Fiscal Sponsorship
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What is fiscal sponsorship?

- To *act like* an exempt organization, have to *be* an exempt organization
  - Foundation grants
  - Tax-exempt contributions
  - Exemption from income tax
- Fiscal sponsorship = fiscal sponsor + sponsored program *or* sponsored project

How can your organization/clients use fiscal sponsorship?

Structure of relationship

- Not an agency relationship
- Sponsor bears full responsibility
- Fiduciary responsibility

Models of fiscal sponsorship

- Direct project
- Independent contractor project
- Grantor/grantee relationship
- Group exemption
- Limited liability company
- Technical assistance

Direct project model

- Most common model
- Program/project has no legal existence apart from the sponsor. It operates just like any other program of the sponsor.
  - Program staff are sponsor's staff
  - No separate governing board (can have advisory board)
  - Contributions are made to the sponsor
- Employer/employee relationship

Independent contractor project

- Project has its own legal existence
- May be organized as a nonprofit or (more likely) as a commercial business
- Separate entity operates the project as a service to the sponsor

- Project is fully owned by the sponsor, as in the direct project model
- Client/contractor relationship

Grant project

- Project may or may not have a legal existence
  - Often is a 501(c)(4) or commercial business
- Project team raises money in the name of the sponsor
- Sponsor makes a grant to the project team using the money raised
- As in all models, sponsor must carefully oversee the project
- Grantor/grantee relationship

Structure of relationships

- Not an agency relationship
- Sponsor bears full responsibility

Fiduciary responsibility

- Who owns the nonprofit?
- Who owns the sponsored program?

Mission must be compatible

Homeless shelter organization could sponsor …

a) Housing counseling program
b) Meal program
c) Arts education program

Direct project written agreement

- Intentions
- Duration
- Rights and responsibilities
- Representatives

Direct project ownership

- If intent is to transfer ownership of assets, document plan
- Document terms under which program staff or volunteers could be disassociated

Direct project employees and volunteers

- Staff = staff

    - Supervision
    - Employment policies
    - Time reporting
- Volunteers
    - "Board"

When direct project fiscal sponsorship can be useful

- Pre-exempt status
- Finite project
- Incubation
- Public support percentage
- Income for sponsor

Income and expenses of a direct project sponsorship

- Revenue of program = revenue of sponsor
    - Contributions generally restricted
    - Earned income unrestricted
- Expenses
    - Generally self-sustaining (positive fund balance)
    - Allocate indirect costs

Net assets in a direct project sponsorship

- Assets should be segregated
- Liabilities should not exceed assets

Accounting procedures for a direct project

- Accounting must be integrated
- Financial statements of sponsor include program's activities and net assets
- Bank accounts controlled by sponsor
- Unique procedures ok if consistent with policies

"Fees"

- Not income or expense
- Be careful about restrictions
- Methods
    - Percentage of income

    - Based on transaction volume
    - Accounting costs plus stated percentage

Forming a nonprofit during the sponsorship period

- Will need:
    - EIN
    - Incorporation
    - Bylaws
    - Form 1023/1024
- No bank account yet

Breaking up is easy

- Sponsoring nonprofit makes a grant to new nonprofit
- Sponsor discontinues program
- New nonprofit begins operations

What can go wrong

- Sponsor fires the founders
- Sponsor commingles the assets
- Program overspends assets
- Program disregards sponsor policies

Alternative arrangements

- Group exemption
- Supporting organization
- Single Member LLC
- Operational support
- Merger

Group exemption

- Useful arrangement if goal is:
    - Avoid multiple 1023s/1024s
    - Avoid multiple 990s
- Central organization supervises subordinate organizations
- Tax exemption granted en masse
- Subordinates may file separate 990s or central organization may file group return

- Central organization always files its own 990

Supporting organizations (SOs)

- Useful structure if goal is
  - Quasi-independence
  - Avoid PF status
  - Supporter-supported relationship
- Avoid PF status based on relationship to a public charity
- SO is operated exclusively for the exempt purposes of the supporTED organization
- SO may be operated, supervised, or controlled by or in connection with the supporTED organization

Limited Liability Company

- Single-Member LLC wholly owned by the 501(c)(3) public charity
- Generally provides liability protection
- Disregarded entity for tax purposes
  - Included in the charity's 990
  - No separate return required in NC

Operational support

- Can share space and other resources
- Back office functions can be outsourced to another nonprofit
- Examples:
  - Bookkeeping
  - Accounting
  - Payroll
  - Tax filing
  - Audit coordination
  - Human resources

Merger

- Full, permanent absorption of one organization into another
- Eliminates administrative burdens: incorporation, exemption, tax filing
- Due diligence is critical

Fiscal Sponsorship Models at a Glance

FISCAL SPONSORSHIP MODELS	BASIC CHARACTERISTICS	IS PROJECT A LEGAL ENTITY?	BASIC RELATIONSHIP	CHARITABLE DONATIONS RECEIVED BY	SPONSOR'S LIABILITY TO 3RD PARTIES	OWNERSHIP OF RESULTS	WHO FILES IRS RETURNS SPONSOR	WHO FILES IRS RETURNS PROJECT	COMMENTS
A DIRECT PROJECT	Project belongs to sponsor and is implemented by its employees and volunteers	No	Employer-employee	Sponsor	Total liability for acts of employees	Sponsor	990; payroll tax returns	Individual employees file their own 1040s	Legally, project is no different than any other activity carried on by sponsor directly
B INDEPENDENT CONTRACTOR PROJECT	Project belongs to sponsor but is conducted by separate entity under contract	Yes	Client-contractor	Sponsor	Varies, may be partial or total	Should be conveyed to sponsor	990; possibly 1099, depending on legal form of contractor	Depends on contractor's legal status	Project can be done by one independent contractor as service to sponsor. Less common than Models A and C
C PREAPPROVED GRANT RELATIONSHIP	Project applies to sponsor for one or a series of grants, sponsor funds project from money received from donors	Yes	Grantor-grantee	Sponsor	Liable for selection of project grantee, plus terms set by funders	Project usually	990; possibly 1099, depending on project legal form and grant circumstances	Depends on grantee's legal status	Used by non-501(c)(3) project entity to raise tax-deductible funds from donors, private foundations or government grants
D GROUP EXEMPTION	Sponsor obtains federal group tax exemption, confers 501(c)(3) status on subordinate projects	Yes	Head-subordinate	Project	Typically only as provided in affiliation agreement	Project	Annual listing of subordinates, no financial info; may file one 990 for all projects	990 if project files own return	Project gets 501(c)(3) status under sponsor's supervision/control, no separate IRS application
E	Deleted (see Summary)				Deleted				
L LIMITED LIABILITY COMPANY	Project contained within LLC solely owned by sponsor as single member (SMLLC)	Yes	Owner-subordinate company	Project usually, but sponsor can also receive	None if SMLLC is properly capitalized and managed	Project, although sponsor does own the SMLLC	990	Employment, excise tax returns	For larger projects with operational risk; project shares sponsor's 501(c)(3) status but has to do its own state filing
F TECHNICAL ASSISTANCE	Project has own 501(c)(3) status, sponsor helps with bookkeeping, tax returns, payroll, management, etc.	Yes	Service provider-client	Project	Only as provided in contract	Project	990, reports fees charged	990, reports fees paid	Sponsor provides financial management to project, but all funds are raised and spent in name of project

Source: Fiscal Sponsorship: 6 Ways To Do It Right, Third Edition

Case study

Summary

- Several models to consider
- Lots of benefits
- A few pitfalls to watch for
- Document the understanding
- Monitor the financial statements

How can your organization/clients use fiscal sponsorship?

For more information

- NC Center for Nonprofits
  - www.ncnonprofits.org
  - 919-790-1555
- National Council of Nonprofits
  - www.councilofnonprofits.org/fiscal-sponsorship
- Adler & Colvin – law firm's site includes sample agreements, short articles
  - www.adlercolvin.com
- Me
  - mig@nonprofitcpa.net
  - 919-419-1119

Organization: Council for Economic Security (CES)

- Mission: to help individuals and families live in economic security
- Programs:
  - Debt counseling
  - Housing resource and referrals
  - Case management services
- Legal status: 501(c)(3) public charity incorporated in NC.
- Director, Connie, has been the nonprofit's CEO for 12 years. Under her leadership, CES has grown from a $200,000 organization with two employees to a complex organization with a budget of $3,500,000 and 14 employees. CES serves as the central organization for a group that includes five subordinate organizations which offer similar services to CES's.

Program: Financial Literacy Program (FLP)

- Volunteers speak to school groups, neighborhoods, etc.; discussing borrowing, saving, banking, and spending.
- Volunteers hold workshops to teach hands-on skills. Paul, the program's founder, anticipates this work will be done eventually by a paid staff.
- Legal status: none
- FLP receives its support from Strong Families Foundation (a private foundation), workshop fees, and Paul expects the program would be appealing to individual contributors.
- Paul has 18 years' experience as a banker and as a volunteer for CES's housing counseling program, but has never worked in the nonprofit sector. He has known Connie since he began volunteering at CES six years ago, and they have developed a strong collegial relationship.

Case:

Paul and Connie recognize there are similarities in the purposes of CES and FLP and they want to identify ways to save costs by collaborating.

Scenarios:

Consider the following alternative scenarios. What type of structure should the relationship take?

1. Assume FLP wants to use the profit from its workshop fees to pay dividends to the founder and the rest of the volunteer leadership.
2. Instead of [1], assume FLP wants to accept tax-deductible donations and grants and not pay income taxes, and is willing to pay only reasonable compensation to personnel.
3. In addition to [2], FLP and CES agree that the FLP program should be a permanent, integral part of the CES organization.

4. In addition to [2], Paul believes that the support FLP will receive from the Strong Families Foundation will comprise 40-50% of FLP's income over the next 8-10 years. This same income would comprise less than 5% of CES's support.
5. In addition to [4], Paul and Connie recognize that the nature of the financial literacy program is such that the program could be exposed to legal claims related to advice provided through its workshops. They agree that the program should obtain liability insurance to protect against such claims, and that FLP should have a separate corporate existence from CES.
6. In addition to [2], CES is willing to provide broad supervision over FLP.
7. In addition to [2], FLP and CES agree that FLP will eventually have a corporate existence separate from CES, but CES volunteers do not currently have the capacity to develop and operate the business of a nonprofit. They need help to set up an accounting system and operational policies and procedures, and they need to learn about the compliance requirements applicable to their program.
8. In addition to [2], Strong Families Foundation has committed to a 5-year grant, and Paul expects that the program will not be viable after the grant is complete.
9. Assume none of the circumstances described in scenarios [3]-[8] apply.

- Case: FLP founder (Paul) and CES director (Connie) recognize similarities in purpose and want to identify ways to save costs by collaborating.
- Scenarios and suggested solutions:

1. Assume FLP wants to use the profit from its workshop fees to pay dividends to the founder and the rest of the volunteer leadership.
   ➔ ***FLP needs to be a commercial operation; it can provide services to CES.***
2. Instead of [1], assume FLP wants to accept tax-deductible donations and grants and not pay income taxes, and is willing to pay only reasonable compensation to personnel.
   ➔ ***Several options – see scenarios 3-9***
3. In addition to [2], FLP and CES agree that the FLP program should be a permanent, integral part of the CES organization.
   ➔ ***The FLP program should merge into CES. Paul and his fellow volunteers could become employees or contractors of CES.***
4. In addition to [2], Paul believes that the support FLP will receive from the Strong Families Foundation will comprise 40-50% of FLP's income over the next 8-10 years. This same income would comprise less than 5% of CES's support.
   ➔***Fiscal sponsorship would prevent FLP becoming a private foundation. In this case, the sponsorship relationship would last at least 8-10 years; maybe longer if FLP's support did not become sufficiently diverse.***
5. In addition to [4], Paul and Connie recognize that the nature of the financial literacy program is such that the program could be exposed to legal claims related to advice provided through its workshops. They agree that the program should obtain liability insurance to protect against such claims, and that FLP should have a separate corporate existence from CES.
   ➔***A 509(a)(3) supporting organization might be appropriate. This would protect FLP from tipping to private foundation status while still allowing for the organizations to be separate corporations.***
6. In addition to [2], CES is willing to provide broad supervision over FLP.
   ➔ ***Consider including FLP in CES's group exemption. This would not save FLP the burden of incorporating but it would eliminate the need to file a Form 1023 to obtain exemption, or to file a separate 990 each year.***
7. In addition to [2], FLP and CES agree that FLP will eventually have a corporate existence separate from CES, but CES volunteers do not currently have the capacity to develop and operate the business of a nonprofit. They need help to set up an accounting system and operational policies and procedures, and they need to learn about the compliance requirements applicable to their program.
   ➔***A fiscal sponsorship arrangement would allow FLP to build capacity while enjoying the privileges of 501(c)(3) public charity status. The fiscal sponsorship arrangement would likely***

be temporary in this scenario, and after that arrangement expires, another structure might be appropriate.

➔ ***Or FLP could form a stand-alone nonprofit, and contract with CES for operational support and strategic advice.***

8. In addition to [2], Strong Families Foundation has committed to a 5-year grant, and Paul expects that the program will not be viable after the grant is complete.

   ➔ ***Fiscal sponsorship would probably be appropriate here, since the FLP will be a project of finite duration. The fiscal sponsorship arrangement would save FLP the burden of forming a legal entity and obtaining tax exemption.***

9. Assume none of the circumstances described in scenarios [3]-[8] apply.

   ➔ ***If the organizations want to share resources, but none of the scenarios described in [3] – [8]apply, they could share facilities, accounting support, office equipment, and other resources without any other type of relationship.***

Note that the potential for additional income to CES is not a significant factor in deciding the structure of the relationship. Any income from fiscal sponsorship is generally not significant, and other factors need to be present before such an arrangement is appropriate.