

# The Community Law Project

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## FISCAL SPONSORSHIP: Frequently Asked Questions

This is a FAQ about fiscal sponsorship relationships. The questions and answers below are meant to assist not-for-profit organizations interested in partnering with a fiscal sponsor. Commonly asked questions are addressed, but the answers are not a substitute for legal advice. Organizations considering a fiscal sponsorship relationship should consult an attorney experienced in such matters.

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### **What is a fiscal sponsorship?**

Fiscal sponsorship refers to a relationship in which an established not-for-profit organization with tax-exempt status offers its tax-exempt status and other support to another entity without 501(c)(3) status (“sponsored organization” or “sponsored project”). Most fiscal sponsors will charge an administrative fee for their sponsorship, usually a small percentage of the funds received for the sponsored organization or

project. Most agreements with fiscal sponsors are informal, but it's considered a best practice to have a written contract in place.

### **What is the difference between a fiscal sponsorship and a fiscal agency?**

People often mischaracterize a fiscal sponsorship relationship as a fiscal agency. Even more confusing is that some fiscal sponsorship contracts are incorrectly titled "fiscal agency" agreements. Fiscal agency is a separate and distinct type of relationship.

In a fiscal agency, an established 501(c)(3) organization (the "fiscal agent") acts as the legal agent of another entity (the "principal"), and the principal has the right to direct and control the agent. If an established 501(c)(3) organization serves as the agent for a project (the principal), the project would have control over the funds and grants, and this would not result in the desired tax outcome as a fiscal sponsorship.

If an individual donor makes a contribution to a fiscal agent, the donor is treated for tax purposes as having made the contribution to the principal. If the principal does not have 501(c)(3) status, the donation would not be tax-deductible to the donor.

Example:

- *Will's family can no longer afford his tuition to their church's parochial school. Ina, his godmother, donates money to the church, but specifies that the money be used as scholarship for Will. The church would be the agent, not actual beneficiary of the donation. In the eyes of the IRS, the church's lack of control and discretion over the funds would indicate that Ina's donation is a gift to Will, not the church. Gifts to individuals are not tax exempt, and Ina's donation would not be deductible.*
- *Ina donates money to her church, a 501(c)(3) organization, but specifies that it be used to fund a ministry led by her godson Will. Will's ministry would be the principal, and the church would be the fiscal agent. The church's lack of control and discretion would indicate that Ina's donation is a gift to Will, not the church. Since gifts to individuals are not tax exempt, Ina's donation would not be deductible.*
- *Ina donates money to a university, a 501(c)(3) organization, but earmarks it for a Professor J's research. The university gives full discretion and control of the funds to Professor J. The professor would be the principal, and the university would be his fiscal agent. The university's lack of control would indicate that Ina's donation is a gift to the professor, not the university. Since gifts to individuals are not tax exempt, Ina's donation would not be deductible.*

### **When would a not-for-profit use a fiscal sponsor?**

Fiscal sponsorship allows groups and projects to seek grants and solicit tax-deductible donations under the fiscal sponsor's exempt status, without attaining its own 501(c)(3) status. A new organization may want to use a fiscal sponsor when:

- It needs funding but does not yet have tax exemption.

- It has interested donors, but does not have tax exemption.
- It is unsure of the success of the organization and would like to pursue donations before committing money and time to setting up an independent not-for-profit organization.
- The organization and several other small not-for-profit organizations want to ally themselves under the umbrella of a larger, more experienced, not-for-profit organization. The larger organization may receive and administer funds on behalf of the small organizations and handle administrative and other matters for the smaller organizations.
- It only intends to operate for a limited period of time. Additionally, if a new organization has tax-exempt status, but it lacks certain administrative capabilities, it may desire the assistance of a fiscal sponsor.

Examples:

- *Ina donates money to her church, a 501(c)(3) organization, but specifies that the money be used as scholarship for her godson Will, who attends the church's parochial school. The church would be the agent, not actual beneficiary of the donation. In the eyes of the IRS, the church's lack of control and discretion over the funds would indicate that Ina's donation is a gift to Will, not the church. Gifts to individuals are not tax exempt, and Ina's donation would not be deductible.*
- *Ina donates money to her church, a 501(c)(3) organization, but specifies that it be used to fund a ministry led by her godson Will, called Will's Ministry, which recently incorporated, but does not have 501(c)(3) status. According to the arrangement with the church, Will's Ministry has all control over the use of the funds. In the eyes of the IRS, Will's Ministry would be the principal, and the church would be the fiscal agent. The church's lack of control and discretion would indicate that Ina's donation is a gift to Will's Ministry, not the church. Since gifts to nonprofits without 501(c)(3) status are not tax exempt, Ina's donation would not be deductible.*

### **What is the nature of a fiscal sponsor relationship?**

For an organization to maintain its tax-exempt status under 501(c)(3), it must retain control and discretion as to the use of its funds, and only distribute funds to projects that further the organization's charitable purposes. The fiscal sponsor is putting its tax-exempt status at risk by sponsoring another project or group. Because the fiscal sponsor needs to protect its 501(c)(3) status, the fiscal sponsor controls the sponsored project and the funds solicited for the project. The fiscal sponsor maintains control over contributions made to the sponsored organization, and has the authority to monitor and evaluate the sponsored organization. Under a fiscal sponsorship, the sponsored organization must cede ultimate discretion and control to the fiscal sponsor.

Example:

- *'Arts for Children' is a newly incorporated nonprofit in Humboldt Park, with a focus on providing arts education to area children. It wants to fundraise and apply to grants, but has not yet received its exemption determination letter from the IRS.*
- *If a homeless aid organization serves as fiscal sponsor for 'Arts for Children', the homeless aid organization would risk losing its 501(c)(3) status for distributing funds to a cause unrelated to its mission.*
- *'Bookworms', a large educational nonprofit for children, agrees to serve as fiscal sponsor. 'Arts for Children' can conduct fundraising through 'Bookworms', and donations can be tax deductible. 'Bookworms' controls the donations and grants made to 'Arts for Children'.*

### **What are the advantages of using a fiscal sponsor?**

With a fiscal sponsor, the sponsored organization can receive tax-deductible donations and grants, get access to a wider network of funders, and receive technical and administrative support from the fiscal sponsor.

### **What are the disadvantages to a new organization for using a fiscal sponsor?**

Most fiscal sponsors charge a fee for its services. The fiscal sponsor serves as a "parent organization" to a sponsored organization. As such, it is legally responsible to both determine how the sponsored organization operates and complies with the terms of the grants awarded. If a not-for-profit organization and its fiscal sponsor disagree, the organization will have to comply with the sponsor's requests. Most importantly, the funds received are under the control of the sponsoring organization.

### **What organization can serve as a fiscal sponsor?**

Any organization that is recognized by the IRS as exempt from income taxes as a 501(c)(3) may serve as a fiscal sponsor but the activities of the sponsored group must be consistent with those of the sponsor. Otherwise the fiscal sponsor's tax-exempt status may be jeopardized for distributing funds to purposes beyond its mission.

For example, a not-for-profit group providing services for the homeless cannot have a fiscal sponsor that is tax-exempt for the purposes of providing music programs for schools.

### **In addition to the tax exemption, what services can a fiscal sponsor provide?**

A fiscal sponsor's services vary depending on the sponsor. Possible services include: financial, tax & information returns, payroll filings, monthly financial statements,

financial record-keeping, insurance, personnel policies in compliance with laws, employee benefits package, bulk rate postal permit, legal advice, grant progress reports and general administration. Some fiscal sponsors may offer a shared office space.

### **What is a fiscal sponsorship agreement?**

A fiscal sponsorship agreement is a contract between the sponsor and the sponsored organization. A fiscal sponsor will often have a standard contract used to sponsor a not-for-profit organization. Based on the specific needs and circumstances of a sponsored organization, this standard agreement can be modified. The contract will establish the relationship between the sponsor and the not-for-profit organization it is sponsoring.

The duties, responsibilities and expectations of each party should be clarified in the sponsorship agreement. The sponsored organization should carefully consider its obligations under the contract. It is a legally enforceable document and should be reviewed by attorneys representing each not-for-profit organization's best interests.

### **What should a fiscal sponsorship agreement include?**

A fiscal sponsorship agreement should:

- be in writing and approved by both organizations;
- establish standards of performance for evaluating the relationship;
- specify the duties and responsibilities for both parties (i.e. who is in charge of expenses, insurance, staffing, filing taxes, etc.);
- establish a reasonable fee for the fiscal sponsor's services;
- establish ownership of work product and assets;
- detail any goods or services the fiscal sponsor shall provide – this should include providing all federal, state and local tax and information returns;
- provide a mechanism for requesting and disbursing funds; and
- establish a term for the relationship and termination procedures.

Several other issues may be addressed in a fiscal sponsorship agreement. Negotiable terms should be discussed with attorneys representing each not-for-profit organization.

### **What should a not-for-profit organization look for in a fiscal sponsor?**

A fiscal sponsor will have a significant impact on the success of the sponsored organization. A not-for-profit organization should select a fiscal sponsor carefully.

Desirable characteristics of a fiscal sponsor include:

- Good reputation in the donor community.
- Solid financial position.

- Strong support staff and services.
- Similar charitable purpose.
- Experience acting as a fiscal sponsor.

Some charitable nonprofits seek, as part of their mission, to operate as fiscal sponsors. These are called “dedicated” sponsors. These organizations typically have extensive experience in assisting other entities with the collection and use of grants and donations. Before entering a fiscal sponsorship relationship, a not-for-profit organization should determine that the charitable missions of each party are similar. Most other issues should be addressed in a fiscal sponsorship agreement.

### **How does a not-for-profit organization find a fiscal sponsor?**

Many fiscal sponsors, including dedicated sponsors described above, fund by issue area or geography. That said, in the Chicago area there are relatively few dedicated sponsors. Some of the places to inquire about fiscal sponsorship services are: word of mouth, churches and other places of worship, local community foundations, volunteer centers, attorneys who specialize in not-for-profits, prospective donors, or an Internet search under "fiscal sponsorship." A great internet resource to find a fiscal sponsor is [www.fiscalsponsordirectory.org](http://www.fiscalsponsordirectory.org), which includes a database of 176 fiscal sponsors.

### **How much do fiscal sponsors cost?**

The fee arrangement of fiscal sponsors varies with each sponsor. Typically, a full-service professional fiscal sponsor will cost a sponsored organization between five and twelve percent of gross receipts. Some sponsors will pay interest to the not-for-profit for collected donations and some will not. Most often, these costs are contracted and can be negotiated for a fiscal sponsorship agreement. A sponsored organization should contact an attorney to represent its best interests in a fiscal sponsorship relationship.

### **What if the not-for-profit no longer wants a fiscal sponsor?**

The terms of the fiscal sponsorship relationship should be in writing before the relationship begins. A well-written sponsorship agreement will have a mechanism to deal with how to terminate the relationship.

If the sponsored not-for-profit organization has decided to terminate the sponsorship agreement, the first step is to inform its current sponsor according to the terms in the agreement. If the organization would like to be independent, it will need to incorporate on its own as a not-for-profit and file for tax-exempt status. This process will usually take four to six months and possibly more than a year. After obtaining tax exemption, a previously sponsored not-for-profit organization can arrange to have the fiscal sponsor transfer the organization’s assets and liabilities to the newly established not-for-profit.