

**Program Preservation, Evolution, and Financial Change: Finances and Fundraising
Fiscal Sponsorship as an Option in Challenging Times**

During times of economic turbulence, there is often increased interest in creating nonprofits. This interest comes from a good place: people feel motivated to assist others who are struggling with economic and other challenges. A person might also be motivated to form a nonprofit organization in order to access funding and create job opportunities for themselves and other like-minded and committed individuals. But creating and maintaining a 501(c)(3) nonprofit involves a lot of work, an understanding of the government oversight of nonprofits, and an appreciation of the administrative burdens. It is not an undertaking that should be entered into lightly.

This FAQ is meant for both nonprofit fiscal sponsors (Sponsor) and projects (whether an individual, a group of individuals or a standalone corporation, the Project) that may not be ready to apply for 501(c)(3) tax-exempt status and are interested in learning more about an alternative: a fiscal sponsorship relationship.

Commonly asked questions are addressed, but the answers are not a substitute for legal advice. Both parties (Sponsor and Project) considering a fiscal sponsorship relationship should consult with an attorney and any fiscal sponsorship arrangement should be memorialized in writing with each side represented by an attorney.

General Information

What is a fiscal sponsorship?

Fiscal sponsorship is an arrangement between a 501(c)(3) organization (the Sponsor) and a person, group, or organization that, usually, does not have its own 501(c)(3) public charity tax-exempt status (the Project), in which the Sponsor agrees to accept certain tax-deductible donations for use by the Project. In order for a Sponsor to undertake a fiscal sponsorship arrangement, the Sponsor's and the Project's missions must be aligned. In other words, whatever it is the Project proposes to do must be activities that the Sponsor itself has the power and authority to undertake directly.

What is a fiscal sponsorship NOT?

Many fiscal sponsors refer to themselves as 'fiscal conduits.' This is exactly the language that the Internal Revenue Service does NOT want to see. A fiscal sponsorship is NOT a pass-through financial arrangement in which the Sponsor automatically passes funds to the Project, which then in turn has control of all funds.¹ Instead, the Sponsor is required to retain control and discretion over the donated funds and continually ensure distributions to the Project or other entities are in furtherance of the Sponsor's own exempt purposes.

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

Considerations for a Project

Why should a Project use a Sponsor?

A Project at the start-up stage may want to consider a fiscal sponsorship arrangement for the following reasons:

- Fiscal sponsorship provides an efficient way to gain access to funding. The Project may already have interested donors, but does not yet have tax-exempt status to accept tax deductible donations and grants. Entering a fiscal sponsorship arrangement can broaden the Project's funding options without subjecting it to the additional process of applying for its own tax-exempt status. This can enable the Project entrepreneur to test their idea and see how much funding is available in a tough economic environment without committing up-front resources, time, and money.
- A Project can benefit from the expertise of a more experienced organization that may handle administrative and other matters on its behalf. Such support infrastructure can assist the Project to run its programs more effectively, which contributes to building a record of programming successes that can be beneficial when the Project is ready to apply for tax-exempt status.
- A fiscal sponsorship agreement can facilitate a Project that only needs to operate for a limited period of time. For example, following a natural disaster, a group may want to raise money to support the victims. Using a Sponsor, the Project is able to immediately begin collecting donations and pursuing their mission, without worrying that they will need to dissolve a nonprofit entity at the end of the project.
- The support of a well-known and respected Sponsor may also bring a level of credibility to the Project that may lead to new opportunities for fundraising, facilitate relationship-building with other organizations, and increase the Project's ability to obtain volunteers, employees, or supporters.

What services does a Sponsor provide?

A Sponsor can assist the Project 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 sponsorship arrangement is a contractual relationship, whatever services the parties agree to should be included in the fiscal sponsorship agreement.

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>.

What are the disadvantages of using a Sponsor?

The main disadvantage of having a Sponsor is that the Project does not have ownership and control over the funds received on its behalf. A Project may request funds for a certain activity; however, it is ultimately the decision of the Sponsor as to how those funds will be disbursed. Sponsors usually also request regular reports on the activities of the Project.

Another disadvantage is that Sponsor usually will charge a fee for its services, generally 5-10%³ of the Project's contributed support.

One other consideration for a Project is to evaluate the credibility and creditworthiness of the Sponsor. Some Project representatives have expressed concern about what sensitive program participant data must or will be shared with the Sponsor. These and other concerns can be addressed to some extent in a reasonably drafted fiscal sponsorship agreement.

Can the Project 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 Project 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 Project 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.

Considerations for a Sponsor

How closely do the missions of the Sponsor and Project need to align?

The IRS requires that the Sponsor only distribute funds to a Project that engages in activities "that are in furtherance of [the Sponsor's] own exempt purposes."⁴ Unfortunately, there is no exact formula to assist the parties with this determination. It is essential, however, that the Sponsor's Board of Directors review the Project's mission and determine that the Project's proposed activities further the Sponsor's own exempt purposes. The Sponsor's Board should adopt a resolution documenting its conclusions and authorizing entering into an appropriate fiscal sponsorship agreement with the Project.

What happens if the Sponsor's and Project's missions do not align?

If the IRS determines that the Sponsor is not exercising appropriate oversight to ensure that the support being provided by the Sponsor to the Project is being used by the Project in a way that furthers the Sponsor's own charitable purposes, the IRS may treat such donations as if they were given directly to the Project; this would mean those contributions would not be tax-deductible to the donors. The Sponsor's tax-exempt status could also be at risk if the IRS determines that the funds were not used in furtherance of the Sponsor's exempt purposes.

Does the Sponsor or the Project own the property created by the Project?

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

³ Note that some organizations charge as little as 1% or as much as 15% depending on the amount of administrative work required and the negotiating leverage of the sponsoring organization. This is often a point of negotiation in fiscal sponsorship arrangements.

⁴ See Rev. Rul. 68-489, 1968-2 C.B. 210

intellectual property) is generally owned by the Sponsor, but the Sponsor is restricted to only using such property on behalf of the Project or for similar exempt purposes. In a “pre- approved grant relationship” model described above, ownership of property is usually retained by the Project.

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 minimum, a fiscal sponsorship agreement should include the following:

- a description of benefits and services to be provided by the Sponsor;
- a statement that the funds received on behalf of the Project only be used in furtherance of the 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;
- term of the agreement;
- clear language that funds are being held under charitable trust legal principles; and
- a termination process.

Ending the Fiscal Sponsor Relationship

How does a Sponsor or a Project end its fiscal sponsor relationship?

It is important for both the Sponsor and the Project 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 Project 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 liability and employment related insurance (workers compensation, etc.) and benefits, if applicable, have been secured, and the new organization’s Board is ready to assume all of its governance obligations including management oversight. Termination of the relationship involving transfer of the Project from one Sponsor to another is also possible.

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 for New York. The book is available here: <https://lawyersalliance.org/publications/list>
- National Network of Fiscal Sponsors: <http://fiscalsponsors.org/>
- Fiscal Sponsors Directory: <https://fiscalsponsordirectory.org>

- Article by Attorney Gregory Colvin that outlines different fiscal sponsorship models. This framework is used by many attorneys that work on fiscal sponsorship issues:

<https://fiscalsponsorship.com/the-models-summary/>

This memo is meant to provide general information only, not legal advice. Please contact Rafi Stern at Lawyers Alliance for New York at rstern@lawyersalliance.org or visit our website www.lawyersalliance.org for further information. To become a client, visit www.lawyersalliance.org/becoming-a-client. Lawyers Alliance would also like to thank Amy Zhang of Columbia Law School for her assistance in preparing this Legal Alert.

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