



Understanding Fiscal Sponsorships

Elizabeth Perez, Legal Director

Ciarra Chavarria, Staff Attorney

December 6, 2017



Overview of Presentation

- What is fiscal sponsorship?
- Roles and obligations of the parties
- Structuring options and considerations
- Fiscal sponsorship agreements
- Ending a fiscal sponsorship



What is a Fiscal Sponsorship?

- A **fiscal sponsorship** is a contractual arrangement between:
 - an organization that is exempt under I.R.C. §501(c)(3) (the “fiscal sponsor”); and
 - an organization that is awaiting, or has chosen not to apply for, tax-exempt status (the “sponsored organization”)

pursuant to which the fiscal sponsor can receive tax-deductible donations on behalf of the sponsored organization.



Legal Basis for Fiscal Sponsorship

- The term “fiscal sponsor” does not appear in the Internal Revenue Code, but is a common, reputable and widespread practice.
- In a 1968 ruling, the IRS held:
 - “An organization will not jeopardize its exemption under section 501(c)(3) of the Code, even though it distributes funds to nonexempt organizations, provided it retains control and discretion over use of the funds for section 501(c)(3) purposes.
 - “The exempt organization ensured use of the funds for section 501(c)(3) purposes by limiting distributions to specific projects that are in furtherance of its own exempt purposes...”

(Source: IRS Rev. Rul. 68-489, 1968-2 C.B. 210 (1968))



NOT Simply a Fiscal “Conduit”

- Fiscal sponsor cannot act simply as a conduit for tax-deductible funds to be used at sponsored organization’s discretion
- Sponsor has “expenditure responsibility” – must have oversight and ultimate control over funds granted to the project to ensure use to further sponsor’s charitable purposes
- If not sufficient oversight, IRS may treat donation as if given directly to sponsored organization (no tax deductibility)
 - May also jeopardize sponsor’s exempt status



How do Fiscal Sponsorships Work?

- The organizations enter into a **contract** (the “fiscal sponsorship agreement”) in which:
 - the fiscal sponsor agrees to accept and administer funds to the sponsored organization; and
 - the sponsored organization can receive tax-deductible donations without having tax-exempt status
- All funds flow through the fiscal sponsor, who retains **oversight** to ensure funds are used in furtherance of sponsor’s mission.



Fiscal Sponsor's Role and Obligations

- Receive funds, exercise **oversight**, including for compliance and reporting requirements
- Have a separate accounting system for sponsored organization's funds (if not fully integrated)

Optional Services a Fiscal Sponsor *May* Provide

- Fiduciary oversight and legal guidance
- Financial services (accounting, donation acknowledgement, tax filings)
- Human resources (payroll processing, employee benefits)
- Audit compliance
- Office space
- Other administrative services or technical assistance



Sponsored Organization's Role and Obligations

- Abide by sponsor's relevant policies (e.g. conflict of interest guidelines, employment policies, and other internal operating guidelines)
- Adhere to reporting obligations to sponsor
- Ensure activities are in line with sponsor's charitable purposes



Pros and Cons: Sponsored Organization's Perspective

- Pros
 - Immediate ability to raise tax deductible funds
 - Focus on programs rather than administration
 - Leverage reputation/network of sponsor
 - Other services, administrative support, and technical assistance from sponsor
- Cons
 - Funds under sponsor's control and oversight/loss of independence
 - Reporting obligations to sponsor
 - Typically have to pay fee to sponsor (5-15% of funds received)



Pros and Cons: Fiscal Sponsor's Perspective

- Pros
 - Allows sponsor to further its mission
 - Fees are small source of revenue (but not intended to make profit!)
- Cons
 - Risks and responsibility to oversee sponsored organization's activities
 - Administrative costs and burdens



Who Might Benefit from Being Fiscally Sponsored?

- Group that wants to test out its charitable projects/mission before pursuing 501(c)(3) status
- Group that will not seek 501(c)(3)
 - e.g. short-term or one-off projects such as disaster relief or building a playground
- Group that has applied for, but not yet received, 501(c)(3) status and wants to begin fundraising right away



Finding a Fiscal Sponsor & The Importance of Mission Fit

- Options:
 - use a “dedicated fiscal sponsor” – an organization that lists fiscal sponsorship as a core part of its mission (e.g. Fractured Atlas; Tides Foundation)
 - online directory of larger fiscal sponsors across the country at <http://www.fiscalsponsordirectory.org/>
 - look for a 501(c)(3) organization that seems like it would be interested in your organization’s programs (even if that organization has not previously served as a fiscal sponsor)
- Mission fit:
 - the mission of the fiscal sponsor must fit with the mission of the sponsored organization
 - check the fiscal sponsor’s certificate of incorporation, application for tax-exempt status with the IRS, or annual filings – anything that publicly states their purpose and activities



Structuring Options for Fiscal Sponsorship

- Because fiscal sponsorships are created by contract, they can be structured in many ways to fit the needs of the organizations

Fiscal Sponsorship Models	Basic Characteristics	Is Project Legal Entity?	Basic Relationship	Charitable Donations Belong to	Sponsor's Liability to Third Parties	Ownership of Results	Payments Shown on IRS Returns Filed By		Comments
							Sponsor	Project	
Direct Project	Project belongs to sponsor and is implemented by its employees and volunteers	No	Employer-Employee	Sponsor	Total liability for acts of employees.	Sponsor	990, payroll tax returns	Individual 1040s	Legally, project is no different than any other activity carried on by sponsor directly.
Independent Contractor Project	Project belongs to sponsor but is conducted by separate entity under contract.	Yes	Project Contract	Sponsor	Varies, may be partial or total.	Should be conveyed by sponsor	990, 1099 if person	Depends on contractor's legal status	Appropriate where project is integral to sponsor's work, may be legally done by independent contractor.
Preapproved Grant Relationship	Project applies to sponsor for one or a series of grants, sponsor funds only to extent that money is received from donors.	Yes	Grantor-Grantee	Sponsor	Selection and payment of grantee, plus terms set by funding source.	Project usually	990	Depends on grantee's legal status	Used by non-501(c)3 project, in order to raise tax-deductible support from donors, private foundations or government grants.
Group Exemption	Sponsor obtains federal group tax exemption, confers 501(c)3 status on subordinate projects.	Yes	Subordinate-Affiliate	Project	Only as provided in affiliation agreement.	Project	Annual listing of orgs., no financial information	990, separate or group return	Project gets 501(c)3 status with separate application to IRS; under sponsor's supervision/control.
Supporting Organization	Project gets its own 501(c)3 exemption, but public charity status is based on support of sponsor's purposes.	Yes	Degree of connection varies	Project	None.	Project	None	990	Project must apply to IRS for 501(c)3 status, but can be a public charity even with only one donor.
Technical Assistance	Project has its own 501(c)3 exemption but needs help with bookkeeping, tax returns, payroll, management, etc.	Yes	Management contract	Project	Only as provided in contract.	Project	990 if fee charged	990 if fee paid	Sponsor provides financial management to project, but all funds are realised and spent in the name of the project.

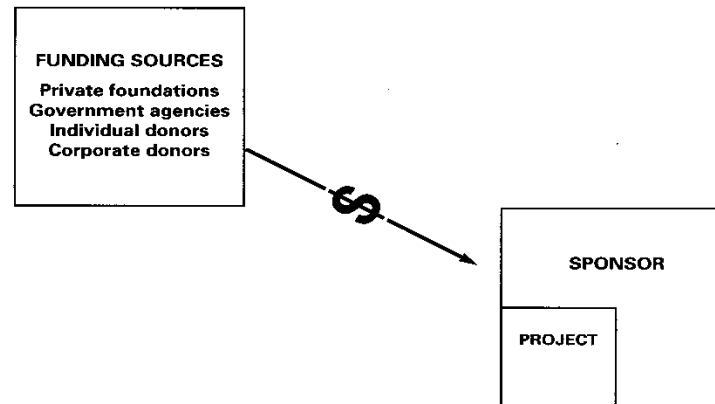
Source: Colvin 2006.

- While there are many options, the two most common arrangements are
 - Direct Project Model (Model A)
 - Pre-Approved Grant Model (Model C)



Model A: Direct Project Fiscal Sponsorship

- Sponsored organization becomes a “project” of the sponsor; legally, the project is no different than any other activity sponsor carries on
- Sponsored organization has no separate legal identity
- Sponsored organization’s staff become employees (or volunteers) of the fiscal sponsor
- Sponsor bears full responsibility for activities of sponsored project
- Good “training ground” for start-up nonprofits, since high level of control by sponsor
- Sponsor files 990, including for the project’s activities

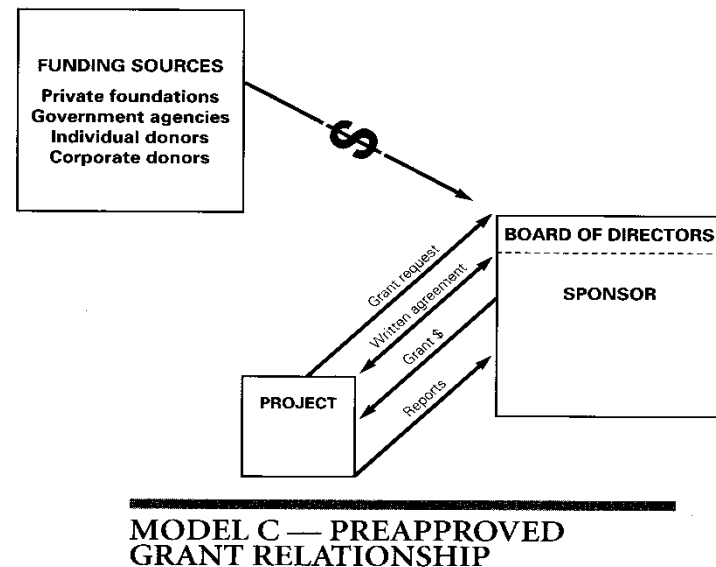


MODEL A — DIRECT PROJECT



Model C: Pre-Approved Grant Model

- A grantor-grantee relationship: fiscal sponsor approves a specific project that aligns with its mission
- The two organizations do NOT become one legal entity
- Fiscal sponsor receives donations on behalf of the sponsored organization and administers them as grants to the sponsored organization
- Sponsored organization retains ownership and control over the project, but is subject to heightened reporting to the fiscal sponsor
- Sponsored organization bears most liability; sponsor's liability is limited to that of a grantor-grantee relationship





Joint Employment Considerations

Separate entities are *joint employers* if they each exercise control or supervision of the same employee in any one of several ways:

- the entities agree to share the employee’s services;
- one employer acts for the other employer with respect to the employee; or
- one employer controls the other, or all are under common control.

Significance of *joint employment*:

- Number of employees included for purposes of calculating federal and state law applicability
- Each employer is potentially liable for legal infractions by the other and will be jointly and severally liable to pay any judgments, fines or penalties.

Implication in Fiscal Sponsorships

- **Model A** - the project’s staff are clearly employees of the fiscal sponsor (no separate legal entity)
- **Model C** (and some of the other less-than-fully integrated models), consider joint employment:
 - Does the sponsored organization fully manage and supervise its employees?
 - Or, does the fiscal sponsor exercise some level of control or supervision over sponsored organization’s employees, suggesting joint employment?
 - Examples of fiscal sponsor control over sponsored organization’s employees:
 - on sponsor’s payroll
 - sponsor has to approve employee terminations



Lobbying Considerations in a Fiscal Sponsorship

- 501(c)(3) organizations are limited by IRS in the amount of lobbying they can engage in
- Key question: does the lobbying of the sponsored organization count towards the fiscal sponsor's lobbying?
- Model A: lobbying activity of sponsored organization counts for sponsor
- Model C: it depends; craft careful contract controlling when sponsored organization's lobbying activity is attributed to sponsor
- Best practices for sponsor:
 - Make the 501(h) election (**expenditure test**) instead of using the “substantial part” test, for easier tracking of lobbying activity (IRS Form 5768)
 - Ensure sponsored organization **does not engage in any partisan activity**
 - Consider lobbying disclosure laws in your jurisdiction



Some Key Provisions of a Fiscal Sponsorship Agreement

- Description of benefits and services to be provided by sponsor;
- Fees charged by sponsor employee obligations;
- Restriction of project activities to sponsor's mission and charitable activities within the meaning of I.R.C. Sec. 501(c)3;
- Fund request and distribution process;
- Recordkeeping and reporting obligations;
- Liability and indemnification;
- Insurance requirements;
- Ownership of intellectual property;
- Fundraising support (may require registration by sponsor as a professional fundraiser or fundraising counsel);
- Term of the agreement (length of time); and
- Termination process.



Fees Charged by Fiscal Sponsor

- Set out in the fiscal sponsorship agreement
- Ways to structure fees to fiscal sponsor:
 - Charge sponsored organization a set percentage of its annual revenue (usually 5-15%)
 - Charge fees for specific services provided by sponsor
 - e.g. a set fee for filing the sponsored organization's taxes



Ending Fiscal Sponsorship

- No limit on how long an organization can have a fiscal sponsor
- Review termination provisions of fiscal sponsorship agreement for key terms (e.g. notice)
- Sponsored organization may need to take any of the following steps to transition out of fiscal sponsorship:
 - Incorporate
 - Apply for federal, state, and local tax exemption
 - Develop board of directors and governance documents
 - Develop corporate policies and procedures
 - Transfer assets and liabilities
 - Employment and other insurances secured
 - Assign contracts/grant agreements in sponsor's name



Caution! 990 Filing for Sponsored Organizations Seeking Own 501(c)(3)

- Organizations fiscally sponsored for a short time before getting own 501(c)(3) status should consider:
 - IRS grants 501(c)(3) ***retroactively to the date of incorporation*** if apply within 27 months after the end of the month in which it was incorporated
 - Failure to file Form 990 with IRS for ***3 consecutive years*** = automatic revocation of 501(c)(3) status
 - Be aware that 3 years ***may start tolling*** while you are fiscally sponsored and are awaiting own 501(c)(3), since status will be retroactive!