



Fiscal Agency versus Fiscal Sponsorship

by Jane C. Nober*

Everything you need to know to stay out of trouble with third-party representatives.

Does hearing the sentence "Just make that grant check payable to my fiscal agent" stop you in your tracks? It should. If your potential grantees are washing your grant funds through an accommodating charity that has no control over your grant-funded activities, you should be worried.

On the other hand, if your potential grantees have a fiscal sponsor, you can feel much more certain that your grant funds are going to a safe place. You'll probably want to see some documentation, but if that's in order, you can write that check with confidence.

So what's the difference between fiscal agency and fiscal sponsorship? How can a public charity or private foundation support new or unincorporated groups through fiscal sponsors? How can grant-makers serve as fiscal sponsors themselves? This article provides an introduction to this area, a topic that is comprehensively covered in Greg Colvin's *Fiscal Sponsorship: Six Ways to Do it Right* (available for purchase at <http://studycenter.org>).

Some Guiding Principles

The Importance of Being Charitable. Everyone likes to make grants to 501(c)(3) charities. Some grantmakers are legally required to do so, while some merely prefer to work with charitable grantees. Individuals and corporations may only secure income tax charitable deductions for gifts to organizations exempt from taxation under Section 501(c)(3). Thus, groups without their own tax exemptions frequently seek to ally themselves with groups that already have a determination letter from the IRS. Groups may lack a tax exemption because they are new, based outside the United States, unable or unwilling to expend resources on securing tax-exempt status.

The Trouble with Earmarking. When a grant is earmarked for a particular individual or organization, the IRS is free to disregard the existence of an intermediary organization and consider the grant as made directly to the ultimate recipient. Earmarking is defined as any oral or

written understanding that a grant will be spent in a particular fashion. According to the IRS, a charity cannot be a "mere conduit" through which contributors' cash flows. Rather, the charity must exercise discretion and control over those contributions for the IRS to consider them gifts to the charity, not some entity further down the line.

Who's the Agent? When lawyers talk about agency, they are talking about situations in which an *agent* acts on behalf of someone, usually called the *principal*. The agent is under the principal's direction and control. If we say that a charity is acting as fiscal agent for a new project or unincorporated group, we are implying that the charity is the agent of the project or group, i.e., that the group or project controls the charity. This is the reverse of how a relationship between a charity and a non-charity must run: The charity must control the project or the group, or at least the funds that it is holding for benefit of the sponsored entity. Therefore, the

philanthropic field has increasingly adopted the term *fiscal sponsorship* to describe any one of a number of possible relationships under which established charities choose to support new projects or groups.

The Troubles with Fiscal Agency

Let's look at a common scenario. A group is organizing after-school programs for teenagers, with an emphasis on training in restaurant and hotel careers. The group plans to conduct some brief training and then send the teens out for internships at local hotels. The group hasn't filed an application for exemption. A local religious institution (we'll call it a church, which is the shorthand the IRS often uses for a church, synagogue or mosque) has informally offered to serve as the group's fiscal agent. The group has no connection to the church other than the fact that some of its organizers are church members. Now the group is asking local private foundations and the community foundation for grants to pay for space rental, equipment, instructors and transportation.

What are legal and practical risks of making a grant to the church that is earmarked for the benefit of this program? A private foundation that makes such a grant runs the risk of being found to have made a grant to a non-charity. While the church is a 501(c)(3), earmarking the grant for the (nonexempt) after-school program means that the church's presence may be disregarded. If the private foundation does not exercise expenditure responsibility in connection with the grant, it may be making a taxable expenditure. Community foundations need not meet this strict standard, but must generally be sure that they can document that their funds have gone for charitable purposes.

What if something goes very wrong with the program? The church does not appear to be accountable for the funds but rather simply wash-

ing them through its coffers and directly paying them out to the program organizers. What if those organizers do not spend the money on teachers and whisks, but rather on jewelry and plane tickets to Bora Bora? The church will no doubt deny all responsibility and refuse to reimburse grantmakers.

Similarly, if there is an accident involving one of the school buses and it turns out nobody bought an appropriate insurance policy, a dispute about who is to blame will no doubt arise. While it is unlikely that a small grant that goes astray will result in charges that a grantmaker has been negligent in its use of charitable assets, no grantmaker wants to see a story in the local newspaper linking them with a poorly overseen program.

And what if the program goes very well? Assume the organizers succeed in raising money and buying equipment for their well-attended training classes. They store the valuable pots and pans in the church basement. When they tell the church that they have received their 501(c)(3) determination letter from the IRS and are renting space in an industrial complex, the church claims the cooking equipment as payment for serving as fiscal sponsor. Private and community foundations that have made grants to the group must now watch as the church takes the grant-funded equipment.

Can This Grant Be Saved?

A well-structured fiscal sponsorship could help the afterschool training program get off to a good start, as well as minimize legal risks to grantmakers. Colvin's *Fiscal Sponsorship* lays out a variety of arrangements under which an unincorporated project can flourish. In some instances, project organizers become the employees of an existing group (say, a local Boys and Girls Club). In other cases, they might be independent contractors running their program

under the auspices of an established charity. They might benefit from a relationship in which a grantmaker preapproves grants to them and then helps them raise funds.

Common to all of those possible arrangements are clearly defined relationships and responsibilities. In most cases, a written agreement between the project organizers and the established charity that is serving as fiscal sponsor will detail who is responsible for fundraising, filing taxes, paying expenses and maintaining insurance. That agreement will also make clear that the fiscal sponsor retains ultimate control over any funds given to it and provide ways in which a project can be terminated or spun off. The fiscal sponsor may or may not charge a fee for its administrative support, but any charges it intends to take should be clearly stated in the agreement at the outset.

Grantmakers who are asked to make checks payable to an entity other than their desired grantee should proceed carefully. They should check to ensure that they are making payments to a charity that has accepted responsibility for the project and is prepared to administer the grant funds wisely.

Grantmakers who are asked to serve as fiscal sponsors should be vigilant as well, to ensure that they have documented their rights and obligations to the group or project. Done correctly, fiscal sponsorships can allow both grantmakers and grantseekers the opportunity to participate in new and exciting projects close to home and abroad.

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