



Statement Before the House Committee on Education and Labor
On For-Profit College Conversions
Andrew Gillen, Ph.D.
4/20/2021

Chairman Scott, Ranking Member Foxx, and esteemed members of the committee, thank you for giving me the opportunity to testify on this important topic.

The recent Government Accountability Office report *IRS And Education Could Better Address Risks Associated with Some For-Profit College Conversions* provides valuable insight into issues regarding insider involvement when for-profit colleges undergo conversion into nonprofit colleges.

As the report notes, there is nothing inherently wrong with either converting from a for-profit college to a nonprofit college or with having insider involvement.

Valid reasons for converting from a for-profit college to a nonprofit college include allowing students to obtain eligibility for state financial aid grants, avoiding bias in perceptions of educational quality, and overcoming local resistance to expansion.

Insider involvement could occur when an individual is a decision-maker at both the buying and the selling institution. For example, if the college president of a for-profit college is also the president of the nonprofit purchasing the college, they would be considered an insider. The main benefit to insider involvement is the maintenance of institutional memory, stability, and continuity.

But while there is nothing inherently wrong with conversions, even when they involve insider involvement, the involvement of insiders does raise the potential issue of improper benefit, where insiders use their decision-making authority to benefit themselves. For example, an insider could agree to an inflated purchase price (as the purchaser) that would benefit the insider (as the seller).

Both the Internal Revenue Service (IRS), enforcing the Internal Revenue Code, and the Department of Education (ED), enforcing the Higher Education Act, forbid insiders from improperly benefiting from any nonprofit, including colleges that convert from for-profit to nonprofit. The GAO report examines recent conversions to probe IRS and ED enforcement of these prohibitions.

The report identified several areas where either the IRS or ED would benefit from additional information to inform their decisions. Two of the three GAO recommendations involve either establishing or consistently following existing procedures to determine if there is improper benefit. These recommendations are sensible, and both the IRS and ED have agreed to implement these recommendations.

To assist IRS, ED, GAO, and this committee, I wanted to raise several issues for further consideration.

First, the GAO recommends that the IRS collect additional information from nonprofits regarding any past for-profit ownership, but this recommendation is likely premature. A proper cost benefit test

should be conducted before implementing this recommendation. I am skeptical that this recommendation would pass such a cost benefit test. The benefits of this information collection would be negligible, while the costs would be non-negligible. All conversions are already required to inform and secure the approval of ED, so new collections by the IRS would be duplicative. In addition, there are very few conversion attempts each year. Over a nine-year period, there were only 20 conversion transactions, some of which involved multiple colleges. GAO estimates that insider involvement may be present in around one third of these. This means that most years will see 0 or 1 conversions involving insiders. Thus, adding questions to annual IRS filings could potentially entail asking for additional information from 300,000 nonprofit organizations when this information is only relevant for a handful of them and the necessary information is already collected by ED.

Second, GAO, IRS, and ED would all benefit from distinguishing among the types of improper benefits to insiders and when those potential benefits should be evaluated. The most common types of insider benefit are 1) paying an inflated purchase price, 2) borrowing from insiders to make the purchase with unfavorable loan terms, 3) leasing land from insiders at inflated prices, and 4) paying inflated prices for services from firms owned by insiders. The IRS and ED should not investigate all four types of improper benefit in the same manner. The sale price and the financing should be evaluated for improper benefit at the time of the transaction, and only at the time of the transaction. Analyzing the sale price or loan terms years later is inappropriate because after the transaction, too many factors could affect the value of a college for an ex-post analysis to yield reliable information about whether the transaction terms were fair at the time. In contrast, paying inflated prices for leases or services should be investigated both at the time of the transaction and on an ongoing basis. But paying inflated prices for leases or services to insiders is a danger at all nonprofits and should be monitored using the same procedures used for all other nonprofits. Thus, I disagree when the report implies that ED should extend its review “beyond the initial approval of nonprofit applications.” The initial approval is the only time that improper benefit from sale and financing terms should be evaluated, whereas improper benefit from leasing and services should be evaluated for all nonprofit colleges on an ongoing basis. If extended reviews consistently expose improper benefit to insiders due to inflated prices for leasing and services, then that is an argument for enhancing data collection for all nonprofit colleges.

Third, ED is increasing student confusion. For a for-profit college to convert to a nonprofit college, it needs IRS approval to become a tax-exempt organization, and then to meet several additional requirements for ED to consider the organization a nonprofit college. These approvals can be years apart, resulting in a situation where a college is tax-exempt according to the IRS, but is not yet considered a nonprofit college by ED. Unfortunately, ED’s proposed restrictions would forbid a college that has tax-exempt status from referring to itself as a “nonprofit institution” in the name of reducing confusion. Yet the vast majority of the general public, including potential students, likely associate the term tax-exempt with the term nonprofit, so this restriction may increase rather than decrease confusion. There is no clear solution since a tax-exempt (according to the IRS) but for-profit (according to ED) college should not exist in theory yet does in practice. But I am skeptical that outlawing truthful statements is the best approach.

Fourth, regulatory arbitrage is an underappreciated factor in conversions because the value of some colleges can be substantially increased by conversion. Recently, states such as California, New York, Maryland, Oregon, and Maine have moved to impose additional burdens on for-profit universities within their borders.¹ For-profit colleges with operations in these states, or colleges wishing to expand into these states would face fewer obstacles by undergoing a conversion into a nonprofit college. At the federal level, there are often additional regulations applied to for-profit universities. For example, the 90-10 rule limits the share of revenue that for-profits can obtain from the federal government. And the short-lived Gainful Employment regulations heavily targeted programs at for-profit universities. These additional regulations targeting for-profit universities can increase the appeal of conversions since the value of a nonprofit college not subject to these additional regulations may be substantially higher than the same college as a for-profit.

Fifth, a better accountability system would provide the best protection against insiders extracting improper benefits. If we had a comprehensive and transparent accountability system, it would be much harder for insiders to extract improper benefits for two reasons. One, with more and more precise metrics of outputs and outcomes, the value of any given college would be less reliant on subjective valuations, making it harder for insiders to benefit from an inflated sales price. Two, once colleges are competing based on better defined and measured outputs and outcomes, there would be constant pressure to eliminate improper insider dealing due to healthier competition among colleges. Because there is too little information on college outputs or outcomes, colleges are locked into the Revenue Theory of Costs, also known as Bowen's laws.² *Introducing Bennett Hypothesis 2.0*³ contains a more detailed explanation of Bowen's laws, but to briefly summarize, because college quality cannot be observed, colleges compete to increase prestige or perceived quality. There is no limit to activities that can increase prestige, so there is no limit to the revenue that colleges will seek. Whatever revenue they raise will be spent (hence the name revenue theory of costs), and the end result is that colleges are locked in a never ended academic arms race to spend as much money as possible in the pursuit of prestige. This has absolutely devastating consequences for important issues like college affordability. But it also means that it is relatively easy for insiders to hide excessive spending.

Improving the accountability system could free higher education from Bowen's laws. Fortunately, ED has recently started releasing data that could truly revolutionize higher education accountability. Specifically, ED's College Scorecard dataset contains program level (e.g., the bachelor's in political science program at Ohio State University would be one program) data on student loan debt and post-graduation earnings for recent college graduates. This would allow for two dramatic improvements in our approach to college accountability.

The first improvement is to facilitate a transition from an institution (college wide) accountability framework to a program level accountability framework. The existing institution framework applies

¹ See for example Ashley A. Smith, States Seek Tighter Regulation of For-Profits, Inside Higher Ed, March 14, 2019. <https://www.insidehighered.com/news/2019/03/14/bills-california-and-several-other-states-would-tighten-regulation-profit-colleges>

² Howard R. Bowen, *The Costs of Higher Education*, Jossey-Bass Publishers, 1980.

³ Andrew Gillen, *Introducing Bennett Hypothesis 2.0*, Center for College Affordability and Productivity, 2012.

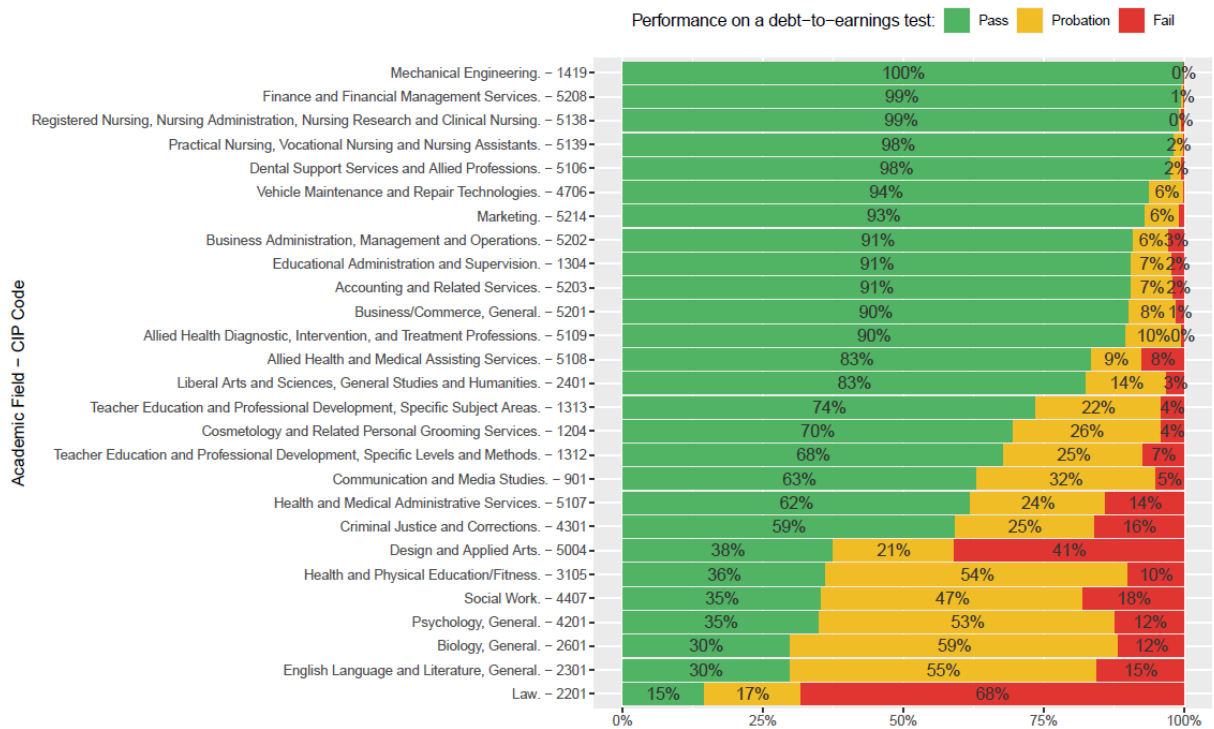
accountability mechanisms such as accreditation and Cohort Default Rates to entire institutions. But an institution wide approach punishes good programs at “bad” colleges while letting bad programs at “good” colleges off the hook. A program level accountability system would avoid both issues.

The second improvement is the ability to hold colleges accountable for the labor market outcomes of their graduates. Programs that consistently leave students with excessive student loan debt that they cannot afford to repay should be held accountable.

My organization has been using the College Scorecard data to enable policymakers to design new program level accountability systems. One of our accountability metrics updates the old Gainful Employment debt-to-earnings tests, which we call Gainful Employment Equivalent.

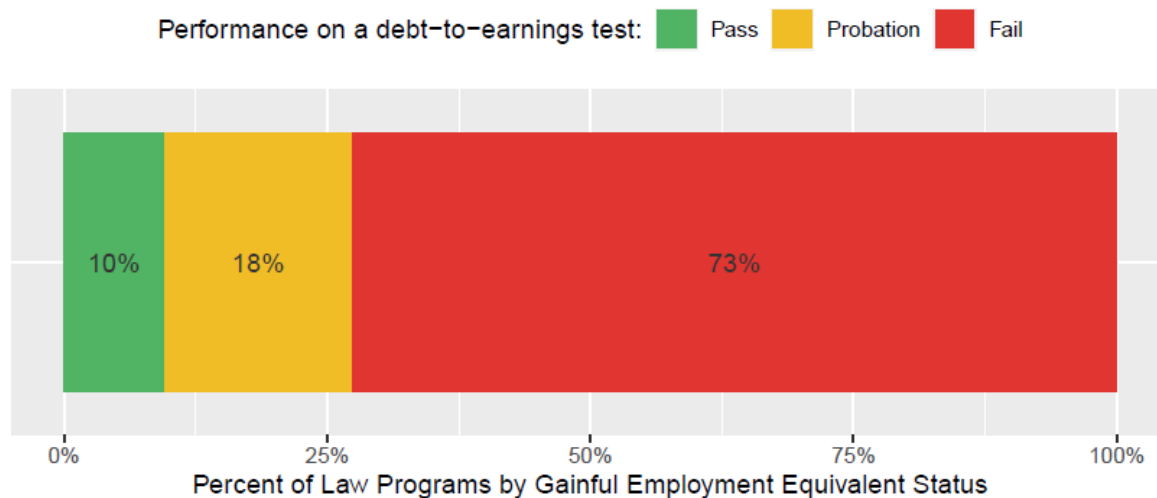
For example, we analyzed the performance of the largest academic fields by conducting the Gainful Employment Equivalent tests on all programs with earnings and student loan debt. We then grouped programs by academic field and aggregated each field’s performance, weighting each program by the number of graduates who received federal financial aid and worked one year after graduation (referred to simply as graduates hereafter for simplicity). The figure below shows wide variation in debt-to-earnings outcomes by academic field. In many fields, such as mechanical engineering, nursing, and vehicle maintenance and repair, 90% or more of recent graduates received their degree from a program passing Gainful Employment Equivalent. However, some fields had much worse outcomes. In the fields of social work and biology, for instance, only around a third of recent graduates completed at a program passing Gainful Employment Equivalent.

Which Academic Fields Prepare College Graduates for Success?



Law stood out as the academic field with the worst outcomes, so we performed an in depth analysis of professional degree programs in law. We found that only 10% of law schools pass Gainful Employment Equivalent as seen in the figure below (reproduced from *Objection! Law schools can be hazardous to students' financial health*).⁴

How Well Do Law Programs Perform?



Note. Data from U.S. Department of Education and author's calculations.

We have also looked at performance by university rather than by academic field. For example, to help inform Texas policymakers, we analyzed the student loan debt and earnings for all public universities in Texas, and found 58 programs that left their students with excessive debt.⁵

We are currently analyzing the most recent data from ED, and will soon be releasing research that updates and expands on these analyses.

Thank you again for the opportunity to provide this testimony and I look forward to answering any questions you may have.

⁴ Andrew Gillen, *Objection! Law schools can be hazardous to students' financial health*, Texas Public Policy Foundation, 2020.

⁵ Thomas K. Lindsay and Andrew Gillen, *Which Texas Public College Degrees Require Excessive Student Debt?*, Texas Public Policy Foundation, 2020.