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Comments on the Oversight of Charitable Assets Act
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I thank the Uniform Law Commission and the Drafting Committee on an Oversight of Charitable Assets Act for allowing me to express my thoughts regarding the July 2010 discussion draft of the proposed Oversight of Charitable Assets Act (OCAA); while a substantial improvement over the prior draft, the current discussion draft (the "Latest Draft") still fails to justify its major changes to the manner in which State governments would gather information, the timing of this activity and incident costs it would impose upon smaller charities. These, in turn, raise constitutional issues.

My principal concerns with the Current Draft are:

> 1. It would require organizations whose normal annual revenues exceed $25,000 to register and annually file information they already make available to the general public under the requirements of the Internal Revenue Code of 1986 (the "Code"); much of this data is already collected on Guidestar; by limiting the requirement that this information be submitted to those circumstances in which confirmed complaints against the organization are made by members of the public, the vast majority of this burden can be eliminated;

1 Co-Counsel to the Free Speech Coalition ("FSC") a 501(c)(4) organization that identifies constitutional and other issues affecting charities and other nonprofit organizations and advocates rules that protects these groups from unreasonable government regulation. Mr. Weinberg is a Fellow of the American College of Trust and Estate Counsel, a past Chair of the committee responsible for advising the American Bar Association's RPPT section on UPMIFA and publishes regularly on tax compliance and corporate governance issues for charities. See, e.g., *Lessening the Burdens of a Changing Government,* **TAXATION OF EXEMPTS,** JANUARY/FEBRUARY 2009.

2. Imposing these costs upon small organizations, especially those whose annual revenues fall below $25,000, creates an unfair entry barrier that discriminates against new, smaller charities;. Failure to quantify the costs associated with compliance under these rules and compare them to the potential public benefits means that, in a time of scarce public resources the public will either have to take resources from elsewhere to administer new unfunded mandates, impose these costs on nonprofits that are least able to absorb those costs or mislead the public into thinking there is oversight where none exits.

3. There are also concerns relating to the due process provided by this proposal under the 4th and 14th Amendments to the United States Constitution.

The Federal government faced similar issues in dealing with the charity registration requirements of Code §508 and the annual reporting requirements of Code §6033. Congress met the first of these challenges by setting a $5,000 annual revenue threshhold for organizations that must apply for recognition of exempt status under Code §501(c)(3). The Service dealt with the reporting burden by exempting groups that normally have annual revenues under $25,000. This in effect created a floor below which small group registration and reporting was deemed outweighed by the costs and dislocation of compliance.

For purposes of the OCAA under the Latest Draft, this federal decision has created a new reality on the ground; there exist copious sources of information about charities that register and file annually. There is no reason to duplicate these efforts (plus costs and dislocations) by setting up an independent registration and filing system. Indeed, the income tax offices in many states already receive a copy of the forms 990 for charities exempt from state income tax. Since the state already has these, there is no good reason they cannot share a pdf copy with the AG's office. If a state wishes to have added or different information than is now submitted in response to forms 1023, *Application for Recognition of Exemption* and 990, *Information Return,* they should be required to justify this in terms of public benefit. From a constitutional standpoint, the state should also be able to quantify the costs of compliance and justify that added burden.

In performing that cost benefit analysis, it appears that the disclosure currently required by state legislation and Charity Office regulations failed to surface major cases of consumer fraud in the charitable field. The Foundation for New Era Philanthropy debacle was stopped by news reporting, not the actual or failed disclosure of information by that organization. The Nature Conservancy's questionable dealings with insiders was discovered by The Washington Post. While the news media clearly rely on publicly available information, there are already more than adequate sources of this information open not only to them, but to the very people who were uninformed despite large scale registration and reporting, at least in the case of the Nature Conservancy. Before endorsing implementation of a broader set of rules upon a questionable registration and reporting model, the Committee should stop and think whether doing so truly serves the public interest.

Specific Comments

The Comments to Section 2, Subsection (3) state:
"… We also need to address L3Cs and companies like Newman's Own that provide a percentage of profits for charitable purposes."

MBW Observation: L3Cs, which conduct business using private foundation investments but also seek profit should be addressed, but Newman's Own, as a company, distributes profits to a regulated charity, so the proprietary company should not be covered. Otherwise, Coca Cola, Pepsi and every mom and pop company that supports a fund raising event may have to register because they raise and contribute funds to charity. If that is to be the model, it should be under a Model Solicitation Act, not the OCAA.

The Comments to Section 3 state:

" . . . The attorney general's legitimate role is to correct abuses, but not to take over governance or to substitute the attorney general's judgment for the legitimate judgment of the charity's board or trustees; to protect the interests of the indefinite beneficiaries of charity, while recognizing that charitable assets are private, not quasi-public property; and to protect the donor's expressed intent and hold the charity to its expressed purposes."

MBW Observation: The Attorneys General should also recognize their constitutional obligation to obtain information from groups only when it is necessary and reasonable; this implies that such costs should be balanced against the potential public benefit from collection of that information. Much information the Attorneys General would collect under the OCAA (as presently conceived) is collected by other government agencies, such as the State Revenue Authority, Secretary of State's corporation division or the Internal Revenue Service. Furthermore, no case has been made that collecting this data, either a first or second time, would improve the behavior of charities or deter law breakers. A great deal of data the Internal Revenue Code requires charities to make publicly available can be seen online for free at Guidestar and more can be viewed at the charity's place of business. What good does it do to collect all of this in yet another place?

The collection of mountains of information to give the public appearance of careful oversight of charities underpins the present Charitable Solicitation rules in the majority of states. Under these exiting laws, state employees impose significant fines for minor, inadvertent infractions publish lists of those who "violate" those rules. The linkage between those actions and improved oversight of charitable activity is questionable.

Especially when tax dollars are scarce, it may seem attractive to fund the salaries of public employees via registration and filing fees, fines and settlement payments. But paying those bills with charitable funds is a false economy, because it takes money from groups that, in many cases, are providing services (child and elder care, community development and education to name but a few) that the state would otherwise have to provide.

The Council should take an approach that provides Attorneys General and State Charity Officers with a clearer and more uniform set of powers and authority, as Section 3, in general, does,[2] but avoids mandating duplicative registration and reporting. The current Comments reflect the Committee's desire to do just this, but the terms of Sections 5 and 6 go well beyond requiring registration of Trusts

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2 In this regard, the standard for initiating an investigation should be the stricter requirement that a judge approve the action or at least that there be probable cause that the law has been violated before one starts. The record of State Solicitation Officers (who would be making these decisions) suggests that the burden inherent in such an investigation be imposed only where there has been some independent review or objective tests of reasonableness have been met.

that otherwise would not be required to file with anyone and should be cut back dramatically.

<u>Section 4 states, in part:</u>

"SECTION 4. INVESTIGATION BY [ATTORNEY GENERAL]. The [attorney general] may conduct an investigation to ascertain whether:

"(1) an action may be advisable within the authority of the Attorney General pursuant to Section 3;
"(2) a law concerning the use or management of charitable assets has been violated; or
"(3) this [act] has been violated.

"Legislative Note: *If a state does not provide through other law for the process the attorney general uses for civil investigative demands, the state should consider making the text of this section subsection (a) and enacting the following provisions as part of this section. A separate possible Section concerning enforcement is also set out for consideration of the states:. . ."*

MBW Observation:

This provision does not set a threshold that must be met before an investigation is launched. It refers to the administrative laws of the state, and if there are none, suggests language that requires only "belief" by the AG or State Charitable Officer that a violation of the law may have occurred. To prevent groundless investigations, the law should state a clear standard of proof that must be met before such an inquiry will begin, that of "reasonable cause." *U.S. v. Bailey*, 228 F.3d 341, 349 (4th Cir. 2000).

The flush language of Section 4 should be amended to read:
The [attorney general] may***, upon a finding of reasonable cause that one of the following events has or is about to occur,*** conduct an investigation to ascertain whether:

* * *

Section 5 establishes a Public Registry, requires registration and annual reports. The Comments to Section 5 state, in part:

Comment

"The main thrust of the 1954 Uniform Supervision of Trustees for Charitable Purposes Act was to provide a mechanism to facilitate the supervisory role of the Attorney General by providing for registration that would alert the Attorney General to the existence and administration of charitable trusts. This Act continues to incorporate that function."

MBW Observation:

This is a valuable provision, since the Internal Revenue Code permits Charitable Remainder Trusts and other trusts that benefit charities to escape reporting to those charitable beneficiaries their future, and in some cases contingent interest. As to those trusts that are currently required to file forms 990, including 990-PF, there is really no need for added notification of the state, since the Attorney General should be able to request this from the Revenue authority or obtain them via Guidestar.

The Comments to Section 5 also state, in part:

". . . Only entities that meet the Act's definition of "covered charity" have the obligation to register in the state. While a large organization that operates in many states will likely have an obligation to register in multiple states, the committee hopes that the Act's move toward uniformity will minimize the burden of multiple registrations."

MBW Observation:

For years efforts have been made to create uniform charitable solicitations registration and reporting forms; these have failed because the State Charity Officers cannot agree as to just what each of them wants, and if all of their requests were honored, the forms would be so long that every filer would have to complete a lengthy form. Charities that solicit contributions nationwide now spend about $25,000 for the first year, and at least $10,000 per year thereafter for preparation of registration and report forms and payment of associated fees. The

committee's hopes that these same administrators will minimize the burden of multiple registrations appears to be overly optimistic.

The Comments to Section 5 also state, in part:

"Charity regulators involved in the drafting process noted that availability of information to the public serves an important function. The Act opens the registration and supporting documents to the public, with the exception of documents made confidential by any other law and, upon request of a charity or charity actor, any part of a document that does not relate to charitable assets and is not otherwise a public record. . . ."

MBW Observation:

With respect to those organizations, corporations, trusts and LLCs, whose records are open to the public under Code §6004(d), that information is already publicly available.

Section 6 states, in part:

SECTION 6. ANNUAL REPORT.
(a) This section does not apply to:
*   *   *
(2) a covered charity that receives revenues of less than $[ ] during the charity's annual accounting period for which this section would otherwise require an annual report.

and the Comments to Section 6 state, in part:

"Many charities will be able to meet the annual report requirement of Section 6 simply by 11 filing a copy of the federal tax return the charity files. If the charity files a Form 990, Form 990-12 EZ, or a Form 990-PF, the charity may file a copy of that return and need not file an additional 13 report. If the charity files Form 990-N, the charity will need to file an additional report, because 14 the Form 990-N does not request a significant level of information.

MBW Observation:

The Internal Revenue Service has already established a threshold below which it will not go in requiring annual reports (except for Forms 990N); that threshold is annual revenues of $25,000. What good reason is there for setting a lower limit than that, in which case only a band of groups whose annual revenue is above that number but below $25,000 would be making reports that are not already being made to the IRS. The Committee should recommend adoption of the Federal threshold for any uniform annual reporting requirement. This would obviate the need for gathering information from groups already deemed too small to handle the administrative burdens in question.

Section 7 states, in part:

"SECTION 7. NOTICE TO [ATTORNEY GENERAL].
"(a) A covered charity shall deliver to the [attorney general] a copy of an amendment to
its articles of incorporation, trust instrument, or other record creating the charity within [ ] days after adoption of the amendment if the amendment changes the purposes of the charity or results in a material change to the [structure, governance, or] activities of the covered charity."

MBW Observation:

Changes in structure or governance are internal matters, modifications of which do not normally present a risk of diversion of assets from their charitable purpose. The Committee should remove the bracketed words "structure, governance, or".

Section 11 states:

SECTION 11. UNIFORMITY OF APPLICATION AND CONSTRUCTION.
In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter in the states that adopt it.

MBW Observation:

This should include rules of the road, making it clear that the state in which the entity is organized has primary responsibility for monitoring and initiating investigations; only when real estate or a permanent collection item of great value is located in a different state should that state's Attorney General have standing to investigate and/or intervene.