MARCH 6, 2012

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A Nonprofit with Shareholders? The Koch Brothers' "Hostile Takeover" of Cato Institute

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CREATED ON TUESDAY, 06 MARCH 2012 14:26
March 2, 2012; **Source:** Washington Post

Like Matthew Iglesias in Slate, we don't get it either. How is it that the nonprofit Cato Institute has shareholders—that is, people who own shares of stock in a nonprofit organization?

Here is the odd story of the structure of the nation's most well known libertarian think tank and the crisis that that structure has helped create.

David Weigel writes that the Cato Institute was established in San Francisco in 1977 and moved to Washington, D.C. in 1985. Upon the move to D.C., the nonprofit Cato established itself as "owned" by four shareholders, each owning 16 shares of stock at $1 per share. The four shareholders were the executive director, Ed Crane, the conservative money man Charles Koch, and two other people (George Pearson and William Niskanen). In 1991, Charles Koch's brother, David Koch, joined the ownership group and purchased another 16 shares.

More than twenty years later, the place is in turmoil. Pearson has given back his shares, so he is out of the picture. Niskanen died last October and left his shares to his wife, but the Koch brothers are claiming that she has no right to the shares. Rather, the Koches argue that Niskanen's shares should either be purchased back by Cato or made available to the remaining shareholders (Crane and the two Koches).

Crane is referring to the Koches' suit as "an attempt at a hostile takeover." Currently, the Koch brothers control half of the stock. If Niskanen's widow has to forfeit her shares back to the corporation or make them available for sale to the Koches and Crane, the Koches would own a controlling interest in the organization. Reportedly, they haven't been pleased with Cato's direction and long ago, despite their "ownership" of the nonprofit, shifted their funding to other organizations such as Americans for Prosperity.

A nonprofit with four shareholders? Former IRS official Marc Owens declared the Cato ownership structure as "completely at odds with the requirements for [a nonprofit]" and as putting Cato "at risk of retroactive revocation of its tax-exempt status back to 1977." Cato's own federal tax lawyer, Bruce Hopkins, acknowledged that the IRS doesn't like this kind of ownership arrangement, but says that the shares are a "strange breed of stock that doesn't have any economic advantage to it." He said that despite the nomenclature of stock, the structure "is more of a control mechanism and in practice it's not much different than a membership."

Is Cato a public charity? How can it be a *public* charity if it is *individually owned* by four people who possess the limited number of shares of stock issued by the corporate entity known as the Cato Institute? If the stock is really only a substitute for the category of the Cato Institute's membership, how can Niskanen's widow inherit the Cato shares? If they are regular corporate-type shares, they can be inherited. Given the strong comments of Marc Owens, who should know the "ownership" issues of nonprofits since overseeing nonprofits was his job at the IRS's tax exemption division, how has the IRS allowed this situation to proceed over the course of the past 27 years?—Rick Cohen