

Part III – Administrative, Procedural, and Miscellaneous

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

Notice 2021-56

SECTION 1. PURPOSE

This notice sets forth current standards that a limited liability company (LLC) must satisfy to receive a determination letter recognizing it as tax-exempt under section 501(a)¹ and described in section 501(c)(3). This notice also requests public comments on these standards as well as specific issues relating to tax-exempt status for LLCs to assist the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) in determining whether additional guidance is needed concerning the standards that an LLC must satisfy to be exempt from taxation by reason of being described in section 501(c). This notice does not affect the status of organizations currently recognized as described in section 501(c)(3).

¹ All Code, section, and “§” references are to the Internal Revenue Code of 1986, as amended, or regulations thereunder, unless otherwise specified.

SECTION 2. BACKGROUND

.01 General Requirements under Section 501(c)(3)

Section 501(a) generally provides that an organization described in section 501(c) shall be exempt from federal income taxation.

Section 501(c)(3) refers, in part, to corporations, and any community chest, fund, or foundation organized and operated exclusively for certain purposes (referred to collectively in this notice as “charitable purposes” or “exempt purposes”), no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 508(e) generally provides that a private foundation will not be exempt from taxation under section 501(a) unless its governing instrument includes provisions requiring the foundation to comply with sections 4941, 4942, 4943, 4944, and 4945.

Section 7701(a)(3) generally provides that the term “corporation” includes associations for purposes of the Code.

Section 1.501(c)(3)-1(b)(1) of the Income Tax Regulations provides that an organization is organized and operated exclusively for one or more exempt purposes only if its articles of organization limit the purposes of the organization to one or more exempt purposes and do not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities that are not in furtherance of one or more exempt purposes. Section 1.501(c)(3)-1(b)(2) provides that the term “articles of organization” or “articles” includes the trust instrument, the corporate charter, the articles of association, or any other written instrument by which an organization is created.

Under § 1.501(c)(3)-1(b)(4), an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An

organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution of the organization, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization will not be considered to satisfy the organizational test if its articles or the law of the state in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders.

Section 1.501(c)(3)-1(b)(5) provides that the law of the state in which an organization is created is controlling when construing the terms of the organization's articles. Any organization contending that the terms of its articles have a different meaning under state law than their generally accepted meaning must establish such special meaning by clear and convincing reference to relevant court decisions, opinions of the state attorney general, or other evidence of applicable state law.

Section 1.508-3(d) describes circumstances in which a private foundation's governing instrument will be deemed to comply with the requirements of section 508(e) based on provisions of applicable state law.

.02 Entity classification

Entity classification regulations under §§ 301.7701-1 through -3 of the Procedure and Administration Regulations (commonly known as check-the-box regulations) were first issued in 1996 and provide federal tax rules for the treatment of business entities.

Under § 301.7701-1(a)(1), whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law. Similarly, under § 301.7701-1(a)(3), an entity formed under local law is not always recognized as a separate entity for federal tax purposes.

Under § 301.7701-2(a), a business entity is any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701-3 (disregarded entity)) that is not properly classified as a trust under § 301.7701-4 or otherwise subject to special treatment under the Code. A business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership. A business entity with only one owner is classified as a corporation or a disregarded entity. If the entity is a disregarded entity, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner. Section 301.7701-3(a) generally provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) is an eligible entity. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or a disregarded entity. In general, a domestic eligible entity that does not file an election is treated as a partnership or a disregarded entity. See § 301.7701-3(b)(1).

Section 301.7701-3(c)(1)(v)(A) provides, however, that an eligible entity that has been determined to be, or claims to be, exempt from taxation under section 501(a) is treated as having made an election to be classified as an association (and thus as a corporation

under § 301.7701-2(b)(2)).

.03 Treatment of LLCs under Section 501(c)(3)

Section 1.501(c)(3)-1(b), which sets forth the organizational test, was issued in 1959, prior to the enactment of the first LLC statute in the United States.² As a result, the regulations under section 501(c)(3) do not specifically address LLCs and the Treasury Department and the IRS have not issued other formal guidance addressing the requirements for recognition of LLCs as organizations described in section 501(c)(3). Historically, the standards that the IRS has applied for purposes of issuing determination letters have generally included a requirement that all the members of an LLC must themselves be section 501(c)(3) organizations, governmental units, or wholly-owned instrumentalities of a state or political subdivision thereof.

.04 State LLC Statutes

In considering the requirements that an LLC must satisfy to qualify as an organization described in section 501(c)(3), the Treasury Department and the IRS reviewed state laws governing LLCs and the ways in which those laws may differ from the state laws governing not-for-profit (or nonstock) corporations and charitable trusts. It appears that, in a few states, the LLC law may not allow an LLC to be organized and operated exclusively for charitable purposes. See section 4.01(3) of this notice. It also appears that most state LLC laws include default provisions granting the members of an LLC certain economic rights that would be inconsistent with section 501(c)(3)

² The IRS first addressed the tax classification of LLCs, in the context of the Wyoming LLC Act, in Rev. Rul. 88-76, 1988-2 C.B. 360 (obsoleted in Rev. Rul. 98-37, 1998-2 C.B. 133). Since then, every other state has enacted laws providing for the creation and regulation of LLCs. Many states have adopted some version of the Uniform Limited Liability Company Act (ULLCA), generally with some modifications. Several states have adopted nonprofit LLC statutes (as discussed in section 4.01(7) of this notice).

requirements if the members were “private shareholders or individuals” within the meaning of § 1.501(a)-1(c). See section 4.01(4) of this notice. A few states do not permit a statement of the LLC’s purposes in the articles of organization, but only in the operating agreement, which is not filed with the state. See section 4.01(6) of this notice.

SECTION 3. STANDARDS FOR AN LLC SUBMITTING FORM 1023

.01 In general

The Treasury Department and the IRS construe section 501(c)(3) and § 1.501(c)(3)-1 to permit the IRS to issue a favorable determination letter to an LLC that submits Form 1023, *Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code*, after October 21, 2021, only if the LLC satisfies the requirements set forth in sections 3.02 and 3.03 of this notice in addition to the general requirements under section 501(c)(3). The requirements in sections 3.02 and 3.03 of this notice are intended to ensure that the LLC is organized and operated exclusively for exempt purposes, including that its assets are dedicated to an exempt purpose and do not inure to private interests.

.02 Required provisions of LLC articles of organization and operating agreement

Except as set forth in section 3.04 of this notice, the IRS will issue a determination letter recognizing an LLC as exempt from tax and described in section 501(c)(3) only if 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 § 1.501(c)(3)-1(b)(1) and (4).
- (3) The express chapter 42 compliance provisions described in section 508(e)(1), if the LLC is a private foundation.
- (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 thereof).

.03 Representation on enforceability

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

.04 States with limitations on articles provisions

If an 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 LLC law, the requirements of section 3.02 of this notice will be deemed satisfied if the LLC's operating agreement includes the provisions set forth in section 3.02 of this notice and if the articles of organization and operating agreement do not include any inconsistent provisions.

SECTION 4. REQUEST FOR PUBLIC COMMENTS

.01 Section 501(c)(3)

The Treasury Department and the IRS request comments on the standards in

section 3 of this notice. Comments supporting recognition of section 501(c)(3) status for LLCs whose membership includes individuals and/or organizations other than section 501(c)(3) organizations, governmental units, or instrumentalities of a state or political subdivision thereof should recommend specific safeguards to ensure the LLC would be able to satisfy the existing federal statutory and regulatory requirements, including the requirement for assets to remain dedicated to an exempt purpose and the prohibition against private inurement. Additionally, comments are requested from state attorneys general and charity officials, as well as from the general public, with respect to interpretation of state LLC laws, reference to other pertinent laws, and applicability of state charity laws to LLCs formed for charitable purposes (charitable LLCs).

In particular, the Treasury Department and the IRS request comments with respect to the following:

- (1) What are the potential advantages and disadvantages of forming an entity for exclusively charitable purposes under a state LLC law rather than under a state not-for-profit (or non-stock) corporation or charitable trust law?
- (2) Do state laws regulating charitable assets apply to assets held by charitable LLCs to the same degree as such laws apply to assets held by trusts or state-law corporations formed for charitable purposes?
- (3) Most state LLC statutes specify that an LLC may be formed for any lawful purpose. In a few states, however, the LLC statute appears to require that an LLC be a profit-seeking enterprise. In those states, is it permissible as a matter of state law for an LLC to be formed exclusively for

section 501(c)(3) purposes?

- (4) Most state LLC statutes appear to provide that, upon dissolution and after payment of creditors, an LLC may dispose of its remaining assets among its members or otherwise in whatever manner specified in its articles of organization (also referred to as a certificate of organization or certificate of formation) or operating agreement (also referred to as a limited liability company agreement). In those states, the state LLC statute merely provides default rules that apply in the absence of any provision in the articles or operating agreement. Other state LLC statutes, however, appear to require distributions of net assets only to members upon dissolution, as immutable rules.
 - a. In a state in which the LLC statute appears to require distributions of net assets only to LLC members on dissolution, could LLC members at the time of creation of an LLC effectively disclaim their financial interests in the LLC or assign or transfer their financial interests to the LLC or to another section 501(c)(3) charity as a means of satisfying the dissolution clause requirement under § 1.501(c)(3)-1(b)(4), notwithstanding the state dissolution requirements?
 - b. Would such a disclaimer be enforceable against the LLC members?
 - c. Would such a disclaimer be enforceable against creditors of the members?
- (5) The organizational test regulations under § 1.501(c)(3)-1(b) generally require certain language (in particular, stated charitable purposes and

charitable distribution of assets upon dissolution) to appear in the articles of organization, defined as the written instrument by which the organization is created. Private foundations also must include certain language in their articles of organization to be in compliance with section 508(e). See § 1.508-3. In many cases, state law satisfies the dissolution requirements and section 508(e) requirements for charitable trusts and corporations if there is no contrary provision in the articles of organization. State LLC statutes generally provide that an LLC is created upon filing its articles of organization with the state. In addition to the articles of organization, an operating agreement governs the affairs and activities of an LLC. Unlike the articles of organization, the operating agreement is not filed with the state. State laws differ as to which document is controlling. In some states, the articles control. In other states, the articles control as to outside parties to the extent they reasonably rely on the public record, but the operating agreement governs relations among the LLC's members and between the members and the LLC.

- a. Are there state laws that satisfy the dissolution requirements and section 508(e) requirements for charitable LLCs?
- b. Is there any reason why an LLC should not be required (except as provided in section 4.01(6)) to include appropriate charitable purpose and dissolution language (and section 508(e) language, if applicable) in both its articles of organization and its operating agreement?

- (6) Most state LLC statutes do not restrict the ability of an LLC to include the language required under § 1.501(c)(3)-1(b) (and section 508(e), if applicable) in its articles of organization. However, a few states appear to strictly limit what provisions may be included in an LLC's articles of organization.
- a. Should the regulations for the section 501(c)(3) organizational test and section 508(e) requirements be revised to accommodate LLCs organized in states that limit what provisions may be included in an LLC's articles of organization if the LLC includes the appropriate language in the LLC's operating agreement?
 - b. Should it matter that the operating agreement (unlike the articles of organization) is not filed with the state, and therefore may not be readily available to the IRS and the public?
- (7) Several states have enacted special statutory provisions for nonprofit LLCs (beyond a mere provision in the statute that allows an LLC to be formed for a nonprofit purpose), subjecting them to regulation as nonprofit organizations and, in some cases, limiting membership. In such states, must a charitable LLC form under the state's nonprofit LLC law, or are charitable LLCs permitted to form under the state's general LLC law?
- (8) State laws generally provide an LLC's members with management authority unless the articles of organization (or in some states, the operating agreement) delegate management authority to one or more managers.

- a. With respect to qualification for section 501(c)(3) status, should LLCs managed by managers be treated the same as LLCs managed by members?
 - b. Should LLC managers be treated as officers for federal exempt organization tax purposes generally, including, for example, the compliance provisions of chapter 42?
- (9) Are there any other provisions of the LLC law in one or more states that may affect the ability of an LLC to qualify under section 501(c)(3)?
- (10) Are there any specific provisions that should be included in an LLC's articles of organization and operating agreement in addition to, or in lieu of, those discussed in section 3.02 of this notice, to address particular provisions of state LLC law?
- (11) Are there circumstances in which an LLC seeking recognition under section 501(c)(3) should be permitted to have members that are not themselves section 501(c)(3) organizations, governmental units, or wholly-owned instrumentalities of governmental units?

.02 Other exemption provisions

The Treasury Department and the IRS also request comments as to whether there should be special requirements or considerations for recognition of tax-exempt status for LLCs under paragraphs of section 501(c) other than section 501(c)(3).

SECTION 5: WHEN AND WHERE TO SEND COMMENTS

Written comments may be submitted by February 6, 2022. Comments should include a reference to Notice 2021-56. Comments may be submitted in one of two ways:

- (1) Electronically via the Federal eRulemaking Portal at www.regulations.gov (type IRS-2020-0042 in the search field on the *regulations.gov* homepage to find this notice and submit comments).
- (2) Alternatively, by mail to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2021-56), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

All commenters are strongly encouraged to submit comments electronically, as access to mail may be limited. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Treasury Department and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.

SECTION 6. PAPERWORK REDUCTION ACT

Section 3 of this notice sets forth a collection of information (required provisions of articles of organization and operating agreement and representation on enforceability, to be provided to the IRS with Form 1023). This collection of information is reflected in the collection of information for Form 1023 that has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)) under control number 1545-0047.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law.

Generally, tax returns and tax return information are confidential, as required by section 6103.

SECTION 7. DRAFTING INFORMATION

The principal authors of this notice are Christopher A. Hyde and Ward L. Thomas of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For further information regarding this notice, contact Mr. Hyde at (202) 317-6171 or Mr. Thomas at (202) 317-6173 (not toll-free calls).