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LABOR AND HUMAN RESOURCES
JUDICIARY
BUDGET
INDIAN AFFAIRS

United States Senate

WASHINGTON, DC 20510–1302

July 18, 1996

The Honorable Margaret M. Richardson
Commissioner, Internal Revenue Service
1111 Constitution Ave., N.W., Suite 1112
Washington, D.C. 20224

Dear Commissioner:

I am writing with serious concerns regarding the activities of a number of "non-profit and charitable" organizations[1] participating in the federal student loan program. These so-called "guaranty agencies" pose significant risks for taxpayers and in some cases are operating at the boundaries of the tax rules, if not outside of the rules.

Primarily serving as fiscal intermediaries for the U.S. Department of Education, guaranty agencies administer the federal default insurance on bank loans to college students.[2] They act as the government's loan police, checking to see that participating schools, students, and banks are in fact eligible to participate. Their most important responsibility is preventing defaults, including checking to ensure that banks actually try to collect on the loans before they ask for reimbursement of a default.

These organizations deserve particular IRS scrutiny because of their mission, structure, financing, and the federal funds they hold in trust ($1,849,130,416 as of the end of fiscal year 1995, according to the Education Department). Unlike most non-profit organizations, these groups generally do not have members or contributors whose money is at stake; instead, they rely almost exclusively on taxpayers and students -- primarily in the form of federal entitlements -- for their base of "contributions." Because these agencies do not solicit the public for contributions, most state attorneys general do not review their operations. And the agencies do not have member-elected boards of directors carefully watching how they spend their money.[3]

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[1]Designated under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended.

[2]The U.S. General Accounting Office (GAO) has pointed out that the term "guarantor" is a misnomer, because "almost all of the risk associated with guaranteeing student loans...is borne by the federal government." *Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement*, March 1993. ("GAO 1993" hereafter).

[3]For example, USA Group is a membership organization under Indiana law, but "is not a membership organization in the traditional sense of such usage," according to the organization's application for tax-exempt status.

(continued...)

462 DIRKSEN BUILDING
WASHINGTON, DC 20510–1302
202/224–2152
TDD: 202/224–5469

230 S. DEARBORN
KLUCZYNSKI BLDG., 38TH FLOOR
CHICAGO, IL 60604
312/353–4952
TDD: 312/786–0308

3 WEST OLD CAPITOL PLAZA
SUITE 1
SPRINGFIELD, IL 62701
217/492–4960
TDD: 217/544–7524

250 WEST CHERRY
ROOM 115–B
CARBONDALE, IL 62901
618/457–3653

Since they serve the government, not a membership, it is particularly important for the IRS to ensure that they are not abusing the privileges they receive under their non-profit designations. IRS scrutiny is critical because if something goes wrong, the taxpayers foot the bill.

This letter details what I have learned about one guaranty agency, USA Group of Indianapolis, Indiana. The serious abuses that I have uncovered point out the need for the IRS to better police all guaranty agencies.

Background on USA Group and Affiliates

United Student Aid Funds (USAF) began with noble intentions in 1960, a private group that sought contributions from the public in order to guarantee bank loans to needy college students.[4] When Congress was considering a federal program to guarantee student loans, USAF and the American Bankers Association pushed for a state-based approach.[5] After Congress took USAF's advice by guaranteeing loans through state-based guaranty agencies,[6] USAF jumped in to administer a number of the programs on a contract basis. As a result, in 1966, the first year of the new federal program, the Office of Education authorized more than $3 million in advance funds for USAF.[7]

But the decentralized, shared-risk approach did not meet the demand for loans. According to GAO, "financial backing from the states was virtually nonexistent from the outset and many did not establish guaranty agencies." In 1976, Congress responded by requiring the U.S. Department of Education "to assume virtually 100 percent of program costs, while still

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[3](...continued)
It goes on to explain that "the directors of the corporation are the sole members of the corporation." USA Group Form 1023 filed with the IRS on November 6, 1990, exhibit VI. (Hereafter "USA Group Form 1023").

[4]USAF's founding -- and current -- purpose, as far as the IRS is concerned, is as an "indorser or guarantor on bank loans to needy and deserving students." Form 1023 filed by USAF on October 27, 1960, question 10-I. The organization was also assisting another entity in a similar guarantee effort (question 8-k).

[5]According to a USA Group history available on the organization's Internet web page, in 1965 "USA Funds and the American Bankers Association led successful effort to amend the Higher Education Act, shifting significant portion of the administration of the student loan programs from the federal government to the states" [http://www.usagroup.com/aboutusa/hist.htm, page last revised September 24, 1995, hereafter "USA Group web page"]. See also statements of Allen D. Marshall, USAF president, before the U.S. Senate Subcommittee on Education (June 3, 1965) and the U.S. House of Representatives Special Subcommittee on Education (February 5, 1965).

[6]In the Higher Education Act of 1965.

[7]"OE Contract USAF for Various States (As of March 22, 1967)," an undated document provided by the U.S. Department of Education.

requiring a network of guaranty agencies to help administer the program."[8] In 1977, with risk-sharing gone but decentralization still the law,[9] USAF became a guaranty agency (in addition to continuing as a contractor). It is now the largest federal guaranty agency, with nearly $4.5 billion in loan commitments in 1993.[10]

In 1982, USAF incorporated a sister non-profit organization to service student loans for banks, the Education Loan Servicing Center (**ELSC**). Although the Inspector General and GAO have raised conflict-of-interest concerns about guarantors also serving as loan collectors for banks,[11] USAF and other guarantors continue to develop and expand such operations. In fact, ELSC grew precisely because of the link between loan collection and the guarantee.[12]

In 1990, USAF began an expansion that included the creation of **USA Group** as an umbrella organization, and a number of other new subsidiaries, both for-profit and non-profit, much of them outside of the student loan business. USA Group recently changed the names of a number of its affiliates. I have attached a copy of a page from USA Group's 1995 Annual Report which indicates the old and new names.

Findings

A review of tax filings, annual reports, and other documents prepared by USA Group and its affiliates reveals that the organization has failed to disclose its lobbying activities to the IRS, pays excessive salaries to its management, and has violated the spirit, if not the letter, of its tax-exempt status by overcharging taxpayers $40.3 million, extending its operations beyond its charter, and engaging in substantial for-profit activity within non-profit organizations without paying unrelated business income taxes.

1. USA Group has vastly under-reported its lobbying expenditures.

If charities choose to lobby, they are limited in the amount of money they may spend, and no more than 25 percent of it may be of the "grassroots" variety. The cap varies depending on the size of the organization, but in no case may it exceed $1 million. The definition of "lobbying" is fairly broad, encompassing attempts to influence elected officials, staff, and even

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[8]GAO 1993, p. 12. USAF admits a "major role" in the passage of the 1976 amendments. USA Group Internet web page.

[9]The industry has implied that "risk-sharing" has returned with the passage of the Student Loan Reform Act of 1993. But guaranty agencies still receive *all* of their funding from federal grants and entitlements, and investment earnings on those funds. (See U.S. General Accounting Office letter to Chairmen Kassebaum and Goodling, March 11, 1996).

[10]U.S. Department of Education, *Report for Congress on Guaranty Agencies*, May 1994, p. 21. ("*Report for Congress*," hereafter).

[11]See text at footnotes 50 to 52.

[12]See text at footnote 48.

the general public (grassroots lobbying).[13]

It would not be a surprise to find that USA Group spent a considerable amount on lobbying while Congress considered a plan to completely overhaul the student loan system. Indeed, the *Indianapolis News* reported that the group planned to spend $750,000 in 1993 to beat back the direct lending plan in Congress.[14] But strangely, this spending did not appear on USA Group's tax filings for either 1993 or 1994.

In 1993,[15] USA Group claims that it spent no money on grassroots lobbying, and only $88,000 on direct lobbying. However, other items in the public domain show that USA Group officials clearly spent more than they disclosed to the IRS, and that the total could easily exceed the $1 million limit. A substantial portion, if not all, of the following expenses should have been reported on the tax forms filed by USA Group and its affiliates for 1993:

➔ USA Group's tax filing for that year shows a payment of $410,101 to Akin, Gump, a lobbying and law firm. Steven Waldman, a journalist who followed the 1993 debate, described how USA Group hired the firm to lead their lobbying efforts against direct lending: "At roughly $20,000 a month, USA Group...hired Akin, Gump -- the lobbying firm of 'Mr. Democrat' Robert Strauss, the former chairman of the Democratic Party, and Vernon Jordan, head of Clinton's transition operation. The firm assigned the account to Kirk O'Donnell, a former top aide to Tip O'Neill."[16]

➔Reports filed with the Secretary of the Senate also confirm Waldman's account that "USA Group also hired Walker/Free Associates, run by James C. Free, a former Carter White House official and Clinton golf partner; and Sagamore Associates, the lobbying arm of the law firm Baker and Daniels."[17]

➔USA Group's tax filing shows salary and benefits of $212,168 paid to Martha D. Lamkin, USA Group's in-house registered lobbyist.[18] She heads the Corporate Affairs Division, which "offers insight and information to policymakers, the news media, and

[13]IRS 1992 Instructions for Schedule A (Form 990), p. 5.

[14]Eileen Ambrose, "Loan guarantor goes into battle: Fishers' USA Group fights plan to turn to direct student lending," *Indianapolis News*, June 22, 1993, page D-1.

[15]USA Group's fiscal years end each September 30. When this letter cites a tax document for a particular year, it refers to the fiscal year ending on September 30 of that year. For example, "1993 Form 990" means the form covering the year ending September 30, 1993 (even if the form itself says "1992").

[16]Steven Waldman, *The Bill: How the Adventures of Clinton's National Service Bill Reveal What Is Corrupt, Comic, Cynical -- and Noble -- About Washington* (New York: Penguin Books, 1995), p. 56.

[17]Waldman, pp. 56-7.

[18]Reports filed by Lamkin with the Secretary of the Senate under the Federal Regulation of Lobbying Act (which has a much narrower definition of lobbying than the IRS definition) show that she had "ongoing legislative interests" beginning in May 1993.

program participants to help ensure that policy decisions are informed decisions."[19]

→USA Group created the Coalition for Student Loan Reform (**CSLR**) to lobby against direct lending.[20] The coalition is operated out of the Washington, D.C., offices of the Widmeyer Group, which bills itself as a "full-service public affairs and media relations firm" which helps clients "win policy battles [and] shape public debate."[21]

→USAF offices participated in a grassroots effort that netted more than 400 letters to Members of Congress from colleges and professional associations.[22]

On its 1994 tax form, USA Group makes the absurd claim that it spent *nothing* on lobbying at the federal level.[23] That claim directly conflicts with the organization's own annual report, documents filed with Congress, and even other parts of the tax filing:

→In the 1994 annual report, USA Group trumpets its leadership role in CSLR, which "developed a series of specific measures to reform and improve the FFELP **and proposed them to key legislators, the U.S. Department of Education**, and higher education organizations." (emphasis added)[24]

→USA Group's tax filing shows a payment of $85,000 to the CSLR, which was separately incorporated in 1994. As I noted earlier, USA Group admits to playing a "leadership role" in CSLR, Inc.[25]

→With salary and benefits of $273,882, Lamkin continued as a registered lobbyist for USA Group, according to documents filed with the Secretary of the Senate.

→ Reports filed with the Secretary of the Senate show that Terry Muilenburg was hired

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[19]USA Group 1993 Annual Report, p. 29.

[20]USA Group admits its leadership role in forming CSLR in its 1994 Annual Report, p. 7.

[21]Widmeyer group advertisement, *Education Week*, April 24, 1995, p. 17.

[22]The CSLR president made the letters available to the U.S. Senate Committee on Labor and Human Resources at a hearing on May 26, 1993. A number of the letters had been faxed to USAF offices in Indianapolis, Atlanta, and Eagan, Minnesota.

[23]Part VI-A of Schedule A shows $6,789 in lobbying expenditures. Part III shows that this was "for work with the Indiana legislature to secure status as designated guarantor for Indiana."

[24]USA Group 1994 Annual Report, p. 7.

[25]USA Group may be required to count all or part of CSLR's total budget ($351,144 for March-December, 1994, according to CSLR's 990) as USA Group lobbying expenditures. The IRS Instructions for Schedule A (Form 990) assert that "[m]embers of an affiliated group are treated as a single organization for purposes of measuring both lobbying expenditures and permitted lobbying expenditures." (p. 6). The USA Group tax filing reports that two of the five board members of CSLR are USA Group representatives.

as the Washington-based Vice President for Government Affairs of USA Group.[26]

→ A total of $733,064 was paid to Wiley, Rein, Felding, a Washington, D.C., law and lobbying firm.[27]

→$78,438 was paid to Walker Free Associates, a registered lobbyist for USA Group.

→ Sagamore Associates continued as a registered lobbyist for USA Group.

→According to USA Group's annual report, its subsidiary ELSC "also remained active in the national debate and transformation of the FFELP. For example, Senior Vice President Daniel L. Yost participated...to help congressional staff members and the U.S. Department of Education understand the private sector's point of view in the wake of reauthorization of the Higher Education Act and the direct lending debate."[28]

With all of that activity in 1994, it is not clear how much USA Group and its affiliates spent on lobbying. But clearly, USA Group cannot honestly claim *no* lobbying expenses.

2. Excessive salaries eat up millions of dollars that should go to low-income students.

USA Group management salaries are exorbitant by both non-profit organization standards and Indiana standards. The annual increases given to USA Group executives have also been excessive. If instead of its excessive salaries, USA Group had paid its executives no more than the U.S. Secretary of Education earned between 1989 and 1994, nearly $5 million would have been available for the organization's charitable purpose: helping low-income students.[29]

USA Group's chief executive, Roy Nicholson, received a salary and benefits of $695,948 in the group's 1994 fiscal year.[30] That is more than twice the salary of the highest paid official

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[26]USA Group now also employs John F. (Jeff) Whorley in its Washington, D.C. office. A press release dated February 26, 1996, announces his promotion from "director, federal policy" to "vice president, legislative policy." USA Group web page.

[27]According to the USAF and USA Group 1994 Form 990s, $340,197 came from USAF, the remainder from USA Group.

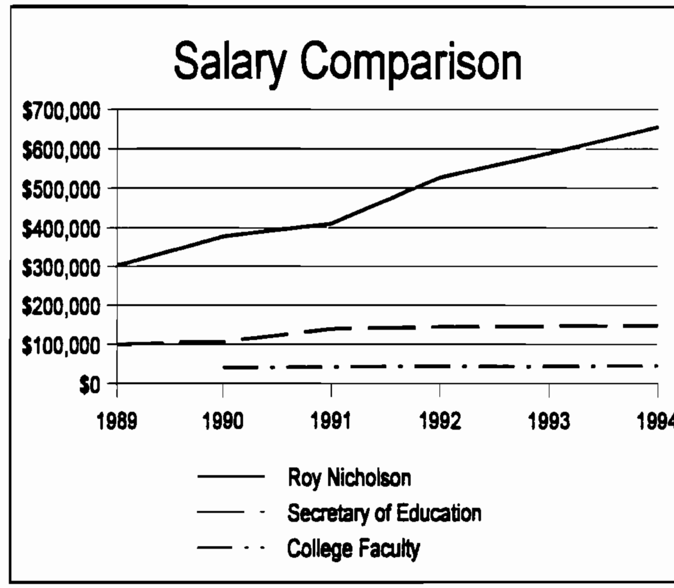
[28]USA Group 1994 Annual Report, p. 16.

[29]The Secretary of Education was paid a salary of $99,500 in 1989, $107,300 in 1990, $138,900 in 1991, $143,800 in 1992, and $148,400 in 1993 and 1994, according to the Congressional Research Service. The salaries reported in Forms 990 filed by USA Group and its affiliates for those years exceeded the Secretary's salary by a total of $4,944,123.

[30]USA Group 1994 Form 990.

at the American Red Cross in 1993.[31] It is 50 percent more than the salary that contributed to William Aramony's downfall at United Way.[32] In 1994, at least 11 of USA Group's executives made more than the Secretary of Education who is responsible for overseeing them.[33]

The group's compensation to its managers is also out of line with other non-profit organizations in Indiana. A study by the *Indianapolis Star* shows that of the top-50 paid non-profit officials in the state, 15 were employed by USA Group or its affiliates.[34] The Lilly Endowment -- the seventh largest foundation in the country[35] -- accounted for only six of the top-50.



USA Group executives' salary *increases* have also been excessive. Nicholson's 1994 salary reflects a one-year increase of 24.5 percent. The organization's general counsel received a 74 percent increase. Tax records show that Nicholson's compensation has more than doubled since 1989. While college professors saw salary increases of only six percent between 1991 and 1993,[36] the top six executives at USA Group saw their salaries increase an average of 43 percent.

USA Group has tried to blunt criticisms of its salaries by promising to limit the amount paid to its executives *from federal funds*.[37] But the funds are fungible, so it accomplishes little to agree to take excessive salaries from the left pocket rather than the right.[38] The point is not that the salaries are coming from federal funds; the point is that USA Group is supposed to be

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[31]The Executive Vice President for Biomedical Services reportedly made $270,080 in 1994. "Compensation of Top Officials at Selected Non-Profit Organizations," *The Chronicle of Philanthropy*, September 7, 1995, p. 36.

[32]Aramony's total compensation was reported as $463,000. *The Washington Post*, February 28, 1992.

[33]Cabinet-level officials have been paid an annual salary of $148,400 since 1993. "Salaries of Federal Officials," Congressional Research Service, 96-108 GOV, February 1, 1996.

[34]From data in Eileen Ambrose, "Non-profit execs' pay hikes dwarfed average Hoosier's," *Indianapolis Star*, December 31, 1995, p. E2.

[35]As measured both by assets and total giving. *The Foundation Directory, 1995 Edition*. Tables 4 and 5.

[36]U.S. Department of Education, National Center for Education Statistics.

[37]February 28, 1996, "confidential" letter from James C. Lintzenich, Executive Vice President of USA Group to Leo Kornfeld of the Education Department.

[38]The next section of this letter demonstrates how funds can easily be moved between subsidiaries.

a charity, and these salaries are not appropriate for the directors of a charity of this sort. "Profits" at a non-profit organization are supposed to be used to further the group's exempt purpose (in this case, helping low-income college students), not for enriching the management.

3. Overcharging taxpayers by $40 million is not a "charitable" act.

When USAF officials first submitted their application to create USA Group, they explained that the new organization would "support" USAF,[39] creating "operating efficiencies" that would allow USAF managers "to concentrate their energies toward their exempt purposes."[40] The IRS was skeptical, and asked some follow-up questions. In response, the management argued that the new structure would improve the "financial condition" of USAF and even suggested that USAF would "profit" from the arrangement.[41]

In fact, the opposite was the case. USAF did not profit from its new arrangement with USA Group. Instead, USA Group and its subsidiaries used the new structure to rob USAF of millions of dollars that were meant to serve the group's exempt purpose of insuring education loans for low-income students. An investigation by the U.S. Department of Education found that USA Group (through another subsidiary, USA Services) was charging USAF more than it would have cost USAF to perform the services itself, directly contradicting USA Group's application for tax-exempt status. As a result of the investigation, USA Group was forced to return $40.3 million to its federal reserve fund.[42]

4. Affiliate admits to serving bank interests, not the needs of the tax-exempt guarantor.

ELSC received its tax-exempt status by saying that it would be a support organization for achieving USAF's exempt purpose.[43] But ELSC's tax filings show that the organization goes far beyond supporting USAF's guarantor function, fully embracing loan servicing -- for banks -- as a tax-exempt function[44]. Whereas banks and other servicers would have to pay taxes on these earnings, between 1986 and 1993 ELSC earned $20,407,004, but appears to have paid no

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[39]Under 509(a)(3) of the Code.

[40]USA Group Form 1023, exhibit IX.

[41]USA Group letter to the IRS supplementing its Form 1023, February 26, 1991, p. 7.

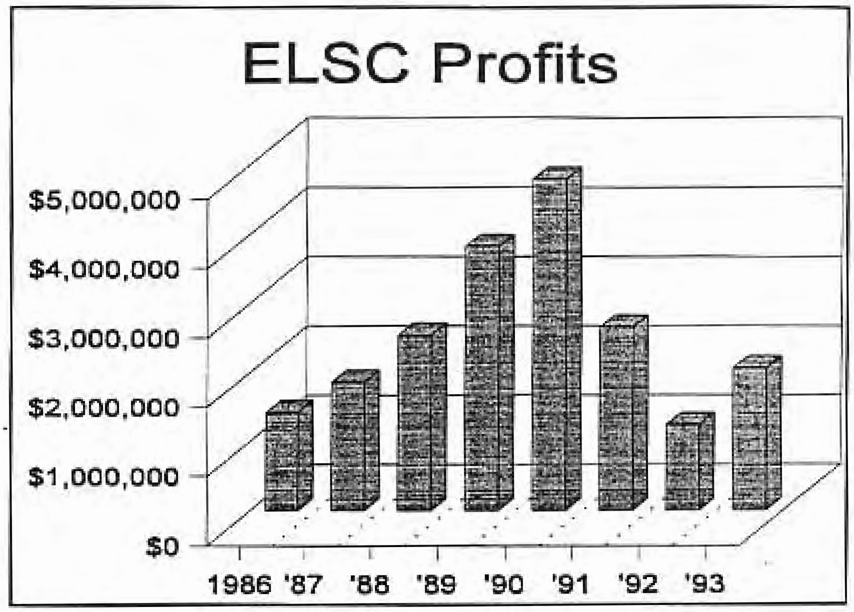
[42]"Most of the $40.3 million represents profits over actual costs charged to and paid for out of USA Funds' federal reserve for work done on behalf of USA Funds by agency affiliates," Education Department press release, March 13, 1996.

[43]According to ELSC's Form 990 (various years) and USA Group's Form 1023.

[44]Form 990 filed for fiscal year 1989 indicates that ELSC "provides data processing, collection, and other assistance to primary lenders, secondary markets, and guarantee agencies in connection with the servicing of educational loans." ELSC further declared that it "does not engage in any trade or business activities which are unrelated to its exempt purpose."

income taxes.[45] In 1994, ELSC's tax-exempt status cost the federal government an estimated $1.5 to $1.8 million in lost tax revenue.[46]

The USAF/ELSC link is also unfair to tax-paying competitors, since "guaranty agencies may give their affiliates unfair advantages," such as pressuring other affiliates to steer business to their loan servicer.[47] USA Group has admitted as much in asserting that a tripling of "loan servicing revenues generated by ELSC" came "primarily as a result of corporate emphasis on linking loan servicing to loan guarantees..."[48]



While ELSC is tax-exempt, it does not act like a charity. In fact, USA Group's annual report boasts that ELSC's *primary mission* is "**to protect the assets of lenders and secondary market holders** while providing timely and efficient service to schools, parents and students." (emphasis added)[49]

To my knowledge, protecting bank assets is not a charitable activity. In fact, loan servicing is fundamentally at odds with the tax-exempt guarantor role. According to the Education Department's Inspector General:

> Affiliations with a FFELP [federal guaranteed] loan servicer, secondary market, or other FFELP service provider compromise a guaranty agency's impartiality in administering

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[45]Revenues minus expenses, from tax returns and balance sheets in bond statement (see footnote 48). Profits dropped in 1991 after some operations were moved to the newly-created USA Group and other subsidiaries.

[46]"[Non-profit loan servicing] costs the federal government roughly 2.5 to 3 basis points per loan in lost tax revenue." Memo from Bill Boger, of Wilkinson, Barker, Knauer & Quinn, Washington, D.C. (firm represents a for-profit servicer), September 29, 1995. USA Group's 1994 Annual Report shows more than $6 billion in loans serviced by ELSC, p. 15.

[47]*ED Should Prohibit Conflicts of Interest Between Guaranty Agencies and Affiliated Organizations*, U.S. Department of Education, Regional Office of Inspector General, Management Improvement Report 93-02, March 15, 1993, p. 5. ("IG 1993" hereafter)

[48]Official Statement, Town of Fishers, Indiana, Economic Development First Mortgage Revenue Bonds (United Student Aid Funds, Inc. Project), September 20, 1989, page 12.

[49]USA Group 1994 Annual Report, p. 3.

> the loan insurance program, and ensuring that lenders exercise due diligence in collecting insured loans.[50]
>
> There is an obvious conflict of interest when a guaranty agency reviews the due diligence practices of its affiliated secondary market or loan servicer. In such cases, the guaranty agency's findings affect its own financial position. The close relationships between the FFELP service providers pose a significant risk that due diligence irregularities could occur and go unreported.[51]

The U.S. General Accounting Office (GAO) has raised the same concern:

> Guaranty agencies have legally extended their activities beyond insuring loans and monitoring lenders to include servicing and purchasing loans. These activities create inherent conflicts of interest because, by assuming ownership and servicing roles, guaranty agencies are, in effect, responsible for regulating their own rather than lender activity...[S]uch activities eliminate the independent oversight for which guaranty agencies are responsible and paid.[52]

Both the Inspector General and GAO cite specific instances where servicing activity has jeopardized loan guarantees. The collapse of the Higher Education Assistance Foundation, which cost taxpayers $280 million,[53] can be attributed in part to HEAF's efforts to expand into other areas such as loan servicing.[54]

This conflict-of-interest problem is further demonstrated by a lawsuit brought by USA Group to prevent the government from establishing loan-collection standards for servicers like ELSC. In the wake of scandals involving servicers that failed to make the minimally required effort to collect on loans,[55] Congress wanted to make sure that servicers do not allow loans to summarily default. This protects the guarantor -- and taxpayers -- from repaying lenders when the loan collection effort was not sufficient. Yet, rather than embracing the standards to protect

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[50]IG 1993, p. 1.

[51]IG 1993, p. 3.

[52]GAO 1993, p. 47.

[53]Neal St. Anthony, "HEAF cost taxpayers $280 million, GAO says," *Minneapolis Star Tribune*, April 24, 1995, p. 5D.

[54]GAO 1993, p. 47.

[55]For example, an audit of one large servicer found that the company's poor performance had caused "unmeasurable hardship to hundreds of thousands of borrowers and has cost guarantors, the United States Government, and taxpayers millions of dollars." Cited in "Abuses in Federal Student Aid Programs," Permanent Subcommittee on Investigations, U.S. Senate Committee on Governmental Affairs, May 17, 1991, p. 24.

USA Funds, USA Group sued to have the standards thrown out.[56] An appellate court found USA Group's primary argument in the lawsuit "so weak as to border on the frivolous."[57]

5. USA Group's own stated purpose no longer fits within its tax-exempt mission.

In their annual Form 990 tax filings, non-profit organizations are asked (in Part VIII) to explain how their income-producing activities meet their exempt purposes. USA Group has dodged the question in recent years. Its 1993 and 1994 filings refer not to the exempt purpose, but to a vague "taxpayer's expressed mission":

> The provision of administrative, systems development, and data processing services to affiliated entities is essential to the taxpayer's expressed mission of supporting the educational finance and credit needs of post-secondary students and schools.

That answer is not appropriate. The question requires the filer to address those activities *"that form the basis of the organization's exemption from tax."*[58] According to its own IRS filings, USA Group was to operate "exclusively in support of USA Funds," whose charitable, tax-exempt purpose is loan guarantees.[59]

USA Group may need to dodge the IRS's question because its activities have grown far beyond its tax-exempt charter. The 1994 annual report takes a rather grand and expansive view of the organization's purpose. It boldly declares that its primary purpose is not just loan guarantees (or even student loans generally), but "providing loan, financial, and information management systems and services for education."[60]

While USA Group calls itself a charity for tax purposes, its self-image is clearly that of a business. USA Group created its lobbying arm, CSLR, as a "business league" -- used by chambers of commerce, real estate boards, and other associations of profit-making entities -- rather than as a social welfare organization. CSLR's application for IRS recognition, signed by Martha Lamkin, USA Group Senior Vice President, describes the lobbying group as "an association of persons having some common business interest, the purpose of which is to

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[56]USA Group 1994 Annual Report, p. 16.

[57]*USA Group v. Riley*, 82 F.3d 708, 5 (7th Cir. 1996). USA Group argued that in requiring the Secretary of Education to establish *minimum* standards for loan collection, Congress meant for the standards to be *minimal*.

[58]IRS Instructions for Form 990 (1994), p. 23.

[59]USA Group was also formed to support ELSC, but the management explained in response to an IRS query, "USA GROUP is operated exclusively in support of USA Funds even though it supports ELSC because ELSC is also a support organization of USA Funds." Letter to the IRS (supplement to Form 1023), February 26, 1991.

[60]1994 Annual Report, p. 1.

promote such common interest."[61] Further evidence can be found on the Internet: USA Group's web page provides a large quantify of information, but my staff could find no reference to the fact that it is a charity or even a non-profit organization.[62]

Given USA Group's expansion into non-exempt activities, and the development and acquisition of for-profit companies (see below), it seems likely that a portion of the USA Group headquarters is used for those non-exempt and non-profit purposes. As I understand it, if that proportion exceeds five percent, then the $45 million in bonds issued in 1989 by the Town of Fishers to finance the headquarters could lose their exemption from federal income tax.[63]

6. USA Group's for-profit companies exceed the size and scope promised in the organization's application for tax-exempt status.

In creating USA Group and planning some for-profit activities, USAF managers promised not to stray from their tax-exempt purposes.[64] In a 1991 letter, they assured the IRS that "the services provided by USA GROUP will not be for unrelated activities and organizations...[it] will all be to organizations related to USA Funds and ELSC." They also claimed that the for-profit subsidiary, USA Enterprises, was *necessary* to protect the tax-exempt status of USAF and ELSC by isolating activities that are related but not exempt from taxation, such as "student loan activities in Canada." USAF managers anticipated that (1) "a very small percentage of USA Group's investments will be in the financing of USA Enterprises," and that (2) the use of USA Group's tax-exempt management services for the for-profit activities "will not be substantial" and that the situation will be monitored to ensure that it "does not become substantial."[65]

By 1994, USA Group had clearly violated both of these assurances: its for-profit activities are substantial and have strayed well beyond the purposes of USAF and ELSC. And the president of USA Group flaunts the organization's expansion. For instance, just before hopping on a plane to meet with the employees of a for-profit subsidiary that USA Group had just acquired, Roy Nicholson told the *Chronicle of Higher Education*, "Our broad vision for the future is that we become a partner to higher education -- a partner not just in financial aid, but

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[61]Form 1024 application dated May 31, 1994, p. 3 of attachment.

[62]USA Group's self description on its web page is "a leader in providing financial, information, and management services to the people pursuing, providing, and promoting education. In other words, we're a family of business units that together meet the needs of the entire education industry." April 17, 1996.

[63]Purchasers of the bonds were told that interest on the bonds would be exempt from gross income for federal income tax purposes. The bond counsel informed my staff that this was on the basis of USAF's 501(c)(3) status, as provided by section 145 of the Internal Revenue Code.

[64] Form 1023 filed on November 6, 1990, with later clarifications.

[65]Letter to the IRS (supplement to Form 1023), February 26, 1991.

in information services generally."[66]

USA Group now runs at least seven for-profit businesses:[67]

➔Secondary Market Services, Inc., purchases student loans from lenders.

➔America's Tuition Assistance Corporation offers a tuition payment plan that allows parents or students to spread tuition payments over the course of several months. (This sounds very much like the definition of a lender.)

➔USA Collegiate, Inc., provides capital financing for schools and universities. (Again, a bank-like function).

➔TRG, Inc. helps schools improve their information infrastructure and increase access to information for students, faculty and staff.

➔America's Financial Aid Office, Inc. helps schools manage their financial aid operations.

➔Enrollment Technologies, Inc. allowed USA Group to enter "a new education market: college admissions."[68]

➔In 1995, USA Group purchased, for an undisclosed price, "Iowa City-based Noel-Levitz Centers, Inc., a leading management consulting firm to colleges and universities."[69]

The non-profit USA Group justified its for-profit subsidiary by saying that it was considering some related but non-exempt activities such as "student loan activities in Canada." But the businesses listed above go far beyond that example. And USA Group executives understand how far they have strayed, boasting that the acquisition and development of these companies "gives USA GROUP a new range of products and entree into new markets."[70] By their own admission, these are not activities that USA Funds and ELSC were performing previously that needed to be "isolated," as the application for tax exemption claimed. And they clearly are not related to

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[66]Jim Zook, "Loan-Guarantee Agencies Adopt a Range of Strategies to Cope With the Era of Direct Lending to Students," *Chronicle of Higher Education*. July 13, 1994, p. A23.

[67]The tax filing for 1994 shows two taxable subsidiaries, Secondary Market Services, Inc. (EIN 35-18721850) and USA Enterprises, Inc. (EIN 35-1810017) and subsidiaries. The 1993 and 1994 annual reports show a number of new entities which must be for-profit subsidiaries of USA Enterprises, since they are not listed as affiliated non-profits on the tax return.

[68]1994 Annual Report, p. 4.

[69]USA Group press release dated April 28, 1995.

[70]1994 Annual Report, p. 4.

the organizations' underlying exempt purposes.

USAF managers also promised the IRS that the for-profit subsidiaries would not use a substantial amount of USA Group's management services. This promise appears to have been violated: in the organization's annual report, 13 pages describe the organization's new activities in "financial services" and "information management;" only eight pages are devoted to education loan services. The money is as substantial as the verbiage. The for-profit SMS, Inc. had volume of $1.1 billion in '94, according to the annual report. USA Enterprises companies lost $6,158,261 according to the 1994 tax return -- not an insubstantial amount.

7. Subsidiary's tax-exempt status is questionable.

In 1992, USA Group managers created USA Services (USAS) to process loan guarantees for USAF and other guaranty agencies. USAS gained its non-profit status "as an organization receiving a substantial part of its support in the form of contributions from publicly supported organizations, from a governmental unit, or from the general public."[71] The application showed a significant portion of its support from "state agencies." But the application failed to make clear that those funds from state agencies are not "contributions" in the traditional sense, but are contracted payments for services, which on USAF's tax filings had been identified as "program service revenue."[72] I do not believe that these types of payments should count as "contributions." After all, if they do count, a lot of companies that do work for the government could easily avoid taxes.

The IRS approved the USAS application for tax-exempt status on a provisional basis through this coming September. I urge you to take a very close look at whether USAS truly meets the public support test required of a 509(a)(1) organization.

* * *

I know that issues surrounding tax-exempt organizations are complex, and that there is a high threshold for imposing fines or rescinding an organization's tax-exempt status. But it is clear from the information I have reviewed that USA Group is either violating any number of tax laws, or is certainly pushing the envelope to its extreme limits. While I know that you cannot divulge whether any particular entity is being investigated, I would appreciate your referring my concerns to the appropriate IRS official, and letting me know whether my understanding of the rules regarding non-profit organizations is correct.

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[71] USAS Application for Recognition of Exemption (Form 1023), April 10, 1992, p. 6. USAS claimed exemption under section 509(a)(1) of the Internal Revenue Code.

[72] See USAF tax filing for fiscal year 1992, parts VII and VIII.

I should also note that USA Group is not the only guaranty agency or non-profit secondary market where I have found irregularities in reviewing tax filings and other documents. I would recommend that you take a closer look at all of these organizations to ensure that tax laws are being followed, taxpayers are protected, and low-income students receive the charity that they are due.

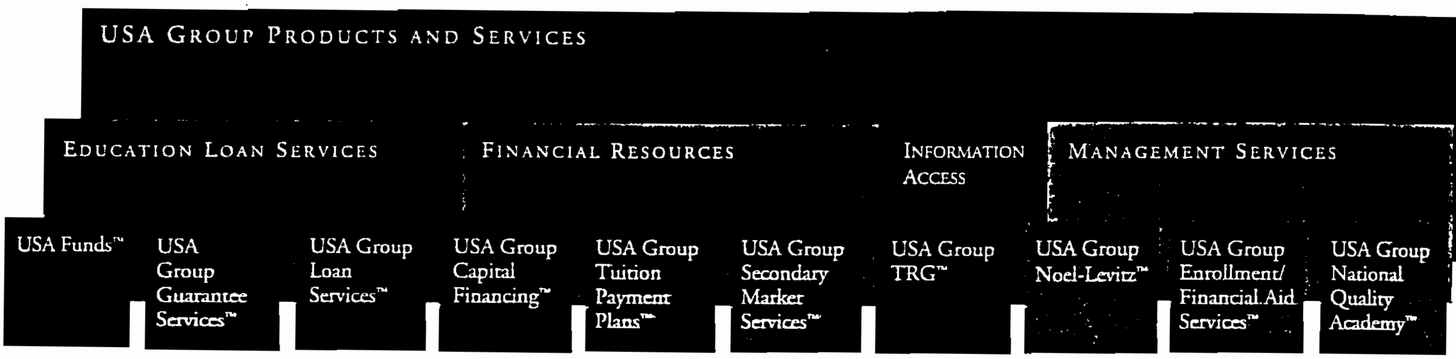
If you have any questions, or if your staff needs any of the backup documentation for the findings in this letter, please don't hesitate to contact me.

Cordially,

Paul Simon
U.S. Senator

attachment
cc: Secretary of Education
Inspector General, U.S. Department of Education
Comptroller General

USA Group Business Units: 1995



New Name (effective 10/1/95)	Former Name	Business Focus
USA Funds	USA Funds	Education loan guarantees, administration, and default prevention.
USA Group Guarantee Services	USA Services	Education loan processing from point of application to final payoff.
USA Group Loan Services	Education Loan Servicing Center (ELSC)	Education loan servicing, collection, and borrower assistance.
USA Group Capital Financing	USA Collegiate	Simplified sources of capital financing for colleges, universities and teaching hospitals.
USA Group Tuition Payment Plans	America's Tuition Assistance Corporation (ATAC)	Customized tuition and fee payment plans for higher education institutions.
USA Group Secondary Market Services	Secondary Market Services	Education loan portfolio management.
USA Group TRG	TRG	Innovative information technologies for higher education.
USA Group Noel-Levitz	Noel-Levitz Centers	Customized planning and management tools for higher education.
USA Group Enrollment/Financial Aid Services	Enrollment Technologies, Inc. and America's Financial Aid Office	Admissions applications software for students and financial aid processing/support services for institutions.
USA Group National Quality Academy	National Quality Academy	Seminars, courses, and consulting services on Continuing Quality Improvement programs.

SOURCE: USA Group, Inc. 1995 Annual Report