

Nonprofit Fiscal Sponsorships: Sometimes the Better Route to Take

07.06.15 | Linda J. Rosenthal, JD



A client comes in with an idea – sometimes a rush of ideas – about needs unmet in the community and how to fill those needs.

This person is “thinking about starting a nonprofit organization.” Of course, most of us in the philanthropic sector know that it’s not a simple matter to get a 501(c)(3) up and running with the all-important determination letter from the IRS approving tax-exempt status. It also takes time, money, and tenacity to operate the organization successfully and for the long term.

Happily, there are alternatives that may fit the bill much better than going the route of an independent 501(c)(3) organization.

Sometimes, the best idea under the circumstances is to steer away from the traditional nonprofit model. Particularly if the idea-person foresees one or more business activities, a social enterprise may be the way to go. Under California law – and in an increasing number of states nationwide – a “benefit corporation” [or in California, another choice is the “social purpose corporation”] allows entrepreneurs with a “purpose” to conduct business in a socially conscious way. This is a new concept in corporate law: a for-profit corporation that is not limited to the goal of maximizing shareholder profit.

Another possibility is a “fiscal sponsorship” arrangement with an established 501(c)(3) group. It’s increasingly popular, but also somewhat misunderstood.

What is a Fiscal Sponsorship?

Simply put, it’s a formal arrangement, with appropriate agreements, between an organization that has 501(c)(3), tax-exempt status and a new effort by an individual, group, or organization that would otherwise qualify for the charitable tax exemption.

It’s appropriate for a group waiting for its own tax exemption – (although for

small, qualifying organizations, the approval process is now quicker with the new Form 1023-EZ) – or for the situation where the new venture organizers haven't decided yet to commit to going the stand-alone 501(c)(3) route. It's also useful for groups who want to accomplish a purpose – especially a short-term one – without undertaking the burdens and expense of an independent tax-exempt organization. It's good as well for temporary or smaller projects, or for “coalitions that are looking for a neutral party to administer their funds.” It also works when the project comprises the work of a single artist or collaboration, or when a project or the funding for it is subject to time restraints.

How Does It Work?

The fiscal sponsor undertakes to accept the available grant money or contributions, distribute it to the sponsored venture, and make sure that the funds are spent as designated.

It's different than a “fiscal agency,” which is an arrangement in which a 501(c)(3) organization acts as a legal agent for a project, to carry out certain tasks like administrative support. The fiscal agent is different than a sponsor because the agent doesn't have the control and oversight responsibility key to the sponsorship situation. The fiscal agent acts as a true agent, under traditional legal principles; that is, to act *on behalf of* the principal – the project or venture. The principal retains the authority to direct the acts of the fiscal agent.

A “fiscal agency” is appropriate in a situation where a group already has its own tax-exempt status, but seeks help from a more established group.

What's the key difference – aside from the different and distinct legal concepts? If there's a properly structured fiscal sponsorship, a donor can take a tax deduction. If there's a fiscal agency, contributions are not tax deductible.

How to Create a Proper Fiscal Sponsorship

The Internal Revenue Service doesn't like conduits; that is, where a donation made to a 501(c)(3) organization that immediately, and with no further strings attached or obligations, turns the money over to the intended recipient. Even if an arrangement is set up with the intention of being a true fiscal sponsorship (but it fails to meet IRS criteria), then there is no fiscal sponsorship, and no tax deduction available to the donor.

What are these IRS criteria?

- Funds must be given directly to a 501(c)(3) organization – the sponsor – which undertakes full legal and fiduciary responsibility;
- The money must be used for specific projects that are in line with the sponsor’s stated exempt purposes;
- The sponsor must have and keep discretion and control over the use of the funds;
- The sponsor has to keep sufficient records to show that the funds were used for exempt purposes; *and*
- Either the project should be short-term or the recipient group should be actively seeking its own tax exemption under 501(c)(3).

Different Models

Over time, organizations and professional advisors have tested out various arrangements to meet the requirements for a true and acceptable fiscal sponsorship.

Several models have emerged. The two most prominent formats are:

- **Direct Project:** The project belongs to the sponsor and is carried out by the sponsor’s personnel.
- **Pre-Approved Grant Relationship:** Group seeking sponsorship applies to a prospective sponsor for one or more grants, and the sponsor funds the project(s) only when and if donors give money.

There is also a new model which may be available in limited situations. There, the sponsor acts as the sole member of a limited liability company (LLC), and the project is conducted through that vehicle.

Conclusion

Finding a sponsor and then structuring and maintaining a workable and legally compliant relationship is not necessarily easy, and there are many traps and pitfalls. But in many situations, it’s a useful alternative to the more standard route of independently seeking tax-exempt status, or is a convenient method to get up and running with charitable projects while waiting for the tax-exemption approval.