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Elaine Waterhouse Wilson

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State Regulation of Charitable Solicitation

By Elaine Waterhouse Wilson

State and local governments have long attempted to protect their citizens from fraudulent and intrusive charitable appeals by regulating charitable solicitation. For nearly as long, the United States Supreme Court has held that the first amendment to the United States Constitution protects charitable solicitation. Many state legislatures overhauled their charitable solicitation statutes in response to the Supreme Court's 1988 decision in *Riley* (discussed below) and the numerous state court cases that followed.

In this turbulent environment, charities have learned to comply with the reporting, licensing and disclosure requirements of their domicile states. In most instances, however, compliance with the charitable solicitation statute of a charity's home state is not sufficient. For the charity that solicits in more than one state, the burden is to determine the states in which the charity is "soliciting" and then to fulfill each state's unique requirements.

Charitable Solicitation as Protected Speech

Charitable solicitation statutes have two purposes. The first is to prevent outright fraud by noncharitable individuals or entities that solicit contributions using a charitable appeal. The other purpose is to encourage efficiency in fundraising activities and discourage the misrepresentations inherent in a charitable appeal when a high percentage of donated funds go to administrative or fundraising costs. To combat these real and perceived abuses and to educate the philanthropically inclined public, the typical charitable solicitation statute, before 1980, contained three elements: (1) registration and reporting requirements for soliciting charities and fundraising professionals; (2) prohibitions against fraud and misrepresentation, including required disclosures; and (3) stringent limitations on fundraising costs.

Older charitable solicitation statutes often prohibited charities from further solicitation if their fundraising costs were over a certain percentage limitation. In *Village of Schaumburg v. Citizens for a Better Environment*, 444 U.S. 620 (1980), the Supreme Court considered an ordinance that prohibited door-to-door canvassing unless an organization could prove that at least 75% of the solicited funds would go to direct charitable activities. The Supreme Court observed that a charitable solicitation contains both a charitable message and an appeal for funds. Because the organization's charitable message was intertwined with and inseparable from the request for support, the entire solicitation became protected speech. As such, the appropriate standard of review of the ordinance was strict scrutiny, as opposed to the more lenient standard of rational review applicable to commercial speech. The Supreme Court held that the ordinance was unconstitutionally overbroad because the 75% limitation was not narrowly tailored to serve the government's legitimate interests in preventing fraud and protecting public safety.

In response to *Schaumburg*, some legislatures amended solicitation statutes to allow a charity to demonstrate that its administrative costs were reasonable even if in excess of the statute's limitation. A professional fundraiser challenged Maryland's solicitation statute, which prohibited paying a professional fundraiser more than 25% of its receipts from a fundraising campaign but provided a waiver mechanism if the charitable organization could show the reasonableness of such expenditures. Finding that waivers were generally granted only in cases of financial need, the Supreme Court held that the "extremely narrow" waiver provision did not save the statute. *Secretary of State of Maryland v. Joseph H. Munson Co.*, 467 U.S. 947 (1984). In so doing, the Supreme Court voiced its concern over the ability of a

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public official to chill or even prevent charitable solicitation by an exercise of discretion. Once again, the Supreme Court struck down percentage limitations, even with waiver provisions, as unconstitutionally overbroad.

Schaumburg and *Munson* spawned suits in state courts across the country, attacking state legislation and local ordinances that limited charities' ability to solicit based on the percentage of solicited funds devoted to fundraising expenses. Responding to the upheaval, the National Association of Attorneys General (NAAG), with the assistance of the National Association of State Charity Officials (NASCO), developed the Model Act Concerning the Solicitation of Funds for Charitable Purposes (Model Act) in 1986. The Model Act emphasized registration, reporting and consumer education over prohibitions against solicitation. State legislatures around the country amended their solicitation statutes to comply with *Schaumburg* and *Munson*, often using the Model Act as a starting point.

Little time passed before charities challenged these new statutes. In 1988 the Supreme Court reviewed portions of North Carolina's charitable solicitation statute, which the North Carolina legislature based in part on the Model Act, in *Riley v. National Federation of the Blind of North Carolina, Inc.*, 487 U.S. 781 (1988). At issue in *Riley* were three different provisions: (1) a sliding scale of fees that a professional fundraiser could charge; (2) point-of-solicitation disclosures, which included the percentage of receipts retained as compensation by the professional fundraiser in prior solicitations; and (3) a requirement that professional fundraisers obtain a license before solicitation while permitting volunteer fundraisers to solicit after submitting an application.

Following the reasoning of *Schaumburg* and *Munson*, the Supreme Court again held that percentage limitations, even with waivers, chilled protected speech without necessarily advancing state interests. The Supreme Court further determined that the requirement that a professional fundraiser disclose its percentage compensation from prior campaigns violated the first amendment. Because the statute imposed content-based requirements on protected speech, the Supreme Court subjected it to strict scrutiny and found it to be overbroad. Nevertheless, the Supreme Court observed in a footnote that "nothing in this opinion should be taken to suggest that the State may not require a fundraiser to disclose unambiguously his or her professional status. On the contrary, such a narrowly tailored requirement would withstand First Amendment scrutiny." 487 U.S. at 799, n.11. Interestingly, Justice Scalia wrote a specific concurrence to object to this footnote only. 487 U.S. at 803. Finally, the Supreme Court found that the prior registration requirements imposed by the statute on professional solicitors placed an undue burden on speech. Because the statute did not require the state to respond within a particular time to a professional solicitor's application, the state effectively could unconstitutionally delay a solicitor's speech indefinitely.

As occurred in the aftermath of *Schaumburg* and *Munson*, state court litigation based on *Riley* started around the country. The early 1990s saw point-of-solicitation disclosure requirements challenged in a number of jurisdictions. As a result, many states have reviewed and amended their charitable solicitation statutes within the last few years.

The NAAG's Model Act of 1986

NAAG and NASCO produced the Model Act, in part, to address the Supreme Court's first amendment concerns elaborated in *Schaumburg* and *Munson*. The Model Act formed the basis for the revised charitable solicitation statutes passed in the 1980s. Although *Riley* affected some of its provisions, the Model Act nevertheless provides a starting point for reviewing the compliance responsibilities of charities undertaking multijurisdictional solicitation campaigns.

The Model Act requires every "charitable organization" not otherwise exempt under the Act to register before soliciting in the state and to renew such registration annually. Each registered charitable organization must file an annual financial report, which may be the charity's IRS Form 990, and an audited financial statement. Organizations that are not required to file the Form 990 because they fall under the financial minimum requirements are not required to file annual financial

reports and audited financial statements under the Model Act.

Section 1 of the Model Act defines a "charitable organization" as any Code § 501(c)(3) organization and, in addition:

> Any person *who is* or *holds himself out to be* established for any benevolent, educational, philanthropic, humane, scientific, patriotic, social welfare or advocacy, public health, environmental, conservation, civic or other eleemosynary purpose or for the benefit of law enforcement personnel, firefighters, or other persons who protect the public safety, or any person who in any manner employs a charitable appeal as the basis of any solicitation or an appeal *which has a tendency to suggest* there is a charitable purpose to any such solicitation [emphasis added].

The Model Act first employs a bright line test: if an organization is exempt under Code § 501(c)(3), it must register. The far more difficult test is for those organizations that "hold themselves out to be" or "have a tendency to suggest" that they are charitable in nature. This could include civic leagues and social welfare organizations exempt under Code § 501(c)(4), business leagues exempt under Code § 501(c)(6) and clubs exempt under Code § 501(c)(7). Although the Model Act is not entirely clear, the question of whether an organization holds itself out to be a charity will most likely be determined from the viewpoint of the potential contributor. An organization must consider how members of the public it contacts will react to a potential appeal to determine whether it is a "charitable organization" required to register.

The Model Act exempts certain charitable organizations from registration. For instance, religious organizations that are not required to file Form 990 are exempt from registration. Political parties, candidates for political office and political action committees required to account to federal or state election committees are also exempt from registration. Finally, the Act contains a de minimis exemption for otherwise charitable organizations that make less than a set amount of revenue or have less than 10 donors, have no employees and do not pay for fundraising assistance.

The Model Act requires only charitable organizations that intend to solicit to register under the Model Act. Section 1(c) of the Model Act defines a "solicitation" as:

> the request directly or indirectly, for money, credit, property, financial assistance, or other thing of value on the plea or representation that such money, credit, property, financial assistance or other thing of any kind or value, or any portion thereof, will be used for a charitable purpose or benefit a charitable organization.

The Model Act lists various methods of soliciting funds, including oral or written statements; "the making of any announcement" to the press, radio or television or via the telephone or telegraph; the "distribution" of written advertisements or other publications that directly or by implication seek support; or sales of various items, including advertisements, if a charitable appeal is used as an inducement in the sale. The drafters of the Model Act intended its definition of solicitation to be quite comprehensive.

The Model Act does not address the question of where solicitation occurs, an issue that plagues multi-jurisdictional charities. The Model Act requires a charitable organization to register if the organization intends to solicit "in this state." Accordingly, if a phone bank for a national charity located in Washington, D.C. calls individuals in every state to request funds or broadcasts an appeal over a national network, it conceivably solicits in each state. By a narrow reading of the Model Act, the actual "making" of the solicitation occurred in Washington, D.C. Individuals, however, received the appeal in many different jurisdictions. Given the rationale of consumer protection that underlies the charitable solicitation statute, jurisdictions generally take the position that a solicitation occurs where received by the consumer.

This may not be a significant difficulty for large organizations undertaking nationwide fundraising campaigns. Presumably, these organizations have the resources to ensure registration compliance in multiple jurisdictions. Smaller organizations may inadvertently undertake a national campaign by virtue of the Internet. Modern technology raises the interesting question of whether a website or "home page" constitutes a solicitation and, if so, in which jurisdiction the solicitation occurs. Many states have recognized this issue and are contemplating the implications of charitable Internet users and the possible need for statutory reform.

A related question is one of volume. Most organizations have a mailing list of donors or patrons that they contact on a regular basis. If an organization has one regular donor on its list in a jurisdiction, is every mailing to that person a solicitation that requires registration? From the wording of the Model Act, the answer appears to be "yes," although as a practical matter it is doubtful that such registration occurs.

The Model Act places even greater registration and reporting requirements on professional fundraisers. Professional fundraisers are classified into three separate categories: fundraising counsel, paid solicitors and commercial co-venturers. Generally, a paid solicitor actually undertakes the solicitation, while fundraising counsel merely helps plan or prepare material for a fundraising event. A commercial co-venturer is a for-profit entity that conducts a charitable sales promotion in concert with a charitable organization. Each type of fundraising professional is subject to different requirements under the Model Act.

- **Fundraising counsel.** Section 5 of the Model Act requires all contracts

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between fundraising counsel and a charitable organization to be in writing and filed with the state. Fundraising counsel need not register with the state unless counsel will have physical custody of solicited funds. To be eligible to hold solicited funds, fundraising counsel must register with the state—renewing such registration annually—and post a bond. After the completion of the fundraising campaign, counsel must account to the charitable organization and is subject to other reporting and record keeping requirements. No individual may act as fundraising counsel before complying with Section 5.

• **Paid solicitors.** The Model Act regulates paid solicitors in a more onerous manner than it regulates fundraising counsel. The Model Act requires all paid solicitors to register and post a bond. Registration is renewable annually. Before commencing a solicitation campaign, a paid solicitor must file a solicitation notice with the state, which the charitable organization must countersign, and must include a copy of the paid solicitor's contract. The contract must clearly set forth the basis for the solicitor's compensation, although the Model Act does not place any percentage limitations on this compensation.

At the point of solicitation, a paid solicitor must disclose the name of the paid solicitor, the solicitor's professional status and that the paid solicitor will receive a percentage of the solicited funds as compensation. The solicitor must follow up with a written disclosure of this information within five days after the solicitation. Within 90 days after a solicitation campaign is complete, the charitable organization and the paid solicitor must file a joint report with the state. The paid solicitor is also subject to various recordkeeping requirements after the solicitation campaign. Although the Model Act requires the solicitor to register and file a solicitation notice before the solicitation campaign, the state must either deny or accept the application within 10 days.

• **Commercial co-venturers.** The Model Act requires a charitable organization to file a notice of a charitable sales promotion with the state. A commercial co-venturer need not register or file the contract between the charitable organization and a commercial co-venturer. The Model Act, however, does require a contract between a charitable organization and a commercial co-venturer to include certain provisions. These include a description of the goods or services to be sold, the geographic area in which the sales will occur, the manner in which the charitable organization's name will be used and accounting and compensation procedures.

Finally, the Model Act contains various provisions designed to protect the public from fraud and to enhance the public's knowledge about soliciting organizations. Section 8 of the Model Act contains point-of-solicitation disclosure requirements that apply to all charitable organizations soliciting in the state. These disclosure requirements are subject to review under the constitutional standards described in *Riley*. The point-of-solicitation disclosure requirements listed in Section 8 of the Model Act require a solicitor to give the name, address and telephone number of a charitable organization, provide a full description of the charitable program for which the solicitation campaign is being conducted and state that a financial statement disclosing assets and liabilities will be provided upon request. Section 9 provides that all forms and other reports that must be filed under the charitable solicitation statute will be public records open for inspection. All professional fundraisers and soliciting charitable organizations must keep records of their solicitation activities for a set number of years. Section 16 prohibits fraudulent and misleading solicitation practices. Finally, the appropriate state agency has substantial authority to enforce the provisions of the Model Act.

Variations on a Theme

Because most charitable solicitation statutes have the common heritage of the Model Act, they are often strikingly similar in many provisions. Nevertheless, state litigation following *Riley* has caused legislatures to repeal and rework part or all of their charitable solicitation statutes to address first amendment concerns. A survey of the charitable solicitation statutes of several states shows a patchwork of approaches. These variations will undoubtedly cause significant headaches for multijurisdictional charities. For this reason,

it is important for a charity's lawyer to understand the numerous permutations and combinations that have arisen from the basic Model Act to ensure that the charity is in full compliance before soliciting a given state.

As previously discussed, the Model Act's definition of covered charitable organizations includes organizations that are tax-exempt as well as those that purport to be charitable or employ charitable appeals. Some states have eliminated the portion of the definition that involves a subjective evaluation of content of the charitable appeal, requiring only those charities that are, in fact, charitable to register. At the same time, almost every statute expands the list of charities exempt from the registration requirements beyond the three classifications listed in the Model Act. For example, states commonly exempt hospitals and schools from registration requirements.

Most statutes continue to define a solicitation simply as a request for money. A recent trend expands the methods of solicitation to include containers, vending machines and wishing wells. These statutes generally require container labels to contain disclosures regarding the charity and professional fundraising, including information about compensation of professional fundraisers that has been found unconstitutional in other contexts. Some of the definitions of solicitation are broader than the Model Act and may more easily encompass Internet communication. For example, Alaska's statute includes "a request made by . . . [any] transmission of images or information. . . . " Alaska Stat. § 45.68.900 (5)(B).

The already complex question of where a charity solicits in multi-jurisdictional communications can be further complicated. Some states' definitions of charitable organizations include only those organizations doing business or holding property in the state. A charity would have to determine at which point a solicitation amounted to "doing business" in that state to comply with all appropriate registration requirements.

Many charitable solicitation statutes continue to include mandatory disclosures. Most statutes only require disclosure of the identity of the charity and the solicitor and the fact that the solicitor is a paid fundraiser, as authorized by the Supreme Court in footnote 11 of the *Riley* opinion. Many states require additional disclosures, including the availability of financial information regarding the solicitor and the charitable organization or the toll free number of the state office that can give the donor copies of the organization's financial statements. In addition to these basic requirements, many states require charities to disclose financial and other information to any potential donor who requests such information, including the information that was subject to mandatory disclosure in *Riley*.

The Model Act lists a number of prohibited acts, most of which involve fraud or misrepresentation, including a general prohibition against violating the other provisions of the Act. Many states have taken this prohibition a step further and specifically prohibit a charity from hiring an unregistered solicitor or a professional fundraiser to solicit on behalf of a charity. This places an affirmative duty on charities to ensure that they protect contributions, that representations made during solicitation are true and that paid fundraisers comply with the registration and reporting requirements.

Reciprocity

Because the definition of "solicitation" appears to contemplate that the solicitation occurs at the point of receipt by the potential donor, a charity can find itself in the position of having to comply with the charitable solicitation laws of many different states. In recognition of this potentially tremendous administrative burden, Section 11 of the Model Act contains the following provisions regarding reciprocity:

> The [state official with jurisdiction] may exchange with the appropriate authority of any other state of the United States information with respect to charitable organizations, fund raising counsel, commercial co-venturers and paid solicitors. The [state official] may accept information filed by a charitable organization with the appropriate authority of another state or of the United States in lieu of the information required to be filed by the charitable organization in accordance with the provisions of this act if such information is substantially similar to the information required under this act.

This provision appears nearly verbatim in a number of state statutes.

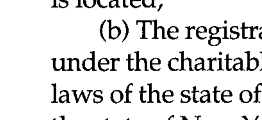
Although the statutes have always authorized reciprocity, as a practical matter it is only beginning to be effective. The recent revisions to state statutes show glimmers of hope in this regard. Almost every state now accepts a Form 990 as a charitable organization's annual financial statement and allows its administrative officials to consolidate solicitation reporting requirements with other filings. For example, New York's solicitation statute provides:

> To the extent practicable, the attorney general shall develop a single registration and uniform set of reporting forms to be filed in accordance with the requirements of this subdivision and those of section 8-1.4 of the estates, powers and trusts law. These forms shall avoid duplication with and make maximum use of information required in federal reporting forms, which are filed with the attorney general.

N.Y. Exec. Law § 172(9). Furthermore, a project by NAAG and NASCO has produced a uniform registration form that will ease the administrative burden on multi-jurisdictional charities. A number of states currently use this form.

Only one true instance of reciprocity appears in the various statutes. In Washington, the charitable organization registration requirements do not apply to the following organizations:

> (2) Any charitable organization located outside the state of Washington if the organization files the following with the secretary:
>
> (a) The registration documents required under the charitable solicitation laws of the state in which the charitable organization is located;
>
> (b) The registration required under the charitable solicitation laws of the state of California and the state of New York; and
>
> (c) Such federal income tax forms as may be required by rule of the secretary.



R.C.W. § 19.09.076. This provision exempts applicable charities from registration but not from compliance with Washington's disclosure requirements.

Conclusion

Ongoing shifts in the charitable community make charitable solicitation and its regulation a top priority. The charitable community need look no further than fundraising debacles in the news over the last few years to realize the danger of "charitable" organizations with questionable motives that give legitimate charities a bad reputation with the giving public. At the same time, the rapid propagation of new charitable organizations can only lead to more entities competing for the same charitable dollars. With technological advances, smaller charitable organizations have taken advantage of the Internet to reach a wider audience and lower fundraising costs. This environment has its own pitfalls and, to date, evades regulation.

The need for consumer protection of charitable solicitation is real. With new charitable solicitation statutes passed in response to *Riley*, charitable advisors can expect a new round of litigation as well. Legislative activity in this area is certain to continue over the next few years.

Elaine Waterhouse Wilson is an associate with Barnes & Thornburg in Indianapolis, Indiana and a member of the Probate Division's State and Local Law Concerns of Exempt Organizations (D-4) Committee.
A list of charitable solicitation statutes is available from the author at 317-231-7728 or **ewilson@btlaw.com**.