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Community Arts Q&A Series

Fiscally Sponsoring an Artist's Project

As part of its Community Arts program area, Lawyers Alliance is providing a series of Q&As to help community arts organizations better understand how the law applies to them. This Q&A is the third in that series. Other Q&As in the series can be found [here](#).

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Arts nonprofits with federal 501(c)(3) tax-exempt status often aim to support the work and endeavors of individual artists in their networks. One way to provide this support is to “fiscally sponsor” an artist’s project, thereby providing the artist with a mechanism to collect charitable donations while furthering the mission of the arts nonprofit. This memo explores the various legal issues that arise from such arrangement.

Legal counsel should be sought to assess any fiscal sponsorship relationship. Nevertheless, we hope that this memo, which is not intended as legal advice, will provide helpful information.

Issue #1: Mission Alignment

Question: Can an arts nonprofit with federal 501(c)(3) tax-exempt status fiscally sponsor an individual artist’s project?

Answer: An arts nonprofit can fiscally sponsor an individual artist’s project (a “sponsored project”), allowing it to collect tax-deductible donations and grants on behalf of that sponsored project, as long as the sponsored project is within the fiscal sponsor’s exempt purpose (i.e., its charitable mission).

Question: What type of artist projects can an arts nonprofit fiscally sponsor?

Answer: What constitutes an appropriate “sponsored project” ultimately depends on the exempt purpose of the arts nonprofit serving as the fiscal sponsor. A sponsored project may refer to a one-time artist project, or the entire artistic practice of an individual. However, it is key that the arts nonprofit requires some specificity from an artist on what particular project is being sponsored to ensure that:

- The project is charitable in nature (i.e., serves the community broadly) and not benefiting the artist’s public gain, and
- The project’s scope and outcomes are aligned with the arts nonprofit’s mission.

Question: How closely do the missions of the fiscal sponsor and the sponsored project need to align?

Answer: The IRS requires fiscal sponsors to choose projects “that are in furtherance of [the fiscal sponsor’s] own exempt purposes.”¹ Unfortunately, there is no exact formula to assist the parties with this determination; however, it is essential that the fiscal sponsor’s Board of Directors review and approve the sponsored project’s mission as furthering the fiscal sponsor’s exempt purposes. In addition, the fiscal sponsor’s Board should adopt a resolution documenting its conclusions and approving grants to the sponsored project.

Example: A nonprofit sculpture studio’s mission is to educate NYC communities on the art of bronze work. The nonprofit is aware of a sculptor in its network who is organizing a large public art installation in a local park, showcasing a number of bronze pieces with detailed descriptions of the casting process. The artist, however, is struggling to raise funds for this massive endeavor. The sculpture studio’s Board has determined that the installation furthers the studio’s mission of sculpture education and has decided to fiscally sponsor the artist’s sculpture installation project.

Issue #2: Fiscal Sponsor Responsibilities

Question: What is legally required of a fiscal sponsor?

Answer: Fiscal sponsors are required to retain a certain amount of control over the funds donated to the sponsored project, and may not act as a mere conduit funneling money to the artist. Control over funds can be enacted via a number of means, such as requiring regular reporting by the sponsored project and by not disbursing funds without receiving a reimbursement request. The exact level of control will depend on the type of fiscal sponsorship arrangement the fiscal sponsor and artist enter into. Overall, it is essential that the fiscal sponsorship agreement between the fiscal sponsor and the artist (discussed in more detail below) clearly sets out any oversight parameters to the sponsor relationship so that the fiscal sponsor can ensure the artist is only using the funds to further the fiscal sponsor’s charitable mission.

Fiscal sponsors should also be aware of all applicable laws relevant to the specific sponsored project and educate the artist, particularly when it comes to compliance and reporting requirements associated with tax obligations, fundraising, and other federal, state, and local regulations, because these activities are attributable to the fiscal sponsor. For instance, a public art installation may need a city permit, or an installation on private property may need an agreement with the property owner.

Additionally, fiscal sponsors must have a system for handling and accounting for project funds separately from the fiscal sponsor’s general budget and should never use project funds for any other project. Fiscal sponsors should also maintain some basic correspondence with donors to the sponsored project, such as providing receipt of tax-deductible gifts. Lastly, the fiscal sponsor is required to include in its annual IRS 990 filing the revenues that are accepted by the fiscal sponsor on behalf of the sponsored project.

¹ See Rev. Rul. 68-489, 1968-2 C.B. 210 (1968).

Prior to engaging in a fiscal sponsorship arrangement, a sponsor should carefully assess their ability to carry out all of the aspects of the sponsorship arrangement and weigh the benefits and burdens of the arrangement, seeking expert legal and accounting advice when needed.

Question: Is there any downside to being a fiscal sponsor?

Answer: If the IRS determines that a fiscal sponsor is not exercising appropriate oversight to ensure that the revenue of the sponsored project is being used by the artist to further the sponsor's charitable purposes, it may treat the donations as if they were given directly to the artist. This would mean that the contributions would not be tax-deductible to the donor and the artist would owe tax on these contributions. The fiscal sponsor could also be at risk of losing its 501(c)(3) tax-exempt status.

In addition, because a sponsored project essentially operates as a program under the umbrella of the fiscal sponsor, the fiscal sponsor needs to make sure that all parties involved with the sponsored project abide by the fiscal sponsor's own policies, including ethics guidelines, conflict of interest policies, and other internal operating guidelines.

Question: Should the fiscal sponsorship arrangement be memorialized in a contract?

Answer: Yes. No matter how small the sponsored project is, the fiscal sponsor needs to enter into a fiscal sponsorship agreement with the artist.

As with other contractual relationships, the parties to a fiscal sponsorship agreement should have a clear understanding of the arrangement and memorialize that understanding in writing. Having a written agreement can help the parties avoid surprises and lay out a clear process for approval of expenditures, reporting, and other essential provisions of the arrangement. A written agreement can also evidence to funders, state regulators, and the IRS the commitment of both parties and a good faith effort to comply with the relevant law.

At the minimum, a fiscal sponsorship agreement should include the following:

- a description of benefits and services to be provided by the fiscal sponsor,
- a statement that the funds received on behalf of the sponsored project only be used in furtherance of the fiscal sponsor's mission,
- a solicitation and contribution acceptance policy,
- a fund request and distribution process,
- recordkeeping and reporting obligations,
- liability and indemnification provisions,
- insurance requirements,
- ownership of intellectual property that is created during the term of the fiscal sponsorship,
- term (length) of the agreement, and
- a termination process.

It is advisable for both parties to have the fiscal sponsorship agreement reviewed by legal counsel knowledgeable in this field.

Issue #3: Fiscal Sponsorship Benefits and Additional Considerations

Question: *How would a fiscal sponsorship arrangement benefit the artist?*

Answer: The biggest advantage of fiscal sponsorship from the artist's point of view is that the artist can more easily receive funding for his or her project from private foundations, government agencies, individuals, or corporate donors. This is because governmental agencies and institutional funders are either required by law, or simply prefer, to make contributions to organizations with tax exempt status. Individual donors, on the other hand, are more likely to give when their donation is tax-deductible.

In addition, depending on the fiscal sponsorship agreement, the fiscal sponsor can assist the artist with project management, fundraising, preparing all required state and federal government reports and informational returns, insurance, and other back office support. Lastly, the support of a well-known and respected fiscal sponsor may also bring a level of credibility to the artist's project, leading to new opportunities for fundraising, relationship-building with other organizations, and increased ability to obtain volunteers and other supporters.

Question: *Can an arts nonprofit fiscally sponsor a project by a group of artists?*

Answer: An arts nonprofit can fiscally sponsor a collaborative project, but at a minimum, consider requiring that the group have a memorandum of understanding or other agreement so that the fiscal sponsor does not become embroiled in disagreements or misunderstandings among the collaborative. The agreement should address the collaborative's operations, such as artist responsibilities and intellectual property ownership, thereby lending some formality to the sponsored project. The fiscal sponsor should also make sure the collaborative identifies the social security number of one of the artist participants for reporting purposes.

Question: *Can an arts nonprofit charge a fee for its fiscal sponsorship services?*

Answer: A fiscal sponsor will usually charge the sponsored project a fee for its services, generally 1-15% of the sponsored project's revenue. The range usually depends on what services the fiscal sponsor is providing and the reputation of the fiscal sponsor in the nonprofit industry. The amount charged for a fiscal sponsorship should be included in the fiscal sponsorship agreement.

General information about fiscal sponsorship can be found on Lawyers Alliances' website at https://lawyersalliance.org/userFiles/uploads/legal_alerts/Fiscal_Sponsorship_FAQs_January_2021.pdf.

This alert is meant to provide general information only, not legal advice. If you have any questions about this alert please contact Elizabeth Wytock at ewytock@lawyersalliance.org or visit our website at www.lawyersalliance.org for further information. To become a client, visit www.lawyersalliance.org/becoming-a-client.

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