

LEGAL ISSUES FACING DEVELOPMENT OFFICES

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by Cliff Perlman & Karen Chang
Perlman & Perlman, LLP

1. State Fundraising Regulation

a. Overview

- i. Charitable solicitation is primarily regulated at the state level. There are approximately 45 states that have statutory schemes dealing with solicitation activity within their state. These statutory schemes typically include registration, filing, and disclosure requirements, and are imposed on nonprofits, professional solicitors, professional fundraising counsel, and commercial co-venturers. While the regulations are well-intended in their efforts to fight fraud, the inconsistency in reporting and disclosure requirements among the states often creates a significant burden for nonprofits, in particular for smaller organizations.

b. The Role of the First Amendment

- i. In the 1930s and 40s, several cases involving the ability of Jehovah's Witnesses to solicit on behalf of their religious beliefs made it to the Supreme Court. The Court held that while states have the power to compel charitable solicitors to identify themselves to the public before they solicit, the First Amendment otherwise protects this activity; and any law restricting that right must be narrowly tailored to achieve the government's goals (i.e., the restriction cannot be so broad so as to unnecessarily limit any First Amendment rights). This is the highest level of speech protection.
- ii. For example in *Schneider v. State*, the state of Wisconsin attempted to prevent Jehovah's Witness members from distributing flyers because the flyers wound up as litter. The U.S. Supreme Court (1939) held that the state could only enforce its anti-litter ordinance, not impose an outright ban on the distribution of flyers, which unnecessarily restricts the organization's First Amendment rights.
- iii. The government's interests in regulating charitable solicitation are to ensure that the funds raised are in fact used for charitable purposes, to

protect citizens from fraudulent solicitations, and to protect the privacy interests of prospective donors.

- iv. Charities' interests in engaging in solicitation activity are to both disseminate information about their cause, and seek funding to support that cause. The Supreme Court has noted that charitable solicitations are inextricably intertwined with informative and persuasive speech, which is protected by the First Amendment.
- v. In the 1980s, when the interests of the government and charities clashed, the Supreme Court resolved the conflicts in a trilogy of cases that struck down various state regulations that limited the percentage of fees that charities could pay fundraisers, and which required fundraisers to make certain pre-solicitation disclosures regarding prior fundraising costs.

c. Who is subject to state fundraising regulation & registration?

- i. Charities: These include a variety of nonprofit and religious organizations engaging in solicitation. 35-37 states require charities and other nonprofits to register prior to commencement of solicitations. The law applies to all nonprofit organizations as defined by the state's charitable solicitation laws, and not just 501(c)(3) tax-exempt organizations eligible to receive tax-deductible contributions. The ability to receive tax-deductible contributions is a completely separate issue. Tax exemption and the ability to receive tax deductible contributions are a function of federal tax law while nonprofit status is a created through state law.
- ii. Professional fundraisers/solicitors: For a fee, a Professional Solicitor (PS) directly solicits the general public on behalf of a charitable organization and often have custody/control of the contributions received. Either direct solicitation **or** custody and control of contributions will generally qualify an entity as a Professional Solicitor. These individuals or entities are required to register in approximately 41 states, all of whom require the posting of a surety bond and the filing of contracts. Many also require a pre-solicitation disclosure of professional status prior to making the request for a gift.
- iii. Fundraising Counsel/Consultants: For a fee, Fundraising Consultants (FRCs) help plan, manage, advise, or produce and design solicitation campaigns, but do not actually make the solicitations or have custody/control of contributions. FRCs are required to register in about 26 states and post bonds in a few.
- iv. There continues to be disagreement about exactly where fundraising consultants must register. It is clear that they should be registered in the state where they are located, in the state where their client is located (assuming they are providing services at the client's office), and in any

other states where they are providing actual services. If the consultant is assisting the organization in selecting mailing lists and is therefore involved in determining where the campaigns will take place, the consultant will probably have to register nationally. A dispute remains as to whether a consultant needs to register nationally if the consultant is only assisting in the planning, management, or creative aspects of a national campaign, but otherwise has no direct involvement with any of the individual states. A coalition of nonprofit organizations and professional fundraising firms, called The American Charities for Reasonable Fundraising Regulation (ACRFR) is currently in litigation in Utah regarding this exact question. There is guidance from an 11th Circuit court case regarding the registration scheme in Pinellas County (in which our firm served as lead counsel), that indicates that a consultant that does not take active steps to target a particular state is not subject to that state's jurisdiction, and that merely assisting in a national direct mail campaign fails to meet that standard.

- v. Commercial co-venturers (CCVs): Generally defined as entities not regularly engaged in fund-raising that uses a charity's name as part of a sales promotion in which the company states that it will make a charitable donation to the charity based on sales (e.g., McDonalds donates a portion of every hamburger sold to the Ronald McDonald House, a nonprofit organization).
- vi. Three states currently require registration (Maine, Massachusetts, Alabama) and about 20 others regulate the activity, but do not require registration of the CCV. They may, however, require a written contract specifying the amount the nonprofit will receive; when and how the payments will be made; and specific disclosure of the amount of the donation (expressed as a dollar amount or percentage of the sales price) to potential purchasers.

d. Fundraising registration exemption for religious organizations

- i. Many states exempt churches and other religious organizations from needing to register or comply with their fundraising regulations. The underlying reason for providing a religious exemption is fear of violating the First Amendment establishment clause notion of separation of church and state.
- ii. Ironically, an establishment clause issue arose when the county of Los Angeles attempted to exempt certain religious organizations from their charitable solicitations ordinance. *See Gospel Missions of America v. City of Los Angeles*. A provision of the city's charitable solicitations ordinance exempted solicitations made solely for evangelical, missionary, or religious purposes, but authorized the city to investigate and publicize its findings if it believed that the solicitation was being made in manner that suggested a charitable purpose. The court held that the ordinance

violated the establishment clause because (1) the city failed to articulate a secular legislative purpose to justify its preference for the exempt solicitations, (2) the ordinance impermissibly advanced religion by exclusively exempting solicitations that were all religious in nature, and (3) the ordinance created excessive entanglement between church and state by requiring the city to examine and monitor religious solicitations and determine whether they were truly for religious purposes, and, depending on its findings, to take certain action.

iii. In many states, it may be necessary to make a written request for confirmation of exempt status, particularly if you are using a professional fundraiser or fundraising consultant, because they may not be able to perform services on behalf of organizations that are not registered or officially recognized as exempt from registration in the state.

iv. Exemptions for religious organizations are granted by states for a variety of reasons:

1. churches or their integrated auxiliaries, ecclesiastical or denominational organizations;
2. religious organizations that conduct regular worship services;
3. religious organizations whose mission is to spread the teaching of their religious doctrines;
4. organizations that are not required to file the Form 990 with the IRS;
5. organizations that do not solicit outside their membership or who receive most or all of their income from within their membership or from previous donors;
6. Some exemptions are very general, e.g., “duly incorporated religious institutions” or “religious institutions exempt from taxation pursuant to the Internal Revenue Code”. In order for Catholic organizations to demonstrate their tax-exempt status, they either need to show that they applied for and received a written determination letter from the IRS stating they are exempt, or they can show that they are a member of the Official Catholic Directory, and are exempt pursuant to the group ruling granted to the U.S. Conference of Catholic Bishops (USCCB) for all “educational, charitable, and religious institutions operated, supervised by, or controlled by or in connection with the Roman Catholic Church in the United States, its territories and possessions.” This ruling, originally granted in 1946, was reaffirmed in a new IRS letter ruling dated July 28, 2009, and is available on the website of the USCCB.

7. Some exemptions are specific to religious purposes - “the exclusively religious activities of any religious order” (CO) or “solicitations ...for religious purposes such as...propagation of its faith and tenets as distinguished from other charitable and civic purposes employed by nonreligious organizations” (KY): this exemption category may be unenforceable as a violation of the establishment clause, a la Gospel Missions case, because it may require the state to examine and analyze whether an organization’s purposes are truly “religious” as vs. “charitable.”

e. Solicitations in the 21st Century – Internet and email solicitations:

- i. The Charleston Principles are a set of unofficial guidelines created by the various states’ charity regulators to help bridge the application of existing registration laws to Internet solicitation. The Charleston Principles clarify that existing registration laws also apply to internet solicitations – the internet is just a new medium through which to conduct solicitations.
- ii. Specifically, the Principles try to help regulators and organizations understand how existing law applies to internet solicitations by defining and limiting the circumstances in which a nonprofit must register with a given state based on their Internet solicitation contacts with the state.
- iii. Before the Principles, it was clear that state registration and reporting regimes applied to: (1) entities located within the state; and (2) out-of-state entities whose non-Internet activities (e.g., direct mail or telephone solicitation into the state) would require registration in the state. The Principles clarify that out-of-state entities must also register if they solicit through a website and either (i) specifically target persons physically located in the state, or (ii) receive contributions from the state on a *repeated and ongoing, or substantial basis* through or in response to the Web site solicitation.
- iv. The problem with the Principles’ use of the terms “repeated and ongoing” (referring to the number of separate contributions) and “substantial” (referring to the total dollar amount of contributions) is that they lack any definite numbers that nonprofits can use to determine whether they need to register and comply with a state’s regulations. The Annotations to the Principles recognize that for the Principles to truly be useful, “states must draw a bright line, even if that line is somewhat arbitrary and even if it is not the same in all states.”

f. Restrictions on charitable gifts:

- i. Restrictions on the use of a gift must be adhered to, not only as a matter of integrity to your donors, but also as a legal matter. There are times when this becomes difficult or impossible for an organization to do, e.g., when the organization has a large amount of restricted gifts, but not

enough unrestricted income to financially sustain itself in the short-run; or when an endowment becomes so large that the annual income is far more than enough to fulfill the narrow purposes for which it was originally intended. Most states have adopted laws that require organizations to seek court approval before they can modify the terms of a gift, and then, they will only be approved under exigent circumstances. The legal principle for modifying gift restrictions is called the cy pres doctrine, and requires that the gift be used for purposes “as near as possible” to the original purpose so as to comply with the donor’s original intent as much as possible. For more details on this issue, please attend Karen Chang’s roundtable workshop Tuesday morning.

g. Charitable Gift Annuity registration

- i. A charitable gift annuity is a contract whereby a charity agrees to pay a fixed amount of money to one or more individuals for their lifetime in exchange for an irrevocable contribution.
- ii. Most state laws require that the payments be fixed for the duration of the contract. A portion of the payments are considered to be a partial tax-free return of the donor's gift, which are spread in equal payments over the life expectancy of the annuitant(s).
- iii. Annuity instruments and administration of the annuity during the annuitant’s life are subject to the laws of the state in which the charity does business and the state of residence of the donor. Most state insurance departments are given the job of regulating charitable gift annuities.
- iv. Currently eleven states require that the charity apply for a license to sell annuities in that state. Those states also require annual filings. Churches and other religious organizations are not exempt from these filings. Approximately 20 other states require notice to the state that the charity is selling annuities within its borders.
- v. Many states also have specific disclosures that must be included in the annuity agreement itself and specific eligibility requirements for a charity to be allowed to sell annuities in those states – even if the state does not require registration.

h. State Consumer Fraud Regulation (deceptive practices acts)

- i. Many states have their own unfair trade practices act to provide consumer protection, including allegedly misleading charitable solicitations. Many state charity regulators will seek to impose fines and penalties on soliciting organizations based on not only their charitable solicitation laws, but also their consumer protection/unfair trade practices acts. Consumer protection statutes tend to provide secondary

protection to the charitable solicitation statutes. Their main benefits tend to be through the addition of fines, penalties, and remedies that may be taken against any organization or fundraiser that defrauds the public. In a few states, consumer protection statutes may also extend the right to sue to individual consumers, or in this case, donors.

2. Applicable federal laws and regulations

a. Nonprofit mail regulations

- i. The general rule of thumb: Only nonprofits can mail at nonprofit postage rate. There are some special rules though.
- ii. Newsletters with charitable sales promotions: An organization can mail its newsletter at the nonprofit rate if all of its advertisements for the sale of products or services are “substantially related” to the exercise or performance of the organization’s “qualifying primary purpose.” If one or more of the organization’s advertisements is not “substantially related”, the organization can still mail its newsletter at the nonprofit rate if: (1) it limits the total amount of advertising (including both “substantially related” and unrelated advertising) to no more than 75% of the total material in each issue, and (2) each issue complies with certain technical requirements (such as having an issue date, volume number, and title).
- iii. When a nonprofit partners up to conduct a mailing with a for-profit entity, the organization must look to the cooperative mail rule, which examines a number of factors to determine whether the mailing would qualify for the nonprofit mail rate. Mailings that involve a professional fundraiser or fundraising consultant that are strictly for charitable solicitation purposes, and do not to promote the sale of any goods or services, are exempt from this rule. However, in order to be exempt from the rule, the fundraiser must provide the nonprofit with the donor list, including contact information and donation amounts. Mailings done by a for-profit to promote their goods or services may not be mailed at the nonprofit rate, even if a portion of the purchase price will benefit a nonprofit.

b. FTC Can-Spam Rules:

- i. The role of the Federal Trade Commission (FTC) is to police unfair and deceptive business practices. Its jurisdiction is quite limited with respect to nonprofits, who do not generally engage in trade or commerce. However, nonprofit organizations’ activities are not completely out of the FTC’s reach. According to the FTC’s Final Rules relating to solicitation e-mails, effective since 2005, certain nonprofits must comply with the FTC’s rules, known as the CAN-SPAM regulations. The CAN-SPAM regulations state that certain information either must be included

in or excluded from any commercial e-mail solicitation. There are certain limited circumstances under which a charity may have to comply with CAN-SPAM for e-mail messages containing commercial solicitations, such as an e-mail message sent by a nonprofit hospital offering medical screening in exchange for a fee. Furthermore, the applicability of the Final Rules to e-mail messages is not based upon the sender's intent, but rather upon the e-mail recipient's reasonable interpretation of the message as a commercial e-mail message.

3. Gift Acceptance Policies

- a. A gift acceptance policy serves several purposes. The overarching purpose is to provide a clear framework in which prospective gifts can be analyzed prior to acceptance.
- b. A key part of that is determining who will make the decision of what gifts to accept.
- c. Another important but perhaps secondary purpose of a gift acceptance policy is to outline the specific kinds of gifts an organization is willing or not willing to accept. Often it makes sense not to become overly specific in this respect, because an organization may need to make decisions that are appropriate on a case by case basis. Instead, providing a set of criteria to assist in making that evaluation for certain types of gifts, especially planned gifts and gifts of real estate, can serve as a guide in determining whether or not acceptance of a gift is in the best interests of the organization.

4. Charity Watchdogs

a. Charity Navigator:

- i. Charity Navigator chooses the charities that it would like to review and rates charities based on publicly available information such as the Form 990.
- ii. Charity Navigator does not request information from the charity being evaluated, except under special circumstances.
- iii. Charity Navigator ranks charities based on a four-star rating system by evaluating their financial efficiency (lower fundraising costs) and capacity (the organization's ability to sustain its programs and services over time).
- iv. Charity Navigator's President (Ken Berger) recently acknowledged that their current rating system does not and is unable to demonstrate the effectiveness or programmatic impact of an organization. They are now looking to add some kind of impact measurement to their rating system.

b. Ministry Watch

- i. Ministry Watch is a ministry of Wall Watchers, a nonprofit charity watchdog that profiles public charities, and church and parachurch ministries. The organization describes itself as "an independent donor advocate facilitating the information needs of donors. It provides information on organizations alleging to be charitable and its key leadership in order to identify materially misleading behavior, or wasteful spending practices, as well as identifying those operations that are above board and running efficiently. The objective is to limit consequences of scams and prevention of fraudulent activity, promote better allocations of giving, encourage intelligent questions of organizational structure, financial health, and advance the idea of organizational transparency and best practices."
- ii. Ministry Watch uses a five-star financial efficiency rating system based on organizations' financial statements. The website states that the rating system is only the beginning of a donor's analysis on the worthiness of an organization. It further states that "the MinistryWatch.com 5 Star Financial Efficiency Ratings are neither a predictive measure nor a recommendation, and we would add that financial ratios are just one of the many ways Wall Watchers analysts look at and evaluate a ministry."

c. Better Business Bureau Wise Giving Alliance:

- i. The Wise Giving Alliance evaluates charities according to a set of 20 voluntary accountability standards that evaluate an organization's

governance and oversight, effectiveness, fundraising and marketing practices.

- ii. Organizations can directly request to be evaluated, or the Wise Giving Alliance can initiate the request, usually based on its receipt a sufficient number of requests for information from members of the public.
- iii. The Wise Giving Alliance sends a questionnaire to the organization and the charity is evaluated based on their Standards for Charity Accountability and produces a report based on the information given by the charity. The report will state whether or not the organization has met all 20 standards. If it has not, the report will specify which of the standards the organization has not met. If an organization chooses to do so, it can provide an explanation of why it is unable to meet one or more particular standards, and that explanation will be included in the report for public viewing.