

EXEMPT ORGANIZATIONS

INFORMATION MEMO

MAY 16, 2022

Can “Business” Activities Ever Be Charitable? New York Thinks Not

As we previously summarized [here](#), the IRS recently brought much-needed clarity for limited liability companies (LLCs) seeking to be recognized as tax-exempt under Internal Revenue Code Section 501(c)(3). ([IRS Notice 2021-56](#)). Given this new guidance, we expressed optimism for expanded use of 501(c)(3) LLCs, which can have significant advantages over nonprofit corporations in a variety of contexts. Unfortunately, however, where the IRS has provided a roadmap for tax exemption, New York has responded by closing off the roads.

On March 10, 2022, the New York State Attorney General issued comments in response to the Notice 2021-56 (as requested by the IRS) advocating that “[w]here state law, as in New York, does not authorize creation of an LLC for charitable purposes, the IRS should refuse to authorize 501(c)(3) eligibility for LLCs domiciled in that jurisdiction.” This statement is based on the Attorney General’s interpretation of Section 201 of the New York Limited Liability Company Law (governing formation of LLCs) which permits LLCs to be organized only for and to engage in “lawful *business* purposes.” In the Attorney General’s view, this precludes formation for “charitable” purposes because Section 102(e) of that law defines business as “every trade, occupation, profession or commercial activity.”

In practice, we have seen immediate implementation of the Attorney General’s view by the New York State Department of State, which now appears to be enforcing the “business purpose” requirement. For example, in response to our efforts to amend LLC articles of organization to comply with the Notice, the Department of State has issued rejection letters stating the following: “please note that a limited liability company may only use business purposes” and “note that the charitable purposes are unacceptable.”

In our experience and from reviews of publicly available filings, the Department of State did not take this position in the past. Articles of Organization have successfully been filed for many years with expressly charitable purposes, including direct references to Internal Revenue Code Section 501(c)(3) and similar language. As far back as 2007, the New York City Department of Taxation and Finance issued a letter ruling which required that the LLC that requested the ruling, apparently a New York LLC, meet the following requirement: that the “articles of organization and/or operating agreement of the LLC, as appropriate, must state there will be no pecuniary profit and the LLC will operate for not-for-profit purposes consistent with section 420-a” in order for property held by the LLC to be exempt from real property tax. This is consistent with the larger recognition under New York law that modern nonprofits can and do engage in “business” activities. Thus, for example, the Court of Appeals ruling in *Consumers Union of U.S., Inc. v. New York* recognizing that the so-called “business judgement rule,” with its origins in business corporations, which protects from judicial scrutiny judgments by boards about “business” decisions, also extends to the decisions of nonprofit corporate boards.

This leaves many existing “nonprofit” LLCs (with or without 501(c)(3) exemption, including disregarded entities relying on the exempt status of a 501(c)(3) sole member) with many questions about the wide-ranging impact of this change and with no realistic reorganization or reformation options in New York. These questions include, most fundamentally, what does this new interpretation mean for exist-

ing New York LLCs that have charitable purposes? Are they not validly existing under New York law, since they do not have “business” purposes, such that their activities will be viewed as being conducted directly by their members? Or is it only that their charitable/501(c)(3) purposes are void? Will the New York State Attorney General attempt to provide answers to these questions, or will the Department of State? Or will it be left to the courts? Will the IRS agree with New York’s view, or will it rely on its own capacity to interpret federal tax laws and reach a different conclusion?

One thing is certain: while the value and path to exemption for the 501(c)(3) LLC has never been clearer, you clearly can’t form one in New York.

If you have any questions or concerns related to issues involving 501(c)(3) tax-exempt organizations, please contact [Thomas W. Simcoe](#), [Delaney M. R. Knapp](#) or the attorney at the firm with whom you are regularly in contact.

