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NEWSLETTER

ANALYSIS: *Citizens United*, Part 2? Controversial Second Circuit Ruling Sets Up Potential Supreme Court Fight Over Donor Privacy

March 2018

Last month, the U.S. Court of Appeals for the Second Circuit ruled against Citizens United and its sister entity, Citizens United Foundation, in the organizations' fight against the New York Attorney General's attempts to obtain their confidential donor lists. The ruling, along with an appeal still pending in the U.S. Court of Appeals for the Ninth Circuit involving the same issue in California (but a different plaintiff), could set the stage for another major U.S. Supreme Court case involving the well-known plaintiff.

At issue in the Second and Ninth Circuit cases is the requirement for nonprofit organizations to register with state regulators in order to solicit donations in those states. Charitable organizations formed under Section 501(c)(3) of the federal tax code are generally required to register. Many state regulators also take the position that Section 501(c)(4) social welfare organizations must register, although the state laws are often quite unclear in this respect.

Registered nonprofit organizations typically are required to file an annual report or a copy of their IRS Form 990 tax return with the state authorities. Most states do not require organizations to submit Schedule B of Form 990, which contains a sensitive list of an organization's donors. (In fact, some states affirmatively remind organizations not to file this schedule.) Unlike the other parts of the Form 990, which are required to be made publicly available, Schedule B is considered to be so sensitive that it is filed on a confidential basis with the IRS, and the tax code imposes stiff

Authors

Caleb P. Burns
Partner
202.719.7451
cburns@wiley.law

Practice Areas

Election Law & Government Ethics

penalties for its unauthorized release.

Notwithstanding the widely recognized confidentiality of Schedule B, the New York and California state Attorneys General in recent years have started demanding that nonprofit organizations registered in those states include Schedule B when submitting copies of their Form 990. The New Jersey state Attorney General also reportedly has recently begun making such demands.

Citizens United, a 501(c)(4) organization, and its related 501(c)(3) entity Citizens United Foundation, resisted these efforts in New York. They sued state Attorney General Eric Schneiderman in federal court for violating the organizations' First Amendment right to associational privacy, among other legal theories. After the district court decided for the Attorney General, the Citizens United entities appealed the ruling to the Second Circuit.

As an initial matter, the Second Circuit determined that the proper framework for judicial review of this issue was "exacting scrutiny." Under this standard, a disclosure law is constitutional if there is a "substantial relation between the disclosure requirement and a sufficiently important governmental interest." A plaintiff challenging a disclosure requirement under this framework can prevail only if it can demonstrate a "likelihood of a substantial restraint upon the exercise by [its] members of their right to freedom of association" that outweighs the government's interest in disclosure.

As for the purported governmental interest here, the New York Attorney General argued that the Schedule B information aids his office in detecting self-dealing. Specifically, donors to nonprofit organizations may not personally benefit from their donations. The Attorney General argued that "[k]nowing the source and amount of large donations can reveal whether a charity is ... doing business with an entity associated with a major donor." The Attorney General further argued that the Schedule B information aids his office in detecting "intentional[] overstatement[s of] the value of noncash donations in order to justify excessive salaries or perquisites for its own executives."

The Second Circuit panel accepted the Attorney General's purported justifications, notwithstanding some flaws and strong arguments to the contrary. (In two places, the panel's opinion also appeared to confuse Citizens United Foundation, the 501(c)(3) entity, with Citizens United, the 501(c)(4) entity.) For example, the Schedule B information likely does not help state regulators discern whether a nonprofit organization's transactions benefit donors unless the regulators also are able to recognize that the specific payees listed on an organization's Form 990 are associated with those donors – which is unlikely.

Moreover, the types of self-dealing the New York Attorney General purports to be concerned with are already required to be reported on Schedule L (transactions with "interested persons"). If an unscrupulous nonprofit organization fails to disclose self-dealing on Schedule L, it is also likely to falsify information on Schedule B to conceal such transactions. As to the Attorney General's purported justification for the need to know about an organization's non-cash donations and excessive pay and perks to an organization's executives, that information is also already required to be reported on Schedules M ("noncash contributions") and L, respectively. In short, the Schedule B information appears to be unnecessary to the Attorney General because both of the types of information he purports to obtain from the schedule is already required to be reported on

other Form 990 schedules.

In fact, in the California litigation – which was brought by another 501(c)(3) entity, Americans for Prosperity Foundation – testimony from employees in the California Attorney General's office revealed that they essentially never use Schedule B information when auditing or investigating nonprofit organizations. On the witness stand, these same employees attempted to claim they have used Schedule B information to initiate only three investigations since 2012, but on cross-examination they acknowledged that the initial source of information for even those three investigations actually originated elsewhere. In addition, the California Attorney General's office had not requested the plaintiff organization's Schedule B's for more than a decade – a fact that the district court judge found to undercut the state's purported argument that such information was useful or essential to the state's regulatory function. (In the Citizens United case, the New York Attorney General similarly had not requested the entities' Schedule B's for more than 15 years, but the Second Circuit judges were unmoved by this fact.)

Ultimately, the most significant distinction between the California case – in which the district court judge ruled against the California Attorney General – and the New York case may be evidentiary. In the California case, Americans for Prosperity Foundation had produced significant evidence and testimony of threats, harassment, intimidation, and retaliation against the organization's donors, employees, and supporters, such that the filing of the plaintiff's Schedule B with state authorities likely would deter donors from giving to the group. The district court judge also found "indefensible" the almost 2,000 Schedule B's that had been posted on the website of the California Department of Justice, even though the information was supposed to be kept confidential. These facts were absent in the New York case. On the other hand, an organization's donors, supporters, and employees arguably should not have to be subject to harm before the organization may be free from compelled disclosure of its donors.

The Citizens United plaintiffs have 90 days from the entry of the Second Circuit's February 15 ruling to seek a writ of certiorari for Supreme Court review. Meanwhile, the California case was appealed by the California Attorney General to the Ninth Circuit, where it has been awaiting a decision for more than a year.