

FEDERAL REGULATION OF CHARITABLE SOLICITATION:
CONDITIONS ON TAX-EXEMPT STATUS

by

Kathleen M. Sullivan*

Paper prepared for conference on "Charitable Solicitation: Is There a Problem?" at New York University, Program on Philanthropy and the Law, October 12-13, 1990.

* Copyright © 1990 by Kathleen Sullivan. All rights reserved.

State efforts at regulating charitable solicitation have met with remarkably consistent defeat in the Supreme Court when challenged under the First Amendment. Can Congress make an end-run around this line of Supreme Court precedent by attaching restrictions on charitable solicitation as conditions on the award of federal tax exemptions? Senator Howard M. Metzenbaum of Ohio apparently thought so when he drafted his proposed new law, the "Truth in Fund Raising Act of 1989." Although that bill has not yet actually been introduced in Congress, the debate over it has squarely raised the question whether conditions on exemptions would be a promising approach.

1. Charitable Solicitation and the First Amendment. Thanks to a long line of challenges by itinerant evangelists, the Supreme Court has repeatedly declared that charitable solicitation is entitled to strong First Amendment protection -- notwithstanding the fact that it involves the exchange of money. See Village of Schaumburg v. Citizens for a Better Environment, 444 U.S. 620, 628-32 (1980)(collecting precedents). As Justice White wrote for the Court in Schaumburg, charitable solicitation is "characteristically intertwined" with the "communication of information, the dissemination and propagation of views and ideas, and the advocacy of causes." Id. at 632.

Regulations that inhibit charitable solicitation are thus to be strictly scrutinized. And such scrutiny extends to the regulation of charitable solicitation even when it is conducted by paid solicitors and professional fundraisers. See id. at 635; Secretary of State v. J.H. Munson Co., 467 U.S. 947, 954-59 (1984) (upholding standing of professional fundraiser to bring overbreadth challenge). As Justice Brennan wrote for the majority in Riley v. National Federation of the Blind, 108 S. Ct. 2667 (1988), whatever the professional fundraiser's "financial motivation for speaking" may be, his fundraising is nonetheless "inextricably intertwined with otherwise fully protected speech." Id.; see also Meyer v. Grant, 486 U.S. 414 (1988) (invalidating a Colorado statute prohibiting the use of paid circulators of state ballot initiative petitions).

In the modern trilogy of Supreme Court cases on the subject, the Court has thrice found state regulations of charitable solicitation wanting in their regard for the First Amendment. In Schaumburg, the Court invalidated, on its face, a local ordinance that prohibited door-to-door solicitation unless an organization could show that at least 75 percent of the proceeds would go directly to charitable purposes. The Court found the state's asserted interest in preventing fraud by fake charities to be substantial, but held that an absolute 25-percent ceiling on administrative expenses and overhead was not narrowly tailored to that goal. The Court noted that state and local governments had available to them less restrictive alternatives, including "[e]fforts to promote disclosure of the finances of charitable organizations," which "may assist in

4 Sullivan

preventing fraud by informing the public of the ways in which their contributions will be employed." Schaumburg, 444 U.S. at 637-38.

In the next case of the trio, Secretary of State v. J.H. Munson Co., 467 U.S. 947 (1984), the Court again declared a 25-percent ceiling on fund-raising costs facially invalid. Here, unlike the village of Schaumburg, Maryland had provided an exception for charitable organizations that could demonstrate that such a limitation would "effectively prevent" them from raising contributions. See id. at 950-51 n.2. But the Court struck down the regulation despite the waiver provision. Whether absolute or waivable, the Court held, a percentage-based formula for charitable in relation to administrative expenses simply draws the wrong kind of line, because it rests on the "fundamentally mistaken premise that high solicitation costs are an accurate measure of fraud." Id. at 966. As noted in Schaumburg, many perfectly legitimate advocacy organizations spend high percentages of their budgets on the salaries of the paid staffers, canvassers and solicitors who research and disseminate their cause. Accordingly, the Court concluded, any inference of fraud from a charitable/administrative expense ratio is illegitimate. The use of such a ratio as even a presumptive proxy for fraud was thus found facially void.

In Riley v. National Federation for the Blind, 108 S. Ct. 2667 (1988), the Supreme Court extended the fundraisers' First Amendment win-loss record against the state and local governments to 3-0. Following Schaumburg and Munson, Riley again

struck down another state's attempt to impose percentage-based limits on the amount a charitable organization could pay its fund-raisers. The state asserted a new interest here in addition to that in preventing fraud: "ensuring that the maximum amount of funds reach the charity." Id. at 2674. But the Court rejected the "paternalistic premise that charities' speech must be regulated for their own benefit," holding that what amount reaches charity is a matter to be determined by the charitable organizations themselves. Id.

Riley also struck down the state's requirement that professional fund-raisers disclose at the point of solicitation what percentage of the previous year's contributions they had actually turned over to charity. Id. at 2676-80. Here the Court applied strict scrutiny because the statute exacted a kind of "compelled speech" from the fundraiser. The Court drew analogies to its decisions striking down state-compelled recitation of a flag salute, display of a license plate motto, or payment of union dues to support political activism. The Court found compelled disclosures too blunt an instrument and suggested that there were at least two less restrictive alternatives to forcing financial disclosures out of every fundraiser's own mouth: the state's own publication of the financial disclosure statements that charities file with them, or better enforcement of the antifraud laws in particular cases. Id. at 2679. Finally, Riley struck down a fundraiser-licensing requirement as imposing inadequate time limits on the state.

6 Sullivan

Of the current members of the Court, only Chief Justice Rehnquist, who dissented in all three cases, and Justice O'Connor, who joined him in dissent in Riley, have protested this line of decisions as fundamentally flawed. In their view, professional fund-raising is more commercial than political activity, and its regulation should be far more deferentially reviewed.

But that position does not appear likely at this point to command any more than two votes. Although Chief Justice Burger and Justice Powell also dissented in Munson, their replacements have sided with the majority's view. Not only did Justices Scalia and Kennedy vote with the majority in Riley, but they also have taken a strong stance in favor of First Amendment protection in other, arguably parallel contexts: for example, both dissented from the Court's ruling last term that a state could bar political expenditures from the corporate treasury of a for-profit corporation, though not from that of a nonprofit corporation formed for the promotion of ideas. Austin v. Michigan Chamber of Commerce, 110 S. Ct. 1391 (1990). In rejecting the Austin majority's for-profit/non-profit distinction, the two new Justices appear plainly to view First Amendment protection as undiminished by the speaker's financial motivation.

2. The "Truth in Fund Raising Act of 1989." Although it has never actually reached the floor of Congress, Senator Metzenbaum's proposed legislation furnishes an example of how Congress might try to move in to fill the gap that some view the Schaumburg-Munson-Riley line of decisions as having left behind. His law would have

amended the Internal Revenue Code to require a tax-exempt organization to disclose its fund-raising cost ratio at the point of solicitation.

In his opening statement at the hearings on the proposal held before the Senate Judiciary Committee's Subcommittee on Antitrust, Monopolies and Business Rights in December, 1989, Senator Metzenbaum described his concern as follows: "Unfortunately, many millions of dollars in charitable contributions end up not in the hands of the deserving -- but in the pockets of the deceiving. . . . In an effort to expose those who abuse the public trust in the name of charity, I intend to develop legislation that would require for the first time, at the point of solicitation, some basic information about how the funds collected will be used."

If such legislation were ever to be passed, would it be constitutional after Riley? If the proposal had appeared in the form of a federal criminal or regulatory statute prohibiting charitable fundraising in the absence of such disclosure, the answer would easily be no; the First Amendment would bar equally what Riley deemed the illegitimate compulsion of speech -- whether the violation emanated from the states or from Congress. The question is more difficult than that, however, because the restriction Senator Metzenbaum proposed may be characterized as a condition on the privilege of exemption from federal income tax, rather than as a law of general application. This feature requires consideration of the problem of "unconstitutional conditions."

3. The Doctrine of Unconstitutional Conditions. One might imagine a world in which government could achieve indirectly what it could not constitutionally achieve directly, simply by attaching conditions to government benefits. But the Supreme Court has long held that we do not live in such a world. Rather, in a long line of decisions often summarized as "the unconstitutional conditions doctrine," the Court has held that government may not grant a benefit on condition that the beneficiary surrender a constitutional right, even if the government may withhold that benefit altogether. See generally Sullivan, Unconstitutional Conditions, 102 Harv. L. Rev. 1413 (1989).

To give but a few recent examples illustrating this doctrine in the context of First Amendment challenges, the Court has held that the federal government may not condition public broadcasting subsidies on the recipient stations' agreement not to editorialize on the air, FCC v. League of Women Voters, 468 U.S. 364 (1984), that a county constable's office may not condition a clerical worker's job on her refraining from rooting for the President's assassination, Rankin v. McPherson, 483 U.S. 378 (1987), and that most public officeholders' jobs may not be conditioned on their loyalty to the winning party, enforced by a variety of patronage practices, Rutan v. Republican Party of Illinois, 110 S. Ct. (1990). Because the Constitution would have barred an outright ban on editorializing, political hyperbole, or membership in the losing party, the Court held, it likewise barred the government from in effect using bribes to achieve similar results.

At the same time, however, the Court has not applied this principle uniformly in recent cases. For example, having held that public jobs generally may not be conditioned on political silence or conformity, the Court has carved out exceptions permitting workers to be fired for speaking out on matters of internal office politics, Connick v. Myers, 461 U.S. 138 (1983), or for belonging to the losing party when they occupy policy-sensitive jobs, Branti v. Finkel, 445 U.S. 507 (1980); Elrod v. Burns, 427 U.S. 347 (1976). And having held that the government may not generally parcel out public space sought to be used for expressive activity in a discriminatory fashion, the Court has carved out an exception for public facilities it deems "non-public forums," where the content of speech may be restricted for the most part at the government's will. Perry Educators' Ass'n v. Perry Local Educators' Ass'n, 460 U.S. 37 (1983).

Thus the cases have steered between two polar positions: that government in its specialized roles as patron, proprietor, or employer is bound by the Constitution exactly to the same extent as it would be in its capacity as public sovereign or regulator, or that in those specialized capacities government is as free of constitutional constraint as a private patron, proprietor, or employer would be. Repeated pronouncements of the doctrine of unconstitutional conditions assert the former, but the pattern in the cases reveals a continuing pull back toward the latter pole.

4. Unconstitutional Conditions Doctrine as Applied to Tax Benefits. Much of unconstitutional conditions law developed in the context of outright government grants -- of money, jobs, or access to public space, for example. But the Supreme Court has expressly treated tax exemptions and tax deductions identically with cash subsidies for unconstitutional conditions purposes. Indeed, the seminal modern decision holding that the government may not condition government benefits on surrender of First Amendment rights involved a tax exemption: Speiser v. Randall, 357 U.S. 513 (1958). In Speiser, the Court held that a veteran otherwise entitled to a property tax exemption may not be denied that benefit for failing to swear a loyalty oath. Justice Brennan, writing for the Court, reasoned that denial of a tax exemption deterred or penalized speech to the same extent as withholding a cash subsidy or imposing a criminal fine. Id. at 518-19.

To be sure, a tax exemption is not the exact equivalent of a cash subsidy, and the two have sometimes been treated differently for constitutional purposes. The leading example of such disparate treatment is perhaps in the Establishment Clause area, where the Court has tolerated tax benefits while invalidating cash subsidies that were designed to bring about the same sort of aid to religious schools. For example, Mueller v. Allen, 463 U.S. 388 (1983), upheld a tax deduction for parochial school tuition, textbook and transportation expenses, and Walz v. Tax Commission, 397 U.S. 664 (1970), upheld a property tax exemption for a church, while at the same time decisions such as Lemon v. Kurtzman, 403 U.S. 602 (1971), have struck down outright

grants to religious schools of funds to pay teachers or buy books. The Court drew this distinction despite its recognition that "[g]ranting tax exemptions to churches necessarily operates to afford an indirect economic benefit" that may be comparable in its utility to an outright grant of cash. Walz, 397 U.S. at 674.

Perhaps the Walz/Lemon distinction is best explained by the fact that tax benefits allow more autonomy to individuals, and correspondingly involve less centralized government administration and control, than do outright cash grants. See generally, Wolfman, Tax Expenditures: From Idea to Ideology, 99 Harv. L. Rev. 491, 492-93 (1985). These are clearly relevant considerations if government "entanglement" is a concern, as the Court has held it is in the church/state area.

The Court has distinguished between tax benefits and cash subsidies in other constitutional contexts too. On the one hand, for example, the Court has held that a state that "buys local," and thus discriminates against outsiders, is nonetheless exempt from scrutiny under the dormant commerce clause because the state is acting as a mere "market participant" -- a buyer of goods or services rather than a regulator of private transactions. Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 809-10 (1976). But on the other hand, the Court recently denied a similar exemption to a state seeking to subsidize a local industry indirectly by giving sales tax exemptions to sellers of local products -- notwithstanding its recognition that the forbidden tax benefit and the permissible cash subsidy would have the same economic

12 Sullivan

effect by "conferring a commercial advantage over out-of-state competitors." New Energy Co. v. Limbach, 108 S. Ct. 1803, 1809-10 (1988).

What is the moral of these two lines of cases, which distinguish tax benefits from cash subsidies to opposite effect for establishment and dormant commerce clause purposes? Apparently that states will do better to favor parochial schools with tax credits but parochial economic interests with cash subsidies!

Fortunately, the caselaw in the unconstitutional conditions area is less complex. The Court pronounced straightforwardly and unanimously in Regan v. Taxation with Representation ("TWR"), 461 U.S. 540, 544 (1983), that "[b]oth tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system." Thus whatever debate may continue about the concept of "tax expenditures" in other contexts, for purposes of unconstitutional conditions analysis, its day has long since arrived.

The recognition that tax benefits are a form of government largesse does not end the analysis, however. The Court has decided two major cases on the question of whether selective denial of tax benefits violates the First Amendment -- with opposite results. In the 1983 decision in Regan v. TWR, the Court unanimously upheld federal income tax laws barring nonprofit organizations from using tax-deductible contributions for lobbying activities, as well as an exception for veterans' organizations within

that law. In Arkansas Writers' Project, Inc. v. Ragland, 481 U.S. 221 (1987), by contrast, the Court struck down an Arkansas statute that imposed a state sales tax on general interest magazines, but exempted newspapers and religious, professional, trade, and sports journals from the tax. Why did the Court treat these two kinds of conditions on tax benefits differently?

The Court's reasoning in TWR went roughly as follows. If Congress had banned lobbying in general, of course, the First Amendment violation would have been plain. But, the Court reasoned, this was not such a case. Here Congress had not imposed a penalty on nonprofit organizations that chose to lobby, but merely declined to subsidize their exercise of that First Amendment right. In other words, there may be a right to lobby, but not at the taxpayers' expense. The Court also held in TWR that an exemption from the lobbying ban for veterans' organizations that receive tax-deductible contributions did not violate the First Amendment, reasoning that veterans were being rewarded not impermissibly because of their ideas, but rather because of their status as having uniquely served their country.

The Court implied in TWR that either of two changes in the facts would have changed the outcome of the case. First, the Court (and especially Justice Blackmun's concurrence, 461 U.S. at 552-53) suggested that had Congress denied nonprofits tax benefits for their nonlobbying activities on account of their lobbying, that would have been a penalty invalid under the First Amendment. For example, if nonprofits that

lobbied had lost their very tax exemptions, it would have been a different case. But here, Congress had not put nonprofits to an all-or-nothing choice -- refrain from lobbying or pay full income tax. Rather, it had given them what the Court viewed as the less onerous alternative of segregating themselves into section 501(c)(3) and 501(c)(4) affiliates, and enjoying tax exemptions for both. All that was lost was the additional benefit of tax deductibility to contributors to the extent their contributions went to support the lobbying activities by the 501(c)(4).

This line of reasoning is hardly so obvious as the TWR Court made it sound. For after all, dividing oneself administratively and financially into two parts is not without significant cost. Indeed, the Court has elsewhere deemed the mere administrative and accounting costs of internal financial and administrative segregation such a grave burden on First Amendment liberties as to warrant the strictest scrutiny: In FEC v. Massachusetts Citizens for Life, Inc. ("MCFL"), 479 U.S. 238 (1986), the Court invalidated under the First Amendment a FEC requirement that corporations segregate funds for political candidate campaign contributions from their corporate treasuries, as applied to nonprofit corporations formed to promote political ideas. Yet the Court inexplicably trivialized the similar costs imposed in the tax context by the combination of IRC sections 501(c)(3) and 501(c)(4). Just as the FEC laws required nonprofits that wanted to make political contributions to spin off separate PACs, the tax code requires any nonprofit organization that wants to lobby to spin off a separate lobbying affiliate.

Why is one constitutional and the other not? The Court declared that they are different, see MCFL, 479 U.S. at 256 n.9, without explaining why.

The second factual scenario that the TWR Court said would come out differently was one in which the government's basis for selective tax treatment was viewpoint-discriminatory. As Justice Rehnquist wrote for the Court in dictum, even in the allocation of subsidies, government may not ""aim at the suppression of dangerous ideas."" TWR, 461 U.S. at 548 (quoting Cammarano v. United States, 358 U.S. 498, 513 (1959) (quoting Speiser, 357 U.S. at 519)). But the Court found no such skewing in the antilobbying provisions of IRC section 501(c)(3) because it proscribed lobbying across the board, and because the veterans' exception was deemed status- rather than viewpoint-based. (The first case testing an arguably explicitly viewpoint-discriminatory condition on government benefits is pending before the Supreme Court this Term: Rust v. Sullivan, No. 90- involves a First Amendment challenge to federal regulations that mandate pregnancy and childbirth counseling, while prohibiting abortion counseling or referral, in federally subsidized family planning clinics.)

Again TWR's reasoning does not seem airtight; the concession about viewpoint-discrimination seems to undercut the ruling. After all, an outright ban on all lobbying surely would be scrutinized just as strictly as an outright ban on Republican lobbying, or lobbying that favored abortion. Why, therefore, treat selective subsidies that deter all lobbying as mere nonsubsidies meriting deference, but selective

16 Sullivan

subsidies that deter lobbying for only one side of an issue as penalties meriting strict review?

Moreover, why not regard speaker-based discrimination -- such as the discrimination in favor of veterans' organizations here -- as just as dangerous to the freedom of speech as viewpoint-discrimination? In many other contexts, the Court has treated all forms of content discrimination -- whether by reference to viewpoint, subject matter, medium, or, as here, the identity of the speaker -- as constitutionally indistinguishable and as all equally highly suspect. The Court would be unlikely, for instance, to uphold a law that said that "no organization, other than a veterans' organization, may demonstrate on Washington Mall."

Arkansas Writers' Project, in contrast to TWR, did find impermissible content discrimination in a selective tax subsidy scheme: it struck down the statute because of its subject-matter distinction between general-interest magazines and other enumerated, special-interest kinds. The Court flatly rejected Justice Scalia's protest in dissent that denial of participation in a tax exemption or other subsidy scheme is not as "coercive" as a direct regulatory restriction or prohibition, and so should always be more deferentially reviewed.

To summarize, the lesson of TWR and Arkansas Writers, is that speech-restrictive conditions on tax benefits do sometimes trigger strict First Amend-

ment scrutiny, but not always. The chances of invalidation increase with either of two factors: (1) the existence of a "penalty" on other aspects of one's operation extending beyond a particular activity that the government is declining to subsidize, or (2) the tendency of a condition to approach a core violation of the First Amendment by preferring some viewpoints or subject matters to others.

5. "Truth in Fundraising: an Unconstitutional Condition?" How would a reviewing court decide the constitutionality of the Metzenbaum legislation or its analogue if it were enacted and subjected to First Amendment challenge under the cases culminating in Riley? There is no decided case precisely on point, but the analysis above suggests that the answer should be that it is unconstitutional.

First, the legislation arguably would operate as a "penalty" on tax-exempt status for organizations that fail to disclose, not as a mere refusal to subsidize the right to nondisclosure. For here, unlike the tax provisions at issue in TWR, the organization is put to an all-or-nothing choice: disclose financial ratios that the First Amendment protects you from being forced to disclose, or lose your tax exemption. Here, the government has provided no less restrictive alternative such as spinning off a 501(c)(4) affiliate. (Note that this conclusion is weakened if the penalty for nondisclosure is merely a minor monetary penalty rather than loss of the exemption).

The second and more powerful objection, though, comes from the substance of the First Amendment right at stake here. The reason Riley invalidated the forced disclosure of charities' overhead cost ratios was that the presumption embodied in such disclosure requirements -- that organizations with high overhead costs are presumptively fraudulent or illegitimate -- reflects unjustifiable content discrimination. In particular, such a rule discriminates, in the words of the Schaumburg opinion, against "organizations that are primarily engaged in research, advocacy, or public education and that use their own paid staff to carry out these functions as well as to solicit financial support" -- groups that government may not casually "lump [together] with those that in fact are using the charitable label as a cloak for profitmaking." 444 U.S. at 636-37. In this respect, the proposed Metzenbaum legislation resembles the law struck down in Arkansas Writers' Project: it presumes that some organizations are more worthy of a tax benefit than others on the basis of a distinction with illegitimate, subject-matter-specific effects. After Riley, discriminating against high-overhead fundraisers is no more permissible than discriminating against general-interest magazines; conversely, neither low-overhead charities nor special-interest magazines may be granted special privileges. Rather, the First Amendment requires content neutrality.

It might be objected that the disclosure condition should be analogized to the speaker-based discrimination (in favor of veterans) upheld in TWR, rather than to the subject-matter discrimination struck down in Arkansas Writers. But this cannot be so, for the very point of Riley was to deny that a low-overhead/high-overhead distinction

can be content-neutral: unlike veterans' connection to past national service, which made the veterans' preference content-neutral, cost ratios were held inherently unrelated to any content-neutral interest in preventing fraud. Accordingly this is closer to a case of illegitimate "suppression of dangerous ideas."

Conclusion. It may seem harsh to find constitutional obstacles in the path when government is simply trying to increase the flow of potentially relevant information to the public. But that line was crossed in Riley. When that decision is coupled with the existing law on unconstitutional conditions, it would appear that point-of-solicitation disclosures may no more be exacted as the price of a tax exemption than compelled by regulation.