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## **Not-for-Profits Helping Other Organizations “Fiscal Agency”**

**KLR Not-for-Profit Services Group**

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## **Not-for-Profits Helping Other Organizations “Fiscal Agency”**

One of the unique attributes of the not-for-profit sector is the willingness of organizations to help others. While the business world seldom, if ever, sees General Motors assisting Toyota, operating relationships are abound in the not-for-profit world. These are referred to by a number of names: fiscal agent, sponsoring organization, financial intermediary, fiscal sponsorship, etc.

This practice is so pervasive that if you perform an internet search for any of these terms, you will find results for each. Unfortunately, much of this information usually does not sufficiently emphasize the important considerations you must review before going forward with such a relationship.

In addition, some sources indicate there is a difference between the different terms such as “fiscal sponsorship” and “fiscal agency”. We believe this is inaccurate – the essential ingredient is the same in all of them. Some organizations with tax-exempt status are accepting funding for a program or project that is going to be conducted by and individual or group that is not tax-exempt. If this is something that is occurring at your organization, this whitepaper is important to you. This whitepaper will further examine the most significant aspects of these relationships.

## **Legal Entity**

The first concept that needs to be understood is that of the legal entity. While in a free society such as ours, the formation of a business or a company is a relatively easy process, it does not diminish the difference between a legal entity and something else that is not an entity (legal or otherwise).

A legal entity is a legal construct through which the law allows a group of natural persons to act as if they were a single person for certain purposes. The formation of a legal entity is a matter of law. KLR is not providing legal advice and we encourage all who want to form a legal entity to seek the appropriate legal counsel.

The most common form of legal entity in the U.S. is the corporation and it has the most specific rules of formation which are governed by each state. Most not-for-profit organizations in the U.S. are corporations.

A company is either a legal entity or it is not. While it is in the process of formation as a legal entity, it is not yet a legal entity. In most cases, a “fiscal agency” relationship is between a legal entity and a group that is not yet a legal entity. See the essential ingredient discussion above.

**Fiscal Agent – etc.**

Although the term “fiscal agent” is used frequently in the not-for-profit sector, it actually has no recognized status or common definition in the legal system or with the IRS.

Frequently the fiscal agent relationship is between an established not-for-profit organization and another group (or individual) which is not a legal entity. The typical situation involves a not-for-profit, charitable, tax-exempt organization that receives funds from a resource provider for the benefit of an individual or organization which is not tax-exempt. That other group usually has a project or program that it will address and for which it has found funding from a resource provider or group of donors.

While the resource provider is willing to support the request for funds, it is unable or unwilling to make the grant directly to the soliciting individual or group. The fact that the group may be in the process of formation and has requested IRS recognition of its tax-exempt status is irrelevant. Until this process is complete, the organization or group is not yet a tax-exempt legal entity. If the organization has partially completed the process, it may be a legal entity (e.g. a corporation), but its tax-exempt status is still unresolved. In almost all situations, it is the tax-exempt status of the established entity that is the reason for the other group to seek a fiscal agency arrangement.

In our opinion, the fact that this relationship has a recognized name (“fiscal agency”) is unfortunate. Fiscal agency or any of the other terms referred to at the beginning of this whitepaper applies a veneer to a relationship that makes it appear more substantial than it is in reality. At the end of the day, what you have is an established charitable organization with tax-exempt status accepting funding restricted for a specific project. The “fiscal agency” veneer frequently hides this fact. In this whitepaper we want to remove this veneer and discuss the reality.

**Fiscal Agency – The Reality**

When a not-for-profit, charitable, tax-exempt organization accepts funds, it is accepting total responsibility for the use of those funds --Total Responsibility. If those funds have been restricted to a specific purpose by the donor, the organization is obligated to comply with those restrictions. How those funds are expended is ultimately the responsibility of the recipient organization.

The absolute first question that a potential fiscal agent must ask is whether the purpose for which the funds were given is a purpose consistent with its own tax-exempt purpose and/or mission. The cornerstone of the not-for-profit, charitable, tax-exempt organization is that its operations are confined to its tax-exempt purpose. The new funding and the related expenditures must be reported as part of the revenues and expenses of the recipient organization. If the new activity lies outside of that organization’s tax-exempt mission, this may create an issue with the IRS. (An educational organization cannot operate a historic preservation project even though both are viable tax-exempt missions.)

There is no place on the annual IRS Form 990 to disclose a fiscal agency arrangement. The Form 990 requires you to report all revenues and all expenditures. There is no exclusion for fiscal agency arrangements.

Once the recipient organization – the fiscal agent - recognizes that this new activity is part of their own organization's operations, it should then address all of the business issues it has with any other phase of its operations. These include, but are not limited to, employee compensation, benefits and insurance concerns as well as liability insurance issues related to the new activity.

Everyone receiving a paycheck is your employee. There are no employees of the “other program” who are different from “your” employees. All employees must be treated equally – compensation, overtime, fringe benefits, retirement, insurance, etc. People working in the “other program” cannot be treated as subcontractors if they qualify as employees. These are only the most obvious issues, but hopefully you are getting the message.

Remember that your organization is responsible for all of the funds and all of the activities of the new program. You are the legal entity and everything that occurs within your legal entity is your responsibility. Compliance with laws and regulations is the responsibility of the legal entity and cannot be delegated to the “other group”. You absolutely must exercise oversight over this project to the same extent you do over your own programs, employees and volunteers.

The reality is that for legal, accounting, payroll, etc., purposes, there is no “other program”. As we said above, fiscal agent has no recognized status or common definition in the legal system or with the IRS.

## **Other Thoughts**

Assuming you are interested in serving as a Fiscal Agent, presumably you believe the new activity (which, as noted above, must be close to your own mission) is worthwhile. Why not ask the new group or individual bringing you the fiscal agent opportunity to become a part of your organization and abandon the thought of creating an entirely new legal entity in which to operate this program? Instead of fostering a new organization, embrace a new program that can operate more efficiently and effectively within your organizational infrastructure.

In addition to this whitepaper, you should review the materials available on the internet. There is a great deal of practical advice on contracts, memorandums of understanding, operational issues, etc., that you should consider as you move into one of these relationships.

Our purpose in writing this whitepaper was simply to help you consider the issues you must consider **before** you decide to enter into a fiscal agency relationship and which may also guide you as you work out operational issues if you decide to move forward. Once you do decide to go forward there are still a number of housekeeping issues to attend to.

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\*Please note that this whitepaper is a general summary of the law and omits many important details, footnotes and caveats. It is no substitute for informed advice from a tax professional based on your particular circumstances.

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