Hughes Medical Institute Seeks THE $36 Million Tax Break

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The Howard Hughes Medical Institute has been trying for three years to persuade the Treasury Department to give it a tax break of at least $36 million annually.

The effort was a secret between the institute and the Internal Revenue Service until last April, when its disclosure stunned Rep. Wright Patman (D-Tex.), Capitol Hill's foremost expert on foundations.

One reason for his surprise was that what the institute is trying to do is discard the status as an exempt foundation it was able to win in the 1950s only over IRS opposition. The agency gave up after billionaire recluse Howard R. Hughes made a partially unsecured loan of $205,000 to a brother of then Vice President Richard M. Nixon.

For almost 21 weeks, Patman has been trying to get Treasury Secretary George P. Shultz to provide detailed information that could disclose whether the White House or other political factors may have intruded in the pending Hughes case.

In a final letter on Oct. 15, Patman told Shultz that his failure to respond "can only be interpreted as another indication of the lack of independence and the politicization of the Internal Revenue Service."

Treasury's long failure to rule on the institute's contest of its foundation status upsets Patman for another reason. Had the institute been classified as a foundation during the three years the case has been pending, it would have had to pay out for charitable purposes a minimum of $36 million a year for a total of $108 million.

The institute would get the tax break it wants if the IRS agrees that it is a medical research organization and legally a charity, in the same category as a church.

Institute counsel Seymour S. Mintz explained the claim of charity status in testimony to Patman's House Domestic Finance Subcommittee on April 5.

Almost throughout its history, the institute "has conducted its medical research itself directly and continuously and not through other agencies," Mintz testified.

Consequently he contended, the institute is treated by the Tax Reform Act of 1969 "the same as it treats schools, churches, and hospitals and exempts it from the private foundation status."

Mintz said the Hughes researchers, among other accomplishments, initiated programs for transplantation of kidneys and for kidney dialysis.

The institute said that in 1971 its "medical research and related expenditures" totaled $1,258,682. The figure included administrative expenses.

Howard Hughes is sole trustee of the institute, which is based in Miami, Fla. Its executive committee is composed of three men close to him: Chester S. Davis, a lawyer for Summa Corp., of which Hughes is sole owner; and two top Summa executives, Raymond M. Holliday and F. William Gay.

Hughes not only appoints members of the executive committee, but also has "full power to remove them," Mintz acknowledged at the subcommittee hearing.

Hughes at the same time is president of Hughes Aircraft Co. Its stock is 100 per cent owned by the institute.

The institute's income, about $2.5 million annually, comes almost entirely from Hughes Aircraft. The company gets back about $1 million a year from the institute in interest on a note.

These relationships suggested to Patman and subcommittee members that dealings between the institute and the company in reality are dealings between Howard Hughes and Howard Hughes.

In an exchange with institute counsel Mintz about the note, which bears the extraordinarily low interest rate of 4 per cent, Rep. Ben B. Blackburn (R.-Ga.) said, "you mean Mr. Hughes, the trustee, has never felt that Mr. Hughes, the chief executives, ought to be hamstrung in paying Mr. Hughes the money Mr. Hughes owes Mr. Hughes?"

The Tax Reform Act of 1969 prohibits "self-dealing" between an exempt foundation and its principal donors and managers.

If the institute is a charity, on the other hand, "you wouldn't have any restrictions of any kind, would you?" Rep. Patman asked lawyer Mintz. "You could have self-dealing, you could have anything else that is prohibited by the 1969 act?"

That, Mintz said, is "legally true."

The 1969 law requires a foundation to distribute to charity either its annual adjusted net income, or 6 per cent of the fair market value of its assets, whichever is greater.

For the institute, the choice would be between giving away income of about $1.5 million or 6 per cent of the Hughes Aircraft stock. This is valued by Mintz "conservatively" at $60 million. Six per cent of that translates into $3.6 million for charity, or more than double the 1971 outlay.

However, subcommittee staff members estimate the true market value of the stock at between $600 million and $1 billion. Consequently, they say, if IRS classifies the institute a foundation, its contribution to charity will have to be between $36 million and $60 million.

In the era when the Hughes Medical Institute won tax-exempt status, foundations were free to do pretty much as they pleased. But in 1962, Patman's subcommittee be-


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NOAH DIETRICH

gan to document a growing and finally overwhelming catalogue of abuses commitited by foundations at taxpayers' expense.

The Tax Reform Act of 1969 was designed to attack the abuses. And, as approved by the House, it would have brought the Hughes institute under the provisions for foundations.

But, Capitol Hill sources said, a successful lobbying campaign by former Sen. George Smathers (D-Fla.) led the Senate Finance Committee and ultimately Congress apparently to exclude medical research organizations — mainly, the Hughes institute.

However, the IRS then threatened an administrative end-run around the Smathers exclusion. The agency tried to reach the Hughes institute and similar organizations, if any, by proposing a rule on pay-outs to charity that was similar to but less strict than that for foundations.

The draft rule would require a medical research organization to pay out 4 per cent of fair market value of its assets, compared to the 6 per cent required of foundations.

The rule, although missing from the final regulations adopted last year, remains in a "reserved" status, meaning that the IRS has neither adopted nor rejected it.

To counter the threat posed by the 4 per cent rule, the institute—unbeknownst to the subcommittee or anyone else—asked IRS to remove it from the foundation classification.

That was in 1970, the year in which Howard Hughes made a secret payment of $50,000 in currency, purportedly as a campaign contribution for Richard Nixon or congressional candidates. A few weeks earlier, then Attorney General John N. Mitchell removed obstacles placed by the Justice Department's Antitrust Division in the path of an effort by Hughes to acquire a casino-hotel on the Las Vegas strip.

The $50,000, like an additional $50,000 in cash in 1969, was handed to C. G. (Bebe) Rebozo, a close friend of the President as well as former Sen. Smathers.

The courier for both sums was a friend of all three, Richard G. Danner, a Hughes aide the Las Vegas strip.

Rebozo has told Senate Watergate committee investigators that he kept the currency for about three years in safe-deposit boxes. He refunded the $10,000 to Hughes lawyer Davis several months ago. Retention of the money, Rebozo is said to have explained, had become an embarrassment.

Also while Treasury had before it the Hughes institute's contest of its foundation status, Hughes contributed an additional $150,000 to the Finance Committee to Re-elect the President.

The institute's application for a charity status—under which it could do as it wished with 49 per cent of its income and assets—first became known to the subcommittee on April 5, the day lawyer Mintz testified.

The disclosure was a surprise, in part because the institute originally had fought to be classed a foundation.

The institute applied in June, 1955, for a tax exemption as a foundation.

The IRS denied the application five months later, saying the institute had been set up with transactions that 'effected insubstance merely a split of a part of a taxable business into a separate operating entity." The taxable business was Hughes Aircraft Co., which gave its stock to the institute.

What was the purpose of the split "Siphoning off taxable income into an exempt organization," the IRS said in a letter to the institute.

The institute protested the IRS denial of tax-exempt status in March, 1956. The following December, a month after then Vice President Nixon was re-elected, Hughes Tool Co., predecessor to Summa Corp., loaned $205,000 to his brother, Donald Nixon. The collateral was worth only $93,000.

Three months later, on March 1, 1957, the IRS reversed itself without explanation and granted the institute on exemption.

Noah Dietrich, who was Hughes' chief executive officer for 32 years until he quit in 1957, raised the question of a cause-effect relation between the loan and the IRS action in his 1972 paperback, "Howard: The Amazing Mr. Hughes."

Dietrich termed the IRS reversal "curious," and asked: " . . . did Howard win a bargain for his $205,000?"

In the book, Dietrich said, "I was thoroughly convinced the loan was wrong—for Nixon, for Hughes, for the state of political ethics."

He said that, without consulting Hughes, he made a "bold move:" a trip to Washington to see Mr. Nixon.

Dietrich said he warned the Vice President that if the loan becomes public information, "it could mean the end of your political career. And I don't believe that it can be kept quiet."

Dietrich said that Mr. Nixon responded immediately by saying, "I have to put my relatives ahead of my career."

The White House has failed to respond to repeated efforts to elicit comment on Dietrich's account.

Nor has Rep. Patman had better luck in getting Treasury to respond to his inquiries, which have not been publicly reported up to now.

Patman wrote Treasury Secretary Shultz on June 1 to request highly specific information about the institute's contention that it is a charity.

William L. Gifford, an assistant to the secretary, responded on June 4 that Patman would have "a further response . . . as promptly as possible." None came. On Oct. 1, Patman sent Shultz a copy of his first letter along with a request for the secretary's "reasons for the four-month delay." Two weeks later, he followed up with his letter charging politicization of the IRS.

A reporter asked a Treasury press spokesman on Oct. 19—four days after Patman's third letter — about the congressman's inquiries. The spokesman phoned later to say that Patman should have responses "in a couple of days." On the same day, Treasury gave Patman a similar assurance and apologized for the delay.

Patman has still not received Treasury's response.