
Legal Implications of the Internet for Nonprofits

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The Internet has profound and proliferating implications for the way that people and organizations do business throughout the world. Although nonprofits are exempt from tax, they are hardly exempt from these seismic developments. This chapter will summarize an assortment of legal issues raised by the availability of the Internet as a mode of communications and interaction. Because these issues are constantly developing and changing, they must be carefully monitored on an ongoing basis by nonprofit organizations and their advisors.

How the Internet Works

Initially, it may be useful to clarify what the Internet is, how it works, and how charitable organizations may use it to further their corporate purposes. The Internet is an enormous network that provides connections to innumerable smaller groups of linked computer networks. One English-to-English translation explains:

To understand [the Internet], picture a modern road network of transcontinental superhighways connecting large cities. From these large cities come smaller freeways and parkways to link together small towns, whose residents travel on slower, narrow residential ways.¹

The foundations of these networks are interconnected “backbone” computers that can transfer data at exceptionally high speeds: 45 million bits per second in many cases, compared to 9,600 to 56,600 bits per second for the average personal computer. The backbone computers are networked with other computers that move data at speeds around 1.5 million bits per second. In turn,

personal computers and other smaller networks are linked to these supercomputers.² Access to the Internet, then, allows an organization or a donor to provide information to and make contact with anyone in the world who is linked into this system of networks.

Simultaneously, increasing numbers of nonprofit organizations have learned that creating a web page is an extremely easy and inexpensive way to describe their programs, provide information related to their mission, and/or seek support for their activities. Creating a web page involves using formatting codes called HyperText MarkupLanguage, or HTML. These codes instruct web browsers (computer programs that guide a computer user to Internet sites) how to display the text and graphic images that make up different parts of a web page or the links between different pages. These relatively simple codes create even the most elaborate web sites. Also, web pages may be located on a hosting service for a modest fee; some Internet Service Providers allow members space on their server as part of the general service fee.

Moreover, once a web page has been created, it is extremely easy to link one web site to another so that clicking on a name or image on one web site immediately transfers the Internet user to another web site or another part of the same web page. Thus, nonprofit organizations may link their web sites with those of other organizations serving similar goals, with the web sites of for-profit organizations with whom they have some relationship, or with web sites where further information about the nonprofit may be found. Similarly, organizations that promote charitable giving generally can easily link their sites to those of particular nonprofits.

Many web sites include links to the web pages of related nonprofits or to nonprofits' for-profit corporate sponsors. Many web sites run by for-profit organizations also have been created to facilitate charitable giving, either through straight donations or by offering the purchaser of goods and services the opportunity to direct a small percentage of the purchase price to a particular nonprofit.

Nonprofits are now using the Internet to raise funds from the public, to acknowledge their corporate sponsors, to sell merchandise, and to display information about their finances and operations. The balance of this chapter discusses the potential problems for nonprofits that each activity raises.

Internet Fund Raising and Its Regulation

Existing Law

Presently, thirty-eight states and some municipalities and counties require nonprofits to register with them before they solicit; unregistered solicitation may

result in injunctive relief or monetary penalties. In addition, at least as many jurisdictions have statutes that authorize investigation and legal action, usually by the state's attorney general, to stop fraudulent charitable solicitation. Most jurisdictions define "solicitation" so broadly that it covers virtually any request for funds by any means. (See Chapter 29, "The Attorney General's Regulatory Authority.")

As nonprofits turn increasingly to the Internet to solicit funds from the public, they must determine the extent to which this activity subjects them to the regulatory jurisdiction of state attorneys general. Because the Internet was a concept out of science fiction at the time most charitable solicitation statutes were written, applying these statutes to Internet solicitation is less than clear and raises substantial constitutional questions.

When a nonprofit engages in "active solicitation" on the Internet, that is, e-mailed requests for funds, it will probably be subject to the jurisdiction of the states whose residents receive the e-mails, much like mail or phone solicitors are. The important question is whether a state would have jurisdiction to regulate a nonprofit whose only contact with the state is through "passive solicitation" on the Internet, that is, requests for charitable funds that occur as a result of maintaining a web site accessible to individuals from various states. A literal reading of the charitable solicitation statutes suggests that they would cover passive solicitation. Unless that result offends the Constitution, nonprofit organizations would be required to register in all states and municipalities requiring charitable registration if they maintain a web site that is accessible to citizens of those jurisdictions and that requests or accepts donations.

Today, it is far from clear how much, if any, state regulation of passive solicitation will pass the constitutional tests. In fact, the proper legal standard to apply to such cases is itself the subject of substantial debate (see Exhibit 1 for an analysis of the current state of the law in this area). At the same time, the National Association of State Charities Officials has proposed a set of principles, known as the Charleston Principles, to guide states in formulating a uniform policy regarding state jurisdiction over Internet solicitation.³ However, it could take years for the individual states to adopt policies or pass laws to implement any uniform approach in this area. Until the issue is settled either by a dispositive legal ruling or a change in state laws, nonprofits that solicit funds from the public via the Internet must determine whether and/or when they, or the organizations assisting them, must comply with state registration laws.

Practical Solutions

What steps should nonprofits that engage in passive Internet solicitation take to ensure they are complying with the law? For large nonprofits already conducting solicitation nationwide, the answer will likely be that no further action is necessary. Having already registered to conduct other types of solicitation

nationwide, they will need to do nothing further to be in compliance with state solicitation laws. However, a small nonprofit whose appeal is local in scope but that has a web site will need to consider whether it must register in thirty-eight states in order to maintain this web site, since the site will have the potential to act as a conduit for out-of-state contributions.

On the one hand, registration often will be impractical for small nonprofits. The cost of multi-state compliance for a nonprofit with geographically limited activities and a small budget will probably be greater than the contributions it would receive from far-flung contributors who learn of its programs through the web site. On the other hand, noncompliance carries significant risk. One approach is to register in the state where the nonprofit does business and indicate on the web site that contributions from outside that state will not be accepted via the web site. Another idea is to include on the web site a link to the web site of a state charities office or other web site where further information about the nonprofit is available. Alternatively, the nonprofit could post its financial Form 990 on its web site. Any of these measures would provide any interested person or state regulator with the information typically required in state regulatory schemes.

These approaches will minimize the risk that a state other than the nonprofit's "home" state would take action against the nonprofit. Certainly, an indication that the nonprofit is not seeking, and will not accept, contributions from states where it is not registered should eliminate the problem altogether. (Of course, in that case any contributions made from such states would have to be returned—never an attractive prospect for nonprofits that need every penny and do not wish to alienate donors.) The posting of the Form 990 on a nonprofit's web page in lieu of registration does not constitute technical compliance with registration laws, if in fact they would apply, but it would greatly reduce the motivation of a state enforcement official to insist upon immediate registration, since the financial information most often required by state registration statutes is contained in the Form 990.

Ultimately, the Internet medium itself may provide the solution to the dilemma of multi-state regulation of web-based solicitation. As discussed below, information about nonprofits is increasingly available on the Internet. In terms of computer technology, it is easy to visualize a protocol where any nonprofit raising funds on the Internet would be required to register and make yearly financial filings on a web page accessible to enforcement officials from states that would have required registration in the past. There seems to be no practical disadvantage (other than the loss of revenue from filing fees) to replacing state registration and reporting with an omnibus electronic filing requirement, assuming that all state regulators have access to computer technology and the expertise sufficient to use the information on such a web page. Certainly, if the information on this web site were made available to the public, it would be a superior means to ensure the public accessibility of financial and other information about nonprofits. Whether the states would be inclined to make such a change in their state laws, on the other hand, is extremely questionable.

Corporate Sponsorship/Advertising on the Internet

Advertising, merchandising, and corporate sponsorship of nonprofit programs are all activities that, even before the advent of the Internet, raised a variety of complex federal tax issues. One major issue is the difference between an advertisement of a for-profit corporation in a nonprofit's publication and an acknowledgment of the corporate support of the nonprofit in that publication. This tricky distinction is further complicated when both for-profit and nonprofit entities make extensive use of web-based promotions.

Under § 513(i) of the Internal Revenue Code, when a for-profit corporation agrees to underwrite a particular program or activity of a nonprofit, the nonprofit's acknowledgment of that financial support through display of a corporate logo or information about the for-profit corporation will be considered "corporate sponsorship," provided that the sponsor's only substantial return benefit is the use or acknowledgment of the sponsor's name or logo in connection with the exempt organization's activities. If the for-profit's corporate sponsorship payments fall within § 513(i)'s definition of "qualified sponsorship payments," they will be considered contributions, rather than unrelated business income. On the other hand, if a for-profit makes payments to a nonprofit that, in turn, displays messages containing qualitative or comparative language, price information, endorsements, or the like, those messages may be considered advertising, and the payments to the nonprofit in connection with those messages will be considered unrelated business income subject to the Unrelated Business Income Tax (UBIT).

In the Internet context, the distinction between corporate sponsorship and advertising must be made in the face of novel and ever-changing technological options and activities. Corporate and nonprofit connections in the Internet era are now typically advertised via the use of "click throughs," where the click of the computer's mouse on a banner ad or hyper-text link takes the user from the nonprofit's web site to the for-profit's, or vice versa. Will these connections, and the funds received by the nonprofit for them, be considered an acknowledgment of the corporation's support of the nonprofit? The most recent training manual for Internal Revenue Service (IRS) agents in this area takes the position that "a link will retain the passive character associated with corporate sponsorship while a moving banner is more likely to be considered advertising."⁴

Whether a link is advertising for a for-profit enterprise or promoting the nonprofit organization's purposes can be difficult to ascertain. Some have suggested that, if the link from the nonprofit's site takes the user to a portion of the sponsor's site devoted to the sale of merchandise, the link should be considered advertising, while a link to the home page of the sponsor's site should not.

It is also unknown whether the IRS will consider a nonprofit corporation's web site a "periodical." Under Internal Revenue Code § 513(i), payments that

entitle the sponsors to acknowledgments in “regularly scheduled and printed material” published by or on behalf of the exempt organization will not be considered “qualified sponsorship payments.”⁵ If the materials on a web site are prepared in a manner similar to a traditional periodical, the nonprofit will risk having the IRS characterize payments by corporate sponsors as advertising. However, the IRS seems prepared to recognize that, in most instances, a review of the facts and circumstances surrounding the methodology used to prepare the web site materials will support a finding that the site is not a periodical.⁶

Although the IRS continues to study these issues, there is no clear guidance concerning where the lines will be drawn in the Internet context. In order to minimize the likelihood that their arrangements with for-profit sponsors will be subject to tax, nonprofits should receive legal advice before venturing into these waters.

Legal Issues Relating to “Charity Malls”

For-profit companies that run so-called charity malls, where donors can give money to a variety of causes, have become increasingly common. The nonprofits described on these e-giving sites may or may not be aware that their names are being used, and they may or may not have entered into a formal relationship with the site that sets out their entitlement to a precise percentage of the donations, the site’s obligation to render an accounting of monies raised, and the like.⁷ In addition, these entities vary greatly in the types of services they provide to the nonprofits for whom they collect funds. Some providers simply use descriptive information supplied by the nonprofit, while others design on-line pages that are intended to persuade the public to donate. Although private watchdog groups such as the BBB Wise Giving Alliance, which set standards of conduct for charitable solicitation activities, have drawn up “best practices” to be followed in “e-philanthropy,” this burgeoning area remains a moving target for nonprofits, consumers, and charities officials (see Exhibit 2).⁸

The legal issues raised by these arrangements are legion. First, there is the question of whether fraudulent representations are being made on these sites. For instance, if the sites imply that a nonprofit has agreed to the use of its name, and such an agreement has not been made, this is a false representation that also will violate the laws of many states requiring that a nonprofit expressly authorize the use of its name.⁹ Moreover, several issues arise to the extent that the site states or implies that all contributions are tax deductible to the donor. First, if a substantial percentage of the contribution were not going to the nonprofit, the IRS might question the appropriateness of the deduction.¹⁰ Also, if the donation were going to a nonprofit based outside of the United States, it would not be

deductible to the donor under many circumstances, a fact that may not be made clear on the site.¹¹ Finally, if the contribution were to a for-profit site that was not an agent for the nonprofit, it is likely that none of the contribution would be deductible.

There also is a question under state registration laws concerning whether these sites should be required to register with the state as professional fund raisers and therefore file their contracts and closing statements and, in many cases, post substantial bonds.¹² As with the definition of "solicitation," discussed above, the definition of "professional fund raiser" in most state laws is drafted broadly, so that these sites might be considered to be professional fund raisers if they do anything at all to aid the nonprofit in receiving monies from the public. Although many nonprofit malls have registered as charitable fund raisers as a cautionary measure, it remains unclear whether registration would be legally required in all cases.¹³

For nonprofits facing the issue of whether to allow their names to be used on these sites, Holly Hall, writing in the *Chronicle of Philanthropy*,¹⁴ offers a number of tips:

- Determine your on-line fund-raising goals, because participation in these sites only makes sense if it fits in with the organization's overall approach to fund-raising on the Internet.
- Avoid long-term or exclusive contracts with particular donation sites, because there may be frequent and significant changes in the sites, given the newness of the market.
- Assess the financial backing of the giving sites, to make sure that they have the stability and wherewithal to bring people to the site and to be financially responsible.
- Seek control over the content of the site's description of the nonprofit and its programs, to ensure accuracy and consistency with the nonprofit's overall solicitation approach.
- Make sure the search function on the proposed site works properly, so that a search for the nonprofit's name yields only that nonprofit and not others with similar names.

Accountability Innovations on the Internet

Nonprofits and their advisors must also be mindful of the Internet's vast potential to increase the information available to the public about their activities and practices. In addition to the myriad possibilities for promoting the nonprofits' programs, the Internet also is a powerful vehicle for making nonprofits more transparent and accountable.

The IRS has begun transmitting the informational returns filed by nonprofits (the 990 and the 990PF) to Guidestar, a nonprofit organization that posts the returns of public charities on its web site, www.guidestar.org. Although the system is still in its infancy, it is easy to foresee a time when most informational returns will be available on-line, either from private web sites or government. As a result, information concerning revenues, expenses (salaries, rent, etc.), as well as programs will be easily available to potential donors. Indeed, pursuant to recently expanded disclosure requirements, the IRS has provided that an exempt organization need not make its financial reports or other documents available to the public if these documents are “readily available” to the public, via the Internet or otherwise.¹⁵

Conclusion

This chapter highlights some of the most important ways in which the Internet poses opportunities and challenges for nonprofit organizations. Fund raising on the Internet puts the organization literally face to face with millions of potential donors. It also requires resolution of thorny practical and legal problems. Giving sites that act as conduits for contributions open wide the doors of opportunity—for both philanthropy and thievery—and force nonprofits to take a careful look at the implications of such arrangements. Partnerships with for-profit sponsors, carried out by means of hyper-links and cross-postings, must be structured to preserve the exempt purposes of the nonprofit and to avoid imposition of unrelated business income taxes. Moreover, the Internet contains enormous potential as a resource for public education and nonprofit accountability to the public in general, particularly for donors. Just as nonprofits will have increased access to potential donors, those donors will have access to information concerning all aspects of a nonprofit’s operations and finances. For these reasons and more, the nonprofit community must proceed very carefully as it adapts to the era of cyber-philanthropy.

Notes

1. Adam Gaffin, *How It Works*, 3.21 ELECTRONIC FRONTIER FOUNDATION’S GUIDE TO THE INTERNET, available at <http://www.eff.org/Net_info/EFF_Net_Guide/netguide_3.1.txt>, with a more accessible version at <http://www.cosy.sbg.ac.at/doc/eegtti/eeg_45.html#SEC46> (April 11, 2000).

2. *Id.*

3. Charleston Principles, available at <<http://www.nasconet.org>>.

4. See text discussion of Ruth and Harper Chasin, *Tax Exempt Organizations and World Wide Web Fundraising and Advertising on the Internet*, 1999 IRS CONTINUING PROFESSIONAL EDUCATION MANUAL at 64.

5. See generally, 1999 CPE text *supra* note 4. In March, 2000, the Internal Revenue Service proposed new regulations interpreting the law of corporate sponsorship. While these proposed regulations do not specifically address the Internet context, the commentary to the proposed regulations notes that the application of corporate sponsorship rules are under Treasury Department review and specifically requests public comments on the application of the rules governing periodicals and trade shows in Internal Revenue Code § 513 to Internet activities and whether providing a link to a corporate sponsor's web site is advertising within the meaning of that law.

6. *Id.*

7. Reed Abelson, *As E-Giving Sites Spring Up, Some Say It's Donor Beware*, NEW YORK TIMES, Nov. 17, 1999, at C11; Mark Demko, *On-Line Solicitors: Tangled Web*, CHRONICLE OF PHILANTHROPY, Jan. 29, 1998, at 23, 24.

8. Reprinted with the permission of The National Charities Information Bureau (2000), subsequently merged into the BBB Wise Giving Alliance.

9. See, e.g., ARK. CODE ANN. § 4-28-412 (Michie 1999); CONN. GEN. STAT. § 21-1-190h (1999); HAW. REV. STAT. § 467B-9 (1999); MISS. CODE ANN. § 79-11-519 (2000); OR. REV. STAT. § 1716.14 (1999); R.I. GEN. LAWS § 5-53.1-7 (2000).

10. See *supra* note 4.

11. *Id.*

12. Demko, *supra* note 7 at 23.

13. *Id.*

14. *Tips on Deciding Whether Your Charity Should Be Listed on Giving Web Sites*, CHRONICLE OF PHILANTHROPY, June 15, 2000, at 39.

15. Internal Revenue Code §§ 6104(d)-(e) (1999); 26 C.F.R. § 301.6104(d)-2 (2000).