California: U.S. Court of Appeals upholds state's disclosure requirement for donors to tax-exempt nonprofits

David M. Kall | Friday, April 5, 2019

The U.S. Court of Appeals for the Ninth Circuit recently denied a petition for a rehearing en banc concerning the constitutionality of the California attorney general's Service Form 990, Schedule B requirement. The petition comes after the court's September 2018 decision in *Americans for Prosperity Foundation v. Xavier Becerra*. The court held on appeal that the attorney general's requirement, which demands that tax-exempt charitable organizations provide the names and addresses of their largest contributors, did not impermissibly burden the Americans For Prosperity or the Thomas More Law Center's First Amendment rights.

California's Supervision of Trustees and Charitable Trusts Act

The initial complaint stems from California's requirement that the Attorney General maintain a registry of charitable corporations. The California Charitable Trusts Act authorizes the state attorney general to obtain a wide range of information in order to establish and effectively maintain the registry. To solicit tax-deductible contributions from California residents, an organization must maintain membership in the registry. Information contained in the registry is public, subject to certain regulations.

The attorney general requires charities to submit complete copies of the IRS Form 990, which includes Schedule B. This schedule requires organizations to report the names and addresses of their largest contributors, but only donors that contribute $5,000 or more during the year. In some special

circumstances, organizations are only required to provide the names and addresses of donors that contributed more than 2 percent of the organization's total contributions. Both the IRS and the California attorney general exclude Schedule B information from public inspection except in judicial or administrative proceedings or in response to a search warrant.

In another case, *Center for Competitive Politics v. Harris,* the attorney general stressed that the Act is intended to collect information that is "necessary to determine whether a charity is actually engaged in a charitable purpose, or is instead violating California law by engaging in self-dealing, improper loans, or other unfair business practices."

Claims of a Constitutional Violation

The Americans for Prosperity Foundation and the Thomas More Law Center claimed that the requirement impermissibly burdened their First Amendment right to free association by deterring individuals from making contributions. Initially the federal District Court agreed with both organizations and held that there was a violation and permanently enjoined the attorney general from gathering the plaintiffs' Schedule B forms. The Court of Appeals disagreed and ultimately held that the requirement survived "exacting scrutiny" because it was substantially related to an important state interest in policing charitable fraud.

In determining if there was a First Amendment violation the court applied "exacting scrutiny" to disclosure requirements. The standard requires a "substantial relation between the disclosure requirement and a sufficiently important governmental interest."

The Governmental Interest

The court recognized that this case was not the first to hold that the disclosure requirements served an important governmental interest. In *Center for Competitive Politics*, the court recognized the attorney general's argument that there were compelling law enforcement interests in the disclosure of significant donors. The main purpose was to ensure that organizations that received special tax treatment were not abusing that privilege. Plaintiffs challenged the strength of the governmental interest and argued that:

1. The collected information was not used frequently enough.
2. The attorney general could investigate organizations in other ways.
3. That the information was not reviewed unless a complaint was received
4. If the information was needed it could be subpoenaed.

The court swiftly rejected plaintiffs' challenges and noted that the Schedule B forms provide the attorney general with investigative efficiency and allows him to flag suspicious activity.

The court stressed that the District Court reached a different conclusion because it applied an erroneous legal standard. Under the proper test, the state was not required to show that "it could accomplish its goals *only* by collecting Schedule B information." Instead, the state successfully demonstrated that "the up-front collection of…information improves efficiency and efficacy."

Potential First Amendment Violation

Even if there is a strong governmental interest, a plaintiff may overcome that interest and prevail if it can show that there is "a reasonable probability that the compelled disclosure of personal information will subject them to threats, harassment, or reprisals from either government officials of private parties." In making that determination the court broke down its analysis to address each factor:

Chilled Contributions - First, the court considered evidence from both plaintiffs that potential disclosure

would deter contributors. Although each plaintiff provided some type of evidence that disclosure *could* deter contributions, neither plaintiff identified any specific individual whose willingness to contribute was based on disclosure of the information. The court held that "the mere possibility that *some* contributors *may* choose to withhold their support does not establish a substantial burden on First Amendment rights."

Potential Harassment and Public Disclosure - Second, each plaintiff provided evidence that some *publicly* associated individuals were threatened or harassed. However, the court stated that plaintiffs did not successfully establish a "reasonable probability of retaliation *from compliance with the…disclosure requirement.*" Plaintiffs recognized that the information provided was prohibited from public disclosure. Despite the prohibition, plaintiffs argued that the Schedule B information could become public because the attorney general had a poor track record of shielding information from public view. To support its assertions Plaintiffs provided several examples of unauthorized public access of confidential information, including staff error. Although the court recognized the past disclosures it determined that the attorney general had made adequate changes to better ensure the security and confidentiality of the information. The court stated "given the slight risk of public disclosure, we cannot say that the plaintiffs have shown 'a reasonable probability that the compelled disclosure of personal information will subject them to threats, harassment, or reprisals."

Petition for Rehearing - After the court rejected the possibility of any First Amendment violations, plaintiffs petitioned for a rehearing en banc. On Sept. 25, 2018 the panel denied the petition. The denial, however, was not reached unanimously. Four Circuit Judges provided a lengthy dissent and claimed that the panel's reversal of the district court's decision "was based on appellate fact-finding and crucial legal errors." The dissenting opinion and the response to the dissent can be found here.

Who got it right? - After what one reporter described as a "stinging dissent," it remains somewhat unclear what standard should be applied when analyzing if there was a First Amendment violation regarding disclosure requirements. In any case, as the case stands, it is apparent that charitable organizations cannot claim a First Amendment violation to avoid disclosing its largest donors as IRS Form 990 Schedule B requires. Stay tuned, as this Pacific Legal Foundation article suggests that this case would be a "very good candidate for review at the Supreme Court."

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