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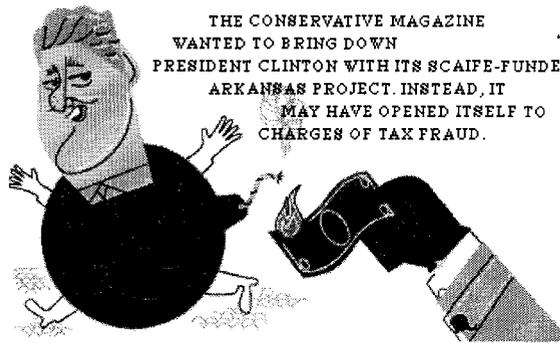
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SPECIAL REPORT

The American Spectator's

► DAILY QUOTE

THE CONSERVATIVE MAGAZINE WANTED TO BRING DOWN PRESIDENT CLINTON WITH ITS SCAIFE-FUNDED ARKANSAS PROJECT. INSTEAD, IT MAY HAVE OPENED ITSELF TO CHARGES OF TAX FRAUD.



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Pittsburgh billionaire Richard Mellon Scaife's effort to damage the Clinton presidency by channeling almost \$2.4 million through the conservative American Spectator magazine may end up, ironically, damaging the magazine instead by exposing it to possible tax code violations, according to knowledgeable sources and internal documents obtained by Salon.

The crisis at the American Spectator stems from the so-called "Arkansas Project," a four-year effort aimed at producing investigative exposés about Clinton in the magazine. The project produced little journalism, according to Spectator staffers. But it led to the breakup of the American Spectator's founding team, which had been together for 30 years, the dismissal of its original publisher and the resignation of three prominent members from the Spectator's board of directors.

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Now, the nonprofit foundation that owns the Spectator and the Scaife charities that funded the Arkansas Project -- the Carthage Foundation and the Sarah Scaife Foundation -- may face serious tax problems under Internal Revenue Service regulations governing tax-exempt charitable organizations, according to current and former Spectator staff and board members, as well as an independent expert in tax law.

Furthermore, the anti-Clinton operation has also raised conflict of interest questions involving independent counsel Kenneth Starr, who until recently had been planning to accept a university position that was partially funded by Scaife, and whose key witness in the Whitewater inquiry, may have received some assistance from the Arkansas Project. Last week, the Justice Department and Starr's office agreed on the appointment of a special investigator, Michael J. Shaheen, to probe the allegations about Hale.

The Arkansas Project may have violated IRS guidelines forbidding political advocacy by charitable organizations, according to a former Spectator employee familiar with how the project functioned. That is because the magazine's nonprofit owner, the American Spectator Educational Foundation, is restricted under the IRS regulations for 501(c) 3 class organizations from engaging in the kinds of activities apparently pursued by the Arkansas Project.

"This wasn't a legitimate use of tax-exempt moneys," said the former Spectator employee, who spoke with Salon on condition of anonymity. "I would suggest that what was going on here was opposition research, which would be fine if the American Spectator were a private business. But it is a tax-exempt 501 (c)3."

Section 501(c)3 is the federal tax code classification for a charitable, educational or religious organization that is "prohibited by the terms of its exemption from participating or intervening, directly or indirectly, in any political campaign on behalf of, or in opposition to, any candidate for public office." The same prohibitions apply to the two Scaife entities, the Carthage Foundation and the Sarah Scaife Foundation, which funded the

Arkansas Project from its inception in late 1993 until it ended in November 1997. "It's not just the American Spectator which ought to be sweating about the IRS," the ex-employee continued. "The Scaife foundations ought to be really sweating."

Thomas A. Troyer, a leading authority on tax-exempt organizations and a partner of former IRS Commissioner Mortimer Caplin at the Washington, D.C., law firm Caplin & Drysdale, told Salon that such political and non-charitable activities, if proven, could result in the loss of tax-exempt status for the organizations involved. According to Troyer, under the law, a public charity like the American Spectator "must control the money it has to make sure it's used for charitable purposes. It has to know what's happening to the money, know what it's being spent for, get records back as to what the expenditures are. If there are legal fees, what are the lawyers doing for that money?"

According to the Spectator foundation's internal accounts, three-quarters of the Arkansas Project funding, or \$1.8 million, was paid out in "legal expenses" with no further explanation of what sort of legal services were provided. Spectator records indicate that the money went to conservative lawyer Stephen Boynton and Spectator board member David Henderson, who in turn funneled some of the money to various anti-Clinton operatives, including at least \$48,000 to Arkansas bait-shop owner Parker Dozhier, who owns a fishing cabin where the principal Whitewater witness, David Hale, stayed rent-free.

Another apparent beneficiary of Arkansas Project funds was private investigator _____ who conducted research aimed at linking Clinton to _____ based at a small rural airport in Mena, Ark. Armistead's allegations were taken up by the House Banking Committee during the presidential campaign in 1995 and were eventually dismissed. Operatives of the Arkansas Project also were involved in the successful effort to have _____ removed from Starr's first trial of Arkansas Gov. Jim Guy Tucker.

Boynton, who declined to comment for this article, has claimed in the past that he possesses complete records of how he spent

the money he received from the American Spectator. The Spectator's new publisher, Terry Eastland, says the magazine is conducting an internal audit, but acknowledges that all the money from the project has not been accounted for. In an interview with Salon last week, Eastland said he could not comment on the audit until it has been completed. "It's not a subject for me to discuss until I have finished doing my work here, reporting back to the board and the board doing whatever it wishes to do," he said.

The Arkansas Project provoked a fierce split within the Arlington, Va., office of the Spectator, whose once tightly knit staff celebrated the magazine's 30th anniversary last fall. Documents obtained by Salon show that Ronald Burr, the magazine's co-founder and longtime publisher, responded to concerns about how the Scaife money was being spent by calling for an independent tax fraud audit by a respected outside firm.

However, the Spectator's other co-founder, president and editor-in-chief, R. Emmett Tyrrell Jr., angrily rejected Burr's call and declared the case as to whether fraud had been committed "closed." When Burr persisted, Tyrrell convened a special board meeting at his home and had Burr summarily fired.

The bitter breakup of Tyrrell and Burr ended a 30-year partnership, dating back to their student days together at Indiana University. In 1967, the pair co-founded an off-campus magazine originally called the Alternative. Over the years, they changed the magazine's name to the American Spectator, moved it to Washington, D.C., and eventually built it into a major voice of conservative political opinion. Its most explosive growth has occurred since 1992, as it expanded from 30,000 in circulation to 210,000 in 1996.

While building the Spectator, Tyrrell and Burr established a long and close relationship with Scaife's foundations. The magazine started receiving funding from Scaife 27 years ago, in 1971, when it was still the Alternative. Until recently, the Scaife foundations donated substantial amounts of money for general support, "investigative reporting" and the Arkansas Project.

The first meeting of the Arkansas Project team

took place in early 1994 in the Washington, D.C., law office of Theodore Olson, a friend of Tyrrell and future Spectator board member, according to participants. Those present included Olson, Boynton, Henderson, then-publisher Burr and Michael Horowitz, then a fellow at the conservative think-tank Manhattan Institute, which also receives funding from Scaife.

Olson, who served as an assistant attorney general in the Reagan administration, is a former law partner and friend of Kenneth Starr. Olson also briefly represented Hale when he was ordered to testify before a Congressional committee.

By 1995, sources say, some Spectator staffers were growing concerned about the large amount of Arkansas Project money coursing through the organization with minimal journalistic results. The grumbling eventually surfaced in the form of a memo written by a senior editor last year that stated, "While the (Arkansas) project continued, it didn't produce much in the way of exciting stories. Initially, Boynton and Henderson would occasionally mention a few things to me about the situation in Arkansas, but I wasn't impressed by what they had to say. They seemed to have a source or two -- David Hale, Parker Dozier (sic) -- but not much more than that. There always seemed to be lots of hush-hush and heavy breathing, but it never amounted to anything concrete enough for a story."

By mid-1997, internal documents show, Burr had clearly become concerned about the lack of documentation to support the money that was flowing to Boynton and Henderson. "There was a certain carelessness in the monitoring of the money," says a former member of the Spectator board, who declined to be identified, "and quite properly, it began to gnaw at Burr." The former board member says Burr let his concerns be known to Tyrrell, Scaife Foundation executive Richard Larry and several Spectator board members.

Burr's candor seems to have backfired, however, because on July 10, 1997, according to an internal document, Tyrrell declared at a meeting in Olson's office, "I am here to announce an audit. Dick Larry said that Ron (Burr) has misallocated \$1 million of the Arkansas Project funds and we are going to

have a complete audit of the project."

The accusation stunned Burr, according to sources. He wrote to Larry four days later, demanding that he retract the alleged remark and write a formal apology. At the same time, Burr began exploring options for a "fraud audit" of the Arkansas Project to protect himself, according to current and former Spectator insiders.

Burr first contacted the Spectator's accountants, the Indianapolis firm of L.M. Henderson & Co. A Henderson partner replied that although the firm was prepared to spend a week on an audit of the payments to Boynton and Henderson, "fraud may exist in this transaction that we will not identify during the performance of these procedures." Burr then contacted the nationally prominent accounting firm Arthur Andersen. An Andersen official responded that the firm would be prepared to spend six weeks conducting a complete audit of the Arkansas Project expenditures.

On Sept. 30, 1997, Burr forwarded both bids to Tyrrell with his recommendation that the Spectator hire Arthur Andersen. Tyrrell responded angrily in writing: "No one has accused anyone at The American Spectator with fraud. I do not want a 'fraud' audit of any project. I do not want any further audits until I have examined our accounting of the Arkansas Project ... This issue is now closed."

A week later, on Oct. 5, a special meeting of the American Spectator Educational Foundation's board was convened at Tyrrell's home in McLean, Va., from which Burr was excluded. At the meeting, the board voted to remove Burr from his positions as publisher of the magazine and secretary and treasurer of the board. The board also voted to appoint Starr's friend Olson as Burr's temporary replacement on the board.

The following day, apparently not yet apprised of his fate, Burr made a final appeal to Tyrrell to hire Arthur Andersen to conduct the audit. "If there is the slightest chance there was fraud by someone, either at the American Spectator or elsewhere, we need to investigate the Arkansas Project thoroughly," he wrote. "The American Spectator must be an example of integrity and honesty ... We need to let the chips fall where they may."

That same day, Tyrrell sent a curt letter to Burr informing him of the board's decision to dismiss him after 30 years at the magazine they had founded together in college. The letter ordered Burr to surrender company property and clear out of his office by day's end. Burr was offered a \$350,000 severance package that contained a "mutual confidentiality" clause, which precludes either side from discussing the circumstances of his dismissal. Burr declined to discuss these matters with Salon.

Left unresolved are the mysteries surrounding what happened to all the money flowing through the Arkansas Project. "How were they spending that money?" asks a former staff member. "Was it legitimately expended to further their work product, which is their magazine, or in fact was there another agenda? And if that other agenda related to, say, the outcome of the 1996 presidential election, then you got a big problem. You got a huge problem -- both the Spectator Foundation and the Scaife foundations."

In the months since Burr's dismissal, according to current and former Spectator officials, three members of the organization's board of directors have quietly resigned -- former United States Information Agency Director Frank Shakespeare, New York investment banker Theodore Forstmann and Heritage Foundation Vice President John von Kannon. Shakespeare, who was one of two board members who abstained from the vote to dismiss Burr, would not comment publicly about his resignation. Forstmann and von Kannon both said they quit because they no longer had time to devote to the magazine. But sources close to the Spectator said that concern over the impact of the Arkansas Project on the magazine's tax-exempt status and anger over Burr's dismissal were factors in these resignations.

The most recent addition to the Spectator board is conservative columnist Robert Novak, who told the New York Observer that he wants to "save the magazine." Pointing out that he would be the only working journalist on the Spectator's board, Novak said, "I think the magazine has made mistakes and is in trouble." Asked to specify which mistakes had endangered the Spectator, Novak at first

replied gruffly, "I'm not getting into that."
Pressed for an answer, he blurted, "How about
the Arkansas Project?"

SALON | June 8, 1998

Jonathan Broder is Salon's Washington Bureau Chief.
Joe Conason is the political editor of the New York
Observer and a frequent contributor to Salon.

PART TWO | _____

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