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Why Nixon's Tax Scheme Backfired

How Nixon's Tax Scheme Backfired

By Tad Szulc

"...It was not a wild improvisation to cut a tax bill, but a careful plan to make Nixon a millionaire before his term was up..."

The President of the United States got the kind of news last week that has driven men into the hands of loan sharks. Both the Internal Revenue Service and the staff of the Joint Congressional Committee on Internal Revenue Taxation found that the President owes a staggering sum in federal taxes going back to 1969 because of huge improper or illegal deductions. The ruling obviously may make Richard Nixon's impeachment more certain, but more, it threatens to leave him literally insolvent. By all appearances, Mr. Nixon is short of ready cash to pay his tax bills and, at the same time, satisfy the enormous mortgage payments he owes this year. If an impeachment process should begin, making him responsible for his own legal fees, his cash bind would grow incalculably worse.

Surely the greatest irony of Nixon's suddenly desperate money troubles is that he brought them on himself. Like the White House tapes, they are the product of Nixonian-style teamwork. For what might appear to have been merely a series of wildly improvised schemes to cut the President's tax bills was, on examination, a carefully constructed six-year plan to make Richard Nixon a millionaire before he left the White House. Self-inflicted insolvency would be an unutterably trite fate for a man once proud of his work as a tax lawyer.

The facts of his present situation are unmistakably bleak. To the I.R.S.'s finding of tax arrears amounting to $432,787 (the committee staff's figure was $442,022), add interest and mortgage payments coming due this year of some $250,000. It comes to more than $700,000 cash right there—and he hasn't begun to pay for nonbusiness trips to San Clemente for the family and King Timahoe. Like many of us, too, Mr. Nixon must pay a lump sum to I.R.S. next week—in his case at least $50,000 on his 1973-74 taxes.

According to an audit prepared for the White House, the Nixons on May 31, 1973, had only $432,874 in various banks. The man only makes $250,000 a year in salary and expenses. Apart from interest on his savings, he has no other known source of income.

According to the accountants, Nixon's real estate was worth $964,164 last May. It may be worth more today because of inflation and various improvements (many of them government financed). But Nixon already carries a $413,000 debt on his California and Florida properties. This reduces the actual value of Nixon's properties for loan purposes to $550,000. Thus, the President right now would seem to have relatively little to show in increased net worth for the last five years of feverish scheming —and this at a disastrous political price.

Last week the President said that he would, as he had promised, pay up. But a man resourceful enough to deduct the sum of $5,391.43, the cost of "food, beverages, decorations, and rentals for Miss Tricia Nixon's masqued ball," as Mr. Nixon did in his 1969 return, is a man resourceful enough to deploy lawyers to argue further about exact amounts due. Between huge tax shelters (item: the "gift" of his vice-presidential papers was the basis for a disallowed claim of $482,000 in charitable donations) and nitpicking deductions (item: $1.24 to a department store in interest charges for late payment), Nixon in his first four years in office paid just $78,651 in taxes on declared income of $1,222,166. Once investigators got access to all his tax material since 1969, the carefully constructed edifice that made it possible began to collapse.

The Nixon plan for financial security was something of a fiscal masterpiece, apparently based on the assumption, which almost worked, that nobody would ever question Presidential returns. It involved at least six separate elements. They are worth a closer look.

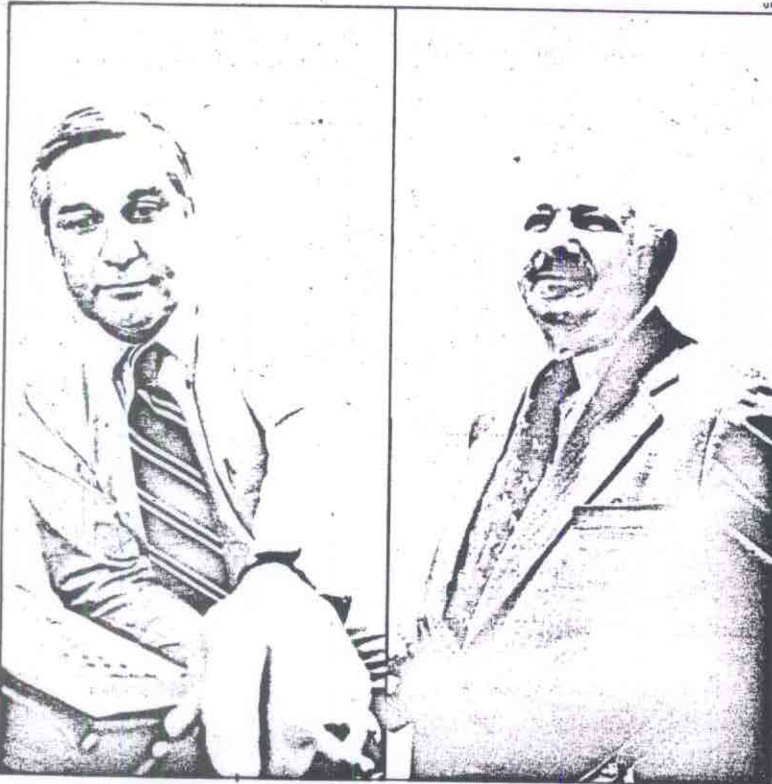
I. Vice-Presidential Papers

The story of the Nixon vice-presidential papers actually began late in 1968, shortly after he won the Presidential election. At that juncture, Mr. Nixon or his advisers evidently realized that with his ascension to the White House, his vast collection of papers and other items covering his 1952-1960 vice-presidential terms had suddenly acquired considerable value.

Because under the old law the fair market value of papers given to the government, libraries, or universities could be used as an income-tax deduction, Mr. Nixon personally signed on December 25, 1968, a "chattel deed" to the United States of America, donating some material to the National Archives. A highly respected appraiser, Ralph G. Newman, who is the president of the Abraham Lincoln Book Shop, Inc., in Chicago, had been summoned a few days earlier to New York, where the papers were stored, to identify and appraise the material Mr. Nixon wished to donate. On December 30, the Archives formally accepted the gift and, in due course, received it.

The 1968 gift, designed to provide Mr. Nixon with deductions for his 1968 tax return, consisted of 45 cubic feet of materials in 21 packing cases. The cases contained 38,300 individual items ranging from "Children's Letters" (9,000 items) to the manuscript of *Six Crises*, campaign speeches and tapes, notes on foreign trips, plaques, pictures, and the 1966 Whittier College Year Book.

How much, precisely, this collection was appraised at is unknown because the Nixons' 1968 returns have not been made available, but it is understood that the 38,300 items were worth between $60,000 and $80,000 in deductions on the Nixons' 1968 and 1969 returns. What criteria Mr. Newman applied then and later to the appraisal of the Nixon materials is not known.



UPI

The Paper Chasers: *Frank DeMarco (left), one of Nixon's lawyers, did the witnessing and Ralph Newman, a Chicago expert, did the appraising.*

No sooner had the first batch of Mr. Nixon's papers been turned over than his tax advisers moved to secure for him huge deductions for the next five years. Thus on March 25 and 26, 1969, all of the remaining vice-presidential papers —a total of 1,217 cubic feet—arrived at the Archives. They were taken in custody for storage—without further instructions, according to a statement by a consultant to the Archives.

What happened next is highly confusing, somewhat reminiscent of Watergate doings. The relevant fact is that on December 30, 1969, the Congress passed a new tax act which, among other things, eliminated the provision allowing income-tax deductions from charitable donations of personal papers and made that elimination retroactive to July 25 of that year. The White House contends that Mr. Nixon deeded roughly one-third of his remaining papers—392 cubic feet out of 1,217—to the Archives before the July deadline. Mr. Newman, the Chicago appraiser, placed a value of $576,000 on the papers, and the President felt free to turn them into a five-year tax deduction. But subsequent scrutiny of this operation turned up some disturbingly contradictory facts.

The Joint Committee staff found that the papers were not legally donated at all. The Archives never received the original deed—the staff could not establish that it ever existed. A back-dated "duplicate" copy reached the Office of the Archivist only on January 13, 1973. For unknown reasons, even this copy was missing for 21 months. It first had been sent from the White House to the general counsel of the General Services Administration on April 10, 1970, together with a detailed tax schedule describing the material. That was the first time the Archives learned that the deed existed—nearly nine months after the revised law's cutoff. The G.S.A. counsel kept the copy until September, 1971 (nobody seems to know why), then returned it to the White House. Finally the White House sent it to the archivist in January, 1973. For these reasons, the Nixon tax return for 1969 had no deed or copy thereof attached to it.

The mystery of the papers deepened when it was discovered the following April that instead of being signed by the President, as was the case with the 1968 deed of gift, the copy of the deed bore the signature of Edward L. Morgan, then deputy counsel to the President. It was dated March 27, 1969 (one day after the papers arrived at the Archives), but, strangely, it had been signed in Los Angeles rather than in Washington. Mr. Morgan's signature, according to an affidavit, was witnessed by Frank DeMarco Jr., acting as a notary. Mr. DeMarco is a partner in the Los Angeles firm headed by Herbert W. Kalmbach, then Mr. Nixon's personal attorney, who was to plead guilty on February 25, 1974, to campaign-financing law violations. Mr. DeMarco also was the President's tax lawyer. He prepared the Nixons' 1969 return and signed it with them. On that return, Mr. Nixon claimed and received a charitable contribution deduction of $98,448.45, the maximum allowable under the law, which in 1969 limited the amount to 30 per cent of the adjusted gross income.

Then the bombshell exploded. In January of this year, the office of the California Secretary of State announced that according to Mr. DeMarco and others the deed for the Nixon papers was falsely dated. Mr. Morgan signed it on April 10, 1970, and not on March 27, 1969, as shown in the Nixon tax return. This probably explains why not even a copy of the deed could have been sent to the G.S.A. before the April date in 1970. The deed had to be signed, however, so that it could be cited in the Nixon return for 1969, due to be filed by April 15, 1970, and the "charitable" deduction claimed for the President's taxes. Later, Mr. DeMarco said he lost his notary book for 1970. Mr. Morgan began to express doubts that he had the right to sign for the President.

Only last February 25, the President still was insisting that "all of my vice-presidential papers were delivered to the Archives in March [1969], four months before the deadline" but "the paperwork on it apparently was not concluded until after that time." He then acknowledged that "this raises a legal question as to whether or not the deduction therefore is proper. The Joint Committee staff's answer is: it wasn't proper.

Tax experts in Washington say privately that Mr. Nixon's advisers most likely became alarmed early in 1969 over the prospects that the Congress might kill the charitable provision for the papers and began to act accordingly. The first sign of impending disaster came in the early days of January, when the Treasury Department, still operating under President Johnson, proposed the elimination because of constant abuses in this field. For the balance of the year, the White House—and most notably Bryce Harlow, a special assistant to Mr. Nixon—lobbied furiously but vainly against a change in the law. To ensure the vital deduction, the only tactic left to Mr. Nixon's advisers at that point may have been to falsify deed dates.

Another unanswered question is why Mr. Nixon thought of donating only one-third of his papers in 1969, instead of the whole lot. But some Washington tax specialists suspect that under the

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financial master plan, Mr. Nixon's advisers had contemplated making a third gift, probably in 1974, when the deductions from the 1969 batch had been used up and fresh ones were needed for the next five or ten years.

Until the question of his taxes erupted in public during 1973 as a by-product of Watergate investigations, Mr. Nixon felt free to take his questionable deductions. In addition to the 1969 deduction, he was able to write off $131,471.28 in 1970, $131,192.37 in 1971, and $134,388.77 in 1972. The President has a carry-over of $93,980.13 for his 1973 return, due this April 15, but under the circumstatnces, whether he will take it is questionable.

How Mr. Newman decided that the 392 cubic feet of vice-presidential materials were worth $576,000 is unclear. Remarks attributed to him in newspaper articles last year had it that he had been told to set aside about a half-million dollars' worth of deductible papers. He selected 1,176 boxes containing approximately 600,000 items. The "gift" is described on the schedule attached to the 1969 return as "General Correspondence as Vice President—AANDAHL through ZWIENG," "Appearance File 1948-1962," "Correspondence Re Invitations 1954-1961" (there are 56 boxes containing 700 invitations and copies of regrets sent to hosts), "Foreign Trip Files as Vice President," and "Visit of Khrushchev to United States."

Mr. Nixon's "charitable contribution" of vice-presidential papers—worth $576,000 in tax deductions—obviously cost him nothing in cash. His other "charitable contributions" for the years 1969 through 1972 totaled $13,481.

II. New York City Apartment

The second important step in building up Mr. Nixon's tax structure was the sale of his cooperative apartment at 810 Fifth Avenue, occupied while he practiced law on Wall Street. The President sold the apartment on May 31, 1969, for $309,772 to Louis Edward Lehrman, a personal friend and president of the Rite Aid Corporation of Shiremenstown, Pennsylvania. Although Mr. Nixon spent $66,860 in improvements during the five years he lived at 810 Fifth, he was still able to make a net profit of $151,848. The White House statement on Presidential finances issued last December 8 duly noted a smaller gain ($142,912) and said that "under the law, capital tax gain was deferred because of the subsequent purchase of a new residence in California."

WIDE WORLD

810 Fifth Avenue: *A swell apartment and, it turned out, a capital gain.*

The new residence was, of course, Casa Pacifica in San Clemente. But what the White House omitted was the fact that Mr. Nixon apparently applied his own interpretation to the law. Thus Section 1034 of the Internal Revenue Code provides that for the capital gain from the sale of the old residence to be "non-recognized" (or deferred), the taxpayer must within one year invest sale proceeds in the purchase and use of the new house "as his principal residence."

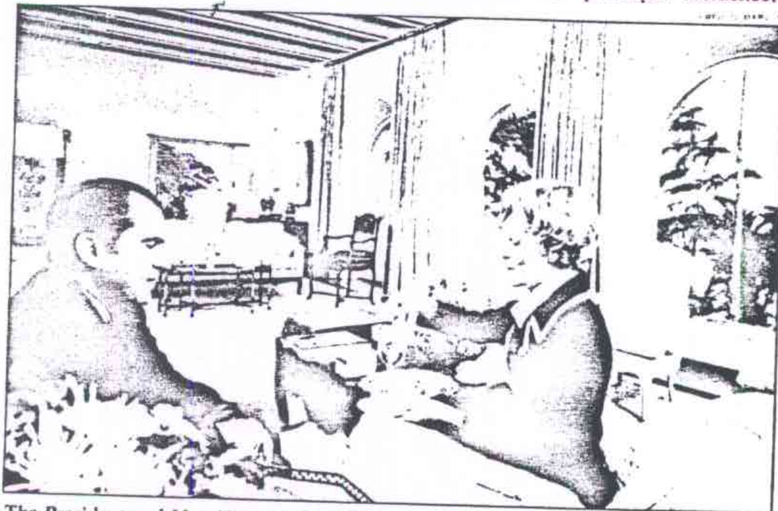
The December 8 statement failed to say, however, that Nixon had claimed Casa Pacifica as his "principal residence," perhaps recognizing that most Americans regard the White House as their President's principal residence.

The I.R.S. assumes that a taxpayer with more than one residence (Mr. Nixon also owns two houses in Key Biscayne and a house in Whittier) will make an honest declaration about his "principal residence" on the basis of "all the facts and circumstances in each case, including the good faith of the taxpayer." If the President had not declared San Clemente as his "principal residence," he was liable for a capital gains tax on the sale of 810 Fifth.

There is another contradiction in the President's claim that Casa Pacifica is his "principal residence": he has not paid any state income taxes after buying the property in 1969 on the ground that he is a resident of the District of Columbia and not California, inasmuch as he lives in the White House. District of Columbia law exempts elected officials from paying income taxes in Washington on the theory that they presumably are taxed in their home states. This is the case of California's entire congressional delegation, including the two senators. Mr. Nixon, however, pays no local income taxes anywhere.

III. Business Use of San Clemente

In San Clemente, too, the President enjoyed the best of all worlds. He was able to avoid a capital gains tax on the New York profit by declaring Casa Pacifica as his "principal residence,"



The President and Mrs. Nixon at San Clemente: *And the house was not a home.*

then proceeded to extract additional linked tax benefits from his property through what seems beyond question to be a double misrepresentation of facts. I.R.S. Form 2119, part of his 1969 return, asked whether "any rooms in either residence [were] rented or used for business purposes at any time?" In reply, Mr. Nixon checked off the "NO" box on the form, presumably because I.R.S. regulations provide that "if the new residence is used only partially for residential purposes only so much of its cost as is allocable to the residential portion may be counted as the cost of purchasing the new residence." In other words, the President would have lost the deferral of his tax on the New York apartment sale gain if he had allocated any part of San Clemente to business use. The law requires *full* investment of sale proceeds in the new residence as a condition for deferring the tax on a profit.

Having denied on one page of his tax return that San Clemente was in any way used for business, Mr. Nixon went on to claim on the next page a 25 per cent depreciation of Casa Pacifica for business purposes because it was used for "official government functions." He calculated this depreciation at $3,211 for 1969 (it was for less than six months, inasmuch as San Clemente was bought on July 15). In the three subsequent years, the President claimed house and furniture depreciation (he took 100 per cent depreciation for furniture) deductions for business use of Casa Pacifica along with moneys from the White House "guest fund" and prorated expenses for utilities, domestic help, insurance, and other items. Between 1969 and 1972, Mr. Nixon thus chalked up a total of $85,399 in business deductions for San Clemente. The Joint Committee staff thinks these should be disallowed.

The President applied the same method to extract deductions for 100 per cent business use of one of his two houses in Key Biscayne. Indicating on the return that the house at 500 Bay Lane had been converted to full-time business operations on January 1, 1969, Mr. Nixon claimed $26,139.82 in deductions for it between 1969 and 1972. These were not questioned by the staff.

But tax specialists hold that there is no justification in the law for putting down business deductions for three residences: White House, San Clemente, and Key Biscayne. No businessman, they say, would ever be allowed such a luxury. Besides, Mr. Nixon had *chosen* to buy himself vacation homes away from Washington—it was not an official requirement—and there is no reason why the Treasury should be subsidizing them. The committee staff said that the President could not charge year-round

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Creditor and Her Debtor: *If Tricia had no risk, how could she have had a "profit"?*

expenses in San Clemente and Key Biscayne because he doesn't spend much time there.

The Joint Committee staff also found that Nixon should either declare as income $92,298 in improvements made by the General Services Administration on his San Clemente and Key Biscayne properties or else reimburse the government $106,262 for these "primarily personal" improvements. It said he should either refund to the government or declare as income $27,015—the value of the flights on Air Force aircraft by his family or friends when there was "no business purpose" for it.

IV. San Clemente Land Deals

By 1970, the Nixon financial operation was in full swing, or so it appears from the reading of his tax returns. The "gift" of the papers in 1969 provided the President with a solid floor for tax deductions which, in turn, would help his cash flow and give him a greater flexibility in investments. Thus, in May, 1969, he made a profit of $184,891 on the sale of stock he had held since 1967 in a Florida company developing Fisher's Island off Miami (he paid full capital gains tax on it except for $1,000 that somehow slipped by), a remarkable transaction in that he doubled his investment in two years. The company's president is Mr. Nixon's close friend, Charles G. (Bebe) Rebozo. The New York apartment had been sold almost simultaneously, providing a tax-free profit for the President. Then came the purchase of Casa Pacifica and 28.9 acres of surrounding land for what was set down in the tax return as $1,499,222. Casa Pacifica, as noted, provided a business depreciation deduction.

But the Nixon fiscal story becomes truly fascinating when the full implications of the San Clemente purchase and subsequent partial resale emerge from the jumble of figures. To pay for it in the first place, the President borrowed $625,000 in two separate loans from another close friend, multimillionaire Robert Abplanalp, while the balance was secured by promissory notes issued by a special trust created by the Nixons. The advantage of acquiring such enormous indebtedness was that it handed the President yet another huge batch of deductions—from interest payments—while the market value of the property kept rising. With payments in Florida and elsewhere, Mr. Nixon's interest deductions grew from $25,594 in 1969 to $109,054 in 1970, the year when he held the entire San Clemente estate. In his tax bracket, owing money is good business.

Then came the grand coup. On December 15, 1970, the Nixons sold 23 acres of San Clemente land to the B & C Investment Company for $1,249,000, retaining only the house and 5.9 acres of land. Because the B & C company was owned by Abplanalp and Rebozo, as the White House finally revealed last December, no money needed change hands: the Abplanalp loans were simply canceled and the company assumed responsibility for $624,000 in outstanding trust notes. The house and the land kept by the Nixons carried a $340,000 mortgage. But here some more fiscal legerdemain developed. Arthur Blech & Company, an accounting firm in Los Angeles retained by Herbert Kalmbach, the Presidential attorney, to look after the Nixon taxes, decided in 1969 to allocate for depreciation purposes $302,786 of the original San Clemente purchase to the house alone. In 1970, Mr. Blech himself reduced the house figure to $144,181 and the cost of the 5.9 acres to $136,000, for a rough total of $280,000 of what the Nixons retained after the sale to B & C. Mr. Blech evidently reduced the value to avoid a taxable gain from selling the land to Abplanalp and Rebozo.

Under his original 1969 allocation, Nixon would have had a taxable capital gain of $158,000. As it was, the 1970 return showed no gain whatsoever on the deal with B & C. It was illegal, by the way, to correct a 1969 depreciation on the next tax returns: instead, an amendment should have been filed reflecting excess depreciation for 1969,

"...Ironically, Nixon's estate after his death may yet turn out to be in excellent shape because of gaps in the tax law..."

paying the extra tax that would have resulted plus 6 per cent interest. This was never done.

The result of all these operations was that in 1970, the Nixon return showed "zero tax" (he had paid $72,682 the year before) and was subject only to the $791.81 minimum tax. For that year, the President's deductions were so numerous that they exceeded his income by $45,000. Mr. Blech said in a newspaper interview last December that he thought that some of the deductions taken by the President in 1970 and 1971 were "unwise." Mr. Blech said he had insisted on seeing Mr. Nixon to discuss this situation with him—he felt that the deductions for the vice-presidential papers in particular were questionable—but the White House apparently twice turned him down. The accountant also said that the whole business of the vice-presidential papers deductions "wasn't my idea," but he was overruled. The interesting point here is that the President apparently never discussed his taxes with his own accountant, although Mr. Blech signed the 1970, 1971, and 1972 returns.

In an effort at candor, the White House itself has confirmed the deception in this particular story. Last December the New York accounting firm of Coopers & Lybrand, brought into the problem by the President, found that Mr. Nixon had indeed made a large profit—$117,370 by their reckoning—on the land sale to Abplanalp and Rebozo. (The Joint Committee staff thought it was $466 more than that.)

V. Family Tax Shelters

Further to reduce his taxable base, though it seemed hardly necessary, Mr. Nixon even turned to his family for tax shelters.

In the first instance, he used his late mother's house in Whittier, which he had inherited, to squeeze out more deductions. The house is rented to a local Quaker group, but the Nixon returns suggest that this was never intended as a business proposition. Thus, while the house rentals dropped from $700 to $450 annually between 1969 and 1972, Mr. Nixon claimed a total of $24,050.92 in losses for tax deduction purposes over the four-year period. This included interest payments (the house carries a mortgage), insurance, utilities, depreciation, and "clean-up." The most plausible explanation for this apparently losing proposition is that, in addition to current deductions, Mr. Nixon may wish to deed the house to the nation in the future and obtain new deductions. Whatever the case, the committee staff went along, calling it an "investment."

In the second instance, it was Tricia Nixon Cox who seemed to provide a tax shelter for her father. In 1967, when he was in private life, Mr. Nixon borrowed $20,000 from Tricia (it is not clear why) to help finance an earlier purchase of two lots of land in Key Biscayne. The money came from a trust fund established for Tricia in 1958 by Elmer Bobst, a millionaire friend of the family. According to the White House, Mr. Nixon and Tricia "entered into an oral agreement" for a 6 per cent annual interest payment on her loan and her father's promise that she would receive 40 per cent of any profits, but would sustain no losses.

The land was bought for $38,080 (which might seem to have made Tricia a 52.5 per cent and not a 40 per cent "partner" in the deal) and resold in December, 1972, to William Griffin, who happens to be Mr. Abplanalp's attorney, for $150,000. The total profit, excluding improvements, was $111,269, or nearly four times the price paid five years earlier. Then Mr. Nixon, electing to report this capital gain on an installment basis, paid Tricia back and assigned her the 40 per cent of the profit —subject to tax liability on her part.

The White House said that the fact that Tricia paid a capital gains tax of $11,617 on this gain on her 1972 return was proof that the President never attempted to "shield his daughter from the income taxes." But the Joint Committee took an opposite view: they said that Mr. Nixon himself should have paid the entire tax on the Florida gain, because Tricia had no risk.

VI. Future Estate Planning

Ironically, President Nixon's estate after his death may yet turn out to be in excellent shape, even if he pays whatever back taxes and penalties he may owe, because of gaps in the tax law. This takes us back into the area of Presidential papers and charitable deductions.

At his death, Mrs. Nixon will be automatically entitled to a 50 per cent "marital deduction" on her husband's estate taxes. If Mr. Newman's appraisals of the Nixon vice-presidential papers are any guide, chances are that Mr. Nixon's Presidential papers will be worth $2-million or more. If so, Mrs. Nixon would gain $1-million worth of deductions on her future income, inasmuch as the law allows charitable deductions for posthumous donations.

Should Mrs. Nixon die first, the President may will his estate, or part of it, to his daughters and others. The children may not claim anything resembling a marital deduction—the whole estate would be taxable—but, again, Presidential papers are likely to be the great tax break for his heirs. Given Mr. Nixon's public pledge that San Clemente will be donated to the nation after his death, additional charitable deductions are possible—unless, of course, as a number of authoritative tax specialists have argued before the Joint Committee, the law on posthumous Presidential papers should be changed to eliminate the gap.

The analysis of the Nixon tax returns for the last four years leaves one totally perplexed as to why the I.R.S. failed to question them in the light of all these glaring discrepancies, to put it charitably. The White House said in its statement last December that in 1973 the I.R.S. had audited the Nixon returns for 1970 and 1971 and had accepted them "as filed." In fact, William D. Waters, then district director of the I.R.S. for the area including Washington, wrote the Nixons on June 1, 1973, that the examination of their returns "revealed that they are correct" and he congratulated them on the correct preparation of the returns. Early this year, Mr. Waters was promoted to I.R.S. regional commissioner for the Mid-Atlantic Region.

Among the determinations to be made by the Joint Committee is whether Mr. Nixon should be held personally accountable for tax avoidance, evasion, or fraud—if any of them is found to exist. The Nixons' signatures appear as sworn statements that the returns are correct, but a question never quite clarified in legal precedent is whether a taxpayer may fall back on his "agents" as culprits for preparing improper returns. (The courts have ruled in the past that the burden of responsibility is greater on a taxpayer with special knowledge of taxes—and Mr. Nixon had done tax work as a lawyer when out of the government.) As one tax man remarked, though, there is one thing of which the President may be sure. He will not be disallowed the $1.24 finance charge deduction for his 1971 payment to Garfinckels, the Washington department store.