

Grants Managers Network 5th Annual Conference

Fiscal Sponsorship & Intermediary

Grantmaking - A Trap for the Unwary

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With you today

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Speech Credit

This presentation is based in substantial measure on a publication by the Council on Foundations entitled: *Use of Fiscal Agents: A Trap for the Unwary*

Strange History of the Term: “Fiscal Agent”

- Not found in IRC or in regulations
- Legitimate meaning? – 3rd party contractor to assist with financial accounting
- “What you use when you can’t make a gift or grant directly”
(??)
- Edie definition = Laundering Agent

The Basic Rule

- A to B “earmarked” for C = A to C
- Earmarking is defined as an oral or written agreement whereby A requires B to transfer the funds to C
- Exception: No earmarking and B “exercises control, in fact, over the selection process” and makes the selection independently

Two Corollaries

- You can't do indirectly what you could not do directly
- You can do indirectly what you could have done directly in the first place

Example – Indirect Grant

- Foundation in NY want to fund two food for homeless charities in Colorado
- Both charities have IRS determination letters as public charities
- NY Foundation wants closer oversight by local org.
- NY Foundation funds Colorado community foundation to monitor and disburse its funds to the two charities
- NY Foundation could have made two grants directly

Gift/Grant To Individual

- Donor gives to individual/family
 - No deduction if earmarked
 - Deduction only if to recognized charity
- Foundation makes grant to individual
 - 20% penalty if earmarked to individual for scholarship/fellowship/research
 - Avoid penalty with advance IRS approval
 - OK for disaster/economic relief if set up correctly: eligibility criteria, charitable class, etc.

Earmark for Newly Established Charity

- Legally formed, but no IRS determination letter yet
- Donor's deduction protected if letter is retroactive to date of formation
- Foundation grant is not protected even if letter is retroactive
- New charity says "use our fiscal agent" until we get our letter:
 - 20% penalty to foundation if grant is earmarked
 - Rarely ever discovered
- Recognized charities need to know they cannot act as fiscal agent

Earmark for Non-U.S. Charity

- Donor: no deduction if earmarked for charity formed outside U.S.
- 20% penalty for Foundation if earmarked for non-U.S. Charity
 - OK if non-U.S. charity get IRS letter
- Foundation avoids penalty by direct grant & expenditure responsibility
- Use of international gift funds (DAFs)

Earmark for Non-Charities

- Examples: chamber of commerce, rotary, fraternity, Sierra Club, National Rifle Association, for profit companies
- No deduction for donors
- 20% penalty for foundations unless exercise expenditure responsibility
- Volunteer fire departments – some are charities, some are not

Earmark to a PF - (PF to PF)

- If direct or earmarked, requires expenditure responsibility
- Grantor PF must show “out of corpus” or cannot count as qualifying distribution towards 5% payout – earmarking does not help here

Public Support Test: Earmark to Avoid 2% Limit

- Large Grant could “tip” due to 2% limit
- 2% does not apply to grants from publicly supported charities, BUT
- Earmarking grant to larger publicly supported charity to then go to a smaller charity does not work

Private Foundation: Worst Case Scenario

- Foundation A makes \$100,000 grant to recognized charity B earmarked for non-charity C
- \$20,000 penalty for not exercising expenditure responsibility
- \$30,000 penalty if need all \$100,000 to satisfy 5 percent payout
- May fail test to pay 1% instead of 2% excise tax resulting in: a) doubling of tax; 2) late payment penalties and interest

Proper Use of Intermediary: Pre-Approved Program

- A to B earmarked for a special re-granting program established by B where funds later go to C, D and others
- Earmarking B's program is not a problem so long as B exercised control, in fact, of the ultimate recipients

Proper Use of Intermediary: Pre-approved Secondary Grantees

- A to B earmarked to support C and D and other grantees chosen by B
 - Example: Designated Fund for local museum established by community foundation
- Earmarking B's grantees is not a problem so long as B exercises control, in fact, in deciding the ultimate recipients
- Good practice: B's board should independently approve the program in advance and document the decision
 - purpose is to support, benefit, and carry out purposes of one or more specified SOs
 - no express power to do anything else
 - specify the SOs (a) by name, or (b) if Type I or II, by class defined by purpose or geography
 - no express power to support or benefit any SO not specified

Proper Use of Intermediary: Emergency Fund for Individuals

- B establishes Disaster Relief or Emergency Hardship Fund for individuals and families
- B's program has eligibility criteria, procedures, documentation, etc.
- Earmarking B's program is not a problem so long as B exercises control, in fact, of the ultimate recipients

Proper Use of Intermediary: Donor Advised Fund (DAF)

- DAFs, by definition, are assets in an account owned by the Sponsoring Organization
- Donors may merely advise; they may not direct
- Sponsor may ignore donor's advice
- Ultimate decision to fund a charity out of the DAF belongs to the Sponsor (B controls in fact ultimate disposition)

