



# Webinars for Wise Nonprofits: Negotiating and Understanding Fiscal Sponsorship Agreements

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## Presenter bios

### *Rafi Stern, Staff Attorney*

*Rafi Stern is the Staff Attorney responsible for Lawyers Alliance's Economic Opportunity program area, assisting community development organizations and nonprofits that are providing investment capital and credit services, pursuing earned revenue activities, stimulating and revitalizing commercial activity, and sponsoring job training and job placement programs in New York City. Prior to joining Lawyers Alliance in 2019, Rafi was an associate at Paul, Weiss, Rifkind, Wharton & Garrison LLP and a law clerk to the Honorable Margaret Cangilos-Ruiz in the United States Bankruptcy Court for the Northern District of New York. Before law school, he worked as program officer at the Stella and Charles Guttman Foundation and as an NYC Civic Corps member at Phipps Community Development Corporation. Rafi graduated from Brown University in 2010 and Cornell Law School in 2017.*

### *Elizabeth Wytock, Staff Attorney*

*Elizabeth Wytock is the Staff Attorney responsible for Lawyers Alliance's Community Arts program area. Before initially joining Lawyers Alliance as a Legal Fellow sponsored by the National Center on Philanthropy and the Law at New York University School of Law, Liz worked as a tax associate at Proskauer Rose LLP. She graduated from the University of Virginia School of Law in 2018, where she served as executive editor of the Virginia Law Review. She also participated in the UVA Law Nonprofit Clinic and interned for the Honorable Nancy Atlas and the Honorable Mary Milloy at the U.S. District Court for the Southern District of Texas. Prior to law school, Liz worked at the National Academy of Sciences in Washington, D.C. She graduated from Georgetown University in 2012 with a B.A. in Art History and Psychology.*



## Disclaimer

**Please note:** Today's presentation is informational only and is not intended to constitute legal advice. This presentation references both federal and state laws and regulations but primarily focuses on New York law. Please consult with appropriate counsel for guidance pertinent to your organization or situation.



# Introduction

- Lawyers Alliance for New York
- How to Become a Client
- Other Webinars
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## Q: Why are you interested in this webinar?

**A**

My nonprofit may sponsor a project and I want to know what is required of fiscal sponsors.

**B**

I'd like to have my project be fiscally sponsored.

**C**

I'm not sure... it sounded interesting!



# Webinar Overview

1. What is fiscal sponsorship?
2. Benefits and limitations of a fiscal sponsorship
3. Finding a fiscal sponsor
4. Key provisions in a fiscal sponsorship agreement
5. Structuring a fiscal sponsorship
6. Special considerations
7. Ending the fiscal sponsorship



# The 'Traditional' Option: Incorporation and Tax Exemption

Two-step process for becoming a nonprofit with tax-exempt status in New York State:

1. Create a nonprofit entity by filing a Certificate of Incorporation with the New York State Division of Corporations
  - New York requires at least 3 board members
  - Adopt bylaws and a conflict of interest policy
  - Benefits of incorporation include limited liability and perpetual existence
2. Apply for federal tax-exempt status with the IRS and New York State (and any other states in which the nonprofit operates)
  - File Form 1023 with the Internal Revenue Service to apply for 501(c)(3) tax-exempt status
  - File for state tax exemptions with state taxing authorities
  - Benefits of tax exemption include **donor tax-deductibility** and exemptions from income and state and local taxes (franchise, sales and use)



## The Alternative: What is Fiscal Sponsorship?

A **fiscal sponsorship** is a *contractual* arrangement between:

- an organization that is exempt under Internal Revenue Code § 501(c)(3) (the “**Sponsor**”); and
- an organization that is awaiting, or has chosen not to apply for, § 501(c)(3) tax-exempt status (the “**Project**”)

... pursuant to which Sponsor can receive tax-deductible donations on behalf of Project.





## Legal Basis for Fiscal Sponsorship

- The term “fiscal sponsor” *does not* appear in the Internal Revenue Code.
- 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...”

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



## What a Fiscal Sponsorship is NOT:

- Not a “fiscal agency” where Sponsor acts as the agent of Project
- Not a “donor-advised fund,” which is a charitable investment account
- Sponsor *cannot* act simply as a conduit for tax-deductible funds to be used at Project’s discretion
  - Sponsor must exercise “control and discretion”
  - Must have oversight and ultimate control over funds granted to Project to ensure use to further Sponsor’s own charitable purposes
  - If no sufficient oversight, IRS may treat donation as if given directly to Project, which does not have its own tax-exempt status, and in extreme cases, Sponsor’s exempt status may be at risk
- Sponsors are not required to be fundraisers for Projects



## How Does a Fiscal Sponsorship Work?

- Sponsor and Project enter into a **contract** (i.e. a fiscal sponsorship agreement), under which:
  - Sponsor agrees to accept and administer funds on Project's behalf
  - Project benefits from Sponsor's receipt of tax-deductible contributions to be used toward Project, without Project having own tax-exempt status
- All funds flow through Sponsor, who retains **oversight** to ensure funds are used in furtherance of Sponsor's charitable mission.
- Sponsor provides administrative services under the terms agreed upon in the contract.
- Again, the legal foundation for fiscal sponsorship is simply a **contractual relationship** between private parties.



# Sponsor's Role and Obligations

## Key Obligations

- Receive funds
- Exercise **oversight** over the Project including over compliance and reporting requirements
  - Have a separate accounting system for Project's funds, if Sponsor and Project are not fully integrated
  - Issue written donation acknowledgment letters
  - File Form 990
- Comply with any funding requirements or responsibilities

## Optional Services that *May* be Provided

- Fiduciary oversight and legal guidance
- Financial services (accounting, tax filings)
- Human resources (payroll processing, employee benefits)
- Audit compliance
- Office space
- Technical assistance



## Project's Role and Obligations

- Fundraising
  - Transparent external communications with potential or current funders regarding fiscal sponsorship arrangement
- Adhere to reporting obligations to Sponsor
- Abide by Sponsor's policies and guidelines
  - Fundraising guidelines
  - Gift acceptance policies
  - Employment policies
  - Other internal operating or ethics guidelines
- Ensure activities are in line with Sponsor's charitable purposes



# Benefits and Limitations: Sponsor's Perspective

- Benefits
  - Mission furtherance
  
- Limitations
  - Responsibility to oversee Project
    - Increase in risk and liability
  - Administrative costs and burdens
    - Fees paid by Project to Sponsor are a small source of revenue, but Sponsor should not intend to make a profit



# Benefits and Limitations: Project's Perspective

- Benefits
  - Immediate ability to raise tax-deductible funds
  - Increased funding opportunities
  - Focus on programs rather than administration
  - Leverage reputation/network of Sponsor
  - Other administrative or technical assistance from Sponsor
  - Flexibility!
- Limitations
  - Compliance with terms of fiscal sponsorship agreement
  - Sponsor's control and oversight (lack of independence)
  - Reporting obligations to Sponsor
  - Fees to Sponsor
  - Funding limitations



# Who Might Benefit from Being a Fiscally Sponsored Project?

- Group that does not intend to seek 501(c)(3) status
  - e.g. short-term or one-off projects, such as disaster relief or building a playground
- Group that may seek 501(c)(3) status in the future
  - Group that has applied for, but not yet received, 501(c)(3) exempt-status recognition from the IRS and wishes to begin fundraising right away
  - Group that has not yet applied for 501(c)(3) status and wishes to test out its charitable projects/mission beforehand





# Finding a Fiscal Sponsor

- Consider a “dedicated fiscal sponsor”, (possibly an organization that lists fiscal sponsorship as a core part of its mission)
  - For an online directory of larger fiscal sponsors nationwide, visit: <http://www.fiscalsponsordirectory.org/>
- Or find a 501(c)(3) organization that may be interested in your organization’s programs, even if that organization has not previously served as a fiscal sponsor
- **Mission fit is key in both cases:**
  - The mission of the Project must fit with the mission of the Sponsor
  - Check the Sponsor’s certificate of incorporation, application for tax-exempt status with the IRS, or Form 990s – anything that publicly provides the Sponsor’s charitable purpose and activities

**Administrative capacity to manage the fiscal sponsorship arrangement is also key!**



# Fiscal Sponsorship Structuring Options

- Because fiscal sponsorships are created by **contract**, they can be structured in various ways to fit the needs of Sponsor and Project.
- First Option: Project can become fully integrated with Sponsor.
  - Legally, Project is no different than any other activity Sponsor carries out under its corporate entity.
  - Project has no separate legal identity from Sponsor.
  - Sponsor bears full responsibility/liability for activities of Project.
  - Project's staff become employees (or volunteers) of Sponsor, and Sponsor retains intellectual property rights.
  - Only Sponsor files Form 990.
  - **Good “training ground” for start-up nonprofits because of high level of control by Sponsor.**



## Fiscal Sponsorship Structuring Options (cont'd)

- Second Option: Sponsor and Project can enter into a grantor-grantee relationship, where Sponsor receives donations on behalf of Project and administers them as grants to Project.
  - Project has separate legal identity from Sponsor.
  - Project retains more control over its program, subject to reporting to Sponsor.
  - Project bears most liability for Project activities, and Sponsor's liability is limited to that of a grantor.
  - Project generally retains its own employees and owns intellectual property.
  - Project files its own Form 990.
  - Suitable for Projects that have capacity to shoulder more administrative burden.



# Key Contract Provisions

- Fees charged by Sponsor
  - Will it be a fixed percentage of Project's annual revenue, or a fixed dollar amount?
  - Fee structuring example:
    - Charge Project a set percentage of its revenue (e.g. 5%-15%)
    - Charge fees for specific services provided by Sponsor
      - e.g. a set fee for filing the Project's tax returns
- Administration of funds
  - How will funds be collected and maintained by Sponsor?
  - What are the requirements required by Sponsor to disburse funds to Project?
  - What accounting, record keeping, and financial reporting requirements will be met by Sponsor and Project, respectively?



## Key Contract Provisions (cont'd)

- Fundraising responsibilities
  - Project is generally responsible for its own fundraising.
  - Will Sponsor provide fundraising administrative support such as drafting donor gift acknowledgments?
- Ownership of intellectual property
  - Who will be granted intellectual property rights for the work of Project? How about after the fiscal sponsorship terminates?



## Key Contract Provisions (cont'd)

- Employment
  - To the extent individuals are hired to provide Project services, will these individuals be employees or independent contractors?
  - Which legal entity will employ Project personnel?
- Termination
  - When can the parties terminate the contract?
  - What requirements must be satisfied in order to terminate?
  - What happens to any Project funds remaining with Sponsor?
  - What if the Project becomes dormant?



## Example: The Musical Group

- Musicians Amanda and Simon wish to form a nonprofit group to provide free music performances in New York City.
- They have identified some interested individual donors and corporations but the donors want to give to a 501(c)(3).
- The musicians approach a fiscal sponsor about a ‘pre-arranged’ grant relationship but have some questions.
- Will the musicians have complete control of money donated to the fiscal sponsor for the musical group’s purposes?
- Should the group of musicians incorporate a new entity?
- Would the group of musicians need insurance?



## Example: The Community-Based Organization

- During the pandemic, Belinda began to provide food and other health resources in the neighborhood.
- The initiative began informally without any legal advice.
- Belinda now wants to formalize the initiative.
- NY Hospital is seeking Projects to give health advice in the community and takes on Belinda's group as a hospital Project.
- Is Belinda an employee of NY Hospital?
- Can Belinda's group ever become its own 501c3? How quickly?
- Who owns rights to the logo t-shirts that have become a hot seller on Instagram?





# Joint Employment Considerations

- Separate legal entities may be considered *joint employers* of the same employee(s) if each exercises **control or supervision** over the same employee(s).
- In a fiscal sponsorship, this can take shape in the following ways:
  - Sponsor and Project agree to share the employee's services
  - One employer (either Sponsor or Project) acts for the other employer with respect to the employee
  - One employer controls the other, or both are under common control
  - Examples:
    - Project staff on Sponsor's payroll
    - Sponsor has to approve Project employee terminations
- Significance
  - Number of employees included for purposes of calculating federal and state law applicability
  - Each employer may be liable for legal infractions by the other and may be ***jointly and severally liable*** for paying any judgments, fines or penalties.



## Lobbying Considerations

- 501(c)(3) organizations are limited by IRS in the amount of lobbying they can engage in.
- Key question: Does the lobbying of Project count towards the Sponsor's lobbying?
  - It depends. Careful contract drafting required to ensure Project's lobbying is not attributed to Sponsor.
  - If Project is fully integrated with Sponsor (and not a separate legal entity), then lobbying activity of Project does count for Sponsor.
- Best practices for Sponsor:
  - Make the 501(h) election for easier tracking of lobbying activity (File IRS Form 5768).
  - Ensure Project **does not engage in any political activity**.
  - Consider state and local lobbying disclosure laws.



## Federal and State Tax Reporting Considerations

- Sponsor is always responsible for filing its Form 990.
- Project is responsible for filing a Form 990 if it has incorporated.
- Sponsor is responsible for state charitable registration and reporting requirements:
  - Initial registration
  - Form CHAR 500 annual report
- Project may be responsible for state charitable registration and reporting requirements, if it has incorporated.



# Federal and State Tax Reporting Considerations (cont'd)

- **CAUTION:**

- Auto-revocation for failure to file 3 consecutive Form 990s -- may affect some fiscally sponsored organizations that intend to file for own 501(c)(3) exempt status
- 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
- Need to file Form 990 while waiting
- 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!



# 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)
- Project may need to take any of the following steps to transition out of a 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
  - Notify funders
  - Assign contracts/grant agreements in Sponsor's name



## Questions?

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# Thank you!

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- Data Protection for Nonprofits: Friday, Mar. 1, 2024, 10:00 am - 11:00 am
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