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U.S.

Private Charitable Foundations Give Lavish Rewards to Insiders

Officers and directors whose job is to safeguard charities' funds can receive a chunk of the money by claiming exemptions from a half-century-old law

By Andrea Fuller

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A mutual-fund manager earned nearly $5 million over eight years from a lucrative side gig. He was trustee of his business partner's private charitable foundation.

Another charitable foundation, set up by a carpet merchant, has millions of dollars in loans outstanding to the man's carpet company.

A third paid out more to companies owned by the foundation president's family than it gave to charity in a recent year.

All these transactions were lawful, the foundations said in their tax filings.

A half-century ago, Congress, troubled by tales of foundation self-dealing, enacted a law to prevent insiders from taking advantage of their positions. The law prohibits most business between private foundations and their insiders—meaning their officers, directors and substantial donors. It says foundations may not engage in property deals, loans or the exchange of other goods and services with insiders.

Some foundations have grown adept at relying on a bevy of complex exemptions to their advantage. More than 1,800 foundations checked boxes on their fiscal 2016 tax filings indicating that they engaged in business activities with insiders but weren't violating the self-dealing law, The Wall Street Journal found in a review of thousands of filings.

The law permits foundations to employ insiders for certain services provided they aren't paid excessive compensation, which would be considered self-dealing. About 10,000 private foundations checked boxes on their fiscal 2016 returns indicating they legally compensated insiders.

It's impossible to determine from tax data how many of the exemption claims were clearly justifiable, or whether some might stretch the definitions.

Even if legally defensible, transactions between foundations and insiders may violate the spirit of the law, said William Josephson, a former charities regulator in New York. Charitable-foundation assets are there for "serving a public purpose, and compensating you is not a public purpose," he said.

Foundation insiders deemed by the Internal Revenue Service to be self-dealing, such as through business they do with the foundation, must pay extra taxes and unwind the deals. The IRS imposes such extra taxes on about 200 people a year. The agency audits less than 1% of nonprofit tax filings.

The foundation of Antonio R. "Tony" Sanchez Jr., a Texas oilman, paid $1.6 million to two Sanchez family-owned companies in 2016. **PHOTO:** ROBERT MCGEE/GETTY IMAGES

Federal regulations say foundations may hire insiders' businesses for certain kinds of professional work: law, banking and investment management. A foundation can hire an insider's investment firm—as long as the pay is reasonable—but not his or her janitorial company.

The Journal found multiple examples of private foundations paying seven-figure sums to insiders' firms. They included the foundation of Antonio R. "Tony" Sanchez Jr., a Texas oilman who was the Democratic nominee for governor in 2002.

His foundation made charitable donations in 2016 of $1.5 million, according to its tax return. The same year, the foundation paid $1.6 million to two Sanchez family-owned companies. The payments were for investment and accounting services, its tax filing says.

Tax filings show that over five years through 2016, it made about $14 million in charitable grants and paid Sanchez companies $7 million. Through an attorney, Mr. Sanchez declined to

comment.

In a twist, the law to prevent self-dealing at private foundations encompasses the spouses, parents, grandparents, children, and grandchildren of insiders—but not siblings.

The late Kevork Hovnanian, founder of Hovnanian Enterprises, and son Ara, who is now CEO, shown on a sign at the sales office for a housing development in California. **PHOTO**: PATRICK T. FALLON/BLOOMBERG NEWS

"I think it was just an oversight," said Bruce Hopkins, a Kansas City-based attorney who is an expert in private foundation law. "I know of no particular reason why [siblings] should be excluded."

The sibling exception helped make possible a series of deals in which about 500 acres of Southern California land owned by Hirair Hovnanian was transferred to his private foundation and then sold to the publicly held home builder Hovnanian Enterprises Inc. over about a decade.

Mr. Hovnanian co-founded that company with his brothers decades ago but left to start his own business. Brother Kevork Hovnanian led the public company until his death and was succeeded by a son.

According to Riverside County, Calif., property records, Hirair Hovnanian donated California land to his private foundation numerous times from 2005 to 2013, and in each case, the foundation sold this land to Hovnanian Enterprises on the same day.

The foundation's tax filings don't disclose the individual land donations and sales. Securities and Exchange Commission filings say Hovnanian Enterprises agreed to buy the land from "an entity that is owned by Hirair Hovnanian" in 2003, before the donations. The company paid $31.4 million for the land.

Asked why Mr. Hovnanian structured his foundation's donations and sales as he did, his daughter Siran Sahakian, an officer of the foundation, said it was probably for tax reasons, but she didn't remember the details. She said her father was unable to comment for health reasons.

Edele Hovnanian, another daughter and foundation officer, said she met with "a number of local and national builders to negotiate offers" before agreeing to the sale to Hovnanian Enterprises, which she said needed until 2013 to pay for the land because of the housing downturn.

A spokesman for Hovnanian Enterprises said its purchase was a "heavily negotiated, arms-length transaction" at market value.

Among things private foundations can't do, except in rare cases, is make loans to their insiders.

The latest available tax filing of the Tufenkian Foundation, dated in November 2015, reported a $9.7 million in outstanding loans to a carpet company owned by the foundation's president.

Former Helmerich & Payne CEO Hans Helmerich, seen giving a talk in 2004, is among five sons of the late Walter Helmerich III who are trustees of his private foundation and were each paid $116,000 in 2016. PHOTO: MATTHEW STAVER/BLOOMBERG NEWS

James Tufenkian said his foundation never made a loan to his carpet company, which is called Tufenkian Import-Export Ventures.

Rather, he said, the carpet company is paying interest on promissory notes donated to the foundation about 20 years ago.

"The notes with their above-market interest rates were created for purpose of donation to the Foundation," Mr. Tufenkian said.

Mr. Hopkins, the expert on foundation law, said such arrangements are a way foundations can get around the 1969 statute. A philanthropist can't donate money to his private foundation,

take a tax write-off, and then have the foundation lend to a business he owns—but he can make a loan to his business and then make a tax-deductible donation of that loan receivable to his foundation. The effect is to simultaneously infuse the business with capital and lower his tax burden.

Mr. Tufenkian said he didn't remember who made the loans to his carpet company and donated the I.O.U.s to his foundation. Tax filings from the early 2000s don't say. Later filings show the foundation repeatedly extended the loans' due dates. Mr. Tufenkian said they now are due in 2021.

The law saying foundations may pay insiders a reasonable sum for certain personal services doesn't clearly define reasonable. In 2016, about 60 foundation insiders earned at least $100,000 while working one hour a week or less on foundation business, the Journal analysis found.

Several were trustees of a single foundation, and sons of the person who funded it.

The funder was the late Walter Helmerich III, former president of Tulsa, Okla., oil-driller Helmerich & Payne Inc. His foundation paid $116,000 to each of its trustees—his five sons—in 2016.

One son worked an average of four hours a week on foundation matters and the others an average of one hour, its tax filing shows.

The men declined to comment.

Some good-governance groups say private foundations shouldn't pay their board members at all, and most don't. The risk is that wealthy benefactors could partly skirt estate taxes by paying children through their foundations, said Dean Zerbe, a former tax adviser to the Senate Finance Committee under Sen. Chuck Grassley (R., Iowa).

"It is particularly troubling when trustee payments involve family members of the donor," Mr. Zerbe said.

A foundation called Carmel Hill Fund paid nearly $10 million to its trustees over eight recent years, its tax filings show.

The late investor William Ruane, who seeded the foundation and co-founded investment-management firm Ruane, Cunniff & Goldfarb, served as trustee of the foundation without pay until his death in 2005.

His business partner Robert Goldfarb then served as the unpaid trustee for a few years, spending zero hours a week on foundation business, according to tax filings. Mr. Goldfarb is a

former CEO of Ruane Cunniff, which manages the 47-year-old Sequoia mutual fund and other investments.

In 2009, Carmel Hill started paying its trustees, of whom there were now two—Mr. Goldfarb and George Gillespie, a retired partner of law firm Cravath, Swaine & Moore LLP. The foundation paid each of them $1.2 million that year, according to its tax return.

Another Cravath partner, Daniel Mosley, has since succeeded the late Mr. Gillespie. Together, Messrs. Goldfarb, Gillespie and Mosley earned $9.4 million from the foundation from 2009 through 2016.

Mr. Goldfarb, who earned nearly $5 million as a trustee from 2009 to 2016 while also serving for much of that time as CEO of the firm managing Sequoia fund, declined to comment.

Mr. Mosley said the foundation was following New York state law in determining the payments. Carmel Hill is a charitable trust, and New York law says trustees of these are entitled to 6% of their income. Carmel Hill reported having $313.6 million in assets at the end of 2016.

Mr. Mosley said Carmel Hill had high income in recent years because of shares donated by Mr. Ruane in his firm, adding that these shares have been sold, so trustee payments should be smaller in the future. He also said Cravath requires him to turn over his trustee fees to the law firm.

Marcus Owens, a former head of the IRS division that oversees charities, said the agency can challenge trustee fees set under a state law. He said the key issue is whether fees paid to trustees are fair, in view of how much work they do.

Carmel Hill's trustees each spent 30 hours a week on foundation work from 2009 to 2016, its tax returns said.

"I was not aware that this statement had been made," Mr. Mosley said. "I have instructed the accountants who prepared the returns to correct this going forward given that I do not devote that level of time to this work."

Carmel Hill's charitable giving has been in decline. Its grants for the past five years totaled $38 million, down 43% from the previous five.

Foundations typically must spend 5% of their assets a year on charitable work, by federal law, though they are permitted to count their overhead spending toward the total.

Carmel Hill does that. Its payments to trustees, sometimes upwards of $1 million in a year, help it reach the 5% threshold.

—Lisa Schwartz contributed to this article.

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