Schnader
ATTORNEYS AT LAW

Schnader Harrison Segal & Lewis LLP

NEW YORK PENNSYLVANIA CALIFORNIA WASHINGTON, D.C. NEW JERSEY DELAWARE

NONPROFIT ORGANIZATIONS
ALERT

AUGUST
2012

IRS Issues Guidance Permitting Deductions for Gifts Made to a Charity's Subsidiary LLC

By Jonathan R. Flora and Marla K. Conley

Charities frequently desire to house some of their assets and operations in a subsidiary company for liability protection, management and other beneficial business reasons. The Internal Revenue Service ("IRS") has issued recent guidance (Notice 2012-52) that makes a limited liability company ("LLC") the ideal choice of entity for this purpose in many instances. In particular, the guidance resolves any doubt about a charity's ability to fundraise from individual donors through a wholly owned LLC.

Background

Many charities create wholly owned LLCs over which they maintain full voting and economic control while at the same time receiving the benefits of a separate legal entity, such as liability protection and distinct management. Unlike corporations, LLCs that are wholly owned are disregarded as an entity separate from their owner for federal income tax purposes. In tax parlance, these LLCs are known as "disregarded entities."

For federal income tax purposes, contributions to an entity generally are not deductible unless the entity is an organization described in Section 501(c)(3) of the Internal Revenue Code. Obtaining such status generally requires a time consuming application process with the IRS.

Prior to Notice 2012-52, there was no direct authority governing the ability of individuals to make charitable donations to an LLC that is wholly owned by a charity without the LLC itself seeking exempt status from the IRS. There have been related rulings suggesting that a wholly owned LLC should be disregarded and therefore not required to seek exemption on its own. For example, the IRS held in private letter rulings and other guidance that assets transferred to and held by a single member disregarded entity owned by a charity are treated as assets of the charity itself for certain tax purposes and for public reporting and disclosure purposes. However, the IRS had not taken a public position on the question of whether a donor is entitled to claim a charitable contribution deduction if the donor makes a contribution to a disregarded entity whose sole member is a charitable organization. This ambiguity was also unresolved by case law.

The July 31, 2012 Notice

In Notice 2012-52, the IRS provided direct guidance on the issue of contributions in these circumstances. The guidance provides that if all other requirements necessary for a deduction are met, the IRS will treat a contribution to a U.S. single-member LLC that is wholly owned and controlled by a U.S. charitable organization as branch or division of the owner charitable organization. As a consequence, the U.S. charitable organization is the donee organization for purposes of the substantiation and disclosure requirements.

The guidance encourages charities to disclose that the single-member LLC is wholly owned by the U.S. charitable organization and treated by the organization as a disregarded entity. The charitable limitations apply as though the gift were made to the U.S. charitable organization.

Notice 2012-52 is effective for charitable contributions made after July 30, 2012, and taxpayers may

(continued on page 2)

(continued from page 1)

rely on the notice before the effective date for tax years for which the period of limitation or refund or credit has not expired.

We caution, however, that use of an LLC can raise other issues that should be addressed with appropriate planning. For example, a wholly owned LLC is generally considered to be an entity separate from its owner for state purposes. As a result, the LLC may have registration and filing obligations separate from those of its parent charity. Moreover, many state laws regarding deductions for donors are not as clear as the recent IRS guidance, and certain states may question an LLC's eligibility for other tax exemptions, such as sales or property taxes. ◆

IRS Circular 230 Disclosure. To ensure compliance with any requirements imposed by the IRS, we inform you that the federal tax advice contained in this document is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

For more information about Schnader's Nonprofit Organizations Practice Group or to speak with a member of the group at a particular Schnader office location, please contact:

Jonathan R. Flora, Co-Chair
215-751-2347; 415-364-6727
jflora@schnader.com

Cynthia G. Fischer, Co-Chair
212-973-8175
cfischer@schnader.com

Marla K. Conley
215-751-2561
mconley@schnader.com