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## The Legal Value of Fiscal Sponsorship: A Proposal of New Law

Emma Geering

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# The Legal Value of Fiscal Sponsorship: A Proposal of New Law

EMMA GEERING<sup>†</sup>

*With social conscientiousness as a core value, American society has utilized nonprofit organizations to motivate social change. But as resources are finite and expertise in the complex legal, operational, and organizational nature of charitable organizations is limited, startup or small and local nonprofit organizations are having a harder time getting off the ground. Fiscal sponsorship—a term of art used to describe the relationship between social entrepreneurs and a tax-exempt organization—provides a functional framework to charitable projects that cannot or choose to not obtain tax-exempt status. Fiscal sponsorship provides a business mechanism to advance the nonprofit sector, as it facilitates collaboration, increases efficiency, provides infrastructure, and gives value to funders. Though fiscal sponsorship is an asset to the nonprofit sector, it is not a concept that is defined by the Internal Revenue Code or state corporate laws. As a result, this complex practice of fiscal sponsorship is not well-utilized. As a practical construct that addresses market failures and motivates social change, fiscal sponsorship needs formal recognition in the law. New state corporate codes and Internal Revenue Code provisions cementing fiscal sponsorship in the doctrines supporting nonprofit law are necessary to continuous growth in the nonprofit sector.*

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## INTRODUCTION

In an age of blossoming social entrepreneurship, there is a heightened desire among the younger generation to think consciously about their business practices.<sup>1</sup> The desire to solve social problems can be addressed by starting a new charitable organization.<sup>2</sup> While many assume the process is straightforward, starting a nonprofit is a complex process, no matter how well-intentioned a mission might be. Establishing a nonprofit organization beyond the startup phase is challenging, especially given that a nonprofit organization must pursue its social purpose first. Such organizations are unlike traditional for-profit businesses, where profit maximization for the owners is at the core.<sup>3</sup> Just having passion for a cause is not enough. Nonprofits require foresight and institutional knowledge, including an understanding of complex legal processes that provide a nonprofit organization with its benefits.<sup>4</sup> The process can be daunting, and though the nonprofit sector has existed for quite a while, there needs to be an efficient way to promote localized or community-based, mission-driven organizations focused on doing a societal good.

Fiscal sponsorship can be a solution to those problems. Those with varying philanthropic goals can benefit from fiscal sponsorship.<sup>5</sup> Fiscal sponsorship is a relationship in which a nonprofit organization provides the legal and financial framework for a charitable initiative, activity, or project that lacks tax-exempt status.<sup>6</sup> These sponsorships provide “adequate internal controls to ensure that the funds will be used for the intended charitable purposes.”<sup>7</sup> The oversight mechanism and the payoff to both the fiscal sponsor and the sponsored project provide an effective and efficient way to structure philanthropic ventures across industries, which in turn yields a greater impact.<sup>8</sup> Yet, fiscal sponsorship is a relatively foreign concept in the law. Despite all of the rules and regulations that outline establishing a nonprofit organization that receives tax-exempt status and

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1. See MARC J. LANE, *SOCIAL ENTERPRISE: EMPOWERING MISSION-DRIVEN ENTREPRENEURS* 1 (2011).

2. See Fredrik O. Andersson, *Necessity Nonprofit Entrepreneurship: A Study of Extrinsically Motivated Nascent Nonprofit Entrepreneurs*, 9 *NONPROFIT POL’Y F.*, 2018, at 1, 2.

3. See generally Emily Heaslip, *Nonprofit vs. Not-for-Profit vs. For-Profit: What’s the Difference?*, U.S. CHAMBER OF COM. (Mar. 30, 2020), <https://www.uschamber.com/co/start/strategy/nonprofit-vs-not-for-profit-vs-for-profit>.

4. BETSY SCHMIDT, *NONPROFIT LAW: THE LIFE CYCLE OF A CHARITABLE ORGANIZATION* 42 (2011).

5. See Jonathan Spack, *How Fiscal Sponsorship Nurtures Nonprofits*, 16 *CMTYS. & BANKING* 22, 23 (2005) (“The sponsorship mechanism enables groups to organize around societal concerns without having to incorporate. It provides an infrastructure that nurtures new leadership, and it can help start-ups organize to challenge conventional practices and approaches to addressing unmet societal needs. It also offers a way to manage specialized responses to cultural communities. In other words, fiscal sponsorships can be a real boon to the fluidity, innovative capacity, and diversity of the community-development and nonprofit sector.”).

6. Erin Bradrick, *Fiscal Sponsorship: What You Should Know and Why You Should Know It*, *BUS. L. TODAY* (Sept. 15, 2015), <https://businesslawtoday.org/2015/09/fiscal-sponsorship-what-you-should-know-and-why-you-should-know-it/>.

7. ADVISORY COMM. ON TAX EXEMPT & GOV’T ENTITIES, IRS, REPORT OF RECOMMENDATIONS 34 (2012), [https://www.irs.gov/pub/irs-tege/tege\\_act\\_rpt11.pdf](https://www.irs.gov/pub/irs-tege/tege_act_rpt11.pdf).

8. See Gene Takagi & Emily Chan, *Alternatives to Forming a Charitable Nonprofit: A Start-Up May Not Be in Your Client’s Best Interests*, 18 *BUS. L. TODAY*, July/Aug. 2009, at 15, 17.

its benefits, there is no legal definition of fiscal sponsorship. There needs to be reform to the nonprofit law landscape through the creation of a statutory framework with clearly identified rules that memorialize the fiscal sponsorship structure as a legally legitimate nonprofit entity.

If fiscal sponsorship is a tool that nonprofit organizations have been using for decades,<sup>9</sup> why is there a lack of legal recognition of such a form? Instead of the current hodgepodge of state corporate codes and state and federal tax laws of fiscal sponsorship tied together with contract law, fiscal sponsorship should be recognized as its own nonprofit corporate structure in the eyes of the law. In an age where motivation to promote societal good or to create charitable movements is prevalent and robust,<sup>10</sup> fiscal sponsorship provides a business mechanism to advance the nonprofit sector, as it facilitates collaboration, increases efficiency, provides infrastructure, and gives value to funders. Committing the concept of fiscal sponsorship to the law will ultimately provide clarity to regulatory oversight, increase knowledge of the model as a tool to create change, and continue to enhance the nonprofit sector. New state corporate codes and amendments to the Internal Revenue Code to create a space for fiscal sponsorship are intriguing ways to accomplish goals of social equity.

This Note explores the current state of nonprofit law and the role of fiscal sponsorship in the continued growth of the nonprofit sector by proposing definitive legal recognition of fiscal sponsorship. Part I provides background, both historical and legal, on the nonprofit sector and how continued legal reform impacts its function in society. Part II then explains the mechanics of fiscal sponsorship and the impact it currently has on the nonprofit sector. It also provides a concrete example of fiscal sponsorship in action to emphasize the cost-benefit analysis of the form. Finally, Part III provides two ways in which preexisting law can be reformed to incorporate fiscal sponsorship and create concrete, legal legitimacy of the practice. The proposal is not intended to provide every solution to this problem; these suggestions are merely a few ways the law may be amended or expanded to provide greater weight behind the structure of fiscal sponsorship so that its continued use can provide long-term benefits to the nonprofit sector.

## I. THE CURRENT STATE OF THE NONPROFIT SECTOR

Generally, nonprofits serve the public good in numerous ways, most commonly through assisting those who are poor, sick, underserved, or otherwise vulnerable. The common denominator across the entire nonprofit sector is that nonprofits “provide a private means to pursue public purposes outside the

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9. Fredrik O. Andersson & Daniel G. Neely, *Bringing Fiscal Sponsor Activity to Light*, 10 *NONPROFIT POL'Y F.*, 2019, at 1, 1–2.

10. See Andersson, *supra* note 2, at 2.

confines of either the market or the state.”<sup>11</sup> Nonprofits structure their mission in various ways: “as educators, advocates, and vigorous agents of social change,” they work to challenge “society to respond to human problems in new ways.”<sup>12</sup> A robust nonprofit sector encourages civic participation and strengthens local communities by mobilizing individuals into groups and turning private initiative into public action. Nonprofit organizations represent the “embodiment of a fundamental national value emphasizing individual initiative in the public good” and a means to “foster pluralism, diversity, and freedom.”<sup>13</sup>

While nonprofits contribute greatly to society, they do not come without their challenges. Securing adequate, stable funding streams has always been a challenge for nonprofit organizations.<sup>14</sup> Traditional sources of nonprofit revenues, like government subsidies, have ebbed and flowed and have not proven to be a dependable source of funding.<sup>15</sup> Competition among nonprofits for foundation grants and charitable donations is intense.<sup>16</sup> Rather than relying on philanthropic or government funding alone, nonprofits also generate revenue by selling goods and services—for example, healthcare (hospitals) and higher education.<sup>17</sup> It’s almost as if nonprofits walk a tightrope suspended delicately between the public and private sectors: markets are here to stay, but so are market failures and social or non-economic needs. We, as a society, need nonprofits as a distinct sector because nonprofit organizations characteristically serve purposes that are not met by market mechanisms.<sup>18</sup> After a brief history of nonprofit organizations, this Subpart will provide an outline of the law that frames the nonprofit sector and, finally, highlight how continuing reform of tax law and policy affects these organizations.

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11. Charles Halpern, *Preface* to LESTER M. SALAMON, *HOLDING THE CENTER: AMERICA’S NONPROFIT SECTOR AT A CROSSROADS*, at ix (1997).

12. William P. Ryan, *The New Landscape for Nonprofits*, *HARV. BUS. REV.*, Jan.–Feb. 1999, at 127, 135.

13. SALAMON, *supra* note 11, at 7 (emphasis omitted).

14. See GEORGE MORRIS, DYLAN ROBERTS, JOHN MACINTOSH & ADRIAN BORDONE, *THE FINANCIAL HEALTH OF THE UNITED STATES NONPROFIT SECTOR: FACTS AND OBSERVATIONS* 6 (2018), <https://learn.guidestar.org/hubfs/Docs/The%20Financial%20Health%20of%20the%20US%20Nonprofit%20Sector.pdf> (finding that many nonprofits “struggle to recruit and retain finance”); *What Financial Challenges Do Nonprofits Face?*, GRANT MAKERS FOR EFFECTIVE ORGS. (Mar. 5, 2015), <https://www.geofunders.org/resources/what-financial-challenges-do-nonprofits-face-661> (“Financial instability is a reality for many nonprofits.”); SCHMIDT, *supra* note 4, at 43 (explaining the various pitfalls—with a particular focus on finances—that plague the establishment of non-profits).

15. See SCHMIDT, *supra* note 4, at 43.

16. IUPUI LILLY FAM. SCH. OF PHILANTHROPY, *GIVING USA 2019: THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 2018* (2019).

17. See SCHMIDT, *supra* note 4, at 40.

18. Vladislav Valentinov, *The Economics of Nonprofit Organization: In Search of an Integrative Theory*, 42 *J. ECON. ISSUES* 745, 745 (2008).

### A. A BRIEF HISTORY OF NONPROFIT ORGANIZATIONS

The tax-exempt sector has been around nearly as long as the United States.<sup>19</sup> Nonprofit organizations originated in the eighteenth century and were the entity instruments by which society could organize their societal ideals into practice.<sup>20</sup> As American wealth grew during the Industrial Revolution, philanthropy grew exponentially.<sup>21</sup> Charitable organizations and their favorable tax treatment can be traced to the earliest iterations of United States tax law.<sup>22</sup> The Sixteenth Amendment of the Constitution ratified the federal income tax, and the Revenue Act of 1913 arguably marks the beginning of tax policy regulation of philanthropic activities.<sup>23</sup> By 1954, the Revenue Act finally codified all modern types of not-for-profit, tax-exempt organizations, colloquially known as 501(c) organizations.<sup>24</sup> Tax-exempt regulations were developed around three major principles: (1) organizations that operated for charitable purposes should be granted federal income tax exemption; (2) charitable organizations cannot be used to benefit the individuals running the organization; and (3) in order to encourage charitable giving, there should be an income tax deduction for contributions.<sup>25</sup> Though conceptual ideas of charity and philanthropy have been around for centuries, the development of the nonprofit sector has taken a long time to blossom to the scale of impact the sector provides to our economy and communities today.<sup>26</sup>

The slow growth of the nonprofit sector was purposeful. It was molded by the actions of people who wanted to preserve and develop the role of the charitable sector in public life.<sup>27</sup> Definitionally, the term “nonprofit organization” merely refers to one thing nonprofits do *not* do, which is distribute profits to owners. Rather, they developed as diverse programs and services meant to contribute directly to our society.<sup>28</sup> Now, there are over 1.5 million nonprofits registered with the Internal Revenue Service (IRS), which contribute just over \$1 trillion to the U.S. economy.<sup>29</sup> These organizations play a fundamental role in creating more equitable and thriving communities and, therefore, are essential to America’s future.

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19. See Paul Arnsberger, Melissa Ludlum, Margaret Riley & Mark Stanton, *A History of the Tax-Exempt Sector: An SOI Perspective*, 27 STAT. INCOME BULL. 105, 105 (2008).

20. Steven Rathgeb Smith, *Policy Analysis and the Nonprofit Sector*, in POLICY ANALYSIS IN THE UNITED STATES 245, 247 (John A. Hird ed., 2018).

21. Arnsberger et al., *supra* note 19, at 105.

22. *Id.* at 106.

23. *Id.* at 107.

24. *Id.* at 106–07.

25. *Id.* at 106.

26. See Smith, *supra* note 20, at 247–49.

27. See *id.*

28. See *id.*

29. *The Nonprofit Sector in Brief 2019*, NAT’L CTR. FOR CHARITABLE STAT. AT THE URB. INST. (June 4, 2020), <https://nccs.urban.org/publication/nonprofit-sector-brief-2019#highlights>. These statistics are based on data collected until 2016.

## B. CURRENT LEGAL FRAMEWORK GOVERNING NONPROFIT ORGANIZATIONS

In order to discuss fiscal sponsorship as an underutilized tool in the nonprofit sector, it is imperative to understand nonprofit corporate law and federal tax law basics. The most common form of a nonprofit organization is a nonprofit corporation,<sup>30</sup> which is created pursuant to state nonprofit corporation acts.<sup>31</sup> Like a traditional for-profit business corporation, a nonprofit corporation “has a legal existence separate from the people who organize and operate it.”<sup>32</sup> Nonprofit corporations are governed and managed by a board of directors.<sup>33</sup> A traditional corporate form is often preferred because “it limits its directors’ or trustees’ personal liability.”<sup>34</sup> To incorporate as a nonprofit incorporation, an organization must file articles of incorporation that outline the purpose of the organization with the respective secretary of state.<sup>35</sup> A nonprofit organization’s purpose need not be charitable; “[t]he key is that no profits are distributed to the members or managers of the organization.”<sup>36</sup> Because articles of incorporation are more difficult to change than bylaws, nonprofit corporations usually include provisions in their articles of incorporation that are unlikely to change during the organization’s existence.<sup>37</sup> It is wise, as a practical matter of memorializing governance structure, for a nonprofit corporation to establish bylaws.<sup>38</sup> Bylaws often establish the nonprofit corporation’s board of directors, officer-election procedures and qualifications, and other governance policies.<sup>39</sup>

Once the nonprofit has identified its legal form and whether it is a charitable organization, the second step of the formation process is to obtain tax-exempt status. The most common type of federal tax-exemption is under section 501(c)(3) of the Internal Revenue Code,<sup>40</sup> as it is the charitable exemption that

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30. AM. BAR ASS’N, *NONPROFIT LAW: A PRACTICAL GUIDE TO LEGAL ISSUES FOR NONPROFIT ORGANIZATIONS* 7–9 (William L. Boyd III ed., 2017). There are two other major forms of nonprofit organizations: unincorporated nonprofit associations and charitable trusts. *Id.* at 1. For simplicity reasons, the scope of this Note will only focus on nonprofit corporations, as they are the most common form of nonprofit organizations.

31. *Id.* at 1.

32. Betsey Buchalter Adler & Gregory L. Colvin, *Structuring Charitable and Philanthropic Organizations*, 1996 NEW DIRECTIONS FOR PHILANTHROPIC FUNDRAISING, Fall 1996, at 3, 4.

33. *Id.*

34. *Id.*

35. See MODEL NONPROFIT CORP. ACT § 2.01 (AM. BAR ASS’N, 3d ed. 2008); CAL. CORP. CODE § 5120(d) (West 2021); N.Y. NOT-FOR-PROFIT CORP. LAW § 402 (McKinney 2021).

36. AM. BAR ASS’N, *supra* note 30, at 2.

37. *Id.* at 16.

38. *Id.*

39. See *id.* at 16–28.

40. Section 501(c)(3) states that the following entities shall be exempt from taxation:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or education purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise



permits tax-exempt entities to receive tax-deductible charitable contributions under § 170 of the Internal Revenue Code.<sup>41</sup> Filing articles of incorporation does not automatically render the nonprofit corporation exempt from federal income tax. Instead, the nonprofit corporation must obtain federal tax-exempt status in order to take advantage of the benefits of being a not-for-profit entity.<sup>42</sup> Logistically, this requires the organization to file a Form 1023 (or Form 1023EZ) with the IRS.<sup>43</sup> Practically, the entity must be organized and operated within the parameters of that section in order for a nonprofit corporation to qualify for tax-exempt status under § 501(c)(3).<sup>44</sup> Under § 501(c)(3), a tax-exempt nonprofit corporation must: be organized exclusively for a permissible exempt purpose;<sup>45</sup> be operated exclusively for exempt purposes;<sup>46</sup> have no part of its net earnings or assets inure to benefit of any private individual or entity;<sup>47</sup> have no involvement in electioneering or political campaigns;<sup>48</sup> and not engage in more than an insubstantial amount of legislative lobbying.<sup>49</sup> Note that there is an overlap of state corporate law and federal tax law: in order for a nonprofit corporation to have tax-exempt status under § 501(c)(3), the articles of incorporation (filed with the secretary of state) must limit the purposes of the

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attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

26 U.S.C. § 501(c)(3) (2018).

41. *Id.* § 170(a)(1) (“There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary.”).

42. Adler & Colvin, *supra* note 32, at 5.

43. AM. BAR ASS’N, *supra* note 30, at 41.

44. *See* 26 C.F.R. § 1.501(c)(3)-1(a)(1) (2020) (“In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.”).

45. *See id.* § 1.501(c)(3)-1(b)(1). The organization must be organized in its articles of incorporation exclusively for one or more of the exempt purposes under § 501(c)(3). An organization is not organized exclusively for one or more exempt purposes if its articles of incorporation permit it to carry on more than insubstantial part of its activities *not* in furtherance of an exempt purpose. *Id.* § 1.501(c)(3)-1(b)(1)(iii).

46. *See id.* § 1.501(c)(3)-1(c)(1). The organization must be operated primarily for exempt purposes; no more than an insubstantial part of its activities may not be in furtherance of an exempt purpose. *Id.*

47. *See id.* § 1.501(c)(3)-1(d)(1)(ii) (“An organization is not organized or operated exclusively for one or more of the purposes [described in section 501(c)(3)] unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.”).

48. *See id.* § 1.501(c)(3)-1(b)(3) (“An organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it . . . (ii) [d]irectly or indirectly to participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of or in opposition to any candidate for public office . . .”).

49. *See id.* (“An organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it: (i) To devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise; or . . . (iii) [t]o have objectives and to engage in activities which characterize it as an *action* organization . . .”).

nonprofit corporation to one or more of § 501(c)(3)'s permitted exempt purposes.<sup>50</sup>

There are many complexities that fold into nonprofit law. However, the basic rules and regulations that govern the nonprofit sector, as well as the impact of ongoing changes to law and policy, are important to understanding where fiscal sponsorship fits in this established legal structure.

### C. IMPACT OF CONTINUING REFORM

Continuing reform in tax law and proposed policies lend themselves to some changes in the nonprofit sector. Nonprofits, in part, rely on financial support from the government, particularly in areas of housing, education, healthcare, and the environment.<sup>51</sup> Big budget cuts and changes in policy may result in less government funding for nonprofits.<sup>52</sup>

Donations—often considered the lifeblood of the nonprofit sector—have been affected too. The Giving Institute<sup>53</sup> observed that the environment for philanthropic giving was far more complex in 2018 than in previous years.<sup>54</sup> Shifts in tax policy and the volatility of the stock market are the likely culprits for the drop in charitability.<sup>55</sup> Individual philanthropic giving nationwide decreased due to tax law changes which made many Americans ineligible for tax benefits that can inspire donations.<sup>56</sup> The changes the 2017 tax overhaul made specifically to the standard deduction impacted donations in 2018, when “[g]iving by individuals fell an estimated 3.4%.”<sup>57</sup> The IRS produced statistics which showed that, in 2018, taxpayers itemized \$54 billion less in charitable

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50. See *id.* § 1.501(c)(3)-1(b)(1)(iii).

51. See *Search Grants*, GRANTS.GOV, <https://www.grants.gov/web/grants/search-grants.html> (last visited May 21, 2021) (search in “Keyword(s)” the terms “housing,” “education,” “healthcare,” and “environment” to view the thousands of government grants in these areas).

52. See OFF. OF MGMT. & BUDGET, A BUDGET FOR AMERICA’S FUTURE: FISCAL YEAR 2021, at 14–16, 66, 118 (2020), <https://www.govinfo.gov/content/pkg/BUDGET-2021-BUD/pdf/BUDGET-2021-BUD.pdf>. The new budget proposes the elimination of a number of federal programs that influence the nonprofit community, including the National Wildlife Refuge Fund, National Endowment for the Arts, Public Service Loan Forgiveness, National Endowment for the Humanities, Corporation for National and Community Service, and many more. *Id.* at 14–16, 66, 114. With the new administration, there is hope that the increase in discretionary funds and the soon-to-be proposed budget will turn the tide for nonprofit organizations. See Letter from Shalanda D. Young, Director, Off. of Mgmt. and Budget, Executive Off. of the President, to Sen. Patrick Leahy, Chairman, Comm. on Appropriations, U.S. Senate (Apr. 9, 2021), <https://www.whitehouse.gov/wp-content/uploads/2021/04/FY2022-Discretionary-Request.pdf>.

53. *Shared Intelligence for the Greater Good*, GIVING INST., <https://www.givinginstitute.org/> (last visited May 21, 2021).

54. IUPUI LILLY FAM. SCH. OF PHILANTHROPY, *supra* note 16, at 14–15.

55. *Id.* at 14.

56. Laura Davison, *Trump’s Tax Law Made Americans Less Charitable, Nonprofits Say*, BLOOMBERG NEWS (June 18, 2019), <https://www.bloomberg.com/news/articles/2019-06-18/trump-tax-law-made-americans-less-charitable-non-profits-say>.

57. *Id.*

contributions than in 2017.<sup>58</sup> The Tax Cuts and Jobs Act nearly doubled the standard deduction threshold,<sup>59</sup> making it more advantageous for millions of taxpayers to file using this lump-sum deduction.<sup>60</sup> The Joint Committee on Taxation estimated that approximately 18 million taxpayers would itemize in 2018, as opposed to the over 46 million that itemized the year before.<sup>61</sup> This meant that about 88% of taxpayers would take the standard deduction.<sup>62</sup> Giving to charity provides a tax deduction for the donor, allowing the donor to decrease their tax liability. If a taxpayer takes the standard deduction, it means they did not need to itemize their charitable donations.<sup>63</sup> An increase of the standard deduction results in decreased incentive for individuals to make charitable contributions because, in order to benefit from writing off donations, a taxpayer would need to give more than the standard deduction.<sup>64</sup> If there is less incentive to itemize, then there may be fewer people giving to charity as a means to get a deduction.<sup>65</sup> Logically, if there is no longer a provided benefit, taxpayers will be unmotivated to give.

Individual donations remain as the largest category of support for nonprofit organizations.<sup>66</sup> Though donations from individuals decreased, donations and grantmaking by foundations and corporations increased.<sup>67</sup> Yet, this does not undo the damage as public charities make up the largest landscape of philanthropic contributors.<sup>68</sup> There is historical data that links charitable giving, the stock market, and conservative tax policies to assess giving patterns,<sup>69</sup> where the economy is on an upswing, as it is now, but the total number of donors in various nonprofit sectors is down.<sup>70</sup> Charitable giving is multi-dimensional, and it requires maintenance of an altruistic attitude and underlying benefits to the

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58. Leslie Albrecht, *Americans Slashed Their Charitable Deductions by \$54 Billion After Republican Tax-Code Overhaul*, MARKETWATCH (July 11, 2019, 8:52 AM), <https://www.marketwatch.com/story/americans-slashed-their-charitable-deductions-by-54-billion-after-trumps-tax-overhaul-2019-07-09>.

59. H.R. REP. NO. 115-409, at 7 (2017).

60. Davison, *supra* note 56.

61. Erica York, *Nearly 90 Percent of Taxpayers Are Projected to Take the TCJA's Expanded Standard Deduction*, TAX FOUND. (Sept. 26, 2018), <https://taxfoundation.org/90-percent-taxpayers-projected-tcja-expanded-standard-deduction/>; *see also* STAFF OF JOINT COMM. ON TAX'N, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2018, at 4 (2018), <https://www.jct.gov/CMSPages/GetFile.aspx?guid=33223a46-e116-4ffa-a718-59a1795c784f> (offering predictions for itemized and standard deduction rates for the year 2018). It turned out that 16.7 million taxpayers took itemized deductions in 2018, lower than the Joint Committee on Taxation's estimations. Darla Mercado, *About 30 Million People Lost These Tax Breaks When They Filed Last Year*, CNBC (Apr. 9, 2020, 1:37 PM), <https://www.cnbc.com/2020/04/09/about-30-million-people-lost-these-tax-breaks-in-2018.html>.

62. York, *supra* note 61.

63. Albrecht, *supra* note 58.

64. Davison, *supra* note 56.

65. Albrecht, *supra* note 58.

66. IUPUI LILLY FAM. SCH. OF PHILANTHROPY, *supra* note 16, at 21.

67. *Id.*

68. *See id.* at 21–22.

69. *Id.* at 14.

70. *Id.* at 21.

donor. Ultimately, the Tax Cuts and Jobs Act is just a catalyst of the tax policy changes that create uncertainty in regard to charitable donations.

It's clear that the nonprofit sector is vital to American society. The framework of corporate and tax law governing nonprofit organizations, and the impact that continuing reform has on charitable organization, only clarify that there is space for further growth. Fiscal sponsorship is a creative way to address the challenges our society faces and contribute positively to the nonprofit sector.

## II. FISCAL SPONSORSHIP OVERVIEW

Fiscal sponsorship refers to arrangements that allow a non-tax-exempt individual or organization to obtain support for a project from a funder that requires tax-exempt status for eligibility for such support, or to allow for support in the form of tax-deductible donations.<sup>71</sup> As described in a leading guidebook:

Fiscal sponsorship arrangements typically arise when a person or group (we will call this a project) wants to get support from a private foundation, a government agency, or tax-deductible donations from individual or corporate donors. By law or preference, the funding source will make payments only to organizations with 501(c)(3) tax status. So the project looks for a 501(c)(3) sponsor to receive the funds and pass them on to the project.<sup>72</sup>

Under this structure, the non-tax-exempt individual or organization establishes a contractual relationship with a tax-exempt sponsor who becomes the recipient of the grant or donation, and then funnels the funds down to the nonexempt individual or organization that performs the work.<sup>73</sup> Fiscal sponsorship allows an organization to team up with an established nonprofit to accomplish their charitable goals. Fiscal sponsors, as established nonprofits, can provide a sponsored organization with both administrative duties and project management.<sup>74</sup> The fiscal sponsorship team unit in this way allows the sponsored organization to take advantage of the tax-exemption granted to the sponsoring nonprofit.

This Subpart will first elaborate on the functional, legal, and operational framework of fiscal sponsorship to provide a clear understanding of the sponsor-project relationship. Then, it will explain the concrete benefits of fiscal sponsorship on the nonprofit sector and discuss the consequences of the legal framework as it stands. Finally, this Subpart will conclude with an explanation for why fiscal sponsorship could be a preferred method to accomplish charitable, organizational goals through concrete examples of how fiscal sponsorship has worked well in practice.

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71. See generally GREGORY L. COLVIN, *FISCAL SPONSORSHIP: 6 WAYS TO DO IT RIGHT* (2d ed. 2005).

72. *Id.* at 3.

73. Gene Takagi, *Fiscal Sponsorship: A Balanced Overview*, *NONPROFIT Q.* (Jan. 28, 2020), <https://nonprofitquarterly.org/fiscal-sponsorship-a-balanced-overview/>.

74. *Id.*

#### A. FISCAL SPONSORSHIP ENTITY AND OPERATIONAL MODELS

Fiscal sponsorship can take on a variety of forms, but they generally involve innovation, some degree of control and supervision, and an accompanying agreement to address the contractual relationship between the parties.<sup>75</sup> “A fundamental component of the relationship is that the [start-up organization] can ‘borrow’ the 501(c)(3)’s tax-exempt status and solicit and accept grants and donations.”<sup>76</sup> These relationships are often best suited for organizations that are just getting off the ground or need tax-exempt funding for a project, or for organizations that desire to eventually blossom into their own 501(c)(3). Nonprofit organizations must operate in furtherance of their exempt purposes, as stated in their articles of incorporation.<sup>77</sup> Therefore, it is imperative that a small organization or project fit within the sponsoring organization’s mission, either broadly or narrowly. If the project falls outside of the fiscal sponsor’s mission, it should seek funding and support elsewhere.

Gregory Colvin outlines multiple models of fiscal sponsorship that cover several different levels of fiscal sponsor involvement in the project.<sup>78</sup> These range from direct support in the day-to-day operation of the project to only providing back-office assistance.<sup>79</sup> Though a complex concept, fiscal sponsorship often takes on one of two forms: (1) comprehensive fiscal sponsorship (Model A); or (2) preapproved grant-relationship fiscal sponsorship (Model C).<sup>80</sup>

In the comprehensive fiscal sponsorship model, the sponsor completely owns the project—in effect, the sponsoring nonprofit houses the project in a parent-wholly-owned-subsiary/employer-employee relationship.<sup>81</sup> The project (the sponsored organization) does not have a separate legal identity.<sup>82</sup> Instead, there is a contractual agreement that outlines the arrangement, where the project agrees to become one of the programs owned by the fiscal sponsor.<sup>83</sup> The contract emphasizes that the fiscal sponsor is in charge, both legally and monetarily, over all aspects of the project.<sup>84</sup> This model is typically used to incubate new nonprofits, where if the project proves to be successful, it can be spun out of the fiscal sponsor’s grip and establish itself as an independent nonprofit.<sup>85</sup>

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75. *See id.*

76. *Mission Alignment Key to Fiscal Sponsorship Arrangements, Experts Say*, NONPROFIT BUS. ADVISOR, Mar. 2019, at 6, 6.

77. *Helping Others Grow: The Nuts and Bolts of Fiscal Sponsorships*, WAGENMAKER & OBERLY BLOG (Nov. 17, 2017), <https://wagenmakerlaw.com/blog/helping-others-grow-nuts-and-bolts-fiscal-sponsorships>.

78. *See* COLVIN, *supra* note 71.

79. *See id.* at 12–13 (chart).

80. *See id.* at 14, 27.

81. *Id.* at 12, 14–16.

82. *Id.* at 14.

83. *Helping Others Grow: The Nuts and Bolts of Fiscal Sponsorships*, *supra* note 77.

84. *See id.*

85. COLVIN, *supra* note 71, at 14.

Under the grant-relationship fiscal sponsorship model, the project does not belong to the fiscal sponsor.<sup>86</sup> Instead, the project exists as a separate entity responsible for its programmatic, legal, and tax issues.<sup>87</sup> The project is funded by the fiscal sponsor through a grantor-grantee model: the project applies for a grant from the fiscal sponsor and the fiscal sponsor funds the grant with fundraised money and awards it to the project.<sup>88</sup> The fiscal sponsor agreement outlines the details of the grantor-grantee relationship between the sponsor and the project.

If an existing nonprofit 501(c)(3) is worried about liability associated with the sponsored project's operation of its activities, the fiscal sponsor can arrange for the sponsored project to be formed as a limited liability company (LLC) with the fiscal sponsor as the sole member.<sup>89</sup> Such a structure offers the limited liability of a corporation without the LLC itself being subject to the federal tax scheme.<sup>90</sup> In this arrangement, the project would be operated from within the separate limited liability entity under state law, but, for purpose of federal tax law, the project would be treated as internal to the fiscal sponsor organization, where the project's activities are imputed upon the fiscal sponsor.<sup>91</sup> As an added perk, the sponsored project will not have to file a separate IRS Form 990 or other annual return.<sup>92</sup>

No matter the form, fiscal sponsorship has some common themes. Fiscal sponsorships should be memorialized in a written agreement because the relationship between the project and the fiscal sponsor involves allocation of responsibility, finances, and risk and legal liability.<sup>93</sup> A typical agreement can address multiple areas, such as project scope, allocation of management responsibility, structure and processing of charitable donations, reporting protocols, sponsorship fee, extent of sponsor involvement, intellectual property ownership rights and designations, terms, and transition or dissolution strategies.<sup>94</sup> Because there are multiple models, there is no standardized form for such agreement. However, the written agreement should establish the fiscal sponsor's ultimate control and discretion over the funds received on behalf of the project, as well as the fiscal sponsor's ability to utilize the funds for other

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86. *Id.* at 29.

87. *See id.*

88. *Id.* at 29–30.

89. *See* George Constantine & Christopher Moran, *Fiscal Sponsorship: Opportunities and Risks for Nonprofits*, LAW360 (Nov. 1, 2018, 4:07 PM), <https://www.law360.com/articles/1097684/fiscal-sponsorship-opportunities-and-risks-for-nonprofits>; *see also* Steven Chiodini & Gregory L. Colvin, *The Use of LLCs in Fiscal Sponsorship—A New Model*, 22 TAX'N EXEMPTS, May/June 2011, at 7, 7 (referring to this model as “Model L,” which shares many characteristics with Colvin’s previously proposed Model A arrangement).

90. Chiodini & Colvin, *supra* note 89, at 10.

91. *Id.* at 11.

92. *See* Constantine & Moran, *supra* note 89; *see also* Treas. Reg. § 301.7701-3(b)(1)(ii) (2020).

93. *See* Takagi & Chan, *supra* note 8, at 17 (“A well-drafted fiscal sponsorship agreement is therefore imperative.”).

94. *See generally* COLVIN, *supra* note 71.

charitable purposes when the fiscal sponsorship relationship ends.<sup>95</sup> These agreements are at the crux of the legal recognition of fiscal sponsorship, so they are imperative to a successful fiscal sponsorship arrangement.

Operationally, fiscal sponsorship could be used to incubate or accelerate smaller organizations that want to create an impact but do not have the resources or access to do so on their own. Fiscal sponsorship can thus look like: (1) “a ‘baby’ project incubating from within a well established nonprofit” organization “and nurtured well by such organization” as the fiscal sponsor (incubate),<sup>96</sup> or (2) “a new project brought to a well established nonprofit” by an external organization “with the hope that such nonprofit will be willing to help supervise the project” or allow the project to grow within the nonprofit (accelerate) with the chance to possibly spin off the sponsoring organization.<sup>97</sup>

An incubator fiscal sponsorship approach is ideal for a project that is in its infancy. The key leaders may not yet know whether it would be wise and prudent to start a full-fledged nonprofit organization, particularly because of the stringent requirements in obtaining and maintaining nonprofit tax-exempt status.<sup>98</sup> By beginning a project in-house with a fiscal sponsor, the leaders will be able to test the waters and to enjoy the administrative support, legal protection, and oversight provided by the fiscal sponsor.<sup>99</sup> Incubation can provide valuable information and opportunities for healthy initial growth for the project as it allows the project to operate well to the extent of the needs the project aims to address.

Alternatively, a project can separately incorporate and still grow operationally under the purview of the fiscal sponsor.<sup>100</sup> This structure might be preferable in terms of risk management for both the project and the fiscal sponsor. Such an acceleration-motivated approach provides a project with independent growth, with the support infrastructure of the fiscal sponsor, to eventually launch as their own independently governed and operated nonprofit organization.<sup>101</sup>

No matter what, there are oversight responsibilities of the fiscal sponsor for the sponsored project that exist at the core of this structure. “In order for the fiscal sponsor to ensure that funds it receives in support of the fiscal[ly] sponsored project are used in furtherance of the fiscal sponsor’s [tax-exempt] purposes, the fiscal sponsor should: [c]onduct a due diligence review of the potential [project] prior to entering into the fiscal sponsorship relationship” and, once brought on as a sponsored project under 501(c)(3), require ongoing reports

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95. Constantine & Moran, *supra* note 89.

96. See *Helping Others Grow: The Nuts and Bolts of Fiscal Sponsorships*, *supra* note 77.

97. See *id.*; see also Takagi, *supra* note 73.

98. Takagi & Chan, *supra* note 8, at 15–17.

99. See *id.*

100. See *Helping Others Grow: The Nuts and Bolts of Fiscal Sponsorships*, *supra* note 77.

101. See Takagi, *supra* note 73.

from the project on the use of their funds.<sup>102</sup> The structure and operation of fiscal sponsorship as it currently stands is a remarkable congruence of state corporate law and federal tax law that provides support to nonprofit entrepreneurs and large nonprofits with the desire to contribute more. Yet, fiscal sponsorship lacks a recognized legal form.

#### B. IMPACT OF FISCAL SPONSORSHIP ON THE NONPROFIT SECTOR

Embracing fiscal sponsorship as a tool is important to continued growth in the nonprofit sector. Organizations may have varying philanthropic goals; fiscal sponsorship can help capitalize on such variance, resulting in more effective and efficient charitable giving nationwide. Fiscal sponsorship facilitates collaboration by providing an immediate—yet reputable and established—vehicle for different constituencies to contribute funds, from individual donors and private foundations to government entities.<sup>103</sup> With the recent changes in philanthropic giving,<sup>104</sup> fiscal sponsorship can skirt around challenges presented by new tax policies by providing a mechanism to contribute to causes that donors care about. On the other hand, the framework as it stands can be challenging to decipher and impacts the nonprofit sector as a result.

One benefit of the fiscal sponsor relationship is the increase in deductible donations as a result of increased visibility of the project. Fiscal sponsors are typically charitable corporations that act as an umbrella entity to a number of projects it “shepherds” as charitable programs.<sup>105</sup> Then, the income and expenses fall onto the umbrella entity, and any hires for the project are employees or contractors of the umbrella.<sup>106</sup> Wholly-owned projects like this are a part of the operations of the umbrella, but often the relationship is structured so that the project is managed by the individuals involved with the project directly.<sup>107</sup> That is to say that all programmatic responsibilities fall upon the project directly, but the support is on the shoulders of the umbrella. Alternatively, the umbrella entity can accept grant funding on behalf of the project.<sup>108</sup> The funds are contributed to its own restricted account and regranted to another entity to perform the project.<sup>109</sup> These regranted funds make it possible for the project to begin operation without the project obtaining exempt status.<sup>110</sup>

As a preexisting tax-exempt organization, a fiscal sponsor serves as a “fiscal manager” of a project’s funds.<sup>111</sup> If a fiscal sponsor properly carries out

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102. Constantine & Moran, *supra* note 89.

103. See Takagi & Chan, *supra* note 8, at 18.

104. See *supra* Part I.C.

105. AM. BAR ASS’N, *supra* note 30, at 4.

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.* at 4–5.

110. *Id.* at 5.

111. *Basic Information on Obtaining Nonprofit Status and Fiscal Sponsorship*, TARGETED NEWS SERV. (Apr. 6, 2018).



its role in the relationship, the fiscal sponsor is legally obligated to exercise control and discretion over the project's funds.<sup>112</sup> This does not mean that the fiscal sponsor must actively manage the project or run its operations; rather, the fiscal sponsor simply needs to ensure that the project is operated responsibly, consistent with the fiscal sponsor's mission, and otherwise operated in accordance with 501(c)(3) requirements. The project is, therefore, just like any other internal program the sponsor runs in its day-to-day operations. Often viewed as an alternative to applying for 501(c)(3) status, fiscal sponsorship in effect allows smaller organizations to make use of a larger nonprofit's tax exemption by enabling those smaller organizations to apply for grants and solicit tax-deductible donations.<sup>113</sup> Fiscal sponsorship allows tax-deductible contributions to be made to the fiscal sponsor to eventually be distributed to the sponsored project. This provides flexibility for project development and optimal advantage to donors. The tax advantage exists because, as already indicated, the fiscal sponsor is legally responsible for the project. This piggy-backing approach is, arguably, the best of both worlds; benefits trickle down to the sponsored organization and the established nonprofit generates more revenue and larger reach.<sup>114</sup> Donor contributions may be eligible for a tax benefit in the form of a tax deduction on the funds they contribute, and, depending on the model of fiscal sponsorship employed, the project receives the bulk of the contributions.<sup>115</sup> Additionally, because fiscal sponsors can provide services across multiple initiatives and different projects, they therefore provide value to potential funders with varying philanthropic goals. Instead of multiple "[w]ell-intentioned changemakers form[ing] too many unsustainable and inefficient nonprofit organizations," fiscal sponsorship provides a possible alternative.<sup>116</sup> With multiple projects housed under a fiscal sponsor, and with the fiscal sponsor's established administrative capabilities, the cost of operations is theoretically lower than it would be if the individual projects had to organize themselves independently.<sup>117</sup> This allows a fiscal sponsor to have a broad-sweeping mission, where the associated sponsored projects address a variety of social issues at a lower administrative expense.<sup>118</sup> This "couching" mechanism provides value to the fiscal sponsor and the projects together.

There is also the added benefit of credibility and marketability of the project by partnering with a fiscal sponsor which they may not have had

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112. Rev. Rul. 68-489, 1968-2 C.B. 210 ("An organization will not jeopardize its exemption under section 501(c)(3) of the Code, even though it distributes funds to nonexempt organizations, provided it retains control and discretion over the use of the funds for section 501(c)(3) purposes.").

113. Takagi & Chan, *supra* note 8, at 17.

114. Takagi, *supra* note 73.

115. Daniel M. Satorius & Stu Pollard, *Crowd Funding: What Independent Producers Should Know About the Legal Pitfalls*, 28 ENT. & SPORTS LAW., Summer 2010, at 15, 17.

116. Takagi & Chan, *supra* note 8, at 17-19.

117. Takagi, *supra* note 73.

118. Constantine & Moran, *supra* note 89.

before.<sup>119</sup> The fiscal sponsor also benefits because they can advance their mission, receive publicity from association with the project, and gain additional donors.<sup>120</sup> Fiscal sponsorship sets up a “mutually beneficial relationship” that supports small(er) projects as well as helps the fiscal sponsor “maintain or build administrative (or other forms of) capacity.”<sup>121</sup> The structure of fiscal sponsorship, which pools and shares administrative functions across multiple nonprofit projects and eliminates duplication, allows the sponsoring organization to acquire unrestricted earned revenue.<sup>122</sup> The sponsoring organizations get the added benefit of administrative fees; typically, a fiscal sponsor charges the project with a management fee, which is generally a percentage of the revenue flowing through the fiscal sponsor to the project.<sup>123</sup> Most fiscal sponsors do not become fiscal sponsors because of the revenue; ultimately, sponsorship is attractive because it pools scarce resources and “allows for innovative approaches and solutions to germinate” to address society’s leading issues.<sup>124</sup> Fiscal sponsors can also provide infrastructure and expertise that would otherwise be minimal for charitable initiatives, particularly startup nonprofit organizations. Because fiscal sponsors are established nonprofit corporations with 501(c)(3) exempt status, they have the wherewithal to handle the complex nature of nonprofit administration. In order to maintain a properly structured fiscal sponsorship agreement, the fiscal sponsor needs to have a more-than-competent knowledge base on financial management, compliance, disbursement of funds, grants management, reporting, and human resources. Reputable fiscal sponsors provide projects with counsel and knowledge of best practices because they are overseen by experienced boards of directors and nonprofit professionals. Fiscal sponsors are, in essence, the backbone of the support system for its projects; the projects depend on the fiscal sponsor’s ability to support them.

Additionally, fiscal sponsorship coalesces resources and expertise to distribute wealth to organizations that otherwise might struggle to survive. Because resources are pooled, there is limited concern from the perspective of the sponsor that it will need to “compete” with the project for those finite resources as the project continues to grow. Growth of the project indicates growth of the sponsor. Fiscal sponsorship “is far from a peripheral activity,” as some nonprofit fiscal sponsors generate “a significant amount of revenue due to their sponsorships.”<sup>125</sup> Even further, fiscal sponsorship is often the preferred

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119. *Id.*

120. *Id.*

121. Andersson & Neely, *supra* note 9, at 4.

122. *Id.*

123. *Basic Information on Obtaining Nonprofit Status and Fiscal Sponsorship*, *supra* note 111.

124. Andersson & Neely, *supra* note 9, at 1.

125. *Id.* at 3–4 (indicating that the organizations that did report sponsorship activities of sponsoring organizations attributed an average of \$16,640 to fiscal sponsorship revenue).

model for social and nonprofit entrepreneurs.<sup>126</sup> If an individual or organization desires to establish a nonprofit, but the nonprofit will have limited resources, it is helpful to consider if there is an alternative.<sup>127</sup> To the extent that there already is an existing organization that accomplishes similar goals, fiscal sponsorship could be the appropriate alternative.<sup>128</sup>

On the other hand, there are challenges to embracing fiscal sponsorship given its current legal framework. Institutions and individuals often misunderstand the basis of fiscal sponsorship relationships and the value of oversight and fiscal accountability.<sup>129</sup> More specifically, individuals are hesitant or unwilling to give money to another organization other than the one they traditionally support. There also exists an overlying idea that fiscal sponsorship is only for startup nonprofit organizations. Though it is indeed an outstanding tool for organizations or individuals who need a solid administrative, financial, or legal infrastructure while they focus on launching their programs, fiscal sponsorship should not be confined to this notion that it is only for organizations that need a boost to get off the ground.<sup>130</sup> As explained by Gregory Colvin, there are multiple models of practice and levels of support that can be applied to the fiscal sponsorship relationship depending on the specific types of activities or stages of organizational evolution.<sup>131</sup> Understanding the basic concept of fiscal sponsorship but having lingering confusion on necessary terms can lead to a dilution of fiscal sponsorship. Fiscal sponsors are more than a mere conduit of tax-exempt funds because they retain full control of how all funds are dispersed (if compliant with IRS rules).<sup>132</sup> By definition, projects must have activity that fits within the boundaries of the sponsor's mission. Fiscal sponsors, in turn, take a layered approach in their support of projects by offering critical infrastructure tools so that projects can focus solely on their programmatic activities and goals. These challenges require a deeper understanding and awareness of the fiscal sponsorship form.

One major challenge faced by fiscal sponsorship is the potential development of a conduit-like, passthrough relationship between the sponsor and the project that threatens the tax-exempt status (and potentially the reputation and legitimacy) of the sponsoring nonprofit organization. The fiscal sponsor needs to keep in mind the impact on their own Form 990 reporting, as the funds raised to be allocated to the project in the future will comprise part of the fiscal sponsor's total revenues.<sup>133</sup> Once the funds are distributed to the

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126. *Id.*

127. AM. BAR ASS'N, *supra* note 30, at 4.

128. *Id.*

129. See Gerald R. Solomon, *At Last—A Way to Evaluate Fiscal Sponsors*, 26 NONPROFIT WORLD, Nov./Dec. 2008, at 10, 10.

130. See *Helping Others Grow: The Nuts and Bolts of Fiscal Sponsorships*, *supra* note 77.

131. See COLVIN, *supra* note 788, at 12–13.

132. Adler & Colvin, *supra* note 32, at 12.

133. Andersson & Neely, *supra* note 9, at 1.

project, they consist of identifiable program activity. Careful consideration must be paid here; particularly, the structure itself can come under close scrutiny by the IRS. If, for example, a nonprofit fiscal sponsor is merely providing the sponsorship of a project to benefit from the deductibility for donations that would otherwise not qualify for favorable taxable treatment, the IRS could determine that such donations were made directly from the donor to the project—removing the middle man—and removing the tax benefits of the donation for both the donor and the project.<sup>134</sup> Even more extreme, if the relationship is abused, the sponsoring organization could lose its tax exempt status,<sup>135</sup> which would result in challenges for the organization to achieve its charitable goals.

Resultingly, the legal relationship between the parties of a fiscal sponsorship arrangement cannot be classified as intermediary, conduit, or pass-through for the new project to receive access to contributions or grants from foundations or government agencies.<sup>136</sup> The reference as such implies that “the charitable and philanthropic organization has chosen to financially support the nonexempt project.”<sup>137</sup> The IRS does not allow “conduit arrangements.”<sup>138</sup> Such “improper conduit arrangements” arise when donated funds (either grants or individual charitable contributions) are earmarked for secondary organizations separate from the 501(c)(3).<sup>139</sup> “Conduit situations always involve three players: a donor, an intermediary grantee through which earmarked contributions pass, and the actual recipient.”<sup>140</sup> A 501(c)(3) fiscal sponsor is acting like an improper conduit when it merely acts as an intermediary grantee providing a channel through which earmarked gifts are passed.<sup>141</sup> If the IRS suspects a fiscal sponsor and a project are in a conduit-like transaction, it will look beyond the status of the fiscal sponsor as a tax-exempt entity.<sup>142</sup> In order for the arrangement to avoid the strict scrutiny of the IRS—particularly because a primary motivation for entering a fiscal sponsor relationship is the receipt of tax-exempt, tax-deductible contributions—the parties to fiscal sponsorship must comply with specific IRS standards.<sup>143</sup> The IRS dictates that the organization that receives a charitable gift must have complete control and discretion over the gift.<sup>144</sup> Plus, the recipient organization (the sponsoring nonprofit) must ensure that the funds are used by

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134. Sartorius & Pollard, *supra* note 115, at 17.

135. *Id.*

136. Adler & Colvin, *supra* note 32, at 10–11.

137. *Id.* at 11.

138. *Id.*

139. George Johnson & David Jones, *K. Community Foundations*, IRS, <https://www.irs.gov/pub/irs-tege/eotopick94.pdf> (last visited May 21, 2021).

140. *Id.*

141. *Id.*

142. *See id.* (citing *Thomason v. Comm’r*, 2 T.C. 441, 443 (1943)). For an example of substance-over-form approach often employed by the IRS in conduit-like situations, see Rev. Rul. 63-252, 1963-2 C.B. 101.

143. Adler & Colvin, *supra* note 32, at 11.

144. *See* Rev. Rul. 68-489, 1968-2 C.B. 210.

the project (the non-501(c)(3), sponsored organization) in a manner that furthers the exempt purposes of the fiscal sponsor.<sup>145</sup>

Fiscal sponsorship is attractive to newly formed organizations with charitable missions that need to raise funds during the startup phase before obtaining their own tax-exempt status from the IRS.<sup>146</sup> Fredrik Andersson and Daniel Neely observe that fiscal sponsors play a uniquely important role in the nonprofit sector by providing support—capital in the monetary and human sense—that is often lacking.<sup>147</sup> However, there is a distinct gap between the knowledge base of smaller organizations that are in the best position to take advantage of fiscal sponsorship activity and the opportunities available to them.<sup>148</sup> Fiscal sponsors often fail to disclose their activities,<sup>149</sup> and in order to achieve growth in the nonprofit sector, there needs to be a deeper understanding of the important role that fiscal sponsorship plays in such a changing landscape.<sup>150</sup> Therefore, another challenge of fiscal sponsorship is compliance with the rules as they currently stand.

Compliance functions differently depending on the form of the fiscal sponsorship. Under the direct, comprehensive fiscal sponsorship model, there is no separate legal existence of the project—the fiscal sponsor has a restricted fund<sup>151</sup> to operate the project.<sup>152</sup> The project and the fiscal sponsor’s combined existence makes the project an “integral part of the fiscal sponsor,” where “its activities create the same liabilities for the fiscal sponsor as would any other project.”<sup>153</sup> The people running the project are employees of the fiscal sponsor, the expenses are paid for by the fiscal sponsor, and the assets (both tangible and intangible property) of the project belong to the fiscal sponsor.<sup>154</sup> All contributions, grants, and funds raised—whether intended for allocation to a specific project or generally to the charitable organization—are the property of the fiscal sponsor.<sup>155</sup> Charitable trust law and contract law dictate that the funds may not be diverted to another purpose, because the fiscal sponsor is “required

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145. Adler & Colvin, *supra* note 32, at 11.

146. AM. BAR ASS’N, *supra* note 30, at 5.

147. Andersson & Neely, *supra* note 9, at 1.

148. *Id.* at 2.

149. *Id.* at 4 (“We find that the majority (51%) of the 51 organizations filing the long form 990 made no mention of fiscal sponsor services.”).

150. *Id.* at 1. Andersson and Neely ultimately argue that in order to enhance the nonprofit sector, there needs to be enhanced disclosures of fiscal sponsorship to ensure that sponsors are held accountable for their sponsorship activities. *Id.*

151. Adler & Colvin, *supra* note 32, at 11. A restricted fund is a common structure in charitable organizations; they are identified by a specific contributor or flagged for a particular project of the organization. Restricted funds are tracked separately from the general treasury, and the organization uses fiscal accounting to steward contributions that are donated and disbursed from the restricted fund. People give to the restricted fund with the understanding that their donation, as tax-deductible, is specifically allocated to a specific project. *Id.*

152. *Id.*

153. *Id.* at 11–12.

154. *Id.*

155. *Id.* at 11.

to treat money designated for the project as a restricted fund.”<sup>156</sup> Because these fiscal sponsor agreements typically allocate a portion of the funds as revenue for the fiscal sponsor in return for their support over the administration of the project,<sup>157</sup> the fiscal sponsor will not contravene any contract or law for using that percentage of the funds in that manner.<sup>158</sup> The fiscal sponsor can only transfer the assets and liabilities to the project at the time it terminates its relationship with the project.<sup>159</sup>

Under the preapproved grant relationship, “[t]he fiscal sponsor furthers its exempt purposes indirectly”<sup>160</sup> through granting financial support to a specific project that advances the fiscal sponsor’s exempt purposes.<sup>161</sup> To avoid classification as a conduit, the fiscal sponsor must not own the project,<sup>162</sup> nor is the project considered under the fiscal sponsor’s umbrella;<sup>163</sup> instead, the sponsor “adopts” the project as one of its charitable programs and funds the project only to the extent it receives money from third-party contributions.<sup>164</sup> The project thus has its own legal identity, and the fiscal sponsor is not legally obligated to fund the project.<sup>165</sup> The fiscal sponsor’s liability, in this scenario, is limited to that of a charitable grantor.<sup>166</sup> The fiscal sponsor has “variance power” over the revenues received for the project: those funds are considered assets of the fiscal sponsor and are audited on their financial statements, as opposed to treating the fiscal sponsor as a custodian of the funds.<sup>167</sup> The charitable donations for the project still belong to the fiscal sponsor,<sup>168</sup> so long as the contributors fully relinquish dominion and control over the funds once donated.<sup>169</sup> Therefore, proper documentation of the relationship as grantor-grantee and proper reporting done by both the fiscal sponsor and the sponsoring organization regarding the allocation of funds lends itself to compliance with IRS expectations.

No matter the structure, compliance with the rules that govern fiscal sponsorship is challenging. It requires great understanding of multiple areas of law and expertise in deciphering tax regulations to ensure that proper forms are filed, the relationship with the project is legally sound, and the allocation and accounting of charitable funds is not inappropriately mingled. On balance, the

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156. *Id.*

157. *Basic Information on Obtaining Nonprofit Status and Fiscal Sponsorship*, *supra* note 111.

158. Adler & Colvin, *supra* note 32, at 11.

159. *Id.* at 12. “Spin-off” means, in this context, the time in which the project obtains its own 501(c)(3) status.

160. *Id.* (emphasis omitted).

161. Rev. Rul. 68-489, 1968-2 C.B. 210.

162. Adler & Colvin, *supra* note 32, at 12.

163. AM. BAR ASS’N, *supra* note 30, at 4.

164. Chiodini & Colvin, *supra* note 89, at 8.

165. Adler & Colvin, *supra* note 32, at 12.

166. Chiodini & Colvin, *supra* note 89, at 8.

167. Adler & Colvin, *supra* note 32, at 12.

168. Chiodini & Colvin, *supra* note 89, at 8.

169. Adler & Colvin, *supra* note 32, at 12.

burden of compliance falls heavily on the fiscal sponsor. The sponsor carries this burden in these different models because, regardless of form, the sponsor is the entity providing the support—be it financial, legal, administrative, or all of the above—to the project. The hodgepodge of rules that must be complied with leave muddled, undecipherable messes for organizations that want to be fiscal sponsors or fiscally sponsored. Without more guidance, such as a concrete legal framework, fiscal sponsorship faces insurmountable roadblocks.

### C. FISCAL SPONSORSHIP IN PRACTICE

Fiscal sponsorship, ultimately, increases efficiency in the nonprofit sector. There are clear positives and negatives to fiscal sponsorship, so an obvious alternative for small organizations is to seek classification as a 501(c)(3) tax-exempt organization, or any 501(c) classification. In fact, many startup organizations apply to the IRS for nonprofit tax-exempt status each year; the IRS has noted that many “organizations may seek [public charity status] without exploring possible alternatives that might be more appropriate in light of their goals and objectives.”<sup>170</sup> This is simpler in theory than in practice: obtaining and maintaining exempt status is more complicated than just filing a form with the IRS. Obtaining recognized tax-exempt status requires developing a comprehensive business plan, properly creating a tax-exempt organization, and preparing and filing the correct formation documents, to name a few.<sup>171</sup> The process to obtain status is lengthy (though retroactive) and expensive, so pilot projects or startup, mission-driven organizations with limited funds, an urgent need, or need immediate fundraising are left without the opportunity to attain exempt status.

Further, maintaining tax-exempt status is even more challenging than obtaining it. Maintenance requires establishing a board, having a clear and identifiable charitable purpose, continuous documentation, an understanding of lobbying laws, filing annual information returns, among other processes involving complicated calculations and regulation compliance.<sup>172</sup> It is fairly common for small, community-based organizations to lack the necessary resources—specifically, a lack of economic and human capital—to obtain 501(c)(3) status, let alone the breadth of expertise required to maintain that status. Even further, these organizations might not want to dedicate the time and resources to these efforts, as they are driven by their mission and aim to serve the larger community. Such time delays and costs can equate to less impact that the project could otherwise make. Building an organization takes time and energy, and where a lot of these small charitable organizations, with their focus on supporting issues faced by the community or the public, are trying to commit

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170. ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, *supra* note 7, at 34.

171. *See id.* *See generally* *Charitable Organizations*, IRS, <https://www.irs.gov/charities-non-profits/charitable-organizations> (last visited May 21, 2021).

172. *See generally* *Charitable Organizations*, *supra* note 171.

to their social purpose, tax-exempt status is just out of reach. Fiscal sponsorship provides these organizations with an alternative by removing the compliance concerns from the small organization and shifting the burden to the well-established, powerhouse nonprofit that has built-in resources to take such a burden on.

A great way to see how fiscal sponsorship works in practice is through a concrete example. Tides is a San Francisco-based 501(c)(3) organization that is self-described as a “philanthropic partner” and “nonprofit accelerator.”<sup>173</sup> Its mission is to accelerate “the pace of social change, working with innovative partners to solve society’s toughest problems.”<sup>174</sup> In addition to grantmaking and impact investing, Tides currently provides comprehensive fiscal sponsorship to over 150 social venture projects of various sizes in the United States.<sup>175</sup> In 2016, Tides managed over \$110 million in philanthropic support for its projects.<sup>176</sup> In addition, projects are able to access Tides’ resources, efficiency, and comprehensive services, like human resources, grants management, finance and accounting, legal and compliance, and a network of funders.<sup>177</sup> A well-run nonprofit organization can expect to spend up to 30% of its annual revenue on administrative and overhead expenses.<sup>178</sup> Fiscal sponsorship through Tides—which provides back-office services, legal framework, and capacity-building support—allows the projects to pay only 9% of their annual revenue.<sup>179</sup> It follows that fiscal sponsorship is cost effective for sponsored projects because fees to maintain the relationship are small compared to the operational costs and burdens the project would have if it was a stand-alone organization. Saving money is highly critical for many types of organizations: those that are newly emerging, testing new approaches to difficult social problems, run solely by volunteers, or working in an area where funding opportunity is limited.<sup>180</sup>

Tides successfully uses the comprehensive fiscal sponsorship model to produce an economic and efficient way to reduce the costs of running an organization while maintaining the organization’s integrity.<sup>181</sup> Tides also imposes specific requirements on potential projects in order to officially become a sponsored social venture: mission alignment, budget, and legal fit.<sup>182</sup> All projects sponsored by Tides must align with its “Vision, Mission and

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173. *See About*, TIDES, <https://www.tides.org/about/> (last visited May 21, 2021).

174. *The Tides Approach*, TIDES, <https://www.tides.org/approach/> (last visited May 21, 2021).

175. *See About*, *supra* note 173.

176. *Id.*

177. *See What Is Fiscal Sponsorship?*, TIDES, <https://www.tides.org/faq/what-is-fiscal-sponsorship/> (last visited May 21, 2021).

178. *Why Choose Fiscal Sponsorship?*, TIDES, <https://www.tides.org/faq/choose-fiscal-sponsorship/> (last visited May 21, 2021).

179. *See id.*

180. *Id.*

181. *Id.*

182. *What Are the Eligibility Requirements for Fiscal Sponsorship at Tides?*, TIDES, <https://www.tides.org/faq/eligibility-requirements-fiscal-sponsorship-tides/> (last visited May 21, 2021).



Approach.”<sup>183</sup> This qualification supports the idea that, because the sponsoring organization carries the burden of the tax-exempt status, the project must fit within the charitable purposes of the organization to avoid IRS scrutiny on fundraising. Before falling under the Tides umbrella, projects must have an expected annual budget of at least \$250,000 comprised of confirmed donative support and formal grant commitments.<sup>184</sup> The project must also have at least one full-time employee, and the project must agree to at least a two-year commitment before exiting the purview of Tides.<sup>185</sup> It is important to highlight that a \$250,000 budget is objectively high, particularly for small organizations that are just getting off the ground.<sup>186</sup> However, this budget meets the threshold the IRS imposes on nonprofit organizations to file Form 990,<sup>187</sup> which, if fiscally sponsored, would be done by the sponsor. Finally, Tides requires that projects agree to giving Tides full governing authority, and that all social ventures have a base of operation in the United States.<sup>188</sup> The idea is that legal governing authority over the projects is preferable to the fiscal sponsor, since the sponsor is responsible for the compliance risks as the tax-exempt entity and the project, because compliance burdens shift from their administrative duties to those of the sponsor. Tides has sponsored over 1,400 projects since its inception,<sup>189</sup> and using its well-established comprehensive framework allows Tides and its projects to continue to flourish.

Noting the success that Tides has had in the field of fiscal sponsorship, it also implies room for growth in the use of fiscal sponsorship in the nonprofit sector. It is clear that when done well, fiscal sponsorship works. But it’s an uphill battle to get to the point where there is repeated and long-term success for fiscal sponsors. Without a complete framework like the one at Tides, fiscal sponsorship can fall victim to pitfalls. Committing fiscal sponsorship as a legitimate entity recognized by state and federal law allows more nonprofit organizations to establish themselves as fiscal sponsors and, in turn, expands opportunities for small organizations to take advantage of the collective resources while advancing their mission.

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183. *Id.*

184. *Id.*

185. *Id.*

186. See Brice S. McKeever, *The Nonprofit Sector in Brief 2018: Public Charities, Giving, and Volunteering*, NAT’L CTR. FOR CHARITABLE STAT. AT THE URB. INST. (Dec. 13, 2018), <https://nccs.urban.org/publication/nonprofit-sector-brief-2018#number-01>. After excluding registered 501(c)(3) organizations with gross receipts under \$50,000, nearly 67% of nonprofit organizations had less than \$500,000 in expenses.

187. *Where to Find Nonprofit Financial Information*, BRIDGESPAN GRP., <https://www.bridgespan.org/insights/library/philanthropy/where-to-find-nonprofit-financial-information> (last visited May 21, 2021). All nonprofits with either \$100,000 in annual contributions or over \$250,000 in assets are required to file Form 990 with the IRS. *Id.*

188. See *What Are the Eligibility Requirements for Fiscal Sponsorship at Tides?*, *supra* note 182.

189. *About*, *supra* note 173.

### III. PROPOSAL: LEGAL RECOGNITION OF FISCAL SPONSORSHIP

Fiscal sponsorship is not a new phenomenon. Today, there are nonprofit organizations around the country that are devoted to the provision and management of fiscal sponsorships,<sup>190</sup> like the aforementioned Tides Center,<sup>191</sup> as well as Fractured Atlas,<sup>192</sup> Community Partners,<sup>193</sup> and TSNE MissionWorks.<sup>194</sup> As discussed above, fiscal sponsorship is a tool that actively contributes to a robust nonprofit landscape. By pooling resources, fiscal sponsorship is a mechanism that brings solutions to societal issues to the forefront. Yet, there is little formal acknowledgement of fiscal sponsorship in the law.<sup>195</sup>

As fiscal sponsorship is not defined by law, the relationship established between the fiscal sponsor and the sponsored project is contractual with, ultimately, little oversight beyond the scope of the agreement.<sup>196</sup> Fiscal sponsorship as it currently stands only works if these agreements are well-crafted “so that both parties are comfortable with the intended purposes for the funds and the required allocation of control.”<sup>197</sup> The need for a legally recognized structure is exacerbated when the contractual relationship is not respected or when the IRS views the relationship as a mere conduit.<sup>198</sup> There is a lack of clear rules that recognize fiscal sponsorship as an entity choice and corporate structure. Instead of a legally defined term, a combination of state and federal corporate and tax codes, mixed in with contract law, exists. Federal tax law and state corporate codes, working together, should include provisions that cement fiscal sponsorship into legal existence. There are two steps to accomplishing this goal: (1) establish a newly recognized nonprofit entity form in state incorporation law so that organizations can incorporate as a fiscal sponsor, and (2) include provisions—either under § 501(c) of the Internal Revenue Code or completely new provisions—in federal tax law that define the contours of the relationship between the sponsor and the project.

#### A. NEW NONPROFIT ENTITY

The first step to establishing legal relevance for fiscal sponsorship is to create a new nonprofit form in state corporate codes. This means that in addition

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190. Andersson & Neely, *supra* note 9, at 1–2. For a comprehensive list of active fiscal sponsor organizations as well as guidelines and best practices for fiscal sponsorship, see NAT'L NETWORK OF FISCAL SPONSORS, <https://www.fiscalsponsors.org> (last visited May 21, 2021). The National Network of Fiscal Sponsors was created by a handful of well-established fiscal sponsors to share and promote effective and responsible practices in the field. *Id.*

191. See TIDES, <https://www.tides.org> (last visited May 21, 2021).

192. See FRACTURED ATLAS, <https://www.fracturedatlas.org> (last visited May 21, 2021).

193. See CMTY. PARTNERS, <https://communitypartners.org> (last visited May 21, 2021).

194. See TSNE MISSIONWORKS, <https://www.tsne.org> (last visited May 21, 2021).

195. Bradrick, *supra* note 6.

196. Constantine & Moran, *supra* note 89.

197. *Id.*

198. Bradrick, *supra* note 6.

to the nonprofit corporation, the charitable trust, and the unincorporated nonprofit associations, there is an entirely new form of nonprofit organization: the fiscal sponsor. Functionally, state corporation codes could include many of the same rules as nonprofit corporations, and the organizations can receive a lot of the same benefits as a nonprofit corporation. However, for organizations that choose to establish themselves as a fiscal sponsor, state incorporation law should include a few clarifying provisions that would be unique to establishing as a fiscal sponsor. A new entity form commits to corporate law the entire structural and operational framework of a fiscal sponsor.

Alternatively, the three traditional forms of nonprofits can remain intact and fiscal sponsorship can be defined under the nonprofit corporation umbrella. State incorporation rules can be modified to include the definition of fiscal sponsorship in an organization's articles of incorporation. Specifically, the "purpose" section of an organization's articles of incorporation should state that the organization's purpose is to fiscally sponsor social ventures or charitable organizations. However, this limits fiscal sponsors to only nonprofit corporations.<sup>199</sup> Further limitations in an area where compliance is already a challenge may not prove to be beneficial.

Legal recognition of fiscal sponsorship alleviates accountability and oversight concerns. Because a nonprofit must be organized and operated exclusively for a charitable purpose in order to receive tax-exempt status under § 501(c)(3),<sup>200</sup> it can organize as a legally recognized entity of fiscal sponsorship in its articles of incorporation to ensure that its sponsorship activities fall within the confines of its mission.<sup>201</sup> By creating a new entity, fiscal sponsorship can solidify its ability to side-step the legal restrictions placed on 501(c)(3) organizations, specifically those around board composition, bylaws, and other processes. Without a discernable legal entity, fiscal sponsorship can result in a project inappropriately deriving a private benefit from charitable contributions.<sup>202</sup> Legal definition, therefore, bridges the gap of oversight of the fiscal sponsor and accountability of the sponsored projects. Overall, creation of a new entity form dedicated to fiscal sponsorship benefits both the sponsors and the projects and enables further growth in the nonprofit sector.

## B. TAX CODE MODIFICATIONS

The interplay between state corporate law and federal tax law forms the contractual basis of fiscal sponsorship. With a new entity form established at

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199. Unincorporated associations and charitable trusts are generally governed by different rules, so a sponsor would be limited to state incorporation laws. *See supra* note 30 and accompanying text.

200. *See* 26 C.F.R. § 1.501(c)(3)-1(a)(1) (2020).

201. *See* Rev. Rul. 66-79, 1966-1 C.B. 48 ("A section 501(c)(3) organization will not jeopardize its exemption even though it distributes funds to organizations that are not themselves charities. The exempt organization must 'ensure' use of the funds for permitted purposes by limiting distributions to specific projects that further its own purposes.").

202. Takagi, *supra* note 73.

state law or modifications to rules around the articles of incorporation, it follows that in order for there to be a legally defined form of fiscal sponsorship there must be changes to the tax code.

One way to do this is to go directly to the source: amending § 501(c) of the Internal Revenue Code. Particularly, the definitional parameters of organizations seeking § 501(c)(3) status could be expanded to include “fiscal sponsorship” as an exempt purpose category. In addition to corporations organized and operated exclusively for “religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children and animals,”<sup>203</sup> fiscal sponsorship could also be listed. This would create fiscal sponsorship as a stand-alone exempt purpose—it would not need to be organized or operated exclusively for one of the other purposes to be worthy of tax-exemption in accordance with section 170 of the Internal Revenue Code. With its own exempt-purpose classification, fiscal sponsors would automatically pass the organizational and operational tests built into the Code. This would allow nonprofit organizations to organize and operate exclusively for the purpose of the fiscal sponsorship.<sup>204</sup> This would encourage more organizations to focus their efforts solely on the incubation or acceleration of smaller nonprofits while maintaining compliance with IRS rules. Creating fiscal sponsorship as a new exempt purpose category would also allow a fiscal sponsor to organize and operate as either a public charity or a private foundation, depending on how the organization chooses to be funded.<sup>205</sup> Therefore, there is potential flexibility in the additional IRS rules and regulations with which sponsors must comply. However, merely creating a new exempt purpose does not fully integrate the complexities of fiscal sponsorship into the law. Working in conjunction with state corporate law, a new exempt purpose gets closer, but the widespread rules on regulation and compliance make it hard to see any difference in what currently exists.

Alternatively, there could be a completely new subsection of § 501(c) that outlines the necessary parameters for fiscal sponsorship. This section has numerous other entities outside of charitable organizations that receive tax-exempt treatment (with their own limitations), including civic or activism organizations,<sup>206</sup> business leagues,<sup>207</sup> fraternal societies,<sup>208</sup> and even life

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203. *See* 26 U.S.C. § 501(c)(3) (2018).

204. *See id.* Note that the exempt purposes are not mutually exclusive—an organization can fit into more than one category. Fiscal sponsors would likely also fall under the “charitable” classification.

205. *See id.* § 501(c)(3). Section 501(c)(3) divides organizations into public charities or private foundations, and distinguishes between organizations that fall under one of the outlined exempt purposes and organizations that meet the requirements of 26 U.S.C. § 509(a). *See id.*

206. *See id.* § 501(e)(4).

207. *See id.* § 501(e)(6).

208. *See id.* § 501(e)(8), (10).

insurance associations.<sup>209</sup> Adding “fiscal sponsor” to the long list of tax-exempt organizations allows more breadth in rulemaking and an opportunity to directly define it. Such a provision logically fits well within this section of the Code, as it addresses the parameters for exemption from tax. However, a new 501(c) subsection does not necessarily guarantee that donations to a fiscal sponsor—which then would be attributed to the sponsored project—would be deductible, detracting from the value of fiscal sponsorship. In order to avoid this, the new subsection would need to be crafted in a way that complies with the deduction requirements of the Code. One way to do this would be to define fiscal sponsors as exclusively charitable organizations.

A final way to incorporate fiscal sponsorship more directly into the U.S. tax code is through adding an additional section that expands on all of the rules that govern fiscal sponsorship. A new section of the Internal Revenue Code would provide the widest latitude to commit the parameters of fiscal sponsorship to the law, albeit daunting to accomplish. Both the comprehensive model—where the project is wholly-owned by the sponsor—and the grantor model—where the project is a grantee of the sponsor-grantor—can be incorporated into this section through its own organizational and operational test. There would need to be Treasury Regulations that continue to expand on the framework, but overall, a new section of the Code would provide lawmakers with the most space to create the law of fiscal sponsorship.

Regardless of how it is logistically accomplished, state and federal law must work together to cement fiscal sponsorship as a high-value alternative and additive to the nonprofit sector. These proposed steps operate in conjunction to bring legal legitimacy to fiscal sponsorship in hopes that fiscal sponsorship becomes a more widely used entity form.

### C. ADDITIONAL RECOMMENDATIONS

If fiscal sponsorship is to work to maximize nonprofit social impact, it needs to have its structure defined in the law. However, a reason why this has not been done (outside of the practical challenges of implementing new law and policy) may be that fiscal sponsorship is not risk-free. With further legal definition comes greater oversight responsibility of governing entities like the IRS and State Attorneys General. Additionally, a defined legal framework standing alone does not necessarily increase public knowledge of fiscal sponsorship, nor would it necessarily decrease the challenge for small organizations to obtain a fiscal sponsor. But the possibility that a fiscal sponsor can slip into an impermissible conduit-like arrangement is far greater without legal parameters. A legal framework requires more accountability to regulators and funders on account of both the sponsors and the sponsored projects. Increased oversight ensures that stakeholders are aware of how resources are

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209. *See id.* § 501(e)(12).

allocated. The practice of fiscal sponsorship is here to stay, so the law needs to catch up. In addition to the proposed changes to the law, there are a few ways to best support the future use of the fiscal sponsorship relationship.

First, there needs to be an increased visibility of fiscal sponsorship and an awareness that sponsorship is advantageous for startup or small charitable organizations. At present, there is a lack of transparency that such an alternative form for tax-exempt benefits even exists because fiscal sponsorship, by definition, is a behind-the-scenes service. Fiscal sponsorship is “often under the public and philanthropic radar.”<sup>210</sup> The American Bar Association admits that, because fiscal sponsorship does not refer to a relationship defined by law and thus could take on many forms, it is imperative for social entrepreneurs to seek legal advice if they desire to start a charitable venture.<sup>211</sup> Though seeking legal advice is a commonly recommended practice, fiscal sponsorship has remained a blind spot in nonprofit policy despite its perceived importance in a robust nonprofit sector.<sup>212</sup> Moreover, many parties in the nonprofit sector—established nonprofit organizations, nonprofit entrepreneurs, donors, regulatory agencies—do not fully understand what fiscal sponsorship entails.<sup>213</sup> One way to increase public knowledge of fiscal sponsorship is through transparent reporting practices, like adequate disclosures on Form 990.<sup>214</sup> Because Form 990 is a public document that is required to be disclosed and is easily accessible by anyone, increased reporting of sponsor activity on a fiscal sponsor’s Form 990 can lead to increased disclosures of fiscal sponsor activity to the wider public.<sup>215</sup> However, without a specific requirement for fiscal sponsors to identify their active sponsor role on Form 990, there is a shortage of knowledge on the fiscal sponsor phenomenon.<sup>216</sup> With a legally recognized entity, an increase in public knowledge and reporting compliance is more feasible; a nonprofit must identify as a fiscal sponsor in, for example, its articles of incorporation and, as a matter of protocol, must submit Form 990 including all of its fiscal sponsorship activities *because* such activities constitute the legally-recognized classification as a fiscal sponsor.

Transparent reporting also increases legitimacy of the smaller organizations in the eyes of the IRS. In conjunction with a new statutory framework, reporting lends itself to increased compliance for both sponsors and sponsored projects. An IRS Advisory Committee produced a report that touches on the benefits of fiscal sponsorship and the impact of the advancement of fiscal sponsorship.<sup>217</sup> The report admits that there is limited precedential guidance

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210. Andersson & Neely, *supra* note 9, at 2.

211. Bradrick, *supra* note 6.

212. Spack, *supra* note 5, at 24.

213. Solomon, *supra* note 129, at 10.

214. Andersson & Neely, *supra* note 9, at 2.

215. *Id.*

216. *Id.*

217. ADVISORY COMM. ON TAX EXEMPT & GOV’T ENTITIES, *supra* note 7, at 34.

from the IRS<sup>218</sup> where organizations can learn about fiscal sponsorship.<sup>219</sup> “From a tax compliance perspective,” the report states, “it would be useful for the IRS to issue precedential guidance in the area of fiscal sponsorship, and such guidance could be incorporated into educational information for new organizations about a legally permissible alternative to seeking exemption.”<sup>220</sup> The Advisory Committee suggests that disseminating information about fiscal sponsorship to state regulators and encouraging the IRS to work with such state regulators and social entrepreneurs to develop coordinated approaches to inform new nonprofit organizations will assist the spread of “legally compliant alternatives” to obtaining tax-exempt recognition under § 501(c)(3).<sup>221</sup>

Second, there must be further encouragement for states to create new nonprofit entities in their corporation codes. Fiscal sponsorship is a way for changemakers without tax-exempt status to keep their administrative costs low over the long-term, comply with relevant government regulations, and collaborate with established tax-exempt organizations with similar missions and objectives.<sup>222</sup> Yet, this is not just a case of administrative convenience. Fiscal sponsorship lessens the burden on small organizations to provide extensive back-office support to accomplish their charitable goals by providing an economical way for charitable projects to attract funding and manage their administrative costs and operations.<sup>223</sup> If a primary objective of the nonprofit sector is to solve market failures and effectuate social good and change, the mechanisms that fiscal sponsorship employs can increase an organization’s access to capital and result in widespread impact.

The IRS Advisory Committee in the aforementioned report noted that alternative structures, like fiscal sponsorship, could better serve the needs of charitable organizations that are seeking the benefits of the tax-exempt status but lack, for one or a multitude of reasons, the ability or desire to obtain it themselves.<sup>224</sup> In an effort to minimize the unnecessary creation of duplicate nonprofit organizations, the IRS acknowledges that fiscal sponsorship is indeed a tool to maximize not-for-profit social impact.<sup>225</sup> However, there is not much knowledge that such form exists.<sup>226</sup> Compliance with tax law and regulations is challenging and easily neglected. When a fiscal sponsor disregards its responsibilities as they pertain to the relationship, a fiscally sponsored project can be operated in a manner “inconsistent with applicable laws” or possibly

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218. See Rev. Rul. 66-79, 1666-1 C.B. 48.

219. ADVISORY COMM. ON TAX EXEMPT & GOV’T ENTITIES, *supra* note 7, at 35.

220. *Id.*

221. *Id.* at 36.

222. Darlene M. Siska, *Fiscal Sponsorships Help Programs Keep Costs Down*, CHRON. OF PHILANTHROPY (Mar. 26, 2009), <https://www.philanthropy.com/article/fiscal-sponsorships-help-programs-keep-costs-down/>.

223. Constantine & Moran, *supra* note 89.

224. ADVISORY COMM. ON TAX EXEMPT & GOV’T ENTITIES, *supra* note 7, at 34.

225. *Id.* at 35.

226. *Id.* at 34.

beyond the fiscal sponsor's financial capacity.<sup>227</sup> With only informal guidance from regulators, oversight of a fiscally sponsored project's activities by both regulators and donors is challenging.<sup>228</sup>

In order to successfully build out support for smaller organizations, encourage compliance in fiscal sponsorship, and continue to contribute to a growing nonprofit landscape, an established fiscal sponsorship entity form is necessary. It legitimizes the arrangement as more than just payroll or administrative support. The need for a legal definition of fiscal sponsorship is overwhelmingly supported by evidence, logic, and practice. Then, fiscal sponsorship will be seen as more than just a "tool" or an "alternative" for social entrepreneurs and nonprofit organizers. Fiscal sponsorship could instead be a legally established structure of a nonprofit corporation compliant with state and federal law.

#### CONCLUSION

As the United States faces a reckoning on a myriad of social issues, lawmakers must seek to fulfill the demands for social equity by expanding upon its limited resources. Fiscal sponsorship is a tool that can strengthen and transform the nonprofit sector. Overall, fiscal sponsorship is a sustainable, cost-effective way to implement programs, bring together groups to collaborate around an issue, or test new approaches to social change. Fiscal sponsorship activity is running paces ahead of academic research on it, so legal recognition of the fiscal sponsorship phenomenon will provide concrete measurements of fiscal sponsorship's contribution to social equity.

Good fiscal sponsorship is a win-win for everyone because the partnerships formed have positive social impacts. "The unincorporated groups, projects, and grassroots coalitions that have strong, experienced fiscal sponsors can focus their attention" on their missions and programmatic activities, and the fiscal sponsors are able to achieve their own mission on a broad level.<sup>229</sup> Alignment between the fiscal sponsor and the project "results in more resources getting directed toward the high-level, shared mission."<sup>230</sup> "After all, helping projects and changemakers achieve their mission is the 'raison d'être' of fiscal sponsorship."<sup>231</sup> Thus, through the development of state corporate law that provides nonprofit organizations the opportunity to incorporate as a fiscal sponsor, management, oversight, transparency, and accountability standards of fiscal sponsorship will be heightened. Perhaps most important, given fiscal sponsorship's influence on the nonprofit sector, a legally recognized entity of

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227. Takagi, *supra* note 73.

228. *Id.*

229. Spack, *supra* note 5, at 24.

230. *Id.*

231. *Id.*



fiscal sponsorship will promote impact-driven entrepreneurship and result in a more robust philanthropic landscape.