

# Leveraging Fiscal Sponsorship for Efficient Philanthropy

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Fiscal sponsorship arrangements have become invaluable tools in the philanthropic landscape, enabling charitable initiatives to attract funding swiftly and efficiently without the immediate need for independent tax-exempt status. These arrangements allow donors — whether individuals, corporations, or private foundations — to support nascent or short-term charitable projects in a tax efficient manner. By partnering with an established public charity as a fiscal sponsor, projects can bypass the lengthy process of obtaining IRS recognition of exemption, which can take more than a year, and also bypass the burden of registering as a fundraiser in all applicable jurisdictions with the focus instead being placed on mission-driven work. This structure not only accelerates fundraising but can also reduce risks for certain donors. While fiscal sponsorship models vary, including comprehensive arrangements where the sponsor employs project staff and provides infrastructure, this article focuses on the preapproved grant relationship model.<sup>1</sup> This arrangement offers flexibility for charitable projects on strategic giving, particularly when time is of the essence.

In a preapproved grant sponsorship arrangement, a public charity preapproves a charitable project and agrees to serve as its fiscal sponsor. The process begins when an organization conducting a charitable activity, often at the prompting of donors, applies to become a fiscally sponsored project. The application typically includes the applicant's official charter documents — such as a certificate of incorporation, bylaws, or a trust instrument — and detailed information about the project — its nature, the charitable purpose it advances, the charitable class intended to be helped, the qualifications of those leading it, a project

budget, and fundraising plans. The public charity then conducts due diligence, reviewing the application to ensure that the project serves a valid charitable purpose under IRC Section 501(c)(3) and aligns with the sponsoring charity's own charitable purpose.

If approved, the public charity adopts the project at the board level (or by a committee) and establishes a restricted fund dedicated to it. A restricted fund is essentially a segregated account within the charity's books, where donations are held solely to further the project's charitable purposes, but not specifically for the organization running the project. For example, if the organization running the project becomes insolvent, the sponsoring charity would attempt to redirect the funds to another organization that is carrying out the original project's charitable purposes (or one that is substantially similar).

Next, the applicant and the public charity enter into a fiscal sponsorship grant agreement. This agreement outlines the parties' responsibilities, including the sponsor's role, reporting requirements, and any charges to offset costs incurred by the sponsoring charity for its fiscal oversight. Donors contribute to the public charity, designate their gifts for the restricted fund, and receive a charitable deduction for their contribution. This setup allows the project to benefit from the sponsor's tax-exempt status and registration at the state level as a fundraiser while maintaining operational independence. It is important that

the sponsoring charity inform donors that the charity has ultimate discretion and control over the donated funds and the ability to redirect funds to another organization to carry out the project's purpose. If the charity fails to retain such discretion, donors run the risk of having their charitable deductions denied as their donations may be deemed made to the organization running the project instead of to the IRC Section 501(c)(3) sponsoring charity.<sup>2</sup>

The sponsoring charity then makes periodic grants from the restricted fund to the entity running the project. These grants are typically net of any administrative charges, provided that such entity meets its obligations under the fiscal sponsorship grant agreement. Finally, the project reports back to the sponsor at least annually, detailing expenditures and progress to confirm that the sponsor's grant funds have been used appropriately. This accountability ensures transparency and confirms adherence to the terms of the fiscal sponsorship grant agreement. In some cases, large donors may require reports from the sponsor, which would incorporate the project's reports to the sponsor.

Preapproved grant arrangements are particularly useful in scenarios where traditional exemption pathways are impractical or time sensitive. For instance, consider a startup organization aspiring to public charity status with a mission to educate the public about liver health and overall wellness. The group has not yet filed Form 1023 for

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IRS recognition of exemption and lacks fundraising registration in key states. Without tax-exempt status, it struggles to attract significant donations as donors cannot guarantee charitable deductions. Facing urgent operational costs, the organization applies to a sponsoring charity to become a fiscally sponsored project. Once the sponsoring charity has approved the project and the parties have entered into a fiscal sponsorship grant agreement, donors can then contribute to the charity and designate gifts for the project's fund. The sponsor then makes grants to the sponsored organization out of the donated funds to cover the project's educational campaigns, workshops, and outreach. This allows the project to launch immediately while the organization pursues independent exemption, bridging the gap without delaying impact.

In another scenario, a local Rotary Club operates a food pantry to feed needy individuals and families in the area. A private foundation expresses interest in providing substantial funding for the food pantry but hesitates granting the funding to the Rotary Club because it is not organized as an IRC Section 501(c)(3) public charity. Therefore, the foundation would need to follow a special set of oversight procedures known as "expenditure responsibility" in making the grant to avoid tax penalties. These special oversight procedures require the foundation to conduct a pre-grant inquiry (due diligence), enter into a detailed grant agreement containing certain terms required by regulations, verify the grantee's use of funds by requiring it to submit ongoing narrative and financial reports until all funds have been spent, and report pertinent grant details on its annual return. These are all tasks that the foundation lacks experience with; therefore, it views this funding approach as risky because failure to follow all of

the procedures as required can result in steep penalties.<sup>3</sup>

The Rotary Club proposes a fiscal sponsorship arrangement with a local public charity experienced in food insecurity programs. The charity reviews the pantry's operations, budget, and other details, adopts the Rotary Club's food pantry as a fiscally sponsored project, and sets up a restricted fund for it. The private foundation donates to the charity, without the need for expenditure responsibility, specifying that the donation is intended to be used for the charity's food pantry fund. The charity uses the donated funds to make grants to the Rotary Club to cover the food pantry project's expenses. Annual reports from the Rotary Club regarding the food pantry project ensure fiscal oversight while reducing the foundation's exposure.

Another example involves a production company filming a documentary on school bullying and prevention strategies. As a finite project ending with the film's completion, seeking IRC Section 501(c)(3) tax-exempt status is inefficient and costly. Yet, without tax-exempt recognition, donors cannot deduct contributions, thus hindering fundraising for production costs like filming, editing, and distribution. The production company applies to a fiscal sponsor, and the sponsor conducts its due diligence, which includes an analysis of whether the grant would result in any impermissible private benefit to the production company. In considering the benefits to both the production company and the general public, the fiscal sponsor concludes that a grant to the production company truly is the best way to accomplish the stated charitable purpose and that any benefit to the production company is outweighed by the benefit to the general public. After completing its due diligence, the sponsor

approves the project, establishes a restricted fund for it, and enters a fiscal sponsorship grant agreement with the production company.

Donors are then able to make tax-deductible gifts to the charity's documentary film fund. The sponsor periodically grants funds raised for the documentary to the production company and requires regular progress and financial reports on expenditures made from grant funds. As previously described, this structure allows the filmmakers to focus on content while leveraging the sponsor's tax-exempt status, ensuring that the film's educational message reaches schools and communities rapidly and efficiently.

In conclusion, the preapproved grant arrangement empowers advisors to guide clients toward impactful philanthropy without unnecessary delays, administrative burden, the expense of applying for recognition, or complexities, while mitigating risk for certain donors. These arrangements not only facilitate rapid tax-deductible funding for charitable projects, but they also hold the project accountable to the sponsor while enabling the project to retain operational independence. As the philanthropic sector evolves, embracing such tools can transform innovative ideas into tangible societal benefits.

## End Notes

<sup>1</sup> This is often referred to as a "Model C" fiscal sponsorship. See Colvin, G. L. and Petit, S. L., *Fiscal Sponsorship 6 Ways To Do It Right*. 3rd ed. (San Francisco Study Center, 2019).

<sup>2</sup> See Rev. Rul. 63-252, 1963-2 C.B. 101 and Rev. Rul. 66-79, 1966-1 C.B. 48.

<sup>3</sup> Per IRC Section 4945, a 20 percent penalty applies to grants made by private foundations to organizations that are not recognized or treated as public charities where the foundation has not exercised expenditure responsibility.