

EXEMPT ORGANIZATIONS

INFORMATION MEMO

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IRS Provides Long-Awaited Formal Guidance on 501(c)(3) LLCs

Since their rise to prominence in the 1990s, limited liability companies (LLCs) have become one of the most valuable tools in the corporate lawyer's toolkit. Amongst all of the possible corporate forms to choose from, LLCs are uniquely flexible from a governance perspective (no board of directors required!), are tax shape-shifters – capable of being corporations, partnerships or being disregarded entirely – and allow for limitless variations on how ownership is structured and profits and losses are shared. Despite this, they tend to play only a niche role in the nonprofit sector. There are multiple reasons for this, including donor preference for the familiar nonprofit corporation and the nonprofit community's discomfort with the sometimes radically different LLC governance model (what do you mean there is no board of directors?!). Another factor has been the very limited guidance from the IRS on the interaction of LLCs and Internal Revenue Code Section 501(c)(3). The nonprofit sector is no fan of uncertainty when it comes to 501(c)(3) status.

On this last point, at least, we now have some progress in the form of IRS Notice 2021-56. Under Notice 2021-56, the IRS indicates that it will issue a favorable 501(c)(3) determination letter to an LLC if, in addition to satisfying the general requirements of 501(c)(3), it satisfies the following requirements in both its articles of organization and operating agreement:

- Inclusion of provisions requiring that each member of the LLC be either (i) an organization described in Code Section 501(c)(3) or (ii) a governmental unit (or wholly-owned instrumentality of such a governmental unit).
- Inclusion of express charitable purposes and charitable dissolution provisions in compliance with Treasury Regulation Section 1.501(c)(3)-1(b)(1) and (4).
- If the LLC is a private foundation, inclusion of the express Chapter 42 compliance provisions described in Code Section 508(e)(1).
- Establishment of an acceptable contingency plan in the event that one or more members cease to be Code Section 501(c)(3) organizations or governmental units.

Additionally, the 501(c)(3) application must include a representation that all provisions in the LLCs articles of organization and operating agreement are consistent with applicable state LLC law and are legally enforceable.

Importantly, this new guidance does not impact LLCs currently recognized as described in Code Section 501(c)(3).

The authors hope that this new guidance will contribute to expanded utilization of 501(c)(3) LLCs, which can have significant advantages over nonprofit corporations in a variety of contexts. One of the

most notable is in the context of a “joint venture” of two or more 501(c)(3) organizations, where the status of a tax-exempt corporation is desired, but flexibility in the manner of distributing the venture’s cash flow and a nimble management structure is desired.

The foregoing is only a summary of Notice 2021-56, please consult the full text for all of the details, available [here](#). 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.

