

Court Papers Hint Connally Dairy Aid

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A 1971 tax audit of the nation's biggest dairy cooperative failed to disclose its massive illegal political donations, and court papers quote the co-op's former lobbyist as saying John B. Connally may have helped in the case.

Also, co-op lawyer Jake Jacobsen once told the dairy group's officials that Connally, who was then Secretary of the Treasury, wrote directly to the Internal Revenue Service district director about the audit, one source said. But the IRS man, R. L. (Bob) Phinney, a long-time friend and former business partner of Connally, denied that Connally contacted him about the matter.

Connally could not be reached for comment. His at-

torney, Edward Bennett Williams, declined comment.

The co-op, Associated Milk Producers, Inc., employed one of Connally's senior law partners, Marvin K. Collie, to handle the tax matter.

Jacobsen testified to Watergate investigators that Connally cleared Collie's hiring in advance, several sources said.

The milk producers' former lobbyist, Bob A. Lilly, is quoted in public records as saying Connally "may have resolved" the tax matter. This remark appears in the handwritten notes of a lawyer who interviewed Lilly last year.

And the co-op's general manager, George L. Mehren, is quoted in similar fashion as saying Connally's partner Col-

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lie "got them off on that one, but said he could not do it again."

The IRS audit began when Doyle Bond, a revenue agent from the co-op's headquarters town, San Antonio, began asking about some suspicious checks.

Lilly said in a letter to Jacobsen that Bond seemed aggressive, and that Bond wanted to "raise an issue over our questionable expenditures." These expenditures may total several million dollars, recent disclosures indicate.

The IRS disallowed a few deductions, including one political outlay that it had uncovered before the audit began. These disallowed deductions were merely subtracted from the co-op's loss carryforward, which is the sum of unclaimed deductions held aside for future years.

What the IRS didn't find were \$100,000 paid to Nixon fund-raiser Herbert L. Kalmbach in 1969, at least \$91,691 in corporate services and money to Hubert H. Humphrey's presidential campaign the year before, another \$34,500 or more to Humphrey's 1970 senatorial campaign, and uncounted sums for other candidates and for office and salary expenses of the group's political trust.

Corporate contributions to political candidates are forbidden by federal law, and cannot be claimed as business deductions on taxes. The milk producers have admitted themselves that the \$100,000 paid to Kalmbach was unlawful and have asked for a refund. Two officials of the cooperative have pleaded guilty for their role in paying a portion of the 1968 Humphrey money, and a third is under indictment. In the Humphrey case, \$22,000 of the illegal money was uncovered by an IRS audit in Little Rock after Connally left the Treasury Department.

In addition to the political spending, there is also evidence in public records that the milk producers spent similar huge sums in illegal kickbacks to dairies that were reluctant to pay the high prices the co-op demanded for milk produced by its member farmers.

These alleged kickbacks and the illegal political expenditures cannot legally be deducted. In any case, the 1971 audit failed to uncover them.

Lilly's letter to Jacobsen is dated Aug. 26, 1971, barely five months after Jacobsen had secured Connally's help in

persuading President Nixon to raise milk price supports. Jacobsen was asked to help again.

Lilly said the IRS had discovered checks that were part of \$90,711.07 which the co-op had paid in corporate money to print a lavish picture book of President Johnson's messages to Congress in 1968. The co-op had claimed this political outlay as a business expense.

Lilly didn't mention it in the letter, but notations on invoices and checks indicate the book was printed at the request of someone in the White House and was intended for use in connection with the Democratic Party's 1968 fund-raising dinner for congressional candidates.

Lilly said eyebrows were raised because one of the checks had been endorsed by the printing firm to the "Salute to the President Committee," which ran the Democratic fund-raising affair.

Lilly asked Jacobsen "to make contact to point out any drastic action would be premature . . ." He said the co-op's financial controller, Robert O. Isham, was worried about what Bond might uncover, and wanted to talk to someone "at a higher level."

Jacobsen has testified that he hired Collie after checking with Connally to "see if it was OK" to use Connally's law partner in the matter. Connally had suspended his connection with the law firm, to which he later returned.

Collie said in a telephone interview that he looked over the facts about the LBJ book payments and advised the milk producers against trying to maintain their claim of a deduction. "I assume they took my advice," he said. "I got a very damn nominal fee."

When the matter was settled, Jacobsen told Isham and others that Connally had written to Phinney about the audit, one source said. "Jake insisted that Connally wrote to Phinney," he said.

Isham was skeptical of the claim, the source said. "Jake said a lot of things, and he didn't know whether to believe him or not."

Phinney, in a telephone interview, denied that Connally had contacted him about the matter. "I had no contact whatever with anybody up there about this audit," he said.

Phinney said the matter of the LBJ book was referred to the Justice Department, and Lilly is quoted as saying that the FBI investigated it. No prosecution resulted.