When Catholic Healthcare West recruited Lloyd H. Dean to be its chief executive four years ago, it made him an offer most nonprofit leaders could only envy.

Besides paying him one of the highest annual salaries in the charity world—$1.2-million in 2001—Catholic Healthcare West gave Mr. Dean a $2-million interest-free housing loan, due in five years, that helped him acquire a penthouse condominium overlooking San Francisco Bay.

Located in one of the city’s poshest skyscrapers, the condominium came with marble floors, Italian-granite countertops, and designer furnishings, according to a brochure on the building. The loan itself came with something far richer: an agreement to forgive all but $250,000 of Mr. Dean’s debt if he stayed in his job for five years.

Mr. Dean’s mortgage deal is among the sweetest that The Chronicle found in a six-month investigation of thousands of loans made by nonprofit groups to charity officers and directors. The transactions include at least 140 interest-free loans like Mr. Dean’s, personal loans for investments in stock and real estate, and loans to wealthy donors who borrowed back money they had contributed to nonprofit groups they started.

$142-Million in Debts

The Chronicle reviewed data on 10,700 Forms 990 informational tax returns filed by groups that had an annual revenue of $25,000 or more and indicated that they had outstanding debt with officers or directors. The transactions include at least 140 interest-free loans like Mr. Dean’s, personal loans for investments in stock and real estate, and loans to wealthy donors who borrowed back money they had contributed to nonprofit groups they started.

Senator Charles Grassley, an Iowa Republican who is chairman of the Senate Finance Committee, said in a statement. Mr. Grassley’s committee has been investigating the financial dealings of a number of nonprofit groups for more than two years.

After reviewing the Chronicle’s findings, Mr. Grassley said that Congress should apply to charities some of the principles of the recently enacted Sarbanes-Oxley Act, which outlaws loans to officers and directors by for-profit companies and otherwise requires them to improve their governance and accountability.

Diana Aviv, president of Independent Sector, the nation’s largest coalition of charities and foundations, denounced the practice of using nonprofit assets for loans, whether they are used to recruit executives or for any other reason. “We’re not in the money-lending business,” Ms. Aviv said in an interview. “That’s not our mission.”

State Laws

Last fall, Independent Sector and BoardSource, a Washington group that seeks to improve the effectiveness of nonprofit board members, jointly called on charities to adopt some of the provisions of the

Continued on Page 8
Charities Bestow No-Interest Loans on Their Well-Paid Executives

By Harvy Lipman and Grant Williams

For the past 15 years, John Rowe has owned a duplex penthouse apartment that offers a view of Manhattan from its perch 29 stories above Central Park. Dr. Rowe bought the apartment in 1989 using a $2.25-million, interest-free loan from the nonprofit Mount Sinai Hospital and School of Medicine, which made the deal as part of an effort to recruit him as president. Dr. Rowe repaid the loan after he left Mount Sinai in 2000 to become CEO of the Aetna insurance company, but he still owns the apartment. That means he can pocket any profit should he ever sell it. Late in 2002 one of his neighbors, the actress Tatum O’Neal, offered her apartment, 13 floors below Dr. Rowe’s, for $4.5-million. Not only does Dr. Rowe stand to make several million dollars should he ever sell the apartment, but—thanks to inflation—he actually ended up paying Mount Sinai back less money than he borrowed. When he repaid the loan in 2001, the $2.25-million he borrowed in 1989 was worth $3.12-million in 2001 dollars. By not charging him interest, Mount Sinai lost $870,000 on the loan.

In most cases, federal tax law would require Dr. Rowe to pay taxes on the amount of money the IRS calculated he should have paid in interest. But because Dr. Rowe, who moved to New York from the Boston area, used the loan to buy a home when relocating from one part of the country to another, he was exempt from paying those taxes.

Saul II, a prominent Washington-area mortgage banker and real-estate developer who sits on the board of the National Geographic Society, in Washington; the Dana-Farber Cancer Institute, in Boston; and the San Francisco Museum of Modern Art. Also among the groups is Catholic Healthcare West, in San Francisco. (See article on facing page.)

Recruiting Leaders

Dana-Farber gave its president, Edward J. Benz Jr., a $600,000 interest-free mortgage in 2000, along with annual compensation of $547,899. By 2002, Dr. Benz’s compensation had reached $735,268. Dr. Benz referred questions about the mortgage to Bill Schaller, a Dana-Farber spokesman, who said the organization provides interest-free loans “on a very limited basis from time to time. Typically it’s used as a recruitment and retention tool, in order to get some top senior faculty.” To take the Dana-Farber job in Boston, Dr. Benz left the Johns Hopkins University School of Medicine in Baltimore, a community with a lower cost of living.

Indeed, advocates of interest-free loans say such perquisites are necessary to compete with for-profit companies for executive talent capable of running complex organizations. “You are trying to compete in the marketplace to get the best person you can,” said B. Francis Saul, a prominent Washington-area mortgage banker and real-estate developer who sits on the board of the National Geographic Society. “This is just a straightforward business thing. You make the best judgment that you can to get the best person you possibly can.”

In October 2001, the society gave John Q. Griffin, the chief operating officer at Hearst Magazines International, an $800,000 interest-free mortgage, in addition to a $289,163 annual compensation package, when he left Hearst to become president of the society’s magazine group. National Geographic agreed to forgive $50,000 of the loan annually for five years as long as Mr. Griffin remains on the job. The mortgage note says the loan must be repaid in full by the end of those five years.

Betty Hudson, a spokeswoman for the society, said that at first the organization did not include such a housing loan in the package it offered prospective applicants for the job, but no qualified publishing executives would even consider the position unless the group helped defray the cost of buying a home in the Washington area, which is more expensive than most of the rest of the nation. Mr. Griffin formerly lived in Allentown, Pa., where housing generally is far cheaper than in Washington.

The San Francisco Museum of Modern Art gave its new chief executive, Neal Benezra, a 10-year, no-interest mortgage of $801,900 in 2002 when he moved from Chicago, where he was a deputy di-

Continued on Page 10
States Where Loans to Officials Are Banned or Limited

<table>
<thead>
<tr>
<th>State</th>
<th>Number of officials banned or limited on loans to officials or directors since 1998-2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>10</td>
</tr>
<tr>
<td>Alaska</td>
<td>2</td>
</tr>
<tr>
<td>Arkansas</td>
<td>6</td>
</tr>
<tr>
<td>Colorado</td>
<td>10</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>30</td>
</tr>
<tr>
<td>Florida</td>
<td>36</td>
</tr>
<tr>
<td>Hawaii</td>
<td>3</td>
</tr>
<tr>
<td>Illinois</td>
<td>33</td>
</tr>
<tr>
<td>Indiana</td>
<td>10</td>
</tr>
<tr>
<td>Iowa</td>
<td>17</td>
</tr>
<tr>
<td>Mississippi</td>
<td>1</td>
</tr>
<tr>
<td>Montana</td>
<td>7</td>
</tr>
<tr>
<td>Nebraska</td>
<td>1</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>3</td>
</tr>
<tr>
<td>New York</td>
<td>75</td>
</tr>
<tr>
<td>North Carolina</td>
<td>9</td>
</tr>
<tr>
<td>Oregon</td>
<td>8</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>2</td>
</tr>
<tr>
<td>South Carolina</td>
<td>3</td>
</tr>
<tr>
<td>Tennessee</td>
<td>30</td>
</tr>
<tr>
<td>Texas</td>
<td>57</td>
</tr>
<tr>
<td>Utah</td>
<td>17</td>
</tr>
<tr>
<td>Vermont</td>
<td>1</td>
</tr>
<tr>
<td>Washington</td>
<td>28</td>
</tr>
<tr>
<td>Wyoming</td>
<td>1</td>
</tr>
</tbody>
</table>

1 Loans allowed to principal or residence if they further the purposes of the organization.
2 Loans allowed if 100% of the principal is used to support a children's shelter.
3 Loans allowed if 100% of the principal is used to support a children's shelter.
4 Loans allowed if 100% of the principal is used to support a children's shelter.
5 Loans allowed if 100% of the principal is used to support a children's shelter.

SOURCE: Chronicle analysis of tax returns maintained by Guidestar.

Government Regulators Say They Lack Funds to Monitor Charity Loans

Continued from Page 6

San Francisco, Calif.—Having found, via its ban on loans to officers and directors, that making loans by nonprofit organizations long has been a priority of state regulators—at least on paper—but that the Chronicle found little evidence of enforcement. Nineteen states and the District of Columbia prohibit or limit nonprofit groups from making loans to officers or directors, yet 221 organizations in those jurisdictions reported loan debt to such officials totaling $10,000 or more.

Among The Chronicle’s other findings:

- In the IRS filings, 2,278 nonprofit groups said they were owed at least $10,000 by top executives, other officers, or directors at some point from 1998 through 2001.
- Tax returns filed by another 4,766 groups reported loans to top officials, but failed, as required, by the Internal Revenue Service, to say how much the debt totaled.
- More than half of the 2,278 organizations that claimed debts of at least $10,000 failed to stipulate on their tax returns, as required, whether the debts were loans, how much was lent, who received the money, and what the loans’ terms were. Nearly one-third of the 1,002 groups that did provide documentation omitted at least one key piece of information.
- At least two dozen donors created foundation-like entities called supporting organizations with tax-deductible contributions and then borrowed back more than $6.7 million, often investing the money for their personal gain. In at least 12 instances, the loans these donors took accounted for 70 percent or more of the organization’s assets.

Objectives Raised

Nonprofit officials, government regulators, and legal scholars raise numerous objections to the practice of lending charitable assets to officers and others.

There’s the question of how that money could have been better spent on programs,” Ms. Avir said. In addition, she said, a loan could put a nonprofit organization’s assets at risk of being lost should the borrower be unable or unwilling to repay. “Most nonprofits don’t have the ability to do the kinds of checks that a bank can do,” Ms. Avir said.

A loan may also make it difficult for a board to fire an executive who is not performing well on the job but who owes the charity a considerable sum, she said. A board might be forced to write off the loan as uncollectible, delay removing the executive until it gets the charity’s money back, or sue the borrower, she said. The last option can be especially troublesome, she added, because the cost of a lawsuit could exceed the amount of the loan itself.

Besides creating the potential for monetary losses, loans also can further erode the image of the nonprofit as a sound financial entity. Nonprofit officials, for example, have said that donations have diminished public confidence in charities, in 2000 when the Chronicle found that other than fraud, the most common form of credit extended by nonprofit groups, The Chronicle found.

One of the 1,262 loan borrowers in the Chronicle’s report could discern from charities’ tax returns, two-thirds, or 846 loans. Some nonprofit officials say that housing loans are defensible on the grounds that they further the personal interest rate and are made available generally to new employees relo- cating from another part of the country. Yale University, for example, offers its faculty members loans to buy homes where the university is located. Mr. Hall, of Harvard, said he purchased a house with a loan program when he taught at Yale. The program not only helped employees afford to buy their homes, he said, but also gave economically depressed New Haven a financial lift. Many other colleges offer similar programs.

Nonprofit groups that operate in high-cost cities frequently give housing loans to officers by noting that they would otherwise not be able to afford housing compar- able to what they previously owned. California real-estate prices that are out of reach of many nonprofit executives. Some officials at Catholic Healthcare say they offered the loan to Mr. Dean. Mark Klein, vice president of corporate communications at Catholic Healthcare West, noted that “Catholic Healthcare West needed a CEO in San Francisco when San Francisco housing prices were the highest in the country.” The loan, he added, “enabled Mr. Dean to purchase a house in the San Francisco Bay Area roughly equivalent to the home he had in Illinois.”

The loan, on the job at Catholic Healthcare West, Mr. Dean was executive vice president of Advocate Health Care. A nonprofit organization that runs hospitals and various other health care services in Illinois, began in 2000, the last year he held that job, was $594,866.

The Chronicle decided to speak with The Chronicle, instead referring all questions to Mr. Klein. Mr. Klein said that Mr. Dean had spokemen

South Dakota | 2

Legal experts say federal law contains no prohibition on loans to officers or directors. Under federal law, and in most states, the term “officers” includes not only people holding titles such as president and vice president, but also those with authority to make key decisions at organizations who hold no special title.

The law prohibits top officials of a nonprofit group from using their relationship with the organization to obtain money or perquisites that benefit them privately but do not help the charity accomplish its mission. A loan could violate that prohibition if its terms are unusually generous—particularly if it carries a below-market interest rate. Federal law, however, allows charities to offer loans and other perquisites when recruiting executive officers.

Loans to officers—especially for housing—are usually considered part of their compensation package, legal experts said, and nonprofit organizations need only show the federal government that the total amount of compensation is reasonable. For example, a Washington lawyer who was previously head of the Internal Revenue Service division that oversees tax-exempt organizations. One
way a nonprofit group can demonstrate that it is a daunting task, to compare an executive’s total compensation to that paid to executives at three similarly sized organizations—which can include for-profit businesses.

Federal law contains no explicit rules on loans that are not part of an overall compensation package, but legal experts said charities could get in trouble if they offered special conditions on a loan, such as a better rate than available from a commercial lender. However, Stephen Schwarz, a professor at the University of California’s Hastings College of Law, in San Francisco, and co-author of a leading law-school textbook on nonprofit organizations, said the laws covering such transactions are “murky,” and therefore tend not to be very effective in making clear to charities what is appropriate and what is not.

Most of the 19 states that have enacted laws banning or limiting loans by nonprofit corporations to their officers and directors mirror a model law the American Bar Association adopted and recommended to the states in 1987. Elizabeth Moody, dean emeritus of Stetson University College of Law, in Gulfport, Fla., who helped draft the model law, said the reason for banning such loans is that they create at least the appearance of a conflict of interest in which a charity’s funds are used to benefit a top official.

Many states also have a standard that requires trustees to diversify a group’s assets among a range of investments so as not to endanger them. That way, Mr. Schwarz and other legal experts said, if one set of investments performs poorly—for instance, stocks in a bear market—any losses could be at least partially offset by putting other assets into more stable investments like government bonds.

Concentrating a nonprofit organization’s assets in a single loan or set of loans to one individual, they added, might violate the “prudent man” rule. “If all the funds are loaned to one person who’s the original donor, that seems to me a gross violation of state-law standards,” Mr. Schwarz said.

Government’s Role

Although legal experts, regulators, and scholars raise questions about nonprofit loans to executives, the chances of federal or state regulators becoming aware of them are minimal.

The IRS relies mainly on Form 990 informational tax returns to monitor the activities of the hundreds of thousands of nonprofit groups that file them, yet the tax agency annually puts only about 20 percent of that data into its computers—and none of the data include information about loans.

Steven Miller, director of the IRS’s Exempt Organizations office, said the agency lacks adequate resources to review tax returns. It has only about 60 staff members to review the forms the IRS receives annually—meaning that the IRS receives an average of 6,000 returns a week for each staff member, including those filed by charities and private foundations.

“It is a daunting task, when you consider that a form can have as many as 300 attachments,” Mr. Miller said.

State regulators say they, too, lack enough computerized data and staff members to investigate the activities of nonprofit groups. In New York, where 47,000 charities are registered with the state, William Josephson, assistant attorney general in charge of the Charities Bureau in the New York attorney general’s office, said none of the information on the registration forms is computerized. New York law bans loans to officers and directors of nonprofit organizations, except those chartered as educational institutions by the state Board of Regents.

Florida has an even stronger statute, banning loans to officers and directors by any nonprofit group. Yet not only did The Chronicle find that 36 Florida charities reported on tax returns filed from 1998 to 2001 that they had made such loans, but Florida has no state agency that is responsible for enforcing the law on charity loans.

“There’s a risk to the residents of the state of Florida and others who donate to Florida charities that their funds could be used in inappropriate ways if the state is not going to have any regulatory review of their operations,” said Victoria B. Bjorklund, a New York lawyer who sits on an IRS advisory committee on nonprofit groups.

Enforcement in California

California requires charities to gain approval from the state attorney general’s office before making any loans. The state makes an exception for charities issuing mortgages for newly hired officials.

“We’re looking to make sure that the loan is for a proper purpose—something related to the organization, not to help the director start another business—and to know that charitable assets aren’t being wasted,” said Belinda Johns, supervising deputy attorney general for Northern California in the office’s Charitable Trusts section.

Ms. Johns said that in several cases, the state has forced officers or directors to repay loans, and in other instances the state has required charities to reorganize their boards after receiving information about questionable loans.

“We’re looking to make sure that that the loan is not for a proper purpose—something related to the organization, not to help the director start another business—and to know that charitable assets aren’t being wasted,” said Belinda Johns, supervising deputy attorney general for Northern California in the office’s Charitable Trusts section.

Ms. Johns said that in several cases, the state has forced officers or directors to repay loans, and in other instances the state has required charities to reorganize their boards after receiving information about questionable loans.

The Chronicle analysis found that 63 nonprofit organizations in California reported on their federal tax returns that they had made loans unrelated to housing costs to officers or directors. When the state attorney general’s office reviewed a list of those groups, it found that not one had applied for the required permission. Ms. Johns said the registrar of charities, the official in the attorney general’s office who receives charity registration forms, is supposed to review the forms, which include a question about loans.

“If it doesn’t appear to me that that occurred,” Ms. Johns said, noting that the person who held the registrar’s job left recently “I can assure you that it’s going to occur now.”

Regardless of whether regulators strenuously enforce legal restrictions on loans to top officials, some scholars and legal experts say charities should avoid them simply because the public is likely to be upset that charitable assets are being used to make loans to nonprofit executives.

“In issues of accountability, the public expects a higher standard than the strictly legal standard,” said Rikki Ahuz, a professor of nonprofit management at New School University’s Milano Graduate School of Management and Urban Policy, in New York City. “If your public demands this, then this is what you should be doing.”
Charities Say No-Interest Home Loans Help to Recruit Qualified Executives

Continued from Page 7

The following organizations reported on at least one Form 990 informational tax return from 1998 to 2001 that they were owed payments on interest-free loans provided to officers or directors. The Chronicle has not determined whether all these loans have been repaid.

Organizations That Made Interest-Free Loans of at Least $250,000 to Officers or Directors

<table>
<thead>
<tr>
<th>Organization</th>
<th>Loan</th>
<th>Recipient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mount Sinai School of Medicine (New York)</td>
<td>$2,250,000</td>
<td>John Rowe, former president</td>
</tr>
<tr>
<td>Catholic Healthcare West (San Francisco)</td>
<td>$2,000,000</td>
<td>Lloyd Dean, chief executive officer</td>
</tr>
<tr>
<td>San Francisco Museum of Modern Art</td>
<td>$1,500,000</td>
<td>Neal Benezra, director of the museum</td>
</tr>
<tr>
<td>National Geographic Society (Washington)</td>
<td>$800,000</td>
<td>John G. Griffin, president of magazine group</td>
</tr>
<tr>
<td>Association of American Medical Colleges (Washington)</td>
<td>$716,965</td>
<td>Jordan J. Cohen, president</td>
</tr>
<tr>
<td>Stanford University (Palo Alto, Calif.)</td>
<td>$750,000</td>
<td>Laurence H. Hobgood, Jr., former chief executive officer of Stanford Management Company</td>
</tr>
<tr>
<td>Dana-Farber Cancer Institute (Boston)</td>
<td>$600,000</td>
<td>Edward J. Benz Jr., president</td>
</tr>
<tr>
<td>Association of American Medical Colleges (Washington)</td>
<td>$458,850</td>
<td>Paul Turner, vice president</td>
</tr>
<tr>
<td>Donnell Danforth Prize Science Center (St. Louis)</td>
<td>$450,000</td>
<td>Roger Beachy, president</td>
</tr>
<tr>
<td>Episcopal Social Services of New York</td>
<td>$422,068</td>
<td>The Rev. Stephen J. Chinlund, executive director</td>
</tr>
<tr>
<td>Combined Jewish Philanthropies of Greater Boston</td>
<td>$432,000</td>
<td>Barry Shrage, president</td>
</tr>
<tr>
<td>Salk Institute for Biological Studies (San Diego)</td>
<td>$400,000</td>
<td>Richard A. Murphy, president</td>
</tr>
<tr>
<td>Association of American Medical Colleges (Washington)</td>
<td>$348,000</td>
<td>Michael Whitcomb, senior vice president</td>
</tr>
<tr>
<td>Dana-Farber Cancer Institute (Boston)</td>
<td>$300,000</td>
<td>Stanley J. Honigley, trustee ex officio</td>
</tr>
<tr>
<td>Council on International Educational Exchange (New York)</td>
<td>$288,750</td>
<td>William Cressey, vice president</td>
</tr>
<tr>
<td>Harvard University (Cambridge, Mass.)</td>
<td>$285,000</td>
<td>Paul S. Gruber, vice president for government, community, and public affairs</td>
</tr>
<tr>
<td>Association of American Medical Colleges (Washington)</td>
<td>$254,500</td>
<td>Ellen Julian, assistant vice president</td>
</tr>
<tr>
<td>Combined Jewish Federation (Ohio)</td>
<td>$250,000</td>
<td>Hal M. Lewis, president</td>
</tr>
</tbody>
</table>

SOURCE: Chronicle analysis of tax returns maintained by GuideStar
How a Loan Deal Backfired on One Nonprofit Leader

By Harry Lipman and Grant Williams

Ronnie Webb, executive director of Kids Incorporated, borrowed $140,000 from the charity and pledged to repay it at a higher interest rate than its other investments. But the loan upset the local United Fund, which withdrew its support.

The loan arrangement also figured to be profitable for Mr. Webb, who expected to make money from his restaurant enterprise. “Then the whole thing blew up in my face,” said Mr. Webb, who has worked at the organization for most of the past 27 years.

Concerns Raised

When they realized the loan had been made, after taking a second look at the charity’s financial statements, leaders of the local United Fund of Cumberland County, a charity similar to the United Way that collects gifts through on-the-job campaigns, decided last year to stop supporting Kids Incorporated in 2004. The Cumberland County Commission decided to eliminate the funds because it was concerned about the loan to Mr. Webb.

“The commission hated to do it,” said Sharon York, a commission member who opposed the move because she worried about the effect on children in the charity’s programs. “But a lot of people in the community just didn’t want their tax money going to an organization that was financially able to make loans.”

The loss of the United Fund and local government money left Kids Incorporated with about $30,000 less to spend than it had anticipated.

“Out in the Open”

“We were stunned by the controversy,” said Mr. Webb. “We felt we’d done nothing wrong, and the loan was always out in the open. I was totally convinced that, when questions were raised about the loan, it would be a simple matter of my explaining what was going on and everybody would be like, ‘OK, we see, that’s fine.’”

Ms. Potter, president of Kids Incorporated, said she was shocked. “This is a small town and everybody got to looking at us like we were Enron,” she said. “I thought, good gracious, it was an investment tool that got caught up in public perception.”

In response to the controversy, Mr. Webb and his charity’s board agreed that he would repay his loan in full last fall. He said he wound up providing the charity with $4,000 more than it would have reaped had the organization never lost him the money.

Kids Incorporated’s board of directors voted to put $500,000 of its reserves into a designated fund that eventually will be used to buy land and construct a building to house the charity, which currently leases its space.

Yet Mr. Webb said that, because his organization is unhappy with the United Fund’s handling of the matter, he does not think Kids Incorporated is likely to again seek money from the group—even though he is a member of the United Fund’s board. Mr. Webb said he hopes that the county government will decide again to provide funds to his charity.

For now, Kids Incorporated must try to make up for the hole in its budget, and for the first time it may send out direct-mail solicitations this spring. “We’re hoping folks in the community will realize that we have lost dollars, and that, in order for us to maintain a strong program, they need to give more personal donations,” said Mr. Webb. “When you lose these kinds of dollars, it’s difficult to make up, if not impossible.”
By Harvy Lipman  

I n 1998, the Muralt family of Missoula, Mont., started the Muralt Family Foundation to provide funds for a local children’s shelter.

Walter R. Muralt, and his father, Gary D. Muralt, owners of a highly successful truck-stop business, donated $1.4-million to their foundation over the next five years, taking tax deductions for the contributions. They and companies they control then borrowed $758,000 from the foundation, using the money to pay off a bank loan owed by Gary Muralt and to invest in real estate and a wireless-communications business. During that time, the organization used the repayments the Murals made on the loans to donate $107,506 to charity.

Although it calls itself a foundation, the Murals’ charity is actually a special legal entity known as a supporting organization, a type of nonprofit group that Congress established 35 years ago when it overhauled the laws governing private foundations. Gary and Walter Muralt both serve on the organization’s board.

Alternative to Foundations

Supporting organizations are designed to finance the work of specific charities. Many universities and other large nonprofit groups have supporting organizations that generate revenue for them by investing in stocks or by operating businesses. In some cases, however, wealthy people who want to set up their own philanthropic groups use supporting organizations as an alternative to private foundations. Supporting organizations offer a number of advantages. While private foundations are barred from making loans to officers or directors or engaging in any other financial dealings with supporting or- ganizations, they are not. Supporting organizations also are not required to pay the federal excise tax on transactions that most private foundations must.

Federal law also allows individuals to benefit financially from their involvement with their supporting organizations. They can donate hundreds of thousands or even millions of dollars to a supporting organization, get a tax deduction on the gift, appoint themselves as much as the entire net assets to their supporting organizations.

But a March 1999 IRS examination showed a glaring flaw in the federal tax code: While supporting organizations are not subject to the excise tax, the IRS does not require them to follow the same rules that private foundations must.

In the Muralt case, the tax agency had raised no problems with their charitable giving, although it did announce the loan practice. “We’ve been ashamed of our conduct,” IRS spokesman Richard Brever said. Mr. Muralt was a “mistake” after getting an opinion from professional advisers that it could be written off as a charitable deduction.

“In Minnesota, Ken Malecha, who is former president of Best Brands Corporation, a baking-industry supplier in Eagan, Minn., established the Malecha Family Foundation in September 2000 to support a volunteer fire department that serves a small town and surrounding area. Four months after its formation, the charity lent Mr. Malecha $800,000 of its $1-million in net assets that year for reasons not specified on its 2000 Form 990 tax return. Mr. Malecha was to repay the money in one year at 8 percent interest.

“Mr. Malecha believed that under the investment climate then in effect, the terms of the loan significantly exceeded the foundation’s regular investment return and thus were beneficial to the charity, said his lawyer, Thomas E. Brever, in an e-mail message. But Mr. Brever added that the charity later decided the loan to Mr. Malecha was a “mistake” after getting an opinion from professional advisers that it could be viewed as unseemly.

“While he was factually correct in his beliefs and certainly did nothing violative of either the letter or spirit of the law, Mr. Malecha agrees that even an appearance of impropriety should be avoided,” said Mr. Brever. Mr. Malecha “has repaid the loan in full with interest, and has pledged not to take loans from the foundation in the future,” said Mr. Brever.

In its first two years, the Malecha Family Foundation gave a total of $15,000 to the fire department that it was established to support, according to the tax returns filed by the charity with the federal government. In another Utah case, Rock T. Ballstaedt and his wife, Terri, of...
Salt Lake City, donated $186,000 in 1998 to set up the Rock and Terri Ballstaedt Charitable Supporting Organization on behalf of several Mormon charities. Days later the Utah attorney general, Mr. Torgersen, chief deputy attorney general, said that “somebody ought to be looking into them,” he said that he was taking the matter “very seriously,” and revenue division. “We have found abuses in the supporting organizations,” said Steven Miller, director of the revenue service’s Exempt Organizations office. “We have a series of cases that have been referred to us. We are taking concrete steps to figure out what’s going on and do a study.” Mr. Wei-thorn, who now is a lawyer in Phoenix. “Congress was really after a lot of fraudulent structures that never were charitable at all that were set up as private foundations. The legislation ended up including a provision that created supporting organizations. The word- ing was fairly broad, he said, to allow a range of existing legal structures that had been used to create those organizations to escape the restrictions the legislation was imposing on foundations. Under the law, which was enacted in 1969, donors can set up an organi- zation that is very similar in structure to a private foundation. But by designating it as a supporting organization and naming a specific charity to which groups of grants, donors can avoid the restrictions on foundations, including the ban on loans to officers and directors. The Internal Revenue Service’s instructions for the federal form 1120-X tax return tell charities they must report—and provide details of—loans made to directors, officers, and other key employees. Charitable organizations with revenues of $500,000 or more are required to file out the Form 990. Failure to fully fill out the form may result in penalties for filing an incomplete tax return, the tax agency says. Charities must also provide detailed documentation for all dues due from such officials, including all secured and unsecured loans to them, on Line 56 of the form. The IRS also requires that groups provide additional informa- tion about loans in a sched- ule attached to the form. The information that the IRS requires for each outstanding loan is: 1. Borrower’s name and title. 2. Original amount. 3. Balance due. 4. Date issued. 5. Maturity date. 6. Repayment terms. 7. Interest rate. 8. Collateral provided by the borrower. 9. Description and fair mar- ket value of the cash, stock, or other items provided to the bor- rower by the charity. The potential penalty for charities with annual gross rece- ipts of $1-quarter or less that fail to provide any of this infor- mation is $80 a day until the in- complete return is corrected, but may not exceed $10,000 or 5 percent of the organization’s annual gross receipts (whichever is smaller). Charities with gross receipts of more than $1-quarter face a maximum penalty of $50,000.
Trust and Transparency: Philanthropy as Private Action in Public Space

Live web and teleconference
Tuesday, March 9, 2004
2:00 – 4:00 p.m.

A Tuesdays@TPF Forum for Donors Presented by the Karoff Center at The Philanthropic Initiative and sponsored by The Citigroup Private Bank Philanthropic Advisory Service

Join this important and open forum broadcast via Web and teleconference to discuss the question, “How does our society’s crisis in trust impact philanthropy?”

Featured Panels:

H. Peter Karoff  
The Philanthropic Initiative
John Abele  
Avery Foundation
Boston Scientific
Marion Fremont-Smith  
at Harvard University
Choate, Hall & Stewart  
The Hauser Center
Peter C. Goldmark, Jr.  
Fmr. Rockefeller Foundation

For more information please visit www.tpi.org or call Cindy at (617) 338-2590 to register at no cost.

By Harvy Lipman
and Grant Williams

The Chronicle analyzed the records of supporting organizations that lent substantial sums of money to their organizations’ donors. One name appeared repeatedly:

Richard H. Bradley, a Salt Lake City lawyer

Supporting organizations are nonprofit groups set up to support specified charities. In many cases, wealthy individuals establish supporting organizations as a way to create their own philanthropy. Sometimes those individuals, who are usually directors or officers of their organizations, also take large loans from them, to be repaid with interest. The organizations then use those repayments to make supportable gifts to charity.

From 1998 through 2001, The Chronicle found that 10 supporting organizations made loans to directors of $100,000 or more that accounted for half or more of each of the groups’ assets. Mr. Bradley helped set up eight of those organizations.

“The first one I set up for a client because another attorney suggested it to me,” he said. Other wealthy people interested in donating to charity were referred to him, he said, and he helped them set up supporting organizations. “I don’t promote them. I don’t have a Web site or anything like that.”

“Most of my clients are members of the Mormon Church, where people give 10 to 15 percent of their money to charity,” he added. “They’re not doing it to get a tax break. They’re doing it because they want to create an orchard so they can give away the fruit every year.”

Internal Revenue Service public documents, but the IRS responded to a Chronicle request for the organization’s forms by saying that its two most recent returns are not “available.” That means, according to the IRS, that either the returns “have been checked out by another department” or they were never filed.

Marc Owens, a Washington lawyer who formerly headed the IRS division that oversees nonprofit groups, said that if the returns were checked out by another department, that would probably mean they were being examined by agents whose job is to decide which groups to audit.

Federal law requires charities to make copies of their tax returns available upon request. Mr. Bradley responded to a Chronicle request for his charity’s returns by sending a complete version of its return for 1999, the year the group was set up and before it had received any funds to distribute.

Loans by Supporting Organizations
Affiliated With Richard H. Bradley

<table>
<thead>
<tr>
<th>Organization</th>
<th>Net assets</th>
<th>Debt owed on loans to officers or directors</th>
<th>Fiscal year of most recent tax return available to the public</th>
</tr>
</thead>
<tbody>
<tr>
<td>Georgetown Title Foundation (Sandia, Utah)</td>
<td>$662,263</td>
<td>167(1), 200</td>
<td>2001</td>
</tr>
<tr>
<td>Hill Family Foundation (Salt Lake City)</td>
<td>$217,594</td>
<td>625, 10, 092</td>
<td>2001</td>
</tr>
<tr>
<td>Jekkes Family Foundation (Sandia, Utah)</td>
<td>$32,828</td>
<td>99, 09, 109</td>
<td>2009</td>
</tr>
<tr>
<td>Landle Family Foundation (Sandia, Utah)</td>
<td>$258,000</td>
<td>78, 90, 90</td>
<td>2009</td>
</tr>
<tr>
<td>Newton Family Foundation (West Jordan, Utah)</td>
<td>$459,185</td>
<td>82, 0, 022</td>
<td>2005</td>
</tr>
<tr>
<td>Scott Olsen Foundation (Salt Lake City)</td>
<td>$275,752</td>
<td>275, 752</td>
<td>2001</td>
</tr>
<tr>
<td>Pledger Family Foundation (Salt Lake City)</td>
<td>$913,712</td>
<td>264, 630</td>
<td>2002</td>
</tr>
<tr>
<td>Remembrance Foundation (Arapahoe, Utah)</td>
<td>$334,179</td>
<td>332,000</td>
<td>2002</td>
</tr>
</tbody>
</table>

Source: Chronicle analysis of tax returns maintained by GuideStar

 injecting that full returns be made public. He has not returned at least a half-dozen phone calls, nor has he responded to written requests for further information.

GuideStar, a nonprofit organization in Williamsburg, Va., that has established a contract with the IRS to receive copies of all nonprofit tax returns for posting on the Internet, said it has no record of ever having received any of Wishes Are Forever’s tax forms. Mr. Owens said the fact that GuideStar never received the returns could mean they may never have been filed with the IRS.

In a telephone interview with The Chronicle before he sent any information about his organization, Mr. Bradley said Wishes Are Forever has donated money to a wide range of nonprofit groups, including “the Church of Latter-day Saints, universities, and humanitarian causes like the United Way, the March of Dimes, and the Make-a-Wish Foundation.”

A spokesman for the Church of Jesus Christ of Latter-day Saints said that as a matter of policy it never comments on who makes donations. After searching its records, official records of the United Way of Salt Lake and the Utah March of Dimes said they have never received donations from Wishes Are Forever. According to the Utah chapter of the Make-a-Wish Foundation, Mr. Bradley’s group donated about $40,000 from 1999 through April of last year.

The Chronicle could find no other public records to show what Wishes Are Forever did with the remainder of the $2-million Mr. Bradley said it had donated to charity.