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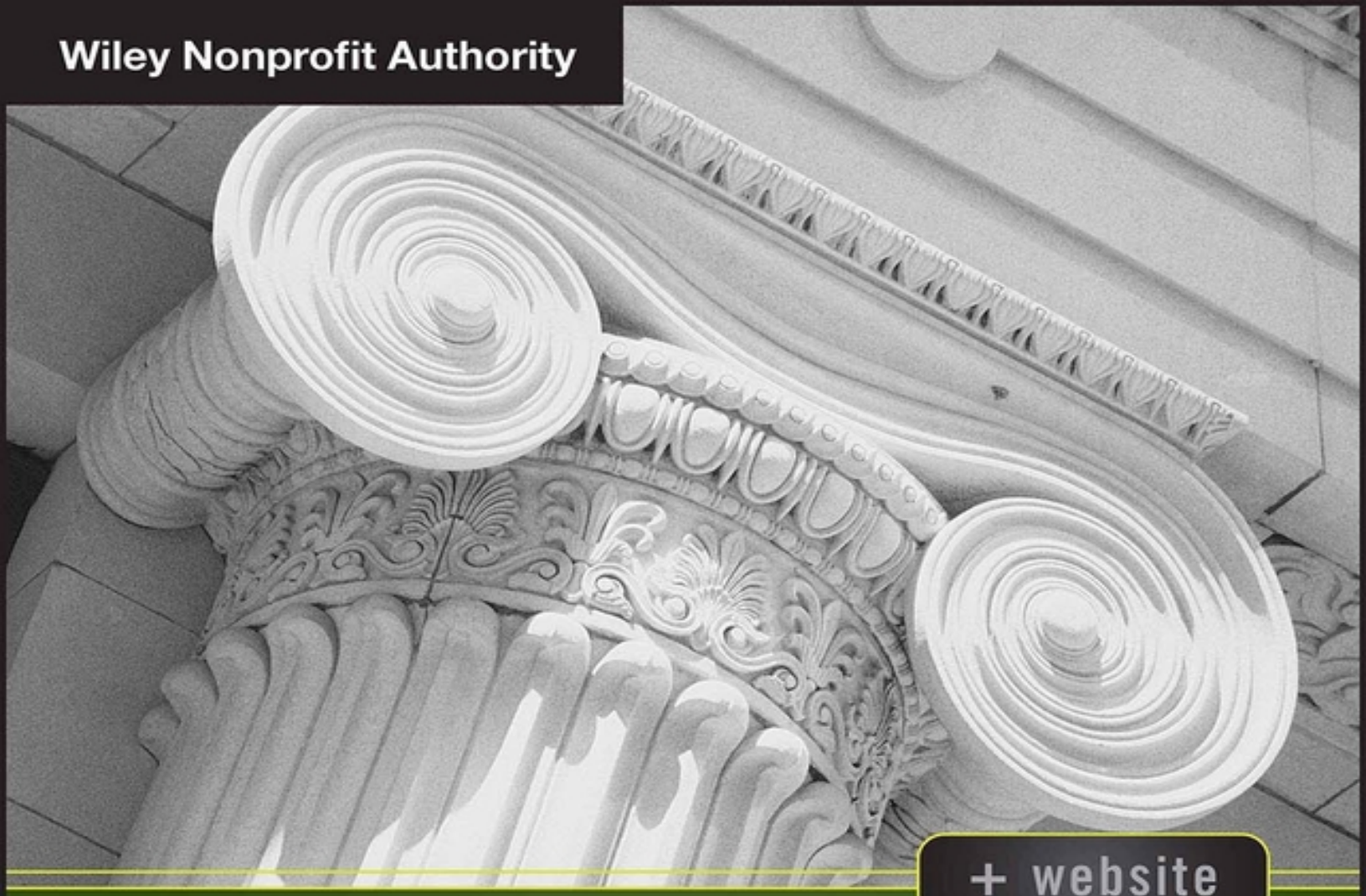

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the law of fundraising

Sixth Edition

Bruce R. Hopkins and
Alicia Beck

WILEY

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Alicia Beck

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A Letter to the Reader

It is with a heavy heart that we relay the news to you that Bruce Richard Hopkins, J.D., LL.M., S.J.D., passed away on October 31, 2021. Bruce's love for the law and for writing resulted in a wonderful relationship with Wiley that lasted for better than 30 years. Throughout that time, Bruce penned more than 50 books as well as writing “The Bruce R. Hopkins' Nonprofit Counsel” (a newsletter published monthly for 40 years). Bruce's texts are practical guides about nonprofits written for both lawyers AND for laypeople, many of which are considered vital to law libraries across the country. The ideas just kept flowing.

Beloved by many, Bruce was often referred to as the “Dean of Nonprofit Law.” His teaching muscle was built over a period of 19 years when he was Professional Lecturer in Law at George Washington University National Law Center. As Professor from Practice at the University of Kansas, School of Law, Bruce exercised his generative spirit teaching and mentoring younger colleagues. Always the legal scholar, he could brilliantly take complicated concepts and distill them down into easily understood principles for beginners, seasoned colleagues, and those unfamiliar with the subject matter. He was a presenter and featured speaker, both nationally and internationally, at numerous conferences throughout his career, among them Representing and Managing Tax-Exempt Organizations (Georgetown University Law Center, Washington, D.C.) and The Private Foundations Tax Seminar (El Pomar Foundation, Colorado Springs, CO). He practiced law in Washington, DC, and Kansas City, MO, for over 50 years, receiving numerous awards and forms of recognition for his efforts.

Bruce will be dearly missed, not solely for his contributions to the Wiley catalog, but because Bruce was a wonderful person who was dearly loved and respected both by all of us at Wiley and by all of those whom he encountered.

Preface

This book, the sixth edition of *The Law of Fundraising*, is the culmination of an effort by Bruce Hopkins (hereinafter the “senior author”) that began over 40 years ago. The book is an attempt to capture the essence of the law of fundraising for charitable purposes in one volume. This task is becoming increasingly difficult. The book reflects what many in the fundraising profession painfully know: federal, state, and local regulation of fundraising just keeps expanding.

When the book originated, as *Charity Under Siege: Government Regulation of Fund-Raising* (published in 1980), it was less than an inch thick, yet it was thought the siege was on even then. (The senior author has heard more than one state regulator cluck at that title over the years.) Over the years, the book, thereafter published as *The Law of Fundraising*, expanded.

Any lawyer whose practice concentration is, like the authors', tax, corporate, and other law as it applies to charitable and other nonprofit organizations, cannot avoid entanglement in the legal morass that constitutes federal, state, and local law regulating charities' fundraising. The representation of charitable organizations by the senior author started over 50 years ago (in 1969) (the junior author emerged a mere 40 years or so later). The law of charitable fundraising has been a significant component of his practice almost from the beginning.

He vividly recalls how it all began. The day was January 20, 1973, a Saturday. A colleague at a client charitable organization telephoned him at his office in Washington, DC, excitedly reporting about a “hearing” that was to be

held in a few days, before a subcommittee of the House of Representatives chaired by Rep. Lionel Van Deerlin. This impending hearing was said to concern “proposed legislation” that would create federal law of regulating fundraising by charitable organizations. The senior author was asked to inquire about this development. Knowing nothing of the proposed legislation, the upcoming hearing, Rep. Van Deerlin, or charitable fundraising in general, he promised his colleague that he would explore the matter.

Your senior author then telephoned Rep. Van Deerlin's office, hoping to find a dedicated staffer toiling there on a Saturday morning. Times were much different then: the call was answered by the congressman himself. It turned out that there was no impending hearing—rather, an informal briefing on a proposed bill was scheduled to be conducted, in Rep. Van Deerlin's office, for interested (and concerned) persons. He attended the briefing the following week, spoke up, found himself appointed to an ad hoc group formed to revise the proposal, and thus innocently wandered into the ambit of government regulation of fundraising for charity.

As the result of that client call, there unfolded innumerable meetings, telephone calls, hours of research, hearings, task forces, new nonprofit organizations, proposals, legislation, and a swirl of other developments that evolved into the contemporary body of law directed at solicitations of contributions for charitable purposes. Congressman Van Deerlin's effort to create federal statutory law in this field was unsuccessful, but certainly the pace and form of fundraising law was hardly abated.

The junior author's interest in the law of fundraising commenced in a University of Kansas School of Law classroom in the fall of 2008. The senior author had relocated his practice to Kansas City and began teaching at

KU Law; the aforementioned class was his first one there. The course was a basic one on nonprofit and tax-exempt organization law, with some attention to charitable fundraising. The junior author was drawn to the intricacies of nonprofit law, earning the highest grade in the course. Four years later, your two authors began practicing law together; this book evolved from that relationship. Today, the junior author is a bank vice president, while the senior author continues in private practice. Your junior author, Alicia Beck, expresses her appreciation for the opportunity to practice with her former professor.

This edition of the book reflects an extensive revision of the previous volume. Yes, coverage has expanded again, with considerable rewriting and restructuring. The book demonstrates expansion of fundraising law on all fronts: accumulating legislation, tax regulations, IRS rulings, and case law. The U.S. Supreme Court has contributed to the shaping of this body of law, beginning with its landmark opinions in the 1980s and continuing through its finding in 2021 that state law disclosure requirements concerning donor information are unconstitutional.

Our thanks go to those who have made interesting and useful contributions to the book: James J. Bausch, James M. Greenfield, Richard F. Larkin, Paul E. Monaghan, Jr., David Ormstead, and Del Staecker. Analysis and commentary that we have written here should not, of course, be attributed to them.

Thanks go as well to those at John Wiley & Sons who have, over the years, seen editions of this book and/or their supplements to completion. In the past, gratitude and appreciation have been extended to Marla Bobowick, Martha Cooley, Jennifer MacDonald, Susan McDermott, Brian T. Neill, Claire New, and Deborah Schindlar. Our thanks are extended, this time around, to our development

editor, Brian Neill, and Deborah Schindlar, managing editor, for their assistance and support in connection with this edition of the book.

Bruce R. Hopkins
Alicia M. Beck
November, 2021

CHAPTER ONE
Government Regulation of Fundraising for Charity

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 Service[1] 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.

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.

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 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]

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 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