CUMMINGS & LOCKWOOD LLC

COURT UPHOLDS REGULATIONS REQUIRING CHARITIES TO DISCLOSE DONORS

March 5, 2018

Authors: Brianna L. Marquis and Andrew M. Nerney

Trusts & Estates Magazine Website

Brianna L. Guerrera and Andrew M. Nerney, attorneys in the Private Clients Group, wrote an article for *Trusts and Estate Magazine* Website entitled "Court Upholds Regulations Requiring Charities to Disclose Donors" which was published March 6, 2018.

For a link to this article, please click here.

Court Upholds Regulations Requiring Charities to Disclose Donors

Will donors now think twice before pledging?

Charities may not be happy about a recent ruling by the U.S. Court of Appeals for the Second Circuit that might result in donors thinking twice before pledging support to a charitable organization.

Two Charities with Different Exemptions

In *Citizens United v. Schneiderman*, the two charities at issue decided to simply disregard the part of the law they disagreed with. The first charity, Citizens United, is exempt from taxation under Internal Revenue Code Section 501(c)(4). Citizens United Foundation, on the other hand, is exempted under IRC Section 501(c)(3). There are notable differences between the two IRC sections affecting these charities: donors who make contributions to charities exempted under Section 501(c)(4) can't deduct their contributions while those who make them to Section 501(c)(3) charities can take the deduction. However, Section 501(c)(4) charities are less restricted than those under Section 501(c)(3) in their ability to use donor funds to influence legislation and participate in political campaigns. Accordingly, Citizens United produces films that focus on political advocacy, and Citizens United Foundation, while also producing films, chooses to focus on world leaders and events instead.

On the federal level, both IRC Section 501(c)(3) and Section 501(c)(4) require charities to submit Form 990 to the IRS, which includes a schedule listing their donors' names, addresses and the amount of their donations. The IRS must keep this list confidential. On the state level, before asking for money in New York, charities must register with the New York Attorney General's office. The AG's regulations require that the same Form 990 and schedules be submitted yearly to remain in good standing. The regulations also mandate that the donor list be made public unless they're "exempt from disclosure pursuant to State or Federal Law."

Donor Identifying Information Omitted

Since 1995, Citizens United and Citizens United Foundation (collectively, the "charities") were registered with the New York Attorney General, but they omitted any identifying information about their donors from their yearly submissions. For years, they received no complaint from the AG's office. In 2013, however, Attorney General Schneiderman served deficiency notices on them, informing them of their failure to comply with the disclosure requirements. Despite the warning, the charities continued to omit their donor information, even though they risked fines of $100 a day and eventual revocation of their privileges to solicit donors in New York.

Lawsuit Filed

To avoid the potential repercussions for their non-compliance with the regulations, the charities filed suit in 2014 in the Southern District of New York and challenged the AG's requirements with a multi-faceted argument. They claimed: (1) the AG created an unconstitutional prior restraint on their speech by requiring them to disclose their donors before allowing them to fundraise in the state; (2) the AG could unconstitutionally intimidate donors by releasing their information at any time; (3) the AG exceeded his powers under New York law to classify Section 501(c)(4) charities as "charitable organizations" and therefore subject them to his regulations; (4) on preemption grounds, it was beyond the AG's powers to duplicate the federal government's disclosure requirements; and (5) a due process violation resulted when the AG suddenly began to enforce his regulations after years of silence.

District Court Dismisses Complaint

The District Court granted the AG's motion to dismiss the entire complaint. The Court found that the complaint failed to state any preemption, New York constitutional or First Amendment violations. It also held that the due process claim wasn't ripe for review. The charities appealed.

Second Circuit Ruling

The Second Circuit evaluated the First Amendment claims. The charities used two distinct theories. First, they argued that the requirement to disclose the donor list would scare potential donors away from making charitable contributions. Second, the charities claimed that the regulations were an unconstitutional prior restraint on their ability to ask for donations. The Second Circuit didn't agree with either theory.

The charities cited *National Association for the Advancement of Colored People v. State of Alabama ex rel. Patterson*, a case that involved a state court's order mandating that the NAACP disclose a list of its members' names and addresses. There, the U.S. Supreme Court held that NAACP members had a legitimate fear that white supremacists would cause them significant harm if it became known they were part of such an organization. The NAACP presented evidence of past retaliation and threats. The Court held that making that information available would reasonably prevent some of the members from engaging in further speech or association. Thus, the charities tried to argue that making their donor list public would have a similar effect on their ability to spread their ideas. Some donors may not want their names associated with the charities' controversial beliefs.

The Second Circuit refused to apply strict scrutiny as the "disclosure requirements aren't inherently content-based, nor do they inherently discriminate among speakers." Put simply: the disclosure requirements are neutrally applied to all charities seeking donations in the state. Moreover, the government has an important interest in policing organizations that receive special tax treatment and have the ability to mislead donors by using their contributions in ways other than what they promised. Although there's some risk that government officials with access to the lists could leak it to other outside parties, a risk with all disclosure-based regulations, this risk alone does not create constitutional problems.

In evaluating the facial challenge, the Court noted that a weak First Amendment claim results from a strong governmental interest and a small First Amendment interest. That was the case of the situation at hand. The government's goals of ensuing that charities in general don't commit fraud or self-dealing outweigh any amount of speech chilling that may result. The charities offered no evidence to show that the AG's office had even published

the list in the past. Thus, the facial challenge failed. With respect to the as-applied challenge, the charities offered only “a bare assertion that the Attorney General has a vendetta against” them. The court drew a stark comparison between the charities’ assertions and the immediate danger members of the NAACP faced with white supremacist sympathizers in the government knowing their names and addresses. The Court also reiterated that the regulations are substantially related to the government’s interest in regulating charitable organizations. Accordingly, the Court held that the regulations didn’t impermissibly chill the speech of the charities or their donors.

The second theory argued by the charities is that the requirement to register with the AG’s office before they can ask for funds within the state operates as a prior restraint against further solicitation. The Second Circuit, however, disagreed holding that the regulations were “not the sort of prior restraint on speech that the First Amendment presumes unconstitutional.” There are two types of prior restraints: The first type doesn’t allow unpopular information to be printed and the second is “a facially-neutral law that sets up an administrative apparatus with the power and discretion to weed out disfavored expression before it occurs.” The regulations at issue don’t fit either of these types. The Court reasoned that while the disclosure requirements, which are “content-neutral, unambiguous, and narrowly drawn standards for disclosure,” don’t restrain speech, refusing to produce the appropriate disclosures could cause the charities to lose their ability to solicit within the state.

There are facially content-neutral laws that require permits or licenses before individuals or entities can engage in certain forms of expression. These types of laws are only prior restraints if they require permission from a government official to allow that expression and they give that official enough discretion to abuse. Here, the loss of permission to solicit only occurs if the charity refuses to submit their disclosures (which they already prepare for the federal government). The charities gave no evidence showing that the AG’s office is biased in its enforcement, so the Court held that the discretion necessary to determine who receives a deficiency notice or penalty is essential to protecting the government’s interest in regulating charities in general.

The Second Circuit then disagreed with the District Court’s ruling that the due process claim was not ripe. Because the dispute over the deficiency notices met the two requirements for ripeness, the Second Circuit then considered the merits of the argument and held there was no violation of the Due Process Clause because the AG never changed what behavior violated his regulations; rather, he merely began enforcing them.

The Court next evaluated the preemption claim, finding it “equally unconvincing.” Looking to the Ninth Circuit’s interpretation of a similar issue, the Court noted that although the IRC section preventing the IRS from sharing the donor lists may be indicative of Congress’ intent to limit their exposure, other government entities weren’t barred from seeking or sharing that information.

Finally, the Second Circuit agreed with the District Court on the New York State constitutional claim. The AG didn’t go beyond his powers by including Section 501(c)(4) charities as “charitable organizations.” Under New York law, the statutory definition of “charitable organization” is “[a]ny benevolent, philanthropic, patriotic, or eleemosynary person or one purporting to be such.” If Section 501(c)(4) charities were excluded from this definition and thus not subject to the same scrutiny as other charities, such organizations could mislead New York donors or misuse their tax-exempt status. Accordingly, the AG was correct to classify Section 501(c)(4) charities as “charitable organizations.”

Impact on Donors?

It’s yet to be seen how this ruling will influence large New York donors who may or may not have known that their donation amounts and personal information are submitted to both the state and federal government and can potentially be made public. Will they now think twice before pledging support to a charitable organization?