Justice & Diversity CENTER

OF THE BAR ASSOCIATION OF SAN FRANCISCO

Fiscal Sponsorship Basics

What is fiscal sponsorship?

Fiscal sponsorship is an alternative to forming a traditional nonprofit public benefit corporation. A fiscal sponsorship relationship confers the sponsor's 501(c)(3) tax-exempt status and certain administrative benefits onto a charitable project so that it can receive grants and tax-deductible contributions that it would otherwise be unable to receive. In essence, it provides an opportunity for a small charitable project to piggy-back on the fiscal sponsor's IRS status and pass certain overhead costs to the sponsor; however, the fiscal sponsor typically retains the ability to exercise certain controls over the sponsoree, and often requests a fee from the sponsoree in exchange for its services. This legal alert explores the different models of fiscal sponsorship and discusses the advantages and disadvantages of these types of relationships.

What are the different types of fiscal sponsorships?

A fiscal sponsorship can take various forms, depending on the needs of the specific project. The most common forms of fiscal sponsorship are the Direct Model and the Grant Model.

The Direct Model

The Direct Model is the most common form of fiscal sponsorship. In the Direct Model, the project becomes an integrated part of the fiscal sponsor, with no legal identity separate from the fiscal sponsor. The fiscal sponsor directly receives donations and grants for the project, and the receipt and use of these funds is reported on the sponsor's tax filings. The project and fiscal sponsor form an employer-employee relationship, and the project's staff and volunteers become employees and volunteers of the fiscal sponsor, respectively. Due to the employee-employer relationship, the fiscal sponsor is both fiscally and legally liable for the actions of the project. Thus, the fiscal sponsor must exercise significant control over the project's actions and funding to safeguard itself from legal liability and losing its 501(c)(3) status.

The Grant Model

The Grant Model gives projects more autonomy over the project than the Direct Model because the project does not become part of the fiscal sponsor; rather, the fiscal sponsor and project have a grantor-grantee relationship. The project writes a grant request to the fiscal sponsor, detailing the project and its activities. Once approved, the fiscal sponsor then receives funds on behalf of the project, and disperses them accordingly. A fiscal sponsor may receive a single, one-time grant on behalf of project, or the relationship may be continual. Unlike the Direct Model, the fiscal sponsor in the Grant Model is not legally liable for all actions of the project, but is still fiscally liable for the project's actions. Thus, the fiscal sponsor must still exercise sufficient control over the project's funds to ensure the funds are used in accordance with the grant agreement. This level of control also requires the fiscal sponsor to retain the ability to redirect the funds it receives to other purposes or projects.

Although the fiscal sponsor receives funds and grants for the project, the project is still responsible for maintaining its own tax liability. Unlike in the Direct Model, a project working under the Grant Model is still required to comply with the necessary tax reporting requirements required by the legal status of the project. For example, a project that is an incorporated nonprofit must file its own IRS form 990 if the project would have to file the form without fiscal sponsorship.

What are the benefits of fiscal sponsorship?

- *Ability to receive tax-deductible donations.* A fiscal sponsorship allows a charitable project to use the sponsor's 501(c)(3) tax-exempt status to receive tax-deductible donations.
- *Better fundraising opportunities using the fiscal sponsor's network and expertise.* Often, a fiscal sponsor is a well-established 501(c)(3) organization with a large network of donors and experience in raising funds for charitable purposes. The project benefits from the experience and reputation of the sponsor, enabling the project to raise funds more effectively.
- *Fewer up-front costs.* A project seeking fiscal sponsorship is not required to incorporate or acquire its own 501(c)(3) status, saving the project these essential start-up fees.
- *Use of various services provided by the fiscal sponsor.* Fiscal sponsors provide numerous services to a project, including administrative support, accounting, office space, grant writing, and technical support. These services can be invaluable to a new project.
- *Lower insurance costs.* In the Direct Model, the sponsor can purchase a blanket liability covering all projects, often at a much lower cost than the projects could purchase separately.

What are the disadvantages of fiscal sponsorship?

- *Loss of control of the project.* Depending on the fiscal sponsorship model selected, a fiscal sponsor may be both legally and fiscally responsible for the projects it sponsors. This liability requires the fiscal sponsor to exercise control over the project's funds and operation to ensure the funds are used for proper purposes to avoid tax and other legal liabilities, which may limit the project's ability to direct its operation in the way it wishes.
- *Administrative fees.* Many fiscal sponsors charge administrative fees for use of their facilities, services, and staff.
- *Sponsor may receive credit for project's actions.* Since the fiscal sponsor receives donations and often fundraises for the project, the sponsor may receive credit from the community for the charitable work the project performs.

- *Difficultly separating from the sponsor.* It may be challenging to separate from a fiscal sponsor if the fiscal sponsorship agreement does not specifically provide for separation. Additionally, if the project is unincorporated, it may have limited legal power when trying to separate from the sponsor.

Who should consider a fiscal sponsorship?

- *Projects with a short duration*. Incorporating and obtaining 501(c)(3) status takes time. If the project will only last a short duration, a fiscal sponsorship may be the more economical choice.
- *Time-sensitive projects*. Fiscal sponsorship may be a good choice for projects that need to get off the ground quickly. Since the fiscal sponsor already has tax-exempt status, the project can immediately begin receiving tax-deductible donations and grants.
- *Projects waiting to obtain 501(c)(3) status*. Obtaining federal tax-exempt status usually takes a minimum of four months. Although tax-exempt status can be applied retroactively, it may be prudent to consider a fiscal sponsorship while awaiting a determination from the IRS in case the project's application is rejected.
- *Test projects*. Fiscal sponsorship gives projects a platform to test the project's success before expending the time and resources on incorporation and obtaining tax-exempt status.
- *Projects that want to focus their resources on the charitable purpose*. Because a fiscal sponsor often supplies administrative and technical assistance to projects, the project can focus its time and resources on furthering its mission instead of administrative tasks.
- *Collaboratives or coalitions*. A fiscal sponsorship can be useful for groups of organizations or individuals working together on a project. The fiscal sponsor can centrally receive and disperse the grants and donations for the project, making money handling more efficient and tax reporting simpler.

Can I have a fiscal sponsor if I already have 501(c)(3) tax-exempt status?

Yes, but the relationship with the fiscal sponsor will likely take a form different from both the Direct Model and the Grant Model. Projects that are already a 501(c)(3) organization generally form a relationship with the fiscal sponsor as a "Supporting Organization." The major benefit of the Supporting Organization Model is that the project does not need to meet the public support test required to qualify as a public charity instead of a private foundation; the project qualifies under the fiscal sponsor's public charity status under IRS Code Section 509(a)(3). Classification as a public charity is preferable because public charities benefit from more favorable tax treatment than private foundations. For example, a private foundation is subject to various federal excise taxes, while a public charity is exempt. The Supporting Organization Model is best for projects that would not meet the public support test on their own and thus would be classified as a private foundation, such as projects that receive its funding from fewer than five private individuals, businesses, or foundations.

How do I choose a fiscal sponsor?

Choosing the right fiscal sponsor is an important factor in the fiscal sponsorship relationship. Some characteristics the sponsor should have are:

- *Similar mission statement as the project.* This will ensure proper tax treatment of donations and grants.
- *Limited funding overlap.* Choosing a sponsor with limited funding overlap from the project will avoid conflict in donations between the sponsor and project. The project may receive inadequate funding if the sponsor has significant funding overlap.
- *Sufficient resources and infrastructure*. A fiscal sponsor should have sufficient resources and infrastructure to adequately support the project.
- *Good reputation.* A fiscal sponsor with a good reputation in the community will help attract donors and funding to the project.

How do I find a fiscal sponsor?

Many different types of 501(c)(3) organizations engage in fiscal sponsorships. Consider asking existing 501(c)(3) organizations in your community if they would consider being a fiscal sponsor. You may also want to consider 501(c)(3) organizations that specialize in fiscal sponsorship. Visit http://www.fiscalsponsordirectory.org/ for a searchable directory of organizations that act as fiscal sponsors.

What are the steps to establishing a fiscal sponsorship?

1) *Evaluate the charitable project*. Evaluate the goals and needs of the project. Be sure to consider and decide what type of legal entity the project will become. If you decide to become an incorporated nonprofit entity, follow the steps to do so. If you do not wish to become an incorporated nonprofit entity, you may want to consider becoming an unincorporated association in order to preserve some legal rights of your project. The types of legal rights the project preserves as an unincorporated association include the power to enter into the fiscal sponsorship agreement, the right to enforce the terms of the agreement in court, and the ability to be represented by an attorney, such as through the CORP program (This approach is suggested in *Fiscal Sponsorship: 6 Ways to Do it Right*, by Greg Colvin.).
2) *Decide on a fiscal sponsorship model*. Consider the different fiscal sponsorship models and decide which will best suit the needs of the project.
3) *Find a fiscal sponsor*. Do your research. Use the resources discussed in this paper to find the right fiscal sponsor to meet the goals and needs of the project discovered in step one.
4) *Contact the sponsor to discuss your ideas*. Contact preferred fiscal sponsors to discuss the project and plans for fiscal sponsorship.
5) *Execute a fiscal sponsorship agreement*. Once an organization has agreed to be the project's fiscal sponsor, a fiscal sponsorship agreement must be drafted and executed. A properly drafted and executed fiscal sponsorship agreement, which will ensure the goals of the sponsor and project are aligned, is essential to a fiscal sponsorship.

I am ready to leave my fiscal sponsor – now what?

It is important that you discuss the possibility of the project separating from the fiscal sponsor when drafting the fiscal sponsorship agreement. Provide for the terms of separation in the agreement to ensure a swift and easy separation from the fiscal sponsor. The steps to end a fiscal sponsorship relationship vary depending on the reason for the separation. Some reasons include:

- *The project is ending.* The project might be coming to a close because its charitable work is complete, loss of funding, or many other reasons. In this situation, it is advisable to use any remaining grants and funds dedicated to the project to guarantee proper tax compliance for both the sponsor and project.
- *Changing fiscal sponsors*. You may decide you want to change fiscal sponsors. In this case, you will need to execute an agreement with a new fiscal sponsor and negotiate a separation from your current fiscal sponsor. The funds held by your fiscal sponsor must be transferred to your new sponsor, a 501(c)(3) organization.
- *The project obtained 501(c)(3) status*. If you decide to become your own 501(c)(3) organization, you should complete the steps to become a tax-exempt organization before separating from your fiscal sponsor. Once tax-exempt status has been achieved, an agreement can be executed to transfer the funds from the sponsor directly to your new 501(c)(3) organization.

Additional Resources

- Sample fiscal sponsorship agreements for the Direct Model (Model A) and the Grant Model (Model C), available at http://www.adlercolvin.com/resources/basic-resources.php#tab_forms
- http://fiscalsponsorship.com/ – Created by Greg Colvin, author of *Fiscal Sponsorship: 6 Ways to Do it Right.*
- http://www.fiscalsponsordirectory.org/ – A directory of potential fiscal sponsors.
- Tides.org – Tides is a nonprofit organization dedicated to fiscal sponsorship with offices in San Francisco and New York.

Please feel free to contact CORP with requests to apply for pro bono legal assistance in drafting agreements with your chosen fiscal sponsor, and incorporating as your own 501(c)(3) organization, should you chose to do so.