NAVIGATING THE MAZE OF STATE CHARITABLE FUNDRAISING REGULATION

TRACY L. BOAK

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Navigating the maze of the financial, compliance and reporting requirements for charitable fundraising can be a daunting experience for charities and their fundraisers and sponsors. Currently, 45 states, as well as the District of Columbia, have some degree of statutory regulation of charitable solicitation activity conducted within their borders.[1] Many states, although not all, require registration and reporting of financial and other information. The states with registration and reporting requirements apply them to charitable organizations, professional fundraisers (a/k/a commercial fundraisers or solicitors), professional fundraising counsel (a/k/a consultants), and commercial co-venturers. Although an organization that solicits contributions nationally may find compliance with registration requirements to be burdensome, the penalties for noncompliance can be harsh, ranging from monetary penalties to "cease-and-desist" orders to intervention in an organization's operations by the state attorney general.

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TRACY L. BOAK is partner at Perlman & Perlman, LLP, one of the nation's leading law firms serving nonprofit organizations, fundraising professionals, companies engaged in philanthropy, and social enterprises. She was formally the director of the Pennsylvania Department of State's Bureau of Charitable Organizations and president of the National Association of State Charity Officials.

The purpose of state charitable fundraising regulations

State solicitation laws generally serve two purposes:

- To provide the public with information relating to persons who solicit charitable contributions in order to prevent (1) deceptive and dishonest practices in the conduct of soliciting funds for, or in the name of, charity; and (2) improper use of contributions intended for charitable purposes.
- To improve the transparency and accountability of organizations that solicit funds from the public for charitable purposes so that donors can make better, informed giving decisions.

The solicitation of charitable contributions is a fully protected activity under the First Amendment of the U.S. Constitution, even when conducted by a professional fundraiser with a profit motive. Of course, the states may enforce their anti-fraud laws to prohibit fundraisers from obtaining money on false pretenses or by making false statements. This ten-

sion between the federal Constitution on the one hand, and the states' legitimate interest in preventing fraud on the other, is a central issue in the state regulation of charitable solicitation.

Defining charitable solicitation

In most instances, it is the act of making a "charitable solicitation" that triggers a state's registration and reporting requirements. Although the definition varies from state to state, a charitable solicitation generally includes any direct or indirect request for contributions for charitable purposes, including oral and written statements, offers for sale, and announcements for special events. Notably, the state solicitation laws do not apply to the receipt of unsolicited donations or other types of charitable activities such as fees related to operating charitable programs. In other words, in order to constitute a charitable solicitation, there must be some affirmative act such as asking for a gift or selling goods or services that will benefit a charitable organization.

Entities subject to the charitable solicitation rules

The "persons" soliciting charitable contributions generally can be classified into four types of entities. Each state identifies and defines only those entities that are regulated under its solicitation laws.

Charitable organizations. Whether an organization has tax exempt status or may receive tax deductible contributions is a completely separate question from whether it is considered to be a charitable organization under state law. So, although "charitable organizations" certainly include Section 501(c)(3) organizations recognized as charitable by the IRS, it may also include other Section 501(c) organizations, other nonprofit organizations defined by state law—or, in some states, even for-profit organizations.

In essence, the important consideration is whether an organization engages in the solicitation of contributions to support a charitable purpose. Charitable purposes include, but are not limited to: relief of the poor, distressed, or underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

The registration process for a charitable organization typically involves filing a state registration form, providing a copy of the organization's IRS Form 990 (if one is required) as well as financial statements (which may be required to be audited, depending on the organization's annual revenue), copies of contracts with fundraisers and commercial co-venturers, and a filing fee. Additional documentation that may be required with the initial registration includes a copy of the organization's charter, bylaws, and IRS acknowledgment letter (if the organization qualifies for tax-exempt status).

Currently, of the 45 states with charitable solicitation statutes, 41 states require charitable organizations to register prior to the commencement of solicitations. The District of Columbia requires it as well. In some states, depending on the amount of overall contributions or the nature of their activities, charities such as religious and educational institutions, hospitals, and membership organizations may be exempt from registration. Moreover, as discussed more fully below, organizations that solicit solely via the Internet (and do not engage in any targeted activity in any state) may not be required to register in any state—other than in the state in which they are domiciled.

Professional fundraisers (PFRs). Generally, a PFR is hired to solicit the general public, directly or indirectly, on behalf of a charitable organization (e.g., telephone and/or door-to-door solicitations) and may have custody and control of the contributions received. PFRs may also have a role in the overall management of a fundraising campaign. Forty-three states require PFRs to register, post a surety bond, file contracts with their nonprofit clients, and file campaign financial reports. Also, many states require PFRs to disclose their professional status as a paid solicitor prior to making the request for a contribution.

Professional fundraising counsel (FRCs). An FRC is an entity retained to help plan, consult, advise on, or produce and design solicitation mate-

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[1] The references to the number of states with some form of statutory regulation of charitable solicitation are current as of the time of this writing. It is also important to note that each state's statute may define the registration categories and requirements somewhat differently and may also have exceptions, limitations, or exemptions to the registration/filing requirements. A careful analysis of each state's law is necessary to determine which requirements may be applicable to an organization's fundraising activity.

rials on behalf of a charitable organization. FRCs do not, however, make the solicitations or, as a general rule, have custody or control of contributions. Currently, 31 states require FRCs to register and file contracts. A few states require them to post bonds.

Commercial co-venturers (CCVs). Finally, a CCV is an entity that does not regularly engage in fundraising, but instead advertises that the purchase or use of its goods or services will benefit a charitable organization. For example, a McDonalds advertisement may state that for every hamburger sold, McDonalds will donate $1 to the Ronald McDonald House (a nonprofit organization). Currently, six states require registration, contract filing, the posting of a bond and/or the filing of a campaign financial report. In addition, 20 other states regulate the activity by requiring specific contract terms and point of sale disclosure, but do not require registration or contract filing by the CCV. Instead, the charitable organization that benefits from the CCV advertising may be required to file and/or report the contract.

Not all activities by commercial entities will fall within CCV regulation. For example, a retail store may ask a shopper to "round up" its total purchase to the nearest dollar amount, with the rounded-up amount being donated to a charitable organization. Doing so would not result in the store being considered to be a CCV. The key question in considering whether an activity is a commercial co-venture is *who* is making the donation? If it is the commercial entity making it out of its own profit, that entity will be a CCV.

Internet solicitations

By a literal reading of most state statutes mandating registration, Internet solicitations that reach residents of the state would be included. However, in order for a state to obtain the requisite jurisdiction to impose its regulation statutes upon an entity's online solicitation activities (including requiring registration), those activities must meet the constitutional requirement of "minimum contacts" with that particular state. Moreover, states acknowledge the practical reality that applying (and enforcing) their registration requirements to every Internet solicitation is virtually impossible.

With this backdrop, in 2001, the National Association of State Charity Officials (NASCO) issued guidelines, called the Charleston Principles (the "Principles") declaring the states' commitment to consistently apply minimum contacts principles to the existing state charitable solicitation regulatory framework (including registration requirements and general enforcement actions relating to deceptive or fraudulent solicitations). As to meeting the appropriate minimum contacts requirements, the Principles assert that existing state charitable solicitation statutes, as drafted, encompass and apply to Internet solicitation. For this reason, the Principles do not advocate amendments to existing law. However, NASCO does encourage state charity regulators to use the Principles as practical guidelines for applying existing state laws to Internet fundraising activities.

The Principles apply to any of the regulated entities that solicit contributions via the Internet (i.e., charities, PFRs, FRCs and CCVs). For organizations soliciting solely via the Internet, the Principles state that the application of state registration and reporting regimes should be limited to the following:

1. Entities domiciled within the state.
2. Out-of-state entities whose non-Internet activities would require registration in the state (e.g., direct mail or inbound telephone solicitation into the state).
3. Out-of-state entities that solicit through an interactive or non-interactive website and either (a) specifically target persons physically located in the state or (b) receive contributions from the state on a repeated and ongoing basis, or a substantial basis, through or in response to the website solicitation.

An entity is domiciled within a particular state if its principal place of business is in the state. However, according to the Principles, a physical presence within a state, such as a branch or regional office, may also be indicative of appropriate state jurisdiction.

The Principles leave the definition of "ongoing" or "substantial" (point 3, above) to the individual states. In that regard, the author is aware of only two states, Colorado and Tennessee, that have formally adopted numerical thresholds. In Colorado, an entity receives "repeated and ongoing" or "substantial" contributions if it receives at least 50 online contributions, or the lesser of $25,000 or 1% of its total contributions, in online contributions during a fiscal year, respectively. In Tennessee, an entity receives "repeated and ongoing" or "substantial" contributions if it receives at least 100 contributions or $25,000 in online contributions in a year.

Organizations should be mindful that the Principles are solely limited to online solicitations that occur in a passive context. In other words, if an organization engages in any targeted solicitation activity—such as telephone, direct mail or in-person solicitations—in addition to online solicitation, the organization must register in all the targeted states. Furthermore, in the same way as a letter or fax might do, it is important to note that e-mail solicitations may also trigger registration requirements.

Coordination between the regulated entities

One of the most critical actions that should be undertaken between charitable organizations and their fundraising partners is a discussion about the states' regulations that might apply to their activities. This is important because the states generally require that charitable organizations establish and maintain control over their fundraising activities. Moreover, it is generally prohibited for a charitable organization to enter into a contract with an unregistered fundraising professional and vice versa. The easiest way to avoid an inquiry by a state for unregistered activity is to communicate and agree about where registration and reporting is required.

Enforcement of the regulations

Enforcement of the state charitable solicitation statutes is undertaken by secretaries of state, attorneys general, or state consumer protection offices. Penalties for noncompliance can include late fees or other financial penalties, cease-and-desist orders, intervention by the state in the organization's operations, judicial dissolution, and even criminal penalties. In every case, the state will publicize the action and most states require disclosure of enforcement actions in their registration statements.

The key issues that are scrutinized by state regulators in the context of charitable solicitation include compliance with registration and reporting requirements, deceptive or misleading solicitations (in terms of how funds will be used and/or the percentage of funds that the charity will receive), proper board oversight of fundraising contracts and activities, and the use of contributions in a manner consistent with the solicitations.

It is also important to understand that while the states assume the responsibility of enforcing their charitable solicitation statutes, there are many other organizations that are watching over the activities of charitable organizations—especially within the context of fundraising, both within and without the government. Organizations should be aware that their activities are scrutinized by the federal government—the IRS, the FTC, and the Postal Service, many times in coordination with the state agencies. In addition, such organizations as the Better Business Bureau, the Wise Giving Alliance, Charity Navigator, and Charity Watch review and publicize information about charities' activities. There are also numerous membership associations within the sector that play a role in monitoring the behavior of their fundraising members and may issue "public" statements about unacceptable behavior. Finally, the media play a critical role in publicizing the fundraising activities of charitable organizations.

Conclusion

Having an understanding of the regulatory framework governing charitable solicitations will make it easier to identify compliance issues and prevent potential fines, penalties, and other consequences for an organization. ■