Law and Regulation

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Through seeking and accepting donations, educational institutions create a trust relationship with donors, a legal as well as a moral relationship. But while the moral aspect of that trust relationship may be obvious, the legality of compelling promises on either the donor's or the institution's part was a point of contention in the nation's early years.

The Historical Perspective

The restrictions that donors put on their gifts are delicately negotiated by development offices and then carefully monitored for compliance. This has not always been the case. In fact the idea that a gift created, by its restrictions, an obligation on the part of the institution receiving the funds was a point of debate in the U.S. courts for two hundred years.[1] The ultimate outcome is that charities are not allowed to divert gifts away from their donors' intentions.

Nor was it clear at first that the promise of a gift created legal obligations on the prospective donor. Such promises were not considered binding under English common law, which did not consider them to be "contracts." According to one scholar of English law, "A promise to contribute money to charitable purposes is a good example of the class of promises which, though they may be laudable and morally binding, are not contracts."[2] But through case law that emerged in the nineteenth and twentieth centuries, the states ultimately rejected that common-law doctrine.[3] It was decided that donors could be held liable for their promises of donations, particularly when educational institutions acted on those promises by beginning to build or to create programs that relied on the donors' pledges.

In addition to compelling donors and institutions to keep promises to one another, the United States has used its tax laws to determine what legally counts as a gift. The tax-law exemption for charitable contributions was the government's way of encouraging individual voluntary contributions to the common good. But the government has determined that unless *donative intent,* which it defines as disinterested and dispassionate giving, is present, and unless the donor receives nothing of value in return, the transaction is, at least in part, something other than a gift.

Only recently have state and federal governments begun to consider what constitutes appropriate *requests* of gifts. Fund-raising regulation and legislation has developed since the mid-twentieth century, mostly in response to pseudo-charities and coercive solicitation procedures that exploited an unsuspecting public. When one considers the vast amount of wealth that U.S. educational institutions have amassed through fund raising (which Eric Wentworth describes in the introduction to this volume), it is surprising how little litigation literature involves these institutions.

The federal and state governments first addressed the matter of fund raising in the mid-1950s. North Carolina was the first state to enact a law regulating fund raising. Other states soon followed, generating a series of laws that came to be known as *charitable solicitation acts.* New York was the second state to pass one of these laws, and the New York law became the prototype for the many that were to follow.

The New York law and its progeny involved a statutory scheme based upon registration and reporting. Charitable organizations were required to register in advance of solicitation and report annually;[4] bond requirements came later. Subsequently, forms of regulation involving professional fund raisers and solicitors were developed. Exceptions evolved, often including religious organizations and sometimes educational institutions as well. These first laws were basically licensing statutes. They gave the states essential information about the fund raising to be conducted so that they would have a basis for investigation and review should abuse be suspected.

With the passage of time, some states responded to abuses by affirmatively regulating charitable solicitations and by developing forms of regulation that applied to professional fund raisers and so-

licitors. Some of the states included provisions regulating disclosure and the requirement that fund raisers act as fiduciaries, and some even defined what counted as (illegal) deception in fund raising. Structurally, the typical statute about charitable solicitation originally had nothing to do with the relationship between the donor and the institution or between the donor and the fund-raising professional. Its requirements were based on the submission of written information (registration statements, reports, and the like) by charitable organizations and their fund-raising advisers, bond requirements, and enforcement authority granted to the attorneys general, secretaries of state, or other governmental officials charged with administering and enforcing the law. Later, however, new laws were written to more affirmatively regulate what some people had considered "ideal" fund-raising behavior. These laws went beyond registration requirements, filing deadlines, and accounting principles and entered the realm of telling fund raisers how they could and could not conduct solicitation.

Federal Law Regulation

Fund-raising regulation at the federal level is universal, with nearly all federal fund-raising regulation administered by the Internal Revenue Service (IRS).[5] It is interesting to note that in 1988, a year in which the IRS took a directive from the U.S. House of Representatives to put charitable organizations under greater obligation for determining how much of an exchange could be counted as a tax-exempt gift, the U.S. Supreme Court limited the states' ability to regulate fund-raising practice. And while the states have been slow to change the language in their charitable solicitation acts to conform to the Supreme Court ruling, the federal government moved in 1993 to enact into law the IRS directive of 1988.

In general, the IRS regulates the practice of fund raising for charitable purposes in the following ways:

- It requires a charitable organization to summarize its fund-raising program at the time it applies for tax-exempt status.[6]
- It requires an organization to report the receipts of its fund-raising activities, as well as its fund-raising expenses, annually.[7]

- It applies the rules concerning private inurement in such a fashion as to discourage fund-raising compensation arrangements that are based on percentages or otherwise involve commissions.[8]
- It interprets and enforces the rules involving deductible charitable contributions.[9]
- It engages in a program of education and examination of charitable organizations that engage in fund raising in order to encourage them to disclose the portions of payments that are not considered "charitable gifts."[10]

These means of regulation are generally quite technical, with the last point constituting the one exception. The IRS has been concerned since 1967 that taxpayers were taking greater charitable deductions than were warranted and that charitable organizations were doing little to inform their donors that only part of their donation might be tax-deductible. In that year the IRS issued guidelines directing charities to advise donors of circumstances in which their "gifts" were not deductible at all (the donor received something from the charity whose value approximated that of the payment) or were only partially deductible (the donor received something in return for the gift whose value was less than that of the gift).[11]

In 1988 a congressional committee expressed dismay over the continuation of, if not an increase in, these practices and demanded that the IRS act to resolve the problem. The IRS commissioner sent all charitable organizations a clarification of what counted as tax-deductible, along with a note stating that the IRS would be working to figure out "the extent to which taxpayers are furnished accurate and sufficient information concerning the deductibility of their contributions."[12]

In 1993 the Omnibus Budget Reconciliation Act became law. While it made the taxpayer responsible for claims of charitable contribution, the law also created affirmative obligations for charitable organizations. Specifically, "no income tax charitable deduction will be allowed for a contribution of $250 or more unless the taxpayer has a written receipt . . . from the donee organization for the contribution." In addition, the charitable organization had to make clear what part of the gift could be counted as tax-deductible. If the charitable organization gave the donor nothing of value, that information was to be included on the donor's receipt; a good-faith value of any

goods or service provided had to be described and deducted from the donated amount.[13]

The IRS is intent on ferreting out instances of abusive fund raising.[14] Under this the IRS includes the following:

- "[M]isleading statements in solicitations literature that imply deductibility of contributions, where none probably exists."
- "[C]ontracts with professional for-profit fund raisers, who themselves use questionable fund raising methods to solicit funds from the general public."
- "[S]ituations where other expenses, such as administrative and fundraising costs [,] constitute an unusually high portion of the solicited funds or noncash contributions."
- "[F]und raising activities that result in other tax consequences, i.e., generating taxable income, resulting in additional filing requirements, etc."

The federal government thus cast a bright light on the hazy area of how educational institutions thank their strongest supporters. When the thank-you involves "admissions or other privileges or benefits . . . received in connections with payments by patrons of fund-raising affairs . . . the presumption is that the payments are not gifts."[15]

For example, the IRS ruled that contributions to athletic scholarship programs are not completely deductible as charitable gifts if the donors are provided with special opportunities to purchase tickets or to get preferred seating.[16] Those contributions are deductible only at a rate of 80 percent. More recently, the IRS held that payments by corporate sponsors of college and university bowl games are not charitable gifts to the bowl game associations but must be treated by the association as forms of unrelated business income because the corporate sponsors received a valuable package of advertising services.[17] This led to the issuance of more general guidelines for donor recognition in order to help educational institutions and other charities distinguish between instances of "mere recognition" and instances in which payers are provided a substantial return benefit.[18]

These federal expectations for fund raisers created a new complexity for educational institutions at which development activities are rewarded by special recognition or dinners or receptions are offered as true expressions of appreciation, something no one could gain through intended purchase. With the 1993 law, if donors have a

reasonable expectation of receiving some benefit, the cost of the benefit must be determined and deducted by the charitable organization. It may be difficult for educational institutions to inform out-of-town alumni that they must subtract the cost of an event from their gift when there this little or no chance that they could take advantage of the benefit. In response to some of these complexities, some development offices give donors an opportunity to formally decline all benefits, thus making their donations 100 percent deductible.

Despite the tightening of regulations through the tax laws, federal decisions also limit state regulation. For example, the U.S. Supreme Court decided in 1980 that states could not use the level of a charitable organization's fund-raising costs as a basis for determining whether a charity might lawfully solicit funds in a jurisdiction.[19] Four years later, in 1984, the Court held that the principles of free speech apply despite the presumption that costs in excess of a specific ceiling are "excessive."[20] In 1988 the Court held that these free-speech principles applied when the limitation was not on a charity's fund-raising costs but on the amount or extent of fees paid by a charitable organization to professional fund raisers or solicitors.[21] Subsequent litigation suggests that the courts are consistently reinforcing the legal principles so articulately promulgated by the Supreme Court during the 1980s.[22]

Despite these rulings, as of late 1993 many states still had such requirements on the books. The laws in Arkansas, Connecticut, Illinois, Massachusetts, Ohio, Tennessee, and Utah all contained questionable language. For example, the provisions of the Illinois law probably requires that professional fund raisers or solicitors must disclose to those being solicited the percentage of their compensation in relation to gifts received.[23] And one Arkansas law makes the failure of a person soliciting funds to "truthfully" recite, upon request, the percentage of funds raised to be paid to the solicitor an "unlawful practice."[24]

State Law

The states continue to provide the lion's share of fund-raising regulations. The application of constitutional law to charitable solicitation acts motivated state regulators to strengthen state laws to regulate the process by which charitable organizations solicit funds. The

registration and annual reports became more extensive. Other states tried, with limited success, to force charities and solicitors into various forms of disclosure at the time of solicitation; some states even dictated the contents of telephone solicitors' scripts.

By the end of 1993 all but four states—Delaware, Idaho, Montana, and Wyoming—had some form of statutory structure for regulating the fund-raising process.[25] Thirty-two of these states, as well as the District of Columbia, formal charitable solicitation acts.

The various state charitable solicitation acts generally contain the following features:

- Procedures by which charitable organizations register or otherwise secures a permit to raise funds for charitable purposes in the state.
- Requirements for reporting information (usually annually) about organizations' fund-raising programs.
- A list of organizations that are exempted from some or all of the statutory requirements.
- A process by which professional fund raisers, professional solicitors, and/or commercial co-venturers register with and report to the state.
- Record-keeping requirements for charitable organizations, professional fund raisers, professional solicitors, and/or commercial co-venturers.
- Rules concerning the contents of contracts between charitable organizations and professional fund raisers, professional solicitors, and/or commercial co-venturers.
- A list of so-called prohibited acts.
- A provision for reciprocal agreements between the states concerning coordinated regulation.
- A summary of the powers of the governmental official having regulatory authority (usually the attorney general or secretary of state).
- A statement of the various sanctions that can be imposed for failure to comply with the law (e.g., injunctions, fines, and imprisonment).[26]

As noted, many of the states exempt one or more categories of charitable organizations from the ambit of their charitable solicitation statute. The basic rationale for these exemptions is that the ex-

empted organizations are not part of the problem that gives rise to the objective the state is endeavoring to achieve through this type of regulation, namely, the protection of its citizens from fund-raising fraud and other abuse.

Twelve states, including the District of Columbia, exempt certain types of educational institutions, including colleges and universities, from their charitable solicitation acts.[27] This exemption usually applies only to accredited educational institutions. The more common practice is to exempt educational institutions from only the registration or licensing, and reporting, requirements. Nineteen states have adopted this approach,[28] which is typified by the provision of the law in North Carolina that exempts from that state's charitable solicitation act's licensing requirement "any educational institution, the curriculum of which in whole or part, is registered, approved or accredited by the Southern Association of Colleges and Schools or an equivalent regional accrediting body."[29]

Nine states, either as an alternative to or in addition to the foregoing approach, exempt from the registration and reporting requirements educational institutions that confine their solicitations to their "constituency."[30] Thus, for example, the law in Virginia provides an exemption from registration for an "educational institution confining its solicitation of contributions to its student body, alumni, faculty, and trustees, and their families."[31] Three states exempt solicitations by educational institutions of their constituency from the entirety of their charitable solicitation laws.[32]

Many colleges, universities, and other educational institutions undertake some or all of their fund raising by means of related "foundations." Thirteen states expressly provide exemption, in tandem with whatever exemption their laws extend to educational institutions, to these supporting foundations.[33] Five states exempt alumni associations from the registration requirements,[34] and one state, Mississippi, exempts them altogether, as long as the fund raising is only among the membership.

The rationale for exempting educational institutions from coverage under these laws is that they do not solicit the general public, they have not abused the fund-raising process, they already adequately report to state agencies, and their inclusion under the charitable solicitation act would impose an unnecessary burden on the regulatory process.[35]

Some states provide other affirmative obligations for fund raisers. Most of the states' charitable solicitation acts contain a list of one or more acts in which a charitable organization (and perhaps a professional fund raiser or solicitor) may not lawfully engage. These may include some or all of the following:

- A person may not, for the purpose of soliciting contributions, use the name of another person (except that of an officer, director, or trustee of the charitable organization by or for which contributions are solicited) without that person's consent.
- A person may not, for the purpose of soliciting contributions, use a name, symbol, or statement so closely related or similar to that used by another charitable organization or governmental agency that it would tend to confuse or mislead the public.
- A person may not use or exploit the fact of registration with the state in a way that would lead the public to believe that the registration in any manner constitutes an endorsement or approval by the state.
- A person may not by any manner, means, practice, or device represent to anyone or mislead anyone to believe that the organization on behalf of which the solicitation is being conducted is a charitable organization or that the proceeds of the solicitation will be used for charitable purposes when that is not the case.
- A person may not represent that the solicitation for charitable gifts is for or on behalf of a charitable organization or otherwise induce contributions from the public without proper authorization from the charitable organization.

The Illinois law states that all solicitations must "fully and accurately" identify the purposes of the charitable organization to prospective donors. The use of more than 50 percent of funds for "public education" must be disclosed under this law. And every contract with a professional fund raiser must be approved by the charitable organization's governing board.[36] In New Hampshire it is a "prohibited act" to represent that a charity will receive a fixed or estimated percentage of the gross revenue from a solicitation in an amount greater than that identified to the donor.[37] In Virginia it is a "prohibited act" for an individual to solicit charitable contributions if the individual has been convicted of a crime involving the obtaining of money or

property by false pretenses unless the public is informed of the conviction in advance of the solicitation.[38]

In Connecticut it is a prohibited act for a charitable organization (or, in some instances, a person acting on its behalf) to misrepresent the purpose of a solicitation; to misrepresent the purpose or nature of a charitable organization; to engage in a financial transaction that is not related to the accomplishment of the charitable organization's exempt purpose;[39] to jeopardize or interfere with the ability of a charitable organization to accomplish its charitable purpose; or to expend an "unreasonable amount of money" for fund raising or management.[40]

Some states—New Hampshire, for example[41]—make violation of a separate law concerning "unfair or deceptive acts or practices" a violation of the charitable solicitation act as well. This list of prohibited acts reads like an ideal standard to which all fund raisers should aspire, in that some of those precepts are difficult to enforce as law.

Many of the state charitable solicitation acts require that the relationship between a charitable organization and a professional fund raiser or solicitor be evidenced in a written agreement. This agreement must be filed with the state soon after it is executed. These types of requirements are clearly law and are not particularly unusual. However, a few states have enacted requirements that dictate to the charitable organization the contents of the contract. In Connecticut, for example, a contract between a charitable organization and a fund-raising counsel must contain sufficient information "as will enable the department [of Consumer Protection] to identify the services the fund raising counsel is to provide and the manner of his compensation." Another provision of the same law mandates that the agreement "clearly state the respective obligations of the parties."[42] The law in Maryland requires a contract between a charitable organization and a fund-raising counsel to contain provisions addressing the services to be provided, the number of persons to be involved in providing the services, the time period over which the services are to be provided, and the method and formula for compensation for the services.[43]

In Massachusetts every contract between a professional solicitor or a commercial co-venturer and a charitable organization must include a statement of the charitable purposes to be described in the solicitation, as well as a statement of the "guaranteed minimum per-

centage of the gross receipts from fund raising which will be utilized exclusively for the charitable purposes described in the solicitation."[44] This type of law seems predicated on the assumption that charitable organizations are not quite capable of developing their own contracts and tend to do so impetuously.

Other states seek to govern the nature of the relationship between charitable organization and donor. Illinois, like a half-dozen other states, imposes on the individual who raises funds for a charitable organization the responsibility to deal with contributions in an "appropriate fiduciary manner."[45] Thus, such individuals owe an explicit legal fiduciary duty to the public, and they are subject to a surcharge for any funds not accounted for or wasted. The position of fiduciary should not be assumed lightly. It is one thing to impose some responsibility on those who temporarily hold "charitable" dollars as these moneys make their way to charitable purposes; to cause them to be "fiduciaries" is to impose a much heavier burden of duty.

The Relevance of Law to Fund-raising Ethics

To "obey the law" is a prima facie moral duty, but the phrase expresses a minimum standard for behavior. It is expected that fund raisers in educational institutions will comply with the law, but this book is written with the assumption that fund raisers have set their sights higher than the legal expectations. In tightening up the tax regulations, for example, the federal government is expressing the expectation that charitable organizations will provide their donors with the kind of information they need in order to be in compliance with tax-reporting requirements. With or without the law, it would be inconsistent for educational institutions to seek to hide such information from their donors. The special social role of educational institutions carries with it a basic assumption of honesty. The trust relationship between institutions and donors upon which successful development depends requires that development officers protect their donors' interests as though they were the institution's own. They often are.