

Tax Break Turns Into Big Business

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Second of two parts

Historic preservation was a sleepy little field until seven years ago, when financial adviser James M. Kearns began inviting property owners into his Dupont Circle home to learn about an obscure federal program.

Kearns and a friend, Steven McClain, advised homeowners that they could use the program to claim sizable income tax write-offs -- tax breaks that generally totaled 11 percent of their house's market value. To obtain that windfall, though, homeowners first had to engage in a complicated process ending in a facade easement donation.

Kearns and McClain offered a pain-free alternative in fliers for their business partnership: "For a fee, the Capitol Preservation Alliance will prepare and process the easement donations for you."

That user-friendly pitch proved a hit. Brass plaques identifying houses in the program began popping up like crocuses, first in Washington, then in New York and other cities.

Not only the homeowners benefited. Millions of dollars also flowed to the for-profit companies that promoted the program and to the nonprofit trusts that held the easements and monitored the facades.

One such nonprofit is the National Architectural Trust, founded by Kearns and McClain. In less than four years in business, the nonprofit trust says it has reaped nearly \$17.5 million in what it describes as contributions -- fees paid by easement donors to underwrite the cost of processing paperwork and monitoring facade restrictions. Although the Washington-based trust used some of the cash to build an endowment, it also paid more than \$5.5 million in 2003 alone to a for-profit company owned by Kearns and McClain, records and interviews show.

Kearns defended the arrangement, explaining that the facilitation company helped conduct seminars for potential donors and tackled administrative tasks associated with the donations.

Even so, after being contacted by The Washington Post, Kearns said he and McClain planned to donate the assets of their for-profit company back to the trust.

"It doesn't look squeaky clean," Kearns said. "And so, we're going to make it look squeaky clean."

Capital Interests

Kearns, 73, is a financial planner and former World Bank employee, and says he was knighted by the government of Finland for his work in the Third World. McClain, 58, is a Dupont Circle real estate broker.

By 1998, both had donated easements on homes they owned. That convinced them they could create a business by marketing the tax breaks and telling homeowners that their company would handle the paperwork, Kearns said in an interview.

The company charged about \$3,000 per easement. Its motto: "Preserving your Capitol and Capital."

In 1997, the year before Capitol Preservation began papering neighborhoods with its fliers, two property owners in Washington applied for historic certification in connection with a planned easement donation, according to National Park Service data analyzed by The Post. The number increased to 16 in the company's first year and to 65 in 2000. Last year, it was 227.

As Kearns and McClain expanded their efforts beyond the District, applications filed nationally also rose, from about a dozen in 1997 to nearly 700 last year.

At first, Kearns and McClain delivered the easement donations to two long-established preservation groups in the District: the L'Enfant Trust and the Preservation Trust.

Then, as their business surged, Kearns said he and McClain realized they could extend their methods across the country, if only there were a trust willing to accept large numbers of new easements outside Washington. So in 2001, the entrepreneurs founded their tax-exempt organization, the National Architectural Trust.

McClain listed himself as president and Kearns as secretary and treasurer. To promote the trust, they hired independent contractors from Illinois to Massachusetts.

They found interest in New York, where no one had applied for historic certification in connection with an easement donation in the six years before they arrived. In Kearns's and McClain's first year there, 22 New Yorkers applied for certification, followed by 76 in 2002 and 244 in 2003.

As of October, the trust said it had accepted 387 easement donations in several states. An additional 225 were nearing completion.

Many preservation groups require donors to handle paperwork themselves or pay a few thousand dollars to a for-profit facilitation company, such as Capitol Preservation. The National Architectural Trust pioneered a new system. Instead of the donors paying, the trust itself paid Capitol Preservation.

To cover that cost and build an endowment, the trust asked homeowners who made easement donations to also make a cash contribution to the trust equal to about 10 percent of the value of their easement. The trust called the payment a "fair share donation" and advised property owners that they could deduct the fee from their income taxes as a separate charitable donation.

In January, Capitol Preservation's Tim Maywalt explained the fee to District homeowners at a sales seminar: "You're going to get a big tax break back; we're going to ask you for a fair share of it." The session was recorded by a person who attended and supplied the tape to The Post.

Federal tax rules do not permit charitable deductions for payments made in exchange for services or other substantial benefits. An Internal Revenue Service ruling defines a charitable donation this way: "A voluntary transfer of money or property that is made with no expectation of procuring a commensurate financial benefit in return."

Daniel Halperin, a former Treasury official now working as a nonprofit tax specialist at Harvard Law School, called it "troubling" that the National Architectural Trust described the fees as tax deductible.

"That can't be true," Halperin said. "A charitable contribution has to be a gift."

The tape recording of Maywalt's seminar shows that he told prospective donors that much of the cash donated to certain nonprofit trusts flowed back to the for-profit



Capitol Preservation Alliance. When a homeowner questioned the arrangement, Maywalt replied: "Forget the fact that I said it. You don't know what we do with that. You don't know what the trust does with that money."

Kearns told The Post that a legal opinion prepared by the National Architectural Trust's law firm, Venable LLP, says there is nothing wrong with donors deducting the full amount of cash contributed to the trust -- including the portion used to pay for processing paperwork. The firm's report described the facade easement and fee as two halves of a single voluntary gift that did not return a "substantial" benefit to the donors.

As of October, the National Architectural Trust reported that it had collected \$17.5 million in such fees. About 55 percent went into a fund that the trust says will pay for enforcing the restrictions, inspecting the facades once a year and processing property owners' requests to alter their facades.

Passing Along Millions

A year after Kearns and McClain founded the National Architectural Trust, they incorporated their for-profit company, Springfield Management Services. The new trust and the new company signed a contract, under which 44 percent of donations made to the trust in 2003 -- more than \$5.5 million -- was passed along to the for-profit company, interviews and documents show.

Both the trust and the management company operate out of a single Dupont Circle rowhouse controlled by McClain. Also based there is McClain's real estate company and Capitol Preservation, which Kearns said was "folded" into Springfield Management shortly after the company's incorporation.

Kearns said Springfield Management earned the money by conducting seminars for potential donors, explaining the program to tax accountants and processing paperwork. He called the arrangement a good deal for everyone involved because it efficiently promoted preservation and lessened the financial risk to the charity.

As the nonprofit National Architectural Trust was starting out in 2002, IRS records show, the trust paid McClain \$125,000 in salary and Kearns \$50,000. The trust also paid Springfield Management \$483,000, for soliciting and processing easement donations that year.

In 2002 and 2003, records show, the trust invested \$600,000 in Springfield Management. "Disbursements were made pretty much as needed" from the trust's accounts, Kearns said.

Kearns told The Post in September that he and McClain no longer drew salaries from the trust, and had not since 2002. Three weeks later, Kearns corrected himself, saying he had used erroneous data. In 2003, he said, "the total amount I received was \$105,000."

The trust no longer pays rent to McClain's company, Kearns said, adding that the trust's \$600,000 investment has been repaid, with interest.

Kearns said he and McClain did not participate in business decisions at the trust when their ownership of Springfield Management created a conflict of interest. Kearns and McClain sit on the trust's six-member board of directors, but payments to Springfield Management were approved by "independent" board members, according to the trust's IRS filing.

Kearns declined to release copies of the board's minutes or a copy of the contract between the trust and the company. A consultant helped the trust determine a reasonable amount to pay Springfield Management, according to Kearns's lawyer, Jeffrey Tenenbaum. He declined to provide a copy of the consultant's report.

After being contacted by The Post, Kearns also said that he and McClain had decided to donate the assets of Springfield Management, known as SMS, back to the trust. Details have yet to be worked out, Kearns said.

"The way we set up SMS was perfectly legal at that time and an acceptable practice. But the whole world is changing," Kearns said, noting that Congress has discussed applying post-Enron corporate reforms to charities.

"There is absolutely no conflict of interest in terms of what is being done there and why it is being done," Kearns said. "But we wanted to make sure there could be no perception of that."

"We went to great trouble to make sure what we were doing was not illegal or improper. . . . It's not just a game that a couple guys are playing to get rich."

A Tangle of Trusts

The National Architectural Trust did not accept easements from the District. Instead, it left that work to groups such as the L'Enfant Trust, for which Kearns was a paid financial adviser.

Those easement donations, and the accompanying cash contributions from homeowners, helped the L'Enfant Trust's net worth swell from \$51,000 in 1998 to \$2.5 million in 2003. Carol Goldman, who worked as L'Enfant's president on a volunteer basis in 1998, also profited; by last year, her salary had increased to \$137,500.

In 2002, Springfield Management tried to recast its relationship with L'Enfant and the Preservation Trust, seeking an arrangement modeled on its contract with the National Architectural Trust, according to records and officials at the nonprofits.

Kearns sought to calm tensions during the negotiations by promising that the National Architectural Trust would not "compete with L'Enfant in Washington, period," according to a letter obtained by The Post. At the same time, Springfield Management proposed to solicit donations and process easement paperwork at L'Enfant in return for 40 percent of the trust's donations, according to Goldman, who rebuffed the offer.

As the negotiations collapsed, a new nonprofit formed in Maryland under the name Tri-State Architectural Trust, records show. It was quickly renamed Capitol Historic Trust and began accepting easement donations in Washington, accepting about 46 in its first year.

At the Capitol Historic Trust's first board meeting, on Dec. 30, its directors voted to pay Springfield Management half of all donations that the charity received from any source this year, as a service fee, records show.

Kearns described the new charity as "totally independent of us." However, records and interviews show the new trust has numerous ties to his corporations.

Florence Muller, president of the trust, said her group began accepting easements in the District after her daughter told her that Springfield Management was "interested in expanding" and was "looking for someone."

Muller is a retired real estate agent who lives in Hagerstown, 70 miles from Washington. Her trust's address in the District, she acknowledged, is "basically a mailbox."

Her trust shares phone systems with Kearns's and McClain's National Architectural Trust. Callers to the Capitol Historic Trust's telephone number in Washington can access extensions for Kearns and McClain. Callers who then punch the "pound" key, to reach a root extension, are greeted with this recording: "Thank you for calling the National Architectural Trust."

Muller said she was unsure how all the companies, people and charities interrelated.

"There are several organizations. I'm not sure where one begins and the other ends, to tell you the truth," Muller said. "I don't really know what their affiliations are. I don't know who does what."

The Capitol Historic Trust's executive director is Washington lawyer Karen Leonel, Muller's daughter. Leonel said she had known McClain for years and had performed legal work for him. Until recently, Leonel was listed on the National Architectural Trust's Web site as an adviser.

The Capitol Historic Trust's first annual report, filed with the IRS in June, lists five board members. Sandy Sheets, one of those named, reacted to the news with shock.

"I am not on the board," Sheets said. "I did not realize my name was a part of that. I would think that would be something I would be aware of."

Muller responded: "I don't know how she could say that. In fact, I have her resignation in my files. It was a form letter I sent on, and she signed it."

The report also lists Doris Sager as a director. Sager said in an interview that she had attended three meetings but remained on the board "in name only." A third director and the corporate secretary, Vickie Sasse, said she resigned some time ago.

Leonel confirmed that about half the trust's revenue this year will go to Springfield Management, describing it as "a pretty fantastic deal."

Today, at least a dozen individuals and companies in the Washington area have followed Kearns's and McClain's entrepreneurial lead and "facilitate" easements in return for fees of \$1,000 to \$4,000 from property owners. One facilitator is Gordon Kerr, a retired chief of staff for Sen. Carl M. Levin (D-Mich.). Another is Kathryn Kailian, who went into business a year after donating an easement on her Dupont Circle home. She now divides her time between easement processing and her other professional interests: skin care, electrolysis and makeup.

"I do the gamut," she said.

Database editor Sarah Cohen and researcher Alice Crites contributed to this report.

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