

I. STATE CHARITABLE SOLICITATION STATUTES

by

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1. Introduction

According to the latest edition of *Giving USA*, Americans gave \$190 billion to charity in 1999 ----- up 6.7 percent from 1998 after adjusting for inflation. As a result, the nonprofit sector continues to grow in both size and significance.

In fact, according to the Fall 1998 issue of the Internal Revenue Service Statistics of Income Bulletin, between 1975 and 1995 the number of tax-exempt organizations more than doubled to 1,200,000, their assets increased by 312 percent to \$1.9 trillion, and their revenue increased by 380 percent to \$899 billion. The nonprofit sector's growth in assets and revenue significantly outpaced the country's 74 percent growth in Gross Domestic Product in the same period.

The astonishing growth of the tax-exempt sector reflects the significant contributions charitable organizations make to society. They perform many important functions that would otherwise need to be performed by government or not at all. Unfortunately, the charitable community is no different than any other sector of the economy in that it also has its share of unscrupulous individuals who seek to profit by defrauding innocent donors out of their hard-earned income and, in some cases, their lifetime savings. These fraudulent schemes harm not only contributors who respond in the mistaken belief they are helping charitable causes, but also the charitable community, as each new scandal hurts every legitimate charitable organization by increasing skepticism in the giving public. The states have the difficult, but essential, tasks of protecting their citizens from charlatans who prey on their charitable natures while challenging them to recognize that we all benefit when worthy charitable organizations are generously supported. Their role is even more critical when major government cutbacks shift the responsibility for relieving many of society's burdens to the charitable sector.

To protect their residents and legitimate charitable organizations, approximately 40 states have enacted charitable solicitation statutes. Although specifics vary, state statutes usually require organizations to register with the state before they solicit the state's residents for contributions.

State solicitation statutes generally serve two important purposes. First, they allow the public to get basic information about organizations asking for contributions so donors can make better, more informed charitable giving decisions.

For example, in Pennsylvania, residents can easily obtain basic information about registered organizations by either calling a toll-free number or visiting the Bureau of Charitable Organizations' web site. Either method allows residents to quickly and easily learn an organization's total income for its most recently completed fiscal year, its total contributions, and how much it spent in three key categories: program services, administration, and fundraising.

The Bureau's web site links directly to the *Guidestar* web site at www.guidestar.org/. As *Guidestar* makes copies of charitable organizations' Forms 990 available, residents can easily view, and even download them 24 hours a day from the comfort of their homes. However, as significant as this recent technological innovation is, our recent experience in Pennsylvania shows that any suggestion that disclosure can replace regulation is overly optimistic, or at least premature. Pennsylvania's recently hired auditors and investigators now regularly document that many organizations' Forms 990 contain material omissions, misrepresentations, or even falsifications.

In addition, the *Chronicle of Philanthropy* recently documented that as many as one out of every four organizations that reported at least \$500,000 in contributions on their Form 990 failed to report any fundraising expenses! That's one quarter of the largest charitable organizations in the country! The *Chronicle of Philanthropy* study confirmed what Pennsylvania's auditors and investigators have been documenting for some time now: that a significant number of the Forms 990 contain material omissions, misrepresentations, or falsifications.

The *Chronicle of Philanthropy* study and the Bureau's auditors' findings highlight the second, and equally important, purpose state solicitation statutes serve: they help protect state residents from charitable solicitation fraud and misrepresentations. Although most charitable organizations are fine, worthy organizations that deserve to be generously supported, unfortunately, many are fraudulent, employ deceptive solicitation practices, or mislead the public by submitting false or inaccurate Forms 990.

Pennsylvania's experience demonstrates the importance of enforcement. Under the previous administration, the Bureau had only been staffed to serve as a registration office. However, when the infamous Foundation For New Era Philanthropy scandal occurred a few months after he took office, Governor Tom Ridge quickly decided the Bureau needed

a staff of investigators and auditors to fulfill its long-standing statutory mandate to detect and prosecute charitable solicitation fraud. As a result, the Bureau is now headed by a prosecuting attorney with extensive experience investigating fraud. In addition, the Bureau created a Special Investigation Unit (SIU) staffed with five investigators and four auditors, two of whom are licensed CPAs. Recently, several prosecuting attorneys have been either permanently or temporarily assigned to prosecute some of the many cases being documented by this new unit.

By attempting to discover and prosecute those individuals and organizations engaged in solicitation fraud, the various state registration offices, like the IRS Tax-Exempt/Government Entities Division, help protect the interests of both the public and the legitimate charitable community.

2. Charitable Organization Registration Requirements

Pennsylvania's Solicitation of Funds For Charitable Purposes Act, 10 P.S. §162.1 *et seq.*, is very similar to the solicitation statutes in most states. The basic registration requirements are not complicated.

Generally, Pennsylvania requires an organization to register with the Department of State's Bureau of Charitable Organizations before it solicits contributions in Pennsylvania. However, like most state solicitation statutes, certain organizations are specifically excluded or exempt from the Act. Although most states exempt similar types of organizations, specific exemptions vary from state to state. For example, in Pennsylvania, *bona fide* religious institutions and organizations of law enforcement personnel, firefighters, and other persons who protect the public safety are excluded from the Act's requirements if they meet certain criteria in the Act. 10 P.S. §162.3

In addition, educational institutions, hospitals, veteran's organizations, volunteer firemen organizations, ambulance associations, rescue squad associations, public nonprofit library organizations, senior citizen centers, nursing homes, and parent teacher associations are typically exempt from the Act's registration requirements if they meet any applicable criteria in the Act. 10 P.S. §162.6

Finally, organizations receiving annual contributions of \$25,000 or less are exempt from the Act's registration requirements as long as they don't compensate anyone to conduct solicitations. 10 P.S. §162.6(a)(8)

Organizations that are not excluded or exempt must file annual registration statements for their immediately preceding fiscal year. 10 P.S. §162.5

Each year organizations must also file reviewed financial statements if their gross contributions exceed \$25,000 per year and audited financial statements if their gross contributions exceed \$100,000 per year. 10 P.S. §162.5(f) Some states don't require reviewed or audited financial statements while others have review and audit thresholds different from Pennsylvania's.

These audited and reviewed financial statements must be accompanied by a report prepared and signed by a licensed, independent public accountant or certified public accountant. Pennsylvania routinely scrutinizes audits and reviews to make sure they are performed by licensed, independent public accountants or certified public accountants. As a result, we have discovered over 110 unlicensed accountants who have submitted reviews and audits to the Bureau. These unlicensed accountants have been, or are being, referred to the State Board of Accountancy for appropriate disciplinary action.

The Bureau has the discretion to waive the requirement for reviewed or audited financial statements if there are "special facts and circumstances" that justify doing so. 10 P.S. §162.5(j) Requests for waivers must be in writing and must set forth "special facts and circumstances" that justify granting a waiver. So, even though the Bureau will generally have audits or reviews available for registered organizations, in certain limited circumstances they may not be available for any given year.

Like the IRS, the Bureau can grant extensions up to 180 days for organizations to file their registration or financial statements. 10 P.S. §162.5(k) However, requests for extensions must be in writing and be filed before an organization's registration expires. Otherwise, statutorily mandated late fees of \$25 per month must be paid before any extension can be granted.

Organizations required to register must also submit copies of their Form 990. 10 P.S. §162.5(b)(6) As mentioned earlier, the basic information from these returns is entered into the Bureau's database and made available to the public through the Bureau's toll-free number and web site.

Lastly, organizations must submit copies of other official documents such as their organizational charters, articles of incorporation, and by-laws, the first time they register. 10 P. S. §162.5(c) Copies of these documents are also available for public review.

These are the basic registration requirements for charitable organizations. Should you need copies of these documents for an IRS examination, you can write the Bureau of Charitable Organizations at 124 Pine Street, 3rd Floor, Harrisburg, Pennsylvania 17101;

call the Bureau toll-free at 1-800-732-0999; or request the documents through the Bureau's web site at **www.dos.state.pa.us**.

3. Professional Solicitor and Fundraising Counsel Requirements

The basic requirements for solicitors and fundraising counsels are also quite straightforward. Solicitors must register before soliciting for charitable organizations in Pennsylvania and counsels must register before providing services related to solicitations in Pennsylvania. 10 P.S. §162.9(a) and 10 P.S. §162.8(a)

Solicitors and counsels must also file annual registration statements and copies of their contracts with charitable organizations no less than ten working days before conducting solicitation campaigns, events, or providing services. 10 P.S. §162.9(e) and 10 P.S. §162.8(d)

Solicitor registration statements must contain the following information: 1) the address of the solicitor's principal place of business and any Pennsylvania addresses; 2) the form of the solicitor's business; 3) the names and residence addresses of all the solicitor's principals, including all officers, directors, and owners; 4) whether any of the solicitor's owners, directors, officers, or employees are related by blood, marriage, or adoption to any of the solicitor's other directors, officers, owners, or employees, to any officer, director, trustee, or employee of any charitable organization under contract with the solicitor, or to any supplier or vendor providing goods or services to any charitable organization under contract with the solicitor; and 5) the name of all persons in charge of any solicitation activity. 10 P.S. §162.9(a)

Solicitor contracts with charitable organizations must be written and contain the following basic provisions: 1) the legal name and address of the charitable organization as registered with the Bureau; 2) a statement of the charitable purpose for which the solicitation campaign is being conducted; 3) a statement of the respective obligations of the solicitor and the charitable organization; 4) a statement of the guaranteed minimum percentage of the gross receipts from contributions that will be remitted to or retained by the charitable organization, if any; 5) a statement of the percentage of the gross revenue that the solicitor will be compensated; and 6) the effective and termination dates of the contract and the date solicitation activity is to commence in Pennsylvania. 10 P.S. §162.9(f)

In addition to filing their contracts with charitable organizations, solicitors must also file written solicitation notices at least ten working days before commencing any

solicitation campaign in Pennsylvania. The solicitation notice must be accompanied by a \$25 fee and contain the following information: 1) a description of the solicitation event or campaign; 2) each location and telephone number from which the solicitation is to be conducted; 3) the legal name and residence address of each person responsible for directing and supervising the conduct of the campaign and each person who is to solicit during the campaign; 4) a statement whether the solicitor will at any time have custody or control of contributions; 5) the account number and location of each bank account where receipts from the campaign are to be deposited; 6) a full and fair description of the charitable program for which the campaign is being carried out; and 7) the date the solicitation campaign or event will begin or be held and the termination date for each campaign or event. 10 P.S. §162.9(e)

Lastly, solicitors must also obtain a \$25,000 bond and file campaign reports within 90 days of the end of each solicitation campaign or annually for campaigns lasting more than a year. 10 P.S. §162.9(c) and 10 P.S. §162.9(l) These campaign reports must detail how much the public contributed as a result of the campaign and how much of the total amount contributed the charitable organization actually received after the solicitor and all its related expenses were paid.

Fundraising counsel registration statements must contain the following information: 1) the address of the counsel's principal place of business and any Pennsylvania addresses; 2) the form of the counsel's business; 3) the names and residence addresses of all the counsel's principals, including all officers, directors, and owners; 4) whether any of the counsel's owners, directors, officers, or employees are related by blood, marriage, or adoption to any of the counsel's other directors, officers, owners, or employees, to any officer, director, trustee, or employee of any charitable organization under contract with the counsel, or to any supplier or vendor providing goods or services to any charitable organization under contact with the counsel; and 5) the name of any person in charge of any solicitation activity. 10 P.S. §162.8(a)

Fundraising counsel contracts with charitable organizations must also be written and contain the following basic provisions: 1) the legal name and address of the charitable organization as registered with the Bureau; 2) a statement of the charitable purpose for which the solicitation campaign is being conducted; 3) a statement of the respective obligations of the counsel and the charitable organization; 4) a clear statement of the fees that will be paid to the counsel; 5) the effective and termination dates of the contract and the date services will commence with respect to the solicitation of contributions in Pennsylvania; 6) a statement that the counsel will not at any time have custody or control

of contributions; and 7) a statement that the charitable organization exercises control and approval over the content and volume of any solicitation. 10 P.S. §162.8(d)

These are the basic requirements for solicitors and fundraising counsels. Again, should you need copies of a solicitor's or counsel's annual registration statements, copies of their contracts with charitable organizations for whom they solicited contributions in Pennsylvania, or copies of final or interim campaign reports or solicitation notices for campaigns conducted in Pennsylvania, you can contact the Bureau as noted above.

4. The Unified Registration Statement

Organizations that solicit contributions nationally typically can save time and money by utilizing the relatively new Unified Registration Statement (URS), which was developed through a collaborative effort between the charitable community and the National Association of State Charity Officials (NASCO). The URS can currently be filed in 34 different states in lieu of the states' own registration statements. The form can be downloaded at www.nonprofits.org/library/gov/urs/.

5. Internet Solicitations

The subject of Internet solicitation is definitely one of the hottest topics currently being debated within both the charitable and regulator communities.

Because the way this type of solicitation activity will be addressed has not yet been finalized and may differ from state to state, I must give you the standard disclaimer that any opinions I express on this topic at this time are my personal opinions and not necessarily those of the Secretary of the Commonwealth of Pennsylvania or the Attorney General of Pennsylvania, the officials who will ultimately decide how this issue will be handled in Pennsylvania.

Equally, if not more, important, any opinions I express are not necessarily those of the various Attorneys General and Secretaries of State throughout the country. The President of NASCO simply doesn't have that authority! All I can share are my personal opinions concerning how I think the area of Internet solicitation might be handled and the current status of NASCO's review of this issue.

NASCO held its most recent conference in October 1999. This was the annual meeting of the state and federal officials responsible for enforcing the charitable

solicitation statutes and Internal Revenue Code provisions that govern the conduct of tax-exempt organizations.

Last year's conference covered a wide variety of topics, including Internet solicitations. In fact, the conference's entire public session dealt with how to address this rapidly growing way to solicit contributions because, as we all know, each day more and more charities are using the Internet to do so.

The Internet has opened up a whole world of possibilities for both large, well-established charities and small, recently-formed charities. It may be especially helpful for smaller charities that do not have the resources to conduct extensive telephone or direct mail campaigns because even small charities can develop relatively inexpensive web sites that can be accessed from anywhere in the world. The potential to inexpensively publicize a charity's mission and message on the Internet is enormous and, as a result, more and more money is being raised via the Internet every day.

According to a recent article in the *Chronicle of Philanthropy*, Toys For Tots raised \$475,000 in cash and received 42,000 toys as a result of its Internet solicitation efforts during the month between Thanksgiving and Christmas last year. According to the same article, the American Red Cross raised \$2.5 million on-line last year.

Soliciting on the Internet is now a hot topic at fundraising conferences all around the country and several books on the topic have recently been published. Charities of all sizes are being urged to set up web sites to solicit contributions. At least one organization is developing web sites for charities for free so they can take advantage of this new and exciting way to raise funds.

In addition, there are now at least 15 "Internet shopping malls" where you can make purchases from hundreds of retailers and the "Internet shopping mall" will donate a small portion of your purchase price to the charity of your choice. There are now even "Internet shopping malls" where you can make similar purchases and these particular "shopping malls" will donate a small portion of your purchase price to your child's school. According to a recent article, there are at least 6 of these new "Internet shopping malls" that specialize in raising funds just for schools.

The bottom line is that the Internet is being used more and more each day by hundreds of worthy charities to raise funds. However, like all things, this incredible technological advancement also has enormous potential to be abused. One could easily

create a so-called "charity" that has an impressive web site that tugs at your heartstrings, but really only exists in the web site designer's mind.

Recent articles in the *New York Times*, the *Chronicle of Philanthropy*, and elsewhere have questioned whether some "Internet shopping malls" always follow through with their promises to donate a portion of each purchase price to the charity or school of the donor's choice. Sometimes these "Internet shopping malls" have administrative policies or procedures that result in no actual donations being made in certain circumstances such as when a minimum amount must be designated for a particular charity or school before any actual donation is made. As a result of these factors and others, there's now considerable media interest in the growing number of charities soliciting on the Internet and how, if at all, they should be regulated.

The press and the public expect the regulators to address this issue. Because of its rapid growth and increasing visibility, the issue of Internet solicitation can no longer be ignored by regulators with the vague hope that it will just quietly go away. There's no getting around the fact that a strict reading of most states' solicitation statutes would require that charities maintaining web sites that include a request for contributions register in those states.

The Pennsylvania Attorney General's Office has recently taken the position that charities soliciting on the Internet do violate Pennsylvania's solicitation law if they're not registered because our law defines "*solicitation*" as "*[a]ny direct or indirect request for a contribution on the representation that [the] contribution will be used in whole or in part for a charitable purpose, including, but not limited to, any of the following:*

. . . [a]ny written or otherwise recorded or published request that is mailed, sent, delivered, circulated, distributed, posted in a public place or advertised or communicated by press, telegraph, television or any other media."

Clearly, the Internet falls into the "any other media" category. However, taking such a position poses enormous practical difficulties given there are now thousands of charities whose web sites ask for contributions. It seems rather unfair and burdensome to require a charity to suddenly have to register in the approximately 40 states that have solicitation statutes simply because the charity creates a web site that, among other things, asks for contributions. Yet, is it really fair to direct mail and telephone solicitors to allow those soliciting over the Internet to play by a different set of rules?

At last year's NASCO conference there was extensive discussion about how states can fulfill their statutory responsibilities to protect their residents and see they have access to basic information about the charities asking them for contributions without unduly burdening the ever-growing number of charities that are, and will be, using the Internet to raise substantial sums.

NASCO hopes to adopt a formal policy on this important subject soon. A draft policy was discussed extensively at both the public and private sessions of our annual conference in October. However, because of concerns expressed by several states and one county, the draft policy has since been modified several times. The most recent version has now been circulated among the NASCO membership and there have been several very long conference calls where NASCO members from around the country have discussed the latest draft in great detail. We hope to arrive at some consensus among the NASCO membership soon so the draft policy can be circulated to our bosses: the various Attorneys General and Secretaries of State for review and comment. It will then be circulated to the general charitable community for further comment and review.

Of course, even if NASCO is able to arrive at a consensus about how to address Internet solicitation, any policy it adopts would not be legally binding on any state. Nonetheless, adopting such a policy would be a significant step in the right direction because it would at least give some much needed guidance to both regulators and the charitable community about when registration in a particular state would, or would not, be required.

One of the many suggestions being considered by NASCO to deal with this problem is to not require out-of-state web sites to register if they only "passively" solicit donations and don't "affirmatively target" residents of a particular state. In other words, if a charity based in Utah has a web site that asks for contributions and a Pennsylvania resident simply finds the web site while surfing the Internet one night from his computer in Pennsylvania, the charity would not have to register in Pennsylvania because the Utah-based charity did not "actively and affirmatively" seek out the Pennsylvania resident and ask him for a donation. Rather, the Pennsylvania resident in this scenario sought out the Utah-based charity.

However, even assuming for the sake of argument that this type of scenario would not require the Utah-based charity to register in Pennsylvania, the reality of fundraising is that, once the Pennsylvania resident has made a donation to the Utah-based charity, it's only a matter of weeks, months, or, at the most, a year before the Utah-based charity will ask the Pennsylvania resident for another donation either by phone, mail, or the Internet.

When that happens, everyone agrees the charity would have to register because using the Internet to directly solicit a specific individual is no different from sending the individual a letter or calling the individual on the telephone.

The bottom line on the subject of Internet solicitations is that most states are undecided at this time about how they're going to deal with this rapidly growing way to solicit contributions. As a result, the entire public session of NASCO's annual conference this year will once again be devoted to this important topic.

6. Prohibited Conduct

Finally, Pennsylvania's solicitation statute, like most other states', prohibits certain conduct and authorizes the Bureau, the Pennsylvania Attorney General, and local District Attorneys to prosecute organizations and individuals for various improper activities.

In Pennsylvania, the prohibited conduct is outlined in Section 15 of the Act, 10 P.S. §162.15, and includes, among other things:

- 1) utilizing any unfair or deceptive acts or practices or engaging in any fraudulent conduct that creates a likelihood of confusion or misunderstanding;
- 2) utilizing any representation that implies a contribution is for or on behalf of a charitable organization, or utilizing any emblem, device, or printed matter belonging to or associated with a charitable organization without first being authorized in writing to do so by the charitable organization;
- 3) utilizing a name, symbol, or statement so closely related or similar to that used by another charitable organization that the use thereof would tend to confuse or mislead a solicited person;
- 4) misrepresenting or misleading anyone in any manner to believe that an organization on whose behalf a solicitation is being conducted is a charitable organization or that the proceeds of such solicitation will be used for charitable purposes when such is not the case;
- 5) misrepresenting or misleading anyone in any manner to believe that any person sponsors, endorses, or approves a particular solicitation when the

person has not given consent in writing to the use of his or her name for such purpose;

- 6) misrepresenting or misleading anyone in any manner to believe that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits, or qualities they do not have or that a person as a sponsorship, approval, status, affiliation or connection that he or she does not have;
- 7) utilizing or exploiting the fact of registration to lead any person to believe that such registration in any manner constitutes an endorsement or approval by the state;
- 8) representing directly or by implication that a charitable organization will receive an amount greater than the actual net proceeds reasonably estimated to be retained by the organization for its use; and
- 9) representing that any part of the contributions received will be given or donated to any other charitable organization unless such organization has consented to the use of its name before the solicitation.

Section 17(b)(3) of the Act authorizes the Bureau to impose fines of up to \$1,000 per violation and additional penalties of up to \$100 per day for each day an organization, solicitor, or fundraising counsel violates the Act. 10 P.S. §162.17 (b)(3)

7. Conclusion

I hope this basic overview of one of the many state solicitation statutes is helpful, if only to inform you that you can obtain additional documentation concerning charitable organizations, professional solicitors, fundraising counsels, or their contracts that may be useful as you conduct your audits and investigations of tax-exempt organizations. I have not attached a copy of Pennsylvania's solicitation statute since it is readily available from the Bureau's web site at **www.dos.state.pa.us**.

In conclusion, as the President of the National Association of State Charity Officials (NASCO), I assure you that NASCO members throughout the country will be pleased to assist you in any way they can with your efforts to combat charitable solicitation fraud and thereby protect both the donating public and the legitimate charitable community.