



Legal Minute

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Getting Tax Exempt Donations Without All the Paperwork: Fiscal Sponsorship as an Alternative to Forming a 501(c)(3) Corporation

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Donors rarely give funds to organizations that do not have 501(c)(3) tax status, however, it can take a great deal of time and resources to comply with the requirements under Section 501(c)(3). When an organization is small, temporary, or is just starting out, it may make more sense for the group to explore alternatives to forming a new nonprofit corporation, such as fiscal sponsorship.

What is fiscal sponsorship?

A fiscal sponsor (referred to here as a “Sponsor”) is a 501(c)(3) organization that accepts grants and donations on behalf of an organization (referred to here as a “Project”) that is not eligible to receive them on its own. The Sponsor manages the funds for the Project. The main benefit of fiscal sponsorship is that it is a relatively quick and easy way to get tax-exempt donations.

When is fiscal sponsorship appropriate?

Fiscal sponsorship may be appropriate when the proposed charitable program is relatively small in scope, temporary in nature, or when the business plan is in its beginning stages. For example, consider a group of volunteers that collects toys for needy children during the holidays. Or, consider a group of first responders who want to assist hurricane victims immediately following a hurricane. Neither group requires a perpetual organization space and both are run almost entirely by volunteers. For groups like these that operate on a smaller scale, incorporating a new entity and filing for tax exemption, in addition to the ongoing obligations that come with exemption, would probably take more time and resources than are necessary to operate the proposed programs. The fiscal sponsorship model can also permit a new idea to be tested in a supportive environment with fewer administrative burdens in the long run.

There are several other situations when a fiscal sponsorship agreement might be appropriate. For example, if a group is a coalition of several groups, or existing 501(c)(3)'s working together on a common issue, a fiscal sponsor may be seen as neutral territory for accepting funds. If the group is committed to its mission, but has no interest or experience in managing all the administrative functions of a business, a fiscal sponsor could be a good option. Finally, individuals who are unaffiliated with any group or nonprofit (such as independent filmmakers) seeking grants and donations may find it convenient to work under a fiscal sponsor.

After a few years of operating with the support of a fiscal sponsor, some groups will be in a position to form a separate charitable entity and to terminate the fiscal sponsorship relationship. However, fiscal sponsorship is not limited only to new programs or new ideas. After realizing the advantages of fiscal sponsorship, many projects have existed for years under fiscal sponsors, declining to incorporate and to obtain separate tax exemption.

What are some legal issues that might arise under a fiscal sponsorship agreement?

Even if the funds are restricted for a Project, it is the Sponsor that is legally responsible for everything the Project does. This includes the responsibility to comply with the terms of the grants the Project has been awarded and to ensure that grant funds are spent properly. The Sponsor must sign all contracts to which the Project is a party. Each organization is responsible for the acts of the other. Thus, in some ways, the Sponsor has the ability to dictate how the Project operates. If the Project and the Sponsor disagree, the Project may be forced to “do it their way.”

What are the advantages of fiscal sponsorship?

- Ability to receive tax-deductible donations
- Ability to get off the ground faster
- Wider base of support
- Technical support/administrative support
- Potentially lower insurance costs

What are the disadvantages of fiscal sponsorship?

- Surrender of control to the sponsor
- Administrative fee – typically 5-15% of the funds collected on the Project's behalf

How do I set up a fiscal sponsorship agreement? What are some guidelines for a good agreement?

First, the Project will need to find a Sponsor. Some organizations specialize in providing financial sponsorship to Projects. These groups have as their charitable purpose the mission of assisting and “incubating” emerging projects and groups. A Project wishing to engage in a fiscal sponsorship arrangement may also seek out tax-exempt public charities that are willing to serve as fiscal sponsors and whose charitable purpose is consistent with the type of work the Project intends to perform. **The Project's goals must be within the Sponsor's mission as set forth in its articles of incorporation, bylaws and original 501(c)(3) application papers (Form 1023).** After choosing a potential Sponsor, the Project should submit to the Sponsor a written sponsorship request or “proposal” describing each activity it proposes to conduct that will further the Sponsor's tax-exempt purpose.

The Sponsor and Project should then complete an agreement in writing that details the terms and conditions of the sponsorship, including the specific work to be performed in furtherance of the Project using funds obtained through the Sponsor. This agreement must state clearly that the Sponsor retains complete discretion and control over the use of the contributions it receives on behalf of the Project. It is very important to have a written agreement or memorandum of understanding signed by both the Sponsor and the Project before beginning to operate under a fiscal sponsorship to make sure that both the Sponsor's and the Project's rights and responsibilities are clear to avoid any misunderstandings. Any good sponsorship agreement will also have a mechanism to deal with how to terminate the relationship. There are certain legal restrictions on how the Project's activities and assets are severed from the Sponsor that should be disclosed in the sponsorship agreement.

Often, a Sponsor will have a standard contract that it uses with new Projects. The Project should read the contract carefully and not be afraid to ask the Sponsor questions. The sponsorship agreement is a legally enforceable document, so unless the Project has experience in this area, a review of the document by an attorney retained to represent the Project's interests is a good idea. The Project should know what it is getting itself into. Examples of fiscal sponsorship agreements are available at: <http://www.compasspoint.org/askgenie/details.php?id=91> (an agreement between a professional fiscal sponsor and one of its projects) and <http://www.compasspoint.org/askgenie/details.php?id=90> (an agreement between two nonprofits).

Once the agreement is executed, written notice should be given to all funding sources that the Sponsor retains complete discretion and control over the use of the contributions it receives on the Project's behalf. Donations should be made to the “XYZ” Sponsor, for the benefit of the “ABC” Project. Finally, the Project should make periodic written reports to the Sponsor showing its actual expenditures of disbursed funds and its progress toward accomplishing its charitable purposes.

Organizations that serve as fiscal sponsors:

- Tides Center, <http://www.tidescenter.org>

Other useful resources:

- Charity Channel: <http://charitychannel.com/publish/templates/?a=4845&cz=0>
- Technical Assistance for Community Services: <http://www.tacs.org/qa/qa.asp?tpID=8>
- Community Technical Assistance Center: <http://www.ctaonline.org/fiscal.asp>

Sources: Public Counsel Law Center, “Fiscal Sponsorship: An Alternative to Forming a Nonprofit 501(c)(3) Corporation”; Barlow, David, CPA, “Frequently Asked Questions on Fiscal Sponsorship”; Nonprofit Genie website; and CompassPoint Nonprofit Services.