
CHAPTER ONE

Government Regulation of Fundraising for Charity

- § 1.1 Charitable Sector and American Political Philosophy 2
- § 1.2 Charitable Fundraising: A Portrait 8
 - (a) Scope of Charitable Giving in General 9
 - (b) Noncash Gifts Statistics 9
 - (i) Form 8283 Reporting 10
 - (ii) Types of Noncash Contributions 10
 - (iii) Decline in Returns and Amounts 10
 - (c) Online Charitable Fundraising 11
- (iv) Average Contribution Amounts 10
- (v) Types of Charitable Organizations 11
- § 1.3 Brief History of Government Regulation of Fundraising 12
- § 1.4 Contemporary Regulatory Climate 22

Charitable organizations are an integral part of U.S. society; many of them must engage in the solicitation of contributions and grants to continue their work, which benefits that society. Yet both these organizations and their fundraising efforts are under constant criticism and immense regulation. Some of this regulation comes from the many state *charitable solicitation acts*—statutes that are designed to regulate the process of raising funds for charitable purposes. Other aspects of this regulation are found in the federal tax law, with mounting legislation and application of legal principles by the Internal Revenue Service¹ and the courts. Increasingly, other federal laws are contributing to the overall mass of regulation of charitable fundraising.

One of the pressing questions facing philanthropy in the United States is whether this form of regulation is far too extensive and thus whether it is unduly stifling the nation's independent and voluntary sector. Another attitude is that charity, and fundraising for it, has become a major "industry," and warrants regulation to minimize abuse, protect prospective and actual donors from fraud and other forms of misrepresentation, and reduce waste of the charitable dollar.

1. Throughout this book, the Internal Revenue Service is referred to as the IRS.

Before examining the extent of this regulation, and the accompanying contemporary issues and trends, the role of charitable organizations must be placed in its historical and public policy context.

§ 1.1 CHARITABLE SECTOR AND AMERICAN POLITICAL PHILOSOPHY

Because modern U.S. charity evolved out of the common law of charitable trusts and property, and has been accorded exemption from income taxation since the beginning of federal tax policy and gifts to charity are tax-deductible, the contemporary treatment of charitable organizations is understandably fully reflected in the federal tax laws.

The public policy rationale for exempting organizations from tax is illustrated by the category of organizations that are charitable, educational, religious, scientific, literary, and similar entities,² and, to a lesser extent, social welfare organizations.³ The federal tax exemption for charitable and other organizations may be traced to the origins of the income tax,⁴ although most of the committee reports accompanying the 1913 act and subsequent revenue acts are silent on the reasons for initiating and continuing the exemption.

One may nevertheless safely venture that the exemption for charitable organizations in the federal tax statutes is largely an extension of comparable practice throughout the whole of history. Congress believed that these organizations should not be taxed and found the proposition sufficiently obvious as not to warrant extensive explanation. Some clues may be found in the definition of charitable activities in the income tax regulations,⁵ which include purposes such as relief of the poor, advancement of education or science, erection or maintenance of public buildings, and lessening of the burdens of government. The exemption for charitable organizations is clearly a derivative of the concept that they perform functions that, in the organizations' absence, government would have to perform; therefore, government is willing to forgo the tax revenues it would otherwise receive in return for the public services rendered.

2. These are the organizations described in section (§) 501(c)(3) of the Internal Revenue Code of 1986, as amended, Title 26, United States Code (IRC).

3. These are the organizations described in IRC § 501(c)(4).

4. 38 Stat. 166. The income tax exemption for charitable organizations originated in the 1894 statute (28 Stat. 556, § 32), which was declared unconstitutional in *Pollock v. Farmers' Loan and Trust Co.*, 157 U.S. 429 (1895). In general, see McGovern, "The Exemption Provisions of Subchapter F," 29 *Tax Law* 523 (1976); Bittker and Rahdert, "The Exemption of Nonprofit Organizations from Federal Income Taxation," 85 *Yale L. J.* 299 (1976).

A companion book by Bruce R. Hopkins describes the federal tax law as it applies to nonprofit organizations. *Tax-Exempt Organizations*, Chapter 1, contains a fuller analysis of this aspect of public policy and of the independent sector.

5. Income Tax Regulations (Reg.) § 1.501(c)(3)-1(d)(2).

1.1 CHARITABLE SECTOR AND AMERICAN POLITICAL PHILOSOPHY

Since the founding of the United States, and earlier in the colonial period, tax exemption—particularly with respect to religious organizations—was common.⁶ Churches were openly and uniformly spared taxation.⁷ This practice has been sustained throughout the nation's history—not only at the federal but also at the state and local levels, most significantly with property taxation.⁸ The U.S. Supreme Court, in upholding the constitutionality of the religious tax exemption, observed that the “State has an affirmative policy that considers these groups as beneficial and stabilizing influences in community life and finds this classification [exemption] useful, desirable, and in the public interest.”⁹

The Supreme Court early concluded that the foregoing rationalization was the basis for the federal tax exemption for charitable entities. In one case, the Court noted that “[e]vidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when not conducted for private gain.”¹⁰

The U.S. Court of Appeals for the Eighth Circuit observed, regarding the exemption for charitable organizations, that “[o]ne stated reason for a deduction or exemption of this kind is that the favored entity performs a public service and benefits the public and relieves it of a burden which otherwise belongs to it.”¹¹ One of the rare congressional pronouncements on this subject is further evidence of the public policy rationale. In its committee report accompanying the Revenue Act of 1938, the House Ways and Means Committee stated:

The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.¹²

One federal court observed that the reason for the charitable contribution deduction has “historically been that by doing so, the Government relieves itself of the burden of meeting public needs which in the absence of charitable activity would fall on the shoulders of the Government.”¹³

Other aspects of the public policy rationale are reflected in case law and the literature. Charitable organizations are regarded as fostering voluntarism and

6. Cobb, *The Rise of Religious Liberty in America*, 482–528 (1902); Lecky, *History of European Morals* (1868).

7. Torpey, *Judicial Doctrines of Religious Rights in America*, 171 (1948).

8. E.g., *Trustees of the First Methodist Episcopal Church v. City of Atlanta*, 76 Ga. 181 (1886); *Trinity Church v. City of Boston*, 118 Mass. 164 (1875).

9. *Walz v. Tax Commissioner*, 397 U.S. 664, 673 (1970).

10. *Trinidad v. Sagrada Orden de Predicadores*, 263 U.S. 578, 581 (1924).

11. *St. Louis Union Trust Company v. United States*, 374 F.2d 427, 432 (8th Cir. 1967). Also *Duffy v. Birmingham*, 190 F.2d 738, 740 (8th Cir. 1951).

12. H. R. Rep. No. 1860, 75th Cong., 3d Sess. 19 (1939).

13. *McGlotten v. Connally*, 338 F. Supp. 448, 456 (D.D.C. 1972).

pluralism in the American social order.¹⁴ That is, society is regarded as benefiting not only from the application of private wealth to specific purposes in the public interest but also from the variety of choices made by individual philanthropists as to which activities to further.¹⁵ This decentralized choicemaking is arguably more efficient and responsive to public needs than the cumbersome and less flexible allocation process of government administration.¹⁶

The principle of pluralism was stated by John Stuart Mill, in *On Liberty* (1859), as follows:

In many cases, though individuals may not do the particular thing so well, on the average, as the officers of government, it is nevertheless desirable that it should be done by them, rather than by the government, as a means to their own mental education—a mode of strengthening their active faculties, exercising their judgment, and giving them a familiar knowledge of the subjects with which they are thus left to deal. This is a principal, though not the sole, recommendation of jury trial (in cases not political); of free and popular local and municipal institutions; of the conduct of industrial and philanthropic enterprises by voluntary associations. These are not questions of liberty, and are connected with that subject only by remote tendencies; but they are questions of development. ... The management of purely local businesses by the localities, and of the great enterprises of industry by the union of those who voluntarily supply the pecuniary means, is further recommended by all the advantages which have been set forth in this Essay as belonging to individuality of development, and diversity of modes of action. Government operations tend to be everywhere alike. With individuals and voluntary associations, on the contrary, there are varied experiments, and endless diversity of experience. What the State can usefully do is to make itself a central depository, and active circulator and diffuser, of the experience resulting from many trials. Its business is to enable each experimentalist to benefit by the experiments of others; instead of tolerating no experiments but its own.

This same theme was echoed by then-Secretary of the Treasury George P. Shultz, in testimony before the House Committee on Ways and Means in 1973, when he observed:

These organizations [“voluntary charities, which depend heavily on gifts and bequests”] are an important influence for diversity and a bulwark against overreliance on big government. The tax privileges extended to these institutions were purged of abuse in 1969 and we believe the existing deductions for charitable gifts and bequests are an appropriate way to encourage those institutions. We believe the public accepts them as fair.¹⁷

14. *Green v. Connally*, 330 F. Supp. 1150, 1162 (D.D.C. 1971), *aff'd sub nom. Coit v. Green*, 404 U.S. 997 (1971).

15. Rabin, “Charitable Trusts and Charitable Deductions,” 41 *N.Y.U. L. Rev.* 912, 920–925 (1966).

16. Saks, “The Role of Philanthropy: An Institutional View,” 46 *Va. L. Rev.* 516 (1960).

17. “Proposals for Tax Change,” Department of the Treasury, Apr. 30, 1973, at 72.

The principle of voluntarism in the United States was expressed by another commentator as follows:

Voluntarism has been responsible for the creation and maintenance of churches, schools, colleges, universities, laboratories, hospitals, libraries, museums, and the performing arts; voluntarism has given rise to the private and public health and welfare systems and many other functions and services that are now an integral part of the American civilization. In no other country has private philanthropy become so vital a part of the national culture or so effective an instrument in prodding government to closer attention to social needs.¹⁸

Charitable organizations, maintained by tax exemption and nurtured by the ability to attract deductible contributions, are reflective of the American philosophy that all policymaking should not be reposed in the governmental sector. Philanthropy, wrote one jurist,

is the very possibility of doing something different than government can do, of creating an institution free to make choices government cannot—even seemingly arbitrary ones—without having to provide a justification that will be examined in a court of law, which stimulates much private giving and interest.¹⁹

The public policy rationale for tax exemption (particularly for charitable organizations) was reexamined and reaffirmed by the Commission on Private Philanthropy and Public Needs in its findings and recommendations in 1975.²⁰ The Commission observed:

Few aspects of American society are more characteristically, more famously American than the nation's array of voluntary organizations, and the support in both time and money that is given to them by its citizens. Our country has been decisively different in this regard, historian Daniel Boorstin observes, "from the beginning." As the country was settled, "communities existed before governments were there to care for public needs." The result, Boorstin says, was that "voluntary collaborative activities" were set up to provide basic social services. Government followed later.

The practice of attending to community needs outside of government has profoundly shaped American society and its institutional framework. While in most other countries, major social institutions such as universities, hospitals, schools, libraries, museums and social welfare agencies are state-run and state-funded, in the United States many of the same organizations are privately controlled and voluntarily supported. The institutional landscape of America is, in fact, teeming with nongovernmental, noncommercial organizations, all the way from some of the world's leading educational

18. Fink, "Taxation and Philanthropy—A 1976 Perspective," 3 *J. C. & U. L.* 1, 6–7 (1975).

19. Friendly, "The *Dartmouth College* Case and the Public–Private Penumbra," 12 *Tex. Q.* (2d Supp.) 141, 171 (1969).

20. *Giving in America—Toward a Stronger Voluntary Sector* (1975). All quotations herein from the Commission's report are by permission.

GOVERNMENT REGULATION OF FUNDRAISING FOR CHARITY

and cultural institutions to local garden clubs, from politically powerful national associations to block associations—literally millions of groups in all. This vast and varied array is, and has long been widely recognized as, part of the very fabric of American life. It reflects a national belief in the philosophy of pluralism and in the profound importance to society of individual initiative.

Underpinning the virtual omnipresence of voluntary organizations, and a form of individual initiative in its own right, is the practice—in the case of many Americans, the deeply ingrained habit—of philanthropy, of private giving, which provides the resource base for voluntary organizations. Between money gifts and the contributions of time and labor in the form of volunteer work, giving is valued at more than \$50 billion a year, according to Commission estimates.

These two interrelated elements, then, are sizable forces in American society, far larger than in any other country. And they have contributed immeasurably to this country's social and scientific progress. On the ledger of recent contributions are such diverse advances as the creation of noncommercial "public" television, the development of environmental, consumerist and demographic consciousness, community-oriented museum programs, the protecting of land and landmarks from the often heedless rush of "progress." The list is endless and still growing; both the number and deeds of voluntary organizations are increasing. "Americans are forever forming associations," wrote de Tocqueville. They still are: tens of thousands of environmental organizations have sprung up in the last few years alone. Private giving is growing, too, at least in current dollar amounts.²¹

Exemption from taxation for certain types of nonprofit organizations is a principle that is larger than the Internal Revenue Code. Citizens combating problems and reaching solutions on a collective basis—in "association"—are inherent in the very nature of American societal structure. Nonprofit associations are traditional in the United States, and their role and responsibility are not diminished in modern society. Rather, some contend that the need for the efforts of nonprofit organizations is greater today than previously, in view of the growing complexity and inefficiency of government. To tax these entities would be to flatly repudiate and contravene this doctrine that is so much a part of the nation's heritage.

This view of nonprofit associations operating in the United States has been most eloquently stated by Alexis de Tocqueville. He, too, espoused the principle of pluralism, as expressed in his *Democracy in America*:

Feelings and opinions are required, the heart is enlarged, and the human mind is developed only by the reciprocal influence of men upon one another. I have shown that these influences are almost null in democratic countries; they must therefore be artificially created, and this can only be accomplished by associations. ... A government can no more be competent to keep alive and to renew the circulation of opinions and feelings among a great people than to manage all the speculations of productive industry. No sooner does a government attempt to go beyond its political sphere and to enter upon this new track than it exercises, even unintentionally, an insupportable

21. *Id.* at 9–10.

1.1 CHARITABLE SECTOR AND AMERICAN POLITICAL PHILOSOPHY

tyranny; for a government can only dictate strict rules, the opinions which it favors are rigidly enforced, and it is never easy to discriminate between its advice and its commands. Worse still will be the case if the government really believes itself interested in preventing all circulation of ideas: it will then stand motionless and oppressed by the heaviness of voluntary torpor. Governments, therefore, should not be the only active powers; associations ought, in democratic nations, to stand in lieu of those powerful private individuals whom the equality of conditions has swept away.

But de Tocqueville's classic formulation on this subject came in his portrayal of the use by Americans of "public associations" in civil life:

Americans of all ages, all conditions, and all dispositions constantly form associations. They have not only commercial and manufacturing companies, in which all take part, but associations of a thousand other kinds, religious, moral, serious, futile, general or restricted, enormous or diminutive. The Americans make associations to give entertainments, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the antipodes; in this manner they found hospitals, prisons, and schools. It is proposed to inculcate some truth or to foster some feeling by the encouragement of a great example, they form a society. Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association.

One distinguished philanthropist believed that if the leadership of the government and business sectors of U.S. society were to assume the responsibility for support of the private sector, "[w]e would surprise ourselves and the world, because American democracy, which all too many observers believe is on a downward slide, would come alive with unimagined creativity and energy."²²

Contemporary writing is replete with examples of these fundamental principles. Those who have addressed the subject include:

... the associative impulse is strong in American life; no other civilization can show as many secret fraternal orders, businessmen's "service clubs," trade and occupational associations, social clubs, garden clubs, women's clubs, church clubs, theater groups, political and reform associations, veterans' groups, ethnic societies, and other clusterings of trivial or substantial importance. —*Max Lerner*

... in America, even in modern times, communities existed before governments were here to care for public needs. —*Daniel J. Boorstin*

... voluntary association with others in common causes has been thought to be strikingly characteristic of American life. —*Merle Curti*

We have been unique because another sector, clearly distinct from the other two [business and government], has, in the past, borne a heavy load of public responsibility. —*Richard C. Cornuelle*

The third sector is ... the seedbed for organized efforts to deal with social problems. —*John D. Rockefeller*

22. Rockefeller 3d, "America's Threatened Third Sector," *Reader's Digest*, Apr. 1978, at 105, 108.

GOVERNMENT REGULATION OF FUNDRAISING FOR CHARITY

... the ultimate contribution of the Third Sector to our national life—namely, what it does to ensure the continuing responsiveness, creativity and self-renewal of our democratic society. ... —*Waldemar A. Neilsen*

... an array of its [the independent sector's] virtues that is by now fairly familiar: its contributions to pluralism and diversity, its tendency to enable individuals to participate in civil life in ways that make sense to them and help to combat that corrosive feeling of powerlessness that is among the dread social diseases of our era, its encouragement of innovation and its capacity to act as a check on the inadequacies of government. —*Richard W. Lyman*

The problems of contemporary society are more complex, the solutions more involved and the satisfactions more obscure, but the basic ingredients are still the caring and the resolve to make things better. —*Brian O'Connell*²³

Tax exemption for charities and the charitable contribution deduction, therefore, are not anachronisms, nor are they loopholes. Rather, they are a bulwark against overdomination by government and a hallmark of a free society. These elements of tax law help nourish the voluntary sector of this nation, preserve individual initiative, and reflect the pluralistic philosophy that has been the guiding spirit of democratic America. The charitable deduction has been proven to be fair and efficient, and without it the philanthropic sector of U.S. society would be rendered unrecognizable by present standards.

In sum, the charitable deduction and exemption are predicated on principles that are more fundamental than tax doctrines and are larger than technical considerations of the federal tax law. The federal tax provisions that enhance charity exist as a reflection of the affirmative national policy of not inhibiting by taxation the beneficial activities of qualified organizations striving to advance the quality of the American social order.

Likewise, in the zeal to regulate charitable solicitations, government must take care not to destroy the very institutions that compose the essence of the American societal fabric.

§ 1.2 CHARITABLE FUNDRAISING: A PORTRAIT

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.

23. These quotations in fuller form, and others, are collected in O'Connell, *America's Voluntary Spirit* (New York: The Foundation Center, 1983).

A companion book by Bruce R. Hopkins, *Starting and Managing a Nonprofit Organization* (7th ed.), addresses this point in additional detail and traces the origins and development of a hypothetical charitable organization to illustrate applicability of the various laws, including fundraising regulation requirements.

(a) Scope of Charitable Giving in General

Charitable giving in the United States in 2020 is estimated to have totaled \$471.44 billion.²⁴ Total charitable giving grew 5.1 percent measured in current dollars over the revised total of \$448.66 billion contributed in 2019. Adjusted for inflation, total charitable giving in 2020 increased 3.8 percent.

Charitable giving by individuals in 2020 amounted to an estimated \$324.1 billion; this level of giving constituted 69 percent of all charitable giving for the year. Grantmaking by private foundations was an estimated \$88.5 billion (19 percent of total funding). Gifts in the form of bequests in 2020 were estimated to be \$41.19 billion (9 percent of total giving). Gifts from corporations in 2020 totaled \$16.88 billion (4 percent of total giving for that year).

Contributions to religious organizations in 2020 totaled \$131.08 billion (28 percent of giving that year). Gifts to educational organizations amounted to \$71.34 billion (15 percent); to human service entities, \$65.14 billion (14 percent); to foundations, \$58.17 billion (12 percent); to public/society benefit organizations, \$48 billion (10 percent); to health care institutions, \$42.12 billion (8 percent); to international affairs entities, \$25.89 billion (6 percent); to arts, culture, and humanities entities, \$19.47 billion (4 percent); and to environment/animals groups, \$16.14 billion (3 percent).

In 2020, 13 percent of total charitable contributions were made online. Fifty-three percent of the U.S. population made charitable gifts in the year. It is estimated that, in 2020, 20 percent of households accounted for 80 percent of charitable giving.

Despite the global pandemic, charitable giving in 2020 increased, for a variety of reasons, including the response to the pandemic, the favorable tax law provisions in the CARES Act, an increase of interest in racial and social justice, and an expanding stock market.

(b) Noncash Gifts Statistics

The IRS, in late May, 2021, made public its most recent data, for tax year 2018, on the extent of noncash charitable contributions by itemizing individuals.²⁵ For that year, these individuals reported \$83.5 billion in noncash charitable gifts on 9.2 million returns.

24. These data are from *Giving USA 2021: The Annual Report on Philanthropy for the Year 2020*, published by the Giving USA Foundation and researched and written by the Indiana University Lilly Family School of Philanthropy. One set of commentators observed that the “story of philanthropic giving in 2020 was as complex as the year itself,” noting that “[g]iving rose 3.8 percent despite a global pandemic that upturned daily life, prolonged but uneven economic fallout, and renewed attention to civil rights and racial justice” (Stiffman and Theis, “Giving Grew in a Tumultuous Year but Not for All. What’s Ahead in 2021?,” 33 *Chron. of Phil.* (No. 9) 28 (July 2021)).

25. IRS, *Statistics of Income Bulletin* (Spring 2021).

(i) Form 8283 Reporting. About 46 percent of these returns carried \$70.8 billion in charitable contributions to their Schedule A using Form 8283. The number of the returns filed with Form 8283 declined by 52.4 percent and the amount claimed by these taxpayers decreased by 15.9 percent in relation to 2017. These declines are attributed, at least in part, to the increase in the standard deduction amount enacted in late 2017. Taxpayers using the standard deduction do not, of course, file Schedule A or Form 8283. The average amount of reported noncash contributions per return increased from \$9,490 to \$16,762 (a 76.6 percent increase).

(ii) Types of Noncash Contributions. Contributions of corporate stock, mutual funds, and other investments accounted for 60.3 percent (\$42.7 billion) of these gifts. Stock contributions alone aggregated \$38.6 billion (54.5 percent of the total). The second largest of these categories was clothing, totaling \$6.9 billion (9.7 percent). In third place are gifts of easements, valued at \$6.5 billion (9.2 percent).

Corporate stock gifts averaged \$254,305 per return. Clothing donations averaged \$2,305 per return. Conservation easements had the largest average contribution amount of \$660,666 per return, with about 9,840 returns carrying contributions to a Schedule A. Gifts of other investments reflected the second-largest average donation amount of \$478,230 per return, based on approximately 3,520 returns that carried \$1.7 billion in contributions to Schedule A.

(iii) Decline in Returns and Amounts. From 2017 to 2018, the number of tax returns filed with noncash charitable contributions declined for nearly all categories of these gifts, the exception being for those of easements. Returns with corporate stock gifts declined by 26.1 percent. Returns with clothing donations, the second-largest gift category, dropped by 54.7 percent.

Contribution amounts declined for nearly all categories, the exceptions being for easements, airplanes, boats, and other vehicles. Specifically, the amount attributed to gifts of clothing fell by 42.2 percent.

(iv) Average Contribution Amounts. The average contribution amount per return for noncash contributions increased 76.6 percent, from \$9,490 per return with an attached Form 8283 in 2017 to \$16,762 in 2018. Average stock gifts grew from \$205,503 per return in 2017 to \$254,305 in 2018 (33.4 percent). The average amount claimed for clothing gifts rose 27.5 percent, from \$1,808 to \$2,305 per return; average household donations increased from \$1,787 to \$2,514 per return (40.7 percent).

Although easement contributions had the largest average amount carried per return to Schedule A in 2017 and 2018, this amount declined 11.5 percent, from \$746,519 in 2017 to \$660,666 per return in 2018. The only other types of

1.2 CHARITABLE FUNDRAISING: A PORTRAIT

charitable contributions that showed declines in average amounts per return were other investments (\$669,230 down to \$478,230) and airline tickets and miles (\$4,879 down to \$2,960).

(v) Types of Charitable Organizations. In recent years, foundations and large organizations have consistently been the greatest beneficiaries of noncash charitable contributions. The amounts for 2018 are \$21.7 billion and \$9.7 billion, respectively. In 2018, however, donor-advised funds were the recipients of the second-largest contribution amount—\$11.3 billion.

Foundations received 30.6 percent of these gifts on nearly 65,000 returns, with an average contribution per return of \$334,747. Donor-advised funds received 16 percent of these gifts on about 71,860 returns, having an average gift of \$157,921 per return. Contributions to large organizations were reported on 3.3 million returns, resulting in the smallest average amount of \$2,938 per return.

Generally, all categories of charitable organizations experienced declines in donation claims for these types of contributions on tax returns from 2017 to 2018. There were two exceptions. One was for contributions to environmental and animal-related organizations, which increased by 44.8 percent. The other was an 8.7 percent increase in these contributions to donor-advised funds.

Most categories of charitable organizations received more of these contributions claimed on returns in 2017 than they received in any year since 2007. Between 2009 and 2017, the amount of these gifts more than doubled for six of the organization types. In 2018, these trends changed significantly, in that most organization types received fewer gift amounts. Contributions to donor-advised funds, however, experienced the highest growth, increasing from \$1.8 billion in 2009 to \$11.3 billion in 2018.

(c) Online Charitable Fundraising

Not that long 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.²⁶ But it was clearly coming, and was expected to someday be a major force in charitable fundraising. That “someday” arrived, but only fairly recently.

In mid-2014, *The Chronicle of Philanthropy* provided a special report on online fundraising.²⁷ Among the findings in this report was that Internet gifts climbed 13 percent in 2013 in relation to 2012, although online fundraising

26. Hopkins, *The Nonprofits' Guide to Internet Communication Law* (Hoboken, NJ: John Wiley & Sons, 2003), Chapter 4.

27. Daniels and Narayanswamy, “Digital Giving Goes Mainstream,” 26 *Chron. of Phil.* (No. 13) F-1 (May 22, 2014).

“still accounts for a very small portion of the money charities rely on.”²⁸ Nonetheless, in 2013, the Leukemia & Lymphoma Society raised more than \$98 million online, the California Community Foundation raised more than \$95 million online, and the American Heart Association raised \$59 million in that manner; other totals were more than \$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).²⁹

About one year later, another report speaks of the “transformative promise of online fundraising” that has yet to materialize.³⁰ 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 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.”³¹

§ 1.3 BRIEF HISTORY OF GOVERNMENT REGULATION OF FUNDRAISING

“‘Helping’ Children” was the first line of a front-page *Washington Post* headline in 1980, which continued: “Va. Charity Raised Nearly \$1 Million, but 93 Percent Went for Expenses.”³² That headline, despite its age, encapsulates one of the prime issues facing America’s philanthropic community today: the reasonableness of fundraising costs, as perceived by federal and state legislators and regulators and by the public—as well as those who manage or

28. Daniels and Narayanswamy, “Online Giving Grows More Sophisticated,” 26 *Chron. of Phil.* (No. 13) F-3 (May 22, 2014).

29. 26 *Chron. of Phil.* (No. 13) F-4 (May 22, 2014).

30. “Click, Click, Cash?,” 27 *Chron. of Phil.* (No. 9) 10 (May 2015).

31. *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). Also, Haynes, “Not Just for Dancing Teens,” 33 *Chron. of Phil.* (No. 7) 16 (May 2021) (describing TikTok as a fundraising tool).

32. *Wash. Post*, Feb. 7, 1980, at A1. Also see “Correction,” *Wash. Post*, May 11, 1980, at 2.

1.3 BRIEF HISTORY OF GOVERNMENT REGULATION OF FUNDRAISING

are generally responsible for the charities involved. Government regulation of fundraising for charity, while encompassing other matters, is fixed on the single issue of fundraising expenses: their measurement, reporting, and “proper” amount.³³ In fact, the origin of government regulation of fundraising is traceable to the fundraising cost issue; the history of this field of regulation reflects reaction to a pageant of alleged abuses by charities soliciting gifts, each of which featured an ostensibly “high” percentage of fundraising costs.

This article detailed the direct-mail fundraising activities of Children’s Aid International (CAI), an organization headquartered in Alexandria, Virginia. According to the account, the organization raised nearly \$1 million over a two-year period—“money it promised to spend on packages of high-protein food for malnourished children around the world”—yet expended on “food for children” less than seven cents out of each dollar raised. The breakdown on CAI’s expenditures: 25 percent for management fees, 17 percent for other administrative costs, 51 percent for fundraising, and the balance—7 percent—for “starving children.”

The clear implication gained from the article is that a 93 percent fundraising cost experienced by a charity is “improper,” may be close to “fraudulent,” and is certainly “wrong.” The closest the article came to expressing criticism was its observations that CAI’s fundraising costs are “high in comparison with ... many established charities,” and that the fundraising costs of the local United Way agency are less than 7 percent. The organization’s defense—unavoidably high startup costs—went unanalyzed and was buried deep in the story. It may be safely assumed that the article helped fuel public suspicion about charitable institutions generally.

Some months before, another *Washington Post* headline had announced: “Pallottines Say Nearly 75% Spent for Fund-Raising.”³⁴ This story featured the celebrated case of the Pallottine Fathers, a Catholic order based in Baltimore, Maryland, that conducted a massive direct-mail fundraising effort and allegedly devoted, in one 18-month period, 2½ cents out of every dollar received for missionary work. Apparently, in 1976, the order raised \$7.6 million and spent \$5.6 million to do so. This undertaking eventuated in a grand jury investigation, which developed evidence of extensive real estate dealings by the order and a loan to the then governor of the state to help finance his divorce. Little of the proceeds of the order’s solicitations went to support

33. One commentator, reflecting a concern that lingers, observed that many states “are beginning to reexamine laws regulating charitable solicitations in the wake of recent disclosures revealing the actual expenditure patterns of many organizations” and concluded: “Of primary concern have been the revelations that in many instances only a small percentage of the money given to further a charitable cause is expended on that cause.” Quandt, “The Regulation of Charitable Fundraising and Spending Activities,” 1975 *Wis. L. Rev.* 1158, 1159 (1975).

34. *Wash. Post*, Nov. 3, 1977, at C1.

Pallottine missions in underdeveloped countries as claimed. The publicity became so intense that the Vatican rector general of the order commanded that Pallottine fundraising activities cease and formed a special investigating commission; the priest who headed the order's fundraising operations was banished from Maryland by the archbishop of Baltimore.

Another well-publicized instance of this nature concerned the Freedom Forum International, Inc., formerly the Gannett Foundation. Although this matter did not involve fundraising costs, it focused on ostensibly high administrative expenses; the organization was under investigation by the office of the state attorney general in New York to determine whether these expenses were "imprudent or excessive." A front-page *Washington Post* headline stated: "Neuharth Foundation Spares No Expense," with an inside-page headline trumpeting that "Freedom Forum's Expenses Far Outstrip Its Contributions, Grants."³⁵ According to this account, in 1991, the foundation incurred expenses of \$34.4 million and made grants in the amount of \$20.2 million. Office expenses were \$17 million and a rooftop conference center accounted for \$5.4 million; trustees' fees were higher than the norm, and the chairman's compensation was said to be "more than 10 times greater than is typical in large private foundations."³⁶ The article related trips of the board of trustees to resort areas for meetings, air travel on first class, and payment of travel expenses of board members and some of their spouses. The newspaper concluded that the organization's "spending is unusual compared with similar-sized foundations—or even those twice or more its size—which ... receive their funding from endowments, not from public donations."³⁷

Another of these reports focused on the use of candy, gum, and other vending devices by charitable organizations as a fundraising technique. Apparently, the charities often receive small amounts of money in the form of licensing fees, while the vast bulk of the funds flows to those who sell and operate the devices. The arrangement spawned this front-page *Washington Post* headline: "For Charity, Just Drops in the Bucket," followed by "Most of Public's Donations Go to Marketers, Vendors."³⁸ Although one national charitable organization was said to have received 10 percent of the amount received from dispensers in 1992 (\$1.4 million), many receive little or nothing in this fashion. When the charities own the devices directly or in partnership

35. *Wash. Post*, Mar. 23, 1993, at A1. The reference to the "Neuharth Foundation" (not its formal name) reflects the fact that the chairman of the board of the foundation is Allen H. Neuharth, formerly the chief executive of the Gannett Co.; the foundation was established in 1935 by New York newspaper publisher Frank E. Gannett.

36. *Id.* at A6.

37. *Id.* The three-year investigation of the spending practices of the Forum culminated in an agreement by its trustees to pay to the organization about \$174,000 in settlement of claims as to lavish spending; the specifics of the settlement are detailed in XII *Nonprofit Counsel* (No. 2) 1 (Feb. 1995).

38. *Wash. Post*, Oct. 2, 1993, at A1.

1.3 BRIEF HISTORY OF GOVERNMENT REGULATION OF FUNDRAISING

with a vending company, it seems that they regularly receive as much as 15 percent of the gross receipts.³⁹

Still another of these episodes, this one involving the Marine Toys for Tots Foundation, was splashed across the front page of the *Washington Post*: “Marines’ Toys for Tots Spent Millions on Itself,” with the subheadline stating: “Donations Used to Run Charity, Not Buy Gifts.”⁴⁰ This organization was said to have “collected nearly \$10 million in the last two years through a direct-mail campaign, but foundation officials acknowledge that none of the money has gone to buy toys for needy children.”⁴¹ When contributions from other sources are taken into account, however, the report added, the three-year-old foundation expended 10 percent of the money raised in its most recent fiscal year for toys for children; the balance was spent on management, fundraising expenses, and promotional materials. The new head of the foundation was quoted as saying that “[m]y goal, and it is an optimistic one, is to have 75 percent of the money raised in the next mailing go toward program expenses, with most of that going to buy toys.”⁴² Other program activities of the foundation included education of the public on the needs of poor children.

In 2010, the CFO of Charity Navigator said, “[o]f the 5,500 largest charities in America that depend on support from the public, our research shows that the typical charity spends 75% of its budget on programs, 10% on fundraising and 15% on administrative costs. . . . Donors should look for groups that hit or come close to this benchmark and remember that charities must pay for mundane things like the electric bill and they do have to spend some money to bring in donations.”⁴³ However, the American Institute of Philanthropy also noted that newer organizations and charities dedicated to less popular issues may need to spend more on fundraising and administrative costs.⁴⁴

In 2010, the Senate Finance Committee opened an investigation into the Washington-based Disabled Veterans National Foundation (DVNF). The DVNF collected nearly \$56 million in donations from 2010 to 2012 yet paid its direct mail provider \$60 million in fees.⁴⁵ This investigation received national attention over how much a charity should spend in order to make money, and at what point is this number so high as to invoke criticism.⁴⁶ Of the

39. *Id.* at A8. According to this account, some states are investigating this practice, either on the basis of fraud, to force the marketers and vendors to register as professional fundraisers (see § 3.31), or to cause the charities to disclose the percentage of their receipts from this source (see § 3.40).

40. *Wash. Post*, Feb. 10, 1994, at A1.

41. *Id.*

42. *Id.* at A16. Deep into the article is this statement: “Part of the problem, according to the foundation, is that it is very expensive to initiate a direct-mail campaign” (*id.*).

43. Kane, “Where Are Your Charity Dollars Going?,” *CNBC.com*, December 9, 2010.

44. *Id.*

45. Fitzpatrick and Griffin, “Little of Charity’s Money Going to Help Animals,” *CNN.com*, June 15, 2012.

46. *Id.*

\$14 million that animal charity Society for the Protection of Children and Animals International raised in 2010, it spent less than 0.5 percent—about \$60,000—in small cash grants to animal shelters across the United States.⁴⁷ (SPCA International also spent about \$450,000 of this amount to bring back animals from Iraq and Afghanistan as part of its “Baghdad Pups” program.) In 2012, both the Disabled Veterans National Foundation and SPCA International received “F” rankings from CharityWatch, a charity-ratings group. Both organizations blamed their cost allocations on a prominent university philanthropy professor’s expert opinion.

InfoCision is a telemarketer that has raised money by large charities, such as the American Diabetes Association. InfoCision keeps anywhere from 70 to 80 percent of the total donations raised through its deceptive charity marketing. According to an investigation by North Carolina regulators, only 22 percent of the funds raised by InfoCision in 2011 went to the charity.⁴⁸ The American Cancer Society, the largest health charity in the United States, enlisted InfoCision from 1999 to 2011. In fiscal year 2010, InfoCision gathered \$5.3 million for the American Cancer Society. Hundreds of thousands of volunteers took part, but none of the money went to the charity, according to InfoCision’s Form 990 and State of Maine annual filings. Government filings show that InfoCision kept 100 percent of the funds it raised, plus \$113,006 in fees from the society.⁴⁹

Thanks to the Internet and other online advances, fundraising scandals are more prevalent. A New York woman was arrested just days after the Sandy Hook Elementary School shooting in 2012, in Newtown, Connecticut, for collecting fraudulent “funeral fund” donations for one of the victims.⁵⁰ According to the FBI, the woman used her Facebook account, telephone, and text messages to solicit donations through her PayPal account. A U.S. attorney said that, in the aftermath of the shooting, federal and state authorities were “actively monitoring the Internet and investigating multiple fundraising scams” stemming from the killings.⁵¹ Unfortunately, stories like these are not uncommon in today’s world. Earlier that year, a south-central Idaho couple was charged with fundraising to pay for what they claimed was their daughter’s leukemia treatment.⁵² Police arrested the couple at the site of a planned car wash and raffle fundraiser and charged them with grand theft by deception.⁵³ Also that year, a man was arrested on accusations that he ran a

47. *Id.*

48. Evans, “Charities Deceive Donors Unaware Money Goes to a Telemarketer,” *Bloomberg.com*, Sept. 11, 2012.

49. *Id.*

50. Winter, “N.Y. Woman Arrested over Newtown Massacre Scam,” *USA Today*, December 29, 2012.

51. *Id.*

52. “Idaho Couple Arrested for Cancer Fundraiser Fraud,” *The Seattle Times*, August 29, 2012.

53. *Id.*

1.3 BRIEF HISTORY OF GOVERNMENT REGULATION OF FUNDRAISING

scam that collected \$100 million in donations from people from 41 states who believed they were helping U.S. Navy veterans.⁵⁴

In 2015, the Federal Trade Commission (FTC) 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 charged 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), and 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 "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.

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 were banned from fundraising and charity management, and CCFA and BCS was dissolved. Subsequently, the FTC announced the total

54. Sheeran, "John Donald Cody, Harvard Law Grad, Suspected of Running \$100 Million Cross-Country Scam," *Huffington Post*, October 2, 2012.

disbandment of the CFA and CSS. Further, James Reynolds Sr. was barred from operating or engaging in fundraising for nonprofit organizations.

Soon thereafter, the New York attorney general announced that the office had 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 that it operated a bone marrow registry and fulfilled the last wishes of dying children. The court papers charged 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 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.

In May 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 had an extensive history of misconducting solicitations for charities.

The attorney general of New York announced in November 2016 that the office had settled its case against the National Vietnam Veterans Foundation. According to a statement, nearly all of the funds raised through the Foundation's direct-mail efforts were used to pay its 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.

In September 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 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 was required to pay \$150,000, with \$125,000 paid

1.3 BRIEF HISTORY OF GOVERNMENT REGULATION OF FUNDRAISING

for breast cancer research and the remaining \$25,000 to recover the state of Michigan's investigative costs. The organization was also banned from soliciting in Michigan for 10 years.

In November 2017, New York's attorney general 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 services 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 safeguard 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 banned Schulman from serving as an officer or director of any New York nonprofit organization for five years.

In October 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 the line of duty. The attorney general found that 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. In July of that year, the Virginia attorney general announced that the 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 were part of a 16-state action. According to a release from the Virginia attorney general's office, the Operation Troop Aid, Inc. settlement required it to dissolve and prohibits its CEO from assuming any fiduciary role with a nonprofit corporation or soliciting on a nonprofit corporation's behalf.

In July 2019, the New York attorney general announced an investigation into the website www.NYCharities.org, alleging that the online fundraising platform failed to distribute hundreds of thousands of dollars to New York charities in 2018 and 2019. This investigation was based on more than 100 complaints from individuals and organizations, including those with unpaid contributions ranging from \$200 to more than \$100,000.

In September 2020, the FTC filed a complaint in the Southern District of New York against Outreach Calling, a fundraiser, its owner, two related

organizations, and three other individuals. The attorneys general of Virginia, New York, New Jersey, and Minnesota joined the FTC as plaintiffs. The plaintiffs alleged that the defendants engaged in deceptive telemarketing schemes on behalf of several sham charitable organizations. The complaint states that Outreach Calling induced tens of millions of dollars in charitable donations by telling donors that the recipient charities provided assistance to the most vulnerable populations such as homeless veterans and cancer patients. The plaintiffs stated that, in reality, the recipient charities spent very little on charitable programs—in some cases, as little as 1 or 2 percent of gross donations. Instead, around 90 percent of the funds raised was paid to Outreach Calling, and most of the rest was paid to fund personal expenses of the charities' principals. The FTC also brought a separate action in January 2021 against a predatory fundraising practice. These two actions ultimately resulted in consent judgments against for-profit fundraisers amounting to \$111.7 million and \$58.5 million, respectively.

These episodes are, unfortunately, only a few in a series of similar exposés that have haunted legitimate charities for years and helped taint the term *fundraising*.⁵⁵ These events also fueled development of the machinery that has been built by and for government to regulate fundraising by charitable organizations. Many an aspiring or practicing politician has parlayed a probe of a charity “scandal” into high office. Thus, *Time* magazine, for example, was moved to characterize the Pallottine order scandal as indicative of widespread wrongdoing: “The Pallottine mess provides Americans with one more excuse not to give money to church agencies, even those that make full public accountings”⁵⁶ and the “Pallottines were not the only agency that used 80 percent or more of their [sic] gifts to cover the exorbitant costs of direct mail.”⁵⁷

Other episodes—isolated instances having major impact on public and regulatory attitudes—include the solicitation activities of Father Flanagan’s Boys Town, the Sister Kenny Foundation, the Police Hall of Fame,⁵⁸ the Freedom for

55. Also, “Charity Fund-Raiser, Client Target of Md. Grand Jury Probe,” *Wash. Post*, Dec. 12, 1991, at D1; “Solicitors Cash In on Budget Pinch Felt by Nonprofit Groups,” *Wash. Post*, Oct. 18, 1982 (Washington Business), at 19; “Many Charity Shows Benefit Mostly the Fundraiser,” *Charlotte Observer*, Mar. 22, 1981, at 1.

56. “Radix Malorum Est Cupiditas?” *Time*, Jan. 23, 1978, at 75.

57. “Wrist Tap,” *Time*, May 22, 1978, at 64.

58. In this matter, the Circuit Court of Cook County, Illinois, ordered fundraisers to pay \$528,231.52 (including \$150,000 in punitive damages) into a trust fund for widows and children of slain law enforcement officers, as the result of a fundraising effort that generated \$785,731, of which the fundraisers received \$622,000 for costs and compensation. One contract allowed up to 75 percent of total contributions to be consumed in fundraising expenses; the court characterized this and other contracts as authorizing “illegitimate commissions and expenses and were outrageous, unconscionable and an assault upon the public conscience in violation of public policy and Illinois law relating to charitable solicitations.” *People of the State of Illinois v. Police Hall of Fame, Inc.*, No. 74 CH 5015 (order dated Oct. 19, 1976).

1.3 BRIEF HISTORY OF GOVERNMENT REGULATION OF FUNDRAISING

All Forever Foundation, the Korean Cultural and Freedom Foundation,⁵⁹ and the Children's Relief Fund.⁶⁰ Thus, the media remain alive with one report after another of the alleged misdeeds of charities. Invariably, the scandals involve solicitations of charitable contributions from the public, by or for organizations that derive their principal support from public giving,⁶¹ with an ostensibly excessive amount of funds devoted to direct-mail campaigns, questionable investments, or administration.⁶² At the same time, these developments should be kept in perspective, in that the organizations involved represent only a very small segment of the charitable community.

A few decades ago, federal regulation of fundraising for charity did not exist (other than by means of the charitable contribution deduction), and state regulation in the field was just beginning to flower. Before that time, fundraising regulation (such as it was) was a combination of occasional IRS audits and state attorneys general inquiries, the latter predicated on their historical role of enforcing the requirements imposed on the administration of charitable trusts.⁶³ These efforts were based on one premise, and today's vast and growing governmental apparatuses overseeing charitable fundraising continue to be guided by that premise: "The greatest possible portion of the wealth donated to private charity must be conserved and used to further the charitable, public purpose; waste must be minimized and diversion of funds for private gain is intolerable."⁶⁴ Out of the inadequacies of common law principles and tax enforcement efforts has grown—and is still growing—a comprehensive supervisory and regulatory program governing the fundraising efforts by charitable organizations at the federal, state, and local levels.

Statutory regulation of fundraising for charity began with codification of the supervisory and investigatory authority of state attorneys general. Thereafter, there came into being provisions seeking to prevent fraud in charitable

59. In one instance, the Attorney General of the State of New York charged the Foundation with raising \$1,508,256 and expending only \$95,674 (6.3 percent) for charitable purposes, and characterized the Foundation as "perpetrating a fraud upon the contributing public" (news release dated Feb. 16, 1977).

60. For a litany of fundraising "abuses," see Hearing on Children's Charities Before the Subcommittee on Children and Youth of the Senate Committee on Labor and Public Welfare, 93d Cong., 2d Sess. (1974), chaired by then-Senator Walter F. Mondale. Also Hearings on Fund Raising By or in Behalf of Veterans Before the House Committee on Veterans' Affairs, 85th Cong., 2d Sess. (1958); Hearings on Federal Agencies and Philanthropies Before a Subcommittee of the House Committee on Government Operations, 85th Cong., 2d Sess. (1958).

61. E.g., Baldwin, "Ideology by Mail," *New Republic*, July 7 and 14, 1979, at 19.

62. These developments have spawned articles in the popular media, such as Smith, "New Guidelines for Giving" (subtitled "Our 10 commandments help you separate top charities from wastrels"), *Money*, Dec. 1989, at 141.

63. Bogert, "Proposed Legislation Regarding State Supervision of Charities," 52 *Mich. L. Rev.* 633 (1954).

64. Karst, "The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility," 73 *Harv. L. Rev.* 433-434 (1960).

solicitations or to promote disclosure of information about these solicitations, or both. Municipal ordinances earlier introduced the concepts of licensing and periodic reporting of charities' fund collection activities, and this approach was adopted by the states as their charitable solicitation acts were written. As the years passed, the statutes became more extensive and stringent; the staffs of the regulatory agencies increased; and regulations, rules, and forms unfolded. In general, the call of one observer, who declaimed that the "evils of inefficient or unscrupulous charitable organizations must be attacked head on by strong government regulation,"⁶⁵ was heard.

The process is by no means wholly an instance of government regulation increasing merely for the sake of increase. The nature of organized philanthropy and the perception of it by the public, lawmakers, and regulators have altered dramatically over the past decades.

§ 1.4 CONTEMPORARY REGULATORY CLIMATE

The number of nonprofit organizations remains steadily on the rise. Most of these are exempt from federal and state income and property taxation, many are eligible to attract tax-deductible contributions, and many utilize preferred postal rates. The involvement of these groups in the day-to-day management and change of American life has never been greater.

Concurrent with the rise in state regulation of fundraising for charity has been a significant upsurge in regulatory activity at the federal level by means of administration of the nation's tax and other laws. The process got under way in 1950, when Congress enacted laws taxing the unrelated business income of otherwise tax-exempt organizations. In 1969, the Internal Revenue Code was sizably thickened by a battery of rules defining, regulating, and taxing private foundations, seeking to prevent self-dealing and large stockholdings and to increase grantmaking and public involvement in the affairs of foundations. In 1974, Congress authorized the formation, within the IRS, of a formal administrative and regulatory structure, which has stepped up federal oversight and audit of the nation's nonprofit, including charitable, organizations. In 1987, Congress enacted disclosure laws for noncharitable tax-exempt organizations engaged in fundraising; in 1989, the IRS launched a renewed effort to require disclosures in the course of fundraising for charitable organizations; in 1993, Congress enacted substantiation and disclosure laws applicable to tax-exempt charitable organizations engaged in fundraising; in 2004, Congress provided rules concerning the charitable deduction for contributions of vehicles and intellectual property, and increased reporting for noncash contributions; in 2006, Congress enacted new substantiation rules, stiffer penalties for inflated valuations, and rules concerning charitable gifts of fractional interests in art

65. Quandt, *supra* note 33, at 1187.

(and other tangible personal property), clothing and household items, and taxidermy; and in 2017, the standard deduction was essentially doubled.

Still, notwithstanding this rise in government regulation, all is not well. The malady was evidenced several years ago by a blast from a normally rather staid publication, hurling the following charges against some nonprofit organizations—they:

- Pay their executives fat salaries and allow them generous fringe benefits.
- Award contracts to their trustees and board members.
- Serve as fronts for commercial enterprises with which they have “sweet-heart” deals.
- Enjoy special mailing privileges and property tax breaks that give them a competitive edge against tax-paying establishments.
- Engage in wasteful and sometimes fraudulent fundraising with little accountability to the public.⁶⁶

The last allegation is the most immediate concern in relation to this book, but this inventory of wrongdoings is indicative of the state of the nonprofit sector as perceived by some. Public regard is essential to the successful functioning of charitable groups; this regard—which has remained high throughout the country’s existence—may be eroding in the face of well-publicized abuses and other pressures.⁶⁷

This, then, is the dilemma of the charities: abuses appear to be on the increase, triggering greater governmental regulation, which makes operations more difficult for authentic charitable undertakings and creates a public climate that is more critical of these undertakings. The inroads being made by a few unscrupulous and fraudulent operators in tapping the resources of philanthropy are threatening to undermine the seriously needed solicitation programs conducted by legitimate charitable organizations.

Coincidentally, the public is demanding greater accountability from nonprofit, principally charitable, organizations. The consumerism movement is causing individual and corporate donors to be more concerned and sophisticated about the uses of their gift dollars. The emphasis now is on disclosure; donors—prospective and actual—are demonstrating a greater proclivity to inquire of federal, state, and local agencies, lawmakers, independent “watch-dog” agencies, and the philanthropic community itself about the fundraising and fund-expenditure practices of charitable organizations.

66. “For Many, There Are Big Profits in ‘Nonprofits,’” *U.S. News & World Rep.*, Nov. 6, 1978, at 45.

67. E.g., Gose, “The Trust Crisis,” *32 Chron. of Phil.* (No. 3) 12 (Jan. 2020) (stating that the “public’s declining regard for nonprofits may hurt fundraising”).

In this age, where taxation is generally increasing, taxpayers often lack sympathy for and even resent organizations that do not pay tax. Greater understanding of the principle that taxes forgone by one entity must be made up by others may be fostering a public attitude toward nonprofits that is somewhat less lofty than that captured by concepts of voluntarism and pluralism. Likewise, the lure of the standard deduction (now used by a substantial majority of taxpayers) is pulling people away from deductible charitable giving, thereby severing still another traditional nexus between Americans and their charities.

Therefore, in the face of seemingly inadequate disclosure of meaningful information to the public, excessive administrative and fundraising costs, and insufficient portions of the proceeds of charitable gifts passing for charitable purposes, government regulation of fundraising for charity is thriving. Some states that currently lack a comprehensive charitable solicitation act are engaged in the process of trying to enact one. Many states with a charitable solicitation act may be toughening it, either by amending the act or by increasing reporting and similar regulatory burdens. Although the drive for a federal charitable solicitations statute has abated, the IRS continues to regulate in this field, augmented quite frequently by the courts.

Despite all this activity, the pressure for still more regulation continues, perhaps ultimately to be manifested in some form of a federal charitable solicitations statute. The drive for such a law, now dormant, may be awaiting only the spark of a well-publicized charity scandal to trigger action by Congress. Part of the interest in a federal law in this field derives from dissatisfaction with the present state-by-state regulatory scheme. Critics voice a variety of complaints about the present reach of federal and state regulation:

- There is no requirement (as there is for private foundations and certain supporting organizations) that public charities annually distribute a portion of their funds for charitable purposes.
- There are no common requirements regarding state registration, licensing, periodic reporting, disclosure of financial information, and limitations on compensation of fundraisers.
- There are no uniform accounting standards for public charities imposed by law.
- Some charitable and other nonprofit organizations are escaping taxation of unrelated activities, in part by portraying those activities as *fundraising*.

Certain legislative and nonlegislative developments (all discussed in subsequent chapters), however, may mute some of this criticism—for example, development of the present extensive federal annual information return⁶⁸ and

68. See Chapter 7.

1.4 CONTEMPORARY REGULATORY CLIMATE

the mandatory document disclosure rules.⁶⁹ Also, efforts going forward under the auspices of the National Association of State Charity Officials may result in significant progress toward uniformity of administration and enforcement in this area.

Some parallel developments may also introduce federal law governing charitable solicitations. These concern the fact that, in the wake of more than five decades of experience in strenuously regulating the operations and activities of private foundations, Congress, augmented by the Department of the Treasury and the IRS, is legislating comparable regulation in the realm of public charities, as illustrated by the intermediate sanctions rules⁷⁰ and additional requirements for hospitals, consumer credit agencies, supporting organizations,⁷¹ and entities that sponsor donor-advised funds.⁷² Indeed, some private foundation law restriction are being applied in the public charity context.

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 included 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).

69. See *Tax-Exempt Organizations* § 28.11.

70. See § 5.7.

71. See § 6.4.

72. See § 10.14.

GOVERNMENT REGULATION OF FUNDRAISING FOR CHARITY

- Lawyers and nonlegal 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 of 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, some require registration 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) to donor advisories (77 percent), training (32 percent), and webinars (7 percent).

1.4 CONTEMPORARY REGULATORY CLIMATE

Unlike the torrents of alleged scandals that preceded the revolution in the federal tax laws pertaining to private foundations, which culminated in a major portion of the Tax Reform Act of 1969, there has been no parade of ostensible abuses warranting strict supervision of public charities. Rather, it appears that this is a last frontier for reformers in the field of charitable organizations and that most of the reforms are being advocated because the statutory basis for the rules is already in place;⁷³ furthermore, the imposition of these rules on public charities strikes many as the thing to do as a logical extension of existing regulation. In this context, the recent attention to the matter of government supervision or regulation of solicitations for charitable contributions may bring some new federally enforced rules to govern the fundraising activities of public charities, that is, as part of a comprehensive effort to regulate public charities to the same degree as is at present the case for private foundations.⁷⁴

Whatever happens, one aspect of the matter is clear: both state and federal regulation are on the rise. The former is not likely to be preempted by the latter, at least not any time soon. Students of this regulatory scene have astutely observed that “[a]s legislators continue efforts to devise schemes which comply with the [Supreme Court] decision [finding a state charitable solicitation act unconstitutional as violating free speech rights], they will certainly not renounce long-standing views on the important role of state regulation of charitable solicitation.”⁷⁵

Probably the most difficult issue to cope with is what all of this regulation is and will be doing to the philanthropic sector. Will fundraising regulation improve the solicitation picture for legitimate charitable groups or will it unduly burden legitimate charitable fundraising efforts? Is there actually sufficient abuse taking place in this area to warrant the massive costs of compliance?

Although no one knows the answers to these questions, the march of government regulation of fundraising for charity continues inexorably. This form of regulation, arising from humble origins only a few decades ago, is now one of philanthropy’s major concerns. How and whether these new governmental policies and philanthropy can coexist will say much about the nature of the charitable sector in the coming years.

73. IRC ch. 42.

74. In early 1989, a task force at the IRS recommended that many of the federal tax rules that are presently applicable only to private foundations be extended to apply to some or all public charities (Report of the IRS Commissioner’s Executive Task Force on Civil Penalties).

75. Harris, Holley, and McCaffrey, *Fundraising into the 1990’s: State Regulation of Charitable Solicitation after Riley*, 90 (New York: NYU School of Law, 1989).

