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# CHAPTER ONE

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## Government Regulation of Fundraising for Charity

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### § 1.2 CHARITABLE FUNDRAISING: A PORTRAIT

**p. 9.** *Insert following heading:*

From the standpoint of the law of charitable fundraising, two aspects of the portrait of charitable giving in the United States are important: the extent of charitable giving in general and the increasing use of the Internet for the purpose of soliciting charitable contributions.

**(a) Scope of Charitable Giving in General**

**p. 9.** *Delete text following the first paragraph and substitute:*

Charitable giving in the United States in 2017 is estimated to have totaled \$410.02 billion. Giving by individuals in 2017 amounted to an estimated \$286.65 billion; this level of giving constituted about 70 percent of all charitable giving for the year. Grantmaking by private foundations is an estimated \$66.9 billion (16 percent of total funding). Gifts in the form of charitable bequests in 2017 are estimated to be \$35.7 billion (9 percent of total giving). Gifts from corporations in 2017 totaled \$20.77 billion (5 percent of total giving for that year).

Contributions to religious organizations in 2017 totaled \$127.37 billion (31 percent of all giving that year). Gifts to educational organizations amounted to \$58.9 billion (14 percent); to human service entities, \$50.06 billion

(12 percent); to foundations, \$45.89 billion (11 percent); to health care institutions, \$38.27 billion (8 percent); to public-society benefit organizations, \$29.59 billion (8 percent); to international affairs entities, \$22.97 billion (6 percent); to arts, culture, and humanities entities, \$19.51 billion (5 percent); and to environmental and animals groups, \$11.3 billion (3 percent).<sup>24</sup>

**p. 10. Delete first paragraph and substitute:**

**(b) Online Charitable Fundraising**

Not that many years ago, use of the Internet for charitable fundraising was only nascent. One analysis of online fundraising, in its beginnings, did not have statistics on this approach to gift solicitation.<sup>25.1</sup> But it was clearly coming, and was expected to someday be a major force in charitable fundraising. Now, that “someday” has arrived.

In mid-2014, *The Chronicle of Philanthropy* gave a special report on online fundraising, with the theme being “Digital Giving Goes Mainstream.”<sup>25.2</sup> Among the findings in this report was that Internet gifts climbed 13 percent in 2013 in relation to 2012, although online fundraising “still accounts for a very small portion of the money charities rely on.”<sup>25.3</sup> Nonetheless, in 2013, the Leukemia & Lymphoma Society raised over \$98 million online, the California Community Foundation raised more than \$95 million online, the American Heart Association raised \$59 million in that manner; other totals were over \$45 million (World Vision), about \$40 million (Campus Crusade for Christ International, Cystic Fibrosis Foundation, National Christian Foundation, Salvation Army), about \$30 million (March of Dimes Foundation, Young Life), and about \$20 million (Global Impact, Memorial Sloan Kettering Cancer Center, United States Fund for Unicef, University of Michigan).<sup>25.4</sup>

About one year later, another report speaks of the “transformative promise of online fundraising” that has yet to materialize.<sup>25.5</sup> This report looks at the “short history of online fundraising” and finds that it “is not without signs of progress.” It summarizes the successes of online-giving websites and notes

<sup>24</sup> These data are from *Giving USA 2017*, published by the Giving USA Foundation, and researched and written under the auspices of the Center on Philanthropy at Indiana University.

<sup>25.1</sup> Hopkins, *The Nonprofits' Guide to Internet Communication Law* (John Wiley & Sons: 2003), Chapter 4.

<sup>25.2</sup> XXVI *Chron. of Phil.* (No. 13) F-1 (May 22, 2014).

<sup>25.3</sup> Daniels and Narayanswamy, “Online Giving Grows More Sophisticated,” XXVI *Chron. of Phil.* (No. 13) F-3 (May 22, 2014).

<sup>25.4</sup> XXVI *Chron. of Phil.* (No. 13) F-4 (May 22, 2014).

<sup>25.5</sup> “Click, Click, Cash?,” 27 *Chron. of Phil.* (No. 9) 10 (May 2015).

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that “[y]ear to year, more people give money online to charity.” Still, for most charitable organizations, this report states that online giving “represents a sliver of their overall fundraising.” The “promised revolution” is “moving at glacial speed” because of ancient tech infrastructure, reluctance on the part of fundraising management to place more emphasis on online operations, and lack of understanding by senior executives and board members of the potential of online fundraising. This report concludes that “effective online fundraising doesn’t eliminate the human touch at the core of giving.” Every day, the report states, “you see more meaning and substance on the Internet, more people forging thoughtful, deep connections—deeper connections, perhaps than a professional fundraiser could ever hope for with a yearly newsletter.”<sup>25.6</sup>

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**\*p. 12. *Insert following after second full paragraph of text:***

There continues to be a nationwide crackdown on fraudulent charities that exploit disadvantaged groups in order to solicit donations. On October 11, 2018, the Minnesota attorney general filed a lawsuit against the American Federation of Police and Concerned Citizens, Inc. (AFPCC) for deceptively representing that contributions it received would be used to help families of officers killed in duty. The attorney general found that in fact only 17 percent of AFPCC’s spending in 2017 and just 9 percent of the \$4 million it received in total donations were used for charitable purposes. On July 19, 2018, the Virginia attorney general announced that his office was taking legal action against two charities, Hearts for Heroes, Inc., and Operation Troop Aid, Inc., alleging they both had used donations to benefit their organizations instead of helping veterans and troops. This suit and settlement are part of a 16-state action. According to a release from the Virginia attorney general’s office, the Operation Troop Aid, Inc. settlement requires it to dissolve and prohibits its CEO from assuming any fiduciary role with a nonprofit corporation or soliciting on a nonprofit corporation’s behalf.

On September 11, 2017, the Michigan attorney general announced a settlement with Breast Cancer Outreach Foundation, Inc., a Florida nonprofit corporation, resolving the attorney general’s claims that the organization deceptively raised \$1.4 million nationwide in 2015. The organization’s solicitations stated

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<sup>25.6</sup>*Id.* at 11, 12, 14, 16, 19. In general, “The Best of Online Fundraising,” articles beginning on pp. 9, 10, 12, 14, 16, 18, 20, and 22, 28 *Chron. of Phil.* (No. 7) (May 2016).

that funds would be used for breast cancer research grants. In reality, all of the money raised, other than one grant, was paid to professional fundraisers and for other expenses unrelated to breast cancer research. As part of the settlement, the Foundation is required to pay \$150,000, with \$125,000 paid for breast cancer research and the remaining \$25,000 to recover the state of Michigan's investigative costs. The organization is also banned from soliciting in Michigan for 10 years.

On May 18, 2015, the Federal Trade Commission and 58 agencies from all 50 states and the District of Columbia filed a complaint charging four cancer charities and the individuals controlling them with allegedly swindling more than \$187 million from consumers. The federal court complaint named Cancer Fund of America, Inc. (CFA) and Cancer Support Services Inc. (CSS), their president, James Reynolds Sr., and their chief financial officer, Kyle Effler; Children's Cancer Fund of America Inc. (CCFA), its president and executive director, Rose Perkins; and The Breast Cancer Society Inc. (BCS) and its executive director and former president, James Reynolds II.

In the complaint, the FTC and state agencies labeled the cancer groups as "sham charities" and charged the organizations with deceiving donors and misusing around \$187 million in donations from 2008 to 2012. According to the complaint, the defendants represented themselves as legitimate charities that spent 100 percent of their proceeds on services for cancer patients, such as hospice care and buying pain medication for children. The complaint alleged that these claims were false and that the charities operated as "personal fiefdoms characterized by rampant nepotism, flagrant conflicts of interest, and excessive insider compensation, with none of the financial and governance controls that any bona fide charity would have adopted." Investigators found that, in reality, the charities spent less than 3 percent of donations on cancer patients.

According to the complaint, the defendants used the organizations to pay lucrative salaries to family members and friends and spent contributions on personal items such as cars, trips, luxury Caribbean cruises, college tuition, gym memberships, concert and sporting event tickets, and dating site memberships. The defendants also hired professional fundraisers who received up to 85 percent or more of every donation. The complaint asserted that in order to hide their high administrative and fundraising costs from donors and government regulators, the defendants falsely inflated their revenues by reporting more than \$223 million in donated gifts-in-kind that were allegedly distributed to international recipients. The complaint states that by reporting the inflated gift-in-kind donations, the defendants created the impression that they were more efficient with donors' dollars than was actually the case. Thirty-five states also alleged that the defendants filed fraudulent and misleading financial statements with state charities regulators.

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Two of the charities, the CCFA and BCS, agreed to settle the charges before the complaint was filed. Under the proposed settlement orders, Effler, Perkins, and Reynolds II will be banned from fundraising and charity management, and CCFA and BCS will be dissolved. On March 30, 2016, the Federal Trade Commission announced the total disbandment of the CFA and CSS. Further, James Reynolds, Sr. was barred from ever again operating or fundraising for nonprofit organizations.

Similarly, on July 21, 2015, the New York Attorney General Eric T. Schneiderman announced that his office filed a court action to close the National Children's Leukemia Foundation (NCLF), and to hold its president and others accountable. The lawsuit came after an investigation by the Attorney General's Charities Bureau revealed that the NCLF, which held itself out as a leading organization in the fight against leukemia, did not conduct most of the programs it advertised, including claims it operated a bone marrow registry and fulfilled the last wishes of dying children. The court papers charge that, despite claims it had a board of directors and other financial and scientific controls, the 20-year-old organization was in fact operated by a single founder out of the basement of his Brooklyn, New York, home.

In February 2016, a federal class action was filed against Gospel for Asia, one of the largest mission organizations in the United States. The lawsuit alleged that the founder of the entity took offerings from tens of thousands of individuals, claiming it was feeding and housing impoverished people. In reality, according to the allegations, the founder used the contributions to build an empire including a \$20 million headquarters, homes, and sports facilities.

On March 28, 2016, Michigan's attorney general announced publication of his annual "professional fundraising charitable solicitation report," which identified the total amount raised by charities in the state, concluding that professional fundraisers were retaining two-thirds of contributions.

On May 25, 2016, Minnesota's attorney general filed a lawsuit against Associated Community Services, Inc. for sending false pledge reminders to donors and making other misleading statements in a campaign to solicit contributions for the Foundation for American Veterans. According to the complaint, the company has an extensive history of misconducting solicitations for charities.

The attorney general of the state of New York, Eric Schneiderman, announced on November 10, 2016, that his office had settled its case against the National Vietnam Veterans Foundation. According to a statement, nearly all of the funds raised through its direct mail efforts were used to pay the Foundation's fundraisers. It is said that in 2014, for example, the Foundation devoted \$7.7 million of the \$8.6 million raised to fundraising. It is further stated that the "fraction" of the money that went to the Foundation "was further

reduced by a pattern of abuse, mismanagement, and misspending” by its former president. That individual and the Foundation’s vice president are now subject to a “permanent nationwide ban” on access to and decision-making with respect to charitable assets.

The New York’s Attorney General’s office, on December 22, 2016, released its annual “Pennies for Charity” report, which focuses on the \$1.1 billion that was contributed in that state in 2015 as the result of 1,143 fundraising campaigns conducted by professional fundraisers. An accompanying press release states that the fundraisers “kept” 34.5 percent of the gift proceeds, or \$379 million. The press release contains these “other significant findings”: in 239 of the campaigns, the charities involved “retained” 70 percent or more of the funds raised; in 622 campaigns, charities retained less than one-half of the funds raised; and in 192 campaigns, fundraising expenses exceeded revenue, for a loss of \$16.7 million.

On November 29, 2017, New York Attorney General Eric T. Schneiderman announced a settlement with Yisroel Schulman, the former President of the New York Legal Assistance Group, Inc. (NYLAG), for breaching his fiduciary duties of care, loyalty, and obedience to NYLAG, a charity providing free legal service to low-income New York residents, and other charities with which Schulman was affiliated. The settlement was reached after an extensive investigation by the Charities Bureau of the Attorney General’s office, which led to the filing of a complaint in the New York Supreme Court. The Attorney General’s investigation found that from around 1998 through 2013, Schulman diverted millions of dollars from NYLAG to other charities that he controlled. These funds were diverted to various donor-advised funds and similar accounts. In choosing donor-advised funds to hold NYLAG’s funds instead of an investment account, Schulman breached his duty to prudently invest and safeguards the assets of NYLAG. Schulman settled with the Attorney General. Pursuant to the settlement agreement, Schulman agreed to pay \$150,000 to NYLAG. The settlement also bans Schulman from serving as an officer or director of New York nonprofit organizations for five years.

A day earlier, Attorney General Schneiderman released his annual “Pennies for Charity: Where Your Money Goes; Fundraising by Professional Fundraisers” report. In 2016, more than \$1.2 billion was raised in the state of New York through 987 fundraising campaigns conducted by professional fundraisers. The report found that of the \$1.2 billion raised through campaigns conducted by professional fundraisers, charities received over \$822 million, or 67 percent of the proceeds, while professional fundraisers’ fees totaled \$403 million, or 33 percent. In the report, the Attorney General stated: “Today’s report shines a light on the high percentage of charitable dollars that too often get pocketed by outside fundraisers. Our Charities Bureau will continue to hold unscrupulous or fraudulent fundraisers accountable.”

## § 1.4 CONTEMPORARY REGULATORY CLIMATE

### p. 19. *Insert following second complete paragraph:*

In September 2016, a study, conducted by the Charities Regulation and Oversight Project at Columbia Law School and the Center on Nonprofits and Philanthropy at the Urban Institute, was released. This is the first organized analysis of state-level oversight and regulation of charitable organizations. The study has three components: (1) a legal analysis of laws pertaining to charities in 56 U.S. jurisdictions; (2) a survey of state and territory offices with oversight, regulatory, and enforcement authority over charitable organizations; and (3) interviews in most of those offices. Major findings of this study include the following:

- There is no single state law of charities oversight; rather, this oversight entails a complex mix of substantive areas, including charitable trust law, governance, criminal law, solicitation and registration requirements and compliance, corporate transaction review, and conservation easements.
- Organization and staffing of state charity offices vary greatly; in 41 percent of the states, one office has primary responsibility, while in the other states responsibility is shared with other agencies or offices.
- Within an attorney general's office, 13 jurisdictions have a charities bureau; 14 jurisdictions house charities oversight within a consumer protection division.
- Most registration oversight is lodged in state attorney generals' offices (21 states), followed by offices of the secretary of state (15 states), and other state-level charity offices, usually consumer affairs or business/financial regulation (8 states).
- Lawyers and non-legal staff who oversee charities number approximately 355 in the 48 reporting jurisdictions.
- Thirty-one percent of jurisdictions have less than one full-time-equivalent staff in this area, 51 percent of jurisdictions have between 1 and 9.9 full-time-equivalent staff, and 19 percent have 10 or more full-time-equivalent staff.
- Training state charities regulation staff is a mix of internal and external provision, with the smaller offices less likely to provide any training and the largest offices providing in-house training.
- States have different requirements for reporting by charities. Some rely on reporting on IRS annual information returns,<sup>60.1</sup> some require registration

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<sup>60.1</sup>See Chapter 6.

information, and some require independent audits and notification of certain transactions.

- In the 47 responding jurisdictions, 68 percent require fundraisers for charitable organizations to register, and 60 percent require charities to register.
- Twenty-two states require charities to file independently audited financial statements; most of the jurisdictions requiring these audits have a \$500,000 threshold before an audit is required.
- Where charities must inform the attorney general's office of major transactions, the top three triggers of this notice requirement are mergers (43 percent), voluntary dissolution (41 percent), and sale of assets (33 percent).
- The three most common areas of enforcement by charity offices are fundraising abuses (62 percent), trust enforcement (36 percent), and governance (36 percent).
- Of the fundraising methods overseen by state charities officials, the most common areas of oversight are telephone solicitations (82 percent), direct mail (80 percent), special events (80 percent), in-person solicitations (80 percent), Internet-based fundraising (76 percent), and social media-based solicitations (70 percent).
- State-level enforcement actions are more likely to be informal resolutions (85 percent), involve correspondence with organizations (98 percent), settlements (88 percent), fines and penalties (80 percent), or formal litigation (e.g., injunctions) (79 percent).
- Offices vary in their efforts to provide education and outreach to the fundraising community, ranging from press releases (82 percent), donor advisories (77 percent), training (32 percent), and webinars (7 percent).