

**National Network of Fiscal Sponsors
Los Angeles November 8, 2012
Outline of Presentation by Greg Colvin, Esq.**

“Brushes with the Law”

1. Possible attention from the Internal Revenue Service

The June 2012 ACT (Advisory Committee on Tax Exempt and Government Entities) report to the IRS earlier this year, recommended promotion of fiscal sponsorship as an alternative to new Form 1023 tax-exemption applications; the full report is here. <http://t.co/5YdOln4m>. The excerpt below is from pages 34-35 of the Exempt Organizations portion of the report.

Also, in the wake of Hurricane Sandy, the IRS (Announcement IR-2012-87) is encouraging use of existing organizations as another pathway besides setting up new 501(c)(3) entities. The IRS said this after Hurricane Katrina, too.

2. Implications of IRS Notice 2012-52, allowing 501(c)(3)s to have subsidiary LLCs for liability protection, receiving deductible donations directly from the public. See <http://www.nonprofitlawmatters.com/2012/08/09/irs-issues-guidance-on-the-deductibility-of-donations-to-llc-subidiaries-of-section-501c3-organizations/>

3. Filling out IRS Form 990: Do's and don'ts, critical accounting data points (restricted and unrestricted funds)

4. Donor-advised funds -- Do you have them? Do you know whether you do?

- a. Definition of a donor-advised fund under IRC 4966, and exceptions.
- b. Consequences (no distributions to natural persons, no benefits to donors, etc.)

- c. Not a problem if:
 - 1) Multiple donors
 - 2) Donor (or representative) has no advisory privileges over use of funds
 - 3) Payments go only to a single identified entity (Model C)
 - 4) Funds used to pay people are handled outside of the DAF
- d. A project can be a DAF: if a single donor, if on the advisory committee, etc.

5. **Increased attention to charitable trust doctrine** under state law. New recommended language for fiscal sponsor agreements:

“Because the restricted fund is held under the charitable trust doctrine for the purposes of the Project as understood by and with funding sources, the parties intend that assets in the restricted fund are not subject to the claims of any creditor or to legal process resulting from activities of Sponsor unrelated to the Project.”

6. **Fiscal sponsor collapses and governmental responses (California and other states)**

a. International Humanities Center, Los Angeles, see <http://www.nonprofitlawmatters.com/2012/02/16/doing-right-by-the-projects-fiscal-sponsorship-after-ihc-2/>

b. Other examples (e.g. Help Is Here)

c. Legislation in California: AB 2327

- 1) attempt to define & regulate fiscal sponsorship (NOT enacted, but a close call)

12599.8. (a) Any fiscal sponsor organization shall carry directors' and officers' insurance and shall provide proof of this insurance to the Attorney General.

(b) For purposes of this section, the term "fiscal sponsor organization" means a nonprofit organization that has qualified for a tax exemption under Section 501(c)(3) of the Internal Revenue Code and manages assets of one or more not-for-profit organizations.

2) final language: protection of restricted funds dedicated to projects and insurance requirement

SEC. 3. Section 12599.8 is added to the Government Code, to read:

12599.8. For any year that the balance sheet of a charitable organization shows that it holds restricted net assets, while reporting negative unrestricted net assets, the organization shall provide an explanation of its compliance with its charitable trust responsibilities and proof of directors' and officers' liability insurance coverage to the Attorney General's Registry of Charitable Trusts.

7. **California Attorney General audit experience** (no names)

4. The IRS should coordinate with the Department of the Treasury and the Office of Chief Counsel on the issuance of precedential guidance about the use of tax-compliant alternatives to the creation of new Section 501(c)(3) organizations, such as fiscal sponsorships and donor-advised funds.

A concern expressed by some practitioners and state charity regulators is that many organizations may seek recognition of exemption under Section 501(c)(3) without exploring possible alternatives that might be more appropriate in light of their goals and objectives. The number of Section 501(c)(3) organizations that lost exemption as part of the Form 990 automatic revocation process and have not applied to regain exemption reinforces these concerns. Our sense is that many small nonprofit organizations obtain recognition of exemption under Section 501(c)(3) to carry out activities of relatively short-term duration. Examples include organizations created to receive memorial contributions or to raise funds for a specific short-term project—such as providing assistance following a local disaster, or construction of a new playground or dog park.

In these cases, the objective is to establish a vehicle to receive charitable contributions for a specific, time-limited purpose and not to create an organization that is intended to operate into the future. After these small, typically volunteer-run organizations navigate the Form 1023 process and obtain recognition of exemption, they may well run into a variety of tax compliance issues brought on by their lack of infrastructure and resources. These compliance issues may include failure to file the required Form 990-EZ or Form 990-N, failure to issue Forms 1099 or to comply with other federal or state tax requirements, or failure to comply with state charitable solicitation requirements. And, as noted, the organizations may be more vulnerable to fraud or theft because they lack basic internal controls.

There may often be alternative structures that could better serve the needs of these organizations—if only they knew about them. For example, community foundations and other sponsoring charities typically offer donor-advised fund options that may meet the needs of families who want to create a charitable fund to receive memorial donations. They may also act as fiscal sponsors for charitable projects in the community, such as playgrounds or dog parks, as could other like-minded Section 501(c)(3) organizations. Either of these options—setting up a donor-advised fund or a fiscal sponsorship with an existing Section 501(c)(3) organization—offers many advantages. These organizations have the ability to receive charitable contributions for specific projects, the infrastructure to ensure compliance with applicable federal and state laws and adequate internal controls to ensure that the funds will be used for the intended charitable purposes.

The IRS has recognized the value of working through existing charitable organizations rather than creating new ones in the context of disaster assistance. IRS Publication 3833 notes that in the immediate aftermath of a disaster or emergency situation, "those who wish to provide help may overlook existing charities and spend precious time and resources establishing a new charitable organization and applying for tax-exempt status." The publication also observes that

"it may be more practical to combine resources with those of an existing charity," or to "see whether an existing charity operating in a related area may be interested in establishing a special program" to address the concern at hand.

We commend the IRS for offering this type of practical advice, which may help minimize the creation of new disaster relief organizations whose purposes can be equally or better served by existing organizations. The ACT believes that the IRS can and should do this in a broader context by including language along the lines of that contained in Publication 3833 in the instructions to Form 1023.

In addition, the IRS should coordinate with Treasury and the Office of Chief Counsel about the issuance of precedential guidance on the appropriate use of fiscal sponsorship arrangements. While our context for this suggestion is to minimize the unnecessary creation of Section 501(c)(3) organizations, we note that such guidance is frankly needed in any event. Although fiscal sponsorship arrangements are often used for large and sometimes complex projects, the only precedential IRS guidance in this area has to be gleaned from a 1966 revenue ruling issued in the context of "American Friends" organizations.⁴¹ This ruling is more than 45 years old, and in the intervening decades fiscal sponsorship arrangements have become a significant part of the Section 501(c)(3) landscape. Most of the guidance in this area comes from a book published at the behest of several Section 501(c)(3) organizations in California that recognized both the potential for abuse and the need for guidance in this area.⁴² From a tax compliance perspective, 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.

⁴¹ Rev. Rul. 66-79, 1966-1 C.B. 48.

⁴² GREGORY L. COLVIN, FISCAL SPONSORSHIP: SIX WAYS TO DO IT RIGHT (2d ed., Study Center Press 2005).