Lawyers Alliance for New York

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FISCAL SPONSORSHIP FAQ

This FAQ is meant for nonprofits who are interested in learning more about fiscal sponsorship relationships. Commonly asked questions are addressed, but the answers are not a substitute for legal advice. Nonprofits considering a fiscal sponsorship relationship should consult with an attorney.

General Information

What is a fiscal sponsorship?

Fiscal sponsorship is an arrangement between a 501(c)(3) organization (the "fiscal sponsor") and a person, group, or organization that, usually, does not have its own tax exemption (the "sponsored organization"), in which the fiscal sponsor collects tax-deductible donations on behalf of the sponsored organization. In order for a fiscal sponsorship arrangement to be allowed by the IRS, the fiscal sponsor's and the sponsored organization's missions must be aligned.

What is a fiscal sponsorship NOT?

A fiscal sponsorship is not a pass-through financial arrangement.[1] Instead, the fiscal sponsor is required to retain control and discretion over the donated funds and limit distributions to the sponsored organization or other entities that are in furtherance of its own exempt purpose.

Considerations for a Potential Sponsored Organization

Why should a not-for-profit entity use a fiscal sponsor?

An entity may want to use a fiscal sponsor when:

- it has interested donors, but does not yet have tax exemption to accept tax deductible donations and grants.
- it needs to be a tax exempt entity to receive certain grants and funding.
- it only intends to operate for a limited period of time. For example, following a tragedy, a group may want to raise money to support the victims. By using a fiscal sponsor, the group is able to immediately begin collecting donations and pursuing their mission.
- it is a small nonprofit that wants to be under the umbrella of a larger, more experienced organization who may handle administrative and other matters for the organization.

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

- it is unsure of its success and would like to pursue donations before committing money and time to setting up an independent not-for-profit organization.

In addition, the support of a well-known and respected fiscal sponsor may also bring a level of credibility to the sponsored organization that may lead to new opportunities for fundraising, facilitate relationship-building with other organizations, and increase the sponsored organization's ability to obtain volunteers, employees, or supporters.

What services does a fiscal sponsor provide?
A fiscal sponsor can assist the sponsored organization with a variety of services, such as:

- program management, including financial/accounting services,
- fundraising,[2]
- facilities for office space and equipment,
- assisting with preparing all requisite state and federal government reports and informational returns,
- technical support,
- insurance, and
- human resources services/payroll services.

Since a fiscal sponsor arrangement is a contractual relationship, whatever services the parties agree to, they should be included in the fiscal sponsorship agreement.

What are the disadvantages of using a fiscal sponsor?
The main disadvantage of having a fiscal sponsor is that the sponsored organization does not have ownership and control over the funds received on behalf of its organization. A sponsored organization may request funds for a certain activity; however, it is ultimately the decision of the fiscal sponsor as to whether those funds will be granted. Fiscal sponsors may also request regular reports on the activities of the sponsored organization.

Another disadvantage is that fiscal sponsor will charge a fee for its services, generally 1-15% of the sponsored organization's revenue. The range usually depends on what services the fiscal sponsor is providing and the reputation of the fiscal sponsor in the non-profit industry.

Can the sponsored organization have any type of independence?
Yes, depending on what type of fiscal sponsorship model the parties agree on. For example, the pre-approved grant relationship fiscal sponsorship model allows the sponsored organization independence to carry out its own programs (while still being monitored by the fiscal sponsor). However, in order for the parties to set up this type of relationship, the sponsored organization must be incorporated and have its own bank account. In addition, the sponsored organization will generally have to obtain its own insurance and be responsible for any liabilities that arise against it.

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[2] It is important to note that individuals (excluding staff and volunteers) and organizations that are compensated to provide services in connection with fundraising to a New York not-for-profit corporation may be considered fundraising professionals and must comply with registration and filing requirements set forth in New York State Executive Law. For more information, see http://www.charitiesnys.com/pdfs/char009.pdf.

<u>Considerations for a Potential Fiscal Sponsor</u>

How closely do the missions of the fiscal sponsor and sponsored organization need to align?

The IRS requires that the fiscal sponsor only distribute funds to a sponsored organization that engages in projects "that are in furtherance of [the fiscal sponsor's] own exempt purposes."[3] 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 organization's mission as furthering the fiscal sponsor's exempt purposes. In addition the board should adopt a resolution documenting its conclusions and approving a grant to the sponsored organization, to be funded to a certain amount, or to the extent that the fiscal sponsor receives outside funds for the sponsored organization.

What happens if the fiscal sponsor's and sponsored organization's missions do not align?

If the IRS determines that the fiscal sponsor is not exercising appropriate oversight to ensure that the revenue of the sponsored organization is being used to further the fiscal sponsor's charitable purposes, it may treat the donations as if it they were given directly to the sponsored organization; this would mean the contribution would not be tax-deductible. The fiscal sponsor's tax-exempt status could also be at risk if the IRS determines that the funds were not used in furtherance of its exempt purpose.

Does the fiscal sponsor or the sponsored organization own the tangible and intangible property created by the sponsored organization?

This answer generally depends on the fiscal sponsorship arrangement that the parties choose to enter into. In a more comprehensive fiscal sponsorship arrangement, property (including intellectual property) is generally owned by the fiscal sponsor, but the fiscal sponsor is restricted to only using such property on behalf of the sponsored organization. In a pre-approved grant relationship described above, ownership of property is usually retained by the sponsored organization.

What should the fiscal sponsorship agreement include?

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.

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 organization only be used in furtherance of the fiscal sponsor's mission,
- a fund request and distribution process,
- recordkeeping and reporting obligations,
- liability and indemnification provisions,
- insurance requirements,

[3] *See* Rev. Rul. 68-489, 1968-2 C.B. 210

- ownership of intellectual property,
- term of the agreement, and
- a termination process.

Ending the Fiscal Sponsor Relationship

How does a sponsored organization end its fiscal sponsor relationship?
It is important for the sponsored organization to review the termination provisions in the fiscal sponsorship agreement in order to understand the term of the arrangement and how much notice and what type of notice is required to end the relationship. However, if a sponsored organization decides to transition from a fiscal sponsorship arrangement to operating as a completely separate not-for-profit entity, it should ensure that incorporation and federal, state, and local tax exemptions are in order, fiscal policies and procedures are in place, any employment related insurance (workers compensation, etc.) has been secured, and the organization's board is ready to assume all of its governance obligations including management oversight.

Interested in Learning More about Fiscal Sponsorship?

If interested in learning more, the following sources are particularly helpful:

- Getting Organized (A comprehensive guide on incorporating and obtaining tax exemption for a New York not-for-profit corporation, that includes a detailed discussion on fiscal sponsorship). Published by Lawyers Alliance of New York, the book is available here: http://lawyersalliance.org/publications_list.php

- National Network of Fiscal Sponsors- http://fiscalsponsors.org/

- Article by Attorney Gregory Colvin that outlines different fiscal sponsorship models: http://www.fiscalsponsorship.com/images/WCTEO_Gregory-Colvin.pdf

This memo is meant to provide general information only, not legal advice. Please contact Judith Moldover at Lawyers Alliance for New York at (212) 219-1800 x 250 or visit our website www.lawyersalliance.org for further information.

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