

More Good News on State Charity Enforcement

10.27.22 | Linda J. Rosenthal, JD



It's shaping up, yet again, to be a consequential year for philanthropy.

Among the unmistakable trends is the accelerating role of state charity regulators. This development contrasts sharply with the continued crumbling of the Internal Revenue Service's nonprofit-organization oversight capabilities, due in large part to sabotage of that federal agency in the last two decades by Congress.

We've covered both of these developments over the course of 2022.

For the story about the weaknesses of the IRS exempt-organizations operations, see [Nonprofits & IRS: Square Peg, Round Hole](#) (September 7, 2022) and [New Reports on IRS Oversight of Nonprofits](#) (October 14, 2022).

And for reports about the brisk activity of the state attorneys general around the nation see [New Charity Enforcement by CA Attorney General](#) (April 19, 2022) [including summaries of several new actions] and [State AGs Continue Aggressive Oversight of Nonprofits](#) (July 21, 2022) [including mention of select cases from Illinois, Massachusetts, Minnesota, New York, and South Carolina].

We pick up now with coverage of the recent [2022 NAAG/NASCO Annual Charities Conference](#) (October 12-14, 2022). In addition to meeting among themselves for purposes of information-sharing and collaboration, members of the National Association of Attorneys General and the National Association of State Charities Officials reported to the general public on key issues, activities, and progress.

Participants heard from spokespeople from several state offices around the nation, including California, Georgia, Minnesota, and New York. Transcripts of the remarks of representatives are available at the [EO Tax Journal](#) website (paywall), Nos. 2022-192 through 196, October 20-27, 2022.

Looking at the breadth of the oversight by the California AG and other charity regulators around the nation (both in types of violations pursued and variety of remedies imposed), there can be some modicum of comfort that “scammy” nonprofits and others guilty of egregious breaches of charitable trust are not permitted to roam and flourish across the United States entirely free and unchallenged.

Of course, a continuing challenge is meeting the huge regulatory demands with way too insufficient staff and resources.

Historical Context

It’s not so much that attorneys general around the nation are taking on *new* roles and duties. Instead, they are reasserting authority that is theirs historically but has been overshadowed for many decades by the Internal Revenue Service’s prominence in oversight of tax-exempt organizations.

There are some “... 500 years of rock-solid Anglo-American jurisprudence” establishing that “... (a) modern-day ‘state attorneys general in the United States’ inherited the *parens patriae* tradition and authority bestowed on the Crown Attorney General in the Statute of Charitable Uses Act of 1601”; and (b) they ‘still carry primary oversight and enforcement responsibility with respect to the nonprofit sector.’”

“The federal government played little part in charities regulation until the early years of the twentieth century when Congress enacted a federal income tax after ratification of the 16th Amendment in 1913. ‘Regulation of charities was the exclusive province of the states until’ then. The federal role grew again after the massive overhaul of the Internal Revenue Code in 1954 and the Tax Reform Act of 1969. But ‘because the federal role was limited to the carrot-and-stick of the tax power,’ the States remained ‘better suited to correcting the behavior of charitable fiduciaries’ than the IRS given the States’ ‘broader oversight role and remedial authority.’”

“The IRS is not the only sheriff in town. Especially for charities, state regulators have the authority and willingness to pursue wrongdoing.” See *The Rising of the States in Nonprofit Oversight* (August 11, 2016), Professor Lloyd H. Mayer, *The Nonprofit Quarterly*.

States like California and New York, with the greatest concentration of charities, are well-staffed but the potential caseloads are enormous.

For instance, the California Attorney General’s office has oversight responsibility for the state’s 104,000 charities. For the last few years, according to the report at the NAAG/NASCO Conference by Elizabeth Kim, Esq., CA Supervising Deputy Attorney General, the Registry of Charitable Trusts has responded to over 262,000 requests for information, received over 2,100 complaints from the public, and issued over 35,000 delinquency letters.

Conference

Elizabeth Kim also presented synopses of several recent enforcement actions and court rulings related to California charities and charitable trusts.

In re The Charley Family Trust

When a wealthy man died, his family-trust corpus was distributed to his nephew, as successor trustee, with directions to give away all of that money to 501(c)(3) organizations of the nephew's choosing but within five years of the old gentleman's demise.

Under California law, when there are unnamed charitable beneficiaries of a trust, the Attorney General's office becomes the representative of those as-yet-undesignated entities. The nephew, who was required to give notice of his uncle's death to the Registry of Charitable Trusts, not only failed to do that but also (along with his wife as supposed successor-trustee) spent the next few years spending all the money on themselves.

Long story short: The couple didn't cover their tracks well enough and the AG's investigators discovered the deceptions and the diversions. A court ordered the nephew and his wife to cough up over \$6.2 million, the appreciated current value of the trust's assets, as well as more than \$150,000 in attorney's fees.

. *In re Marriage of Tamir/People v. Newton Center*

The AG had an enforcement action against a charity and its directors. Certain financial records were needed for the investigation, but the items in question were sealed during family court proceedings.

California filed a motion to unseal; the matter went all the way to the state appellate court. There was a favorable ruling, confirming that the Attorney General not only has authority over nonprofits but also over other individuals who have a role in managing and operating a charity, including their financial records.

. *Canyon Vineyard Estate v. Paul DeJoria et al*

The founder of the Paul Mitchell line of hair care products bought a 416-acre tract in the Malibu mountains. Although he originally planned to develop it commercially, he decided instead to make sure it stayed as "beautiful open space" in perpetuity. He sold the property for a relatively small amount of money to a nonprofit dedicated to owning and maintaining conservation easements in the Santa Monica mountains.

At some point, the property was used as collateral for a loan to the nonprofit. The commercial paper changed hands many times, as it often does. Eventually, someone tried to sell the lovely Tuna Canyon property to a developer, claiming that there was no conservation easement established at all or that it had been extinguished.

The conservation nonprofit, Mr. DeJoria, the California Attorney General and the County of Los Angeles successfully fought the matter in court. See [Canyon Vineyard Estate v. Paul DeJoria et al.](#) [79 Cal.App.5th 995 (4/21/2022)].

Conservation easements in California are "perpetual in duration" ([§ 815.2, subd. \(b\)](#)) and may only be acquired and held by "501(c)(3) organizations, local government entities, or Native American tribes. "In enacting California's conservation easement statutory scheme, the Legislature declared that 'the preservation of land in its natural, scenic, agricultural, historical, forested, or open-space condition is among the most important environmental assets of California.'"

Case closed. The appellate court admonished the plaintiff: Don't mess with our beautiful open space. A "Latin phrase" – (that is, a contorted interpretation of the phrase 'inter alia') – and a passing reference do not undo the specific language of the grant deed under which the property is held in perpetuity for the benefit of the public."

By the way, this state conservation-easement law is not at all the same as the federal law allowing charitable deductions of qualified conservation easements. Plaintiffs who tried to use that federal precedent were unceremoniously shut down on this point, too.

Broad Enforcement

These three new examples, combined with the case synopses in our earlier posts in April 2022 and in July 2022, demonstrate a remarkably wide swath of oversight at the state level in California.

And the additional cases from other jurisdictions described in the July 2022 post as well as more recently presented at the recent NAAG/NASCO conference from other states present an equally impressive snapshot of enforcement actions and remedies pursued around the nation.

Compare these representative cases with the much more limited "carrot and stick" nature of the federal tax-exemption statute: that is, obey certain rules or we'll (either) take away your tax exemption or slap you with sanctions or excise taxes.

Conclusion

While we can lament the crumbling of the federal enforcement mechanism, there is some definite benefit in applauding and encouraging the stepped-up enforcement at the state level.

Startling news reports in the last few days underscore this point. On October 25, 2022, the New York Attorney General, Letitia James, announced a [landmark settlement](#) with the Catholic Diocese of Buffalo for mishandling child sexual abuse cases. In that action, for the first time, the "New York Catholic Church will be required to comply with independent oversight" and "... priests credibly accused of sexual abuse must agree to monitoring under [a] newly created priest supervision program."

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