



Statement for the
Committee on Ways and Means
Subcommittee on Oversight
U.S. House of Representatives
October 7, 2015
The Rising Costs of Higher Education and Tax Policy

The Business Coalition for Fair Competition ([BCFC](#)) is a coalition of private sector firms, large and small, trade associations, think tanks, organizations, and individuals who support the competitive free enterprise system and seek relief from unfair government sponsored competition with private business.

BCFC is deeply concerned that some universities operate activities in direct and unfair competition with for-profit, tax-paying private businesses. At a time when small business is struggling and job creation is not being maximized in the private sector, small business cannot afford to compete against universities that don't pay their fair share of taxes.

Private enterprise constitutes the strength of the United States economic system and competitive private enterprises remain the most productive, efficient, and effective sources of goods and services.

There are thousands of legitimate institutions of higher education that do exemplary work training the future workforce. The tax treatment of these institutions is not an issue for BCFC. However, when the institutions of higher education encroach on private business activities, there are a number of undesirable consequences.

Entities organized under various provisions in section 501(c) of the Internal Revenue Code are provided special tax "exempt" treatment were clearly intended to perform activities and provide services otherwise considered "governmental" in nature, not those that are commercially available. A 1954 report by this Committee noted:

"The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds and by the benefits resulting from promotion of the general welfare."

Source: (Unfair Competition: The Profits of Non-profits, James T. Bennett, Thomas H. DiLorenzo, Hamilton Press, 1989, p. 26)

The problem is, this policy has not been adequately codified by Congress or efficiently implemented by the IRS. The situation has become so pervasive that unfair government-sponsored competition has been a top issue at every White House Conference on Small Business.

In 1980, the first White House Conference on Small Business made unfair competition one of its highest-ranked issues. It said, "The Federal Government shall be required by statute to contract out to small business those supplies and services that the private sector can provide. The government should not compete with the private sector by accomplishing these efforts with its own or non-profit personnel and facilities."

In 1986, the second White House Conference made this one of its top three issues. It said, "Government at all levels has failed to protect small business from damaging levels of unfair competition. At the federal, state and local levels, therefore, laws, regulations and policies should ... prohibit direct, government created competition in which government organizations perform commercial services ... New laws at all levels, particularly at the federal level, should require strict government reliance on the private sector for performance

of commercial-type functions. When cost comparisons are necessary to accomplish conversion to private sector performance, laws must include provisions for fair and equal cost comparisons. Funds controlled by a government entity must not be used to establish or conduct a commercial activity on U.S. property.”

And the 1995 White House Conference again made this a priority issue when its plank read, “Congress should enact legislation that would prohibit government agencies and tax-exempt and anti-trust exempt organizations from engaging in commercial activities in direct competition with small businesses.” That was among the top 15 vote getters at the 1995 Conference and was number one among all the procurement-related issues in the final balloting.

Non-profit organizations, including universities, unfairly compete with private, for-profit businesses by engaging in commercial activities, but not paying taxes.

Billions of dollars in economic activity occurs each year that is untaxed. This results in lost revenue to Federal, as well as state and local government agencies. And it creates an unlevel playing field for the private sector, particularly small business. When this occurs in universities, it unnecessarily drives up the cost of room, board, tuition and fees.

The 2013 IRS Colleges and Universities Compliance Project studied the unrelated business income tax (UBIT) for which tax-exempt entities, such as most universities, are required to pay on any activities and revenue unrelated to their tax-exempt status. The April 25, 2013 [IRS report](#) "found increases to unrelated business taxable income for 90 percent of the colleges and universities examined, totaling about \$90 million. There were over 180 changes to the amounts of unrelated business taxable income reported by colleges and universities on Form 990-T; and disallowance of more than \$170 million in losses and net operating losses that could amount to more than \$60 million in assessed taxes."

Non-profit organizations are provided special tax status under section 501(c) of the Internal Revenue Code. These groups are required to pay an "unrelated business income tax" or UBIT on its commercial or "non-exempt" activities. The IRS report showed this is not occurring.

The Federal Government first exempted charitable organizations from tax in 1913. In 1950, in response to outrageous examples of unfair competition, Congress changed the tax law by creating the UBIT. Under UBIT, revenues from sources unrelated to the non-profit's tax-exempt purpose are subject to taxation.

Attempts by government to address the problem of unfair competition have been few and far between, and those few measures that have been taken have been largely ineffective. The UBIT which was intended to level the playing field by taxing the revenues of non-profits has, for example, proven difficult if not impossible to enforce. The courts have not been able to give a rigorous and consistent definition of just what constitutes an “unrelated” business activity by a non-profit. And because the UBIT tax was to apply only to “commercial activity which is not significantly related to the purposes for which the non-profit organization was established,” enforcement and collection by the IRS has been less than successful. For their part, non-profits, including universities, have taken an extremely expansive view of

what constitutes a related purpose, making the under-reporting or non-reporting of revenues commonplace.

Unfair university competition impedes the development of small business by making it hard for them to enter markets and compete. This is significant because two-thirds of all new jobs are created by businesses with fewer than 20 employees. Because commercial enterprises run by non-profits, including universities, are exempted from taxes and receive other subsidies, taxpaying businesses must bear an extra burden by paying higher taxes than they would otherwise to make up for exemptions enjoyed by their “non-profit” competitors. Unfair competition ends up crowding out of the market precisely those firms which are the principal source of new jobs—ultimately reducing the rate of economic growth.

Unfair university competition takes many forms. It is universities venturing out of the classroom and into activities unrelated to their core and exempt education mission, such as hotels, mapping services, bicycle repair, golf courses, gym and fitness centers, cultural resource assessments, testing laboratories and others. A few examples were highlighted in BCFC’s [2013](#) and [2014](#) lists of the most egregious examples of unfair government competition as collected by media reports, include:

- The University of Mary Washington’s [Alumni Center](#) in Fredericksburg, VA not only competed for similar events and opportunities as provided by a neighboring small business in the wedding, banquet, lodging and catering business, but it also was building a hotel less than a mile away that would further compete with the hotels, motels and other lodging destinations that are not tax-exempt. The only reason provided by lost clients for choosing the university was the lower price thanks to the tax differential. University hotels and conference centers are proliferating across the country;
- George Mason University in Fairfax, Virginia announced in December 2013 it would close its hotel, the Mason Inn, after losing [\\$11 million](#);
- Towson University, a Maryland state University in the Baltimore suburbs, purchased air time on Washington, DC radio stations advertising a [nursery school program](#) for children 2, 3, and 4 years of age and a summer camp programs for pre-teens;
- "Bluffing" to win its first contract, St. Mary's University (MN) [performed](#) commercially available mapping services for the National Park Service and other clients;
- The University of Houston operates the National Center for Airborne Laser Mapping ([NCALM](#)), mapping services utilizing aircraft equipped with Light Detection And Ranging (LIDAR), a technology commercialized by NASA in the 1990s. Towson also runs a [mapping program](#) that has purchased television ads touting a software system that is otherwise commercially available;
- Believing that bicycle repair is inherent to the success of higher education, Virginia Tech University opened its own shop and hired a mechanic to [pedal](#) services to students in Blacksburg, VA in competition with local small business;
- James Madison University in Harrisonburg, VA [operates](#) a variety of charter bus and transit options to not only university students, but also to the general public including local school systems thereby in direct competition and duplication of the local market as would be provided by the small business operators; and
- Elon University in North Carolina started [Live Oak Communications](#), a communications agency that provides public relations, advertising, special event marketing, viral marketing, media relations, website development, video creation and

graphic design services for businesses and not-for-profit organizations in the North Carolina region.

The previously referenced 2013 IRS report listed the following activities as within its scope of UBIT research: Fitness, recreation centers and sports camps; advertising; facility rentals; arenas; and golf.

Another form of university competition is in the schools' bookstore. These on-campus, university-owned retail operations go far beyond selling essential textbooks to students, but compete with local, for-profit, tax-paying business in offering office supplies, clothes and apparel, computer equipment and goods under the blanket of the institution's tax exempt status. Finally, universities historically competed with travel and tour companies by offering foreign trips that looked more like vacations rather than instructional endeavors.

Schools of higher education are increasingly venturing away from their core missions of teaching and conducting basic research. Financial pressures, ranging from reduced government funding to pressures to limit tuition increases have led university presidents to transform academicians into entrepreneurs. Universities are generating revenues from commercial activities to supplement their budgets.

University engagement in commercial activities could be called the "Gatorade Syndrome". Ever since professors at the University of Florida invented the popular sports drink to hydrate football players practicing in the heat, academicians have been trying to find the next big discovery. Most simply consume tax dollars, divert scarce resources including tuition, and fail to turn profits. These university-sponsored enterprises have cost their schools millions, exacerbating an unaffordable tuition system that has made a college education a financial burden, if not impossibility, for most students and their parents.

Universities enjoy significant advantages over for-profit companies. They are eligible for billions of dollars in grants from Federal and State governments. They often have the ability to secure non-competitive, sole source contracts with government agencies. They pay no taxes. Their overhead – buildings, electricity, even equipment, is already paid for and is provided for "free". Their student labor force is either unpaid or compensated at well below prevailing market wages. They carry no professional liability insurance, do not have to pay unemployment compensation and in many cases are exempt from social security contributions. When universities enter into contracts to perform services, they usually insist on "best effort" clauses, which absolve them of ever completely finishing a project. They are also recipients of millions of dollars in free or discounted hardware and software, donated from vendor firms so that students will learn on their systems, be proficient in their use upon graduation and instill a consumer loyalty that will translate into sales once these students move up in the ranks of their private sector employers. The advantages universities bring to the market make it virtually impossible for private firms to compete.

Private sector and for-profit colleges and universities face unfair competition from government institutions. In recent years, such private schools have been singled out for attack from a bevy of regulations proposed by the federal government that create an unfair and unlevel playing field. The latest effort comes in the form of a retooled "gainful employment" regulation by the Department of Education that is impacting private sector schools and largely leaving traditional public and non-profit schools untouched. The "gainful

employment” regulation prevents students – often low-income, minorities, and veterans – from having access to thousands of programs at private sector higher education institutions.

In addition, federal actions, including the “90/10 rule”, regulations dealing with state authorization, and the definition of a credit hour all threaten to punish private sector schools to the advantage of traditional public institutions.

For too many years, the unfair government-sponsored competition issue has not been a top priority for Congress or Administrations of either party. The Small Business Administration’s Office conducted a series of hearings and issued a report, “Government Competition: A Threat to Small Business” (March 1980), and “Unfair Competition by Non-profit Organizations With Small Business: An Issue for the 1980s” (June, 1984). The last serious look at non-profits and the UBIT by the Ways and Means Committee was by Congressman J.J. Pickle (D-TX) in 1987-88.

In February 2013, BCFC [testified](#) before this Committee including “unfair university competition” and UBIT within the [hearing](#) entitled, “Tax Reform and Charitable Contributions.”

From April 18 through April 25, 1993, the Philadelphia Inquirer presented an exhaustive investigative exposition of the multibillion-dollar world of America's so-called non-profit industries, exposing, in several different contexts, the abuses of their unique tax-exempt status. Certainly, this sweeping indictment by the Philadelphia Inquirer encompasses the world of non-profit sometimes run amok. However, as you, Mr. Chairman, contemplate future oversight hearings and legislation to reform this multibillion-dollar, non-tax-paying competition for many of America's struggling small businesses, you will find valuable factual, albeit dated, information in the Inquirer series.

Source: (Non-profits: America's Growth Industry They're Called Non-profit Businesses, But That Doesn't Mean They Can't Make Money. They Do - Billions Of Dollars. At The Same Time, Their Tax-exemptions Cost Government More Than \$36 Billion A Year,” by Gilbert M. Gaul and Neill A. Borowski, The Philadelphia Inquirer April 18, 1993)

In February 1987, a GAO report found:

- The U.S. Department of Commerce estimates that \$1.2 billion, or 1.3 percent, of the \$91 billion gross national product (GNP) in 1930 could be attributed to non-profit institutions. This share grew to \$131 billion, or 3.3 percent, of the \$3,989 billion GNP by 1985;
- A 1975 IRS Statistics of Income (SOI) study found that for tax-exempt organizations (religious, schools and colleges, cultural and historical, other instructional, health-related services, scientific research, business and professional, farming and related, mutual organizations, employee or membership benefit, sports-athletic-recreational and social, youth, conservation and environmental, housing, inner city or community, civil rights, litigation and legal aid, legislative and political advocacy, other activities directed to individuals, other activities directed to organizations, other purposes and activities, no activity reported) on average, 39% of their total activity receipts were business receipts; and

- Complete data do not exist to quantify the nature, extent, and impact of competition between non-profits and the private sector. However, the limited data available indicate that taxable businesses and some tax-exempt organizations are increasingly competing to provide similar services.

Source: (GAO Briefing Report to the Joint Committee on Taxation; “Tax Policy: Competition Between Taxable Businesses and Tax-Exempt Organizations”, February 27, 1987 – GGD-87-40BR)

In March 1980, a report of the Small Business Administration (SBA) Advocacy Task Force Group on Government Competition with Small Business found:

- The activities of foundations and universities were of particular concern to a number of witnesses;
- In Fiscal Year 1978, the IRS audited approximately 17,000 of the 150,000 required filings by non-profits. Unrelated business income was discovered in 1,800 or 10.6 percent of these 17,000 audited cases. Of the 1,800 audits where unrelated business income was discovered, 46 percent (828 cases) resulted in successful action by IRS to levy additional taxes, and a combined total of \$10 million was recovered. On average, the IRS recovered additional taxes at the rate of \$12,078 per audited case where unrelated business income was discovered and recovery action succeeded; and
- The small business community’s perception of the extent of abuse of the tax system by non-profits strongly suggests that a more extensive review of unrelated business income activities is warranted.

Source: (“Government Competition: A Threat to Small Business” Report of the SBA Advocacy Task Force Group on Government Competition with Small Business, March 1980)

This is a problem that is growing, not diminishing. From 1975 to 1990, the non-profit sector grew by 150 percent, while the gross domestic product grew about 50 percent.

University competition is part of a larger problem of unfair government sponsored and tax-subsidized competition with private enterprise including government (including the insourcing of contracts performed by tax-paying private sector firms out of the private sector for performance by Federal employees), non-profits, prison industries, etc. The Federal government and universities can lower costs and increase revenue by applying the “Yellow Pages’ Test”, a simple test that says if an activity is available from a private sector company found in the Yellow Pages, that activity should not be a responsibility of a college and university and, instead, should actually be performed by a tax-paying private sector firm.

In December 2012, BCFC attempted to bridge the impasse in negotiations on the fiscal cliff and sequestration by providing President Obama and Congressional leaders [budget savings of \\$795 billion](#) by simply utilizing tax-paying private sector firms for commercially available goods and services currently performed by a government or tax-subsidized entity. The federal government can achieve \$795 billion in savings simply by getting out of activities that duplicate or compete with the private sector, which subsidize unfair competition with private, for-profit companies, or by privatizing activities for which there are current or potential private sector providers. This includes:

- Enforce UBIT on commercial activities revenue of non-profits - \$36 Billion.

Institutions of higher education should not be able to use their tax-exempt status to avoid paying income taxes on what are essentially commercial activities. These tax-subsidized entities should not be making the same kind of profits on activities that are virtually identical to those of a for-profit, tax-paying business.

The IRS should more vigorously enforce current rules governing the tax status of universities to assure that academic activities are indeed related to research and education, not commercial production. Here are five very specific recommendations.

1. The Department of the Treasury should be required to provide an annual public estimate of revenues lost through avoidance of UBIT.

2. The Treasury Department should provide an official public estimate of potential new revenues to the Treasury if the UBIT law were expanded to require all commercial operations of universities to pay their fair share of taxes.

3. The law should be modified or new legislation introduced that lets the Treasury Department collect taxes that insures that all commercial activities of universities are taxable. The IRS has only one option today – that is to revoke an organization’s charter to do business. They simply can't administer the law the way it is.

4. Congress should amend the Higher Education Act to focus universities on their core missions – education and basic research. Legislation should be passed to apply a “commerciality” test to all non-core university activities. Any university that receives direct federal funding, or indirect funding through tax-exempt or “non-profit” status, should be prohibited for using such institutions for the performance of commercial, tax generating activities otherwise available in the private sector.

5. Universities entering a commercial undertaking should be required to form a for-profit subsidiary that must obey all the same laws and regulations that apply to for-profit enterprises. It is only when we move beyond hidden subsidies and the ineffectual regulations of UBIT that both consumers and producers, and all taxpayers, will be able to enjoy the benefits of even-handed competition. In forming a commercial subsidiary, this would help implement a “commerciality clause”, and thus implement the “Yellow Pages’ Test”.

Unfair university competition with the private sector, and small business, is a public policy issue deserving of immediate attention and reform. This hearing will provide an important forum for the private sector to discuss the broader aspects of this issue. We commend your efforts to further explore private sector complaints in this area and advance the debate. The private sector seeks a competitive environment in which all participants play by the same rules.

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