

December 2021

## Private Foundations Bulletin

# IRS Issues Guidance Regarding Tax-Exempt LLCs

The Internal Revenue Service (IRS) recently issued Notice 2021-56 (Notice) entitled **Standards for Section 501(c)(3) Status of Limited Liability Companies**. The Notice defines the current standards a Limited Liability Company (LLC) must satisfy to receive an IRS determination letter and be recognized as tax-exempt under section 501(a) of the Internal Revenue Code (IRC) and as described in section 501(c)(3). The Notice is also requesting comments from the general public regarding these standards along with comments on other issues affecting the tax-exempt status of LLCs. In recent years, we have seen an increase in the number of LLCs being created and utilized. This bulletin will discuss the key points of the Notice along with the impact it may have on private foundations.

Private foundations create LLCs for a variety of purposes, especially private operating foundations, and include but are not limited to creating an LLC for real estate transactions, investment activities and multimedia productions and for joint activities carried on by one or more not-for-profit organizations.

### Background

The IRS decided to issue this Notice to clarify the current standards surrounding tax-exempt LLCs. Prior to this Notice, the IRS had not issued guidance specifically related to tax-exempt LLCs. Any regulations related to this topic did not specifically address LLCs as these statutes were issued and last updated in 1959, prior to the creation of the first LLC of any kind.

It should be noted that the current standards in the Notice do **not** apply to LLCs currently recognized by the IRS as being tax-exempt.

### Eligibility Requirements

In order for an LLC that has a private foundation as a member to be recognized as tax-exempt, the current standards require the following must be included in the LLC's articles of organization and/or operating agreements:

- Must include a stated charitable purpose;
- Include a contingency plan in the event one or more of the members of the LLC are no longer considered a 501(c)(3) organization;
- Require that income be distributed in a manner that does not subject the private foundation to penalties under section 4942 of the IRC; and
- Must include provisions that prohibit self-dealing, excess business holdings, jeopardizing investments and transactions that are considered taxable expenditures.

The foundation itself must also be recognized as a 501(c)(3) organization, exempt under section 501(a) of the IRC.

### Request for Public Comments

At this time, the IRS and U.S. Department of Treasury are seeking comments from the general public on the current standards and other topics that specifically apply to tax-exempt LLCs in order to make informed decisions regarding any possible changes that need to be made to the standards in their current form. Instructions on providing comments can be found in [Notice 2021-56](#).

## Conclusion

When properly set-up, private foundations can utilize tax-exempt LLCs strategically in order to achieve a specific goal or purpose. As these transactions can be complex with state specific requirements, we recommend that a private foundation considering creating an LLC consult with their trusted advisors prior to organizing.

## Contact Us

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

**Thomas Blaney, CPA, CFE**  
Partner, Co-Director of Foundation Services  
[tblaney@pkfod.com](mailto:tblaney@pkfod.com)

**Joseph Ali, CPA**  
Partner  
[jali@pkfod.com](mailto:jali@pkfod.com)

**Scott Brown, CPA**  
Partner  
[sbrown@pkfod.com](mailto:sbrown@pkfod.com)

**Anan Samara, EA**  
Principal  
[asmara@pkfod.com](mailto:asmara@pkfod.com)

**Christopher Petermann, CPA**  
Partner, Co-Director of Foundation Services  
[cpetermann@pkfod.com](mailto:cpetermann@pkfod.com)

**Elizabeth Gousse Ballotte**  
Principal  
[eballotte@pkfod.com](mailto:eballotte@pkfod.com)

**Raymond Jones, Sr., CPA**  
Partner  
[rjones@pkfod.com](mailto:rjones@pkfod.com)

**Barbara Van Bergen, CPA**  
Partner  
[bvanbergen@pkfod.com](mailto:bvanbergen@pkfod.com)

[www.pkfod.com](http://www.pkfod.com)

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