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# the law of fundraising

2021 Cumulative Supplement

*Fifth Edition*

**Bruce R. Hopkins** and  
**Alicia M. Beck**

WILEY

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# **the law of fundraising**

**2021 Cumulative Supplement**

*Fifth Edition*

**Bruce R. Hopkins** and  
**Alicia M. Beck**

**WILEY**

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## **Preface**

This 2021 cumulative supplement is the sixth supplement to accompany the fifth edition of this book. The supplement covers developments in the law of fundraising for charitable purposes as of the close of 2020.

Congress has been quite active in the realm of nonprofit tax law, including enactment of the Tax Cuts and Jobs Act; some of what has been conjured directly impacts charitable fundraising. These law changes include revisions in the percentage limitations on deductible charitable giving and the way tax-exempt organizations compute their unrelated business taxable income (what we call the bucketing rule). In the aftermath of these revisions in the statutory law, the Department of the Treasury and the IRS have been busy writing guidance that amplifies these statutes. Thus, for example, final regulations to accompany the bucketing rule have been promulgated.

In addition to the foregoing, the Treasury Department issued final regulations applying the quid pro quo principle in the context of deductible charitable gifts, Treasury also issued final regulations concerning donor disclosure requirements, the IRS has revised its application for recognition of tax exemption as part of the requirement that it be filed electronically, and the IRS published guidance as to when the business expense deduction is available in the charitable giving setting.

From a federal law standpoint, a significant development in the realm of fundraising occurred when the U.S. Tax Court, in response to considerable litigation on the point, found a way to salvage charitable gift substantiation where the charitable donee has not supplied a gift substantiation

letter (or at least not a qualifying one) to the donor, doing so in the context of gifts of easements: the deed of easement may serve as the gift substantiation document. This development is discussed in a section added by this supplement but in essence the court is disregarding as mere boilerplate a provision in the deed reciting consideration by reason of a merger clause.

Also notably, what would have been an important development in the realm of charitable fundraising occurred when the Department of the Treasury and the IRS published proposed regulations to implement the exception to the general charitable gift substantiation requirement. Pursuant to this exception, donee organizations would have been able to file information returns with the IRS that report the required information about contributions. The fundraising community has become rather familiar with the general substantiation rules, using the required contemporaneous written acknowledgment letters as an opportunity to communicate with (as in say thank you to) their donors. If these rules concerning this exception had been implemented, administrators of charitable organizations would have had to make the decision as to whether to stay with the general substantiation regime or begin filing information returns with the IRS. The professional fundraising community certainly had a vested interest in the outcome of that decision-making. The decision not only would have had an impact on donor relations efforts but, as the Association of Fundraising Professionals noted in its October 28, 2015, eWire, the proposal raised problems regarding donor confidentiality and privacy. The fundraising community, however, sidestepped these dilemmas when the IRS, overwhelmed and frustrated by the controversy, summarily, on January 7, 2016, withdrew the proposed regulations. Indeed, the

underlying statute was repealed on enactment of the Tax Cuts and Jobs Act.

A section has been added to the book, addressing the matter as to when an organization can be considered a tax-exempt charitable entity where its sole functions are fundraising and grantmaking. As we discuss, it has been IRS policy since 1924 that a nonprofit organization that only carries on operations that involve generation and receipt of contributions (and perhaps investment income) and distribution of its income to public charities is eligible to receive recognition of tax exemption as a public charity. This point has often been restated over the years. The IRS caused a major shift in thinking concerning this topic when, in 1964, the agency introduced the commensurate test. As applied to fundraising and grantmaking charities, this test requires that the amounts distributed to one or more charities must be “significant.” (This aspect of the topic was raised to a much higher level of concern when, a few years ago, the IRS launched its “charitable spending initiative.” This could have been a major development for the fundraising community; the initiative, however, collapsed and disappeared in the aftermath of the chaos surrounding the brouhaha over the IRS's mishandling of certain applications for recognition of exemption.)

In recent months, however, largely by means of private letter rulings, the IRS has taken a harder line as to fundraising charities, principally by adversely applying the doctrines of private benefit and commerciality. There has been an unusually large number of IRS private letter rulings concerning nonprofit organizations established to engage in forms of online fundraising for charity. The IRS has denied recognition of tax exemption as a charitable entity in every one of these cases. Some of these rulings are inconsistent with law that has been in existence for over 90 years, concerning exemption for entities whose

functions are solely fundraising and grantmaking. The IRS's fixation on the commerciality doctrine has spilled over into this area, causing policy shifts, with the agency resting its denial positions on that doctrine and, in some instances, as noted, also the private benefit doctrine. We added this section to explore this aspect of the IRS's recent ruling policy.

Recent years have brought many court cases concerning the matter of disclosure of donor information. This issue has arisen in the fundraising setting but, as recent cases illustrate, this issue is ballooning beyond the fundraising context. The extent to which donor disclosure is permissible and when it violates fundamental principles of free speech and privacy may be considered by the U.S. Supreme Court. This litigation is summarized in this supplement.

The IRS's focus in this area notwithstanding, online fundraising by charities that are tax-exempt continues to grow, and thus we expanded our portrait of charitable giving to include a look at this phenomenon.

Other topics we have covered include a study of state-level oversight and regulation of charitable organizations, discussion of a troubling IRS technical advice memorandum finding a charitable organization's fundraising program to be an unrelated business, the import of the IRS's streamlined application for recognition of exemption, fundraisers' compensation, and more law concerning raffles conducted by charities.

We appreciate the assistance we have received from John Wiley & Sons in the preparation of this supplement. Our thanks are extended, in particular, to our development editor, Brian T. Neill, and Deborah Schindler, managing editor, for their assistance and support in connection with this cumulative supplement.

Bruce R. Hopkins  
Alicia M. Beck  
March 2021

# CHAPTER ONE

## Government Regulation of Fundraising for Charity

### § 1.2 Charitable Fundraising: A Portrait

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

#### (b) Online Charitable Fundraising

### \*§ 1.3 Evolution of Government Regulation of Fundraising

### § 1.4 Contemporary Regulatory Climate

## § 1.2 CHARITABLE FUNDRAISING: A PORTRAIT

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

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

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

Charitable giving in the United States in 2019 is estimated to have totaled \$449.64 billion.<sup>24</sup> Giving by individuals in 2019 amounted to an estimated \$309.66 billion; this level of giving constituted 69 percent of all charitable giving for the year. Grantmaking by private foundations was an estimated \$75.69 billion (17 percent of total funding). Gifts in the form of bequests in 2019 were estimated to be \$43.21 billion (10 percent of total giving). Gifts from

corporations in 2019 totaled \$21.09 billion (5 percent of total giving for that year).

Contributions to religious organizations in 2019 totaled \$128.17 billion (29 percent of giving that year). Gifts to educational organizations amounted to \$64.11 billion (14 percent); to human service entities, \$55.99 billion (12 percent); to foundations, \$53.51 billion (12 percent); to health care institutions, \$41.46 billion (9 percent); to public/society benefit organizations, \$37.16 billion (8 percent); to international affairs entities, \$28.99 billion (6 percent); to arts, culture, and humanities entities, \$21.64 billion (5 percent); and to environment/animals groups, \$14.16 billion (3 percent).

## **(b) Online Charitable Fundraising**

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

In mid-2014, *The Chronicle of Philanthropy* gave a special report on online fundraising, with the theme being “Digital Giving Goes Mainstream.”<sup>25.2</sup> Among the findings in this report was that Internet gifts climbed 13 percent in 2013 in relation to 2012, although online fundraising “still accounts for a very small portion of the money charities rely on.”<sup>25.3</sup> Nonetheless, in 2013, the Leukemia & Lymphoma Society raised 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).<sup>25.4</sup>

About one year later, another report speaks of the “transformative promise of online fundraising” that has yet to materialize.<sup>25.5</sup> This report looks at the “short history of online fundraising” and finds that it “is not without signs of progress.” It summarizes the successes of online-giving websites and notes that “[y]ear to year, more people give money online to charity.” Still, for most charitable organizations, this report states that online giving “represents a sliver of their overall fundraising.” The “promised revolution” is “moving at glacial speed” because of ancient tech infrastructure, reluctance on the part of fundraising management to place more emphasis on online operations, and lack of understanding by senior executives and board members of the potential of online fundraising. This report concludes that “effective online fundraising doesn't eliminate the human touch at the core of giving.” Every day, the report states, “you see more meaning and substance on the Internet, more people forging thoughtful, deep connections—deeper connections, perhaps than a professional fundraiser could ever hope for with a yearly newsletter.”<sup>25.6</sup>

## **§ 1.3 EVOLUTION OF GOVERNMENT REGULATION OF FUNDRAISING**

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

There continues to be a nationwide crackdown on fraudulent charities that exploit disadvantaged groups in



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

On September 11, 2017, the Michigan attorney general announced a settlement with Breast Cancer Outreach Foundation, Inc., a Florida nonprofit corporation, resolving the attorney general's claims that the organization deceptively raised \$1.4 million nationwide in 2015. The organization's solicitations stated that funds would be used for breast cancer research grants. In reality, all of the money raised, other than one grant, was paid to professional fundraisers and for other expenses unrelated to breast cancer research. As part of the settlement, the Foundation is required to pay \$150,000, with \$125,000 paid for breast cancer research and the remaining \$25,000 to recover the state of Michigan's investigative costs. The organization is also banned from soliciting in Michigan for 10 years.

On May 18, 2015, the Federal Trade Commission and 58 agencies from all 50 states and the District of Columbia filed a complaint charging four cancer charities and the individuals controlling them with allegedly swindling more than \$187 million from consumers. The federal court complaint named Cancer Fund of America, Inc. (CFA) and Cancer Support Services, Inc. (CSS), their president, James Reynolds Sr., and their chief financial officer, Kyle Effler; Children's Cancer Fund of America, Inc. (CCFA), 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 will be banned from fundraising and charity management, and CCFA and BCS will be dissolved. On March 30, 2016, the Federal Trade Commission announced the total disbandment of the CFA and CSS. Further, James Reynolds Sr. was barred from operating or engaging in fundraising for nonprofit organizations.

Similarly, on July 21, 2015, the New York attorney general announced that his 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 charge that, despite claims it had a board of directors and other financial and scientific controls, the 20-year-old organization was in fact operated by a single

founder out of the basement of his Brooklyn, New York, home.

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

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

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

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