The Philadelphia Cultural Fund

Fiscal Sponsorship Guidelines and Grant Eligibility

The Philadelphia Cultural Fund (the "Fund") is a nonprofit corporation established by Philadelphia's Mayor and City Council in 1991 to support and enhance the cultural life and vitality of the City of Philadelphia and its residents. Grants are made from the City budget allocation to the Fund for operating support of Philadelphia-based arts and cultural organizations.

With limited resources, the Fund strives to use its funds in impactful ways to foster a vibrant and healthy community (one that, in particular, is artistically and culturally enriched). The Fund recognizes the importance of fiscal sponsorship arrangements, and the role that fiscal sponsors can play in providing operational support. Specifically, fiscal sponsorship arrangements leverage the nonprofit sector's limited resources and help to ignite and sustain creative initiatives that may not otherwise exist, or would struggle without the infrastructure that fiscal sponsorship arrangements can offer. By providing incubation and/or back office services, fledging and well-established initiatives can be well served by fiscal sponsorship arrangements.

Fiscal sponsors have the potential to provide valuable services that collectively benefit and conserve the assets of the City's arts and cultural community. But fiscal sponsorship is also widely misunderstood, and if not implemented properly, these relationships can undermine the strength of this community.

As a grantmaker, the Fund believes it has a stewardship obligation to ensure that the funds it awards to grantees through fiscal sponsors are used responsibly and efficiently and in accordance with relevant laws and nonprofit compliance standards.

The Fund recognizes the importance of avoiding misunderstandings among all parties involved in fiscal sponsorship. Toward these purposes, the brief overview below provides some background about fiscal sponsorship arrangements and explains how the Fund evaluates these arrangements to ensure that the Fund's grantees, and the fiscal sponsors with which they affiliate, are leveraging their relationships to strengthen the City of Philadelphia's arts and cultural community.

Overview of Fiscal Sponsorship

Fiscal sponsorship is a formal legal arrangement through which a 501(c)(3) organization (a "Sponsor"), consistent with and in furtherance of its own exempt purposes, commits to providing support to a specific charitable project (a "Project"). Generally, the array of services offered by a Sponsor is designed to strengthen and sustain Projects. Services provided by Sponsors are typically those necessary for any successful enterprise, including accounting, bookkeeping, legal, HR, marketing, research and development, asset management, leadership support, and unique to the nonprofit sector: the acceptance of charitable contributions in support of Projects. This service menu is by no means an exhaustive list of all of the services Sponsors provide, and services provided vary in each arrangement depending on the Sponsor, but most fiscal sponsorship arrangements have a common denominator: the Project seeks out the Sponsor so that it may raise funds from donors who wish to make tax-deductible charitable contributions to a 501(c)(3) organization.

Such a premium is placed on this attribute (accepting charitable contributions) that it has come to define for many the essence of fiscal sponsorship, and often is the primary reason for entering into these relationships. The industry emphasis on this attribute, coupled with the fact that fiscal sponsorship arrangements are so commonly misunderstood, can disadvantage grantees. For one thing, the suite of other services, which are critical for sustainability and efficient use of charitable funds, can be overlooked. Projects also tend to overlook their own legal obligations, assuming that these are taken care of by the Sponsor. It is not uncommon for Sponsors to misunderstand their role in the relationship. Consequently, the perception of many in the funding community is that funding Projects through fiscal sponsorship arrangements offers less opportunity for impactful giving.

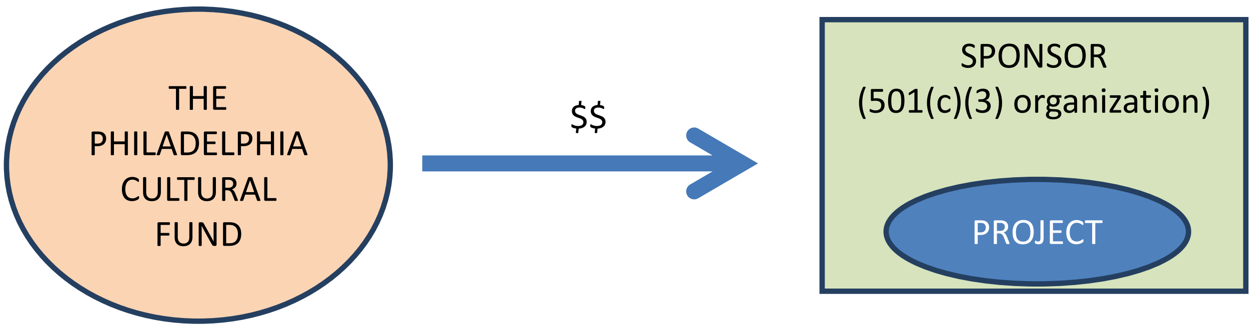
While the Fund recognizes frustrations with the fiscal sponsorship model, it believes that support of Projects through fiscal sponsors is critical to its mission. The Fund is committed to supporting valued arts and cultural initiatives, regardless of their corporate structures or tax-exempt status. The Fund will continue to make grants to Projects through Sponsors, provided the fiscal sponsorship arrangements meet standards established by the Fund. **Please contact the Fund for a list of preapproved sponsorship programs or if your organization wishes to become a fiscal sponsor.**

Common Models of Fiscal Sponsorship

One common misconception about fiscal sponsorship arrangements is that there is only one purpose to the arrangement: to re-grant funds to an entity that does not yet have its own 501(c)(3) status. In fact, fiscal sponsorship relationships can be structured in a number of different ways, depending on the needs and nature of the Project. They can be established for a finite period (e.g., until the Project obtains its own tax-exempt status), or can exist indefinitely.

The three most common models (including the re-granting model) are discussed below. Some models allow Project leaders to focus primarily on program activity, rather than administration. Other models create an independent contractor relationship between the Sponsor and the Project. In no instance can a Sponsor act merely as a pass-through or conduit for funding the Project. Regardless of how the relationship is structured, the Sponsor must retain control over the flow of contributions and grants.

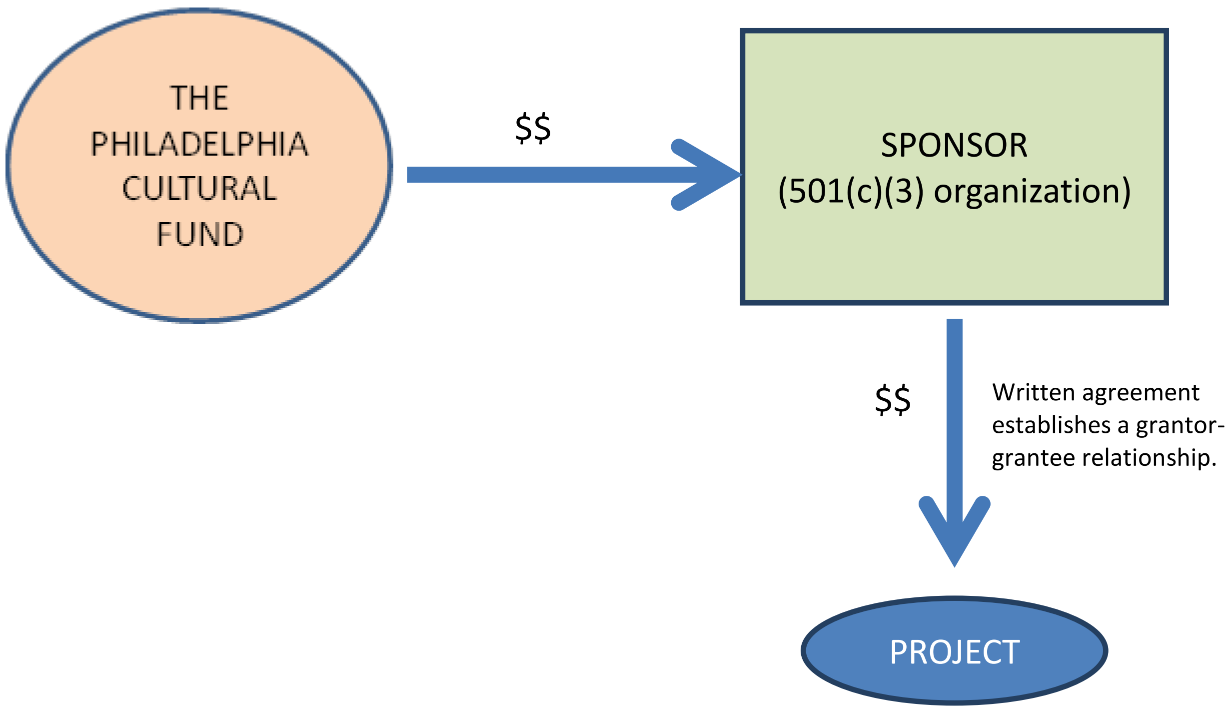
1. <u>The Charitable Program Model</u>



Under the Charitable Program model, the Project (which was initiated as an external project) is an in-house project of the Sponsor. From the Project's perspective, this model is relatively simple to implement and administer. It allows the Project's personnel and resources to focus primarily on programmatic activity. From the Sponsor's perspective, the Sponsor will have control over the Project's funds, and ultimately over the Project's program or product itself. The Project's assets and liabilities become the Sponsor's assets and liabilities, and the Sponsor is responsible for reporting the Project's financial information on the Sponsor's tax returns. The Sponsor also assumes responsibility for the Project's employees, including compensation, benefits, and reporting requirements.

Generally, the Sponsor retains control over all work conducted on the program by the Project and ownership of the program itself. The Sponsor essentially absorbs the Project into its operations, which has the potential to create tension between these two parties. However, the structure of this relationship is flexible in duration, making it a good model for both short-term and long-term collaborations, and good communication and agreement on program objectives between the Project and the Sponsor can help avoid these tensions. A written agreement should be created spelling out the details of this arrangement.

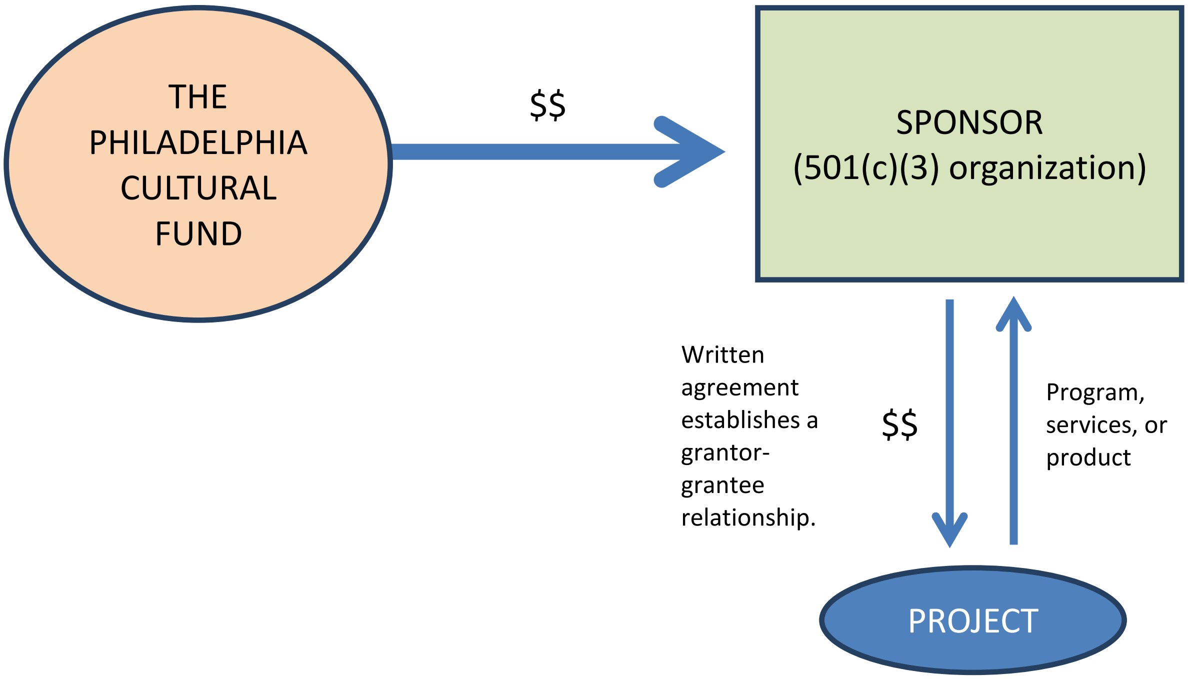
2. <u>The Re-Granting Model</u>



The Re-Granting Model is a granting relationship between the Sponsor and the Project. The Project may request contributions from funding sources in the name of the Sponsor. The funding source's contributions are then re-granted to the Sponsor. The Sponsor maintains complete discretion over the funds and may choose not to re-grant the funds to the Project if certain conditions are not met, or if the Project's activities jeopardize the 501(c)(3) status of the Sponsor. In this model, the program, along with its assets and liabilities, ultimately belongs to the Project and not the Sponsor. The burden is on the Project to maintain its own tax reporting and fulfill other state and IRS compliance requirements. Each party maintains its separate identity and operation. The Sponsor may still, however, choose to offer support services to the Project such as those described in the Overview section. A written agreement should be created spelling out the roles of each organization.

The Re-Granting Model may come under greater scrutiny by the IRS to ensure that the Sponsor is not acting merely as a conduit for the Project to accept tax-deductible contributions. The Sponsor must exercise sufficient control over the funds and cannot simply accept contributions earmarked specifically for the Project. Lack of discretion can jeopardize the Sponsor's 501(c)(3) status and preclude donors' charitable deductions.

3. Independent Contractor Relationship



Unlike the Re-Granting Model, under this relationship, the Sponsor owns the program or product and then contracts with the Project to create or operate it. In that respect, the Project is an independent contractor of the Sponsor. Like the Re-Granting Model, this relationship preserves the independence of both organizations while allowing the Sponsor to leverage the Project's skills and expertise. This model is well-suited for a single or short-term project. Both entities are responsible for filing their respective tax returns.

This model has some potential pitfalls as well. The Sponsor must determine whether the Project can be classified legally as an independent contractor. The IRS has a multi-factor test to determine whether an individual or entity should be classified as an independent contractor or an employee. Once it is determined that the Project qualifies as an independent contractor, a written agreement describing the relationship between the two organizations should be created. Even if a contractor agreement is in place, private benefit issues could arise if there is shared ownership of assets. Ownership of the program or intellectual property could also potentially default to the Project, as contractor, if ownership is not agreed to in writing.

Requirements for Approval as Fiscal Sponsor

In order to foster healthy fiscal sponsorship arrangements, the Fund requires that certain actions be taken and policies put in place by the Sponsor in order to be eligible for grants from the Fund. Below are the Fund's mandatory criteria for Sponsors to receive Fund grants:

1. <u>Written Agreements</u>

All fiscal sponsorship arrangements between a Sponsor and Project must be detailed in a written agreement that must address the following, as applicable:

- The agreement must identify the Sponsor and the Project, with a description of the legal entity status of both, as well as explain the objective of the fiscal sponsorship arrangement;

- The agreement must clearly set forth any fees charged by the Sponsor and any services it will provide to the Project;

- The agreement must contain a written disclosure explaining that the Project may have its own legal obligations and filing requirements;

- The Sponsor must agree to comply with any and all IRS reporting requirements and state and federal employment laws and regulations, and will be held legally accountable should it fail to do so;

- The agreement must require that both the Sponsor and the Project (as applicable) are registered for charitable solicitation in the Commonwealth of Pennsylvania and any other state as required by charitable solicitation laws;

- The agreement must state that the Sponsor retains full legal ownership of, and discretion and control over, funds contributed to the Sponsor for the purposes of the Project;

- The agreement must set forth the reporting requirements of the Sponsor and Project to each other and to the Fund (see Section 3: Reporting and Accountability);

- The Sponsor must agree not to use funds dedicated to Project purposes for its own activities or operations, and must agree to keep Project funds in a separately identified account.

- The agreement must detail all funds the Sponsor will provide to the Project, and any restrictions or terms imposed on the distribution of those funds;

- The agreement must detail ownership interests retained by the Sponsor and Project regarding any programs or products created through the fiscal sponsorship arrangement;

- The agreement must specify the duration of the fiscal sponsorship and terms for terminating the arrangement; and

- All signatories to the agreement must be authorized representatives of the Sponsor and the Project.

In addition, the following additional criteria are required depending on the fiscal sponsorship arrangement:

- If undertaking a Charitable Program Model, the agreement must set forth the Sponsor's responsibility for the Project's employees, tax filing requirements, and legal liabilities. The Sponsor and the Project must have clearly defined terms of separation.

- If undertaking a Re-Granting Model, the Project must agree that grant funds provided by the Sponsor will be used solely for tax-exempt purposes and will not provide a private benefit to any individual. The agreement must also state that the Sponsor has the legal right to withdraw financial support for the Project and re-direct the funds to other purposes.

- If undertaking an Independent Contractor Model, the Sponsor must acknowledge that the Project is properly classified as an independent contractor.

If you need a template for an agreement between fiscal sponsor and project, PCF will provide one for you that can be customized for your purposes. However, it is recommended that once complete, you have an attorney review the agreement.

2. Overhead Fees

- The Sponsor may only charge Projects reasonable fees commensurate with the services it will provide. If the Sponsor is merely re-granting funds to the Project, the overhead fee may not exceed 7% of the total funds collected on behalf of the Project. If the Sponsor is providing additional services to the Project, such as accounting or back office administration, the total fee collected by the Sponsor may not exceed 15% of the total funds collected on behalf of the Project.

3. Reporting and Accountability

- Within 60 days after all grant money has been expended, a final report of 1-2 pages must be provided to the Fund summarizing actual expenditures from the grant funds and the progress toward accomplishing the objectives for which the grant was made. Depending on the fiscal sponsorship arrangement, responsibility for providing the final report may be shared between the Sponsor and Project.

- The Sponsor must provide the Fund with written documentation of its 501(c)(3) tax-exempt status and affirm in writing that it is not being reviewed or challenged by the IRS or any other state or federal agency.

- If re-granting services, the Sponsor must agree to provide donors with the required charitable gift acknowledgements, and that it will provide the Project with an accounting of all funds received from donors.

4. Sponsor Governance

- The Sponsor's Board must pass a Resolution approving the fiscal sponsorship arrangement (as expressed in the written agreement) with the Project.

- The Sponsor must have a conflict of interest policy in place that contemplates conflicts with sponsored Projects and their leadership, and provides clear direction for vetting potential conflicts and otherwise implementing the policy.

- The Sponsor must have a written mission statement and adhere to high standards of integrity in acting as a steward for funds entrusted to it for the public benefit.

- The Sponsor must maintain sufficient financial resources to assure continuous, uninterrupted operation, and employ procedures and internal controls that are based on generally accepted financial and accounting principles and regulations.

- The Sponsor must evaluate the capability, potential, experience, and integrity of Project leaders to assure a constructive, mutually respectful working relationship between the Sponsor and the Project.

- The Sponsor’s Board of Directors must adhere to the highest standards of legal and fiduciary responsibility in its policy-making and governance of the organization.