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BLOG POST

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Model C Fiscal Sponsorship: The More Formal, the Better

Model C fiscal sponsorships, where a public charity enters into a pre-approved grant relationship with an unrelated individual or organization, may be less common than Model A direct-program sponsorships, but they do offer some advantages, including the possibility of limiting a sponsor's liability for project activities.

Unfortunately, they also pose a number of traps for the unwary, and a recent private letter ruling by the IRS provides a cautionary example.

In PLR 201138050 (June 21, 2011), the IRS determined that an organization formed as a "friends of" charity did not qualify for exemption under Section 501(c)(3). Although in fact the charity was intended to benefit a specific foreign school, the exemption application said that the organization would make pre-grant inquiries on all grantees and would establish procedures to ensure that grant funds were used in furtherance of its exempt purposes, among other things. The problem, however, was that the organization never actually did what it promised: it failed to document any pre-grant inquiries into the sole grantee, its board never met, outsiders had check-signing authority on bank accounts, and there were no records showing that it monitored the grantee's activities. Consequently, there was little evidence that the "friends of" charity was anything more than a conduit for contributions to the foreign school.

So what does this PLR have to do with Model C fiscal sponsorships? Unlike the more standard grant situation—for example, where a foundation solicits grant proposals, investigates candidates, and awards grants—a "friends of" charity and a Model C sponsor usually have a much closer and informal connection to the grantee. In this situation, any number of things can go wrong:

- Donors may be told to write checks directly to the project organization.
- Project staff might be given authority to sign checks directly on the sponsor's accounts.
- Fundraising material may neglect to disclose the fiscal sponsorship.
- The sponsor may fail to obtain periodic written reports from the project.

After all, why bother reviewing quarterly activity reports when you can simply walk down the hall and talk to project staff in the space they rent from you? And isn't it easier to tell donors to write their checks to the project they're familiar with and want to support?

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While it's true that the situation considered in PLR 201138050 was extremely egregious, it does underline something crucial: in both a "friends of" arrangement and a Model C fiscal sponsorship, the charity ***must*** have meaningful discretion and control over the funds it receives in support of the grantee. If the charity doesn't observe the cumbersome but essential grantor-grantee formalities that are necessary for maintaining this discretion and control and for avoiding public confusion, the charity runs the risk of becoming a mere conduit for donations from the public to the grantee. When this happens, charitable deductions for contributions could be disallowed, and private foundations could find that their grants to support the project were not made to a proper public charity.

This doesn't necessarily mean that every Model C sponsor needs to demand extensive reports from its projects, or suppress any mention of a project's name in public fundraising appeals. It does mean, however, that sponsors should be wary of having a too-informal arrangement with their Model C projects. In particular, donation checks should always be written to the sponsor, not to the project, and all fundraising materials should clearly identify the sponsored status of the project.

Ultimately, Model C fiscal sponsorships can be extremely useful, but not at the risk of jeopardizing the sponsor's tax-exempt status.

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