



# **A BRIEF OVERVIEW OF FISCAL TRANSITIONS AND THINKING AHEAD**

For those in the early stages of establishing a mission-driven project or program that has neither been fiscally sponsored nor incorporated, this document is intended to provide a brief overview of fiscal sponsorship, as well as some preliminary steps to transition into 501(c)(3) status from current fiscal sponsorship. Entering into either arrangement will enable the project to fundraise, and there are benefits and disadvantages to both. What follows are some of the things to think about when deciding whether to seek 501(c)(3) status or to team up with a fiscal sponsor.

## **WHAT IS FISCAL SPONSORSHIP?**

Mission driven projects and starter projects often opt to become “fiscally sponsored.” This essentially means they choose to have a parent nonprofit organization house the project and the project benefits from the 501(c)(3) tax-exempt status of the parent nonprofit fiscal sponsor. The fiscal sponsor takes a fee that is typically a percentage of annual expenses to manage administration and legal compliance such as accounting, payroll, bank accounts, healthcare, human resources support and more.

This is a common setup for small or starter nonprofits in particular, for whom it is not cost effective to pay for their own organizational administrative infrastructure. In this way, fiscal sponsors provide certain human capital in the form of administrative and management services and oversight. The degree of autonomy, control and decision-making authority that your project/program retains under a fiscal sponsorship, however, is largely driven by which model of sponsorship you choose.

The two most common types of fiscal sponsorships are:

- a) comprehensive fiscal sponsorship
- b) pre-approved grant relationship

### **Comprehensive Fiscal Sponsorship**

With this type of sponsorship agreement, the fiscal sponsor exercises the most control. Your project/program becomes one of the sponsor’s projects/programs, though you retain the right to enforce, amend or terminate the agreement.

Fundraising is on behalf of the fiscal sponsor, but donations given specifically to support your project are considered restricted funds that should be used for your project only. The sponsor, however, has the ultimate

authority to decide how to spend the money. This model is often used for short-term/limited projects, or to grow a new program until it is successful and ready to be spun off into its own independent nonprofit.

## **Pre-Approved Grant Relationship Fiscal Sponsorship**

Under this arrangement, your project or program remains yours. While the fiscal sponsor may be amenable and in a position to offer practical guidance and advice on operational and other matters, you remain responsible (legally and otherwise) for managing all programmatic, legal, financial and tax matters. The project/program applies for grants from the sponsor who, in turn, funds the grants with the monies that it collects. Fundraising is similarly done on behalf of the fiscal sponsor, who has ultimate discretion and control over whether to use such contributions itself or to re-grant them out to you or to another grantee (even if your project representatives were the ones that actually raised the funds).

## **THINGS TO CONSIDER**

A significant benefit to entering into a fiscal sponsorship arrangement is that your project/program can solicit contributions from the general public which are tax-deductible to the fullest extent of the law, as well as from other charitable organizations and potential funders that may only provide funding for, or donate to, other tax-exempt entities. There are other benefits, as well as drawbacks, to the fiscal sponsor arrangement.

### **Logistical Support**

Sponsors often provide administrative and logistical support such as grants management, fundraising, legal, accounting and HR services for fiscally sponsored projects. This allows project leaders to rely on the experience and management expertise of seasoned nonprofit organizations that already navigate the logistics and financial and legal compliance aspects of charitable work.

Overall operational responsibilities may also shift in a fiscal sponsorship relationship because your comprehensive fiscal sponsor owns and becomes legally responsible for the project/program. That includes: ensuring that IRS regulations with regard to the operation of the program are complied with and appropriate tax filings are made; procuring and maintaining all necessary insurance-providing employee benefits to project staff; and adhering to state requirements. This can remove many of the uncertainties out of starting a new nonprofit.

### **Employee Benefits**

Fiscal sponsors can offer benefits to their employees that small nonprofits might not have the capacity to provide. For example, fiscal sponsors can take advantage of a larger employee base to get better rates on healthcare or access to retirement plans, or other benefits such as life insurance or HRA/FSAs.

## Costs of a Fiscal Sponsor

Fiscal sponsorship does not come cheap. Typically, a portion of the funds that you raise goes to the fiscal sponsor as an administrative fee, and can often range from between five and ten percent. With a comprehensive fiscal sponsorship, the actual costs of fiscally sponsoring a project (which include the management/administration of charitable solicitations, tax/financial reporting, government filing requirements, insurance and benefits costs, payroll, legal and accounting services, and human resources and other operational support) are oftentimes higher than the administrative fees charged by the fiscal sponsor. So, you also need to consider whether you can afford to *not* have a fiscal sponsor. Ask yourself:

- *How many people do you have on staff?*
- *Do staff members have the bandwidth, experience, and know-how to do operational work (legal, financial, human resources, etc.)?*
- *Is it financially feasible to hire an individual/s to meet those infrastructural needs rather than working with a fiscal sponsor?*

## Relinquishing Control

Unlike when you form a 501(c)(3) and control of your mission-driven project fully lies with you and your Board, varying degrees of control over your program/project are ceded to a fiscal sponsor depending on the type of sponsorship you choose. Since your project or program becomes your sponsor's project/program with a comprehensive fiscal sponsorship, your sponsor will "own" it all – from websites, branding, webinars, and materials to creative content. Another challenging part of entering into this type of sponsorship agreement – and also the reason you need to be mission-aligned and have established trust – is that all fiscal responsibilities are handed over to your sponsor as well.

## Tax Filing Considerations

As a requirement for maintaining tax-exempt status, non-profit organizations must complete an annual IRS return known as [Form 990](#) that is available to the public. Under a fiscal sponsorship arrangement, that burden falls to the fiscal sponsor and not to the project/program itself. The fiscal sponsor also carries the burden of passing what is known as the public support test. The public support test, at its most simplified, looks at whether too much funding comes from a single source as at least one-third of all donations must be given by donors who provide less than 2% of a program's funds. Calculating and measuring public support is a complex and nuanced task, as is filing a nonprofit's taxes. Entering into a comprehensive fiscal sponsorship relationship places the burden of the Form 990 and the public support test requirement on the fiscal sponsor.

## CHOOSING A FISCAL SPONSOR

Finding a fiscal sponsor is not always easy. Ultimately, the most successful sponsorship relationships are those where the sponsor's overall mission aligns with the mission of your project, so that you are working towards a common goal. Establishing boundaries and trust is critical, as the relationship your project will have with its sponsor will be ongoing and ceding decision-making authority and accepting direction can be

difficult. Systems that work for both parties will need to be established as well as ongoing, respectful communication, and everyone should know their role starting from day one.

A comprehensive, all-encompassing agreement should be in writing to avoid conflict and to set expectations, and the finer details should be established *before* getting into a relationship. Examples of questions to cover with a fiscal sponsor are as follows:

- Who maintains relationships with funders?
- Do staff members get credit cards for expenses?
- What is the process for signing off on an expenditure?

For a nationwide list of nonprofits that offer sponsorships, look at our website's [List of Fiscal Sponsors](#).

## BEYOND FISCAL SPONSORSHIP

At some point fiscally sponsored projects may outgrow this model. They may decide they want the flexibility to have their own HR policies, accounting practices, healthcare choices, etc. At that point a fiscally sponsored project may make the decision to transition away from their “parent” nonprofit (fiscal sponsor) and become its own tax-exempt nonprofit entity.

The federal costs associated with starting a new nonprofit, such as application fees for [Form 1023](#) and tax-exempt status, are reasonably straightforward. Yet, other expenses involved in starting a nonprofit organization are not as easily defined. Calculating the exact cost of starting a nonprofit organization depends on where it is based, and the size of its initial structure. If you decide to take the route of applying for 501(c)(3) status, beyond basic incorporation fees that vary by State, you will also have to be prepared to cover the costs of maintaining staff, payroll and insurance, and specific organizational needs such as websites and branding, as well as legal fees. All of these can be burdensome and timely to small programs with minimal staff.

Tax-exempt status may be worthwhile if:

- It is important to direct and control your project/program, how it is implemented, and how funds are spent;
- You would like to grow and expand the project/program and/or have long-term objectives (rather than, for example, a fundraising mission to raise money for a one-time cause); or
- It is important to you that all of the monies you raise or contributions that you secure be exclusively for use by your project rather than by your sponsor or other projects or programs as well.

## INITIAL STEPS FOR BECOMING A TAX-EXEMPT NON-PROFIT

Project leaders who have considered the operational costs and decided they want the flexibility -- and have the support to do so -- are likely ready and in a good place to transition to 501(c)(3) status. The following are some initial steps for transitioning from a fiscally sponsored project to an independent tax-exempt nonprofit:

## 1. Establish a Nonprofit Corporation

This is a state-level process that establishes a nonprofit, corporate entity by the filing of Articles of Incorporation. The vast majority of nonprofits organize as corporations for a variety of reasons, including liability protection for the officers, directors and other key individuals. Other parts of this initial process usually include obtaining a federal tax ID number (FEIN) from the IRS and the preparation of bylaws.

## 2. Obtain IRS 501(c)(3) Status

This next step is much more complex than incorporating. To obtain 501(c)(3) status, a nonprofit corporation must apply to the Internal Revenue Service for recognition of tax exemption by filing IRS Form 1023. Relatively speaking, forming the corporation is fairly straightforward. Applying for 501(c)(3) status, however, is less so. [Form 1023](#) itself is up to 28 pages long. With the required attachments, schedules and other materials that may be necessary, it is not uncommon for these submissions to the IRS to be up to 100 pages. Think of Form 1023 as an IRS examination. Instead of an audit of a tax return, the 501(c)(3) application process is more like an audit of proposed (and/or previous) activity. It is a thorough examination of the organization's governing structure, purpose and planned programs. The IRS is looking to make sure that the organization is formed for exclusively 501(c)(3) purposes and that its programs are designed to fulfill these stated purposes.

## 3. Meet Your State Requirements

While obtaining 501(c)(3) status grants your new nonprofit federal tax exemption, there are two other, critical issues that should be considered.

- Charitable Solicitations Registration: This is a required registration in 40 states and is usually administered through the Attorney General's office, though not always. Most states require registration prior to soliciting donations.
- State Corporate Tax Exemption: Most states recognize the federal 501(c)(3) status as valid for state corporate tax exemption. California and Texas are exceptions, requiring their own application process for charity status in their state. Several other states require a separate application, but those are typically simpler registrations.

Becoming a tax-exempt nonprofit may be the ultimate goal for your project or program. If so, the above should help you to decide whether to first enter into a fiscal sponsorship or directly obtain 501(c)(3) status. Regardless of your long-term vision, fiscal sponsorship can offer the initial support needed across multiple timeframes to expand your organization's mission before taking additional steps to becoming an independent tax-exempt organization.

## ADDITIONAL RESOURCES

[National Network of Fiscal Sponsors](#)

[National Council of Nonprofits](#)

[Neon](#)

Fiscal Sponsor Directory: [10 Questions a Potential Project Should Ask a Fiscal Sponsor](#)

Nonprofit Quarterly: [Fiscal Sponsorship: A Balanced Overview](#)

Philanthropy New York: [Fiscal Sponsorship](#)