United States Senate
WASHINGTON, DC 20510

April 9, 2018

The Honorable David Kautter
Assistant Secretary of the Treasury for Tax Policy and Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

Dear Acting Commissioner Kautter:

We write to urge the Internal Revenue Service (IRS) to closely scrutinize applications from institutions of higher education seeking to convert from for-profit status to nonprofit and tax-exempt status. We believe heightened scrutiny is necessary in order to ensure that institutions' post-conversion activities align with the requirements of Section 501(c)(3) of the Internal Revenue Code ("Code"), which prohibits any net earnings benefitting private interests. We want to ensure that colleges are not able to use their new tax-exempt status to unjustly enrich executives, administrators, board members, officers, or other institutional insiders at the expense of the students served by such institutions.

There has been a recent and troubling trend of for-profit colleges converting to or attempting to convert to nonprofit organizations with tax-exempt status. Specifically, for-profit colleges are reorganizing themselves as newly created nonprofit institutions and then entering into third-party contracts with for-profit entities often operated by individuals in charge of the former for-profit college. These entities appear to be taking advantage of opportunities to create a tissue-thin veneer of nonprofit and tax-exempt status that allows the for-profit entity to continue to run and manage key operations of the newly formed nonprofit. The net result is that students' taxpayer-funded federal financial aid flow directly into the pockets of the same executives, shareholders, and associated individuals of the reorganized for-profit entity for their own excessive benefit.

We are concerned that these recent attempts by for-profit colleges to convert to nonprofit organizations with tax-exempt status may violate federal tax law. There are numerous potential opportunities of private inurement regarding the sale, compensation, and planned operation of the new nonprofit entity, and we are concerned that these newly designated nonprofit and tax-exempt institutions of higher education are being organized and operated exclusively for undue private interest rather than for the purposes of serving the public.

Code Section 501(c)(3) provides an exemption from federal income tax for organizations that are "organized and operated exclusively" for educational purposes, but this exemption is conditioned on the organization being one for which "no part of the net earnings of which inures to the benefit of any private shareholder or individual."[1] If these newly created tax-exempt institutions

[1] 26 U.S.C. § 501(c)(3).

enter into third-party contracts with for-profit entities operated by individuals who operated - or who were financially linked to - the for-profit colleges prior to conversion, then those individuals still directly and substantially profit from student and taxpayer dollars that flow to the new "tax-exempt" institution. In fact, the entire transaction would appear to be conducted in order to evade and avoid taxation in violation of the Code.

Recently announced conversion attempts raise the need for additional inquiry and scrutiny. In March 2017, the nonprofit and tax-exempt Dream Center Foundation ("Dream Center") announced plans to purchase Education Management Corporation's (EDMC) for-profit college portfolio (including 31 Art Institute schools, and the Argosy University and South University systems),[2] despite EDMC's history of predatory recruiting practices that resulted in a $95.5 million settlement with the Departments of Education and Justice.[3] The Dream Center, which has never managed an institution of higher education, plans to purchase the EDMC's for-profit college portfolio for $60 million.[4]

On March 5, 2018, Purdue University ("Purdue"), a nonprofit and tax-exempt institution, received approval from its accreditor, the Higher Learning Commission (HLC), to acquire for-profit Kaplan University ("Kaplan"), its 15 campuses and learning centers, approximately 32,000 students, and its approximately 3,000 employees. Purdue also announced that Kaplan's former holding company would operate as newly created Purdue Global, a fully-online extension of the Purdue system, which would contract with Purdue and fulfill services such as marketing, online technology, student financial aid, student recruiting and other general administrative and financial functions, while Purdue will maintain responsibility for academic functions. [5] How this separation would work in practice, however, is not clear, as the academic functions of an institution of higher education are intrinsically connected to and impacted by the non-academic functions. For example, a college's academic quality is directly tied to the budgetary resources the institution can commit to teaching and student support. Therefore, if Kaplan maintains any decision-making power over the budget, they have indirect control over the academics of the institution.

On March 6, 2018, Grand Canyon University (GCU), a for-profit college based in Arizona, received approval from HLC to convert to nonprofit and tax-exempt status,[6] despite being denied

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[2] Smith, A.A. (2017, March 6). "New nonprofit owner for EDMC." *Inside Higher Ed.* Online at: https://www.insidehighered.com/news/2017/03/06/large-profit-chain-edmc-be-bought-dream-center-missionary-group.

[3] Department of Justice. (2015, November 16). "For-profit college company to pay $95.5 million to settle claims of illegal recruiting, consumer fraud and other violations." The United states Department of Justice. Online at: https://www.justice.gov/opa/pr/profit-college-company-pay-955-million-settle-claims-illegal-recruiting-consumer-fraud-and.

[4] Moore, D. (2017, October 18). "EDMC completes sale of schools to Dream Center." *Pittsburgh Post-Gazette.* Online at: http://www.post-gazette.com/business/career-workplace/2017/10/18/EDMC-completes-sale-of-schools-to-Dream-Center-Art-Institute/stories/201710180113.

[5] Purdue University. (2018). "Purdue University Global taking shape as final approval is granted by accreditor." *Purdue University.* Online at: https://www.purduenewu.org/.

[6] Thomason, A. (2018, March 6). "On its 2nd try, Grand Canyon U. gets the green light to become a nonprofit." *The Chronicle of Higher Education.* Online at: https://www.chronicle.com/article/On-Its-2nd-Try-Grand-Canyon/242752?cid=wcontentlist_hp_latest.

by HLC merely two years prior.[7] Under the plan submitted to the HLC, Grand Canyon Education, Inc. (GCE), which owns and operates GCU, would sell certain academic-related assets to a tax-exempt entity that will carry the GCU name, and then continue to operate a for-profit entity that will "operate as a third-party provider of educational and related services to GCU."[8] The level of independence of these GCU-related for-profit entities remains unclear, but a similar organizational structure was proposed during GCU's failed sectoral change application in 2016.[9] In fact, in a January 2018 interview, GCU President Brian Mueller acknowledged, "(t)his is an identical structure to what we proposed the first time."[10] In HLC's dismissal letter of GCU's 2016 application, the agency noted a lack of evidence that the college would serve students instead of shareholders.[11]

There is little evidence that GCE is taking steps or has a long-term plan to sever the financial relationship between its for-profit and planned tax-exempt arms. Whether individuals will serve on both governing boards, whether the current President will be in charge of one or both of the organizations, and who is in charge of decision-making processes at each organization remain open questions. If any operational or financial relationship between the two entities and associated individuals persist, the profit-seeking goals of the for-profit arm could directly impact the decisions of the nonprofit and tax-exempt educational institution.

In March 2018, Ashford University announced plans to also seek nonprofit status.[12] Ashford University has faced significant legal issues around their deceptive recruitment of veterans and servicemembers, resulting in on-going investigations by several state attorneys general.[13] Bridgepoint Education, which owns Ashford University and the for-profit University of the Rockies, announced its intention to merge these two institutions (collectively to be known as Ashford University) and will seek to convert the new Ashford into a nonprofit and tax-exempt entity. Bridgepoint would then operate separately as an Online Program Management company and contract with Ashford as its first client.[14]

These conversions and attempted conversions create significant opportunities for these companies to skirt federal regulations targeted at addressing predatory actions by for-profit institutions at the expense of students and taxpayers.[15] Sectoral conversions also create clear opportunities for associated individuals to continue to unjustly profit personally as a result of their institutions' conversion to tax-exempt status. For example, the Dream Center was only able

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[7] Kelderman, E. (2016, March 4). "Accreditor rejects Grand Canyon U.'s bid to turn nonprofit." *The Chronicle of Higher Education.* Online at: https://www.chronicle.com/article/Accreditor-Rejects-Grand/235608.
[8] Grand Canyon University. (2018, March 6).
[9] Kelderman, E. (2016, March 4).
[10] Smith, A.A. (2018, January 8). "Second attempt at becoming a nonprofit." *InsideHigherEd.* Online at: https://www.insidehighered.com/news/2018/01/08/grand-canyon-u-again-tries-become-nonprofit.
[11] Kelderman, E. (2016, March 4).
[12] Fain, P. (2018, March 13). "Ashford seeks to become a nonprofit." *InsideHigherEd.* Online at: https://www.insidehighered.com/news/2018/03/13/ashford-university-latest-big-profit-attempt-nonprofit-conversion.
[13] Douglas-Gabriel, D. (2017, November 29). "California attorney general sues for-profit Bridgepoint Education." *The Washington Post.* Online at: https://www.washingtonpost.com/news/grade-point/wp/2017/11/29/california-attorney-general-sues-for-profit-bridgepoint-education/?utm_term=.4931c543ab69.
[14] Fain, P. (2018, March 13).
[15] Shireman, R. (2015, September 22). "The covert for-profit: How college owners escape oversight through a regulatory blind spot." *The Century Foundation.* Online at: https://tcf.org/content/report/covert-for-profit/.

to support the conversion of EDMC institutions with funding from a private equity investment firm and financing from the family trust of Mr. Brent Richardson. Mr. Richardson, the former chief executive officer of GCU who led their failed nonprofit conversion attempt in 2016, was tapped to manage the Dream Center's higher education portfolio, raising questions about whether he stands to personally profit from the transaction and management of these schools raising the risk of private inurement or private benefit.

Previous sectoral conversions have resulted in financial windfalls for individuals closely connected to for-profit colleges as well. In 2011, for-profit Keiser University in Florida was sold to the nonprofit Everglades College, which was created by the Keiser family to serve as a nonprofit institution. Mr. Arthur Keiser, who served as the president of Everglades College and was a former Keiser University executive, made a $300 million loan to himself in order to complete the purchase. In addition, ten of Everglades College's non-profit campuses paid rent to companies that Keiser had an ownership interest totaling about $14.6 million.[16] The HELP committee, at that time under Senator Tom Harkin's leadership, expressed deep concerns about the conversion.[17]

It is critical that tax-exempt higher education institutions' income, revenue, and assets do not personally enrich executives, administrators, board members, officers, or other institutional insiders at the expense of the students served. To help us better understand the process by which the IRS reviews these types of institutional sectoral conversions, we request a briefing from the Tax-Exempt and Government Entities Division of the IRS on their procedure for reviewing Form 1023. We also reiterate our request that the IRS closely examine these conversation applications from for-profit educational organizations.

We look forward to working with the IRS to ensure these higher education sectoral conversions comply with federal tax law and do not create opportunities for certain individuals to personally benefit from such conversions. If you have any questions, please contact Josh Delaney in Senator Warren's office at (202) 224-4543. Thank you for your attention to this matter.

Sincerely,

ELIZABETH WARREN
United States Senator

RICHARD J. DURBIN
United States Senator

[16] Vasquez, M. (2015, April 23). "Keiser: Not-for-profit but still lucrative." *Miami Herald.* Online at: http://www.miamiherald.com/news/local/education/article19383987.html.
[17] Harkin, T. (2014, February 12). *Letter from Senator Tom Harkin to Commissioner John A. Koskinen, IRS Commissioner.*

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