

Standards for Section 501(c)(3) Status of Limited Liability Companies

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Practices

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Article

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The Internal Revenue Service (IRS) issued Notice 2021-56 - Standards for Section 501(c)(3) Status of Limited Liability Companies as its first attempt to set the standards for a limited liability company (LLC) to become a tax-exempt organization under Internal Revenue Code (IRC) section 501(c)(3). Currently, section 501(c)(3) does not specifically address LLCs because it was issued prior to the enactment of the first LLC statute in the United States. Until now, the Treasury Department and IRS had not issued other formal guidance. Historically, the IRS has applied the standard that all the members of an LLC must be 501(c)(3) organizations, governmental units, or wholly owned instrumentalities of a state or political subdivision for purposes of issuing determination letters.

The notice now sets forth the following standards that an LLC must satisfy to receive a determination letter recognizing it as tax-exempt under section 501(a) and described in section 501(c)(3) of the IRC.

1. Submit Form 1023 and satisfy the general requirements under Section 501(c)(3), as well as the requirements set forth below.
2. Both the LLC's articles of organization and its operating agreement each include:
 1. Provisions requiring that each member of the LLC be either (i) an organization described in section 501(c)(3) and exempt from taxation under section 501(a) or (ii) a governmental unit described in section 170(c)(1) (or wholly-owned instrumentality of such a governmental unit).
 2. Express charitable purposes and charitable dissolution provisions in compliance with section 501(c)(3)-1(b)(1) and (4).
 3. Private foundation provisions described in section 508(e)(1), if applicable.
 4. An acceptable contingency plan (such as suspension of its membership rights until a member regains recognition of its section 501(c)(3) status) in the event that one or more members cease to be

section 501(c)(3) organizations or governmental units (or wholly-owned instrumentalities).

3. The LLC represents that all provisions in its articles of organization and operating agreement are consistent with applicable state LLC law and are legally enforceable.

If the LLC is formed under a state LLC law that prohibits the addition of provisions to articles of organization other than certain specific provisions required by the state law, the requirements in #2 above will be deemed satisfied if the LLC's operating agreement includes the provisions and the articles of organization are not inconsistent with the operating agreement.

The new standards may present challenges to LLCs in states with limitations in their statutes that may prevent the LLC from meeting the requirements. If you have questions or comments, please reach out to Yolanda Davis Brisco and your Nexsen Pruet Nonprofit and Exempt Organizations Team.

Prior to joining Nexsen Pruet, Yolanda spent more than a decade as a nonprofit and accounting consultant, advising a diverse group of nonprofits in 501(c)(3) nonprofit administration and management. Her clients included sports philanthropists, human service organizations, private foundations, churches and other religious organizations, schools, financial counseling and money management organizations, community development corporations, and start-up charities.