

Go! Understand Fiscal Sponsorship



Go forward.

10%

penalty taxes may be levied on a private foundation that misuses a fiscal sponsor arrangement.¹

It seems simple enough.

You have a great project in mind. It will accomplish a charitable purpose but can't get off the ground without funding. You don't want to apply for a 501(c)(3) at this time. Not surprisingly, the donors you approach want their gifts to be tax deductible. Most foundations only make grants to 501(c)(3) tax-exempt organizations.

Then you hear about fiscal sponsors. With this arrangement a 501(c)(3) tax-exempt organization agrees to accept gifts and grants for your project.

Sounds good!

But, there are complications that may not be apparent to even the experienced nonprofit manager.

Is it a tax deductible gift?

A charitable organization cannot allow non-exempt organizations to simply use its 501(c)(3) status as a fundraising vehicle.² The IRS opposes such "conduit" or "pass-through" arrangements. In such cases, when funds are earmarked for a specific project the IRS will treat it as a gift to that project and ignore the intermediary grantee.³

This means that the individual donor cannot claim a tax deductible gift. The foundation would not be making a grant to a charitable organization. That is, until all parties involved have worked out the details including who controls the project and funds.

Mission, fiscal, and project control

The ideal fiscal sponsor would be one whose mission is advanced by the new project. It should be a well respected organization with strong fiscal systems and good management.

How to Use a Go! Guide

1. Read the guide text for practical advice.
2. Use numbered "Endnote" links that match with Superscript numbers (like this one ¹) after key text points. You'll link to materials that expand on the key points.
3. Use other Web sites in the "General Resources" for more access to practical information.
4. Not getting the answers you need? Call for help from the Allen County Public Library Nonprofit Resource Center at (260) 421-1238.

However, becoming a fiscal sponsor entails a significant commitment:

- assuming legal responsibility for the funded project;
- receiving grant funding for the designated program;
- ensuring that funder reports are submitted;
- writing checks for program expenses;
- acting as the employer for the project employees, subject to workers compensation, unemployment compensation and personnel policies; and/or
- including information about grant funding in its annual tax return and audit.

A commitment of this magnitude deserves considerable thought and board approval. When it comes to both boards you can expect questions like these:

Does this mean we are liable for any mistakes the project creators may make?

What happens if there is an employee grievance or disagreement with an independent contractor?

What controls will we have over the expenditure of funds?

Will the project creators collaborate with us to ensure that final project reflects positively on our organization?

Can this arrangement put our nonprofit status at risk?

What about our reputation?

Each of these concerns is valid. Before deciding to become a fiscal sponsor, you will want to be comfortable with all the answers. And have policies in place when issues arise.

The implications of a fiscal sponsor relationship are significant to the project creators as well.

Will they be giving up too much autonomy or project control?

Will they be turning ownership of their project over to the sponsoring agency?

Like so many things, what starts out simple often becomes complex.

Types of fiscal sponsorship

When fiscal sponsorship is discussed in the nonprofit literature, two publications are often mentioned:

1. John A. Edie, Use of Fiscal Agents: A Trap for the Unwary; The Council on Foundations, 1989; and,
2. Gregory L. Colvin, Fiscal Sponsorship: 6 Ways to Do It Right; Study Center Press, 1993, 2000.

Both agree that there are risky and legitimate ways to use fiscal sponsorship. They reveal that fiscal sponsorship comes in many formulations, each with its own obligations, and each with its own limits on the autonomy of the sponsored program. A fiscal sponsor can take a broad role or a more limited one depending on what is needed to help the sponsored program accomplish its goals efficiently and well. Of course, the sponsoring organization must consider its own interests too.

However, Edie and Colvin do not agree on all points. In fact, their examples of acceptable fiscal sponsor arrangements seem at odds. If you are seeking or considering being a fiscal sponsor, it's a good idea to read both publications and seek the advice of a good nonprofit attorney before you decide to proceed.

A written agreement

It is important to the project creators and the fiscal sponsor that the terms of the relationship are in writing before the relationship begins. Importantly, the contract should outline how to terminate the relationship when necessary. A built-in exit strategy for all parties is crucial.

Project creators will want to be sure that the prospective fiscal sponsor is well respected with sound management and fiscal controls. They will want a fair and timely process to access project funds, and to know that the fiscal sponsor will handle their affairs responsibly.

A fiscal sponsor will want to have confidence in the project's creators and implementers so that their reputation with funders, constituents, and even the IRS, is not damaged.

Because the sponsorship agreement is a legally enforceable document, both parties will want to have their own attorney review it for them.

The fee

Fiscal sponsor services are not free. It is costly to process paperwork, write checks, keep records, produce reports, etc. There will be bank fees, accounting fees or audit costs. The project should expect to pay for the fiscal sponsor's services and plan for them in their budget. The sponsor might charge a flat fee or a percentage of project revenues. It is important to agree on the fee in advance, in writing, and list services the fiscal sponsor will provide in return for that fee.

While fiscal sponsorship offers many benefits, it should not be entered into without forethought. It may be the best route for your project. It may further the sponsoring organization's impact, but only when both parties consider the implications fully.

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Research was completed December 10, 2004. The sites below were active at that time. For your convenience, copies of all information are available at the Allen County Nonprofit Resource Center.

Endnotes

- ¹ John A. Edie, *Use of Fiscal Agents: A Trap for the Unwary*; The Council on Foundations; 1989 Indiana Nonprofit Sector: Scope and Community Dimensions; <http://newsinfo.iu.edu/news/page/normal/1637.html>
- ² Beth Kingsley and Doug Smith; *Fiscal Sponsorships: Do It Right and Stay Out of Trouble*; May 2001 edition of the Nonprofit Navigator; <http://www.harmoncurran.com/navigator/may2001.html>
- ³ John A. Edie, *Use of Fiscal Agents: A Trap for the Unwary*; The Council on Foundations; 1989

General Resources

- John A. Edie, *Use of Fiscal Agents: A Trap for the Unwary*; The Council on Foundations; 1989
- Gregory L. Colvin; *Fiscal Sponsorship: 6 Ways to Do It Right*; Study Center Press; 1993, 2000.



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