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# Successor Liability in a Model A Fiscal Sponsorship

Fiscal sponsorship can be ideal for startup charitable projects: operating under the aegis of an existing charity, organizers can test-run a concept before going through the expensive, time-consuming process of applying for exemption under Section 501(c)(3). But there may be reasons for sponsors to take in established projects as well. For example, organizers may find after several years of running a charity that the administrative burden is too great and takes too much of their time away from valuable program work, and they may decide to become a fiscally sponsored project instead. Or a group that has been informally conducting charitable activities for several years may want access to tax-deductible contributions, but might shudder at the thought of spending the time and expense to file for exemption. (For a complete overview of sponsorship models, see Gregory Colvin's book, *Fiscal Sponsorship: 6 Ways To Do It Right*, available at San Francisco Study Center.)

In these situations, the prospective sponsor needs to take certain precautions, especially with regard to potential liability. In the for-profit context, when a company acquires a company or a division of a company through means other than a merger and nonetheless is found liable for its past operations, this concept is known as "successor liability," and there are a number of well-established factors that a court will examine in conducting the analysis. For example, courts generally examine whether the purchaser has explicitly or implicitly assumed liabilities in the asset-purchase agreement. Also, a court will look at whether the purchaser continued to operate the same business as the seller, and whether the purchasing corporation is a mere continuation of the seller, by virtue of having the same employees or holding itself out to the public as continuing the seller's business. To my knowledge, there is no case law applying these factors in fiscal sponsorship, but it is definitely possible that a court could apply them here as well, particularly since the standard factors are strikingly analogous to what happens when a charity takes in an existing program under a Model A sponsorship.

How, then, can a new sponsor protect itself? The most obvious way—a Model C pre-approved grant relationship, where the sponsor has no more liability than a traditional grantor—may not be appropriate or desirable in some cases. Requiring indemnification by the transferor may not be helpful either, since the transferring charity or group is likely to become defunct after the transfer.

There are, however, several strategies. First and foremost, the sponsor should conduct thorough due diligence on the transferring charity's operations, and should discuss with an insurance broker what coverage may be available to manage the risks from various types of liabilities. Second, the sponsor can require indemnification by project principals

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themselves. Also, the sponsor should expressly disclaim any assumptions of liability in the transfer agreement, although the efficacy of doing so may be limited. Where the potential for unforeseen liabilities is especially acute, the sponsor might consider setting up a Model L sponsorship, where the project assets and operations would be transferred into a limited liability company wholly owned by the sponsor. (For more information on Model L, please see The Use of LLCs in Fiscal Sponsorship A New Model, *Taxation of Exempts*, May/June 2011, by Steven Chiodini and Gregory Colvin).

Hopefully, the instances in which a new fiscal sponsor faces claims of successor liability in these situations may prove uncommon. Nonetheless, it is certainly possible that the appearance of a sponsor with ample resources could inspire claimants to come out of the woodwork. As the saying goes, an ounce of protection is worth a pound of cure.



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