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August 11, 2021

The Honorable Charles P. Rettig
Commissioner
U.S. Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

Dear Commissioner Rettig:

I write to submit the following supporting documentation for the Committee's referral to the Internal Revenue Service (IRS) regarding the activities of Grand Canyon University (GCU), currently a 501(c)(3) tax-exempt organization.

The U.S. Government Accountability Office (GAO) recently investigated the process through which for-profit educational institutions convert to non-profit status and found serious shortcomings, such as the possibility of insiders taking advantage of non-profit institutions at student and taxpayer expense.¹ These issues, combined with concerns raised at a hearing before the Committee,² suggest that the IRS should revisit and review previous approvals of GCU's 501(c)(3) exemption.

The requisite Form 13909 is enclosed with this letter.

Summary

GCU was previously doing business as Gazelle University, which received 501(c)(3) exemption approval in 2015. This referral describes GCU activity that appears to violate the requirements of tax-exemption, namely engaging in commercial, for-profit business activities for the benefit of Grand Canyon Education, Inc., a for-profit corporation. This referral requests that the IRS revisit and review its previous approval of 501(c)(3) exemption to GCU.

GCU is engaged in commercial, for-profit business activities.

Gazelle University received 501(c)(3) exemption status in 2015. In 2018, Gazelle University purchased the assets and operations of GCU, which was owned and operated by Grand Canyon Education, Inc. (GCE), a

¹ See U.S. Gov't Accountability Off., GAO-21-89, *Higher Education: IRS and Education Could Better Address Risks Associated with Some For-Profit College Conversions*, 39 (Dec. 31, 2020).

² See *For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud*, Hearing Before the H. Comm. On Educ. and Labor, 117th Cong. (2021), <https://edlabor.house.gov/hearings/for-profit-college-conversions-examining-ways-to-improve-accountability-and-prevent-fraud>.

Delaware publicly traded corporation. After the purchase of GCU, Gazelle changed its name to “Grand Canyon University.” For the purposes of this referral, Gazelle and GCU are the same entity and will be referred to as “GCU,” which continues to have 501(c)(3) exemption status under the Internal Revenue Code.

In order to be tax-exempt under section 501(c)(3) of the Internal Revenue Code, an organization must be organized and operated exclusively for an exempt purpose.³

As the United States Tax Court stated in *Intl. Postgraduate Foundation*, “[w]hen a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if it furthers other exempt purposes.”⁴

Your agency’s own guidance outlines several key factors to consider whether an institution is overly reliant on a for-profit, such as whether the entity:

- 1) Purchases everything it needs to operate from a for-profit management company;
- 2) Is severely impaired in its ability to remove itself from the management agreement, due to the consequences of removal and its reliance on the for-profit;
- 3) Is totally dependent on one for-profit company for its operation; or
- 4) Has ceded too much control of its operations to the for-profit, such that the educational institution only operates at the for-profit’s sufferance.⁵

GCU’s conduct appears to violate the requirements of a 501(c)(3) exempt organization because, as outlined below, it is not organized and operated exclusively for an exempt purpose, and it fails several of the factors outlined in the IRS’ analysis of private benefit under section 501(c)(3).

GCU and GCE are inextricably linked financially for the benefit of GCE.

Since the sale of GCU from GCE to Gazelle University, the finances of these entities have been intertwined. One of the main vehicles of the sale was a Master Services Agreement (MSA)⁶ between GCU and GCE in which GCU purchased many services from GCE for an initial term of 15 years with 5-year automatic renewals, potentially in perpetuity.⁷ It costs GCU approximately \$686 million more to outsource these services to GCE

³ See “Exception Requirements for 501(c)(3) Organizations,” Internal Revenue Service, available at <https://www.irs.gov/charities-non-profits/charitable-organizations/exemption-requirements-501c3-organizations>.

⁴ See *Intl. Postgraduate Med Foundation v. C.I.R.*, 56 T.C.M. (CCH) 1140, 1989 WL 3808 (Tax 1989) citing *Better Business Bureau v. United States*, 326 U.S. 279, 283 (1945) and *Nat. Ass’n. of American Churches v. Commission*, 82 T.C. 18, 28-29 (1984) which conclude that “the existence of a ‘single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes’”.

⁵ See generally Megosh, Scollick, Salins, Chasin, “H. Private Benefit Under IRC 501(c)(3),” available at <https://www.irs.gov/pub/irs-tege/eotopich01.pdf>.

⁶ See Review of the Change in Ownership and Conversion to Nonprofit Status of Grand Canyon University OPE ID: 00107400, the U.S. Department of Education, Federal Student Aid, November 06, 2019, available at <https://s3.documentcloud.org/documents/6548148/Grand-Canyon-University-Decision-on-CIO-11-06-19.pdf> (hereinafter “CIO Letter”); reaffirmed in Reconsideration Review of the Change in Ownership and Conversion to Nonprofit Status of Grand Canyon University OPE ID: 00107400, U.S. Department of Education, Federal Student Aid to Grant Canyon University, January 12, 2021, available at https://drive.google.com/file/d/16MAy_o2-nRoYh18MAmLLmBakEVRm7GKX/view (hereinafter “CIO Reconsideration”).

⁷ See CIO Letter, pgs. 2-3. These services include marketing, enrollment, student support, counselling, technology, document intake, student records management, curriculum services, accounting services, financial aid services, procurement services, audit services, human resources, business analytics services, faculty operations, compliance monitoring and audits.

than if GCU performed these services in-house, which Gazelle was doing prior to the sale. This suggests that the services fees GCU pays to GCE include a considerable mark-up and that a significant portion of GCU's revenue is being used to benefit GCE.⁸ GCU also submitted a draft Amended and Restated Master Services Agreement ("ARMSA") to the Department of Education (Department), but without substantial changes to address these concerns.⁹ As such, the Department rejected GCU's request to be considered a non-profit institution for purposes of the *Higher Education Act*.¹⁰

Additionally, GCU is indebted to GCE for over \$800 million for the initial sale transaction.¹¹ In addition to the services fees that GCU must pay to GCE under the MSA, when payments on the debt are included in the analysis, GCE will receive approximately 95% of GCU's revenue.¹² Furthermore, if GCU's revenues increase, GCE has the potential to be paid additional amounts *beyond* the cost the services GCE provides, resulting in additional revenue not being used for a tax-exempt purpose, but rather to benefit GCE and its shareholders.¹³

GCU is a captive client of GCE and cannot remove itself from GCE.

GCE acts as the exclusive provider of the services under the MSA for an initial term of 15 years, with potential for it to continue in perpetuity.¹⁴ If GCU decides to procure services from anyone else, GCU is penalized up to 60% of its Adjusted Gross Revenue from several revenue streams, including tuition, housing, meal plans, and sales from sporting-related merchandize – some of these sources of revenue are completely unrelated to the services provided by GCE.¹⁵ Similar fees are owed if GCU decides not to renew with GCE or to terminate GCE early.¹⁶ And while some of these concerns about the nature of these provisions were considered in the proposed ARMSA, the principle concerns about penalties and revenue-based fees continue.¹⁷ GCU is a captive client of GCE since disentangling itself from GCE is prohibitively expensive.

GCE's profitability as a publicly traded company relies on GCU.

Arguably, GCE would not exist as a profitable, publicly traded company without GCU. GCE's main client is GCU, making up more than 85% of GCE's revenue in 2019.¹⁸ GCE's filings with the Securities and Exchange Commission (SEC) show how reliant GCE is on GCU for revenue as well as for its existence. The 2020 10-K filing discusses several risk factors, all related to GCU: enrollment rates and revenue, GCU's status with the Department of Education as a non-profit entity, and GCU's eligibility to participate in Federal Student Aid

⁸ See *id.* at pg. 5, referencing a report prepared for the Board of Directors of Gazelle University.

⁹ See CIO Reconsideration, pgs. 2-3.

¹⁰ See *id.*

¹¹ See CIO Letter, pg. 2, referencing the Senior Secured Note and Credit Agreement between GCE and Gazelle University for the purchase of GCU.

¹² See *id.* at pg. 14.

¹³ See *id.*

¹⁴ See *id.*

¹⁵ See *id.*

¹⁶ See *id.* at pgs. 3-4.

¹⁷ See CIO Reconsideration, pgs. 3-4.

¹⁸ See GCU Form 990 (2019), Schedule O declares payments to GCE for a approximately \$665 million, listed as "Education Service Fees." See Grand Canyon Education, Inc. (LOPE) 2020 10-K Filing, pg. 79, available at https://www.sec.gov/ix?doc=/Archives/edgar/data/1434588/000155837021001135/lope-20201231x10k.htm#Item1ARiskFactors_246861 (hereinafter GCE 2020 10-K Filing), declaring service revenue for 2019 at \$778 million.

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programs.¹⁹ As outlined by GCE itself, any changes to GCU, its programs, enrollment, and revenue will severely impact the existence of GCE.²⁰

Additionally, there is overlap in the personnel of GCE and GCU. Mr. Brian Mueller acts as both the President of GCU and the Chief Executive Officer of GCE, which results in a conflict of interest: the duty of the GCE CEO is to maximize profits and shareholder returns and the interest of the GCU President is to manage costs and provide adequate services to students.²¹ Several of the employees responsible for GCU were former GCE employees with continued stock interests in GCE, resulting in similar conflicts of interest.²²

Conclusion

Based on the factors outlined by the IRS, GCU's activity appears to violate requirements of tax-exempt status by engaging in commercial, for-profit business activities for the benefit of GCE.

GCU purchases a substantial number of services from GCE in order to operate and is dependent on GCE for its operation. It purchases these services at a markup of hundreds of millions of dollars. Additionally, GCU is severely impaired in its ability to remove itself from GCE due to the prohibitive termination costs, the management agreement, and reliance on the for-profit.

Based on the substantial benefit provided by GCU to GCE, GCU is not operated exclusively for a 501(c)(3) purpose and is arguably a *de facto* for-profit entity operating for the benefit of GCE.

In summary, based on the information provided above and the analysis detailed in the Department's rejection of GCU's request for non-profit status recognition, we request the IRS to review its previous approval of 501(c)(3) exemption to GCU.

Sincerely,



ROBERT C. "BOBBY" SCOTT

Chairman

Enclosures:

IRS Form 13909

Department of Education, CIO Letter

Department of Education, CIO Reconsideration Letter

Cc: The Honorable Virginia Foxx, Ranking Member

Cc: Sunita Lough, IRS Deputy Commissioner of the Tax Exempt and Government Entities Division (TE/GE)

Cc: Grand Canyon University

Cc: Grand Canyon Education, Inc.

¹⁹ See GCE 2020 10-K Filing, pg. 30.

²⁰ See GCE 2020 10-K Filing, pg. 26, Item 1.A. Risk Factors.

²¹ See CIO Letter, pg. 15; see GCE 2020 10-K Filing, pg. 27.

²² See CIO Letter, pg. 16; see GCE 2020 10-K Filing, pgs. 68, 89 (discussing former GCE employees that became GCU employees and their stock options and vesting schedules).