

LLCs: A New Horizon For Charitable Giving?

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When Mark Zuckerberg recently announced that he was giving away up to 99 percent of his Facebook shares (valued at approximately \$45 billion), he was severely criticized for it. Zuckerberg and his wife created the Chan Zuckerberg Initiative, a Delaware-based limited liability company dedicated to “advancing human potential and promoting equality.” Zuckerberg’s pledge to donate his Facebook shares to his charitable LLC has been characterized as an empty promise because, critics say, he could “take it back” at any time. These critics are not faulting Zuckerberg for his desire to “do good”; it is the manner by which he is attempting to accomplish this good deed that has raised eyebrows.



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Although an LLC is a flexible and practical approach to forming and managing a for-profit business, it may not be a viable approach to achieving philanthropic and charitable endeavors. On the one hand, an LLC combines the more favorable aspects of partnerships, including flow-through taxation (unless it elects to be taxed as a corporation), avoids the double taxation and administrative formalities of a corporation, and grants the owner more control over its management. On the other hand, contributing property to an LLC alone does not constitute a completed gift under federal law, and, depending upon the way the LLC is structured, the donor may not receive the favorable income and gift tax charitable deductions that would otherwise be immediately available by using more traditional charitable structures.

Use of an LLC for charitable purposes raises two issues regarding control. The first relates to the federal tax law definitions of a gift. The second relates to the level of control that an owner has to manage and invest the assets of the LLC.

Tax Issues

The choice to form an LLC for a charitable enterprise is not a common practice — for good reason. First, many individuals are directly concerned with obtaining an immediate charitable income tax and gift tax deduction in the year of contribution for the fair market value of the property contributed. The income and gift tax deductions are unavailable, unless a completed gift is made to a qualified charity. As discussed below, Zuckerberg’s use of an LLC as a charitable vehicle makes these deductions unavailable.

Generally, federal law imposes (as do some states) an excise tax on the value of the gift of cash or other property at a rate of 40 percent. The value of the gift for gift tax purposes is the value of the gifted property as of the date of the gift. The federal gift tax is generally not imposed on qualifying transfers to

a qualified charity because of the federal gift tax charitable deduction. In addition to the gift tax charitable deduction, an individual can also take advantage of the income tax charitable deduction for gifts made to such qualified charities. No deduction may be taken if the transfer of property fails to satisfy the federal requirements.

A gift for federal gift tax purposes is defined as “a transfer of property for less than an adequate and full consideration in money or money’s worth.” It appears that Zuckerberg contributed his Facebook shares to the LLC and, in return, received ownership interests in the LLC. As a result, he continues to have full and complete use of the assets held in the LLC. This failure to relinquish control of the property does not constitute a gift and will not be subject to gift tax. This “incomplete gift” is a valid argument against Zuckerberg’s use of an LLC for his charitable giving.

Management and Investment of LLC Assets

Despite the foregoing arguments, structuring a charitable entity as an LLC gives Zuckerberg a unique level of control that he would not otherwise have if he were to use the more typical vehicles for charitable contributions.

For example, in many cases, individuals who wish to make large charitable contributions are typically advised to create a private foundation or make a contribution to a donor-advised fund (DAF) in the family’s name to make their charitable contributions. Private foundations are administratively burdensome with many complex federal and state rules and regulations. A donor-advised fund is a simpler way of creating a foundation-like entity. Many financial institutions and banks have programs whereby a donor can establish such a fund and stipulate those individuals who will make donee recommendations as “advisers” while the institution running the fund (the “DAF organization”) takes care of all of the administrative and tax compliance headaches. The donor family can just sit back and enjoy the fun part: making the distributions.

Like a foundation, a DAF may continue with family members as advisers until no family member who wants to remain involved is living. The disadvantage of a DAF is that, as a legal matter, the DAF organization controls the management and reinvestment of the property. As a practical matter, the donor may make investment recommendations that will be reviewed and subject to approval by the DAF organization. However, the flexibility of this approval process will depend upon the DAF organization’s internal policies. In addition, with respect to the grant-making in a DAF, the donor may make “nonbinding recommendations” for grants to be made to particular charities or a “category” of charities. Again, as a legal matter, the DAF organization has the right to override the donor’s recommendations as to the recipient and timing of any grant. As a practical matter, it is widely understood that a donor’s recommendations are rarely denied.

Zuckerberg’s choice of an LLC structure for his charity alleviates the administrative burdens of a private foundation while simultaneously allowing for the ease and facility of management, similar to a DAF. The greatest advantage in this new structure is the ability to directly manage and control the investment of the assets held in the LLC, which is somewhat restricted in both a private foundation and a DAF.

Final Thoughts

Use of an LLC in place of traditional charitable vehicles has created new possibilities for high-net-worth individuals to make charitable gifts. Zuckerberg defends this structure by stating, “The Chan Zuckerberg Initiative is structured as an LLC rather than a traditional foundation. This enables us to pursue our

mission by funding nonprofit organizations, making private investments and participating in policy debates — in each case with the goal of generating a positive impact in areas of great need. Any net profits from investments will also be used to advance this mission.”

Zuckerberg’s initiative is not the first time individuals have used an LLC for charitable giving. In recent years, the formation of an LLC for charitable entities has generated curiosity due to the launch of such organizations as the Emerson Collective by Steve Jobs’ widow, Laurene Powell Jobs, and the Omidyar Network by Pierre Omidyar, founder of eBay. The creation of the Chan Zuckerberg Initiative merely continues and reignites the conversation on the viability of this structure. The question is whether this structure will gain traction and the sustainability of accomplishing the intended charitable purposes within the structure.

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