

IRS PROVIDES GUIDANCE ON SINGLE-MEMBER LIMITED LIABILITY COMPANIES

By Rick Baroway, Nonprofit Organizations Law Section Executive Committee Chair

A public charity (501(c)(3)) has long had the option to form a single-member limited liability company (SMLLC) and elect to have the SMLLC treated as a "disregarded entity" for federal income tax purposes. One benefit to establishing a SMLLC is to isolate certain activities (and related liabilities) from the main charity.

For example, a charity that owns a low income housing project may form a SMLLC to hold title to and manage the real estate, thereby isolating real-property-related liabilities from the other activities of the charity. (Incidentally, the burden to this type of arrangement is that, though legally separated as to liability, the activities and income of the SMLLC are reportable by and fully attributed to the public charity.)

In the gift setting, however, it has not been clear whether a charity could receive gifts indirectly through an SMLLC, thereby avoiding having title to real estate or other riskier gifts (closely held business interests, for example) flowing through the charity to the SMLLC. The IRS has recently addressed this issue.

In Notice 2012-52, the IRS clarified that, under Internal Revenue Code Section 170, contributions made to a "domestic" SMLLC will be treated as a deductible charitable contribution to the charity, since the SMLLC is considered to be a branch or division of the U.S. charity.

The charity is considered the donee with respect to any substantiation and disclosure requirements. See Code §§ 170(f) and 6115. The charity can issue the gift receipt to the donor, but should disclose to the donor that the gift was to its SMLLC, which is treated as a disregarded entity.

Charities that receive gifts of real property or other noncash gifts should benefit from this Notice. While most such charities will have gift acceptance procedures that compel substantial due diligence before accepting noncash gifts, such as requiring title reports and environmental surveys for real property gifts, they will take added comfort by directing such gifts to their SMLLC whenever possible, thereby insulating the charity from unanticipated liability.

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The text of the Notice is as follows:

Charitable Contributions to Domestic Disregarded Entities

Notice 2012-52

PURPOSE

This notice provides guidance on the deductibility of contributions to domestic single-member limited liability companies that are wholly owned and controlled by organizations described in § 170(c)(2) of the Internal Revenue Code (U.S. charities) and for federal tax purposes are disregarded as entities separate from their owners under § 301.7701-2(c)(2)(i) of the Procedure and Administration Regulations (SMLLCs).

BACKGROUND

Section 170(a) allows as a deduction any charitable contribution, as defined in § 170(c). Section 170(c)(2) in part defines the term "charitable contribution" as a contribution or gift to or for the use of a corporation, trust, or community chest, fund, or foundation--

(A) Created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) Organized and operated exclusively for specified purposes, including religious, charitable, scientific, literary or educational purposes;

(C) No part of the net earnings of which inures to the benefit of any private shareholder or individual; and 2

(D) Which is not disqualified for tax exemption under § 501(c)(3) by reason of attempting to influence legislation or participating in a political campaign.

Section 170(b) prescribes limitations on the maximum amount deductible as a charitable contribution.

Generally, a business entity that has a single owner and is not a corporation under § 301.7701-2(b) is disregarded for federal tax purposes as an entity separate from its owner (disregarded entity). See § 301.7701-2(c)(2)(i). Section 301.7701-2(a) provides

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that “if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.” A business entity (including a disregarded entity) is domestic if it is created or organized within the United States, or under the law of the United States or of any state. See § 301.7701-5(a). A U.S. charity that wholly owns a disregarded entity must treat the operations and finances of the disregarded entity as its own for tax and information reporting purposes. See Ann. 99-102, 1999-2 C.B. 545. However, for employment and certain excise tax purposes, an entity that is disregarded as separate from its owner for any purpose under § 301.7701-2 is treated as an entity separate from its owner. See § 301.7701-2(c)(2)(iv) and (v).

CONTRIBUTIONS TO DOMESTIC SMLLCs

If all other requirements of § 170 are met, the Internal Revenue Service will treat a contribution to a disregarded SMLLC that was created or organized in or under the law of the United States, a United States possession, a state, or the District of Columbia, and is wholly owned and controlled by a U.S. charity, as a charitable contribution to a branch or division of the U.S. charity. The U.S. charity is the donee organization for purposes of the substantiation and disclosure required by §§ 170(f) and 6115. To avoid unnecessary inquiries by the Service, the charity is encouraged to disclose, in the acknowledgment or another statement, that the SMLLC is wholly owned by the U.S. charity and treated by the U.S. charity as a disregarded entity. The limitations of § 170(b) apply as though the gift were made to the U.S. charity. **EFFECTIVE DATE** This notice is effective for charitable contributions made on or after July 31, 2012. However, taxpayers may rely on this notice prior to its effective date for taxable years for which the period of limitation on refund or credit under § 6511 has not expired.

DRAFTING INFORMATION

The principal author of this notice is Susan J. Kassell of the Office of the Associate Chief Counsel (Income Tax & Accounting). For further information concerning this notice, contact Ms. Kassell at (202) 622-5020 (not a toll-free call).