CAROL PATTERSON WAS waiting for a call from her doctor. When the phone rang on that afternoon in August 2011 at her home in Cortland, Ohio, it wasn’t a physician on the other end. A woman named Robin said she was representing the American Diabetes Association. Robin didn’t ask for money. She asked Patterson to stamp and mail pre-printed fundraising letters to 15 neighbors. Both of Patterson’s parents and one grandmother had been diabetic, so she agreed to do it.

“I thought since it does run in the family, it wouldn’t hurt for me to help,” says Patterson, 64, a retired elementary school teacher. She guessed, based on what she knew about charity fundraising, that about 70 to 80 percent of the money she brought in would be used for diabetes research.

The truth was almost the exact opposite. The vast majority of funds Patterson, her neighbors and people like them throughout the country would raise—almost 80 percent—would never be made available to the Diabetes Association. Instead, that money collected from letters sent to neighbors would go to the company that employed Robin and an army of other paid telephone solicitors: InfoCision Management Corp.
Just 22 percent of the funds the association raised in 2011 from the nationwide neighbor-to-neighbor program went to the charity, according to a report on its national fundraising that InfoCision filed with North Carolina regulators.

“It’s like a betrayal,” Patterson says, sitting in her kitchen in June, after being shown copies of the North Carolina report and the contract the association signed with InfoCision. “I know I won’t donate again. It’s like they stabbed you in the back. It’s terribly wrong.”

And it gets worse. Many of the biggest-name charities in the U.S. have signed similarly one-sided contracts with telemarketers during the past decade. The American Cancer Society, the largest health charity in the U.S., enlisted InfoCision from 1999 to 2011 to raise money. In fiscal 2010, InfoCision gathered $5.3 million for the society. Hundreds of thousands of volunteers took part, but none of that money—not one penny—went to fund cancer research or help patients, according to the society’s filing with the U.S. Internal Revenue Service and the state of Maine. Every bit of it went to InfoCision, the filings show. The society actually lost money on the program that year, its filings show. InfoCision got to keep 100 percent of the funds it raised, plus $113,006 in fees from the society, government filings show.

Major charities compound the deception by encouraging telephone solicitors to lie. InfoCision scripts approved by both the Diabetes Association and the Cancer Society for what the telemarketer calls neighbor-to-neighbor campaigns in 2010 instruct solicitors to say, when asked, that at least 70 percent of the money raised will be used for charitable purposes. Yet in contracts with InfoCision in that very same year, the association and society said they expected that the telemarketing firm would keep more than 50 percent of all the funds it collected. Altogether, more than 5 million Americans volunteered to raise money for these two groups—and other charities that hired InfoCision—from their neighbors since 2005 after being pitched by solicitors using charity-approved scripts, according to state regulatory filings.

Charities should be held accountable for deceptive fundraising done in their name, says James Cox, a professor at the Duke University School of Law in Durham, North Carolina, and co-author of Cox and Hazen on Corporations (Aspen Publishers, 2005). “If that’s what they do systematically, then they’re obtaining money under false pretenses,” he says. “I don’t just think it’s incredible. I’d be surprised if it isn’t criminal.”

Naomi Levine, chair and executive director of the George H. Heyman Jr. Center for Philanthropy and Fundraising at New York University, says

Carol Patterson says she feels betrayed by the American Diabetes Association after learning that just 22 percent of the money she helped raise went to the group.

PORTraits BY GRANT CORNETT
charities are knowingly being dishonest. “I’m amazed at that,” she says. “I didn’t know about it. It’s deceitful.” Levine, 89, was a nonprofit fundraiser for three decades, bringing in more than $2 billion for NYU. “Even for them to engage in a program like that is shocking to me,” she says. “And I’m in the field. So how can you expect donors to know that?”

Richard Erb, vice president of membership and direct marketing at the Alexandria, Virginia–based Diabetes Association, defends his group’s practices. “If we came into it and said, ‘Geez, I’m not going to make a dime on this,’ do you think we would have anyone who would give us money?”

Greg Donaldson, a senior vice president at the Atlanta-based Cancer Society likens telemarketing campaigns that net the charity low percentages of donations to retailers pricing a product below cost to lure shoppers. “It’s certainly not inconsistent for organizations like ours to invest in some loss-leader strategies, to engage people in long-term meaningful relationships,” he says.

In the past decade, many of the nation’s biggest health charities have hired InfoCision, including the American Heart Association, American Lung Association, American Society for the Prevention of Cruelty to Animals, March of Dimes Foundation and National Multiple Sclerosis Society. Overall, InfoCision brought in a total of $424.5 million for more than 30 nonprofits from 2007 to 2010, keeping $220.6 million, or 52 percent, according to state-filed records.

InfoCision, which is based in Bath Township, Ohio, near Akron, says on its website that it raises more money for nonprofits than any other telemarketer in the world. The privately held company was founded by Gary Taylor, who got his start raising money for evangelical preachers. InfoCision, which isn’t required to and doesn’t disclose revenue or profit, also does marketing for corporate clients such as Time Warner Cable Inc. and Verizon Communications Inc.

The company has a political operation as well. It did fundraising for Citizens United, the conservative group best known as the plaintiff in the Supreme Court case that allowed unlimited independent spending by corporations and unions on behalf of political candidates. From 2009 to 2011, InfoCision raised $14.7 million for Citizens United. The telemarketer was as stingy with Citizens United as it was with some of the charities: It kept $12.4 million, or 84 percent, of the money it raised for Citizens United, according to InfoCision filings with North Carolina. InfoCision has also worked for the National Republican Congressional Committee. The group paid InfoCision more than $115 million to raise money from 2003 to 2012, according to company filings with the Federal Election Commission. The filings don’t say how much InfoCision raised for the committee. The company’s website tells prospective solicitors, “As part of our political call center, you’ll help raise funds for political leaders and spread the word about conservative causes.”

InfoCision has barely been
touched by legal trouble over its fundraising for charities. The Ohio Attorney General’s Office, after listening to recordings of phone calls by InfoCision solicitors, negotiated a settlement with the company, filed in civil court in April. Ohio said InfoCision’s employees had misled people by giving them false information about how much of their contributions would actually go to charities. While denying that it had done anything wrong, InfoCision promised not to mislead potential future donors. The company agreed to pay $75,000 to settle the case—an amount equal to less than one-10th of 1 percent of its revenue from charity fundraising from 2007 to 2010.

Big charities don’t need telemarketers to raise money, yet they continue to use them—even when it appears to make little economic sense. Organizations generally get most of their contributions through their own mailings, phone calls, Internet sites and foundation grants. In those appeals, charities can honestly say that about 70 to 80 percent of the money directly serves the cause donors are supporting. The rest covers overhead.

The Diabetes Association says on its website that it invested more than $33.5 million last year in medical research. The group says it offers help to the 24 million people in the U.S. with diabetes. “An impressive 73 percent of every dollar spent supports research, advocacy and services for people affected by diabetes,” the website says. “Please make a tax-deductible donation today.”

The Cancer Society’s website is headlined “The Official Sponsor of Birthdays.” The society says it offers support to the 13.7 million Americans with cancer and pays for research and public education about the disease. “Because of supporters like you, people who rely on the American Cancer Society will get the help they need,” its website says. “Please donate.”

Americans trust charities—and like giving them money. The U.S. is the most generous country, according to the World Giving Index compiled by Charities Aid Foundation based on Gallup data of 153 nations. Americans donated $298 billion to charities in 2011, according to the Center on Philanthropy at Indiana University in Indianapolis. And they gave with confidence. When the center and Bank of America Corp. polled households with annual
incomes exceeding $200,000 in 2010, 94.5 percent said they trust nonprofits compared with 68.4 percent for corporations and just 31.9 percent for Congress.

Telemarketing companies representing charities know that people more often give with their hearts than with their heads. On its website, InfoCision says: “Telephone purchases and donations are made on impulse. These are dictated not by reason or logic but by feelings of emotion. We are very familiar with the emotions of fundraising: sympathy, fear, anger, guilt, etc.”

There’s one tactic the InfoCision website doesn’t cover: deception. The ruse begins with the name that flashes on your caller ID when a telemarketer is phoning on behalf of a charity. It’s the charity’s name that often shows up, not that of the telemarketing firm. The misrepresentation can continue on the call itself. Solicitors in recordings obtained by the Ohio Attorney General’s Office sometimes identify themselves to potential donors as “volunteers.” They’re not; they’re paid employees of InfoCision.

The bigger lie telemarketers tell is what they say about how much money will go to the charities they’re working for. According to documents obtained through an open records request with the Ohio attorney general, the Diabetes Association approved a script for InfoCision telemarketers in 2010 that includes the following line: “Overall, about 75 percent of every dollar received goes directly to serving people with diabetes and their families, through programs and research.” Yet that same year, InfoCision’s contract with the association estimated that the charity would keep just 15 percent of the funds the company raised; the rest would go to InfoCision.

Association Vice President Erb offers no apologies for the script, saying the association runs many fundraising campaigns and, overall, about 75 percent of the money goes to its programs. He acknowledges that the contract with InfoCision estimated that the telemarketer would get to keep 85 percent of the funds it raised.

Erb also says he isn’t happy that volunteers are upset upon learning the truth. “Obviously, if people feel betrayed or that we’re not being honest with them, it doesn’t make me feel well,” he says. “But the thing is, we’re a business. There has never been a time or a place where we said, ‘Most of this money is coming to us.’”

The Cancer Society, in a Sept. 1, 2009, contract with InfoCision, estimated that the charity would get 44 percent of the amount the company collected in the following fiscal year. The telemarketer script for the same year approved by the society for InfoCision asks solicitors to say something different: “Overall, about 70 cents of every dollar received goes to the programs and services that we provide.”

Donaldson, the society’s senior vice president, declined to comment on the contradiction between the contract and the script, saying the society doesn’t provide “proprietary competitive information regarding individual programs.” Once the charity has the names of new donors, he says, it goes back to those people in the future to request more contributions, without paying a telemarketer, he says.

NYU’s Levine scoffs at that explanation. Even if the society increases its future list of donors, it purposely misled and disrespected millions of people who wanted to contribute to medical research, she says. Few would donate again if they were aware the charity had knowingly pushed them to contribute money that would end up in the coffers of a telemarketer. “I think it’s a bunch of baloney,” she says. “It’s not an honest way to get volunteers involved. Their donors don’t really know this is a loss leader. Volunteers are critical to a campaign. But you don’t have to use that technique.”

A clearer picture of how charities work with telemarketers emerges in the recordings of calls made by InfoCision for the society’s Notes to Neighbors program in 2009. Copies of the recordings, gathered by the Ohio Attorney General’s Office, were obtained by BLOOMBERG MARKETS through an open records request.

The phone rang at the home of Paul Kolb in Cleveland Heights, Ohio, on Aug. 9, 2009. Kolb’s adult son, also named Paul, picked it up. “Hi, Mr. Kolb?” the caller said. “My name is Stephanie. I’m calling from InfoCision for Ohio division of American Cancer Society.”

The rest of the conversation went like this:
Stephanie: “Because of supporting and caring people like you, we’ve made great strides in our mission to fight cancer and create a world with more birthdays. We’re calling today to ask for your help just by mailing 15 letters to your neighbors. All you have to do is address and stamp and mail the letters. OK, Mr. Kolb?”

Kolb: “Yeah. Now, how much of the donation goes to the American Cancer Society?”

Stephanie: “Seventy-eight cents of every dollar.”

Kolb: “Does the money go to you guys and then to the American Cancer Society?”

Stephanie: “No, we only get, like, 22 cents of the dollar. We don’t get that much.”

Kolb: “I’ll look over the material, and if I feel comfortable with it, I can pass it out.”

Stephanie: “We need a definite yes or no. We don’t want to waste material. We’re a very legit company and American Cancer Society is a legit company.”

Kolb: “I can’t really give you a yes or no over the phone.”

Stephanie: “I’m very sorry because the money is going to a good cause.”

As it turned out, the society got less than half of the money raised in that campaign, according to its filings with the IRS and North Carolina. In addition to giving false information about how the donations would be used, the solicitor unknowingly made another mistake. Paul Kolb Jr. is an investigator for the Ohio Attorney General’s Office. That was one reason the state decided to request recordings of calls from InfoCision, including that one.

The society halted its Notes to Neighbors campaign on July 31, 2011, Donaldson says. That came after 360,000 volunteers participated in the program last year. “The costs have been difficult to defray,” says Catherine Mickle, the society’s chief financial officer.

Many charities say they see little downside to contracts that allow InfoCision to keep most, or even all, of the money raised. “We have break-even contracts with these telemarketers so we don’t ‘lose’ money and sometimes we even make a little,” says Mike Townsend, spokesman for the American Lung Association. March of Dimes spokeswoman Michele Kling says, “This cost of fundraising is in line with other large nonprofit health organizations.” Kelly Browning, chief executive officer of the American Institute for Cancer Research, says he’s happy that his organization has used InfoCision for more than a decade. “They have the kind of scale required to do it and do it fairly efficiently,” he says.

InfoCision presents itself to the world in grand fashion. A green sign outside its three-story corporate headquarters in a Bath Township office park proclaims the firm to be “The highest-quality call-center company in the world!”

InfoCision boasts of its high ethical standards. “The quality and integrity of the people we hire, the way they operate and the services we provide will be second to none in all the industries we serve,” the company says on its website.

A visit to InfoCision’s headquarters shows row after row of mostly middle-aged, headset-wearing telephone solicitors separated by partitions. Many of NYU’s Naomi Levine says it’s inexcusable for charities to deceive people who may donate.
them earn the minimum wage of $7.40 an hour, according to InfoCision filings with Ohio. InfoCision has more than 4,400 employees in three states and Ontario, Canada, it says. Some telemarketer desks display gold trophies awarded by the company for telemarketing prowess.

The solicitors receive on-the-job training in reading scripts, keeping people from hanging up and coaxing time and money out of those who are reluctant. Job turnover in the industry runs high—as much as 70 percent a year, says Sally Emch, who founded telemarketing company FutureMarket Telecenter Inc. and ran it for 19 years. Her company raised money for both the Cancer Society and the Diabetes Association. Solicitors are on the phone almost nonstop for hours, under pressure from their bosses and themselves as they cold-call hundreds of people who routinely resent them from the start, says Emch, who’s now retired.

In that kind of stressful environment, telephone solicitors sometimes make mistakes. One InfoCision caller for the Diabetes Association forgot which charity she was representing in the middle of a conversation, according to a recording of the call. During a May 2010 call to Beth Short in Columbus, Ohio, a woman named Carol started by saying she was a “volunteer” for InfoCision calling on behalf of the Diabetes Association.

“Volunteers like you and your husband, John, are the backbone of the American Diabetes Association’s effort to save lives,” Carol said. She requested that Short send 15 letters to neighbors to raise money.

Short asked what the donations would be used for. The ensuing conversation went like this:

Carol: “The money goes toward research to prevent birth defects.”
Short: “What group is this for?”
Carol: “The March of Dimes.”
Short: “I thought you said it was diabetes.”
(Pause)
Carol: “I’m so sorry. I am calling for the American Diabetes Association today. I also help the Cancer Society. Gosh, I think I should have gotten a cup of coffee before I sat back down to make this call.”

Even though Carol called herself a “volunteer,” she wasn’t. She was a paid employee of InfoCision. And she unwittingly made another mistake, the same one Stephanie made when she called Paul Kolb. Beth Short happened to be a charities unit supervisor in the Ohio Attorney General’s Office.

InfoCision uses a hidden tactic for some charities that could lead to invasions of donors’ privacy. An obscure contract provision allows InfoCision to force clients such as the Diabetes Association to rent out the names of their donors to other charities—if InfoCision doesn’t receive full payment on a contract.

Asked about this provision, Erb, the Diabetes Association vice president, says he has to go back and read it. As he does, he expresses concern. “It’s not a great clause,” he says.

InfoCision founder Taylor, whose company has received so much money from charities, is himself a benefactor. In 2004, he donated $3.5 million to start the Taylor Institute for Direct Marketing at the University of

Sally Emch, who ran a telemarketing firm for charities, says people wouldn’t donate if they knew the truth.
A special report:

DUPING THE DONORS

Akron, his alma mater. The university’s InfoCision Call Center is a 12-seat room where students learn to make telemarketing calls. In 2007, Taylor paid $10 million for naming rights to the university’s InfoCision Stadium.

Taylor began his fundraising career in the 1970s, working for the late televangelist Rex Humbard. Taylor started InfoCision in his house in 1982 to raise money for religious groups. The company’s website says that solicitors at its religion division sometimes pray with callers as the firm seeks donations.

InfoCision is a family affair. Taylor, 59, who suffered a heart attack in 2009 a day after the InfoCision Stadium dedication ceremony, stepped down as CEO in 2004. His wife, Karen, 57, is chairman; his son, Craig, 27, is executive vice president; and his daughter, Lindsay, 30, is assistant secretary. Taylor and Karen live on a 28-acre (11-hectare) wooded estate in Akron. In addition to InfoCision, he owns three golf courses and a marketing company.

Taylor was an outspoken opponent of efforts by the Federal Trade Commission in 2003 to begin the National Do Not Call Registry, allowing people to block calls from for-profit solicitors. In an interview with Customer Interaction Solutions, a trade journal, he said, “The most pressing issue, without a doubt, is excessive governmental regulation. It seems that the politicians and regulators are ignoring the significant benefits we provide through job creation, economic growth and the goods and services we cost-effectively market for our clients.”

InfoCision Chief of Staff Steve Brubaker says his company is vital to the success of charity fundraising. Many nonprofits have stayed with InfoCision for more than 20 years, proving the firm offers value and integrity, he says. “We’ve developed that high level of trust by being good stewards of their money and mission,” he says. Campaigns to develop new donors are more expensive than those seeking money from previous supporters, he says. He declined to answer specific questions, saying such information is proprietary to the company or its clients. He turned down a request for interviews with Taylor and InfoCision executives.

Charities should never agree to one-sided contracts with telemarketers, says Ken Berger, who runs Glen Rock, New Jersey–based Charity Navigator, the nation’s largest nonprofit watchdog service. Berger, who was an executive for 30 years at Volunteers of America, Homeless Solutions and other nonprofits before starting his group, says that charities use telemarketing arrangements as just one more way to gain some money, however small the percentage of donations they receive. “These organizations were created to provide public benefit,” he says. “The fact that the vast majority of money is instead lining the pockets of telemarketers defies the whole reason behind the very creation of these charities.”

The nonprofits have become adept at hiding the money they spend on telemarketing firms. An examination of hundreds of annual filings that nonprofits are required to submit to the IRS shows how charities can bury, and sometimes omit, their expenditures on telemarketing. In state filings, by contrast, charities and telemarketers are required to explicitly say how much is raised by the contractors and who gets the money. Those numbers can be more telling than the IRS filings. It’s an InfoCision filing with North Carolina...
that reveals that the Diabetes Association got just 22 percent of the money raised nationally by volunteers recruited by the telemarketer in 2011. That figure isn’t found in any public filing with the IRS.

Charity reports to governments can be contradictory and confusing. In fiscal 2010, the entire $5.3 million raised in the name of the Cancer Society by InfoCision, along with additional fees, went to the telemarketer, according to filings by the charity with both the IRS and the state of Maine. Those dollar amounts and percentages conflict with an InfoCision filing with Ohio for the same period. That report says InfoCision kept 73 percent, or $5.65 million, of $7.77 million in fiscal 2010.

The society’s Donaldson says his group didn’t pay more to InfoCision than that firm raised, as it reports to the IRS and Maine. “I can state definitively that the American Cancer Society’s Notes to Neighbors program was indeed profitable for the society and never revenue negative,” he says. The IRS reporting requirements skewed the society’s reports to the IRS and the Maine filing didn’t include all of the charity’s Notes to Neighbors revenue, he says. He declined to provide any additional dollar amounts. “We consider that to be competitively proprietary,” Donaldson says.

It’s no surprise that telemarketers are wrong when they tell people where donation money would go, says Emch, the founder of FutureMarket. She says the industry standard is that donors are kept in the dark about contracts with charities. “Would it work for you to know that only 25 or 30 cents of your dollar was going to the organization?” she asks. “No. You’d be pissed. They wouldn’t contribute anymore if they knew the truth.” Emch closed Corpus Christi, Texas–based FutureMarket in 2010.

Regulators haven’t done much to curb telemarketer practices. InfoCision’s $75,000 settlement with Ohio was its largest penalty. The company has settled civil complaints of violating fundraising laws in six other states since 2009, paying fines and costs totaling $14,250—sanctions that are meaningless in monetary terms for a company of its size.

SOLICITOR: ‘WE’re CALLING TO ASK FOR YOUR HELP JUST BY MAILING 15 LETTERS TO YOUR NEIGHBORS.’

PAUL KOLB: ‘HOW MUCH GOES TO THE AMERICAN CANCER SOCIETY?’

SOLICITOR: ‘SEVENTY-EIGHT CENTS OF EVERY DOLLAR. WE ONLY GET, LIKE, 22 CENTS OF THE DOLLAR. WE’RE A VERY LEGIT COMPANY.’

IN GOVERNMENT FILINGS, THE SOCIETY SAYS IT GOT LESS THAN 50 PERCENT.

No less an authority than the U.S. Supreme Court has weighed in on what telemarketers working for charities can say to potential donors. While telephone solicitors have no obligation to volunteer what the firm’s cut is of each donation, they don’t have a constitutional right to lie, the court ruled in a 2003 Illinois case. “States may maintain fraud actions when fundraisers make false or misleading representations designed to deceive donors about how their donations will be used,” the court said.

Sometimes charities using telemarketers end up hurting the very people they say they’re trying to help. Beth Rutledge’s phone rang in her Clayton, California, home in February 2009. The voice at the other end, an InfoCision solicitor, was filled with urgency on behalf of the American Institute for Cancer Research, according to the recorded call. The Washington-based Institute provides people with information about how to prevent cancer, it says on its website. Rutledge, 50, was suffering with breast cancer at the time. This is how the call went:

Solicitor: “Since there will be over 1 million new cases of cancer this year alone, we desperately need your help to mail out the 15 pre-printed letters.”

Rutledge: “I’m just so overextended with volunteer work right now. I can’t take this on. It’s too overwhelming for me.”

Solicitor: “I certainly do realize that your time is valuable and you’re very busy. By volunteering a half-hour of your time, you could have an impact on someone’s life in your community. Is there any way you’d reconsider, Mrs. Rutledge?”

Rutledge, a retired bookkeeper, says she gave in to the pressure from the solicitor and finally agreed to do it. She handed envelopes to her neighbors.

In 2011, Rutledge quit her job on the advice of her physician, as cancer had spread through her body. She becomes silent upon being informed that 70 percent of the money the institute raised in the 2009 campaign for which she and 500,000 other Americans volunteered went to a telemarketing company. “That’s very disturbing,” she says. “I’m very disappointed. I’m feeling sick right now. I’m just totally not expecting this.”

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ROFIT
IN NAME ONLY

A SHIP INSPECTION COMPANY THAT MAKES HUNDREDS OF MILLIONS OF DOLLARS AND REWARDS ITS EXECUTIVES WITH LAVISH PAY AND FIRST-CLASS OR CHARTER TRAVEL SHOWS HOW POROUS U.S. RULES ARE FOR TAX-EXEMPT ORGANIZATIONS. BY DAVID EVANS
SINCE 1862, AN OBSCURE COMPANY CALLED American Bureau of Shipping has been approving oceangoing vessels as seaworthy. The Houston-based firm reported $3.17 billion in revenue and just under $600 million in profits from ship inspections from 2004 to 2010 and paid no U.S. income taxes on those earnings. The Internal Revenue Service hasn’t had any complaints. That’s because the company has been registered as a nonprofit for 150 years.

ABS routinely inspects independently owned ships on behalf of the U.S. Coast Guard, and one of its customers is the U.S. Navy. The company employs about 3,028 people in 70 countries. ABS paid Robert Somerville, then its chief executive officer, $21.7 million from 2004 to 2010.

ABS shows how an organization that isn’t a charity, a school, a religious institution, a hospital or any other kind of body that commonly has nonprofit status can earn millions of dollars and legally avoid paying U.S. taxes. Another such outfit is the U.S. Polo Association, which tells the IRS its tax-exempt status is allowed because its purpose is to govern the sport of polo in America. In 1982, more than five years after clothing designer Ralph Lauren featured a player with a mallet on horseback for his Polo brand logo, the Polo Association began licensing its own line of merchandise—with a similar image. Today, the association’s brand, U.S. Polo Assn., has annual retail sales of $1 billion, placing it in the top 50 of all licensed brands. The association pays no income tax on its licensing income, its filings show.

At a time when the U.S. is struggling with a gaping budget deficit, nonprofit companies such as ABS and the Polo Association operate large-scale, profit-making commercial enterprises tax-free. “This showcases a massive problem of tax-exempt companies that walk, talk and quack like tax-paying businesses but benefit from very favorable treatment under the tax code,” says Dean Zerbe, a lawyer who was senior counsel and tax counsel for the Senate Finance Committee until 2010. “Taxpayers are subsidizing them. It’s wild.”

Anyone can start a nonprofit. It’s as simple as incorporating in any state and correctly filling out an IRS application. Once that’s done, a company is tax-exempt. “It’s complete rubber-stamping,” says Ken Berger, CEO of Charity Navigator, a watchdog group based in Glen Rock, New Jersey, which is itself a nonprofit. “The IRS and the states are tremendously understaffed.”

For a company to get tax-exempt status, the IRS requires it to qualify in one of 28 categories, including charities, religious organizations and schools. The IRS says that some kinds of groups—such as trade associations, unions, agricultural organizations and social welfare groups—don’t even have to apply for nonprofit status. Such groups, which include ABS and the Polo Association, can self-declare their tax-exempt status, the IRS says.

Federal law on tax-exempt companies is so lax and vague that organizations can legally skip taxes on hundreds of millions of dollars of profits, Zerbe says. “The problem is growing because there is so little enforcement, and the laws are so losey-goosey,” he says.

The roster of tax-exempt trade associations includes the National Football League and the National Hockey League. The NFL—which in 2011 negotiated $27.9 billion in television contracts over nine years for its 32 member teams—paid Commissioner Roger Goodell $11.6 million in fiscal 2011. It reported a loss of $52.2 million. The NHL paid Commissioner Gary Bettman $4.6 million in fiscal 2011 and reported a $14.8 million loss. Broadcast and ticket revenue go to the teams, which are required to pay taxes on profits.

It wasn’t always so simple to start a nonprofit. In a bizarre twist of jurisprudence, a 1961 New York State Court of Appeals ruling involving a white supremacist group known as the Association for the Preservation of Freedom of Choice made it much easier for all sorts of organizations to become tax-exempt. Until that point, would-be nonprofits had to get a state judge to approve their tax-exempt status. The supremacist group’s application was at first rejected by a New York trial level judge. The appeals court reversed that decision, saying the right to form a nonprofit was guaranteed by the freedom of expression.
Robert Somerville, chairman of ABS, was honored in October by the Coast Guard Foundation at a New York fundraising dinner.

allowed in the Constitution.

Incorporating a nonprofit soon became a right, not a privilege, in states across the country, says Norman Silber, a professor who specializes in nonprofits at Hofstra University’s Maurice A. Deane School of Law in Hempstead, New York. “That case reflected a national trend,” he says.

There are 1.63 million tax-exempt organizations in the U.S., according to the Urban Institute. Nonprofit charities reported revenue of $1.51 trillion in 2010 from donations, government grants and contracts. Zerbe says that the U.S. Treasury could collect tens of billions of dollars annually in taxes from nonprofits that make money essentially as for-profit companies.

One of the most profitable nonprofits is American Bureau of Shipping—a company whose members are the ship owners who use its services. ABS inspects 11,898 vessels annually. The IRS asks companies in its standard filing form to say why they are nonprofits. ABS answers that question every year with the following phrase: “To promote the security of life & property on the seas.”

ABS’s headquarters occupies an entire eight-story office building on the north side of Houston. Its reception area, with rich dark-wood trim and furniture, displays scale models of a schooner, an oil tanker and an offshore oil-drilling ship. The nonprofit company has earned hundreds of millions of dollars in profits in the past decade; lavished its executives with multimillion-dollar pay packages and perks; and purchased an offshore hedge fund, its IRS filings say.

“ABS’s status as a nonprofit organization allows it to achieve the necessary impartiality to fulfill its mission,” ABS spokeswoman Jean Gould says. She declined to make any company executives available for interviews. ABS has a particularly close relationship with the Coast Guard. On Oct. 11, at a fundraising event in New York, the Coast Guard Foundation, a nonprofit organization that supports the Coast Guard, honored ABS and its Chairman Somerville, who stepped down as CEO in 2011. He was presented with a 10-inch (25-centimeter) engraved glass obelisk. The foundation said Somerville had supported its sailing and scholarship programs.

Since 1998, ABS has hired four former Coast Guard admirals as executives. They include retired Admiral Robert Kramek, who led the Coast Guard as commandant from 1994 to 1998. It was Kramek who signed an agreement with ABS in 1995 that expanded the nonprofit’s powers to inspect independently owned ships on the Coast Guard’s behalf. In June 1998, three years after Kramek signed that inspection agreement, ABS hired him as president of its Americas division.

Jack Devanney, a retired executive of companies that own ships that used ABS services, says this revolving door is bad for ship safety. “When you give Kramek a nice job, you’re sending a message to all the Coast Guard guys that they’ve got a second career at ABS,” says Devanney, who has a Ph.D. in management science from the Massachusetts Institute of Technology. “If you rock the boat, that opportunity’s not going to be available to you.” In a written response to questions, ABS says, “The U.S. Coast Guard and ABS share a common mission to promote maritime safety.”

ABS has also hired executives from its private-sector clients, most notably Frank Iarossi, a former Coast Guard officer who joined ABS after working for Exxon Mobil Corp. Iarossi was
president of the oil giant’s Exxon Shipping Co. from 1982 to 1990. During his last year in that job, the Exxon Valdez oil tanker struck a reef in Alaska, causing what was then the largest oil spill in U.S. history. The following year, a federal grand jury indicted Exxon and Exxon Shipping for allowing an incompetent crew to run the ship. Two days after the indictment, which didn’t name any Exxon executives, ABS announced it was hiring the Exxon executive as its chairman and CEO. He also became chairman and CEO of ABS Group of Cos., a for-profit subsidiary owned by ABS. Exxon eventually settled government criminal and civil cases, paying $1 billion.

Iarossi took a $2 million lump sum retirement payout in 1999, at age 62, without retiring, according to ABS’s federal filings. He stepped down as chairman and CEO of ABS in 2004, receiving $1.4 million in compensation from the nonprofit that year, the company reported. But he still wasn’t retired. He stayed on as CEO of ABS Group, a for-profit subsidiary, until 2006. ABS didn’t disclose his salary there. Iarossi, who lives in Naples, Florida, says his compensation wasn’t excessive. “When you hire an executive out of Exxon, you’ve got to cover their lost stock options,” he says. “That’s how executives get hired out of big companies.” ABS says in its written response that its executive compensation is reasonable and conforms with IRS standards.

ABS paid no U.S. income taxes from 2004 to 2010 on just under $600 million in profits it reported for what the company refers to as ship classification. Its filings show that it may have paid taxes on profits from less than 0.3 percent of revenue during that period on sales the IRS calls unrelated business revenue—any income not from ship classification. ABS didn’t make public details on that revenue.

The tax-exempt company earns income from writing rules for ship construction, inspecting vessels and certifying offshore oil rigs. Its net assets soared to $787.3 million at the end of 2010 from $292.7 million six years earlier. In 2010, the company’s holdings included $241.7 million in cash, $349.9 million in publicly traded securities and $144.8 million invested in subsidiaries. “A strong financial reserve is prudent given ABS is subject to unlimited liability,” ABS says in its response.

ABS reported in its 2010 IRS filing that it had shifted some of its profits into Cayman Islands–based AIP Custom Hedge Fund Solutions. It transferred $61.8 million of its $152.7 million in profit in 2010 to AIP, a fund of hedge funds. That gave the nonprofit 41.8 percent ownership of AIP.

ABS’s board has been generous with perks for its officers, directors and highly paid employees. The company checked off boxes on its 2010 tax return showing it had provided some of them with first-class or charter air service, travel for companions, health or social club dues and personal services such as chauffeurs, chefs and maids. In its filing, ABS wrote that those expenses were within company policy. The company declines to say who got which perks (chefs and maids)*.

$600 MILLION IN PROFITS (2004 TO 2010)
$144.8 MILLION TO SUBSIDIARIES*
$349.9 MILLION IN PUBLICLY TRADED SECURITIES*
perks. “Generally, some of these benefits are provided to employees on overseas assignments in foreign countries where company-provided services of this nature are typically standard business practice,” ABS says in its written response.

“My eyes popped out when I saw how many boxes were checked and their lack of explanation,” Hofstra’s Silber says. “It’s extremely opaque and cries out for explanation. If their answer satisfies regulators, we have a problem.”

IRS spokesman Dean Patterson declined to comment for this story.

One explanation for such lavish spending is that nonprofits sometimes have more money than they know what to do with—and one thing they don’t have to do is pay taxes. “The problem with a nonprofit is, when you start grinding out money, what do you do with it?” Devanney says. “There are only so many fancy cars you can buy your top executives.”


European authorities take a similar view. ABS Europe Ltd. paid 3.3 million British pounds ($5.3 million) of taxes in Europe on profits of £12.6 million in 2010, the company’s annual report says. “The recognition of this type of entity as tax-exempt is somewhat unique to the United States,” ABS says in its response.

Rare details of ABS’s operations emerged following a disaster on the high seas. On Nov. 19, 2002, an oil tanker that had passed a recent ABS inspection split in half during a storm in the Atlantic Ocean and sank. The nonprofit company had approved the 26-year-old single-hulled Prestige, registered in the Bahamas, in May 2002.

The wreck of the Prestige, 130 miles (225 kilometers) off the coast of Spain, spread more than 50,000 tons of fuel oil along hundreds of miles of Spanish and French beaches and disrupted fishing and tourism, causing damage estimated at more than $1 billion by the Spanish government. The Kingdom of Spain sued ABS in U.S. District Court in New York in 2003, claiming the company had behaved recklessly. In a sworn statement in that case, former Prestige Captain Efstratios Kostazos said he informed the tanker owner and ABS that he was leaving the ship two months before it sank. “During my almost 40 years of going to sea, I have never seen a vessel in this poor condition that was still in actual service,” he wrote.

Former ABS surveyor John Lee said in a sworn statement that he had inspected the Prestige on Dec. 13, 2000, and had refused to certify it. “I was shocked and horrified by the general level of deterioration and condition of the vessel,” he wrote. Lee wrote that ABS allowed the ship to go to sea, despite his objections.

ABS denied having any obligation to Spain. A New York federal judge threw out Spain’s lawsuit in 2010, agreeing with the company’s argument. In September, the U.S. Court of Appeals for the Second Circuit in New York turned down Spain’s request for reconsideration.

ABS vetted the Deepwater Horizon oil rig used by BP Plc, which exploded on

Fuel tanker Prestige, left, split apart after ABS inspected the ship and allowed it to go to sea. ABS inspected the Deepwater Horizon oil rig, below, before the BP driller exploded in 2010.
April 20, 2010. The disaster killed 11 workers and triggered a massive spill that soiled beaches along the shores of the Gulf of Mexico. A Coast Guard investigation wrote that ABS inspectors failed to report that critical safety systems aboard the rig had not been properly maintained. In its written response, ABS says the Coast Guard made no findings against the company.

Like ABS, the U.S. Polo Association has used its nonprofit status to earn money from around the world. Founded in 1890, the Lexington, Kentucky-based company, with 14 employees, governs polo in the U.S. Although its 3,500 members pay annual dues of $150, 90 percent of its income comes from investments and the licensing of more than 900 polo-related trademarks, according to IRS and court filings. With those trademarks, the association can use its name and the image of a polo player on everything from umbrellas to swimwear to handbags and deodorants. Such items are sold at Sears, J.C. Penney and stores in 130 countries. The association collected more than $30 million in royalties from retail sales from 2006 to 2010, according to IRS filings and CEO Peter Rizzo.

“Getting millions of dollars tax-free for licensing these polo ponies helps undermine confidence in the tax system,” Zerbe says. “You’ve got to put them on the same playing field with other businesses.”

The tax-exempt group has increased profits in the past seven years, according to its filings. Annual earnings rose sevenfold to $7.9 million in 2010 from 2004. Its net assets, including unspecified publicly traded securities and cash, increased sixfold to $37.3 million.

The USPA spent just 13 percent in 2010—$1.1 million of the $9.9 million it earned from royalties and investments—on delivering polo program services. It gained $6.8 million from royalties and $3.1 million on investment income in 2010, its IRS filing shows. The association also used $1.1 million from membership dues and fees for polo purposes.

Rizzo says his organization is increasing its spending on polo to 40 percent. Most of the money the group earns on invested profits will eventually be used to support polo, says Rizzo, interviewed in the association’s rented suite at the Museum of Polo and Hall of Fame in Lake Worth, Florida. The Polo Association provides the museum with no financial support. “It’s a business decision,” Rizzo says. Ralph Lauren Corp., which reported $6.93 billion in revenue in fiscal 2012, has sued the Polo Association at least twice in the past three decades. Lauren argued that the nonprofit was infringing on the trademarks for its Polo line, which Lauren registered in 1974. Courts have found that the association could market products with some restrictions. In 2011, a federal judge in New York issued an injunction forbidding the association from competing with Lauren’s Polo fragrances. The USPA filed an appeal in July, which is pending.

Rizzo says he sees no issue with brand confusion. “We are the legitimate connection to the sport,” he says. “There was an opportunity out there to license trademarks. We seized it.”

Both the USPA and Lauren have shops at the Ontario Mills factory outlet mall an hour east of Los Angeles. The similarities and proximity can cause confusion among consumers. Ferial Sharifi, a 28-year-old fashion consultant visiting from Toronto, shopped at both stores in early October. She bought a $99 jacket at the Polo Ralph Lauren store and then entered the Polo Assn. boutique, which sells polo shirts for $15. When asked, she says both shops are owned by Lauren. She says the second one sells less expensive shirts of lower quality, sporting a variation of a polo player logo. She’s surprised to learn the Polo Association isn’t owned by Ralph Lauren and receives tax-exempt royalty payments. “Why does a nonprofit sports group have a commercial store in a mall?” she asks.

Reviewing the filings of hundreds of tax-exempt companies leads to similar questions. Entities that look and smell like for-profits are permitted to pay no taxes on tens of billions of dollars of income, Zerbe says. As the U.S. struggles to deal with its growing budget deficit, legislators may want to re-examine an oxymoron: nonprofit companies swimming in profit.

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