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Koch, Cato Institute battle could test non-profit law limits

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Billionaires Charles and David Koch are suing in Johnson County court, trying to enforce decades-old contracts related to control of the Cato Institute, a famous libertarian think-tank based in Washington.

The lawsuit was filed in Johnson County because Cato was organized by the Kochs and others in Kansas, where Koch Industries is located.

Cato is resisting what it calls a takeover by the Kochs. It has even set up a website making its case.

Merits of the case aside, though, the dispute could provide an interesting test of the limits of federal tax law relating to organizations like Cato -- a test that could have profound effects on the organization's fundraising, as well as the Kochs' ability to give money to it.

Cato's latest tax return -- which shows expenditures of around \$23 million from revenue of \$40 million -- shows the think tank filed as a 501(c)(3) non-profit charity.

Federal tax law strictly limits political activity by a 501(c)(3). "All section 501(c)(3) organizations are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign," the IRS says.

But:

"Certain activities or expenditures may not be prohibited depending on the facts and circumstances. For example, certain voter education activities (including presenting public forums and publishing voter education guides) conducted in a non-partisan manner do not constitute prohibited political campaign activity," IRS rules say. That could cover

Cato, which bills itself as a non-partisan organization, albeit one that deals almost exclusively with political issues.

That could change dramatically if the Kochs link Cato with Americans for Prosperity, their tea party-related organization that has played an active role in political debates for two years.

"Voter education or registration activities with evidence of bias that (a) would favor one candidate over another; (b) oppose a candidate in some manner; or (c) have the effect of favoring a candidate or group of candidates, will constitute prohibited (political) participation or intervention," the IRS says.

In short, a Koch takeover could mean Cato would lose its tax-exempt status.

It could refile as a 501(c)(4), which is allowed more leeway in addressing political matters. Americans for Prosperity is a (c)(4), for example.

But there is a huge difference between a (c)(4) and a (c)(3): Donations to a (c)(3) are tax-deductible -- they're considered donations to a charity.

Donations to a (c)(4) are not tax deductible.

If the Kochs take over Cato, and the IRS removes its tax-exempt status, donations to Cato would no longer be tax-deductible... potentially a huge hit to fundraising for the group, and a potential tax penalty for the Kochs if they give to the organization.

We asked Cato for comment, but have not heard back.