to be a jeopardy investment under I.R.C. §4944. The IRS treats any income derived from the PRI in the same manner as any investment considered to be money permanently removed from the private foundation’s endowment (such as a grant) and, therefore, if a private foundation receives its investment back that and any gain would have to be invested in another PRI or grant within one year of receipt. I.R.C. § 4940(C)(4)(D).
The L3C Legal Structure: A For-Profit LLC with a Non-Profit Purpose

3. For-Profit Investors
   Taxation of the for-profit entities investing in an L3C will depend on their format.
   
   a. Pass-through Entities
      LLCs, partnerships and S corporations each “pass-through” any gains and losses to their individual investors. An LLC or partnership must file IRS Form 1065, *U.S. Return of Partnership Income* with the IRS. S corporations must file IRS Form 1120S, *U.S. Income Tax Return for an S Corporation*.

   b. C Corporations
      A C corporation is subject to what is called an “entity level” tax, which means that the corporation pays taxes itself. As a general rule, graduated tax rates for C corporations range from fifteen percent (15%) to thirty-five percent (35%). C corporations must file IRS Form 1120, *U.S. Corporation Income Tax Return*. I.R.C. §11(b).

H. How it’s done

1. Formation
   While it is certainly feasible to convert an existing LLC to an L3C, because of the complexities of both state law conversion and federal tax law compliance, as well as the newness of the L3C, it is the author’s judgment that parties wishing to create an L3C should take a “create from scratch” approach, under the desired state law formation rules or, in states that do not specifically authorize L3Cs, organize one under the state’s limited liability company statutes and track the rules, in forming same, as they appear under legislation in a state that has specific L3C laws. As with any other LLC, Articles of Organization or a Certificate of Formation is filed with the Secretary of State’s office (see sample Certificate of Formation, in Exhibit A, for Texas, which does not presently recognize L3Cs). This should be a relatively straight forward process that most counsel are familiar with. Simply “click on” the Secretary of State’s website and download the corresponding formation certificate (in Texas that would be Form 205), follow the completion directions and forward to the Secretary of State’s office with the appropriate fee. Unless or until the Texas Legislature acts, however, attorneys and their clients should consider, as an option, doing a little “forum shopping” for a suitable jurisdiction, form the L3C there, with the assistance of local counsel, then get the entity admitted to do business in Texas. As one colleague pointed out, “it simply requires another lap around the block”.

2. Completing the Organization Process
   As with most other regular LLCs, this simply entails the preparation of a suitable Company or Operating Agreement (see the pro forma Company Agreement in Exhibit B), preparing organizational minutes as appropriate, issuing Member Certificates, obtaining a tax identification number and tax classification, and finally funding the L3C, in accordance with the agreed business plan.

3. Accounting and Tax Compliance Issues
   As with most other regular LLCs, the L3Cs classified as partnership will be required to file Form 1065, *U.S. Return of Partnership Income*, with the IRS, unless and until the IRS issues a new form for L3Cs. The proposed federal legislation would also require an information return for many L3Cs. The reporting and compliance audience, both internal and external, for an L3C is quite varied and needs to be carefully understood and taken into consideration when designing the entity’s accounting and reporting mechanism. Tranched capital structures, which work well in the L3C environment, need careful accounting and oversight. In addition to federal tax filing requirements, state nexus and registration are extremely important and can be costly to both the L3C and/or its members if not considered carefully. Certain states have additional filing and withholding requirements for non-resident partners. Foreign members of an L3C may also be subject to special provisions of federal tax law, i.e., a mandatory thirty percent (30%) withholding requirement for any distributions.

4. Ongoing Management and Maintenance
   As with most other regular LLCs, the managers will operate the L3C. The operating agreement is the entity’s controlling document and the accounting and reporting structure needs to appropriately monitor compliance with how the PRI is handled, how allocations are made and other provisions of that agreement. Managers must prioritize the exempt purpose of the L3C over the profit making purpose, or risk loss of L3C status. This reordering of priorities cannot be waived because state statutes mandate this order. For states that do not have a statute, like Texas, this ordering should be mandated, as part of the entity structure (see Section I, paragraph (5), in the pro forma Company Agreement in Exhibit B). Foundation investors should ensure that as members, their vote is required on matters fundamental to protecting their role and their PRI, such as converting the entity (see Section III, paragraph (13) of the pro forma Company Agreement in Exhibit B) or the ability to exit and withdraw their capital (see Section VI, paragraph (1) of the pro forma Company Agreement in Exhibit B).
5. Exit Strategies.

It is important to note, at this point, that when a foundation exits such an arrangement, an amount of money equal to the amount the foundation had originally invested, plus the amount of the gains received, would have to be invested in another PRI or grant within one year of receipt. Alternatively, depending on the structure of the company or operating agreement, the foundation’s investment could remain in the L3C (so long as the L3C continued to meet its mission requirements) and the foundation could continue to earn a return on its PRI. Assuming a successful venture and further assuming there is a defined exit date or event (i.e., after a stated period of time or upon the occurrence of a predetermined event [i.e., the sale of the project or venture, after certain benchmarks are reached]), such that the L3C is not designed to exist indefinitely, then the company or operating agreement could provide for a mandatory buy out by the non-foundation members, under the terms of the operating agreement (see Section VI, paragraph (3) of the pro forma Company Agreement, in Exhibit B). At that time, the for-profit members could either stay in L3C, if it continues to meet the requirements or convert to an LLC. The foundation then, would convert the PRI into a mission related investment, engage in another L3C arrangement or make grants consistent with its charitable purposes. Of course, not all exits are amicable and not all members, on the way out, are “happy campers”. For other types of exits (see same provisions of pro forma Company Agreement, noted above, at Exhibit B).

6. Examples: L3Cs being formed or successfully operating

Below are examples of L3Cs that are being formed or are underway and that have received, in the case of MOO Milk Co., positive media attention. The purpose of including this information here is to demonstrate, in the words of my colleague Thomas Baird, that these are “for real deals”. [Author’s Note: The information relating to these examples was developed from interviews and email exchanges with Robert Lang from April 30 through May 5, 2010. Mr. Lang is actively involved in a number of these projects. In other cases, information was garnered from a particular L3Cs website, as indicated].

a. In Formation

(1) The Endless Sky Project and the Montana Food Bank Network (Deer Lodge, MT)

The Montana Food Bank Network and their advisors (L3C Advisors, L3C) retained Community Wealth Ventures to develop a business plan for the Endless Sky Project and to structure it as an independent L3C, integrating both mission and revenue generation. Its business plan calls for the Company to provide food for the Montana Food Bank Network, while earning enough income (from both the sale of a branded line of fine quality, locally grown, healthy fresh foods and a similar quality but lower priced bulk line to the Montana State Prison and other state institutions) to be self sustaining. In accordance with its L3C purposes, Endless Sky, while carrying out its primary business, will maximize inclusion of socially beneficial services. It will create quality new employment opportunities for the local Deer Lodge, Montana community, new markets for Montana farmers, a variety of occupational training and work experiences for inmates from the Montana State Prison, and a broad range of opportunities for former prisoners. The facility also plans to incorporate environmentally progressive features and will attempt to reduce carbon output through new concepts in waste processing and power generation. And, as a for profit, it will be a tax payer.

(2) Endless Opportunities L3C (Deer Lodge, MT)

The Endless Sky facility, discussed above, is slated to be built as part of the Endless Opportunities L3C complex, to be developed on land leased from the state of Montana and located right outside the gate of the Montana State Prison in Deer Lodge, Montana. The goal is to expand upon the concept of the Endless Sky L3C’s food processing facility. Although the Endless Sky Project will help the small farmers of Montana, who are restricted by both kinds of crops and length of growing season, Endless Sky will be a year round operation with a wide variety of products. Endless Opportunities will include a state of the art greenhouse created by Home Town Farms. This facility will permit the sale by Endless Sky of a variety of products grown and packed fresh year round. It will also improve the ability of the Food Bank to deliver fresh vegetables and fruits to its clients year round. Another component of Endless Opportunities will be a biomass waste processing and energy generating facility that can utilize the waste and garbage from Endless Sky, the prison, its dairy and cattle farms, and the city. The plant will produce gas that will be used to power generators for electricity and heat for the greenhouses and buildings of the Endless Opportunities operation and the resulting compost will be sold to farmers and used in the greenhouses. Waste water may be used in additional greenhouses to grow special oil producing algae for biodiesel and flowers for the cut flower market. In addition, facilities for mobile slaughterhouses are being considered.

(3) Blue Earth Bistros L3C (Atlanta, GA)

Blue Earth Bistros L3C is a new concept in cafés for college campuses. Created to be pop up stores...
located in common areas and other convenient locations on college campuses, they will be served from a central kitchen in a region. The central kitchen will be staffed with individuals who are disadvantaged or challenged in some way and the bistros themselves will be connected to each other worldwide via special internet connections designed to facilitate better understanding among different cultures. This is a prototype for similar specialized café chains. Another possibility is the development of a chain of cafes to be built on military bases and staffed by disabled veterans.

(4) YouPharma L3C (San Diego, CA)
YouPharma L3C will engage in the discovery and development of novel therapeutics for global unmet medical needs, using the power of social responsibility. As such, YouPharma will not be competing with existing players, but rather addressing those healthcare needs not well served by the current marketplace and its participants. It will do so by creating a PRI fund for foundations and will invest in the high risk proof of concept stage of product development. It also intends to utilize the concept of crowd sourcing to help develop products.

(5) Home Town Farms L3C (San Diego CA)
Home Town Farms L3C is a new state of the art concept in indoor, organic, urban, drip hydroponic, farming especially designed to operate in facilities of all sizes to create high end food opportunities for disadvantaged areas and populations. It targets a zero waste, zero carbon footprint. One of its unique features is its ability to produce multiple crops of different types economically in a relatively small space of say, 150,000 sq ft. This will allow for an attached retail store, if desired, and neighborhood sales.

b. Currently Operating

(1) Maine's Own Organic Milk Company, L3C ("MOO Milk Co")
Maine's Own Organic Milk Company, L3C is selling organic milk under the MOO Milk brand. It is a collaboration among dairy farmers that was created with the help of state agricultural officials. The Maine Farm Bureau and the Maine Organic Farmers and Gardeners Association (MOFGA) helped to form the L3C. The company’s goal is to keep the member farms in business, by offering them a fair price for their milk by paying an advance price of $24/cwt. a week after they ship the milk, as the floor level payment. Farms will receive an additional payment the month following shipment after all expenses have been paid. The short-term goal is to have the two payments total $30/cwt, with a long-term goal of increasing it to $40/cwt. In all, ninety percent (90%) of the company profits will go directly to the farms as payment for their milk. The remaining ten percent (10%) will be retained for expansion, maintenance, and balancing cash flow.

The structure of the Company is what will make this possible. The farmers are part owners of the company – and thus owners of the milk from the time it is produced until the time the consumer buys the product. The farms will self-balance, and will be responsible for returns of unsold product through reductions in the company’s profits. The farms collectively own forty-five percent (45%) of the voting units of the company and elect three of the seven board members. An additional forty-five percent (45%) will be owned by investors now being sought, to provide half-a-million-dollars ($500,000) in working capital. Farm Bureau and MOFGA will each own one half of one percent (.5%). Four percent (4%) will be owned by a three-person team – all Farm Bureau members – who formulated and executed the development plan, and the last five percent (5%) is being withheld for future employee performance incentives.

What makes this project different is that the ten (10) farms involved are working together in all aspects of the company management. In MOO Milk Co’s case, the goal is to provide a stable and profitable market for the individual farms, with the company maintaining only a fraction of the profits. The goal is to use the company to make the farms profitable. That means Farm Bureau and MOFGA will see little, if any, return on their half-percent (.5%) ownership shares in the company, but will see some Farm Bureau/MOFGA members stay in business and profit in their own right.

The milk is trucked from the farms by Schoppee Milk Transport to Smiling Hill Farm, in Westbrook, Maine, where it is processed on an organic production line that has been installed. It is packaged in half-gallon paper cartons under the MOO Milk Co’s own label, which includes the use of Farm Bureau’s “Maine Producers” logo. The milk is homogenized and pasteurized and sold in retail grocery stores in Maine and New Hampshire. It is also available in whole, two percent, one percent and skim. Cream, half & half, butter, yogurt, ice cream and other products may become part of the mix in the coming years. These byproducts will be organically certified and sold into the wholesale market. Oakhurst Dairy and Crown O’ Maine Organic Cooperative are distributing the milk. Hannaford, Associated Growers and a number of natural food stores are already stocking it, and sales negotiations are in process with Shaw’s and Wal-Mart. [Author's Note: The information was garnered from MOO Milk Co’s website and Mr. Lang. For further information see http://moomilkco.com]
The L3C Legal Structure: A For-Profit LLC with a Non-Profit Purpose

(2) Allegheny Greenworks L3C

Its mission is to improve the quality of life in Allegheny County through the creation and support of green initiatives. Allegheny Greenworks creates and operates its own green initiatives and provides technical support services to nonprofit organizations, government agencies, and commercial enterprises in an effort to increase environmental awareness, promote sustainable business practices, support green enterprise, develop a green workforce and engage local residents in the process of rebuilding their communities. [Author’s Note: Information developed from company’s website. For more information, see their URL at: http://www.alleghenygreenworks.com/index.html].

I. Reasons To Form an Exempt and For-profit Combination

With the L3C and the B corporation now in play (and possibly other hybrid forms on the horizon), what “facts and circumstances” should be taken into account by social entrepreneurs, in choosing such a hybrid for a social enterprise venture? Mr. Wexler, in his article on Effective Social Enterprise (supra at pp 575, 576) offers the following cogent advice. “A for profit combined with an exempt entity to carry out a social enterprise makes sense under the following circumstances:

- when only a portion of the activity can qualify for exemption;
- when capital is required both in the form of private investment and from grants and contributions; and
- when the founders want to build a business to sell, but also are willing to dedicate some portion of the enterprise to charity in perpetuity.

Whenever an enterprise considers a hybrid structure, it must at a minimum:

- be prepared to delineate clearly the activity that will rest in the exempt versus the for-profit structure; there must be a logical and practical way to divide the activities;
- be cognizant of, and be prepared to comply with the procedures to avoid, intermediate sanctions under I.R.C. §4958; the enterprise must develop and follow clear conflict of interest policies and disclose financial interests to the disinterested members of the nonprofit board of directors;
- give up legal control of the exempt entity to those who will not benefit financially from the for-profit business; the disinterested members of the tax exempt board need to be individuals who will understand their independent fiduciary duty and not simply rubber-stamp the decisions of the for-profit founders; and
- ensure the private investors, particularly any venture capitalists, understand that they do not control, and cannot control or benefit from, the exempt side of the enterprise.”

III. OVERVIEW OF "PRIVATE FOUNDATION EXCISE TAX RULES"

A. Generally

Due to egregious abuses by certain private foundations in the past, Congress enacted a number of rules in 1969, designed to preclude wealthy individuals from using a private foundation to accomplish primarily private, rather than tax-exempt purposes. The rules, generally referred to as the "private foundation excise tax rules," are contained in Chapter 42, I.R.C. §4940 through 4945. For convenience, these rules are summarized, in detail, in Exhibit D.

B. L3Cs; How are they affected by the Private Foundation Excise Tax Rules?

1. L3Cs; Created to advance Charitable Purposes, but are not Charities

L3Cs are not exempt from federal or state tax and investments in L3Cs are not tax-deductible. While the L3C is designed to facilitate Program Related Investments (“PRIs”) by nonprofit foundations, these foundation investments are governed by the federal tax rules applicable to PRIs as well as the Self Dealing rules, discussed above [Author’s Note: Running afoul of the Self Dealing rules when investing a foundation’s PRI in an L3C type vehicle can be one of the most significant “tax traps for the unwary”]. Rather, an L3C—like a traditional LLC—is a “pass-through entity,” like a partnership or sole proprietorship. This means that no federal income tax is imposed on the L3C itself. Instead, items of income, expense, gain, and loss “pass through” the L3C to its members, are allocated in proportion to the members’ ownership shares, and are reported on members’ individual tax returns [Author’s Note: While L3Cs could theoretically elect C corporation status, this would not practically serve the goals of either the for-profit stakeholders or the nonprofit, making the investment]. Though L3Cs by their nature begin as enterprises that are expected to generate low overall profits, those profits are subject to taxation at the rates of tax that apply to their members.

2. Unresolved Issues

The IRS had not yet resolved several key questions with respect to the tax treatment of L3Cs. Foremost among these are whether an investment by a private foundation in an L3C will constitute prima-facie evidence of a legitimate PRI. Another unresolved issue
is whether profits flowing from an L3C to a tax-exempt member with a similar mission may be less subject to the Unrelated Business Taxable Income (“UBTI”) rules than if they had come from a traditional investment. Assuming the foundation’s investment in the L3C is in fact a PRI, this result should follow [Author’s Note: It is the author’s opinion that a properly structured L3C, following its mission, with a foundation’s PRI that also qualifies a qualifying distribution will not generate UBTI to the foundation member and author/commentator Marcus Owens concurs with this analysis (based on the author’s interview with Mr. Owens on February 24, 2010)].

IV. CONCLUSION
Helping clients achieve their overall estate planning goals can be a complex process, particularly if the clients want to incorporate charitable giving into their estate plans in a manner other than making outright gifts of cash to a public charity. Many factors are involved in helping each client select the most appropriate and effective charitable giving techniques and strategies, including when, to whom, of what property to donate and how to make the charitable gift. Knowledge of the charitable giving fundamentals, such as, the tax benefits of lifetime vs. testamentary gifting, the impact that the nature of the gifted property and the type of recipient charity have on the income tax charitable deduction, the annual income tax deduction limitations, and the different charitable giving vehicles and strategies is the starting point in working with any charitably inclined client. Assimilation of information about the client, his family, assets, income, business interests, anticipated liquidity events and short-term and long-range goals, and then identification of appropriate charitable giving techniques for the client’s consideration are keys to helping clients achieve their overall planning goals.

In the case of extremely wealthy clients with successful businesses, who have significant philanthropic goals and desire the control, tax and economic benefits of private foundations and operating foundations, and are willing to contend with the complexities, tax compliance and strict rules related to their operation, creative business succession strategies using private foundations and private operating foundations can multiply both the wealth the family controls and retains and the amount of philanthropic good it can do. When considering expanding philanthropic initiatives into the arena of social enterprise investing and simple grant making and “hands-on philanthropy” is not enough, the foundation manager may wish to consider a partnering arrangement with a for-profit entity in the manner described herein.

**WARNING:** These transactions are complex and fraught with tax traps for the unwary and some in some cases may lead the client and his advisor into “uncharted” waters. They should be undertaken only with the utmost of due diligence and adequate advisory support. However, when successfully implemented, the experience, for the client and the advisor, can be a real, natural high!

V. BIBLIOGRAPHY

**LEGAL ARTICLES**

Bishop, Carter G., Professor or Law, Suffolk University Law School; Fifty State Series: L3C & B Corporation Legislation Table, Legal Studies Research Paper Series, Research Paper10-11, Suffolk University Law School, March 1, 2010-last updated as of May 1, 2010.


The L3C Legal Structure: A For-Profit LLC with a Non-Profit Purpose


NON-LEGAL ARTICLES & OTHER SOURCES


Lewis, Stuart M., Chair ABA Section of Taxation; Letter to Hon. Douglas Shulman Commissioner Internal Revenue Service, regarding comments Concerning Proposed Additional Examples on Program-Related Investments (March 3, 2010).


990-PF Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation (both Form and Instructions).
The L3C Legal Structure: A For-Profit LLC with a Non-Profit Purpose

Exhibit A
Sample format for a Certificate of Formation for a Low Profit Limited Liability Company
Formed under Texas existing TBOC

Form 205—General Information
(Certificate of Formation—Limited Liability Company)

The attached form is designed to meet minimal statutory filing requirements pursuant to the relevant code provisions. This form and the information provided are not substitutes for the advice and services of an attorney and tax specialist.

Commentary

The limited liability company (hereinafter LLC) is neither a corporation nor a partnership; rather, it is a distinct type of entity. An LLC is governed by title 3, chapter 101 of the Texas Business Organizations Code (BOC). Title 1, chapter 3, subchapter A of the BOC governs the formation of an LLC and sets forth the provisions required or permitted to be contained in the certificate of formation.

The owners of an LLC are called “members.” An LLC may have one or more members. Members may be individuals, partnerships, corporations, and any other type of legal entity.

Taxes: LLCs are subject to a state franchise tax. Contact the Texas Comptroller of Public Accounts, Tax Assistance Section, Austin, Texas, 78774-0100, (512) 463-4600 or (800) 252-1381 for franchise tax information. For information relating to federal employer identification numbers, federal income tax filing requirements, tax publications, and forms call (800) 829-3676 or visit the Internal Revenue Service web site at www.irs.gov.

Instructions for Form

- **Article 1—Entity Name and Type:** Provide a company name and organizational designation. Under section 5.053 of the BOC, if the name chosen is the same as, deceptively similar to, or similar to the name of any existing domestic or foreign filing entity, or any name reservation or registration filed with the secretary of state, the document cannot be filed. The administrative rules adopted for determining entity name availability (Texas Administrative Code, title 1, part 4, chapter 79, subchapter C) may be viewed at www.sos.state.tx.us/tac/index.shtml. If you wish the secretary of state to provide a preliminary determination on name availability, you may call (512) 463-5555, dial 7-1-1 for relay services, or e-mail your name inquiry to corpinfo@sos.state.tx.us. A final determination cannot be made until the document is received and processed by the secretary of state. Do not make financial expenditures or execute documents based on a preliminary clearance. Also note that the preclearance of a name or the issuance of a certificate of formation under a name does not authorize the use of a name in violation of another person’s rights to the name.

- **Article 2—Registered Agent and Registered Office:** The registered agent can be either (option A) a domestic entity or a foreign entity that is registered to do business in Texas or (option B) an individual resident of the state. The limited liability company cannot act as its own registered agent; do not enter the limited liability company name as the name of the registered agent.

  **Consent:** Effective January 1, 2010, a person designated as the registered agent of an entity must have consented, either in a written or electronic form, to serve as the registered agent of the entity. Although consent is required, a copy of the person’s written or electronic consent need not be submitted with the certificate of formation. The liabilities and penalties imposed by sections 4.007 and 4.008 of the BOC apply with respect to a false statement in a filing instrument that names a person as the registered agent of an entity without that person’s consent. (BOC § 5.207)
Office Address Requirements: The registered office address must be located at a street address where service of process may be personally served on the entity’s registered agent during normal business hours. Although the registered office is not required to be the entity’s principal place of business, the registered office may not be solely a mailbox service or telephone answering service (BOC § 5.201).

- Article 3—Governing Authority: The certificate of formation must state whether the LLC will or will not have managers. If the LLC will have managers, select option A and provide the name and address of each initial manager in the space provided. If the LLC will not have managers, select option B and provide the name and address of each initial member of the LLC in the space provided. A minimum of one person is required.

If the governing person is an individual, set forth the name of the individual in the format specified. Do not use prefixes (e.g., Mr., Mrs., Ms.). Use the suffix box only for titles of lineage (e.g., Jr., Sr., III) and not for other suffixes or titles (e.g., M.D., Ph.D.). If the governing person is an organization, set forth the legal name of the organization. For each governing person, only one name should be entered. Do not include both the name of an individual and the name of an organization. An address is always required for each governing person.

Please note that a document on file with the secretary of state is a public record that is subject to public access and disclosure. When providing address information for a manager or member, use a business or post office box address rather than a residence address if privacy concerns are an issue.

- Article 4—Purpose: An LLC may be formed for any lawful purpose or purposes not expressly prohibited under chapter 2 of title 1 or title 3 of the BOC. This form provides for the creation of an LLC with a general purpose. Please note that while the BOC allows a general purpose, other laws, including the Internal Revenue Code, may require that the certificate of formation include more specific purposes or language as a basis for granting a license or tax-exempt or tax-deductible status. The additional space provided in the “Supplemental Provisions/Information” section may be used to set forth a more specific purpose or purposes.

This form cannot be used to engage in a licensed activity when such license cannot be issued to the LLC. To form a professional limited liability to provide a professional service use Form 206.

- Supplemental Provisions/Information: Additional space has been provided for additional text to an article within this form or to provide for additional articles to contain optional provisions.

Duration: Pursuant to section 3.003 of the BOC, a Texas LLC exists perpetually unless provided otherwise in the certificate of formation. If formation of an LLC with a stated period of duration is desired, use the “Supplemental Provisions/Information” section of this form to provide for a limited duration.

- Organizer: Only one organizer is required for the formation of an LLC. An organizer may be any person having the capacity to contract for the person or for another; that is, a natural person 18 years of age or older, or a corporation or other legal entity. There are no residency requirements for an organizer.

- Effectiveness of Filing: A certificate of formation becomes effective when filed by the secretary of state (option A). However, pursuant to sections 4.052 and 4.053 of the BOC the effectiveness of the instrument may be delayed to a date not more than ninety (90) days from the date the instrument is signed (option B). The effectiveness of the instrument also may be delayed on the occurrence of a future event or fact, other than the passage of time (option C). If option C is selected, you must state the manner in which the event or fact will cause the instrument to take effect and the date of the 90th day after the date the instrument is signed. In order for the certificate to take effect under option C, the entity must, within ninety (90) days of the filing of the certificate, file a statement with the secretary of state regarding the event or fact pursuant to section 4.055 of the BOC.

On the filing of a document with a delayed effective date or condition, the computer records of the secretary of state will be changed to show the filing of the document, the date of the filing, and the future date on which the document will be effective or evidence that the effectiveness was conditioned on the occurrence of a future event or fact. In addition, at the time of such filing, the status of the entity will be shown as “in existence” on the records of the secretary of state.
**Execution:** The organizer must sign the certificate of formation, but it does not need to be notarized. However, before signing, please read the statements on this form carefully. The designation or appointment of a person as registered agent by an organizer is an affirmation that the person named in the certificate of formation has consented to serve in that capacity. (BOC § 5.2011, effective January 1, 2010)

_A person commits an offense under section 4.008 of the BOC if the person signs or directs the filing of a filing instrument the person knows is materially false with the intent that the instrument be delivered to the secretary of state for filing. The offense is a Class A misdemeanor unless the person’s intent is to harm or defraud another, in which case the offense is a state jail felony._

**Payment and Delivery Instructions:** The filing fee for a certificate of formation for an LLC is **$300**. Fees may be paid by personal checks, money orders, LegalEase debit cards, or MasterCard, Visa, and Discover credit cards. Checks or money orders must be payable through a U.S. bank or financial institution and made payable to the secretary of state. Fees paid by credit card are subject to a statutorily authorized convenience fee of 2.7 percent of the total fees.

Submit the completed form in duplicate along with the filing fee. The form may be mailed to P.O. Box 13697, Austin, Texas 78711-3697; faxed to (512) 463-5709; or delivered to the James Earl Rudder Office Building, 1019 Brazos, Austin, Texas 78701. If a document is transmitted by fax, credit card information must accompany the transmission (Form 807). On filing the document, the secretary of state will return the appropriate evidence of filing to the submitter together with a file-stamped copy of the document, if a duplicate copy was provided as instructed.

**FYI:** An LLC is required to maintain a registered agent and a registered office address in Texas. If the registered agent or registered office address changes, it is important to file a statement with the secretary of state to effect a change to the certificate of formation. Failure to maintain a registered agent and registered office may result in the involuntary termination of the LLC.
Article 1 – Entity Name and Type

The filing entity being formed is a limited liability company. The name of the entity is:

Social Enterprise Investments, LLC

The name must contain the words “limited liability company,” “limited company,” or an abbreviation of one of these phrases.

Article 2 – Registered Agent and Registered Office

A. The initial registered agent is an organization (cannot be entity named above) by the name of:

OR

B. The initial registered agent is an individual resident of the state whose name is set forth below:

C. The business address of the registered agent and the registered office address is:

1234 Social Enterprise Parkway Development City TX 77777

Article 3—Governing Authority

A. The limited liability company will have managers. The name and address of each initial manager are set forth below.

B. The limited liability company will not have managers. The company will be governed by its members, and the name and address of each initial member are set forth below.

<table>
<thead>
<tr>
<th>NAME AND ADDRESS OF GOVERNING PERSON</th>
<th>(Enter the name of either an individual or an organization, but not both.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>IF INDIVIDUAL</td>
<td></td>
</tr>
<tr>
<td>Thomas  M For-profit</td>
<td></td>
</tr>
<tr>
<td>First Name M.I. Last Name Suffix</td>
<td></td>
</tr>
<tr>
<td>OR</td>
<td></td>
</tr>
<tr>
<td>IF ORGANIZATION</td>
<td></td>
</tr>
<tr>
<td>Organization Name</td>
<td></td>
</tr>
<tr>
<td>4321 Profitable Way Dollar City TX USA 77777</td>
<td></td>
</tr>
<tr>
<td>Street or Mailing Address City State Country Zip Code</td>
<td></td>
</tr>
</tbody>
</table>
The L3C Legal Structure: A For-Profit LLC with a Non-Profit Purpose

<table>
<thead>
<tr>
<th>NAME AND ADDRESS OF GOVERNING PERSON</th>
<th>(Enter the name of either an individual or an organization, but not both.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>IF INDIVIDUAL</td>
<td></td>
</tr>
<tr>
<td>James S Nonprofit</td>
<td></td>
</tr>
<tr>
<td>First Name</td>
<td>M.I.</td>
</tr>
<tr>
<td>OR</td>
<td></td>
</tr>
<tr>
<td>IF ORGANIZATION</td>
<td></td>
</tr>
<tr>
<td>Organization Name</td>
<td></td>
</tr>
<tr>
<td>73945 Tax Exempt St.</td>
<td>Social Enterprise</td>
</tr>
<tr>
<td>Street or Mailing Address</td>
<td>City</td>
</tr>
</tbody>
</table>

Article 4 – Purpose

The purpose for which the company is formed is for the transaction of any and all lawful purposes for which a limited liability company may be organized under the Texas Business Organizations Code.

Supplemental Provisions/Information

Text Area: [The attached addendum, if any, is incorporated herein by reference.]

Notwithstanding the Company may be organized for any lawful purpose under the Texas Business Organization’s Code, the company will at all times be operated exclusively for a business purpose that must satisfy each of the following requirements:

(a) The limited liability company (i) significantly furthers the accomplishment of one or more religious, charitable, scientific, literary or educational purposes within the meaning of Section 170(c)(2)(B), Internal Revenue Code, and (ii) would not have been formed but for the entity's relationship to the accomplishment of such one or more religious, charitable, scientific, literary or educational purposes;

(b) No significant purpose of the limited liability company is the production of income or the appreciation of property; provided, however, that the fact that the entity 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

(c) No purpose of the limited liability company is to accomplish one or more political or legislative purposes within the meaning of Section 170(c)(2)(D), Internal Revenue Code of 1986.
Organizer

The name and address of the organizer:

Sam S. Smith

<table>
<thead>
<tr>
<th>Name</th>
<th>Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>1234 Social Enterprise Parkway</td>
<td>Development City TX 7777</td>
</tr>
</tbody>
</table>

Street or Mailing Address  City  State  Zip Code

Effectiveness of Filing  (Select either A, B, or C.)

A. ☒ This document becomes effective when the document is filed by the secretary of state.
B. □ This document becomes effective at a later date, which is not more than ninety (90) days from the date of signing. The delayed effective date is: ____________________________
C. □ This document takes effect upon the occurrence of the future event or fact, other than the passage of time. The 90th day after the date of signing is: ____________________________

The following event or fact will cause the document to take effect in the manner described below:

Execution

The undersigned affirms that the person designated as registered agent has consented to the appointment. The undersigned signs this document subject to the penalties imposed by law for the submission of a materially false or fraudulent instrument and certifies under penalty of perjury that the undersigned is authorized to execute the filing instrument.

Date: ____________________________

Signature of organizer

Sam S. Smith

Printed or typed name of organizer
Exhibit B
Sample Company Agreement for a Manager-Managed
Limited Liability Company organized as a Low Profit Limited Liability Company
Under the TBOC

SOCIAL ENTERPRISE INVESTMENTS, LLC

I. PRELIMINARY PROVISIONS

(1) Effective Date: This Company Agreement of SOCIAL ENTERPRISE INVESTMENTS, LLC (hereinafter the “Company Agreement”), effective __________ ___, 2011, is adopted, for good and valuable consideration, when signed (hereinafter the “Effective Date”), by the initial manager named in the Certificate of Formation, whose signature appears at the end of this Company Agreement (the “Manager”).

(2) Formation: This limited liability company (the “Company”) was formed by filing a Certificate of Formation (the “Formation Certificate”) with the Secretary of State of the State of Texas (the “Secretary of State”), on __________ ___, 2011. Copies of this organizational document have been placed in the Company’s records and Minute Book.

(3) Name: The formal name of this Company is as stated above. All Company business must be conducted in the Company name. However, this Company may do business under a different name by complying with the applicable assumed business name statutes and procedures.

(4) Registered Office and Agent: The registered office of this Company and the registered agent at this address is as follows: SAM M. SMITH, 1234 Social Enterprise Parkway, Texas 77777. The registered office and agent may be changed from time to time as the Manager may see fit, by filing a change of registered agent or office form with the office of the Secretary of State or in another state filing office, as applicable. It will not be necessary to amend this provision of the Company Agreement if and when such a change is made.

(5) Business Purposes: While it is understood that the Company is permitted to engage in any and all lawful business activities for which limited liability companies may be formed under the Texas Business Organizations Code (the “TBOC”), notwithstanding the foregoing, the Company is solely organized and will at all times be operated exclusively for a business purpose that must satisfy each of the following requirements:

(a) The Company (i) significantly furthers the accomplishment of one or more religious, charitable, scientific, literary or educational purposes within the meaning of Section 170(c)(2)(B) of the Code, and (ii) would not have been formed but for the entity’s relationship to the accomplishment of such one or more religious, charitable, scientific, literary 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 the entity 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

(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 Code of.

If this Company intends to engage in business activities outside the state of its formation (Texas) that require the qualification of the Company in other states, it shall obtain such qualification before engaging in such out-of-state activities.

(6) Duration of Company: The duration of this Company shall be perpetual, so long as it is operated for solely for the purposes set out Paragraph (5), above. Further, this Company shall terminate when a proposal to dissolve the Company is adopted by the membership of this Company, when the Company is no longer operated for the purposes set out in Paragraph (5) or when this Company is otherwise terminated in accordance with law, or with the provisions of this Company Agreement.

(7) Defined Terms: Certain terms which are capitalized in this Company Agreement have particular meanings which are either designated in Section IX, entitled DEFINITIONS, herein, or ascribed to them in context.

II. MEMBERSHIP PROVISIONS

(1) Members: The term Members of the Company mean any person executing this Company Agreement as a Member, or hereafter admitted to the Company as a Member, as provided in this Company Agreement, but does not include any person who has ceased to be a Member in the Company (the “Member” in the singular or “Members” if
more than one, as the context requires). Initially this Company will have only two Members; one Member that is a private foundation, organized under Texas law and classified as tax-exempt private foundation by the Internal Revenue Service, i.e., the James S. Nonprofit Family Foundation (hereinafter the “Foundation Member”) and a for-profit LLC organized under the TBOC, i.e., the Social Enterprise Holdings, LLC (hereinafter the “For-profit Member”).

(2) Non liability of Members: No Member of this Company shall be personally liable for the expenses, debts, obligations or liabilities of the Company, or for claims made against it.

(3) Reimbursement for Organizational Costs: Members shall be reimbursed by the Company for organizational expenses paid by the Members. The Company shall be authorized to elect to deduct organizational expenses and start-up expenditures ratably over a period of time as permitted by the Code and as may be advised by the Company’s tax advisor.

(4) Members’ Percentage Interests: A Member’s Percentage Interest in this Company and the number of Units held by each Member is set out in the table in Paragraph (1) of Section V herein.

(5) Limitations on Members’ Rights: Except as specifically provided in this Agreement to the contrary, no Member (other than a Manager or officer, acting in such capacity) will have the right, in his, her, or its capacity as a Member, to:

(a) participate in the control of the Company’s business affairs;
(b) transact any business of or in the name of the Company;
(c) act for or on the Company’s behalf,
(d) have any power or authority to contractually bind or obligate the Company;
(e) incur any expenditure on the Company’s behalf; or
(f) require partition of the Company’s property or to compel any sale or appraisal of the Company’s assets.

(6) Membership Voting: Except as otherwise may be required by the Certificate of Formation, other provisions of this Company Agreement, or under the laws of Texas, each Member shall vote on any matter submitted to the membership for approval in proportion to the Member’s Percentage Interest in this Company, provided, however, Members may not cast their vote in a manner that would cause the Company to operate in any other manner than as stated in Section I, Paragraph (5) above.

Further, unless defined otherwise for a particular provision of this Company Agreement, the phrase “Majority of Members” means the vote of Members whose combined votes equal more than 50% of the votes of all Members in this Company. A Majority of Members present or participating in a Members meeting shall constitute a quorum.

(7) Members’ Meetings: Except for an annual meeting, the Company shall not provide for regular Members’ meetings. However, any Member may call a meeting, including a Special meeting, by communicating his, her or its wish to schedule a meeting to all other Members. Such notification may be in person or in writing, or, by facsimile machine or electronic message address, when a person becomes a Member, he she or it consents to same, pursuant to TBOC section 6.051(b)(2), and said Member provides his, her or its address or contact information to the Company and agrees to maintain it currently. The other Members shall then agree, either personally, in writing, or by facsimile machine or electronic message to the Company, via its Registered Agent at sams@socialenterpriseinvestments.com or such other email address as the Registered Agent shall, in writing, provide to each Member, to meet at a mutually acceptable time and place or by one of the alternative forms of meetings set forth in TBOC section 6.002 (i.e., conference telephone or similar communications equipment, or another suitable electronic communications system, including videoconferencing technology or the Internet, or any combination, if the telephone or other equipment or system permits each person participating in the meeting to communicate with all the other persons participating in the meeting). Should all of the Members waive, in writing, notice by one of the methods set forth above, then notice by telephone shall suffice. Notice of the business to be transacted at and/or the purpose of the special meeting must be given to Members by the Member calling the meeting, and any business may be discussed and conducted at the meeting. Meetings of Members may be held within or out of Texas.

If all Members cannot attend a meeting, it shall be postponed to a date and time when all Members can attend or participate, unless all Members who do not attend or participate have agreed in writing to the holding of the meeting without them. If a meeting is postponed, and the postponed meeting cannot be held either because all Members do not attend or participate in the postponed meeting or the non-attending or non-participating Members have not signed a written consent to allow the postponed meeting to be held without them, a second postponed meeting may be held at a date and time announced at the first postponed meeting. The date and time of the second postponed meeting shall also be communicated to any Members not attending or participating in the first postponed meeting. The second postponed meeting may be held without the attendance of all Members as long as a majority of the percentage interests of the membership of this Company is in attendance or participating at the second postponed meeting.
Written notice of the decisions or approvals made at this second postponed meeting shall be mailed or delivered to each non-attending or participating Member promptly after the holding of the second postponed meeting.

All Member meetings will be presided over by the meeting’s chair, who must be a Manager, as provided for in this Company Agreement, or if none, or if absent, then a Manager designated by a majority of the Managers. A Member meeting’s chair may determine the order of business and the procedure at the meeting, including regulating the voting manner and the discussion conduct.

Written minutes of the discussions and proposals presented at a Members’ meeting and the votes taken and matters approved at such meeting, shall be taken by the chair, or someone designated at the meeting by the chair for that purpose. A copy of the minutes of the meeting shall be placed in the Company’s Minute Book after the meeting and a copy shall be mailed or delivered to each non-attending or participating Member promptly after the holding of the second postponed meeting.

(8) Action without a Meeting: Any action required to be taken or that may be taken at a Member meeting may be taken without a meeting, without notice and without a vote, if consent in writing, setting forth the action has been signed by all the Members. Every written consent must be signed, dated and delivered by the Member. The consent will become effective at that time and remain effective for the period specified in the consent. A telegram, cablegram, or similar transmission by Member, or a photographic, photostatic, facsimile or similar reproduction of a writing signed by a Member, will be regarded as a signed by the Member. Taking action includes amending this Company Agreement or creating a class of membership interest that did not previously exist.

(9) Membership Certificates: This Company shall be authorized to obtain and issue certificates representing or certifying Membership Interests in this Company. Each certificate shall show the name of the Company, the name of the Member, and state that the person named is a Member of the Company and is entitled to all the rights granted members of the Company under the Certificate of Formation, this Company Agreement and provisions of law. Each membership certificate shall be consecutively numbered and signed by one or more officers of this Company. The certificates shall include any additional information considered appropriate for inclusion by the Members on membership certificates.

In addition to the above information, each membership certificate shall bear a prominent legend on its face or reverse side stating, summarizing or referring to any transfer restrictions that apply to memberships in this Company under the Certificate of Formation and/or this Company Agreement, and the address where a Member may obtain a copy of these restrictions upon request from this Company. A legend on each Member’s certificate, substantially in the following language, shall be deemed to comply with this provision:

"The transfer of Membership Interests represented by this Certificate is restricted under the terms of a Company Agreement dated _______ ____, 20__ as may be amended from time to time, a copy of which is on file at the offices of the Company."

The Minute Book of this Company shall contain a list of the names and addresses of all persons to whom certificates have been issued, show the date of issuance of each certificate, and record the date of all cancellations or transfers of membership certificates.

(10) Compensation: Members shall not be paid as Members of the Company for performing any duties associated with such membership. Members may be paid, however, for any services rendered in any other capacity for the Company, whether as Managers, officers, employees, independent contractors or otherwise.

(11) Acknowledgment of Managers Authority: The Members acknowledge and understand that the Managers are granted broad authority and discretion under this Company Agreement and that the Managers’ exercise of broad authority and discretion may impair the value of the Members’ Membership Interest. The Members further acknowledge and understand that the Managers would not cause the Company to issue Membership Interests to the Members if the Managers did not have broad authority and discretion and the Members agree not to challenge the Managers’ exercise of authority and discretion, so long as the Company is operated according to the provisions of Section I, Paragraph (5).

III. MANAGEMENT BY MANAGER

(1) Management of Company Affairs: The right to exercise the powers of the Company and to manage the business and affairs of the Company is vested exclusively in the Managers, as listed in the Certificate of Formation. A person may not serve as Manager unless the person is a resident of Texas and (i) as to the non-profit member, is a manager, director or officer of the non-profit Member; and (ii) an officer, manager or other governing person of the for-profit Member. Every Manager is an agent of the Company for the purpose of its business. Except as expressly provided elsewhere in this Company Agreement, the act of a Managers, including executing in the Company’s name any instrument for apparently carrying on in the usual way the Company’s business, binds the
Company. The Company, however, is not bound by a Manager’s act if the Manager lacks the authority to act for this Company and the person with whom the Manager is dealing had knowledge of the fact that the Manager does not have the authority or if the Manager attempts to act in and bind the Company in a matter that is inconsistent with the Company’s purposes, as stated in Section I, Paragraph (5).

(2) Number of Managers and Election of Managers: The initial Managers specified in the Certificate of Formation will serve as the Company Managers, together with a third Manager appointed by them, who qualifies as a Company Manager, in accordance with the provisions of Paragraph (1), the same being the initial Company Managers. The initial Company Managers shall serve until the first annual meeting of the Company or until their successor are elected and serving, as hereinafter provided in this Agreement. Unless the number of Managers is expanded by the initial Company Managers; the number of Managers of the Company, will be no less than three (3) and no more than five (5), with at least on Manager at all times being an officer, manager or director of the non-profit Member.

(3) Succession of Company Manager: Upon the resignation, death, incapacity or inability of the initial Company Managers, or any of them, all Members of the Company agree to vote and shall vote all of their Member Interests in favor a person or person who meet the qualifications of a Company Manager, pursuant to the provisions of this Company Agreement. For the purpose of this paragraph (3), “incapacity” or “incapacitated” means, with regard to an individual serving as the Company Manager, the inability of such individual to give prompt and intelligent consideration to the business affairs of the Company, due to that individual’s physical or mental condition and it is probable that a court supervised guardianship would be required for that individual’s person and/or property, and the foregoing facts are certified by two independent physicians.

(4) Written Employment Agreements: No Company Manager or officer may be employed by the Company directly, without a written employment agreement. No such agreement shall be for a term in excess of one year. In addition, any person serving as an officer of the Company, shall always serve at the pleasure of the Company Managers and may be dismissed, forthwith, provided such dismissal shall not relieve the Company of any of its obligations to such officer under the terms of such employment agreement. Upon termination of such officer’s employment, all amounts then due and owing to such Manager or officer, under the terms of the employment agreement, shall be promptly paid to such Manager or officer by the Company and the Company shall have no further liability to such Manager or officer.

(5) Removal of Manager for Cause: A Member may remove any Manager before the expiration of the Manager's term specified in this Agreement if:
   (a) The Manager is convicted of a felony or crime of moral turpitude; or
   (b) The Manager acts outside the scope of the Manager's authority or the Company’s purpose.

(6) Removal of Manager by Consent of Members: At any meeting of Members called expressly for the purpose, any Manager may be removed for any reason, with or without cause, on a resolution unanimously adopted by the Members.

(7) Quorum of Managers: At all meetings of the Managers, fifty per cent (50%) of the Managers constitutes a quorum for the transaction of business.

(8) Voting Rights and Action by Managers: Each Manager will have one vote on each matter that is presented to the Managers. An act of the Managers is effective if fifty per cent (50%) of the Managers vote approval of the act at a meeting at which a quorum of Managers is present.

(9) Manager Committees; Officers: By resolution, the Company Managers may designate and vest Management authority in a single Manager; designate from among the Managers one or more committees that may exercise the authority of the Company Managers generally, and may designate one or more Managers to serve as alternate members of any committee. A committee may not amend this Agreement; and/or designate Officers of the Company. Members selected for such Committees must also meet the qualifications for being a Company Manager, as stated herein. The Managers may appoint one or more individuals who may or may not be Managers or Members to be officers of the Company. No officer need be a Texas resident or a Member. Any officers designated will have the authority and perform the duties as the Managers may delegate to them. The Managers may assign titles to the particular officers. Unless the Managers decide otherwise, if the title is one commonly used for officers of a business corporation formed under the TBOC, assigning the title constitutes delegation to the officer of the authority and duties normally associated with that office. Each officer will hold office until the officer’s successor is designated and qualifies, the officer dies, the officer resigns or is removed in the manner provided herein. Any number of offices may be held by the same individual. The salaries or other compensation, if any, of the Company’s officers and agents will be fixed by the Managers. Officers may resign at any time and their resignation will be effective when received by the Managers. Officers may be removed, with or without cause, by the Managers, at their discretion.

(10) Regular Meetings of Managers: Regular meetings of the Managers will be held at the Registered Office of the Company, as provided in this Company Agreement. By resolution, the Managers are authorized to
The L3C Legal Structure: A For-Profit LLC with a Non-Profit Purpose

designate, from time to time, a place or places other than the Registered Office for regular meetings of the Managers. Regular meetings of the Managers will be held immediately following the annual meeting of the Members and at such other times as agreed upon by the Managers, in their discretion. No notice of regular meetings is required.

(11) Special Meetings of Managers: Special meetings called by action of the Managers will likewise be held at the Registered Office of the Company. By resolution, the Managers are authorized to designate a place or places other than the Registered Office for a special meetings of the Managers. Written notice of the time and place of special meetings will be delivered to the Managers or sent to each Manager, in the same manner as provided for notice of Member meetings, in Section II, Paragraph (7), herein.

(12) Notice of Purpose of Meetings: Notice of any special meetings of the Managers will also include and specify the purpose of the meeting or the business to be transacted at the meeting, in addition to the place, date, and time of meeting.

(13) Restrictions on the Manager’s Authority: The Managers may not perform any of the following acts, without the affirmative vote of all of the Members:

(a) Sale of Assets: The sale, lease, exchange or other disposition of all or substantially all of the Company’s assets;
(b) Company Purpose: Take any action inconsistent with the Company’s purpose;
(c) Dissolution of the Company: To vote, or take any other action, to dissolve the Company;
(d) Amendment to Company Agreement: To amend the Company Agreement;
(e) Confess Judgment: To confess a judgment against or affecting the Company;
(f) Merge or Consolidate: To merge or consolidate the Company with or into another business entity;
(g) Dissolve or Liquidate Company: To dissolve or liquidate the Company; and
(h) Change or Reorganize Company: To change or reorganize the Company into any other legal form.

(14) Actions taken by the Company on behalf of the Company: Any actions take by the Company on behalf of the Company, where such action is in writing, shall be done in the following manner:

SOCIAL ENTERPRISE INVESTMENTS, LLC

By: ____________________________________
(THOMAS M. FOR-PROFIT or JAMES S. NONPROFIT),
Company Manager

IV. TAX AND FINANCIAL PROVISIONS

(1) Tax Classification and Elections of Company: The Members of this Company intend that this Company not be classified as an “Association taxable as a Corporation” for federal income tax purposes and shall be taxed as a partnership. If necessary, all Members agree to elect the foregoing tax treatment for this Company by signing, or authorizing the signature of, an IRS Form 8832 Entity Classification Election, and filing it with the IRS within the prescribed time limits.

(2) Tax Year and Accounting Method: The tax year of this Company shall be the calendar year. The Company shall use the cash method of accounting. Both the tax year and the accounting period of the Company may be changed with the consent of all Members if the Company qualifies for such change, and may be effected by the filing of appropriate forms with the IRS and state tax authorities.

(3) Tax Matters Partner: The Member hereby designates THOMAS M. FOR-PROFIT, to act as the “Tax Matters Partner” pursuant to Section 6231(a) (7) of the Code, as amended. Thereafter a majority of Managers who are Members will designate a Manager who is a Member (or Trustee or other fiduciary of a Member) to be the Tax Matters Partner. The Tax Matters Partner will consult with the other Members on any material tax issues. The Company may remove any Tax Matters Partner, with or without cause, and designate a successor to any Tax Matters Partner who for any reason ceases to act. The Tax Matters Partner shall inform the Members of all administrative and judicial proceedings pertaining to the determination of the Company’s tax items and shall provide the Members with copies of all Notices received from the Internal Revenue Service regarding the commencement of a Company-level audit or a proposed adjustment of any of the Company’s tax items. The Tax Matters Partner may extend the statute of limitations for assessment of tax deficiencies against the Members attributable to any adjustment of any tax item. The Company shall reimburse the Tax Matters Partner for reasonable expenses properly incurred while acting within the scope of the Tax Matters Partner’s authority.

(4) Annual Income Tax Returns and Reports: Within 60 days after the end of each tax year of the Company, a copy of the Company’s state and federal income tax returns for the preceding tax year shall be mailed or
otherwise provided to each Member of the Company, together with any additional information and forms necessary for each Member to complete his or her individual state and federal income tax returns. As this Company is, or will be, classified as an S Corporation for income tax purposes, this additional information shall include a federal Form K-1 or equivalent income tax reporting form. This additional information shall also include a financial report, which shall include a balance sheet and profit and loss statement for the prior tax year of the Company. In the case of a Foundation Member, such information shall include a written report demonstrating that such Foundation Member’s investment in the Company qualifies as a “Program Related Investment” within the meaning of Section 4944(c) of the Code and the applicable Treasury Regulations thereunder, including Section 53.4944-3(a)(2) and (3) of the Treasury Regulations. In making such written report, the Company shall provide such financial and other information as any Foundation Member reasonably may request as necessary to comply with the Code and applicable Treasury Regulations concerning Program Related Investments, including information required to be submitted to the Internal Revenue Service in connection with such Foundation Member’s IRS Form 990 or any other returns or reports required to be filed by such Foundation Member for federal, state, or local income tax purposes.

(5) Bank Accounts: The Company shall designate one or more banks or other institutions for the deposit of the funds of the Company, and shall establish savings, checking, investment and other such accounts as are reasonable and necessary for its business and investments. One or more Members of the Company and the Manager and one or more officer shall be designated by the Manager to deposit and withdraw funds of the Company, and to direct the investment of funds from, into and among such accounts. The funds of the Company, however and wherever deposited or invested, shall not be commingled with the personal funds of any Member or Manager or officer of the Company.

(6) Title to Assets: All personal and real property of this Company shall be held in the name of the Company, not in the names of individual Members, Managers or officers.

V. CAPITAL PROVISIONS

(1) Capital Contributions by Members: Contemporaneously with the execution of this Agreement, all the Members shall make the following contributions of cash, property or services as shown next to each Member’s name below. Unless otherwise noted, cash and property described below shall be paid or delivered to the Company on or by the thirtieth day after the company formation or as soon as reasonably practical thereafter, but in no event, later than the close of the second fiscal year quarter, following such date. The fair market values of items of property or services as agreed between the Company and the contributing Member, if any, are also shown below. The Percentage Interest in the Company that each Member shall receive in return for his or her capital contribution is also indicated for each Member.

<table>
<thead>
<tr>
<th>Name of Member and Address</th>
<th>Contribution</th>
<th>Fair Market Value of Member Interests</th>
<th>Percentage Member Interest Held</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Enterprise Holdings, LLC</td>
<td>Cash</td>
<td>$80</td>
<td>80%</td>
</tr>
<tr>
<td>James S. Nonprofit Family Foundation</td>
<td>Cash</td>
<td>$20</td>
<td>20%</td>
</tr>
</tbody>
</table>

(2) Additional Contributions by Members: The Members may agree, from time to time by unanimous vote, to require the payment of additional capital contributions by the Members, on or by a mutually agreeable date, provided however, no such capital shall be valid if the effect of same would cause a Foundation Member to jeopardize its tax exempt status or expose such Foundation Member to violate what is commonly called the “private foundation excise tax” rules of the Code.

(3) Failure to Make Contributions: Except as limited in Paragraph (2), above as to a Foundation Member, if a Member fails to make a required capital contribution within the time agreed for a Member’s contribution, the remaining Member or Members, as the case may be, may, by unanimous vote, agree to reschedule the time for payment of the capital contribution by the late-paying Member, setting any additional repayment terms, such as a late payment penalty, rate of interest to be applied to the unpaid balance, or other monetary amount to be paid by the delinquent Member, as the remaining Members decide. Alternatively, the remaining Member or Members may, by unanimous vote, agree to make up the difference of the non-contributing Member and the membership interests and capital accounts of the members shall be adjusted accordingly, as provided in Paragraph (5) below, taking into account the additional contributions made by the other members.

(4) No Interest on Capital Contributions: No interest shall be paid on funds or property contributed as capital to this Company, or on funds reflected in the capital accounts of the members.
(5) **Capital Account Bookkeeping:** A capital account shall be set up and maintained on the books of the Company for each Member. It shall reflect each Member’s capital contribution to the Company, increased by each Member’s share of profits in the Company, decreased by each Member’s share of losses and expenses of the Company. Each Member’s capital account must be determined, maintained and adjusted on the books and records of the Company in accordance with Section 704(b) of the Code and Treasury Regulations § 1.704-1(b) and all provisions of this Company Agreement must be interpreted and applied so as to comply with the requirements of the Code and Treasury Regulations.

(6) **Consent to Capital Contribution Withdrawals and Distributions:** Members shall not be allowed to withdraw any part of their capital contributions or to receive distributions, whether in property or cash, except as otherwise allowed by this Company Agreement or required by federal tax law, under the Code, as to a Foundation Member and, in any case, only if such withdrawal is made with the written consent of all Members.

(7) **Allocations of Profits and Losses:** No Member shall be given priority or preference with respect to other Members in obtaining a return of capital contributions, distributions or allocations of the income, gains, losses, deductions, credits or other items of the Company. The profits and losses of the Company and all items of its income, gain, loss, deduction and credit shall be allocated to Members according to each Member’s Percentage Interest in the Company, provided, however the Members, by agreement, may alter such preferences and allocations, upon the Company Managers obtaining an opinion from qualified tax and legal counsel that such altered preference or allocation does not jeopardize the tax-exempt status of a Foundation Member or cause such Member to be in violation of the private excise tax rules, under the Code.

(8) **Allocation and Distribution of Cash to Members:** Cash from Company business operations, as well as cash from a sale or other disposition of Company capital assets, may be distributed from time to time to Members in accordance with each Member’s Percentage Interest in the Company, as determined by the Company Manager (“Distributable Cash”), as a dividend, if deemed appropriate and such dividend has been approved by the Company’s advisors.

(9) **Allocation of Non-cash Distributions:** If any distributions consist of property other than cash, the Members shall decide the value of the property and allocate such value among the Members in accordance with each Member’s Percentage Interest in the Company. If such non-cash proceeds are later reduced to cash, such cash may be distributed to Members as otherwise provided in this Company Agreement.

(10) **Allocation and Distribution of Liquidation Proceeds:** Regardless of any other provision in this Company Agreement, if there is a distribution in liquidation of this Company, or when any Member’s interest is liquidated, all items of income and loss shall be allocated to the Members’ capital accounts, and all appropriate credits and deductions shall then be made to these capital accounts before any final distribution is made. A final distribution shall be made to Members only to the extent of, and in proportion to, any positive balance in each Member’s capital account and then only in accordance to each Member’s Percentage Interest in this Company.

(11) **Limitation on Distributions:** Notwithstanding any other provision of this Company Agreement to the contrary, no distribution to the Members will be made unless: (i) after the distribution is made the Fair Market Value of all the Company assets is in excess of its liabilities, other than the liabilities to the Members on account of their Capital Contributions; (ii) such distribution is in conformity with any outstanding loan agreements of the Company; and (iii) such distribution will not jeopardize the tax-exempt status of a Foundation Member or cause such Member to be in violation of the private foundation excise tax rules, under the Code.

VI. **MEMBERSHIP WITHDRAWAL AND TRANSFER PROVISIONS**

(1) **Withdrawal of Members:** Except as specifically provided herein, with respect to a non-profit Member, a Member may not withdraw from this Company, except by giving written notice to all other Members at least ten (10) days before the date the withdrawal is to be effective and then only upon the written consent of all non-withdrawing Members and the Company Managers. In the case of a non-profit Member, such non-profit Member may withdraw upon ten days written notice, without the consent of the non-withdrawing Members, provided such written notice is accompanied by a written consent of all the governing persons of the non-profit Member, approving a unanimous resolution of withdrawal. Serving such written notice shall constitute a Triggering Event, pursuant to Paragraph (3), herein, requiring the purchase and sale of the non-profit Members interest, by the other Members.

(2) **Restrictions on the Transfer of Membership:** A Member shall not transfer its membership in the Company unless all non-transferring Members in the Company first agree, in writing to such transfer and approve the admission of the transferee, as a Member, into this Company. Further, no Member may encumber a part or all of its membership in the Company by mortgage, pledge, granting of a security interest, lien or otherwise, unless the encumbrance has first been approved in writing by all other Members of the Company and the Company Manager. Any purported transfer or encumbrance in violation of this provision shall be null and void, and shall give the Company and the other non-transferring and non-encumbering Members an option to purchase such transferring or
encumbering Member’s interest in the manner and on the terms provided herein.

(3) Events Triggering the Purchase of a Member’s Interest: The occurrence of any of the following events (hereinafter “Triggering Events”) shall trigger a purchase of a Member’s Interest:

(a) The attachment, sequestration, imposition of a court ordered charging order, levy of execution or foreclosure upon such charging order, garnishment or other involuntary transfer or encumbrance of a Member’s Interest, by statute, court order or otherwise;

(b) The insolvency of a Member, whether the proceeding is voluntary or commenced otherwise; or

(c) The withdrawal of a non-profit Member, as provided in Paragraph (1), above.

All of the Member Interests of the Company owned by the Member (the transferring Member), including any Permitted Transferees of such Member (with respect to an assignee’s interest), shall be deemed to be offered to the Company and the other Members (non-transferring Members) under the terms and at the price set forth herein.

(4) Option to Purchase and Sell Member Interests: Upon the occurrence of any event in stated in Paragraph (3), the Company and non-transferring Members, if any, shall have an absolute right and first option to purchase from the transferring Member or his or her personal representative, all of the Member Interests of the transferring Member in the Company. The Company shall be given the first right of refusal. If the Company fails to exercise such first right of refusal, then in that event, the non-transferring Members shall have the second right of refusal. If the non-selling Members fail to exercise their right to purchase such transferring Members Interest, then the Company shall be bound to purchase the Member Interests of the transferring Member. Regardless of who exercises said option, upon notice, the transferring Member will be obligated to sell such Member’s Interest within the requisite time period. If the Company is legally and/or financially unable to do so, then the transferring Member may sell/transfer the Member Interests, but only on the terms and conditions offered to the Company, and the non-transferring Members as set out herein and provided further such transferee will have only the rights of an assignee and such an assignment shall not include a transfer of the Member’s voting or management rights in this Company, and the transferee shall not become a Member of the Company. A transferee shall only have a right to such Membership status upon all non-transferring Members in the Company first agreeing to approve the admission of the transferee into this Company, in writing, and the transferee executing and becoming a party to this Company Agreement, at which time such Member Interests shall be subject to the terms and conditions of this Company Agreement.

(5) Exercise of Option: The Company or non-selling Members must exercise the respective options set forth above in (4) within thirty (30) days of receipt of notice from the transferring Member. Notice to the Company must be given in writing and sent to the Company at its principal office. Notice to the non-selling Members shall be given to them at their respective addresses as set out in Section V, above.

(6) Closing: The closing of the purchase and sale of Members’ interests shall take place at the principal office of the Company at a date designated by the Company, which may not be more than sixty (60) days following the Triggering Event.

(7) Valuation of Member Interests: The price of Member Interests of each Member to be sold pursuant to this Company Agreement shall be the fair market value of the Member Interests. The fair market value shall be determined by a disinterested, qualified third party appraiser and shall be made based on the value of the Company as of the close of business of the most recent fiscal calendar quarter preceding the event triggering the purchase of the Member Interests as set out herein. In the event that the transferring Member and the non-transferring Members cannot agree on an appraiser, each will choose an appraiser, who in turn will agree on a third, all of whom meet the requirements as herein setout. In the event the latter method is used, the parties agree to be bound by the average valuation found by the three (3) appraisers. If all agree on single appraiser the expense of the appraisal will be borne by the Company. If the alternative method of selecting an appraisal is used, the cost of the appraisal process shall be borne equally by the transferring Member and the non-transferring Members.

(8) Payments: The payment of the purchase price or any part thereof (remaining after the payment of any insurance proceeds) shall be made by installment payments. Promissory notes shall be given to secure the payment of the installments. The notes shall be secured by the Member Interests in the Company. The notes shall bear interest at the then applicable federal rate and shall accelerate in the event of default. The payments shall be made in equal monthly installments over a five-year period.

VII. DISSOLUTION PROVISIONS

(1) Events That Trigger Dissolution of the Company: The following events shall trigger dissolution of the Company, except as otherwise provided:

(a) the expulsion, dissolution, bankruptcy of a Member, unless within 60 days of the happening of any of the foregoing events; all remaining Members of the Company vote to continue the legal existence
of the Company;
(b) the expiration of the term of existence of the Company, if such term is specified in Certificate of Formation or this Company Agreement;
(c) the written agreement of all Members to dissolve the Company;
(d) the entry of a decree of dissolution of the Company, under state law; and
(e) the investment of capital by a Foundation Member fails to qualify as a Program Related Investment or a Qualifying Distribution by a private foundation as those terms are defined under the Code and regulations thereunder.

(2) Effect of Dissolution: Upon dissolution of the Company, the Company will cease to carry on its business, except insofar as may be necessary for the winding up of its business, and the assets of the Company will be determined and valued effective as of the day on which the event occurs that results in dissolution, but the Company will not terminate until there has been a winding up of the Company’s business and affairs and the assets of the Company have been liquidated and distributed as provided in this Company Agreement. In no case may the Company terminate until the Company, upon the dissolution, shall cause prior written notice of its intention to dissolve to be mailed to each known creditor of and claimant against the Company in the manner required by the TBOC.

(3) Winding up Procedure: Upon the dissolution of the Company, the Company will:
(a) proceed to collect its assets,
(b) dispose of such of its properties as are not required to be distributed in kind to its Members,
(c) pay, satisfy and discharge its liabilities, or make adequate provision for payment and discharge of such liabilities, and
(d) do all other acts required to liquidate its business and affairs.

(4) Distribution of Assets upon Dissolution: In settling the accounts of the Company after its dissolution, the assets of the Company will be applied and distributed in the following order of priority:
(a) First, to the payment of the expenses of the terminating transactions, including without limitation brokerage commissions, legal fees and accounting fees;
(b) Second, to the extent permitted by law, and in accordance with the priorities, if any, established by applicable law, to creditors in satisfaction of liabilities of the Company, including liabilities of the Company to its Members as a creditor (other than for distributions and Capital Contributions), whether by payment or establishment of reserves; and
(c) Third, to its Members in proportion to their Membership Interests.

(5) Distributions in Kind: If any assets of the Company are distributed in kind, such assets will be distributed in accordance with the provisions of Paragraph (4), above, to the Members.

(6) Articles of Dissolution: When all liabilities and obligations of the Company have been paid or discharged, or adequate provision has been made for such liabilities, or in case its property and assets are not sufficient to satisfy and discharge all of the liabilities and obligations of the Company, then when all the property and assets of the Company have been applied, to the extent available, to the bona fide liabilities and obligations of the Company and all of the remaining property and assets of the Company have been distributed to its Members, or adequate provision has been made therefore, the Articles of Dissolution will be executed on behalf of the Company by the Members or the Managers, and will be filed with the Secretary of State of the State of Texas, and the Members or the Managers will execute, acknowledge and file any and all other instruments necessary or appropriate to reflect the dissolution and termination of the Company.

VIII. INDEMNIFICATION

(1) Right to Indemnification: Subject to the limitations and conditions in this Section VIII and any and all limitations set forth in the TBOC, each Person who was or is made a party or is threatened to be made a party to or is involved in any threatened, pending, or completed action, suit or proceeding, whether civil, criminal, administrative, arbitrative or investigatory (hereinafter a “Proceeding”), or any appeal in such a Proceeding or any inquiry or investigation that could lead to such a Proceeding, by reason of the fact that it, or a person of whom it is the legal representative, is or was a Member of the Company or while a Member of the Company is or was serving at the request of the Company as a Member, manager, director, officer, partner, venturer, proprietor, trustee, employee, agent, or similar functionary of another foreign or domestic limited liability company, corporation, partnership, joint venture, sole proprietorship, trust, employee benefit plan, or other enterprise, or serving in such foregoing capacity, whether or not a Member of the Company, shall be indemnified by the Company to the fullest extent permitted by the TBOC, as the same exists or may hereafter be amended (but, in the case of any such amendment, only to the extent that such amendment permits the Company to provide broader indemnification rights than said TBOC
permitted the Company to provide prior to such amendment) against judgments, penalties (including excise and similar taxes and punitive damages), fines, settlements and reasonable expenses (including attorneys’ fees) actually incurred by such person in connection with such Proceeding, and indemnification under this Section VIII. This indemnification obligation shall continue as to a person who has ceased to serve in the capacity which initially entitled such person to indemnity hereunder. The rights granted pursuant to this Section VIII shall be deemed contract rights, and no amendment, modification or repeal of this Section VIII shall have the effect of limiting or denying any such rights with respect to actions taken or Proceedings arising prior to any such amendment, modification, or repeal. It is expressly acknowledged that the indemnification provided in this Section VIII could involve indemnification for negligence or under theories of strict liability.

(2) Advance Payment: The right to indemnification conferred in this Section VIII shall include the right to be paid or reimbursed by the Company for the reasonable expenses incurred by a person of the type entitled to be indemnified under Paragraph (1) of Section VIII who was, is or is threatened to be made a named defendant or respondent in a Proceeding in advance of the final disposition of the Proceeding and without any determination as to the person’s ultimate entitlement to indemnification; provided, however, that the payment of such expenses incurred by any such person in advance of the final disposition of a Proceeding, shall be made only upon delivery to the Company of a written affirmation by such person of his, her or its good faith belief that he, she or it has met the standard of conduct necessary for indemnification under this Section VIII and a written undertaking, by or on behalf of such person, to repay all amounts so advanced if it shall ultimately be determined that such indemnified person is not entitled to be indemnified under this Section VIII or otherwise.

(3) Indemnification of Employees and Agents: The Company shall indemnify and advance expenses to an employee or agent of the Company to the extent required doing so by the TBOC or other applicable law. The Company, by adoption of a resolution of a majority of Members owning Member Interests, may indemnify and advance expenses to an employee or agent of the Company to the same extent and subject to the same conditions under which it may indemnify and advance expenses to Members under this Section VIII; and, the Company may indemnify and advance expenses to persons who are not or were not Members, employees, or agents of the Company but who are or were serving at the request of the Company as a Member, manager, director, officer, partner, venturer, proprietor, trustee, employee, agent, or similar functionary of another foreign or domestic limited liability company, corporation, partnership, joint venture, sole proprietorship, trust, employee benefit plan, or other enterprise against any liability asserted against such person and incurred by such person in such a capacity or arising out of its status as such a person to the same extent that the Company may indemnify and advance expenses to Members under this Section VIII.

(4) Limitation on Liability of Members: The indemnification set forth in this Section VIII shall in no event cause the Members to incur any personal liability beyond their total Capital Contributions, nor shall it result in the liability of any Member to a third party.

(5) Appearance as a Witness: Notwithstanding any other provision of this Section VIII, the Company may pay or reimburse expenses incurred by a Member in connection with his, her or its appearance as a witness or other participation in a Proceeding at a time when the Company and/or person of the type entitled to be indemnified under Paragraph (1) of Section VIII, is not a named defendant or respondent in the Proceeding. At the discretion of the Company Manager, the Company Manager may choose to pay or reimburse expenses incurred by a person, other than the foregoing.

(6) Non-exclusivity of Rights: The right to indemnification and the advancement and payment of expenses conferred in this Section VIII shall not be exclusive of any other right which a Member or other person indemnified pursuant to Paragraph (3) of Section VIII may have or hereafter acquire under any law, provision of the Certificate or this Company Agreement, or otherwise.

(7) Insurance: The Company may purchase and maintain insurance, at its expense, to protect itself and any person who is or was serving as a Member, officer, employee, or agent of the Company or is or was serving at the request of the Company as a Member, manager, director, officer, partner, venturer, proprietor, trustee, employee, agent, or similar functionary of another foreign or domestic limited liability company, corporation, partnership, joint venture, sole proprietorship, trust, employee benefit plan, or other enterprise against any expense, liability or loss, whether or not the Company would have the power to indemnify such person against such expense, liability or loss under this Section VIII. The Members shall from time to time agree on the types of insurance, levels of coverage and the deductible amounts of the insurance to be procured and maintained by the Company.

(8) Member Notification: To the extent required by the TBOC, any indemnification of or advance of expenses to a Member in accordance with this Section VIII shall be reported in writing to the other Members with or before the Notice or waiver of Notice of the next Members’ meeting or with or before the next submission to Members of a consent to action without a meeting and, in any case, within the 12-month period immediately.
following the date of the indemnification or advance.

(9) **Savings Clause:** If this Section VIII or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then the Company shall nevertheless indemnify and hold harmless each Member or any other person indemnified pursuant to this Section VIII, as to costs, charges and expenses (including attorneys' fees), judgments, fines and amounts paid in settlement with respect to any action, suit, or proceeding, whether civil, criminal, administrative, or investigative to the full extent permitted by any applicable portion of this Section VIII that shall not have been invalidated and to the fullest extent permitted by law.

IX. **GENERAL PROVISIONS**

(1) **Records:** The Company shall keep at its principal business address a copy of all proceedings of Manager and Membership meetings, as well as books of account of the Company’s financial transactions. A list of the names and addresses of the current Membership of the Company also shall be maintained at this address, with notations on any transfers of Members’ Interests to non-Members or persons being admitted into Membership in the Company.

Copies of the Company’s Certificate of Formation, a signed copy of this Company Agreement, and the Company’s tax returns for the preceding three tax years shall be kept at the principal address of the Company. A statement also shall be kept at this address containing any of the following information that is applicable to this Company:

- the amount of cash or a description and value of property contributed or agreed to be contributed as capital to the Company by each Member;
- a schedule showing when any additional capital contributions are to be made by Members to this Company;
- a statement or schedule, if appropriate, showing the rights of Members to receive distributions representing a return of part or all of Members’ capital contributions;
- a description of, or date when, the legal existence of the Company will terminate under provisions in the Company’s Certificate of Formation or this Company Agreement; and
- a record, showing at all times, how the Company’s operation and the deployment of its capital assets is meeting the Company’s purposes.

If one or more of the above items is included or listed in this Company Agreement, it will be sufficient to keep a copy of this Company Agreement at the principal business address of the Company without having to prepare and keep a separate record of such item or items at this address.

Any Member may inspect any and all records maintained by the Company upon reasonable notice to the Company. Copying of the Company’s records by Members is allowed, but copying costs shall be paid for by the requesting Member.

(2) **All Necessary Acts:** The Members, Managers and officers of this Company are authorized to perform all acts necessary to perfect the organization of this Company and to carry out its business operations expeditiously and efficiently. The Secretary of the Company, or other officers, or all Members of the Company, may certify to other businesses, financial institutions and individuals as to the authority of one or more Members or officers of this Company to transact specific items of business on behalf of the Company.

(3) **Entire Agreement:** This Company Agreement represents the entire agreement among the Members of this Company, and it shall not be amended, modified or replaced except by a written instrument executed by all the parties to this Company Agreement who are current Members of this Company as well as any and all additional parties who became Members of this Company after the adoption of this Company Agreement. This Company Agreement replaces and supersedes all prior written and oral agreements among any and all Members of this Company.

(4) **Severability:** If any provision of this Company Agreement is determined by a court or arbitrator to be invalid, unenforceable or otherwise ineffective, that provision shall be severed from the rest of this Company Agreement, and the remaining provisions shall remain in effect and enforceable.

(5) **Governing Law:** This Company Agreement will be governed by the law of the State of Texas.

(6) **Specific Enforcement:** The Managers and Members declare that it is impossible to measure the damages that shall accrue to a party to this Company Agreement or to the Company in the event a Manager or Member breaches the terms of this Company Agreement. Therefore, if a Manager or Member, individually or on behalf of the Company institutes an action or proceeding to enforce the provisions of this Company Agreement, the Company Agreement must be specifically enforced, if such breach of this Company Agreement is found to exist by any of the method of dispute resolution as provided herein or subsequently by a court of competent jurisdiction, and no damages shall be awarded.
X. DEFINITIONS

The following terms, as used in this Company Agreement, unless otherwise indicated, have the following meanings:

1. "Additional Contributions" means any Capital Contribution in excess of a Member’s Initial Contribution, made to the Company pursuant to Paragraph (2) of Section V, entitled CAPITAL PROVISIONS.

2. "Capital Account" means the account maintained for the Members in accordance with Paragraph (5) of Section V, entitled CAPITAL PROVISIONS.

3. "Capital Contribution" means any Initial Contribution or Additional Contribution to the capital of the Company in cash or property when and as such contribution is actually made to the Company by Members.

4. "Certificate of Formation" means the Certificate of Formation filed with the Secretary of State of the State of Texas on ______________, as may be amended, modified or supplemented from time to time as provided in the TBOC and this Company Agreement.

5. "Code" means the Internal Revenue Code of 1986, as amended from time to time. All references in this Company Agreement to the Code will include any corresponding provision or provisions of succeeding law.

6. "Distributable Cash" means the cash available to distribute to Members pursuant to Paragraph (8) of Section V, entitled CAPITAL PROVISIONS.

7. "Fair Market Value" means the price in cash, or its equivalent, that an asset would bring considering its highest and most profitable use, if then offered for sale in the open market, in competition with other similar assets at or near the same location, with a reasonable time allowed to find a purchaser.

8. "Foundation" or "Private Foundation" means a tax exempt private foundation or private operating foundation, as defined under the Code and regulations thereunder.

9. "Losses" means, for each accounting year, or portion thereof, as may be applicable, the losses and deductions of the Company in accordance with accounting principals consistently applied from year to year under the Company’s method of accounting.

10. "Member" has the meaning set forth in Paragraph (1) of Section II, entitled MEMBERSHIP PROVISIONS. The term Member shall include a Foundation Member. A “Foundation Member” is a Member who is organized as a Foundation.

11. "Membership Interest" means the interest of the Members in the Company, including the Member’s Capital Account and the Member’s rights to a share of the Profits and Losses of the Company, to receive distributions (liquidating or otherwise), to obtain information and to or approve actions by the Company.

12. "Percentage Interest" means the portion of the Company’s total Membership Interests owned by a Member.

13. "Permitted Transfer" means a Transfer to another Member or Person, but only with pursuant to the provisions of the Company Agreement.

14. "Person" means any individual or entity, public or private.

15. "Program Related Investments" shall have the meaning ascribed thereto in Paragraph (4), Section IV, herein.

16. "Profits" means, for each accounting year or portion thereof, as may be applicable, the income and gains of the Company determined in accordance with generally accepted accounting principals consistently applied from year to year under the Company’s method of accounting.

17. "Required Capital Contribution" means the Initial and Additional Capital Contribution required of a Member pursuant to Section V, entitled CAPITAL PROVISIONS.

18. "TBOC" means the Texas Business Organizations Code; as such statute may be amended from time to time. All references in this Company Agreement to the TBOC will include corresponding provision or provisions of succeeding law.

19. "Treasury Regulations" means the regulations adopted from time to time by the United States Department of Treasury under and pursuant to the Code.

XI. DISPUTE RESOLUTION

1. Disputes: If any controversy dispute, claim or other matter arising out of or relating to this Company Agreement, the relationship of the Managers, the Members with each other or the Company, or any agreements or instruments relating hereto or delivered in connection herewith, including, but not limited to, a claim based on or arising from an alleged tort, whether between Members or a Member and the Company or the Managers or any combination thereof ("Dispute") shall occur, all such Disputes shall be settled by arbitration before a single arbitrator in accordance with the United States Federal Arbitration Act (9 U.S.C. § 1 et seq. as amended or superseded) and United States Federal case law interpreting the same (the “Federal Arbitration Act”), notwithstanding any choice of
law provision in this Company Agreement, and under the Commercial Rules of the American Arbitration Association (“AAA”) then in effect. The arbitration will be administered by AAA pursuant to its Commercial Rules. This agreement to arbitrate shall be specifically enforceable under the Federal Arbitration Act.

(2) **Selection of Arbitrator:** At the beginning of the arbitration, AAA will be instructed by one or more parties to the arbitrator to prepare a list of proposed arbitrators. Within 10 days of receipt of the list, each party may strike one name from the list. The AAA will then appoint one arbitrator from the name(s) remaining on the list.

(3) **Procedure:** Any party to this Agreement shall have the right to refer a Dispute to arbitration as provided herein, and all parties concerned agree to cooperate in obtaining such arbitration. Each arbitration shall be submitted to AAA for arbitration and shall be held in Houston, Texas. The parties to the arbitration, in addition to the rights granted under the Commercial Arbitration Rules of the AAA, shall have the right to discovery, offer evidence and testify at the hearings and cross-examine any and all witnesses in accordance with the Federal Rules of Civil Procedure. Each Member shall pay a proportionate share of all expenses of arbitration equal to the ratio that the Membership Interest owned by the Member bears to the Membership Interests of all parties participating in the arbitration, excluding each party’s attorneys’ fees which shall be borne separately by each party. In no event shall any demand for arbitration be made after the date upon which the institution of legal or equitable proceedings based upon such dispute would be barred by the applicable statute of limitation and the arbitrator will take the applicable statute of limitations into account in making any decision or award. Any controversy concerning whether an issue is arbitrational will be determined by the arbitrator. The institution and maintenance of an action for judicial relief or pursuit of a provisional or ancillary remedy will not constitute a waiver of the right of any party, to submit the controversy or claim to arbitration if any other party contests such action for judicial relief.

(4) **Arbitrator’s Award:** The award rendered by the arbitrator will set forth findings of the facts and conclusions of law. A failure by the arbitrator to make findings of fact and conclusions of law will not be grounds for overturning the award. The arbitrator’s award will be final and binding on all parties, and neither party will have any right to contest or appeal the arbitrator’s award, except as expressly provided for by the Federal Arbitration Act. The arbitrator may, in the award, allocate all or part of the costs of the arbitration, including the fees of the arbitrator and the reasonable attorneys’ fees and costs of the prevailing party incurred in the arbitration. Judgment on the award may be entered in any court having jurisdiction. This Section is self-executing, and in the event that either party fails without good cause to appear at any properly noticed arbitration proceeding absent a previously issued court order to the contrary, an award may be entered against the party notwithstanding the failure to appear.

(5) **Equitable Relief:** In addition to the foregoing rights and obligations to arbitrate, and without limitation to the powers and authority of the arbitrator appointed and as set forth in the AAA Rules, either party may, without bond, apply ex parte for the entry of emergency equitable relief in accordance with these provisions either before initiating arbitration or during the course of arbitration, including but not limited to provisional equitable relief in aid of arbitration from a court of appropriate jurisdiction. Once such equitable relief has been granted, the parties shall jointly request a stay of the court case pending completion of the arbitration pursuant to these provisions.

(6) **Choice of Law for Arbitration:** Notwithstanding any choice of law provision in this Company Agreement, all issues relating to arbitration or the enforcement of the within agreement to arbitrate will be governed exclusively by the Federal Arbitration Act. The parties will expressly agree not to be bound by any state rules on arbitration, including those relating to the site of arbitration. The Parties hereby appoint the Secretary of State of the State of Texas in Austin, Texas as their agent for service of process and hereby waive any claim of lack of jurisdiction of the state or federal courts in Texas over such Party or the award. All proceedings shall be undertaken in the English language.

(7) **Miscellaneous:** The subject matter of this Company Agreement involves interstate commerce. The provisions of this section shall survive termination of this Company Agreement and shall control over any conflicting agreements of the parties. Without limiting the foregoing, if there shall be any conflict between the provisions of any other document and this Company Agreement, the terms of this Company Agreement shall control. Compliance with the provisions of this Section shall be a condition precedent to the institution of any court proceeding relating to the subject matter of this Company Agreement other than a suit to compel arbitration.

(8) **No Punitive Damages:** The parties waive the right to punitive or exemplary damages and the arbitrator shall have no authority to award any damages other than actual damages.

**XII. SIGNATURES OF MEMBERS AND MANAGERS**

Execution of Company Agreement: In witness whereof, the Members of this Company sign and adopt this Agreement as the Company Agreement of this Company.
Signature Page

Social Enterprise Holdings, LLC
A Texas Limited Liability Company

By: _____________________________
Printed Name: THOMAS M. FOR-PROFIT,
It’s Managing Member
Date: ___________________________

James S. Nonprofit Family Foundation
A Texas Nonprofit Corporation

By: _____________________________
Printed Name: JAMES S. NONPROFIT,
It’s President
Date: ___________________________
Exhibit C
Compendium of Sources opposing the L3C


Exhibit D
Summary of the Private Foundation Excise Tax Rules*

*[Author’s Note: This Summary is adapted from the CLE Article “Sophisticated Charitable Planning: Helping Your Clients Achieve Their Charitable Goals On A Tax-Enhanced Basis” by Cheryl Cain Crabbe at the State Bar of Texas 30th Annual Advanced Estate Planning And Probate Course, June 7-9, 2006, Houston and updated for the Pension Protection Act of 2006.]

A. The Private Foundation Excise Tax Rules.

Generally speaking, they break down into two types of rules: (i) mandatory requirements relating to the accomplishment of exempt purposes; and (ii) specific restrictions or prohibitions against transactions which might benefit related parties. Generally, a moderate tax is imposed (on the foundation, its managers and/or disqualified persons) upon the initial violation of a rule. If the violation is not timely corrected within statutorily prescribed time periods, a much more punitive level of tax is imposed on the responsible parties (both the foundation and the foundation managers). Various taxes and penalties were significantly increased by the Pension Protection Act of 2006, as set out in footnote 3). 1 Private foundations are subject to all of the Chapter 42 excise tax rules, i.e., net investment income, self-dealing, minimum required distributions, excess business holdings, jeopardy investments and taxable expenditures. I.R.C. §§4940 through 4946.

B. Annual Excise Tax - Net Investment Income  I.R.C. §4940

I.R.C. §4940 requires a private foundation to pay an annual excise tax equal to 2% of its net investment income. Under certain circumstances, the excise tax may be reduced to 1%. I.R.C. §4940(e). This special rule allows a private foundation that has not been delinquent in fulfilling its annual distribution requirements (as discussed below) in the previous five (5) years to reduce the excise tax for any taxable year (other than the first taxable year) to 1% if the foundation makes qualifying distributions during such year which are at least equal to a "required amount (however the 1% rate is not available in the initial year)." The "required amount" is, in essence, equal to (i) the current year’s asset average for the foundation's assets, multiplied by the average percentage of assets distributed as qualifying distributions over the five preceding taxable years (or all prior years if less than five), plus (ii) 1% of the foundation's net investment income for the current taxable year. I.R.C. §4940(e)(2)(A). The 2% (sometimes 1%) excise tax is levied on all private foundations (other than certain operating foundations), as a matter of course, and, unlike the other five excise taxes discussed below, is not triggered by violation of a requirement or prohibition.

Illustration: A foundation with $1,000,000 in assets, net investment income of $100,000, and an average payout percentage for the preceding five tax years of 5.5% would be eligible to reduce its excise tax on net investment income to 1% if it pays out at least $56,000 during the tax year. Note, however, that an extraordinarily large distribution in any single year could significantly raise the average payout percentage and, effectively, prevent the foundation from taking advantage of the excise tax reduction over the ensuing five year period.

C. Required Distributions- Minimum Distributions Requirements - I.R.C. §4942

1. In General- Minimum Distributions

I.R.C. §4942 contains the primary operational mandate. It requires a private foundation to distribute a minimum amount of its assets for its exempt purposes on an annual basis. The current year minimum payout requirement is 5% of the prior year’s average value of the foundation's net assets (as calculated on the foundation’s IRS Form 990-PF) for the year. I.R.C. §4942(e). In meeting the distributional requirements, the Code imposes restrictions on the types of distributions that will qualify. Generally speaking, "qualifying distributions" consist of gifts made by a

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1 See, e.g., I.R.C. §§ 4941(a)(I) and 4941(b) (imposing self-dealing penalties of 10% for initial tax for the self-dealer and 5% for the foundation manager[1st tier], up to a maximum of $20,000 and 200% self-dealer and 50%, up to the $20,000 maximum for the manager, if not timely corrected [2nd tier]); (fn. 3 cont’d; I.R.C. §§ 4942(a) and 4942(b) (penalties of 30% [1st tier] and 100% [2nd tier] for the foundation, for failure to make minimum required distributions); I.R.C. §§ 4943(a) and 4943(b) (penalties of 10% [1st tier] and 200% [2nd tier] for excess business holdings); I.R.C. §§ 4944(a) and 4944(b) (penalties of 10% for the foundation and 10% for managers up to a maximum of $10,000 [1st tier] and 25% for the foundation and of 50% for the foundation manager up to $20,000 [2nd tier] for making jeopardy investments); I.R.C. §§ 4945(a) and 4945(b) (penalties of 20% for the foundation and 5% for the manager up to $10,000 [1st tier] and 100% for the foundation and 50% for the foundation manager [2nd tier] for making taxable expenditures).
The L3C Legal Structure: A For-Profit LLC with a Non-Profit Purpose

private foundation to other charitable organizations which, in turn, utilize the funds directly in carrying out the charity's particular exempt activity. Gifts or grants made directly to individuals can be qualified distributions, if made for its exempt purposes, but only if the private foundation maintains significant involvement in active programs in support of which payments were made and follows onerous record keeping requirements. If a foundation distributes more than the required amount in any given year, the excess qualifying distributions can be carried forward for five years and can be used to satisfy the minimum distribution requirements in those years. I.R.C. §4942(i).

2. Minimum Distribution Penalties
   Failure to make minimum required distributions triggers a 30% 1st tier excise tax on the amount which was improperly accumulated within the foundation and is payable by the foundation. I.R.C. §4942(a). If the foundation fails to timely correct the shortfall, an additional 100% tax on the undistributed amount will be triggered as a 2nd tier penalty. I.R.C. §4942(b).

D. Prohibited Distributions - Taxable Expenditures - I.R.C. §4945
   1. In General- Taxable Expenditures
      Not only must a private foundation make minimum "qualifying distributions" under I.R.C. §4942 (discussed above), the private foundation must be careful not to make certain prohibited distributions. I.R.C. §4945 imposes penalties on a foundation and its managers for making certain prohibited distributions (referred to as "taxable expenditures"). See I.R.C. §4945(d). The most significant limitation may be the prohibition against making grants (distributing funds) to an individual for travel, study or other similar purposes unless the private foundation obtains advance approval from the IRS of the procedures for making them. I.R.C. §4945(d)(3). Other "taxable expenditures" include grants made or amounts incurred by a foundation: (a) to carry on propaganda, or otherwise to attempt, to influence legislation; (b) to influence the outcome of any specific public election, or to carry on directly or indirectly, any voter registration drive, except for certain non-partisan activities; (c) to another organization that is not recognized as (or treated as) a "public charity," unless the foundation undertakes fairly strict supervision of the grantee's expenditures of the grant funds; and (d) for any purpose other than, basically the charitable purposes for which the foundation was created. I.R.C. §§4945(d)(1), (2), (4) and (5).

   2. Taxable Expenditure Penalties
      Each taxable expenditure triggers a 20% initial excise tax on the foundation and a 5% tax on each foundation manager who is knowingly involved (1st tier). I.R.C. §§4945(a)(1) and (2). If the private foundation fails to timely correct the taxable expenditure, additional excise taxes of 100% on the foundation and 50% on the managers are imposed. I.R.C. §§4942(b)(1) and (2). The maximum tax on a manager is limited to $10,000 for the initial tax and $20,000 for the additional tax. I.R.C. §4945(c)(2).

E. Prohibited Investments Jeopardizing Investments - I.R.C. §4944
   1. In General - Jeopardizing Investments
      I.R.C. §4944 requires a foundation to make investments in a manner that does not "jeopardize" its ability to carry out its exempt purposes and imposes an excise tax on a foundation and its managers for violation of this rule. I.R.C. §§4944(a) and (b). This restriction is designed to prevent a private foundation from making speculative investments. The regulations under I.R.C. §4944 incorporate a "prudent investor standard" and set forth guidelines for determining whether a specific investment is a "jeopardy investment" See Treas. Regs. §53.4944-1(a)(2). Although the regulations do not contain absolute prohibitions, they do provide that certain types of investments, such as commodity futures, securities purchased on margin, working interests in oil and gas wells, and short sales of securities, will be "closely scrutinized." Id. However, whether such investments will attract the excise tax on jeopardizing investments must be determined in light of the whole portfolio. Id.
      If a foundation invests its assets in a balanced, diversified portfolio designed to meet both its current and future needs in carrying out its exempt functions, jeopardizing investment excise taxes should not be a concern.

   2. Jeopardizing Investment Penalties
      If a foundation makes a jeopardizing investment, an initial tax on the amount so invested is imposed on both the foundation (10%) and on any foundation manager (10%) who participates in making the investment knowing that it jeopardizes the foundation's exempt purposes (1st tier). I.R.C. §§4944(a)(1) and (2). An additional 25% tax will be imposed on the foundation if the IRS notifies the foundation of the need to make a correction and the notice is not timely followed. I.R.C. § 4944(b)(1). An additional 50% tax will be imposed on a foundation manager who refused to agree to removal of the investment from jeopardy (2nd tier). I.R.C. §4944(b)(2). With respect to anyone
investment, the initial tax imposed on a manager is $10,000 (1st tier), and the additional tax at $200,000 (2nd tier). I.R.C. §4944(d)(2).

F Prohibited Transactions or Involvement in Self-Dealing - I.R.C. §4941
1. In General- Self-Dealing
I.R.C. §4941 prohibits both direct and indirect self-dealing, whether or not the transaction benefits the foundation. Direct self-dealing involves transactions between a foundation and related parties. Indirect self-dealing involves transactions between such related parties and an entity that the foundation controls.

2. Disqualified Persons - Self-Dealing
In the context of dealing with related parties, I.R.C. §4946 defines the types of related parties, i.e., "disqualified persons" whose participation in a transaction will trigger potential self-dealing penalties. These related parties include: (i) substantial donors to the foundation, including an individual, trust, estate, partnership or corporation whose contributions to the foundation total more than $5,000, if that total exceeds 2% of all the contributions received by the foundation from its creation through the close of the taxable year in which the donor's contribution is made, I.R.C. §§4946(a)(I)(A) and 4946(a)(2); (ii) foundation managers, i.e., officers, directors, trustees and certain employees of the foundation, I.R.C. §4946(a)(I)(B); (iii) persons holding more than a 20% interest in corporations, partnerships or trusts that are substantial donors to the foundation, I.R.C. §4946(a)(I)(C); (iv) family members of any person described in (i), (ii) or (iii) above, that is, such person's spouse, ancestors and descendants, and spouses of such person's descendants, I.R.C. §4946(a)(I)(D); and (v) corporations, partnerships and trusts in which persons described in (i), (ii), (iii) or (iv) above hold more than a 35% interest. I.R.C. §§ 4946(a)(I)(E), (F) and (G).

3. Direct Self-Dealing
A general familiarity with the concept of "disqualified persons," as discussed above, is essential to complying with the "self-dealing rules," which are a series of general rules prohibiting a broad range of direct transactions between a private foundation and its disqualified persons. Subject to certain exceptions described below, the term "self-dealing" means any of the following transactions: (i) a sale, exchange or leasing of property between a private foundation and a disqualified person; (ii) any lending of money or other extension of credit between a private foundation and a disqualified person; (iii) any furnishing of goods, services or facilities between a private foundation and a disqualified person; (iv) any payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person; (v) any transfer to, or use by or for the benefit of a disqualified person of the income or assets of a private foundation; and (vi) an agreement by a private foundation to make any payment of money or other property to a government official. I.R.C. §4941 (d).

4. Indirect Self-Dealing
Indirect self-dealing involves transactions between a disqualified person and an entity that the foundation controls. The transactions covered by the term "indirect self-dealing" are those that would have been acts of direct self-dealing if entered into between the disqualified person and the foundation directly. See Treas. Regs. §53.4941(d)-1 for when a foundation is deemed to control an organization, for exclusion of certain grants and transactions from the term "indirect self-dealing" and for examples of what does and does not constitute indirect self-dealing.

5. Exceptions to Self-Dealing
I.R.C. §4941(d)(2) provides exceptions to self-dealing which apply to both direct and indirect acts of self-dealing. Major exceptions allow disqualified persons and private foundations to participate together in the following acts without imposing self-dealing penalties: (i) a disqualified person can make an interest-free loan to a foundation if the proceeds are used entirely for the foundation's charitable purpose, I.R.C. §4941(d)(2)(B); (ii) a disqualified person can furnish goods, services or facilities to a foundation if the furnishing is without charge and the goods, services or facilities are used exclusively for the foundation's exempt purposes, I.R.C. §4941(d)(2)(C); (iii) a private foundation can furnish goods, services or facilities to a disqualified person if the furnishing is made on a basis no more favorable than that on which such goods, services or facilities are made available to the general public, I.R.C. §4941(d)(2)(D); (iv) a private foundation can pay compensation and expenses (or reimburse expenses) to a disqualified person for personal services which are reasonable and necessary to carrying out the foundation's exempt purpose as long as such payments are not excessive, I.R.C. §4941 (d)(2)(E); and (v) any transaction between a private foundation and a corporation which is a disqualified person, pursuant to any liquidation, merger, redemption, recapitalization, or other corporate adjustment, organization or reorganization if all of the securities of the same class
as that held by the foundation are subject to the same terms and such terms provide for receipt by the foundation of no less than fair market value. I.R.C. §4941(d)(2)(F).

6. Self-Dealing Penalties

The taxes on self-dealing are imposed on the disqualified person, as well as on any foundation manager who knowingly and willfully participates in the act of self-dealing. It should be noted that these penalties are mandatory and not subject to abatement. The initial excise tax on the disqualified person is 10% of the amount involved in the act of self-dealing, I.R.C. §4941(a)(1); the initial excise tax on a foundation manager who knowingly and willfully participates in the act of self-dealing is 5% of the amount involved, up to $20,000 (1st tier). I.R.C. §§4941(a)(2) and (c)(2). If the act is not timely corrected, an additional tax of 200% of the amount involved will be imposed upon the disqualified person, I.R.C. §4941(b)(1); an additional tax of 50% of the amount involved, up to $20,000, will be imposed on the manager if the manager does not agree to part or all of the correction (2nd tier). I.R.C. §§4941(b)(2) and (c)(2). Where a foundation manager is also a disqualified person (other than in his capacity as a foundation manager), he or she is liable for all the taxes in both capacities. Treas. Regs. §53.4941(a)-1(a).

G. Prohibited Holdings-Excess Business Holdings- I.R.C. § 4943

1. In General-Excess Business Holdings

I.R.C. §4943 imposes penalties on a private foundation's investment, in entities in which disqualified persons are also investors, depending upon the level of investment. These are the "excess business holdings" rules. A foundation has excess business holdings when its holdings, together with those of disqualified persons, exceed 20% of the voting stock, profits or capital interest in a corporation or partnership. I.R.C. §4943(c)(2)(A). Business holdings do not include interests in a business that is "substantially related" to a foundation's exempt purposes, or interests in a business at least 95% of the gross income of which is derived from passive sources. I.R.C. §4943(d)(3). Permitted aggregate business holdings are increased from 20% to 35% if it can be established that effective control of the business entity is in one or more persons who are not disqualified persons with respect to the foundation. I.R.C. §4943(c)(2)(B).

2. De Minimis Exceptions

There are specific de minimis exceptions which allow the private foundation to hold a limited amount of otherwise prohibited holdings. A private foundation will not be treated as having excess business holdings in any corporation in which it owns no more than 2% of the voting stock and no more than 2% in value of all outstanding shares of all classes of stock. I.R.C § 4943(c)(2)(C). A similar de minimis rule applies to partnership interests. I.R.C § 4943(c).

3. Transition Rules

There are also certain transition rules which allow the private foundation to dispose of prohibited holdings without imposition of the excise tax penalties. Generally, the transition rules provide that a private foundation may avoid an excise tax on excess business holdings if it disposes of such holdings, as follows: (i) if a foundation acquires excess business holdings by gift or bequest, it has 5 years to dispose of excess business holdings and can request an extension of time to do so, I.R.C §§ 4943(c)(6) and (7); and (ii) if a foundation's excess business holdings arise as a result of a disqualified person's purchase of business interests, the foundation has 90 days to dispose of what became, by such purchase, the foundation's excess business holdings, Treas. Regs. §53A4943-2(a)(ii). However, if a foundation's purchase of business interests creates the excess business holdings, there is no grace period, and the excise tax is imposed immediately.

4. Excess Business Holdings Penalty

The excise taxes on excess business holdings are imposed on the foundation. I.R.C. §4943(a) imposes an initial tax on a foundation's excess business holdings equal to 10% of the value of such holdings (1st tier). If the foundation does not timely dispose of the excess business holdings, an additional tax equal to 200% of the value of the excess business holdings is imposed (2nd tier). I.R.C. §4943(b).