Koch Brothers: Who Controls the Kochs' Political Network?

Who Controls the Kochs' Political Network? ASMI, SLAH and TOHE

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Libertarian billionaire brothers Charles and David Koch were among the first to grasp the political potential of social welfare groups and trade associations — nonprofits that can spend money to influence elections but don't have to name their donors.

The Koch's and their allies have built up a complex network of such organizations, which spent more than $383 million in the run-up to the 2012 election alone.

Documents released in recent months show the Koch's have added wrinkles to their network that even experts well versed in tax law and campaign finance say they've never seen before — wrinkles that could make it harder to discern who controls each nonprofit in the web and how it disperses its money.

A review of 2012 tax returns filed by Koch network groups shows that most have been set up as nonprofit trusts rather than not-for-profit corporations, an unusual step that reduces their public reporting requirements.

It sounds complicated and arcane because it is. Some of the nation's top nonprofit experts said they could only speculate on the reasons for the network's increasingly elaborate setup.

"My guess is that we're looking at various forms of disguise — to disguise control, to disguise the flow of funds from one entity to another," said Gregory Colvin, a tax lawyer and campaign-finance specialist in San Francisco who reviewed all the documents for ProPublica.

Four other leading nonprofit experts and three conservative operatives with knowledge of the Koch network said the most likely reason that the Kochs and their inner circle are using this arrangement was to exert control over the groups without saying publicly who was in charge. In particular, they said, the Kochs likely wanted to prevent any of the groups that they help fund from going against their wishes — as happened with the Cato Institute, the libertarian think tank the Koch's had long supported before they got into a dispute with its president, Ed Crane.

After a top Cato official ridiculed Charles Koch in a 2010 New Yorker article, the brothers pushed to put allies on the think tank's board. The following year, they pressed Cato to provide "intellectual ammunition" for their oldest politically active nonprofit, Americans for Prosperity, Cato officials later alleged. The dispute was settled in 2012, with the departure of Crane and the installation of a traditional board. (Cato previously was controlled by four private shareholders, including the Kochs, an unusual setup for a nonprofit.)

Robert Levy, Cato's board chairman, told ProPublica that while he didn't disagree with the Kochs' aims, Cato's leaders were uncomfortable with serving as advocates for their political agenda.

"The Kochs had their notions about what they wanted to focus on, and those tended to focus on intellectual ammunition for what their political ambitions were," Levy said in an interview last fall. "We didn't disagree with that, but we didn't want to operate at the direction of the Kochs. We're not involved in electoral politics. We are strictly nonpartisan."

The Kochs have disputed the allegation that they tried to force Cato to do their political bidding.

In this story, we define the Koch network as including 12 nonprofits active in 2012 — 11 social welfare nonprofits and one trade association. These nonprofits all shared the same attributes: They used LLCs, installed Koch allies at the helm and hired the same set of lawyers. (We did not include think tanks, foundations or other charities, nor the like-minded groups that are funded by the Kochs.)

Officials with Koch Industries and groups in the Koch network did not respond to calls or written questions from ProPublica.

When asked about his involvement with Americans for Prosperity in a rare interview with the Wichita Business Journal last month, Charles Koch downplayed his political activity, saying he and his brother did not have day-to-day involvement with the group.

"Listen, if I could do everything that's attributed to me, I would be a very busy boy," he told the Journal.

Here's what we know so far about how the Koch network uses trusts and LLCs, as well as the advantages they may offer.

Disregarded Entities

As of 2012,all 12 Koch network groups had offshoots known as "disregarded entities" — LLCs that are "owned" by their parent nonprofits and are considered part of them for tax purposes.

The first such LLC sprang up in February 2010, when Sean Noble, the head of a Koch network nonprofit called the Center to Protect Patient Rights, formed SDN LLC, using the initials of his own name. (ProPublica wrote a story last month about Noble, the Koch network's money man in 2010 and 2012.)

Koch network groups came to have a total of 19 disregarded entities, tax records show; Freedom Partners Chamber of Commerce, a trade association that distributed almost $236 million to other nonprofits in the year before the 2012 election, led the way with five.

Unlike corporations, LLCs set up in Delaware are not required to disclose who runs them. The only documentation available is the name of the person who creates them. In the Koch network, 11 of the disregarded entities were formed by the same Chicago trust lawyer, Jonathan Graber. Most had nonsensical strings of letters for names, like SLAH, ORRA or DAS MGR. All were set up in Delaware.

Charities typically use disregarded entities to protect themselves from liability. For instance, they'll hold property in a disregarded entity to shield the nonprofit from lawsuits over anything from environmental pollution to slip-and-falls.

But these LLCs appear to serve different purposes for the Koch network, experts said.

Before the 2012 election, two groups sat at the top of the Koch money spigot. TC4 Trust, which has since folded, and Freedom Partners, which remains on top of the Koch pyramid, shelled out more than $204 million to the network's 10 other nonprofits. But instead of giving the money directly to the nonprofits, TC4 and Freedom Partners gave those millions to the groups' disregarded entities.

That made the money more difficult to follow.

Consider the case of the LLC with the inscrutable name of TOHE. (No, that's not a typo.) Records for TC4 Trust show that it gave a $1,968,500 grant to TOHE between July 2011 and June 2012.

So what's a TOHE?

You would think you could go to the Internal Revenue Service web site, punch in the magic letters, and get an answer. But that's not how it works.

Disregarded entities cannot be searched by name because their tax returns are filed as part of their parent nonprofit, which of course is exactly what you don't know.

To solve the mystery, we searched IRS databases of recognized nonprofits by the names of lawyers known to work for the Koch network. We found one, Vets for Economic Freedom Trust, that seemed like a possible match for TOHE. Then we requested the group's application from the IRS, which showed a leader, Wayne Gable, who had deep ties to the Koch brothers, earlier serving as a managing director at Koch Industries. But still, the application didn't mention TOHE.

We had to wait for the group's tax return, filed in August 2013, to become public, which took a couple of months. The return showed that Vets for Economic Freedom Trust was using a different name: Concerned Veterans for America. And it showed the group's disregarded entity: TOHE. Concerned Veterans spent most of its money on ads criticizing the government for not doing more to help veterans vote and for the rising national debt.

A more recent tax filing by Freedom Partners gave the names of the disregarded entities and their parent nonprofits when listing grants, dispelling some of the confusion.

The Center for Responsive Politics and The Washington Post have also written about how the Koch network has used disregarded entities to hide the money trail. But disregarded entities offer other advantages.

Donors to social welfare groups and trade associations have only become public in a handful of cases, but some corporate and individual donors still worry about scrutiny from stockholders or the IRS. One operative told ProPublica he'd heard a Koch network official suggest that a donor with such concerns write checks to disregarded entities rather than to better-known nonprofits.

"You don't want to just create one layer of anonymity, because that layer could be breached, maybe just by accident — you know, the memo that's left lying around kind of situation," said Lloyd Hitoshi Mayer, a law professor and associate dean at the University of Notre Dame who specializes in nonprofits and campaign finance and who reviewed the groups' available documents for ProPublica.

Further, while nonprofits are required to disclose their top administrators and boards in tax filings, disregarded entities can have separate managers who are not identified anywhere, said Ellen Aprill, a professor at Loyola Law School in Los Angeles who has studied politically active nonprofits. Such a manager would be able to control how the money received by the LLC was spent.

Seven disregarded entities in the Koch network took in more than three-quarters of the money received by their parent nonprofits. POFN, the disregarded entity of a nonprofit called Public Notice, for instance, brought in more than 75 percent of its parent's $6 million in revenue from May 2011 through April 2012. POFN's manager — whoever that may be — would control how that money was spent, nonprofit experts said.

So far, the Koch network's use of disregarded entities has been unique. ProPublica reviewed tax returns filed by more than 100 liberal and conservative nonprofits that reported spending money on elections in 2010 and 2012. No group unaffiliated with the Kochs had such offshoots.

Their use might be catching on: In July 2012, the American Future Fund, a dark money behemoth that received most of its money through the Koch network but is not part of it, formed its own disregarded entity, Franklin Squared.

Trusts

Social welfare nonprofits are typically formed as not-for-profit corporations, with boards that set their policies.

But nine of the 12 nonprofits in the Koch network were formed as trusts — an approach several tax experts said they had rarely, if ever, encountered. The first was TC4 Trust, which was established in August 2009 and folded in 2012. Eight more Koch-affiliated groups were set up as trusts in 2010 and 2011.

Trusts are subject to little outside oversight. They don't have to file incorporation papers or annual reports to the state. Any documents filed with the IRS take effort and time to get. "It keeps it out of the public eye a little longer," said Lawrence Katzenstein, a lawyer in St. Louis who has formed charitable trusts.

Trust agreements rarely have to be filed publicly, but since most of the Koch-connected trusts have been recognized by the IRS as social welfare nonprofits, their trust agreements are available from the agency. ProPublica examined six trust agreements for groups that are still active.

The trust agreements are all "irrevocable," meaning the trustee cannot change them, except for changing the trust's name or anything necessary to maintain the group's tax-exempt status. Two of the trustees are longtime Koch insiders; a third used to be a lawyer for the Charles G. Koch Charitable Foundation. Two other trustees are relatively new to the Koch fold but have long conservative pedigrees.

Despite those credentials, the trustees can be axed at any time. Each trust agreement gives an LLC — not a disregarded entity, but a different one with a similarly nonsensical string of four letters for a name — power to remove the trustee for any reason. For instance, Daniel Garza, the trustee for the LIBRE Initiative Trust, can be removed by an LLC called THGI.

Tax experts say that this means that someone behind that LLC can actually control the nonprofit. "It's someone having control, and it's that someone going to great lengths to avoid being known," said lawyer Marcus Owens, who used to run the Exempt Organizations division of the IRS.

Little else is known about these LLCs except that they, too, were formed by Graber in 2010 and 2011 in Delaware, a state that requires virtually no disclosure.

Giving someone the power to remove the trustee is increasingly common, said Charles Durante, a Delaware lawyer who does work with trusts, nonprofits and LLCs. But it's typically a named individual, he said, not an anonymous LLC.

"That is not customarily how people structure their trusts," he said.

One employee of a nonprofit with ties to the Kochs, who spoke on condition of anonymity because he feared retribution, said the LLC arrangement fit in with the brothers' desire to keep a tight grip on their organizations.

"Their level of degree to which they insist on control is truly spectacular," he said.