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IRS Confirms Deductibility of Contributions to LLCs Wholly-Owned by a U.S. Charity

By Ofer Lion and J. William Gray

The IRS has finally confirmed that if a gift to a U.S. charity is tax-deductible, then so is a gift to its domestic "disregarded" single-member limited liability company (SMLLC). This welcome news will allow charities to more easily use LLCs to protect assets and segregate liability among distinct operations. Forming a tax-exempt corporate subsidiary generally requires an application for tax-exempt status and a review by the IRS that can often take nearly a year. A SMLLC can be formed in a day, allowing a charity to quickly and efficiently restructure to protect separate assets and operations.

IRS Notice 2012-52 eliminates the uncertainty about deductibility that the IRS created in 2001 training materials for its agents. A SMLLC is disregarded for most federal income tax purposes unless it affirmatively elects to be treated as a corporation. The 2001 article confirmed that a disregarded SMLLC's activities, revenues and expenses, whether for exempt or unrelated purposes, (i) are imputed to its sole member charity for purposes of determining the charity's eligibility for tax exemption, liability for excise taxes and liability for unrelated business income taxes and (ii) are to be reported on the member charity's Form 990 information return. However, the article noted that "the Service is considering whether the same treatment applies for purposes of IRC 170 [charitable contribution deductions]." Acknowledging the significance of the deductibility question, the article promised that "[g]uidance on this issue will be forthcoming in the near future." After 11 years, the "near future" has finally arrived. Notice 2012-52 makes clear that direct gifts to a domestic SMLLC are equally as deductible as gifts to its sole member charity.

Even though a gift goes to a SMLLC, Notice 2012-52 makes its member charity responsible for meeting substantiation and disclosure requirements applicable to the gift. To avoid unnecessary inquiries by the IRS, the Notice encourages the charity to disclose, in a gift acknowledgment or another statement, that the SMLLC is wholly owned by the charity and is disregarded for federal income tax purposes. Annual percentage limitations on charitable contribution deductions apply to a donor's gifts to a SMLLC as if the gifts were made to the sole member charity.

Charities should keep in mind that state laws are distinct from federal tax rules. A SMLLC disregarded for federal tax purposes may be "regarded" for state law purposes, including for tax-exempt status and reporting requirements. Charities considering using SMLLCs should consult their tax advisors as to state law issues such as whether gifts made directly to a SMLLC will generate state income tax deductions, whether assets a charity transfers to its SMLLC will remain eligible for property tax exemption, and what state and local reporting obligations are applicable to a SMLLC.

Conclusion

It's official: if a charitable contribution to a U.S. tax-exempt organization is tax-deductible, then so is a contribution to its domestic "disregarded" SMLLC. Taking state law implications into account, tax-exempt organizations may wish to consider using LLCs when restructuring to protect assets and segregate liability among distinct operations, now with comfort that each such LLC can receive tax-deductible contributions. Private foundations may conclude that the Notice allows direct grants to a U.S. charity's domestic SMLLC without triggering expenditure responsibility requirements, subject to verification of the SMLLC's status as a disregarded entity and the sole member's public charity classification.

If you have any questions about this alert, please contact any of the Hunton & Williams lawyers listed below.

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