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Legal Issues for Nonprofits

“FISCAL SPONSORSHIP” AND ARTS-RELATED NONPROFITS

*Prepared for Community Legal Resources by
Catherine Brainerd, Sarah E. Heineman, Julie A. Karkosak, and
Robert Rodemeyer of Dykema Gossett PLLC*

In coordination with the State of Michigan’s Cool Cities initiative, active individuals and groups in Michigan’s cities have developed innovative ideas about how to invigorate traditionally challenged, yet valuable, aspects of our communities. One of the concepts being explored is for non-profit organizations to work with art organizations in a role of fiscal sponsorship. This *Legal Lines* provides a brief overview of the benefits and limitations of such a partnership.

The key benefit of a fiscal sponsorship between non-profits and an arts organization is financial. Many grants and larger donors require funding recipients to have tax exempt status, as governed by Section 501(c)(3) of the Internal Revenue Code. Larger organizations typically possess the resources and knowledge necessary to obtain this status, while many small programs and artists do not. Fiscal sponsorship can provide smaller programs and artists (the “beneficiaries”) the opportunity to apply for and receive funding from a wider base of resources. Fiscal sponsors can also benefit by being able to support their operating expenses with funding from the grants and monies they handle. Traditionally, fiscal sponsors take between 5-10% of collected donations in order to cover their administrative costs, before disbursing the remainder to beneficiaries.

While the benefits of such a partnership are great, the key limitation to forming this type of fiscal partnership is vision. In order for fiscal sponsorship to succeed, both the sponsoring non-profit organization and the beneficiary arts organization or artist must share a vision and a goal. If the product of the beneficiary party is not consistent with the declared goal, the non-profit sponsor can lose its 501(c)(3) status.

A. Fiscal Sponsorship Overview

In the simplest terms, fiscal sponsorship is one entity (the “sponsor”) accepting and managing funds for another (the “beneficiary”). A fiscal sponsorship requires a written agreement between the fiscal sponsor and the beneficiary outlining the terms of their relationship. As a fiscal sponsor, an entity collects all the funds for either another agency/program or a specific project/artist and then disperses the funds to the program or project

Community Legal Resources
615 Griswold · Suite 1400 · Detroit · Michigan · 48226
Phone: 313/962-3171 · Fax: 313/962-0797
www.clronline.org

as needed. Each beneficiary arts organization or artist will generally apply for its own grants from public agencies, foundations, corporations and individual donors, using the tax exempt status of the sponsor to assist in obtaining the donations. The tax-exempt donation is then made to the fiscal sponsor, which earmarks the funds for the donor’s intended beneficiary. This allows the beneficiary arts organization or artist to apply to prospective donors under the auspices of 501(c)(3), increasing both the array of potential donors and the donors’ incentive to donate.

All beneficiary programs, projects and artists must be pre-approved by the fiscal sponsor. Approval requires meeting both the requirements set by 501(c)(3) non-profit standards, and those of the particular sponsor’s mission and goals. After approval the beneficiary must continue to demonstrate compliance throughout the project or program.

There are various benefits and limitations associated with a fiscal sponsor relationship. By understanding these considerations, an entity is better able to determine whether a fiscal sponsor relationship may be right for it. Evaluating how the benefits may further the goals of the beneficiary program or artist, and how the limitations may hinder its efforts, the beneficiary arts organization/artist can determine whether it should pursue the possibility of fiscal sponsorship. In addition, the fiscal sponsor must also evaluate the costs and obligations of providing sponsorship and the value of supporting the beneficiary program or artist.

B. Benefits

1. Project/Program Benefits

Several foundations, government agencies, and corporate sources only grant donations to nonprofit organizations with IRS tax-exempt status. To be considered exempt, an organization must hold a current 501(c)(3) acknowledgment of tax-exempt status letter from the IRS. Applying for and securing this approval takes resources and knowledge not typically possessed by individual artists or local artists’ groups. Accordingly, rather than attempting to obtain 501(c)(3) certification on their own, these local artists can work with fiscal sponsors to realize the benefits of tax-exempt status.

Fiscal sponsorship enables the local artists to receive the benefits of 501(c)(3) certification without the hassle of obtaining certification. Once fiscal sponsorship is obtained, the local artist or artist organization can apply for funds from the government, foundations, and corporations, that would otherwise be unavailable. Due to the reputation of certain fiscal sponsors and their broad representation of numerous projects within the art community, many foundations and government entities are familiar with, and comfortable donating to, proven positive fiscal sponsors rather than uncertain, unknown, projects or artists.

2. Sponsor Benefits

Organizations with 501(c)(3) certification can benefit by choosing to become fiscal sponsors. Fiscal sponsorship allows the fiscal sponsor to collect an administrative fee on any money granted. These proceeds must be reinvested in the fiscal sponsor’s organization and cause, enabling the organization to increase its operating budget, status and visibility. Fiscal

sponsorship requires that each sponsored program share a purpose with its sponsor. It also requires that the sponsor retain some control of the administration of funds in order to ensure that the spending is in furtherance of the proposed project and the purpose of the sponsor. Sponsorship, therefore, enables the fiscal sponsor to grow its presence in the very areas of concern in which it is already involved.

C. Limitations

1. Project/Program Limitations

A beneficiary arts organization or artist is limited in several ways by entering into a fiscal sponsorship relationship with a non-profit organization. Though the beneficiary arts organization or artist can receive donations under the guise of a 501(c)(3), it does not have independent 501(c)(3) status. The project does not receive tax exempt purchasing power, nor any of the other benefits associated with being a 501(c)(3).

The beneficiary project must remain non-commercial. It is not permitted to be organized for or seek to make a profit, or to have investors. To do so would not only jeopardizes its agreement with the sponsor, but also the sponsor’s 501(c)(3) status. The IRS requires that the sponsor remain non-profit, and in existence solely to further the arts. If any of its beneficiary projects were to become for-profit, the certification for the sponsor and all of its projects would be lost. The beneficiary project and program is, therefore, limited in its scope and its potential donors once it enters into a fiscal sponsorship arrangement with a 501(c)(3). For this reason, fiscal sponsorship is not a means for local artists to earn independent income. However, fiscal sponsorship can still be a beneficial way to fund community art projects or other non-profit-making artistic ventures.

Vision and purpose are also limited in a fiscal sponsor relationship. Fiscal sponsorship requires that the project be in furtherance of the sponsor’s purpose and vision. In order to apply its 501(c)(3) exemption to a beneficiary project, the IRS requires that the project be in line with the sponsor’s mission. Any notable differences in purpose or vision are in breach of the sponsorship agreement and jeopardizes the sponsor’s tax-exempt status. Beneficiary projects and programs are, therefore, confined to working towards the purpose and in accordance with the vision of the sponsoring organization. Though this limitation may be avoided by simply finding a sponsoring organization whose purpose is aligned with the particular project for which funding is being sought, this is not always an option.

Projects must remain apolitical. Political themes and purposes aimed at influencing elections or political objectives are barred from 501(c)(3) exemption, and therefore there is no organization capable of sponsoring this type of beneficiary project.

Compliance with the central purpose also places several limitations on the day-to-day function and operation of a beneficiary project. Fiscal sponsorship requires pre-approval of both the purpose and budget. Further, the beneficiary project must continually demonstrate that its usage of the funds is in in-line with the proposed mission and budget. The sponsor is also given

oversight and supervisory privileges. All three are done in order to protect the sponsor’s 501(c)(3) status. With this oversight, the beneficiary project’s flexibility in achieving its goal may be limited.

2. Sponsor Limitations

As discussed above, the sponsor is limited in providing its service and status to beneficiary projects that share its tax-exempt purpose. In ensuring this, the sponsor incurs substantial responsibility and administrative burdens: managing each project’s funds, keeping their donations separate, making sure that they are adhering to the non-profit guidelines, and overseeing projects. Each beneficiary project taken on by the sponsoring non-profit organization brings new burdens and these increasing burdens create additional strain on the sponsor’s internal resources. Each non-profit organization, accordingly, is only able to enter into a fiscal sponsor relationship with a limited number of groups or individuals.

D. Conclusion

Entering into or creating a fiscal sponsorship can create excellent financial opportunities for an art program, project, or artist wishing to work on a special project. Sponsorship increases the availability of grants and donations, and brings together groups and individuals working towards a common goal. At the same time, sponsorship can impose several limitations. Most notably, it disallows private investors, and work aimed at influencing elections and legislation. It also requires that a beneficiary project/program and the sponsor coordinate their efforts and pursue the same goal, imposing numerous administrative and budget constraints. A program/project must therefore weigh the independence needed, the availability of private investors, and the desire to make a profit from the work, against the need for government, corporate, and individual tax-exempt grants. For the right types of projects, and the right non-profit entities, fiscal sponsorship could provide significant, previously untouched, resources for Michigan artists and art organizations.

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