PUBLICATION

Spotlight on Exempt Organizations: Private Foundation Grants to Single-Member LLC Owned by Public Charity

June 28, 2011

Any grant by a private foundation to an organization will be deemed a "taxable expenditure" and taxed to the grantor under Section 4945 of the Internal Revenue Code unless (1) the grant is made to a public charity, or (2) the private foundation exercises "expenditure responsibility." The following are the specific grantees for which expenditure responsibility is *not* required: (i) a public charity described in section 509(a)(1) or (2); (ii) an eligible Type I or Type II supporting organization under 509(a)(3); and (iii) an exempt operating foundation under section 4940(d)(2).

Until last year, there has been a question as to whether a private foundation grant to an LLC would invoke expenditure responsibility rules where the LLC's sole member was a public charity. According to the Internal Revenue Service in Information Letter 2010-0052, released on *June* 25, 2010, such a grant generally does *not* require expenditure responsibility.

The rationale supporting this position is that single-member LLCs are generally disregarded for federal tax purposes unless such an LLC elects otherwise. Where the sole member of a disregarded LLC is a tax-exempt organization, the LLC is treated as a component of the exempt organization so that the exempt owner must include the LLC's financial information on *its own* annual information return. Therefore, under the rationale of that Information Letter, a grant by a private foundation to a single-member LLC owned by a public charity is essentially a grant to the public charity itself, and such grants would avoid the tedious requirements of expenditure responsibility.

If a foundation is required to exercise expenditure responsibility, the foundation must exert all reasonable efforts and establish adequate procedures to:

1. See that the grant is spent only for the purpose for which it is made;
2. Obtain full and complete reports from the grantee organization on how the funds are spent; and
3. Make full and detailed reports on the expenditures to the IRS.

Further, to meet the expenditure responsibility requirements, each grant must be made subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee organization. This commitment must include the following agreements by the grantee to:

4. Repay any amount not used for the purposes of the grant;
5. Submit full and complete financial reports to the private foundation at least once a year;
6. Maintain adequate books and records that are available to the private foundation;
7. Not use any of the funds to (i) influence legislation; (ii) influence the outcome of elections, or to carry on any voter registration drive; or (iii) undertake any nonexempt activity when such use of the funds would be a taxable expenditure if made directly by the foundation.

There are similar requirements for "program-related investments."

Importantly, while this Information Letter clarifies the treatment of grants to single-member LLCs where the sole member is a tax-exempt organization, it does *not* address the deductibility of gifts to LLCs under Code Section 170. While helpful guidance about deductibility is missing, however, it may not be intentional. Rather, it may simply be a function of IRS rulings for Section 170 coming from a branch of the IRS different from the branch that issues rulings with respect to private foundations. Information Letters call attention to well-established interpretations or principles of the Code by the IRS, but are advisory only and are not binding on the IRS.

Should you have any questions about private foundation grants in the circumstances described above, or any other issues regarding exempt organizations, please contact one of the attorneys in the Firm's Tax Department.