

**BUSINESS AND FINANCIAL PRACTICES  
OF THE AARP**

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**HEARINGS**  
BEFORE THE  
SUBCOMMITTEE ON  
SOCIAL SECURITY AND FAMILY POLICY  
OF THE  
COMMITTEE ON FINANCE  
UNITED STATES SENATE  
ONE HUNDRED FOURTH CONGRESS  
FIRST SESSION

—————  
JUNE 13 AND JUNE 20, 1995  
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# **BUSINESS AND FINANCIAL PRACTICES OF THE AARP**

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**TUESDAY, JUNE 13, 1995**

**U.S. SENATE,  
SUBCOMMITTEE ON SOCIAL SECURITY  
AND FAMILY POLICY,  
COMMITTEE ON FINANCE,  
*Washington, DC.***

The hearing was convened, pursuant to notice, at 10:00 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Alan K. Simpson (chairman of the subcommittee) presiding.

Also present: Senators Pryor and Breaux.

## **OPENING STATEMENT OF HON. ALAN K. SIMPSON, A U.S. SENATOR FROM WYOMING, CHAIRMAN OF THE SUBCOMMITTEE**

Senator SIMPSON. Good morning. The hearing will come to order.

We will have a most interesting day, you may be assured. And it is a pleasure to begin some hearings with regard to the issue of tax-exempt organizations. This is a serious issue which I believe needs attention.

But I must say that, when I got into this, I have been in it for many years with regard to this particular organization and other senior organizations. Please do not feel that I am picking on the AARP. That is not my intent.

I have said serious things to the National Committee on the Preservation of Social Security and Medicare and other senior groups because I have been alarmed about the fact that, if we do not begin to get some sense into senior programs, in the year 2010, 60 percent of the entire Federal budget will be going to people over 60.

Every single thing that we have recommended, including work with regard to Medicare, which is going to go broke. Medicare will go broke in the year 2002. And that is not Simpson saying that; that is the trustees of the Social Security system telling us that. And the trustees are telling us that the disability insurance will go broke in the year 2016. Social Security will go broke in the year 2031, and will begin its swan dive of disaster in the year 2013.

Meanwhile, in dealing with the groups, as I refer to them, in my work with such things as Social Security, immigration, and veterans' issues, I have learned in that process to simply grow a second set of epidermis just to get a second skin because I have had it ripped off by the best of them.

But it seems to me that, when we are saying we are going to do these things, and the things we are suggesting to bring some sem-

blance of order to Medicare, Medicaid, Social Security, Federal retirement, none of it really affects people over 51. But you would never know that from the reaction that comes from these groups. Nothing that we would have suggested in the Entitlements Commission activities would have affected anyone over 51. But the people between 18 and 45 or 50 would be seriously affected and, in every sense, devastated, while the senior groups simply ask for more and more from the Federal Treasury.

And this particular senior group, the AARP, not only continually asks for more from the Treasury, that is their theme, their motif. They ask for long-term health care for everyone in the U.S., regardless of your net worth or your income. Break the bank. I have said that before. And it is odd to me that the group continues to ask for funds from the Federal Government when they receive grants from the Federal Government in the sum of \$86 million, when they have a revenue stream of \$386 million.

But I am fully aware of the political hazard of this for myself, and I do not want to take too many down the road with me. I am not going to take Senator Pryor down the road with me. He will not go down the road. But he came here with me, and Dave Pryor is a special friend. We do not always agree, but we have a great affection and regard.

This reminds me of the great play by Larry King—the author, not the television personality—the sheriff in the great play about Texas, about local politics and foibles. He was standing there, and did not even know what happened, and his great phrase was, “I did not even know it was hungry till it et me.” And that is what is going to happen to Simpson in this one. I did not even know they were hungry till they et me. But I am going to go right ahead with it.

We have some interesting witnesses who have been good enough to come and testify. This is the first of possibly several hearings regarding the practices and structure, and the tax-exempt nonprofit status of the American Association of Retired Persons, or AARP. It will eventually include other organizations who, in my mind, abuse the nonprofit status. They are not a 501(c)(3); they are a 501(c)(4). In that capacity, they are able to lobby, and have spent between \$26 million and \$36 million in the last 2 years for lobbying, just pure lobbying.

When I first announced that I was reviewing the AARP's operations, I was besieged with phone calls and mailings. I was not surprised; I expected that. After all, it had been assumed here in Washington that the AARP represents the great mass of senior citizens in this country, and that no one would ever dare to attack America's most powerful and sympathy-invoking voter group.

And here indeed are letters from those who wrote to chastise me for attacking the AARP. Those are people who apparently think that AARP really does represent the interests of most senior citizens. And back here in a box, a rather significant box, are people who fully support what I am doing and say, “Go for it.” Many of these are from AARP members. And that is this sizable box versus this stack. I weigh my mail on this one. I really do not read a great deal of it, unless it is from Wyoming. Then I read every word of it. [Laughter.]

Now I have talked to the AARP people from Wyoming; they are friends of mine—Helen Fitch, Ray Swarting—wonderful people. And when I told them what I was up to and why, they said they did not really know all that about the organization. And I said well, here are the facts and figures. And I will share that with the public. So, when you look at those two piles, I think you realize how far AARP has gone astray from really representing the wishes of America's seniors.

We are here not only because AARP has drifted from its stated mission of representing senior citizens, but also because I believe the evidence is clear that AARP has drifted considerably from any possible description of a "nonprofit organization" that should enjoy a tax exemption and unlimited lobbying privileges which, in a sense, are subsidized by you and me.

I have been a long-time critic of AARP. Ever since I joined, I have been fascinated by the magazine, *Modern Maturity*. There was an interesting *New Yorker* cartoon this week. It showed a man lying on his deathbed, a great curtained bedstead. And he said, "Be sure to cancel my subscription to *Modern Maturity*." It was actually a touching cartoon, and I enjoyed it. He looked like Ebenezer Scrooge lying there in his bed of pain.

So I have been a long-time critic. I confess though that I was surprised by the overwhelming rejection of AARP's actions by America's seniors. I knew they had taken the revenues they had received, and spent \$17 million for the annual lease of the building here in Washington. That is the annual lease rental of a lease which I have not been through yet because it nearly gave me a hernia picking it up. But it has a 5-year renewal, and it is an interesting lease because it is a rather significant annual lease rental, \$17 million.

Out in the land, there is about another \$7 million or \$8 million in rentals. Then I was a little surprised that they had shelled out \$58 million in salaries in 1993, \$63 million this last year, to their employees. And apparently, if you can read it all as it comes in the great bales—and they have produced great bales for me—19 of the employees receive over \$100,000 per year. There are 1,732 employees.

When you meet with the board they say, do not forget, we do not receive any money, any salary, just our expenses. That may be true, but 50 percent of the board of the pharmacy operation are members of the board of the AARP. That is something I had to dig around to find. There will be lots more to share with you.

I knew they had taken \$86 million annually from the Federal Government in grants. And I knew from reading the poll they did, 70 some percent of their members embraced the balanced budget amendment, and they rejected it, so something was askew. And I knew, particularly when we dealt with this crushing issue of Medicare, that they indicated to their members in all of their publications and information systems that we have already cut Medicare \$200 billion since 1980.

Now, ladies and gentlemen, all I know about Medicare—and I know something of it—is that Medicare has gone from \$32 billion in 1980 to \$162 billion today. If anyone can please disclose to me how that is a \$200 billion cut, the drinks are on me.

So I know that they could in no way claim to represent the interests of the seniors, since most of their money comes from somewhere else. I nonetheless believed that the illusion persisted that AARP actually represented senior citizens. People have called and written.

I am not in this one to see how many cameras will fit in the room. I think I have had about 10 single press conferences in 17 years in this place. That is not my bag. The stuff I mess with is filled with emotion, fear, guilt and racism anyway—immigration, veterans, Social Security, Clean Air Act, environmental issues. But that is the arena I chose to play in.

But people out there know that something is very wrong with the operations of the AARP. But I am finding out that they do not yet know the whole story. Nor, I am discovering, do I. That is why I propose to find out, and it is a story that seems to have eternal life.

People know that something is wrong when an organization that gets more than half its income from commercial business activities simultaneously spends millions annually to lobby, with a claim that they represent the interests of seniors and the elderly. They know that something is wrong when the Government pays \$86 million in 1 year to an organization that is lobbying continually and avidly for more spending and more debt, always more money from the District of Columbia.

They know that something is wrong when a supposedly nonprofit organization has to pay the IRS \$135 million "in lieu of taxes", and then has no problem in simply writing a check for that amount.

They know something is very wrong when the IRS is simultaneously paying millions in grant money to the AARP to give, yes indeed, "tax counseling" to America's elderly. This is from an organization that continues to have rather substantial problems justifying its self-declared exemption from taxation. And they seem to have underpaid their own taxes by more than \$100 million.

Those were the starting points, and I will be looking into other questions. I am exploring several others which, I believe, are just as serious, but which have thus far been only dimly illumined by much less public awareness.

I do not believe, for example, that most Americans are aware of the full extent to which AARP has used the U.S. Postal Service improperly to mail for-profit solicitations to sell things and policies. We will have a quite a discussion about that, together with evidence of how they solicit in that form, how they settled with the Postal Service, and how the Postal Service was besieged and beseeched by AARP counsel to join them in changing the law, and was asked not to bother them if they did not follow the law.

I do not believe that AARP members know how AARP profits whenever they buy products advertised in their magazine, nor do I believe they know the extent of AARP's influence in the boards of some of those "supposedly independent organizations". I do believe there is much to be learned here about the full extent of their commercial operations, above what is evident from their publicly disclosed form to the IRS, the 990.

And I further believe that only a very few AARP members fully know the extent to which the national leadership imposes a policy agenda on an unwilling membership.

I have been reviewing the public positions, the polls that they took, the organization's bylaws and membership surveys provided by the AARP, and I believe that they only reveal the extent to which the AARP's legislative council has put the vast resources of the AARP behind efforts and goals that are fundamentally out of step with anything truly endorsed by the AARP members.

There are many other issues I do not wish to raise as questions until the AARP is present here. But I do wish to firmly state that the goal of these hearings is to determine whether there is indeed a problem here, either of policy or propriety. And then, if appropriate, to possibly seek a legislative solution, or some solution. If this empire is not what our nonprofit laws are intended to facilitate, and if there are other organizations that are doing this too, let us look at them all. Then, obviously, we need to change the law.

This is not about ideology. This is not about philosophy. It is not about partisanship. It is not part of a great Republican trick. I have visited with no one, no other group, as to what I am up to. If others are interested in that, that is fascinating too, but that is not where I am coming from.

This first hearing was originally conceived to disclose various sides of the AARP story fairly. AARP's absence from this hearing will unavoidably tilt the balance of today's discussion.

Our first panel is here to provide general academic expertise about activities such as AARP's. Paul Hewitt of the National Taxpayers Union Foundation has previously published studies of AARP's legislative agenda and its effects.

Dr. Natwar Gandhi and the GAO have performed a general overview of nonprofit organizations and their sources of revenue and support. We have that here before us.

And Mancur Olson of the University of Maryland is an expert on special interest group politics in general.

Roy Goldberg will be here as a second panel witness. He represents AARP members who are dissatisfied with the way the AARP has been run. I had hoped to have the discontents represented here just prior to the AARP leadership itself. However, we will not have their side of the story today.

I am disappointed by that, but AARP had indicated they had a longstanding schedule conflict, I believe in the State of Oregon, which they felt would not enable them to be here. I do not completely understand that, but I believe they would wish to rebut some of the things we knew well would be said about them today. So I urged them to come. They simply did not feel able to do so, and that is understandable, so I have scheduled a second hearing on June 20, at which they have stated they will be present.

There are many issues I wish to discuss with these witnesses and the AARP, far too many to cover in one opening statement. So, if we could begin with—

Senator Pryor, would you care to comment on any part of this? David Pryor, who is a very active Member with aging issues, chaired the Special Committee on Aging, and has done yeoman work in the area of senior citizens.

[The prepared statement of Senator Simpson appears in the appendix.]

**OPENING STATEMENT OF HON. DAVID PRYOR, A U.S. SENATOR  
FROM ARKANSAS**

Senator PRYOR. Alan, a lot of people have asked me recently why I decided not to run for the Senate any longer. Recently in an airport, a man came up to me, and said, "May I ask you a question, sir?" And I said yes. And he said, "Are you not Congressman Claude Pepper?" [Laughter.]

I said at that time, it is time to leave. [Laughter.]

But I do want to thank you for your kind words.

Senator Simpson, I want to—and I mean this very sincerely—congratulate you. We usually say that in our opening statements to the chairman of a committee or a subcommittee, but you are truly to be congratulated for opening up a debate that we have long needed to have in the United States Senate and the Congress.

My only real concern with what we are doing this morning—and I would say this respectfully—is that we are selectively taking one organization that is nonprofit, that is tax-exempt, and that has grown substantially and very rapidly as our aging population has grown in the country.

I think it is very fitting that the American Association of Retired Persons will have the opportunity next week to come forward and basically answer any and all allegations, or whatever they are, against them. And I assume that they will be here to answer that. I am sorry they could not do that today.

I think this is a milestone today because for too long we have been too reluctant to look into many nonprofit and tax-exempt organizations. I am not here to defend AARP. I am not here to defend any organization or individual who does not meet their obligation to the Internal Revenue Service.

I am not here to defend any organization or individual who abuses the law. I am here with you, sir, basically to help find some facts, not only about this particular situation that you have raised, but also as to where we might be in our entire gambit, the entire spectrum of tax-exempt, nonprofit organizations.

We have in this country today some 600,000 501(c)(3) organizations. We have 140,000 organizations of the 501(c)(4) type that Senator Simpson has talked about. And I can say that I think our work is just beginning. We are taking on one organization today, but I am sure that there are going to be many to follow; I hope there will be. We want to look at their purpose, their intent and, if there are abuses, they are not paying their fair share of taxes, then it is time that they do it.

We are also seeing a whole new area that Senator Simpson's debate has sort of triggered. We are now beginning to see other areas of a related debate. For example, in yesterday's Washington Post, the Church of God in Christ, a tax-exempt church, nonprofit organization, now has its own Visa card—its own Visa card. And I think this is an area that I hope Senator Simpson and his subcommittee, and the Finance Committee, can look at.

Just this morning in the Washington Post, we saw a story on page 1 about the audit of the National Rifle Association, their use of funds for political purposes, and also where these funds came from, and how they are being expended.

Once again, I think this debate being triggered by Senator Simpson is a healthy debate. It is a debate that, in my opinion, is long overdue.

On May 23, in the Washington Times, there was a large ad. I have condensed this ad. It also appeared in the New York Times I think a week ago Saturday in a full-page ad. This ad says, Wanted—a fair trial for Vincent Foster. We all know who the late Vincent Foster was. But I think the key element that I bring to the attention of the distinguished Chairman and this Committee is, if you want to see what the real story behind Vincent Foster is, and why the media has not done its job in reporting his suicide, what you need to do is send a check to Accuracy in Media, Inc., 4455 Connecticut Avenue, Washington, D.C., telephone number (202) 364-4401. If you send a check to this group, and it is tax-deductible.

Now, I think once again we should applaud Senator Simpson because these are the areas which I think the Finance Committee should look into, as to why organizations like this pay no taxes, the members get a tax deduction, and where there might be lobbying in their main thrust of activities.

So, Senator Simpson, you have indeed taken the bark off the tree, and we are indeed interested in where we go from here. Once again, I hope this can be expanded, and I look forward to the AARP appearing in due time.

Thank you, sir.

Senator SIMPSON. David, thank you very much. We know each other well, and I can assure you that if there is any legislative remedy here, it may likely affect several organizations. And we certainly would want any solution to be neutral, and not directed toward specifics. But, to me, this is the most grievous example of a group because they get less than 45 percent of their money from dues, and the rest of it comes from commercial operations.

I am principally going to zero in on 501(c)(4)'s. But I think there are tremendous abuses with 501(3)(c)'s. Just in the last 2 years, they have gone into activities. But I can pledge to you that I will pursue all things within my jurisdiction, including the other senior groups.

I think you know me well enough, and I want you to know that I have visited with the AARP and told them almost exactly what I am going to ask them in these public hearings. There are not too many whizzers; oh, there are a couple there lying in the weeds. But that is because I have not had a chance to visit with them yet. But I said here is what I am going to ask you. And they were quite forthcoming, but also quite irritated. Nevertheless, there is not much blindsiding going on, and that is something that does not happen very often in this town.

So thank you, David Pryor, and we will miss your services.

Senator PRYOR. Mr. Chairman, I owe you not only my apology, but also my thanks. All day yesterday, I meant to contact you to tell you that I would try to appear today. I was not quite sure of my schedule. I never did get that opportunity. I am not a Member of your Subcommittee; I am a Member of the full Committee. But, under the rules of the Finance Committee—I think it is Rule 16—

I am allowed to participate. And I appreciate your allowing me to participate this morning. I am very grateful to you for it.

Thank you, sir.

Senator SIMPSON. Well, I am more grateful. I did not think anybody would show up. [Laughter.]

All right, if we can have our panel now, please. Dr. Natwar Gandhi, Mr. Paul Hewitt and Dr. Mancur Olson. We will proceed with Mr. Hewitt, if we might, and then Dr. Gandhi and then Dr. Mancur Olson.

So take 10 minutes each, if you wish, because I want to set a tone as to where we go here, and then we will have the AARP on the 20th.

Thank you.

**STATEMENT OF PAUL HEWITT, EXECUTIVE DIRECTOR, NATIONAL TAXPAYERS UNION FOUNDATION, WASHINGTON, DC**

Mr. HEWITT. Mr. Chairman, thank you for having me testify today.

The American Association of Retired Persons' former executive director once proclaimed of AARP that "the fear level in Congress is just incredible." So let me open, Mr. Chairman, by commending your courage. If the only outcome of this hearing is that you have exposed AARP's lobbying agenda to the AARP membership, you have accomplished an important service in the interests of democracy.

Two years ago, the National Taxpayers Union Foundation conducted a study of AARP that raised troubling questions about the association's role in the democratic process. We found that its agenda, a veritable whole earth catalog of expensive Government programs, did not and could not possibly reflect the views of its diverse membership. AARP advocated more than 100 ideas for new spending that within a decade would cause annual Federal outlays to rise by more than \$1 trillion.

AARP proposed not a single dollar of spending reduction. Yet it called for an end to the Federal budget deficit. In short, AARP's vision was to raise taxes by more than \$1.3 trillion a year within a decade. And, to this end, AARP advocated a panoply of new tax increases: a new consumption tax, higher gasoline taxes, much higher income taxes, higher taxes on business, and so on and so forth.

So, Mr. Chairman, AARP's lobbying agenda would have raised the annual tax bill of the average American household by more than \$13,000 within a decade. Because AARP's members are relatively affluent, these tax increases would fall very heavily on the AARP membership.

AARP's membership has never endorsed these tax increases. Only the smallest fraction of its 30 million members have even seen one of the few thousand copies of its legislative agenda, which I have brought here. It is 492 pages long. As the committee can see, it is thicker than the District of Columbia phone book.

To the extent that AARP's lobbyists succeed in achieving the policies in this agenda, they can only diminish the American people's faith in their Government. For example, in 1993, AARP helped convince the Clinton administration and the Democratic Congress to push through a giant package of tax increases. The as-

sociation then played a major role in crafting a health reform package that created 89 new ways for Americans to get fined or go to jail if they did not follow the dictates of Federal health bureaucrats.

Far from being popular, these two Acts sparked what was arguably the greatest upsurge in public revulsion with Congress this century.

Only a few years earlier, in 1988, AARP's lobbyists almost single-handedly stampeded Congress into passing the Catastrophic Health Care Act. This Act would have levied an additional \$9 billion in new taxes on senior citizens in return for expanded Medicare benefits. But AARP's members staged a tax revolt. They did not want more Government, and they forced Congress to repeal the Act.

Mr. Chairman, AARP's members deserve to know that their lobbyists are advocating tax increases that are 144 times larger than the taxes AARP's members rejected in 1990.

One reason why AARP's lobbyists can get away with so much under the noses of their membership is that they stifle internal debate. AARP's political positions are so tightly controlled from the top that they permit little dissent or debate by the association's 400,000 volunteers, let alone the larger membership.

For example, under AARP's bylaws, members can be expelled for calling unauthorized meetings with other AARP members. They can be expelled for criticizing the association. They can even be forced out for uttering disparaging remarks about the products that AARP markets to its members.

Many AARP members, of course, could not care less if they were expelled. But, for some of the more committed volunteers, the prospect of expulsion is a subtle form of elder abuse.

Former AARP chairman, Kermit Phelps, once put it this way, "As we get older," he said, "many of us discover our family and support groups are gone." For many of us, AARP fills that role. Yet AARP holds over the heads of emotionally vulnerable seniors the threat to expel them from their last remaining support group for the simple crime of voicing dissent.

To our knowledge, no other groups representing large, diverse memberships, from the Boy Scouts to the Democratic Party, impose such Draconian sanctions on the exercise of free speech, or do so much to eliminate the prospect of factions arising within the organization. Most either encourage broad vocal participation and policy development, or they simply avoid taking stands on issues that divide their membership. It is indeed most unusual for such a diverse membership to agree on anything so specific and controversial as this 492-page agenda.

The conclusion we draw, Mr. Chairman, is that AARP does not represent its members. Rather, it uses them to push an agenda with which most members would strongly disagree. Our research has shown that AARP has virtually no internal due process, few checks and balances, and a self-perpetuating power structure. Its impulse is basically dictatorial. And yet, AARP is decisively influential over Congress.

In the halls of this institution, it is no secret that AARP's lobbyists push an agenda that is unpopular with the association's mem-

bership. Their immense political influence grows not out of the wellspring of democracy, but rather from the power to propagandize. AARP is a dispenser of discounts and products. It is a self-appointed voice for senior citizens. But, above all, AARP is a media giant, dedicated to the exercise of raw political power.

AARP's two flagship publications, *Modern Maturity* and the *AARP Bulletin* have a larger circulation than those of *Time*, *Newsweek* and *U.S. News & World Report* combined. In today's media age, such market penetration represents an immense concentration of power. Every word in these publications is subject to the editing of AARP's political staff. And I need not remind you that the power to print is the power to destroy. Every member of Congress lives in mortal fear of becoming the target of AARP's media machine.

AARP also sends out hundreds of millions of pieces of mail each year to its member households and prospective members. The association is the nation's largest mailer. Much of this mail is designed to influence public policy by scaring senior citizens out of their wits.

Listen to this 1992 attack on the balanced budget amendment: "For a single elderly widow," goes AARP's scare letter, "the average Social Security check would fall from \$625 to \$533 per month, or a cut of \$1,104 in 1995." Of course, this was not true, but the damage was done. We can only guess how many elderly widows responded by mailing in their last \$10 to AARP, or how many billions of dollars in debt we loaded onto our children because AARP came down on the side of deficits.

Mr. Chairman, the National Taxpayers Union Foundation has no desire to curb the First Amendment right of AARP's leadership to misinform and misrepresent their members. We do believe that the scope of AARP's political, financial and media empires gives its lobbyists unparalleled power to intimidate members of Congress in ways that thwart the popular will.

In this, we find a compelling public interest in limiting the tax privileges and exemptions and Federal grants that have subsidized AARP's growth—subsidies which may have totalled as much as \$1 billion dollars since the late 1950's.

In creating the tax exclusions and postal subsidies for nonprofit organizations, Congress intended to foster a robust debate over public policy, characterized by a broad diversity of views. These subsidies and preferences make it possible for a lot of groups with shoestring budgets to participate in the public policy debate.

But AARP has become so big that further subsidies actually cement its power over certain areas of the public debate. By intimidating groups and individuals with rival viewpoints, AARP works to narrow the diversity of debate over public policy. Providing large public subsidies to AARP works against the very goals Congress originally sought to promote with these subsidies.

Accordingly, we suggest the following reforms:

First, organizations that spend more than 5 percent of their budgets lobbying Congress should not be eligible to receive or administer Federal grants. This would help to ensure that grants are awarded on the basis of merit, rather than as political patronage for the powerful.

Second, Congress should cap the amount of nonprofit mail subsidies that any 501(c)(4) nonprofit organization is eligible to receive in any given year. We recommend that subsidized mail rates apply to no more than 5 million pieces of mail annually.

Third, no more than 20 percent of a lobbying organization's operating budget should be funded by untaxed commercial activities. This will help to ensure that advocacy organizations depend on their members for support, rather than on selling things to those members.

In addition, Mr. Chairman, it may be time for Congress to consider drafting a consumers' bill of rights for members of groups who do blur the line between marketing and lobbying. When a lobby derives more than a certain percentage of its budget from commercial activities in order to retain its nonprofit status, it should be required to take steps to ensure that there is accountability with its members. We recommend that members have the right to receive, on demand, a list of the lobbying organization's lobbying positions.

We recommend that they should have the right to delegate, or not to delegate to the lobbying organization the power to represent them before Congress.

And we recommend that the lobbying organization should be required to disclose how many of its members have given their informed consent to have the organization represent them before Congress.

In closing, Mr. Chairman, we have a recommendation for the American people: consumer beware. Do not sell your political soul for the price of an airline discount. Other businesses do not claim to speak for their customers before Congress, but AARP does. And because it does, AARP members bear a special responsibility to monitor and correct what is being said in their names.

In this, AARP members may have only one option. AARP executive director, Horace Deets, recently said that unhappy AARP members are free to vote with their checkbooks and feet. If you do not like AARP, he said in effect, leave.

So, if you do not agree with AARP's message of spiraling taxes, exploding Government, and pitting the political power of the old against the young, consider it your civic duty to deprive AARP of your voice.

Thank you, Mr. Chairman.

Senator SIMPSON. Thank you, Mr. Hewitt.

And now, please, Dr. Gandhi.

[The prepared statement of Mr. Hewitt appears in the appendix.]

**STATEMENT OF NATWAR M. GANDHI, Ph.D., ASSOCIATE DIRECTOR, TAX POLICY AND ADMINISTRATIVE ISSUES, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC**

Dr. GANDHI. Thank you, Mr. Chairman.

Mr. Chairman, and Members of the Subcommittee, we are pleased to be here today to provide information on the revenue producing activities of tax-exempt organizations.

Of particular interest are the activities of charitable and educational organizations under section 501(c)(3) of the Internal Reve-

nue Code and social welfare organizations under section 501(c)(4). These organizations account for most tax-exempt assets.

On the basis of our past work and analysis of the most recent IRS data, we have four observations to make:

First, the tax-exempt community represents a large and diverse group of over a million organizations organized and operated for a variety of purposes. However, the community has been characterized by concentration of resource among some large organizations. For instance, in 1989, about 2,100 charitable and educational organizations, or roughly 1.6 percent, controlled 70 percent of all such organizations' assets and 61 percent of their revenue.

Similarly, about 300 social welfare organizations, or roughly 1.4 percent, controlled 78 percent of the assets and 69 percent of the revenue of all such organizations.

Second, many tax-exempt organizations have relied upon income-producing activities to fund their operations. IRS data show that these organizations receive a substantial proportion of their revenue from program services and other income-producing sources.

For example, in 1990, such revenue accounted for 79 percent of total revenue of charitable and educational organizations and 81 percent for social welfare organizations. Program service revenue broadly refers to fees and income organizations generate while administering programs.

For example, it includes hospital charges for patient care, entrance fees to museums, fees for services at YMCAs and tuition at schools.

The IRS data also indicate that in 1990, contributions represented 20 percent of revenue of charitable and educational organizations, while membership dues accounted for 11 percent of revenue of social welfare organizations. These traditional sources of revenue for tax-exempt organizations have declined considerably from 1975, as a percent of total revenue.

Now, the third observation. Concerns of competition between the tax-exempt community and taxable businesses led to enactment of the Unrelated Business Income Tax, the so-called UBIT, in 1950. IRS data show that tax-exempt organizations have reported the bulk of their fees and business-like income as derived from activities related to exempt purposes and, therefore, not taxed.

In 1991, 71 percent of revenue of charitable and educational organizations was reported as derived from activity related to exempt purposes, and 11 percent from unrelated activities. For social welfare organizations, this percentage was 82 percent and 18 percent respectively.

However, we should note that not all unrelated business income is taxable. About 4 percent of the unrelated income of charitable and educational organizations in 1991 was taxed, while 96 percent was not. This was because the income fell under one or more exclusions that the Tax Code establishes. For social welfare organizations, about 25 percent of the unrelated income was taxed, while 75 percent was excluded.

Exclusions include income from royalties, interest and dividends and rents, if they are not generated from debt-financed property. Generally, exclusions were enacted because Congress did not believe such income, usually of a passive nature, was likely to gen-

erate competitive problems. In 1993, some 37,000 tax-exempt organizations—that is about 3 percent of all such organizations—paid almost \$174 million in taxes.

Both the number of organizations who paid taxes, and the total amount paid, has increased considerably since 1985.

Finally, Mr. Chairman, our last observation. Administration of and compliance with the UBIT required determining whether a business activity furthers an organization's exempt purpose and, if not, whether it falls within one of the statutory exclusions. Such determination has been problematic for both IRS and taxpayers. Current controversy surrounds the extent to which various income sources fit the so-called royalty exclusion.

That concludes my statement, Mr. Chairman. I request that my written statement be made part of the record. I would be pleased to respond to any questions.

Thank you, sir.

Senator SIMPSON. Thank you. Your statement shall appear in full in the record.

[The prepared statement of Dr. Gandhi appears in the appendix.]

Senator SIMPSON. And now, Dr. Mancur Olson, please. Dr. Olson?

**STATEMENT OF MANCUR OLSON, JR., Ph.D., PROFESSOR, DEPARTMENT OF ECONOMICS, UNIVERSITY OF MARYLAND, COLLEGE PARK, MD**

Dr. OLSON. Mr. Chairman, Senator Breaux, Senator Pryor, I want to commend you for your courage in holding and attending these hearings. I am pleased to testify here today.

I would like to emphasize a point that you, Mr. Chairman, mentioned, and that Senator Pryor emphasized. That is the point that the American Association of Retired Persons is only a leading example of a very large class. And the problem presented by this large class of special interests that get various kinds of tax favoritism and subsidy from our Government is very serious indeed. The example of the National Rifle Association that Senator Pryor mentioned is an apt one, but there are many, many other examples.

The reason that this problem is so serious can be understood if we look at the logic of a lobbying organization, if we look at how it is that lobbying organizations get members.

Let us think first of a lobbying organization that we might think of setting up, just to serve the public interest, or the interest of consumers, or taxpayers, or the poor, or any other large class. If we had such a lobbying organization, the benefits of it would go to a huge number of people, whether or not they paid dues. In other words, if we were working for the interests of Americans in general, over 250 million people would get the benefit of whatever we did, whether or not they paid dues.

So that means that, with lobbying organizations, a problem of financing them arises because it is not rational for the typical beneficiary to pay dues or to make other sacrifices in the interest of the organization, because the typical member will get the benefits anyway. So that means that we do not have any mass membership organizations that lobby for the public interest in general. There are

no powerful organizations that serve the interests of consumers and other broad groups.

The logic that I have set out raises the question of how those large lobbying organizations that do exist support themselves. How do those lobbying organizations that have a lot of money obtain this money?

Well, some of them are trade associations, or organizations of a small number of large firms in particular industry or line of business. If there are, say, three firms of similar size in an industry, each of these firms will get a third of the benefit of any lobbying it does in the interest of the industry with three firms.

So small groups of large firms can lobby effectively. They can set up organizations to lobby or to collude. The free rider problem is less serious for them because each firm obtains a large part of the benefit and therefore has an incentive to make substantial contributions.

When it comes to mass membership organizations, the free rider problem that I have talked about—the problem that the benefits go to people whether or not they have paid dues—is solved by various devices that make it financially advantageous for the individual to join the organization. That is to say, selective or individual benefits for those who join, or punishments for those who do not, are what motivate membership in organizations.

Let me read for you what arrived in my own mail from the American Association of Retired Persons. It says, "It costs only \$8 to join. You can easily recover this amount and more the very first time you use your member benefits." And then it talks about a whole array of services that are provided only to members by the American Association of Retired Persons.

But this is just a representative example. Almost all of the major special interests will have some benefit or punishment that they can administer individually to give individuals an incentive to join. Let us take, for example, the closed shop, or the union shop, of the labor union. Essentially what this does is penalize a person who resists paying union dues by forcing the person to lose his or her job. This is an individualized or selective punishment that can motivate membership in organizations that lobby the government or cartelize markets. One finds in all sorts of other organizations similar things. In the bar associations of 34 States, membership is compulsory. The individual lawyer is punished if he does not join the bar association of the State.

Look at various other lobbying organizations with substantial memberships. There will always be some credit card, some saving on insurance, some special service, or some social benefit that mainly explains the membership.

These benefits would not be so important were it not for various subsidies and tax advantages that are received by the organizations that do the lobbying. If an industry is highly competitive, then a firm that adds on the cost of dues in a lobbying organization has to charge more. A business that adds the cost of political activity onto its price will be at a competitive disadvantage. These businesses will in general not thrive so much.

But, if there is a tax advantage, if there is an explicit Government subsidy, if there is a subsidy in reduced postal rates, then an

organization has a competitive advantage that can generate a surplus it can use to lobby the government. The subsidy or tax advantage can more than make up for the cost of the lobbying.

I showed in a book on the logic of collective action, written quite a long while ago, that all of the large lobbying organizations in the United States that lasted any length of time owed most of their membership to various selective benefits or punishments.

This is very important for our country. The large number of special interests that emerge because of these devices or selective incentives, as I call them, has a profound effect on the character of our political life and on the functioning of our economy.

The typical special interest group represents only a tiny segment of the country. Therefore, it makes its beneficiaries better off if it can redistribute income to them—if it can get Government subsidies or tax loopholes for them. Its constituents will gain, even if the Nation loses because our economy is made less efficient, many times as much as the amount that is redistributed to the special interest group in question.

In other words, if you were talking about a lobbying organization that represents, say, 1 percent of the population and 1 percent of the income earning capacity of the country, and such an organization obtains a subsidy for its members, its members get all of that subsidy. But, though the economy is made poorer, that does not stop the organization from seeking the redistribution to its members, for it will typically bear only 1 percent of the Nation's loss. Indeed, if the organization is 1 percent of the country, it gains from getting goodies for its own members, up to the point where the national income falls by \$100 for every dollar redistributed to it.

So, if I might use a metaphor that I am fond of, a society dense with special interests is like a china shop filled with wrestlers battling over its contents, and breaking much more than they carry away.

We can see evidence of this even from the most casual glance at the economies of the world. Consider, for example, at the British disease of slow growth. Great Britain, the country that invented modern economic growth with its industrial revolution, has come in our century to do less well than most of the other developed democracies. This is partly because in that society, stable for so very long, so many groups have overcome the difficulties of collective action that I described. So Britain has more cartelistic and lobbying organizations than other societies. These organizations are pillaging that society to a greater extent than other societies are pillaged.

In our own country, consider the relative decline of the Northeast and the older Middle West, compared to the newer, more recently settled States of the West and the until recently turbulent States of the South. The decline of the Northeast and the older Middle West is due in large part to the fact that there has been more time for special interest organizations for cartelization and lobbying to emerge in the Northeast and the older Middle West.

The economic miracles of Germany and Japan after World War II were due in large part, I believe, to the fact that totalitarianism and defeat in war wiped away the special interest organizations in these societies. So, for a time, they were able to grow at rates so

rapid that people could not explain it—there were economic miracles.

I would suggest then, that the problem this subcommittee is dealing with is a very general and serious problem. Basically, what is happening is that our Government, through various devices in the Tax Code and various of its grants and subsidies, is making far more serious a special interest lobbying problem that is, in my judgment, the single most important thing holding up the progress of the American economy today.

Yes, the American Association for Retired Persons is a leading example, but only one example out of many.

So I commend you for holding these hearings, and I hope you will have others that look at other organizations as well.

Thank you for the invitation to testify.

[The prepared statement of Dr. Olson appears in the appendix.]

Senator SIMPSON. Thank you very much, Dr. Olson.

Let me ask you, Paul Hewitt, with regard to AARP's receipt of Federal grant money, would you say there is an inherent conflict of interest anywhere in a lobbying organization such as AARP receiving \$86 million annually in Federal grant money?

Mr. HEWITT. Well, I do think that they have managed to glom onto a very large share of grant money for purposes of serving senior citizens. And I suspect that their ability to do so was very much a function of their political influence in Congress. There is a smell of patronage in this grant.

Senator SIMPSON. Does it concern you that we do not know the facts with regard to the settlement of the AARP with the Internal Revenue Service of \$135 million? The AARP maintains that there was no "back tax liability" included here, and it was from the years 1985 to 1993. So let us be sure that we all know that this was not a one-year assessment. It was an assessment by the IRS from 1985, if I recall, to 1993. But we do not know how the figure of \$135 million was determined. We do know that they paid considerably less than what they owed to the Postal Service. They owed \$5.2 million and settled for \$2.1 or \$2.8, I do not recall, something close to that.

So it is reasonable to guess that the AARP did not pay the first figure that might have been suggested by the IRS. But when my staff asked for the closing agreement between the AARP and the IRS, they declined to give that to us. Do you have any thoughts about this settlement?

Mr. HEWITT. Well, I do think it does suggest that what AARP agreed to was probably somewhere in the middle between nothing and what the IRS was asking. And I think that, here again, there is the potential for conflict of interest, to the extent that AARP was able to mobilize its friends in high places to grease the wheels of settlement.

It would be appropriate that, where a nonprofit organization is concerned, the IRS not observe the same rules of confidentiality that would apply to private individuals and for-profit corporations. And I do think that AARP should disclose the full terms of this agreement and settlement.

Beyond that, of course, I know no more than you.

Senator SIMPSON. There was another interesting case where a former executive director sued the AARP. And apparently it was a rather remarkable case, which set out the whole scope of activities. I believe her name was Harriet Miller, and I think that was settled with a \$480,000 settlement. That court case was sealed. All the records of that case were sealed, and remain so. That is another interesting aspect of activity, and we will ask the AARP about that when they are here.

Let me ask Dr. Gandhi, I understand that a 501(c)(4)—now we are talking about a 501(c)(4), not a 501(c)(3)—must be organized and operated exclusively for promotion of social welfare, must promote the common good of the entire community, no cap on lobbying expenses, tax deductible of course. The number of those over the years that have been subject to IRS audit has decreased substantially. Yet the amount of unpaid taxes collected from that shrinking pool has increased substantially. Could you provide us with the exact number of audits of these organizations conducted in 1990 versus those in 1994?

Dr. GANDHI. Yes, sir. In 1990, the audits were around 816; and in 1994, the audits were about 397. So that is about 51 percent decline. But I want to point out that there has been a general decline of audits of most of these organizations. It is an overall trend where there have been less and less audits.

Senator SIMPSON. But also, the amount recovered has gone up significantly, is that not correct?

Dr. GANDHI. That is correct, sir.

Senator SIMPSON. Well, there is a chart of it, taxes and penalties assessed against 501(c)(4) organizations. And there is the line as to what was received in assessments in 1990, 1991, 1992 and 1993. And you see the line then rocketed off the edge. What is your opinion of that?

Dr. GANDHI. Well, I would point out that there has been a steady increase. In 1993, you do see a surge there. And it is quite likely when IRS lands on some very big case or cases, and settles on that, you could have a large settlement there. But I would point out that that is not unique to these organizations. You could have international transfer pricing cases where, if IRS were to settle on some very big case, you could also have a big surge there as well.

But you are right. There is a growth in taxes assessed and collected from 1990 all the way to 1993.

Senator SIMPSON. And, of course, without further adieu, the big one there. And the reason for that is the settlement with the AARP. The \$135 million is what took that line off the chart.

You are not here speaking of the AARP. You were speaking of these organizations in your GAO report. But I add that as an editorial commentary, without dragging you in.

Dr. GANDHI. Yes. Thank you, sir. I appreciate that.

Senator SIMPSON. Yes. Yes, you are quite welcome.

You have heard about the \$86 million that they receive in grants. Do you know of any other 501(c)(4) organizations that received that amount or more money from the Federal Government than the AARP?

Dr. GANDHI. Now, as you know, sir, in our report we did look at 46 of the largest 50 501(c)(4) organizations. And we looked at them

in terms of Government grants. Now I want to point out here that, when you talk about Government grants, they are not necessarily Federal grants. They could be at the State or local level as well.

So what we have found is that, in addition to the AARP, there are 6 organizations out of those 46 that I talked about that had received grants. And it adds up to something like \$98 million. And they vary from as large as \$83 million advanced to the Marine Spills Corporation, all the way to something like \$247,000. And they would vary in terms of something like 99 percent of that particular organization's revenue to less than 1 percent. So they are all over the lot. No question about that.

In the case of AARP, in 1992 at least, it comprised about 22 percent of its overall revenue, in terms of the Federal grant.

Senator SIMPSON. Thank you very much.

May I ask Dr. Olson, is there an implicit problem in the AARP's lobbying "on behalf of America's seniors" when a majority of the revenue comes from other sources?

Dr. OLSON. Yes, I think there is a problem, and more than one problem. One problem is that there can be an interest in an organization in its own revenue that can lead it at times to take stands that are not in the interests of its constituents.

For example, if an organization has lobbying power, one of the things that is rational for it to do is use that lobbying power to make the law more favorable to the business activities of this non-profit organization, and that can be harmful, even to the constituents of the organization.

Now, however, there is also the more general problem that, if the argument I presented is right, we do not have much in the way of lobbies to serve the broad national interest, but lots of special interest lobbies. When these business activities that support special interest lobbying are subsidized or given tax breaks, you get more of a disproportion of political power in our political system than you would otherwise have.

You get a situation not only where there is essentially no lobbying on behalf of the general interest, and some lobbying on behalf of special interests, but you get massively well financed lobbying on behalf of special interests. This is the source of most of the campaign contributions that distort the political races in the country.

Senator SIMPSON. Of course, this issue is going to come up in the Congress before the August recess. It will be a very spirited debate with regard to lobbying and gifts, and so on. And we are all certainly looking forward to that.

I have copies of a survey which was done by the AARP, used to determine the position against the balanced budget amendment. Now I would appreciate if you would review that. This was done by the Worthland Group, contracted to them apparently. I have reviewed it, and it is puzzling to me because it says here that even though 79 percent—this is AARP membership—favor a balanced budget amendment, 53 percent gave us a negative mention of how it will impact them. Twenty-six percent think it will have a positive impact. Seventeen percent think it will simply not affect them. Older Americans dominate the group who think that a BBA, balanced budget amendment, would not affect them. They simply feel

immune, and think that programs like Social Security and Medicare will not be touched.

So they went on to go the opposite direction of 79 percent of their members and, in fact, think that they would not be touched. So here you have a poll saying that most seniors favor it. Further, they believe it would not require Social Security to be cut, yet they lobbied against the measure precisely on that basis.

Is it not the point that you can read these polls, and develop any position you want when you have this kind of power?

Dr. OLSON. That is right. As it happens, I personally am not in favor of a balanced budget amendment. So I would not have a disagreement in this particular case with the AARP position.

But yes, you are definitely right that an organization can, and organizations often do, take stands that are against the wishes of their own membership.

What is it that makes that possible? It is precisely the logic I was describing that shows that the revenues of lobbying organizations do not come because the membership passionately believes in the goals and contributes money just because they believe in the organization's goals. The source of revenue is business activities or compulsory dues or other things like that. This enables the special interest organizations, in many circumstances, to ignore the wishes of their own members.

Senator SIMPSON. I thank you very much. Now let me yield to the Ranking Member of the Subcommittee, a man that I have come to highly regard and respect, not just because he is willing to stop by. But, more than that, he and I have worked together on issues of nuclear regulation. He was chairman, I was then ranking member. We have served together during our time in the Senate. I have a high regard for him, and he has been very helpful to me, both when I was chairman and when I was ranking member, on many issues that have always been hot ones.

And John Breaux, please. Do you have any comments?

#### **OPENING STATEMENT OF HON. JOHN BREAU, A U.S. SENATOR FROM LOUISIANA**

Senator BREAU. Thank you very much, Mr. Chairman. I appreciate your very generous comments, and for your perseverance in proceeding with these hearings. I would also like to thank the Member from Arkansas, David Pryor, for letting me just make a comment. I have a Democratic leadership meeting, that I have to go to, and I apologize.

I think Senator Simpson is to be congratulated for really pulling back the sheets and exposing one of Washington's dirty little secrets. And that is that there about a million organizations in this country that are "tax-exempt."

I think most Americans would agree that little groups of organizations and people that band together to do charitable and educational functions should not be taxed. But this has grown, and has continued to grow, as you have presented, Dr. Gandhi, in your excellent paper. And it is growing every day. I think 501(c)(3) now has 25 separate categories, ranging through all types of activities. I am not saying this as a fact, but I am sure there are some in that

group that said, well, if you want to have a good business and avoid taxes, become a 501(c)(3) organization.

In the opening statement of my colleague, Senator Pryor, he said that this is an opportunity to look at many of these organizations and all of these areas to find out whether this is legitimate public policy.

Particularly at a time when we are trying to reduce the deficit, balance the budget, and make sure that everybody pays their fair share and no more, I think it is very appropriate that the Chairman has called these hearings, and I look forward to working with him to find some solutions to what I think has become a good idea that has gone haywire somewhere down the line. I do not think any of us thought that we would end up with over a million and some very large organizations that pay no taxes. I do not think that was our intent.

I thank the Chairman, and congratulate him for bringing this to our attention. I hope to follow up with him on seeking some solutions to the problem.

Senator SIMPSON. Thank you very much, Senator Breaux. Senator Pryor?

Senator PRYOR. Yes, sir. Thank you, Mr. Chairman.

I have a question for Mr. Hewitt. I appreciate seeing you, Mr. Hewitt. I want to thank you for our past associations. We have worked together on the Taxpayers' Bill of Rights and other issues in the past, and I have always appreciated this alliance we have had.

However, I do want to put things in perspective a little bit here this morning by first asking you, are you with the National Taxpayers Union Foundation?

Mr. HEWITT. Correct.

Senator PRYOR. Now, are you a tax-exempt organization?

Mr. HEWITT. We are a 501(c)(3) educational organization.

Senator PRYOR. All right. If you are a 501(c)(3), it is by definition that you cannot lobby.

Mr. HEWITT. We do not lobby.

Senator PRYOR. What are you doing here? [Laughter.]

Mr. HEWITT. I was asked for technical advice and assistance. Under the Tax Code, as it has been written by Congress and defined by the IRS, that is not legislative lobbying.

Senator PRYOR. Well, let us see if this lobbying. For example, you state that the AARP agenda does not reflect the views of its membership.

Mr. HEWITT. That is a fact.

Senator PRYOR. The AARP membership has never endorsed such policies. The AARP stifles internal debate. The AARP's lobbyists are notorious for booing the volunteers' every word. The AARP's publications are subject to the editing by AARP's political staff. The AARP is a profoundly undemocratic organization, effectively controlled by and for the benefit of the lobby. And then you conclude that, if you do not agree with AARP's message of spiraling taxes, exploding Government, pitting the political power of the old against the young, consider it your civic duty to deprive AARP of your voice.

Is that lobbying?

Mr. HEWITT. I think it might be described in some very broad sense as educating public opinion. But it has nothing to do with lobbying, as defined by the Tax Code.

Senator PRYOR. Now, Mr. Hewitt, the point I am trying to make is that in Washington, D.C., there are a lot of glass houses. And I think you live in a glass house, sir, with all due respect. And I think that you yourself have come close to abusing this authority and abusing what I would call this privilege.

And I think that, when we look at the thousands of nonprofit, tax-exempt organizations, that we are going to have to start at ground zero. And we are going to have to look at yours; we are going to have to look at every conceivable type of organization that we can imagine—some that we cannot imagine.

As I said to Senator Simpson earlier, this is just the beginning of this debate. And I am proud that it is beginning because it is long overdue. But I am just hoping that we will establish an arena, or a mission, of where we stop and start. But I truly believe that we have got to be very cautious about coming up here and lambasting another organization when we may live in a glass house, and may also be guilty of an abuse.

So I think we just need to put it in perspective.

Mr. HEWITT. If I could, Senator, I stand by everything I said, and we are certainly able to offer corroborating evidence.

With respect to our organization, we welcome any kind of investigation you may wish to initiate.

Senator PRYOR. Well, thank you, sir.

I cannot initiate this; only our Chairman can initiate. But, as he goes forward, I would surely like to follow these hearings closely. May I ask a question to Dr. Gandhi?

Dr. GANDHI. Yes, sir.

Senator PRYOR. In summary of your testimony, on page 15, Dr. Gandhi, you make the following statement. And, once again, I think this can be a kind of preamble to an area of this whole debate that is beginning, and I quote you. "Tax-exempt status does not prohibit an organization from engaging in commercial activity, and data indicate that tax-exempt organizations rely upon income-producing activity, both related and unrelated to their exempt purposes, to finance operations." That is on page 15 of your statement.

Now, from what you have heard this morning so far about the operation of the AARP, do you think that this particular operation, this organization, is in conflict with your statement?

Dr. GANDHI. We have not really looked at the activities of AARP. And that is not what we are here for. I think it is for the IRS to determine, whether or not the activities that they have undertaken have deviated from their tax-exempt purpose.

So I really cannot comment on that, sir.

Senator PRYOR. All right. Then let me follow on with a question, and you may want to answer this question with the same answer you just gave.

It sounds like you might agree that, just because an organization such as AARP is involved in income-producing activities, such as receiving royalties from credit cards, it does not necessarily mean that they are in violation of nonprofit tax law, as described by you. Would that be your conclusion?

Dr. GANDHI. That is correct. Yes, sir. I think the Congress has allowed these organizations to undertake commercial activities, to the extent that those activities relate to and enhance the tax-exempt purpose. In addition, Congress also allowed certain commercial activities, even though they may be unrelated, as an exception. And there are about 40 exceptions to the Code.

Senator PRYOR. I see. Now, Mr. Hewitt, may I ask you another question? I believe you have raised the issue of the mailing permit, or subsidized mailing. Is this correct? You have talked about this?

Mr. HEWITT. I did talk about that, yes.

Senator PRYOR. All right. What about your foundation? Do you have subsidized mailing?

Mr. HEWITT. Yes, we do.

Senator PRYOR. How much does it cost you to send a letter through the mail?

Mr. HEWITT. I would say that we generally pay the regular first-class postal rates on most of the mail that I send out. We get virtually all of our funding from individual gifts and foundation grants. Direct mail does not fund our foundation.

Senator PRYOR. But you do have a mailing permit which allows you to mail at a significantly lower rate?

Mr. HEWITT. Yes, we do.

Senator PRYOR. All right.

Mr. HEWITT. It is worth pennies to us, and we would gladly relinquish it.

Senator PRYOR. Well, we have made some headway, Senator Simpson. [Laughter.]

In fact, congratulations. We will apply it to the deficit.

Senator SIMPSON. If we can do that with the AARP we have made bucks, I can tell you. [Laughter.]

Senator PRYOR. Dr. Olson, how many of our 501(c)(3) and (c)(4) organizations have this subsidized mailing?

Dr. OLSON. I do not know the figures on that, Senator. I do know that there is an awful lot of such mail that comes into my mailbox.

Senator PRYOR. I cannot speak for Senator Simpson, but we are trying not to hurt the churches. We are trying not to hurt the Cody, Wyoming garden club. We are trying not to hurt organizations which truly have a purpose in making this a better country.

I do think there may be some areas that we need to look further at. Once again, I applaud Senator Simpson for doing this.

Senator Simpson, I am going to yield back the balance of my time because I know you still have other witnesses to call.

Thank you, sir.

Senator SIMPSON. I thank you much, David.

Just for the record, I must say that I think an invitation to testify is not to be defined as lobbying under the IRS Code. I invited Mr. Hewitt to come, and I think the thing he is suggesting in his testimony is to propose legislative reforms which would apply to your organization too. Is that not correct?

Mr. HEWITT. Absolutely.

Senator SIMPSON. All right. I think that is very important, that whatever you have suggested, you also suggest bringing down upon yourself, your own organization.

Senator PRYOR. May I interrupt?

Senator SIMPSON. Yes.

Senator PRYOR. I am trying to reclaim a few seconds. I am an Indian giver.

Senator SIMPSON. No, no. That is fine.

Senator PRYOR. Excluded from the definition of lobbying under the 501(c)(3) definition is: (1) making available research of non-partisan research; (2) providing technical assistance to a Governmental body in response to a written request by that body. I do not really put this in the category of technical advice this morning, Mr. Hewitt, nor of non-partisan research. I think the exclusions do not apply to you. That is my position.

Mr. HEWITT. Well, even to the extent that that would be the case—and I would dispute it—nonprofit organizations, 501(c)(3) organizations, still can spend a very modest percentage of their budgets toward this type of activity.

Senator PRYOR. Thank you, sir. Thank you, Mr. Chairman.

Senator SIMPSON. I too remember that this group testified before the Entitlements Commission. And every group that testified knocked every other group, so there is nothing untoward. They all do it—veterans groups, senior groups. But I think that, for me, there is an inability to tie these two organizations of the NTUF and the AARP together because this group that Mr. Hewitt represents has none of the sources of commercial revenue used by the AARP. We are not challenging AARP's right to lobby; we are challenging their tax-exempt status business income in doing so.

But there is one thing that I think is very important to get in here, so that we all hear it. And that is, I will enter into the record the section of the bylaws of the AARP, where they can get rid of people. There is no question about the truth of that. So I enter into the record Article VIII, suspension or expulsion under section 1 of the AARP bylaws, where they can simply dismiss people. In fact they can even do it in a summary form, if they do anything that is detrimental to the best interests of the association, or if they do anything to comment on the services provided. So I would place that in the record.

[The information appears in the appendix.]

Dr. GANDHI. Mr. Chairman, may I just make a comment in addition to what Professor Mancur Olson was saying and, to some extent, what Senator Pryor was suggesting?

Senator SIMPSON. Yes.

Dr. GANDHI. I already pointed this out in our testimony, but what you want to observe here is kind of a historical trend where (c)(3) and (c)(4) organizations have moved away from the so-called traditional sources of revenue.

For example, in the case of the (c)(3)'s, contributions used to be a major source. For example, in 1975, roughly one-third of their revenue came from contributions. Today, it is something like 20 percent.

Similarly, in the case of (c)(4)'s, dues and assessments used to be a substantial portion of their revenue, which was about 58 percent in 1975. Today, it is only about 10 percent.

So this has been an historical trend. The organizations that have been mentioned here are not unique about that. They simply represent a larger trend.

Senator SIMPSON. I think it is a trend, and it is a trend that disturbs Senator Pryor as much as it disturbs me. And this is what we are about.

Let me ask Dr. Olson. I have a letter here from the Food and Drug Administration, dated December 13, 1989, directed to our friend Bill Armstrong, former Senator, who came here when we did—a wonderful colleague and friend. He had written to them because he had sent them a letter from a constituent, saying something that you are very interested in—how come I have to pay these kinds of drug prices?

Then this is the letter to Senator Armstrong from the Food and Drug Administration. The Associate Commissioner for Legislative Affairs of the Food and Drug Administration kind of gave him the business about generic drugs and what patients can do, and so on. And then, at the end, it says, "Some cooperative consumer organizations have programs which allow their members to buy drugs at lower prices. The American Association of Retired Persons, a national organization, offers its members reduced prices on prescription and non-prescription drugs. The association can be reached by writing to the membership processing department, AARP, Long Beach Boulevard, Long Beach, California."

That is interesting. Should the Government of the United States be steering customers to the AARP?

Dr. OLSON. Definitely, no. But I would like to suggest that, alas, this is not such an isolated example. The Government has provided the funding for lots of lobbies. Senator Pryor mentioned the National Rifle Association. It is not well known that it began largely because of a Government subsidy to encourage marksmanship in the interest of national defense.

Similarly, the Farm Bureau began because the U.S. Agricultural Extension Service wanted organizations of farmers to work with the county agents. Of course, the Farm Bureau ultimately became a major lobbying organization.

So I think that Government support of lobbies, which then affect the Government, and extract more out of the Government, is a very common problem. And, of course, it leads to a vicious circle. The more the Government aids the lobbies, the stronger they are as lobbies, so the more they suck out of the Government. This makes the economy go down in a spiral. And what is next is maybe Bolivia, if we do not fix it.

Mr. HEWITT. If I could add to that, the Older Americans Act, which provides much of the grant revenue AARP receives, actually has in it a provision which allows this money to be used for legislative advocacy.

Senator SIMPSON. Very interesting. There is another group, and I know that Senator Pryor has run across them. As we deal with the senior groups, there is one group that receives 96 percent of its money from the Federal Government to represent seniors. It is the National Council of Senior Citizens. They have written me saying, in a sense, stop what you are doing with the AARP. And there are many leadership councils of aging organizations that have signed onto the letter, supporting the AARP. One of them, of course, is the National Council. So they are all in it, and we know why they are

all in it, because it is a concern that goes far deeper than the AARP as to what is happening.

I might ask Dr. Olson, is the marketplace in an area such as pharmaceuticals or financial services affected by the presence of organizations with the tax-exempt support and the lobbying clout of the AARP?

Dr. OLSON. Yes, I believe it is enormously affected, and that this is a major source of why health care is so fantastically expensive in this country.

Essentially, our system of financing medical care grew out of organized interests in the medical area: organized hospitals, organized physicians and, of course, the drug industry. So what was set up in the beginning, mainly through Blue Cross-Blue Shield, was a system of paying for medical care and drugs where, in essence, the more that was spent, the more insurance was paid. And all sorts of devices were set up as part of the arrangements to reduce competition among providers of hospital services, among drug companies, among physicians, and so forth.

Then, when Medicare came in, Medicare was structured, because of these interests, in such a way that the Federal Government would then pay the providers more and more.

Of course, these things have been changed some lately, but the net effect of all this is a gigantic percentage of our National income that is spent on drugs and other forms of health care. And that gigantic percentage is in part explained, in my opinion, by the strength of special interests.

Senator SIMPSON. Another part of that is that all of us hear from our retail druggist in our home town, the so-called hometown pharmacy, which are being slowly wiped out by organizations who can provide these pharmaceuticals. And, of course, AARP has indicated that their profit there is only \$4.1 million, but there are a lot of subcontractors, and there are a lot of other businesses and corporations that fold clear back into the foundations that are monitored by the AARP, the Andrus Foundation, on and on.

It is a labyrinth that is far beyond my ability and intent to spend too much time in. I would be here the rest of my life doing that. But I want to ask you this. Are there any limits on the lobbying activity of a 501(c)(4)?

Let me ask that of Dr. Gandhi, please. Are there any limits on the lobbying activity of a 501(c)(4)? We know of the alleged and supposed limits on 501(c)(3)'s, but what about a (c)(4)?

Dr. GANDHI. A (c)(4), (c)(5) and (c)(6) can have unlimited lobbying activity. But we want to make sure that whatever lobbying they do relates to their basic tax-exempt purpose.

Senator SIMPSON. And so in your study of the GAO report, you were not specifically looking at any organization at all?

Dr. GANDHI. No, sir.

Senator SIMPSON. And the things you have said this morning are not directed at any organization at all?

Dr. GANDHI. No, sir.

Senator SIMPSON. I think that is very important that you have met that test as a Government employee.

I believe Senator Pryor has some questions, but I think we will go to the final panel.

I want to thank all of you. I have further questions, which I would like to submit in writing, if I may. It has been very helpful to have the information you have furnished. It gives us a base to start. And thank you so much.

Dr. OLSON. Thank you.

Mr. HEWITT. Thank you.

Dr. GANDHI. Thank you.

Senator SIMPSON. Now we have Mr. Roy Goldberg, attorney with Galland, Kharasch, Morse and Garfinkle, accompanied by Geoffrey Gitner.

So if you would please share your testimony with us this morning, we would appreciate it very much.

**STATEMENT OF ROY GOLDBERG, GALLAND, KHARASCH,  
MORSE & GARFINKLE, WASHINGTON, DC**

Mr. GOLDBERG. Thank you and good morning, Senator.

My name again is Roy Goldberg, and I am with the firm here in town of Galland, Kharasch, Morse & Garfinkle. I am here today with Geoffrey P. Gitner, of the firm.

Mr. Gitner and I represent a retired doctor in the Chicago area, named Dr. Joseph Schiff. He is currently involved in some litigation against the AARP. For the record, he is also represented by counsel Beigel, Schy, Lasky, Rifkind, Goldberg & Fertik in Chicago.

The reason why Mr. Gitner and myself are here, and the reason why Dr. Schiff has sued the AARP, is because of his discovery and dismay that an organization that he thought was looking out for the interests of aged people in this country, soon-to-be-aged people in this country, senior citizens, that their primary goal and objective was to advocate on their behalf, to look out for them. He believed that this was a position of trust, something like a clergy type of relationship or a family type of relationship, to look out for their interests.

He found out that that was not the case at all. Rather, this is an organization that in many ways looks out for its own interests, and primarily the interest of making a lot of money, sometimes hand over fist. And he was very surprised to find this out when the facts of the settlement between the IRS and the AARP became known.

Now Dr. Schiff has been a member of the AARP for 20 years. He has purchased services and goods from the AARP. One of the things is Medicare insurance, supplemental health care. Also, he purchased for both himself and his wife long-term care, so that if you are in a nursing home, or somebody needs to take care of you, that is an insurance package that he purchased.

When he bought that insurance, he thought he was getting a good price, and that he was getting a good value because the AARP, with its strength in numbers, would be getting only quality insurance, and would be giving him a very good price because the AARP was not in it for the money. In fact, the representation was made to him in writing that the AARP was going to make an allowance to cover its costs, and would make some interest from the funds that were waiting to be given to the insurance company.

Based on that, Dr. Schiff believed that the organization was looking out for his interests, and he bought that insurance. But he

found out after the IRS settlement came to light, which you can see in the 1993 financial statements from the AARP, that the allowance for soliciting and monitoring those insurance programs was about \$17 million.

All right; that was disclosed to him. But the AARP made \$85 million from that insurance. So somewhere there is a \$70 million profit that he did not know about, he was not told about, and he assumed that that profit did not exist, and that his pricing was based on something that the AARP was not getting that profit.

We have other examples of misrepresentations that the AARP made to Dr. Schiff and all of its members, or many of its members. The essence of his allegation is one of failure to disclose. His primary complaint is actually brought here in D.C. Superior Court, under the D.C. Consumer Protection Procedures Act.

And he alleges that the AARP was acting as a merchant when it sold insurance, pharmaceuticals, investments, credit cards, and that they did not disclose something that was very important to him. This was that although they are acting like a nonprofit, and saying that they are a nonprofit corporation, they are in fact making quite a handsome profit. He would very much have liked to know that. It was material, and it was not told to him.

There are some things that we want to find out ourselves. If you have a discovery from the AARP, that is a point we are not at yet in the litigation, and we hope to get to that point. Perhaps if we were back here in 6 months to 9 months, we would know a lot more. We know about the failure to disclose things to Dr. Schiff and other members of the AARP. We know these are material omissions. We hope to get further discovery. And we hope to make sure that in the future the AARP fully discloses what it is about, and what it is up to.

I want to thank you for the chance to appear here. I would like to request that our written comments are made part of the record. Mr. Gitner and I would be happy to answer any questions.

[The prepared statement of Mr. Goldberg appears in the appendix.]

Senator SIMPSON. Thank you very much.

Let me show you a copy of an ad for health insurance, back here in the corner. It is obviously an ad. It speaks of AARP's long-term care plan, Plan FF, for members and spouses. Of course, I think that could be described as a typical ad, which might be sent to a client as an AARP member. Would you say that looks like an advertisement?

Mr. GITNER. If I could respond to that, Senator Simpson. Yes, it does look like an advertisement. And that is the advertisement, or a similar advertisement, that Dr. Schiff saw when he agreed to obtain the long-term health care.

What we found in our investigation was that, in the long-term health care portion of the AARP's business, was that there was a profit, as Mr. Goldberg said, of some \$70 million. That is \$70 million in a single year on the premiums that were paid under the long-term health care provisions. And it is a business. They are running their business just like any other insurance company, although they have the advantage of being a tax-exempt non-paying organization.

This is \$70 million that could have been rebated, \$70 million that could have been used to discount premiums to its members, \$70 million that simply sat in the coffers of the AARP, along with approximately \$300 million other dollars, for what purpose we do not know.

And what we have determined is that members of the AARP believe that they are getting the benefit of a bargain. They have been led to believe that they are getting something of value, and something of value is that they are getting insurance or discounted pharmaceuticals, or other products, from a company that has ostensibly has led them to believe that there is no profit motive, and they are going to get these at the best commercially available rates possible. And this just has not been the case.

Indeed, from what we have been able to determine, it appears that \$18 million a year is collected by AARP on premiums, that is the interest that AARP is making off the premiums that are being paid by its members before it finds its way to the insurance company. This, again, is \$18 million that could be rebated or used to discount for lower rates to its members, who are primarily on fixed incomes or recipients of Social Security.

And this is the gist of our complaint, Senator.

Senator SIMPSON. Let me indicate, for those who cannot see as well in the back, this says here that this is for AARP members and spouses. It helps pay for home health care, adult day care, nursing home expenses not covered by Medicare and private insurance up to \$50 to \$70 per visit, lifetime maximum 730 visits, \$100 a day qualified nursing home containments. It pays for all benefits of nursing home care, plus individual age pricing. Rates are guaranteed not to increase. You have the opportunity to purchase, no prior nursing home stay, no prior hospitalization required.

And that went out for 8 cents. That went out around the United States of America in a huge number of mailings. If you will get to the next chart, as to the number of mailings the AARP has sent out, I notice it increases a bit, depending on what is up in Congress, but there are the mailing dates, and that is indeed difficult to see for those of us who are members of the AARP.

However, I have a copy of it here before me, insurance mailings under the AARP permit No. 1-1992. And it describes here the number of pieces, the nonprofit rate paid, 8 cents, 9 cents, 11 cents—they differ slightly. There were 5 or 6 mailings in January, some in February, March, heavy in May, heavy in June. Here is a copy I shall insert in the record of the envelope in which this ad was mailed, showing that it was .81 cents—anyway, 8 cents—and these were all mailed at rates between 6 cents and 11 cents over 8 months, a huge, huge volume, 21,000 at one crack, 19,000, 22,000, 27,000, 21,000.

[The information appears in the appendix.]

Senator SIMPSON. I am going to be very interested to see what happened between the last entry here of August 21 and what happened before the election in November of 1992. I have a hunch that might have been a stimulating increase. I do not know that. I have no idea, but I have a hunch.

But let me tell you, when you get into clout, where we are with this group, especially with regard to this ad and mailings. Would you put the ad back up please, Chuck.

On February 26, 1992—Buffalo Bill's birthday, I might add. We all cherish that in Cody, WY. A great ceremony is held on February 26 in my home town. On February 26, Mr. Jack Lahr, an attorney for the AARP wrote Mr. Donald Dillman Director of the Office of Classification and Rates Administration, U.S. Postal Service, and said, re—in other words, regarding—third class NPO (nonprofit organization) insurance premiums. It said, "Dear Mr. Dillman: Enclosed is a discussion draft agreement between USPS and AARP, addressing the recent legislation, the problems it generated, and solutions discussed. Preliminary reactions will especially be welcomed by March 5th.", and so on.

And what Mr. Lahr and the AARP sent the Postal Service was a draft of an agreement. And I enter it into the record here, for the purposes of anyone's review.

It says that they really could not handle this issue of "not generally otherwise commercially available." The AARP wanted the Postal Service to be aware that they were both concerned about the administration of mailings which were "not generally otherwise commercially available," saying that litigation may arise, and so on.

Then the AARP suggested that, even though they knew what they were doing, they had been told not to do. In fact, the Postal Service told them on March 11 to stop doing what they were doing because it was illegal. And the AARP kept right on mailing. And that is all part of this record.

Then they submitted this agreement saying that, commencing January 1 of 1993, which was several months on down the road, AARP will not do this any more. They will not submit any insurance mailing for mailing at NPO special rate, which is what this is.

And then they also asked the Postal Service to indicate that they would not bring any enforcement action, even though they knew they had broken the law, charging any violation to collect any postage deficiency from the AARP for these mailings, which are obviously a violation. They advertise, they promote, they offer and they recommend.

And then they asked the AARP to make no material change in current group health insurance programs, or in its mailing practices prior to December 31, 1992. And for that, the Postal Service would "release, forever discharge and promise not to sue or serve a deficiency notice on AARP, the AARP insurance plan or its directors." It is an extraordinary document that they asked the AARP to sign, together with a letter, which I enter in the record, dated March 11, 1992.

The Postal Service acted with great sensitivity and brilliance, if you will, because they said, "You have proposed to us that we not bring any enforcement action, charging violation." And, speaking of the AARP, "You have also proposed that the Postal Service should act in concert with AARP to secure a amendment of the law to replace the test of the qualified insurance mailings being not gen-

erally otherwise commercial available," to put in statutory language to eliminate that.

And the Postal Service said, "We believe it would not be proper for the Postal Service to enter into the type of administrative agreement you have proposed. We lack authority to do this."

But to think that the AARP, at least as I read it—others can read it as they wish—would write to the Postal Service, say that they knew they were in violation of the law, but we do not want you to do anything. And then they went ahead and ignored it anyway, and did. They asked them to give them release from all further litigation, and then asked them to join with the AARP to lobby the Congress to change the law. I think that is a pretty heavy hit. What is your view of that, as a lawyer?

Mr. GOLDBERG. Well, I understand that the Postal Service has levied some sort of a fine on the AARP, of at least \$2 million, which is probably only a drop in the bucket, because they were using a discount postage for non-nonprofit activity. And we applaud that. As I said, I think it is just a drop in the bucket, and that fine probably should be a lot higher.

I think it is very consistent with what you are looking at, and what our lawsuit is looking at, which is that, if the AARP is going to act as a for-profit corporation, it should not be entitled to the benefit of laws that are designed for nonprofit corporations.

Senator SIMPSON. Do you think that is what AARP members believe, that AARP does seek ways to avoid the intent of the law, not only the intent but the actual law, to be able to continue to make money off of AARP members? And then they try to enlist Government agencies to assist them in that effort with the Congress. What do you think of that?

Mr. GOLDBERG. No, I do not think so. I think that maybe these hearings will make a difference. But, at this point, a lot of the people think the AARP is doing things that are legal, and doing things that are primarily designed to be on behalf of its rank and file members.

I think things like what you say will be a surprise to a lot of people. It was a surprise to Dr. Schiff that the AARP has been doing things that are not designed for the benefit of the members.

Senator SIMPSON. Apparently the AARP paid the Postal Service \$2.8 million in settlement. They owed more than \$5 million, and I would perceive that the Postal Service probably got about as much as they thought they could in that situation.

But, nevertheless, it is a disturbing scenario, and I want it all entered into the record in its proper order, with the letter, the request, the ignoring of the law and all the rest.

You say that the doctor, who I gather was quite enamored of AARP, when you speak of his early membership and years of purchasing products and things from them, he had no idea they earned a profit from these various affiliations of theirs. As a bright consumer, hopefully, why do you think he never knew of that?

Mr. GOLDBERG. Well certainly, for example, when he was given promotional material, there was emphasis on the fact that he was dealing with the AARP, a "nonprofit organization." It is part of the promotional materials that came along with the services and other benefits the AARP was trying to provide to its members.

So it was definitely reinforced. It is reinforced through many things the AARP does, so that an average person on the street, and average people I have talked with, believe that the AARP is a non-profit organization designed to do nonprofit type things.

Senator SIMPSON. Are you of the opinion that the AARP has somehow deliberately concealed the facts about these business interests?

Mr. GOLDBERG. That is certainly an element of the case. That is true. One of the claims is also for common law fraud, and that includes misrepresentation. It can be an omission, as well as an act of misrepresentation.

Senator SIMPSON. AARP asserts that all of their members are fully aware of what they do. That is the claim of Horace Deets, their executive director, who will be here next week to present the view of his organization. They assert that the members are fully aware of everything they do, and the income earned from the businesses. They also argue that they insert a summary of AARP's finances in the AARP Bulletin.

Do you feel that those are correct statements?

Mr. GOLDBERG. Well, I would just make one note about the financial statement of 1993, where the payment to the IRS, in sort of a ho-hum fashion, is at the very end of the statement. Certainly, that is something that Congress has been looking at in the derivatives, as to whether these statements are sufficient.

What we know as a fact is that, when he was sold this insurance, he was told that the allowance would be solely to cover costs. And we know as a fact that, in 1993, the costs of these insurance programs to the AARP was about \$17 million. And we know as a fact that they made \$85 million. So those facts speak pretty loudly.

If you are dealing with the investment program, the promotional material says it is designed specifically by Scudder Financial Services. It is designed for elderly people, for AARP members, for senior citizens. But if you actually look at the investment program, there is nothing specific about it for elderly people.

The material also says that there is basically no fee or commission paid to the AARP. Well, that may be read in some way by some people. However, there is an AARP wholly-owned subsidiary. And, truthfully, that subsidiary is not tax-exempt, but it is wholly-owned by the AARP, and the pass-through of the profit is to the AARP. And they do make millions of dollars a year because of the sale of this investment program.

So our plaintiff, our case, is that these were misrepresentations made by the AARP so that they could sell these services, and there was not full disclosure. And one of our primary goals is full disclosure by the AARP.

Senator SIMPSON. Did your members know that the AARP accepts no advertising in the magazine Modern Maturity from those who compete with any of the products?

Mr. GOLDBERG. To the contrary. Many millions of members—certainly our plaintiff, Dr. Schiff—believes that the AARP is out looking for the best value for the best prices, that any product the AARP is involved with will not only be a great value because it is a great product, but because the AARP is not getting something back from that sale. Certainly, that would not be consistent with

the only products that are being advertised in that magazine are products that pay a substantial endorsement fee back to the AARP.

So, at this point, I think many members certainly do not know that.

Senator SIMPSON. Would they feel betrayed if they knew, if it was shown that the AARP simply places the ads, and does its contracting and its business dealings with those who provide them with the greatest profit, not with those who provide the best product for seniors, the finest product for their members, or any of those allied traits?

Mr. GOLDBERG. Well, yes. And especially when you have articles like what appeared in Smart Money magazine article, which says that, in fact, some of these products, investment programs and insurance policies that the AARP is pitching are not the best value.

Senator SIMPSON. Several years ago, Consumer Reports referred to them as mediocre products in their very unbiased work.

But I would be interested, and then we will wind down here.

The AARP asserts that most of the business entities that they deal with are completely separate from the AARP. And the only connection to the AARP is that those entities are granted permission, if you will, from AARP to use the name and logo as an endorsement by AARP.

And AARP continually asserts that these separate entities are not owned or controlled by the AARP. Well, I am sure that is true with some of the larger companies. You can see that exact language in the ad for the pharmacy service. And I will present that in the record.

[The advertisement appears in the appendix.]

Senator SIMPSON. But I find it most interesting that 50 percent of the board of directors of the pharmacy are either on the board of directors of AARP, or hold positions on the AARP member hierarchy.

Do you think that Dr. Schiff and other persons similarly situated are aware of that interest? And, if the AARP pharmacy is not owned or controlled by the AARP, what are the AARP directors doing on the pharmacy board?

Mr. GOLDBERG. Well, I think that they would be surprised. And we are trying to find out that information ourselves, and have met a similar stone wall. We hope, through discovery and through court order, to get that type of information.

I think they would be surprised to find out that what appears to them to be the AARP doing its homework and research, and just blessing what appears to be the best company, is in fact paying quite a steep fee to the AARP to fund the AARP offices, to fund the AARP salaries. It is going back to the AARP.

So whether there is actual control or not, certainly has nothing to do with the payments that are going back and forth.

Senator SIMPSON. And finally, what triggered Dr. Schiff to feel this betrayal, and do what he is doing?

Mr. GOLDBERG. He found out about it through the media coverage, I believe it was around the end of August, 1993. I think it was around April that the IRS and the AARP entered into their settlement of all those tax claims by the IRS. And then, right before that, AARP needed to go public with its financial statement.

The press found out about the story, and Dr. Schiff read about it, I believe, in an article in *The Wall Street Journal*. Up to then, he had no idea that the AARP had made such profits that they settled for \$135 million over the course of 8 years of profits.

Senator SIMPSON. Well, I thank you very much. It has been of some interest to me, and that is the purpose of the hearing, to determine what we have here in the way of a "nonprofit organization." And I will submit for the record the facts and figures about the AARP, which should be part of the record.

Let me just summarize them one more time, so that we will know what we are doing here, that it does not have anything to do with whether they are going to line up and get aboard on Medicare or Medicaid reform, or Social Security. That is not what I am up to at all. I do not give a whit whether they come aboard or not.

But I can tell you that the American people need to know, when we are finished, that this is an organization of huge business interests, with huge affiliations with large business enterprises in America, with a total revenue of \$382 million for 1994. Their membership dues and assessments amount to \$146 million. Interest on savings—this is yield on investments—\$23 million. If they are good investors, they should be getting maybe 7 percent yield on investments, so figure what the principal is, if the yield is \$23 million.

Group health insurance allowances from Prudential, 3 percent of every premium, \$101.6 million, including the float, which is the interest earned which they hold and receive the benefit of.

Tax-exempt royalty income, \$34 million for 1993. Hartford Insurance Company, \$22.5 million. These are revenue figures.

Retired persons' services—that is the mail order pharmacy—\$4.1 million. Auto rentals, \$4.1 million; Amoco, \$1.8 million; Foremost, the mobile home insurance, \$1 million; American Express travel services, \$300,000; books, \$100,000, all for \$8 a year.

Employee salaries, \$63 million; 19 persons on the payroll receive over \$100,000 a year; the other 1,760 some are well compensated. One should also review the employee compensation and retirement benefits of this organization, rather striking.

Funds spent on leased luxury office space, \$24.6 million, including \$17 here for one building in the city.

Other material has come forward today, and we will continue to pursue it, and it will not be just this organization. Obviously, this type of thing is very successful. It has worked very well for others.

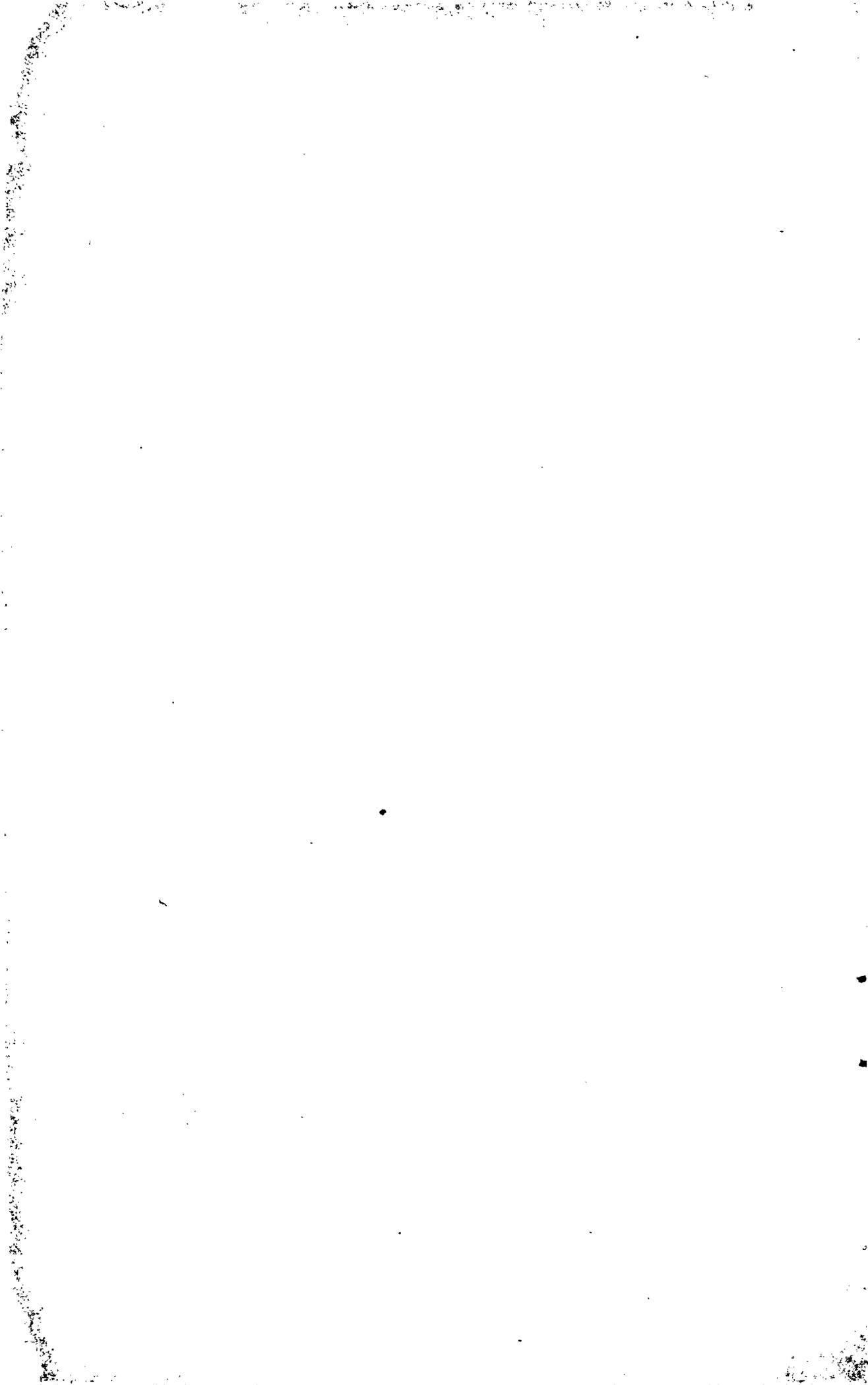
And I do know that there are some professional veterans' fund raising organizations that I am involved with, as Chairman of the Veterans Affairs Committee. Perhaps we should look into those too. I think that all of them should be carefully reviewed.

Thank you very much. I appreciate your coming here. We will conclude the hearing, and take it up again. The next hearing will be June 20, with the AARP and its organizational persons present.

Thank you very much.

Mr. GOLDBERG. Thank you.

[Whereupon, at 12:08 p.m., the hearing was recessed, to reconvene at 9:30 a.m. on Tuesday, June 20, 1995.]



# **BUSINESS AND FINANCIAL PRACTICES OF THE AARP**

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**TUESDAY, JUNE 20, 1995**

**U.S. SENATE,  
SUBCOMMITTEE ON SOCIAL SECURITY  
AND FAMILY POLICY,  
COMMITTEE ON FINANCE,  
Washington, DC.**

The hearing was convened, pursuant to recess, at 9:55 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Alan K. Simpson (chairman of the subcommittee) presiding.

Also present: Senators Chafee, Pryor, and Breaux.

## **OPENING STATEMENT OF HON. ALAN K. SIMPSON, A U.S. SENATOR FROM WYOMING, CHAIRMAN OF THE SUBCOMMITTEE**

Senator SIMPSON. The hearing will come to order.

Good morning, and welcome to the second hearing of the Subcommittee to review the structure and tax-exempt status of the American Association of Retired Persons.

Let me first review where I believe we are as a result of the first hearing. I was joined at that hearing by our friend, Ranking Member Senator John Breaux, and the former Chairman of the Senate Select Committee on Aging, my colleague Dave Pryor, who came here when I did. They each made a welcome contribution to that hearing with their statements and questions.

Some of them may show up during the day, but do not count on it, because it is that kind of situation when you are wandering into the swamp with an organization which exerts tremendous powers over us. We want to remember that.

So one of the salient points, properly raised by my colleagues, is that many of the issues and facts which concern us about tax-exempt organizations—

Now my friend, John McCain, is here, so I am going to accelerate this thing a little to hear from him. And we will come back to the basic theme of what we are doing here, so that we can hear the testimony of Senator McCain, my friend from Arizona, who represents a State where there are probably more senior citizens, more veterans, more persons more deeply affected and influenced by the AARP—or vice versa—than perhaps any of us.

He, in his own unique way, with his courage, which is legendary, will state his case. And I am not at all aware of what it might be, but I can tell you it will be impelling.

One of the things I just want to say before I go right to Senator McCain is that many of the facts and issues which concern us

about tax-exempt organizations are not necessarily unique to the AARP.

Senator Pryor read from a nationwide mailing by another tax-exempt organization, apparently attempting to capitalize on the tragic death of Vincent Foster. He was appalled at that. Nothing more needs to be said about that mailing to provoke indignation.

There are many tax-exempt organizations which engage in a variety of deplorable practices, not the least of which is the dispensing of a cauldron of misleading, dramatically hyped or sensational material in the course of fundraising—plain old fundraising.

I would earnestly caution that I am not reviewing AARP for reasons such as these. As much as one may disagree with some of the things AARP has said to, and in the name of, its members, we must remember that distortion and misrepresentation is often in the eye of the beholder. And, in any case, it is fully protected by the First Amendment.

We are chiefly interested, as we go forward with the statements of AARP's leadership, to the extent that we may determine that the leadership has used its vast resources to impose a "policy agenda" upon an unwilling or uninterested membership, who joined simply because of discounts and benefits, and really had no concept that this is what the AARP wants.

This inch-and-a-half thick publication "Toward a Just and Caring Society" is filled with demands upon the Federal Treasury—stuffed full. And that is a very interesting thing. Do these 32 or 33 million members really respond to the leadership of this organization? And certainly the singular topic of outrageous, false or inflammatory statements utilized in nonprofit fundraising might well be a worthy subject for another hearing one day.

And I see my good friend, Senator Pryor is here. And I mentioned the fundraising letter you showed us last hearing, which was certainly repugnant with regard to the death of your friend.

But that might be a worthy subject for a hearing. It might be the title of it—Outrageous, False and Inflammatory Statements Used in Nonprofit Fundraising. That would be a good title. And on that subject, if Senator Breaux or Senator Pryor would wish to have separate hearings on that subject, I would certainly be willing to try to accommodate them, and would be even eager to explore that.

But we must continually bear in mind here that the central reason we are here is not because of the things that AARP has in common with other tax-exempt organizations, but because of the ways in which it is completely different and unique.

I know of no other organization, as yet, which operates quite in the manner of AARP, a 501(c)(4) corporation.

I am going to reserve the balance of my remarks so that we can hear from Senator McCain, who has been very good to indicate that he would come before the Subcommittee.

And I am going to go right now to my friend from Arizona. At the completion of that, if there are any remarks by anyone of the panel, I will then conclude my statement and go directly on to the next witness.

So, with that, Senator John McCain, a very highly regarded and respected member of this body. When he speaks, we listen. So, what do you have to say?

[The prepared statement of Senator Simpson appears in the appendix.]

**STATEMENT OF HON. JOHN McCAIN, A U.S. SENATOR FROM ARIZONA**

Senator MCCAIN. Thank you very much, Mr. Chairman. I want to express again that so many of us appreciate your having this series of hearings on an organization which, in my view, has an incredible amount of influence in the legislative process. I think we can prove that by the record, which I intend to go into briefly.

And, Mr. Chairman, I am cognizant of the dangers involved in talking about this organization. They have millions of members. They have been able to shape legislation. They have been able to block legislation. And I want to again congratulate you because I think not just this organization, but many other organizations, have too much influence over the legislative process.

From watching the media and reading about the previous hearing, I agree with anyone who says that we ought to look at the influence that any organization has which, frankly, is not in keeping with the will of the majority of the American people.

At the same time, I recognize that any organization has the right to petition the Government. Obviously, the question is—and I know that this Committee will address it—how many Federal dollars should be involved? What is the nature of that relationship? And should any organization that wields an inordinate amount of power, that distorts the legislative process, be subject to scrutiny and oversight on the part of the Congress of the United States?

Since the subject of these hearings is the AARP, Mr. Chairman, you have been kind enough to let me make a few remarks because, as you mentioned, my State has a very large number of senior citizens. It was a very large number of members, and I have had first-hand encounters on several issues with the AARP in relation to issues that affect seniors.

Mr. Chairman, we hold different opinions about the repeal of catastrophic health care, but I think you will agree that senior citizens came to resent with great vigor the Medicare Catastrophic Coverage Act. All we have to do is ask the former chairman of the House Ways and Means Committee, who was clobbered over the head with a sign by some irate constituents over this issue.

As you remember, the bill was passed into law on July 1, 1988. After several iterations, it was basically repealed in November, 1989 by a House-Senate conference. We all know that, when seniors finally realized the impact of the catastrophic bill, a veritable revolt among the beneficiaries forced Congress to repeal the Act. What is less remembered is that the bill was by and large conceived, written and sold to Congress by the Washington lobbyists of the AARP.

According to an article by Mr. Hank Cox in *Regardies* magazine, January 19, 1991, and I quote, "The American Association of Retired Persons may be the only lobby in Washington with enough clout to bulldoze a massive new benefit program through the Congress, only to have its own members force the repeal of the program less than a year later, and not experience so much as a twinge of embarrassment or offer a hint of apology. After the bill

became law, when increasingly agitated seniors demanded that it be revoked, the AARP fought all efforts to repeal it. Local chapters throughout the nation repudiated the national AARP organization for continuing to support the legislation, but still the national AARP opposed repeal." Every local chapter in my home State of Arizona opposed the catastrophic bill, and called for its repeal. AARP would not listen, and continued to support the bill. In my efforts, Mr. Chairman, 44 national seniors' organizations, including National Committee to Preserve Social Security, National Association of Retired Federal Employees, and so forth, supported repeal, but not AARP.

Although they occasionally conceded their membership's concurrence with my concerns about the bill, AARP's Washington leadership did not simply withhold support of repeal efforts; they actively opposed those efforts.

During the debate on the amendment that I had to delay for 1 year the implementation of the provisions of the bill, I received a letter from AARP which stated, "AARP did not like the financing requirements of the Medicare Catastrophic Coverage Act when the law was being debated, and its position has not changed. We proposed alternatives, but they were not acceptable to the present Congress. Since enactment, AARP has received tens of thousands of letters from our members, voicing their strong objection to the financing." This is a letter I received from them, Mr. Chairman.

Despite this concession, the AARP did not support any of our efforts, even though they received tens of thousands of letters from their own members.

Mr. Chairman, I think it is important to recognize that AARP is more than just a nonprofit advocacy organization; it is the prescription drug business, and stood to make millions of dollars if prescription drugs remained a part of the catastrophic bill. So they had more than an objective opinion on this issue. To my mind, this profitable sideline of AARP's clearly raised questions about whether AARP's advocacy represented a conflict of interest.

AARP's executive director, Horace Deets, claims, "Congress messed it up, not AARP."

It is not surprising then that AARP lobbyists failed to apply any lessons from that experience to their consideration of current legislation. They never learned any! AARP's national headquarters again ignored the views and concerns of their members during debate of the President's health care reform bill in the 103rd Congress.

According to AARP's 1993 executive director's financial report, "Our chief focus in 1993 was, and still is, comprehensive health care reform. AARP's strong financial position allowed us to mount a highly effective campaign throughout the year in support of reform."

Despite that, Mr. Chairman, over 75 percent of the letters, phone calls and correspondence I received from AARP members in Arizona expressed their outrage that their Washington lobbyists had endorsed the Clinton health care plan—75 percent.

I need not remind the Committee that Arizona is home to a great many senior citizens. I hear from most of them quite regularly. There is no doubt in my mind whatsoever that the vast majority

of senior citizens were unalterably, absolutely, single-mindedly, at times quite bitterly opposed to the President's health care reform proposal.

Many of these seniors mailed my their AARP membership cards, renouncing their membership in AARP for endorsing President Clinton's health care bill. These seniors were appalled that their opinions were being ignored by an organization which promotes itself as an advocacy organization for the nation's elderly.

Coincidentally, AARP would have stood to financially benefit—greatly benefit—from the mail order prescription drug section of the Clinton health care bill.

Let me just mention one other issue. That is, of course, the Social Security earnings test. Again, every major seniors' organization in America supports repeal of the Social Security earnings test. And yet, AARP states in its 1993 executive report, "With respect to AARP's work opportunities goal, the association continues to defend the rights of workers as they age . . ."

If AARP was really concerned about the rights of workers, it would enthusiastically fight to repeal the earnings test. In reality, what the AARP means when it states that it is "fighting for work opportunities," it is fighting to preserve the Federal largesse that funds its work programs.

I believe that the AARP is less interested in ensuring that working seniors can make ends meet than it is concerned with its own bottom line.

As you know, Mr. Chairman, last year AARP received over \$86 million in Federal Government grant money. And my understanding is that about 15 percent of that money goes to administrative costs.

Finally, Mr. Chairman, AARP questioned members in my State on the balanced budget amendment by asking them, "A balanced budget amendment will mean cuts in your Social Security. Do you favor the balanced budget amendment?" Now, Mr. Chairman, that is not the kind of policy advocacy that seniors need.

Seniors, as all Americans, can and should be able to join together and ensure that their collective voices are heard. That is the American way. But we must ensure that those collective voices are not muted by some Washington hierarchy that no longer listens to or cares about the concerns of its members.

As I said, Mr. Chairman, I have had a lot of exchanges with the AARP over the years. I have dealt with the local chapter presidents back in Arizona, and have always had an excellent working relationship with them. I have had just the opposite relationship with the people here in Washington.

And I do not believe I can state categorically on major issues, such as catastrophic health care, the Social Security earnings test, the Clinton health care plan, and such as a balance budget amendment, that the AARP represents the majority of the views of the members of that organization who reside in my home State of Arizona.

I thank you very much, Mr. Chairman.

[The prepared statement of Senator McCain appears in the appendix.]

Senator SIMPSON. Senator McCain, I thank you very much for that powerful testimony. It once again brings to light something that I have felt, the issue that has been brought to my attention most by AARP members who write to me—and I have a bale of stuff on this one, as you might imagine. And, believe it or not, it runs 10 to 1 in favor of what we are trying to do.

Most of it is from AARP members, who say, look, I joined for the benefits, I joined for stuff, I did not have any idea that this was their agenda, I have never read this inch-and-a-half book. I never knew what they were doing to my children or my grandchildren. I never realized that they would not even let us try to correct these things.

And I guess it is the fact that they do not represent the interests of most of their membership when the organization comes here to Capitol Hill, rolls up their sleeves and shows off their political muscle. And, brothers and sisters, do not think that they do not do that with a very remarkable ability.

And it has been shown time and time again when they stream through here, and then you go back to your State and hold town meetings, you never hear a peep about what they are asking for. They say, I do not believe that. I want a balanced budget amendment. Forget that stuff. I am not going to get off into the sideline there. They have heard that the reason of my interest here is because they voted against things I was in favor of.

Let me tell you, I have been after the AARP for years. So let the record be absolutely clear. Ever since I first read the magazine, when I first joined at the age of 55, I have thought, what is this outfit up to? So do not read too much more into it. Do not divine it beyond its reality because I have been looking at it for a long, long time.

Anyway, I thought about their own surveys, and how they seem to reject those. And I think the puzzling thing to me is that the people believe that their advertising conveys the best deal for them. And it is not the best deal for them; it is the best deal for the AARP. And I think we will find that as the hearing goes on, at least a better understanding, and you have given us that.

I thank you very much.

Senator MCCAIN. Mr. Chairman, could I just make one additional comment?

Senator SIMPSON. Yes.

Senator MCCAIN. What I think has happened here is what has happened in a lot of other areas of interest that lobby in Washington. And I have cautioned my Native American friends on this time after time after time. No lobbying organization that represents a group of Americans should align themselves with one party or another too closely. If they do that, they then have a tendency to go along with the issues that are more important to the party they are aligned with than their membership.

And I believe that you could make a case that this happened in the AARP here in Washington, There is no other way, Mr. Chairman, that I can explain how seniors in my State were up in arms, and literally having demonstrations against the catastrophic health insurance bill. And here in Washington, their lobbyists were still fighting to maintain it. I know of no other way to explain that.

If I had some advice, not only for the AARP, which I am sure would not be particularly welcome, but for other organizations also, you should only align yourself with the issues, and go to those individuals, Representatives and Senators, who will fight with you for those issues. If you become too aligned with one party or another—and I am saying that to organizations that are aligned with my party—sooner or later you may suffer, and not really represent the organization and the members which you purport to do.

Senator SIMPSON. Thank you.

Senator Pryor, it is good to have you here, my friend. Do you have any questions you might wish to address to Senator McCain?

Senator PRYOR. Well, Mr. Chairman, I have an observation or two. I have been on this Committee almost 10 years, and I must say that I am a little bit troubled because I do not know what our mission is in doing this.

For example, you talked about letters my good friend, Senator Simpson, has received. One or some of these letters says that they agree with what we are trying to do.

Senator SIMPSON. I have not finished my opening statement. You will know when I finish.

Senator PRYOR. All right. Well maybe then, I will not continue until you finish your opening statement.

I do apologize.

Senator SIMPSON. Senator Breaux?

Senator BREAUX. I have no questions, Mr. Chairman.

Senator SIMPSON. Thank you very much, Senator McCain. I appreciate it very much.

Senator SIMPSON. Now let me conclude my remarks, and get into what we are doing here, at least what I see that I am doing here, because this is nothing that anyone else is involved in, nor would they be.

First of all, we are not talking about a 501(c)(3), and I misspoke. We are talking about a 501(c)(4) organization. Recall 501(c)(3) organizations which receive Federal grant money, indeed there are—many of them. But they are limited by statute in the extent of lobbying that they may do.

Then there are the 501(c)(4) organizations which, as AARP, have no statutory limit on how much they can lobby Congress, but which also must depend on their members signaling their support for such lobbying activities by rendering of their contributions and their dues.

And there are also some 501(c)(4) organizations which, like AARP, derive their income primarily from program services, such as insurance sales, but which do not pose in their lobbying or advertising as selfless advocates for a single sector of society—a huge difference.

In short, the AARP is still the one remarkable organization that I know of in my research that manages to have it all ways at the same time, the best of all worlds.

When AARP is criticized for refusing to accept advertising from products which are rated by Consumer Reports or any other organization, or Money magazine, as being superior to their own, their attitude is, caveat emptor, buyer beware. Seniors can buy from

somewhere else. You are on your own. It is not our job to look out for their consumer interests.

But, oddly enough, whenever we here in Washington wonder who it is that AARP really represents, given that their tremendous flow of money comes primarily from commercial activity, we are told then that they are an organization primarily and deeply concerned with the social welfare of elderly Americans, and thus should be tax-exempt. You cannot have it both ways, and they have had it because of their clout and the awesome force of their alleged numbers. In every applicable situation, the AARP adopts the posture that most benefits those running the AARP.

While I sincerely believe the AARP is absolutely unique, I also believe we must heed Senator Pryor's admonition that any solution to this problem must be neutral, and must affect every similarly situated organization. I mean that.

Thus, as a consequence of my previous review, and of facts gained at the first hearing, I am giving serious consideration to introducing legislation—I hope Senator Pryor will hear what we are up to—to prevent any 501(c)(4) organization, whether the AARP or whatever, out into the vapors, from being able to receive and to administer Government grants.

And I assure you that this does not mean that these people will go unattended. There will be plenty out there to fill that gap.

I simply believe we may find that the very construction of the 501(c)(4) law, with its blank check to lobby, tax-free and without limit, is wholly incompatible with the receipt of Federal grant money. Section 501(c)(4) is quite different from 501(c)(3), in which there is a global cap of \$1 million on lobbying expenses.

I do hope to garner at least a bit of support from my colleagues for reforms such as these, which do not single out any specific organization—that is, if any of my colleagues ever show up. But, nevertheless, we will pursue it.

Senator BREAUX. We are here.

Senator SIMPSON. Yes you are. These good colleagues here have been very, very courageous. Over here, it is a little scarce.

Yes. Good morning to all of you.

Well, onward now. I want to clarify a couple of things too. One matter, with regard to the Money magazine article, those photos there were not interchanged on that page. In an otherwise excellent article about AARP, which I thought was rather fair, they listed everything they peddle, and said here it is. Some of it is great, and some of it is appalling. And it was done by "experts," that wonderful phrase. And there are a lot of experts in the AARP too.

Anyway, it said that I had indicated that I felt that the giving of grant money to AARP, "creates a seeming conflict of interest. "He," meaning me, "has charged that the AARP lobbies for more Federal entitlement spending in part to collect more Federal contracts." Well, I do feel that a seeming conflict of interest is indeed created by this practice. I do not allege that the acquiring of grant money is the zero base of AARP's lobbying efforts. I want to make that very clear.

I further believe that the testimony last week added additional weight to the contention that there should be a minimum level of financial dependence on direct membership dues and other con-

tribution support, in order to be able to qualify as a 501(c)(4) because this designation enables organizations to enjoy the ability to lobby without limit, as I have said. We do, I think, need to find criteria to ensure that such organizations are indeed lobbying with the full and at least generally enthusiastic support of the members that they "claim" to represent.

It is my intent today to continue to build upon what we have learned in the first hearing last week. We learned from GAO that, despite a declining number of IRS audits of tax-exempt organizations, settlement money collected from social welfare organizations, which had not exceeded \$5 million for years, suddenly shot up to \$138 million, an increase of more than 25-fold. This was almost solely due to one organization—the AARP. Now I think that tells us something about the uniqueness of AARP's size and activity. Indeed, it should.

We also learned that the AARP saved, and the taxpayers paid, more than \$5 million in 1991 and 1992 by improperly mailing health insurance solicitations at nonprofit postal rates. And we learned that, when the Postal Service attempted to stop this practice, AARP continued for months to send these mailings. They even tried to enlist the Postal Service to agree not to enforce the regulations and, instead, to help to influence the Congress to "change the law" in AARP's favor. The correspondence will be reviewed.

I truly believe that AARP has become so big and so powerful, so accustomed to its almost reverential super-legal status in many respects, that AARP's leaders genuinely do not see what is wrong, and what is going to happen to their children and grandchildren and mine if all of this is simply the official line, which would cost \$1 trillion bucks in the next 10 years. And those are findings that do not come from my office resources, but from others.

And so I think the AARP's feels aggrieved. I think they feel picked on, that I, a single emaciated senior citizen Senator from Wyoming, am trying to intimidate them. That is a phrase they have used, or to "silence" them in the Medicare debate. What a chuckle. They can weigh any of this to political unrest in a New York minute. Let us hear that.

You can see in their responses to the many questions, and I have visited with them and told them the questions I was going to ask. That is not very common in this town. Usually you just line them up down here and then tee them off somewhere down Pennsylvania Avenue. I have not done that. I have a few that I have never revealed before, but not too many.

And I believe that you will see in their responses to many questions—and all of them will become public, either this form or another—that they believe that they are doing what everybody else does. It is an old, time-honored defense, especially in Washington—everybody does it. And, of course, by every lobbying organization, we are just doing God's work.

Well, everybody does not do it. And when most persons or groups are alerted by the U.S. Postal Service that they are mailing items at the wrong rate, they stop. They feel neither the power nor the right or, I guess, the righteous indignation, to get the Postal Service to "change the rules."

When most individuals or companies sell insurance policies, they pay taxes on the income. When most businesses want to provide a benefit to their employees or their customers, the Government does not provide the funding to do it. When most 501(c)(4) organizations lobby Congress, their members usually strongly endorse their policy choices.

And I believe that the last hearing and this one will continue to demonstrate that the AARP was established from its beginnings, its origins, its roots, to hawk insurance products tax-free. That is how they came to pass. A source of significant income then and now, remaining very lucrative even to this day. And, however dedicated these individual AARP representatives might be, the AARP continues to operate in a manner that I believe is wholly inconsistent with the basic intent of the tax-exempt nonprofit laws, and Congressional intent also.

I continue to have many questions as to just how the AARP is run. It is a huge operation, digging down through the trusts and the foundations, and all the stuff. I have no resources to get there, but we can certainly try to find out. Because I believe it is critical to determine whether or not AARP—or any other groups similarly situated—should continue to be treated as a nonprofit organization, or rather to be taxed in the classic American way. If you are big business, you pay big taxes.

So that is where I am coming from. It will be along that theme that I will address these issues.

I am very pleased that Senator Pryor is here, as a Member of the full Committee. And particularly, my friend, John Breaux for whom, as my Ranking Member, it is very difficult for him to wander in here. And I said, I do not want you to go over the cliff with me at all. And he said, do not worry. And the same with Senator Pryor. So I appreciate their genial forbearance as we proceed with this hearing.

And now, Senator Pryor, if you wish to make any remarks, please feel free to do so.

#### **STATEMENT OF HON. DAVID PRYOR, A U.S. SENATOR FROM ARKANSAS**

Senator PRYOR. Yes. Thank you, Mr. Chairman. I do apologize for interrupting your opening statement a moment ago. I was not aware that you had not completed that statement.

I think I have come to express the concern that I fear we are singling out one organization, the American Association of Retired Persons. Maybe they need to be discussed, but I think they need to be discussed in the whole context of everything else and the other organizations.

For example, here are four organizations right here. These are allegedly seniors' organizations, and they speak for and lobby for seniors. I have their tax returns. They take in millions and millions of dollars from people in mail campaigns. They solicit contributions from them. They lobby. In fact, they list their lobbying activities right here. As they say, they are involved in public awareness and public advocacy, and on down the line. This is a lobbying organization. These are four other lobbying organizations that pay zero—absolutely nothing—in income tax.

Now, if we are going to go after the AARP, let us go after—I even hate to say going after. Let us also look at these other organizations that lobby and pay no income tax. And, as Senator McCain stated earlier in his statement, maybe exercising “too much influence over legislative process.”

Now I just do not know where the parameters of a hearing like this might go. And it concerns me to some degree that I think we do not exactly know where we are going here, or what we are trying to accomplish.

For example, I think we need to ask ourselves a question. Are we going to hold a hearing in the Finance Committee of the United States Senate relative to every organization that one of us might feel does not represent their people? I think we need to ask that question. Are we going to serve here the purpose of indicting the AARP? Are we here to embarrass the AARP? Are we here to change the laws that affect the AARP, and literally 600,000 to 700,000 organizations that pay no taxes in our system?

Or are we here to charge the AARP with violation of a postal law, or the violation of the intent of 501(c)(3)'s or 501(c)(4)'s, whichever their organization might be?

That is my concern, Mr. Chairman. And I appreciate your mentioning the concern I expressed about the late Vince Foster. Another type of organization is springing up. My tax-deductible contribution helped this effort—and this is the group, Advocacy in Media. And what they are doing is rehashing the death of Vince Foster. Was this approved by the Vince Foster family? Of course not. This was paid for by you and me, and all of us in this room, and every American, because this is a tax-exempt organization that spells out this kind of hate and spews out this kind of venom.

Now, if we are going to investigate this, let us do it all the way. That is my only purpose. Let us investigate AARP. Let us investigate United Seniors, the Seniors Coalition, Accuracy in Media, Inc., and thousands of other organizations. Let us investigate the NRA. Maybe they do not represent all of their members.

That is my plea, Mr. Chairman. And I look forward to hearing these witnesses.

Senator SIMPSON. Senator Breaux?

#### **OPENING STATEMENT OF HON. JOHN BREAUX, A U.S. SENATOR FROM LOUISIANA**

Senator BREAUX. Thank you, Mr. Chairman.

I think that the Senator from Arkansas makes a good point in the sense that, because of these hearings, I have found out that there are over a million organizations in this country that have tax-exempt status for a whole list of reasons.

I think it is entirely appropriate and proper, and also very timely, for this Committee in particular to look at what type of organizations have been created that are taking advantage of a tax-exempt status in order to conduct their activities.

It would be wonderful if everybody could just form a tax-exempt foundation and continue your normal business activities under that tax-exempt status. But then, what would we have as a country, and where would we find the funds to do the things that a government is supposed to do?

Back in 1950, as we are all aware, Congress tried to put a limitation on these tax-exempt foundations by saying that those of you who are formed in order to present an opinion to the Congress of the United States, and have members who pay dues are, of course, tax-exempt.

Those of you who engage in other business activities which are unrelated to the purpose for which you are organized, and are really generating income, should pay an unrelated business income tax.

I think, Mr. Chairman, we have not really addressed it for 45 years now. And I think, with the explosion of the groups and organizations that we now see, it is timely that we do it.

In 1993, about 3 percent of all tax-exempt organizations paid unrelated business income tax. That means 97 percent of them did not. And some of these organizations really have millions and millions of dollars of income being generated from magazines and publications and sales of products that they think their membership has an interest in purchasing.

I think it is very timely that we use these hearings as an opportunity—not to go after any one group, not to get any one group—but to take a real look at all of the organizations to see whether this is what Congress intended or not, whether it has gotten out of hand, and whether it is proper and appropriate for us to consider legislation that brings it in, so that we do not ultimately have nothing but tax-exempt organizations in this country.

The politics are interesting. I know there are some who are accusing you, Mr. Chairman, of going after the AARP because you differ with their views, perhaps as a Republican, on their statements on Medicare budget cuts.

There is an article about the National Rifle Association saying that they are a target of Democrats going after their tax-exempt status because Democrats differ with some of their views.

I think we have to raise it to a much higher level. Having political parties go after groups or organizations that differ with our political philosophy, we have to be very careful when we move into this area of free speech.

But it is appropriate, and it is proper, and it is necessary that we look at the one million organizations that have tax-exempt status, and determine whether they are in compliance with what we, as members of Congress, think is a legitimate exercise of that tax-exempt status. So I certainly hope that we can broaden our review. I think it is proper, appropriate, and certainly very timely.

Thank you, Mr. Chairman.

Senator SIMPSON. Thank you very much.

I hope that my colleagues hear me correctly when I have said, and said long before this, that we are going to deal with this issue in the actual manner that my friend, Senator Pryor, has said. Any solution to this problem should be neutral. And that is what I have said.

There are some organizations which are extraordinary, one called the National Council of Senior Citizens. If you really want to get into philosophy, it is a left-wing operation, 96-percent funded by the Federal Government. I could have had them here, but they are small potatoes. They have very few members. And this group alleg-

edly has 33 million members. That is why I am directing my attention here.

And the issue is very clear to me. Maybe none will hear it, but I have heard it. What I am seeking to accomplish through these series of hearings, in English, is to cut off all 501(c)(4)'s from administering Federal grants. That is number one. And, two, to ensure that 501(c)(4) status only follows upon direct financial dependence on membership or contribution direct support, and not upon businesses.

And is the income of these other senior organizations primarily from dues and contributions, or is it from business activity, big business activity? AARP has joined together with Prudential Life, New York Life, Hertz, Hartford, Scudder, this is big, big business. It is not in the kiddie league like the rest of them.

I would hope that my good friend from Arkansas would realize that it is my prerogative, as chairman of the subcommittee, to pursue issues of interest to me, just as the Senator from Arkansas pursued things of interest to him like procurement and stacks of stuff spread all over the community. I loved that. I thought that was great what you were doing. Nobody was there helping you. So you had a great interest in procurement and warehousing, and that is an interest of yours. And I shall pursue this with the same vigor with which you pursued those issues which were of greatest interest to you. And I know you would extend me the same courtesy that I extended to you in that situation.

And so please, Jeffrey Zerkowitz, Senior Counsel, Classification and Customer Service, U.S. Postal Service, Washington, DC.

Mr. Zerkowitz?

If you could proceed, sir, in a 5-minute period, we would appreciate it.

**STATEMENT OF JEFFREY ZELKOWITZ, SENIOR COUNSEL,  
CLASSIFICATION AND CUSTOMER SERVICE, U.S. POSTAL  
SERVICE, WASHINGTON, DC**

Mr. ZELKOWITZ. Thank you, Mr. Chairman, and good morning. Thank you again for asking us to testify today.

Again, my name is Jeff Zerkowitz. I am a Senior Counsel in the Postal Service's law department. My duties include providing advice to officials responsible for deciding mail classification appeals and related matters, including the use of nonprofit mail rates.

First, I would like to give you a quick overview or history of special bulk third-class mailing rates. Eligibility for the nonprofit rates, including the types of organizations authorized to use them, and what may be mailed, is established by statute.

Third-class nonprofit rates, as we know them, originated in 1951 when Congress created an exemption from a general rate increase for matter mailed in bulk by 8 generic types of nonprofit organizations.

Included in this number were such broad categories as religious, educational and philanthropic organizations, as well as groups described as scientific, agricultural, labor, veterans and fraternal.

In order to mail at the special rates, organizations had to meet two requirements. They had to be nonprofit, and they had to meet the requirements of one of the 8 categories.

In response to the explosive growth of the nonprofit sector in the 1960's, the Postal Service decided that it was necessary to adopt detailed definitions of qualified nonprofit organizations. This was accomplished in 1973. These definitions attempted to correlate the postal meaning of the terms such as educational and philanthropic with those used by other agencies, most notably the IRS.

While postal officials focused their attention on the eligibility of organizations to mail at the nonprofit rates, a different set of enforcement problems arose concerning the material those organizations were mailing. In simple terms, some nonprofit organizations had decided to push the literal terms of the preferred rate statutes by mailing in bulk the advertising matter of for-profit companies. In this they were assisted by commercial direct mail promoters, who discerned the competitive advantage offered by nonprofit postage rates.

The Postal Service responded to this development by revising its regulations in 1975 to limit the use of the special rates to an organization's own matter, and to forbid nonprofit groups to delegate or lend their permits, or to mail matter on behalf of, or produced for, an ineligible organization.

These regulations, which are commonly called the Cooperative Mailing Rule, have been challenged and upheld in Federal courts.

Eligibility issues remained controversial during succeeding years, as concern regarding the Federal deficit stimulated closer inspection of the nonprofit mailing subsidy. That inspection focused on what groups are eligible for the subsidy, and what those groups are mailing.

More currently, enforcement activity by the Postal Inspection Service during the late 1980's focused on a variety of cooperative mailing ventures between nonprofit mailers and commercial firms. Typically, these ventures promoted the sale of affinity credit cards, group insurance, vacation and travel plans, and other goods or services not typically associated with charitable activity.

Congress took action to address these concerns in the fall of 1990. As part of the Postal Service Appropriations Act of 1991, which was signed into law on November 5, 1990, Congress enacted significant changes affecting nonprofit rate mail.

Before these provisions were enacted, there were no content-based restrictions on what might be sent at the special rates. That is, the only test was the cooperative mail rule, which concerned whether the mail was that of the nonprofit party.

However, for the first time, the 1990 legislation added restrictions on content. Thus, nonprofit third-class rates shall not apply to mail which, in the words of the statute,

"Advertises, promotes, offers, or, for a fee or consideration, recommends, describes, or announces the availability of:

"(A) Credit, debit or charge cards, or similar financial instruments provided through or with an ineligible party;

"(B) Insurance policies unless the policy is designed for and primarily promoted to members, donors, supporters, or beneficiaries of the eligible nonprofit organizations, and it provides coverage not generally otherwise commercially available;

"(C) Travel arrangements unless they contribute substantially to one or more of the eligible mailer's qualifying purposes (aside from

fund-raising and cultivating new members, donors, or supporters) and they are designed for and primarily promoted to the organization's members, donors, supporters or beneficiaries."

These restrictions are sometimes referred to as the TIF restrictions. The restrictions on insurance solicitations are pertinent to our subsequent dealings with AARP.

The 1990 legislation was not Congress' final action in the area of content-based restrictions on nonprofit mail. In 1993 and 1994, as part of broader reforms concerning preferred rates, Congress enacted additional restrictions on nonprofit third-class mail by establishing restrictions on other types of advertising, as well as on certain products. Regulations implementing these provisions were published on May 6, 1995, and will become effective on October 1, 1995.

It is difficult to estimate the precise number of organizations now authorized to mail at the nonprofit third-class rates. It is estimated that at least 400,000 total authorizations have been issued by the Postal Service. However, because organizations must obtain an authorization at each post office where they mail, some organizations have multiple permits. Accordingly, as a rough guess, the number of organizations authorized to mail at the nonprofit rates is 300,000.

The nonprofit third-class rates have been and will remain lower than the regular third-class rates, although this gap is closing due to changes enacted by Congress in the 1993 legislation.

It is difficult to provide a single precise number to convey the relationship between the nonprofit and regular rates, since they vary due to mail preparation and other factors. However, as an approximate figure, the regular bulk third-class rates are nearly double the analogous nonprofit third-class rates.

Senator SIMPSON. Could you go to your summary of remarks? I hate to do that, but if you could go perhaps toward the end of your statement and begin to summarize, that would be very helpful.

Mr. ZELKOWITZ. All right. I am sorry.

I will now get into the actual dispute between the Postal Service and the AARP, if that would please you.

Senator SIMPSON. That would be good.

Mr. ZELKOWITZ. All right.

As I mentioned, a dispute developed between the Postal Service and AARP after enactment of the TIF restrictions in 1990 concerning the scope of the restrictions against insurance solicitations, particularly the group health insurance solicitations.

Specifically, the dispute concerned the interpretation of the exception for policies that would be considered "not generally otherwise commercially available."

The law was declared effective 90 days from the date of enactment, which was on February 3, 1991. On September 13, 1991 and June 25, 1992, the Postal Service published standards in the Federal Register to implement the statutory restrictions. AARP provided extensive comments during the rulemaking implementing these restrictions. However, the Postal Service did not adopt the interpretations it proposed.

Additionally, in early 1992, AARP sent a draft agreement to the chief Postal Service mail classification official, proposing a resolution to this dispute.

Under this proposal, AARP proposed the AARP and the Postal Service jointly seek a statutory amendment eliminating the exception to the prohibition against mailing insurance solicitations at the nonprofit rates. This amendment would be effective January 1, 1993.

Under AARP's proposal, it would stop mailing group health insurance solicitations as of January 1, 1993. And, in return, the Postal Service was supposed to agree not to pursue any back postage claims, which we call revenue deficiencies or postage deficiencies, on group health insurance mailings made before January 1, 1993, even if it was determined that the mailings violated the 1990 statute.

In a written response, the Postal Service refused to enter the proposed agreement. We explained that the Postal Service did not have the authority to permit an organization to make mailings at a rate which violated statutory provisions. With respect to the proposed statutory amendments, our letter stated that that was a matter within the discretion of Congress.

In August, 1992, approximately 2 months after the Postal Service concluded its second rulemaking, AARP wrote again to the Postal Service. AARP advised that it did not agree with the rules. It also advised that, while not waiving its rights to take legal action to challenge the rules, it would begin to mail its group health insurance solicitations at the regular rates.

A short time later that year, postal inspectors reviewed AARP's mailing practices. They found that AARP had started mailing the group health insurance solicitations at the regular rates.

They also found that, prior to that change in August, 1992, these types of mailings had been sent at the nonprofit rates. As a result of these findings, postage deficiency assessments were issued against AARP.

By statute, AARP had two levels of administrative appeals concerning these assessments, and it began its appeals process. In the meantime, however, it initiated settlement discussions with the Postal Service, but no agreement was reached.

In August, 1993, AARP filed suite against the Postal Service, challenging the validity of the regulations implementing the insurance restrictions in the 1990 legislation. Settlement discussions were initiated in this proceeding, and these discussions also involved the postage deficiency assessments, which were still the subject of administrative appeals, and not part of the lawsuit.

Eventually, the parties reached a settlement, under which AARP dropped its challenge to the Postal Service regulations, and settled the postage deficiency assessments. This effectively ended the dispute between the parties.

Thank you. I would be happy to answer any questions you may have.

Senator SIMPSON. Thank you very much, Mr. Zelkowitz. You have summarized it well.

We will go to 5-minute rounds here for the panel.

[The prepared statement of Mr. Zelkowitz appears in the appendix.]

Senator SIMPSON. On February 26, the AARP sent a discussion draft agreement, which I have a copy of, to the Director of the Postal Service's "Office of Classification and Rates Administration".

This agreement contemplated that the Postal Service would do the following: They would not bring an enforcement action against the AARP for violating the law, which prohibits the AARP from taking advantage of preferential postage rates to mail Prudential's group health insurance solicitation. This is it right here. This solicitation right here went out for 8 cents. It is obvious as to what it is. It is an ad. There is no other way to describe it. It is very clear in what it is. It talks of what it is, and the envelope that went with it shows 8 cents. I believe there is a copy of that.

And then the suggested draft also wanted the Postal Service to assist AARP in getting a law passed which would allow AARP to lawfully take advantage of preferential postal rates to mail all of their insurance solicitations. They even went so far as to provide the Postal Service with the actual legislative language, and said in effect, get Congress to help with this. Here is the proposed legislative language, drafted by the AARP. And, of course, this would get rid of the offending statement, "not generally otherwise commercially available", which of course is the key.

But, more importantly, the Postal Service notified the AARP on March 11 to stop doing that, but AARP kept right on mailing. That never stopped them at all.

What was the Postal Service's response to the request by the AARP to enter into this agreement?

Mr. ZELKOWITZ. Well, part of the agreement was to ask us to forebear from going back and assessing any back postage deficiencies on improper mailings. And we advised them that we were not permitted to do that, that Congress set out what could be mailed at the nonprofit rates, and what cannot be, and we cannot allow one mailer to violate those rules, while not giving the same forbearance to all other mailers.

With regard to the proposed legislation, we did not agree to join in and ask Congress to pass that.

Senator SIMPSON. I believe you said it was inappropriate. The words from your division, or from the Postal Service, said it would be highly inappropriate.

Mr. ZELKOWITZ. Improper.

Senator SIMPSON. Improper was the word.

Mr. ZELKOWITZ. Right.

Senator SIMPSON. So how long did the AARP improperly take advantage of the preferential postal rates?

Mr. ZELKOWITZ. They continued to mail at the nonprofit rates—and I guess there were a number of different insurance plans for which they mailed solicitations—until sometime in August, 1992.

Senator SIMPSON. So, from the date of your notification from the United States of America Government Postal Service to stop on March 11, they went right on doing it until August?

Mr. ZELKOWITZ. Until August, 1992.

Senator SIMPSON. They did that?

Mr. ZELKOWITZ. Yes, they did.

Senator SIMPSON. They went right ahead.

Let me see then. After the Postal Service refused to join or be in cahoots with AARP by helping them to lobby Congress to change the law for them, the AARP then sued the Postal Service in August of 1993. Is that correct? And what was the basis of that lawsuit?

Mr. ZELKOWITZ. The lawsuit was based solely on the validity of the regulations that we had promulgated to implement the insurance restrictions. I think it was particularly the regulations enacted in June 1992, concerning "not otherwise commercially available."

Senator SIMPSON. And so then, I think the AARP wanted the Postal Service, among other things, to consider the price of the insurance to determine whether it met the test of the statute. In effect, that would have allowed every policy with a different price to meet the test, seeing that they also wished to shift the burden of determining whether an insurance product meets that test, and tried to put that on the Postal Service.

Did the AARP then offer to settle the lawsuit?

Mr. ZELKOWITZ. Let me go back a minute. Actually, there were a number of grounds on which they challenged the regulations. I think they are pretty well set out in their complaint.

As I said, eventually we agreed to settle the lawsuit. Both parties obviously had to consent to settle it.

Senator SIMPSON. Well, I understand you prefer not to mention the amount paid by AARP to the Postal Service. In fact, I had previously made mention of payments or deficiencies, and I understand that it is something that was disturbing. But paid is one thing, so I will not ask any further there. But can you share with us how much they owed?

Mr. ZELKOWITZ. If I may, Mr. Chairman, I think the amount paid is public knowledge. It might be better if I stated that, rather than the amount they actually owed. They actually paid \$2.8 million, and obviously owed something more than that, but I prefer not to get into that.

Senator SIMPSON. All right. My time has expired. Senator Pryor?

Senator PRYOR. Mr. Chairman, thank you.

In the postal world jargon, this issue that evolved around AARP and their mailings, was this classified as a "dispute"?

Mr. ZELKOWITZ. In our jargon, when they owed back postage, that is either a revenue deficiency or a postage deficiency. There also was a dispute as to the validity of the regulations, and that was part of the lawsuit.

Senator PRYOR. All right. Then my next question relates to the regulations. Was this an issue of how the regulations should be interpreted, or how they would be implemented?

Mr. ZELKOWITZ. I think that is fair to say, yes.

Senator PRYOR. How many such disputes do you have, let us say, each year in the Postal Service? This is a whole new area for me, and perhaps this Committee, to become aware of. How many such disputes would you have?

Mr. ZELKOWITZ. These regulations on the insurance restrictions are fairly new. Are you limiting the question to those insurance restrictions?

Senator PRYOR. Or just mailing for any nonprofit organizations, or third-class permits, or what have you.

Mr. ZELKOWITZ. All right. The more common dispute is based on our older rules, which we call the cooperative mailing rule. Basically, you are only supposed to mail your own material. There are other disputes. I could not venture a guess at the number, but there are other disputes in that area.

Senator PRYOR. I understand, Mr. Chairman, that even the Democratic Party and the Republican Party have been assessed for back postage in some sort of dispute situations. Is that correct?

Mr. ZELKOWITZ. I think it is State parties. I am not aware of anything with the national committees.

Senator PRYOR. The information came to me through staff that both political parties had. And also that a large number of nonprofit organizations have been assessed back postage, and have been engaged in what you might call the dispute process.

Mr. Chairman, I think it might be of interest for the record—I know you want to build a record—for us to ask our friend from the Postal Service if he might not provide for the record, to the best of his knowledge, those nonprofit organizations who have been involved in the dispute process, or in the rulemaking process that might have impacted their ability to mail at the lesser cost. Would that be a proper request?

Senator SIMPSON. I think it is to me.

Mr. ZELKOWITZ. We can certainly provide you with what parties filed as part of the rulemaking process. That is public record. As far as parties that have been in disputes over back postage, one concern I have is that some of those cases might not be settled, and they may still be subject to administrative appeals. We may be naming parties whose assessments will ultimately be overturned. And I guess we would be providing a stigma against those parties unnecessarily.

Senator PRYOR. I am going to ask you a question, and I do not know how you are going to answer it, and I might not should even ask it, but I am going to ask it anyway.

Did the AARP knowingly violate any laws, or did it instead have different interpretations of the statute with the Postal Service?

Mr. ZELKOWITZ. You are really asking me to speculate on what the AARP's knowledge was.

Senator PRYOR. Was this a question of interpretation of the statute?

Mr. ZELKOWITZ. I think, if this had gone on to court, they would have made that the issue. I think that is fair to say. But, again, what they knowingly did is just something you would have to ask them.

Senator PRYOR. I understand. If I might ask, what changes to the postal law might we consider to ensure that all nonprofit organizations use their nonprofit mailing permits properly? Can you give us any guidance on that?

Mr. ZELKOWITZ. Again, that is really a matter for Congress to decide, who should get the nonprofit postage rates, and who should not. I guess, from our perspective, the clearer and more objective test that could be provided would be most helpful. Now we are in a situation where we really have to look at the content of the mail,

which of course adds to what we have to with each mailing, and it is difficult.

We have been talking about (c)(4) organizations. If it was decided that (c)(4) organizations should not mail at the nonprofit rates, that could be stated precisely in the statute. That is one idea.

Senator PRYOR. But each year, you grant around 300,000 to 400,000 nonprofit mailing permits.

Mr. ZELKOWITZ. All right. I meant to say that that number have been granted and are current. We do not have to grant them every year. Once you have them—

Senator PRYOR. Oh, I see. I did not know if you had to do that annually or not.

Mr. Chairman, my time is just about out, and I thank you for letting me ask these questions.

Senator SIMPSON. Senator Pryor, I appreciate that. Let me say that it is good, and we are trying to build an appropriate record.

I would ask our witness to provide for us the list of any other seniors' organizations to whom you have assessed back postage or deficiency for mailing insurance ads—nothing else—insurance ads at nonprofit rates. I think that would be helpful for the panel.

And if you would also produce for us the list of groups—any groups, whether they were selling insurance or not—who, when notified to cease this activity, simply continued to go forward, such as the AARP did when notified February 26 to stop, simply went another 6 months and continued in blatant disregard for the law.

If you can get us a list of those organizations, that would be very helpful to us.

[The information appears in the appendix.]

Senator SIMPSON. I thank you very much for your testimony and your assistance here at this hearing.

Mr. ZELKOWITZ. Thank you, Mr. Chairman.

Senator SIMPSON. We will proceed now please. And, as I said, thank you Mr. Zelkowitz.

We now have a panel consisting of three persons, Horace Deets, executive director of the American Association of Retired Persons, Washington, DC, Margaret Dixon, president-elect of the American Association of Retired Persons, Washington, DC, and Eugene Lehrmann, president of the American Association of Retired Persons, Washington, DC.

If that panel will please come forward. You may do this any way you wish. You can allocate 5 minutes to each of you, or one of you may wish to take the entire 15 minutes. I shall leave that fully to your discretion, but would like to limit this to 15 minutes. However, as you see, we are willing to extend that if need be.

So, how would you like to proceed?

Mr. LEHRMANN. Mr. Chairman, I will give the testimony, and then we will answer questions.

Senator SIMPSON. Thank you very much Mr. Lehrmann. It is good to have you here. We appreciate it.

#### **STATEMENT OF EUGENE LEHRMANN, PRESIDENT, AMERICAN ASSOCIATION OF RETIRED PERSONS, WASHINGTON, DC**

Mr. LEHRMANN. Mr. Chairman, I am Gene Lehrmann, president of AARP. Joining me are Dr. Margaret Dixon, president-elect, and

Horace Deets, our executive director. Also with me this morning, seated behind us, are Dr. Bob Shreve, our AARP board chairman, Joe Perkins, our vice president, and Helen Fitch, AARP's State director for Wyoming, whom I know you have met.

As I watched the videotape of last week's hearing, and read many of the related news stories, I was reminded of the radio reporter, Paul Harvey. He is known for saying, "Now for the rest of the story." Unfortunately, the rest of the AARP's story has never come out.

Until now, these hearings and most video reports have focused only on the size of AARP's membership and its budget, with virtually no mention of how the resources serve our members and society.

This is important. AARP's mission is to serve the needs and interests of older Americans. And it effectively fulfills this mission every day.

AARP serves by providing volunteer programs, including specific efforts on health promotion, consumer protection, crime prevention, retirement planning, tax counseling and driver re-education. Specific examples are included in our written testimony.

AARP serves by acting as a clearinghouse of information. In 1994 alone, AARP distributed more than 35 million information pieces to members and the public, all at little or no cost. Topics included financial planning, coping with the loss of a spouse, and grandparenting.

AARP serves by advancing job opportunities for older workers and fighting to eliminate age discrimination. And our research efforts and Andrus Foundation grants provide unique insights into meeting the needs of the aging population.

AARP serves by advocating on a wide variety of aging issues at the national, State and local levels. This policy agenda is set by our volunteer board of directors, based on extensive research, polling, field hearings and tens of thousands of letters and telephone calls from members.

I also want to stress that AARP's advocacy and activities are strictly nonpartisan. We focus on issues, not party affiliation. Moreover, AARP has no political action committee. AARP's member services, which were discussed at great length at last week's hearings, are also consistent with AARP's mission of service.

From group health to annuities, these member services are designed to meet the growing needs of our members, and help them achieve economic security later in life. And these member services generate the additional revenues that, along with our primary source of funding, membership dues, allow AARP to provide so many valuable programs and information sources, typically at little or no cost.

In all of these ways, Mr. Chairman, AARP is clearly working to serve the growing needs and interests of older Americans.

But, to fully understand AARP, you must also consider that the association is both tax-exempt and nonprofit. This is an important distinction. Should the Congress choose to change the tax-exempt laws, requiring organizations like AARP to pay more taxes, our nonprofit status would not change. Neither will our mission to serve needs of our members and promote the social welfare.

You see, AARP is all about service, not making money. AARP is people, millions of dedicated and concerned people, who believe in addressing the growing needs of an aging America.

This is why, for example, AARP will not be distracted from the ongoing debate on Medicare. Changes in this program must be made to protect and strengthen the program, not only for our generation, Mr. Chairman, but for our children and grandchildren as well. But these changes must be made judiciously, and with significant input from beneficiaries. Although Medicare should be a part of responsible deficit reduction strategy, it should not bear the brunt of this burden or be sacrificed in the process.

It now seems apparent that AARP's support for Medicare is a driving force behind these hearings. I think that Senator McCain's early testimony made that point clear.

Still, we appreciate this opportunity to set the record straight on several issues that have been raised about AARP's activities, including AARP's role in administering Federal contracts that provide tax counseling and job placement to more than 1½ million low-income older people each year.

Thousands of other organizations, businesses and universities, administer similar contracts every year. We will clarify the direct link between AARP's mission and its income sources, and the association's continuing reliance on dues as a major revenue source.

We also hope to address some of the broader questions related to the tax treatment of member service income. As reported by the GAO last week, these activities are not unique to AARP. In fact, they represent a growing trend within the tax-exempt community.

AARP believes that no organization should be beyond scrutiny. That is why we continue to be open about our programs, policies and finances.

As a member and a volunteer, I am proud of AARP's record in serving older Americans and promoting the social welfare. Our volunteer programs, publications, advocacy efforts, research projects and local level activities are helping to shape and enrich the experience of aging for our members and society.

Mr. Chairman, that cannot be ignored. For more than 30 years, AARP has utilized its resources to promote independence, dignity and purpose for all Americans as they age. Independence, dignity and purpose—this is what AARP is all about. It is what we want for older Americans, and it is what we help our members achieve every day.

Thank you very much, Mr. Chairman. We would be happy to try and answer questions.

Senator SIMPSON. Thank you very much, Mr. Lehrmann. I have met you on several occasions. I have visited with your board in your leased offices here, and we have had other cordial visits, including a discussion of questions to be reviewed at these proceedings.

[The prepared statement of Mr. Lehrmann appears in the appendix.]

Senator SIMPSON. I have, of course, sent a list of questions to answer, and I do appreciate your making the effort to answer those. That is to say, giving fair warning is rather unique in Washington, I thought—telegraphing the punches, as we say in the fight game.

One question I asked you was question 40, and it was whether, in the course of developing legislative positions, AARP ever consulted with the businesses whose products are advertised in Modern Maturity magazine. Your answer, "AARP neither consults with nor solicits input from the businesses whose products are advertised in Modern Maturity regarding the association's positions on public policy issues."

I thought, well, that is fair enough until I myself was conducting some research with regard to these hearings, about application of nonprofit laws. And I came across an internal memo from within your organization. It is a memo that outlines just how these businesses are to respond to my own particular legislative inquiry. It is dated May 16, 1995. It is addressed to one person at Prudential, one at Hartford, one at Foremost, one at New York Life. And here we are, before the beginning of the first hearing, and I am finding advisory memos going around to those exact entities that you have told me you do not consult with. Can you explain that?

Mr. DEETS. The question had to do with developing legislative positions, and our answer is correct on that. Whenever we have been in the process of developing a legislative position, we have never consulted with any of these vendors, these businesses with whom we have contracts.

The reason for the memo we sent is that questions were coming from them as to the nature of the hearing, and what is this about? There was no legislation that we are aware of that is being considered by this committee at this time.

Senator SIMPSON. I was a little bit startled. Here is a copy of it, dated May 16, 1995, to Anna Mae Kinne of Prudential, Mike Hughes. All of them are named. It is a cordial letter. In a sense, it says be alert. So, when you tell me that you do not communicate with your businesses, and then say now that this is about public policy, I am just a little startled at that.

And you are telling them that this is serious business. It is signed here by Wayne Haefer, and he is saying that the media is working busily with The Washington Post, Money magazine, Washington Times, Cox and Newsday. We anticipate the stories. If you need any information, contact us, and so on.

I think in a future reference, when a question is designed to determine the closeness of your relationship with these reportedly independent businesses, and when one would ask about consultation, you will at least know what I had intended to receive, and I think you will know what is expected in any further inquiry of that nature in the future, I would hope.

Mr. DEETS. I understand, Senator. We read quite literally, "In the course of developing legislative positions", and we were not in the position of developing a legislative position, so we thought we had answered that very correctly. And our positions are developed independently of any of these businesses.

Senator SIMPSON. Well, it has to be a pretty close relationship with people who you select.

Mr. DEETS. We work very closely with them, but not for the purpose of developing legislative positions.

Senator SIMPSON. I see. It just kind of seemed like an all-points alert there. And I was wondering about the nature of that.

You have listed a large number of programs that you run to benefit senior citizens, and certainly we commend that work. Who would not? We do.

But, in your 1994 Arthur Andersen report, it says that you spent \$71 million on programs for your members. And last year the Federal Government spent \$86 million on your programs. Are your members aware that you spend less on the programs for your members than the Government does? Less than half of that spending comes from you.

Mr. DEETS. That functional budget that you are referring to just itemizes programs and field service activities. In addition, we have publications which are significantly more. There is research, and many other things that we do, that are not listed under the functional title of programs. I think if you look at the total operation of what we do, some 75 to 80 percent of our resources go into member services and programs.

Senator SIMPSON. My time has expired. We will take 5-minute rounds.

Senator Pryor?

Senator PRYOR. Mr. Chairman, could I yield to Senator Breaux?

Senator SIMPSON. I was just doing it by order of appearance. But he certainly is my Ranking Member, and I do appreciate your being here very much, John.

Senator BREAUX. Thank you. And I thank the panel for providing us information.

Again, I want to emphasize that when I approach this issue, I approach it looking at all of the 501(c) organizations. I think it is timely, it is appropriate, it is proper that we look at this tremendous growth. I am concerned about all the tax-exempt organizations that have wonderful purposes in general, in lobbying and keeping their membership informed, presenting their positions to Congress and State organizations. I think it is all totally appropriate and proper. I think the concept of being tax-exempt in those areas is totally appropriate and proper.

I am concerned, however, that when the organizations get so large that they go beyond the purpose for which they were founded, and have large amounts of outside earned income for which they pay no taxes. I think it is totally appropriate and proper that we look at all of them, whether they are liberal, conservative, moderate, Republican-oriented, Democrat-oriented, or what have you. So that is where I am coming from on this particular set of hearings.

Now, in looking at your testimony, Mr. Lehrmann, it seems to me that you have become a multiple purpose organization in the sense of the income that you have. I mean you have all types of income coming from licensing your name. It is like Michael Jordan, who gives his name to endorse products, to get royalties and revenues from it. But you all have done much better than any person that I can possibly think of.

On page number—oh, you do not have the page numbers on your testimony; it is towards the end—about 4 pages from the end, you are in the auto insurance business, you are in the homeowner insurance business, you are in the mobile home insurance business. You have a motoring plan with Amoco. You have a pharmacy pro-

gram. You have a mutual fund program. You have a credit card program. You have a rental car program. You have a life insurance program. You have an annuity program. And it seems to go on and on.

And it seems to me that, when you started back a long time ago, none of this was there.

Mr. LEHRMANN. That is correct.

Senator BREAU. And do you have any concern with the huge amount of growth? You are involved in so many different businesses. And it just seems to me that that is an explosion of growth, and yet you are still a totally tax-exempt organization.

And I could ask that same question for an awful lot of other similarly situated organizations.

Dr. Dixon?

Dr. DIXON. Yes, Senator Breau. Thank you.

As Mr. Lehrmann stated in his testimony, if the Congress should change the laws regarding tax-exemption, and we should have to pay additional taxes, we will certainly comply with the law.

Regarding our enterprises that you mention, these did not just happen all of a sudden. These evolved over a number of years, and many of them are in response to member inquiries. Members called and asked, why do you not have life insurance? Why do you not have this program and that program?

Senator BREAU. I understand that. But are these companies not also calling you and saying, look, we would like to use AARP's name, please endorse this product?

Dr. DIXON. No. There is a needs assessment process at AARP.

Senator BREAU. They have never done that?

Dr. DIXON. Let me tell you how it happens.

Senator BREAU. Solicitations have never come from all of these groups to AARP, and said let us put together a package that you can promote to your members?

Dr. DIXON. As a member who has been on the board for about 7 years, I cannot say never. But a membership committee reviews all applications for services. We look at all the research. We look at the possible providers. It comes to the committee first. This takes a long time; it may take a year. If the committee feels it is something that is good for our members, it will refer it to the full board.

Senator BREAU. I understand. But what I am saying is that I have a concern that there are groups, there are businesses, legitimate business that have wonderful products, that are using the AARP to market their products. You say only if you endorse it. It is just back to the Michael Jordan example. Michael, if you will drink this product on television, we will sell it to a whole group of people who think you are the most wonderful person in the world. AARP, if you put your seal of approval on this brand of aspirin, for instance, there are going to be a lot of seniors who will say, boy, I feel much better because AARP has endorsed it.

Dr. DIXON. We do not do it that way. It has to go through the committee. And we are members; members of the board are members of AARP. We are just like our other members. We are mothers and fathers, grandparents, widows and widowers, and caregivers. And we consider, is this something that is good for me? Is it some-

thing that I would approve? And we want to stand behind our products. So we will only endorse a product if we feel it is good for our seniors, it is something that our members need and want.

Senator BREAUX. I understand that. I do not think that any of the products you have approved are bad products. In fact, I think they are probably all good, and that they target benefits to your members. And I think that is very good. It is just a question of whether that should be a tax-exempt operation.

The final point, Mr. Chairman, which I want to point out for balance purposes, I think when you look at other organizations, I go back to the fact that there are a million of these around the country that are tax-exempt foundations. When you look at other 501(c)(4) organizations, which you are—

Mr. DEETS. That is correct.

Senator BREAUX [continuing]. According to GAO, that program services of these groups, the total groups, account for about 62.3 percent of their revenues from what they call program services. Staff tells me that is these commercial endorsement type of products. Gifts and grants and contributions account for 13.7 percent. And dues and assessments account for only 9.9 percent, from all of these organizations around the country that are 501(c)(4), which you are part of.

Your organization, they tell me, really does much better than the average because your commercial income from these products sales and endorsements account for about 45 percent of your revenues. Your dues are about 40 percent. Interest income, they tell me, is about 15 percent. So your dues are about 40 percent, they tell me, of your revenues to run the organization. The average 501(c)(4)'s in the country are only 9.9 percent.

There are some problems out there.

Thank you, Mr. Chairman.

Senator SIMPSON. Thank you, Senator BreauX.

Senator Pryor, your 5-minute round?

Senator PRYOR. Yes, sir. Thank you, Mr. Chairman. I guess I would pose this question to Mr. Deets. But I want to go back to the statement, or statements, given in response to questions by our friend from the U.S. Postal Service. And I would like to see if we could walk through that a little bit, because I think we may be leaving an impression here that might need to be cleared up.

In August, 1992—and you correct me, Mr. Deets, or perhaps the others, Dr. Dixon or Mr. Lehrmann would be the proper respondents here—the AARP wrote to the U.S. Postal Service and said that it would begin complying with the regulations, even though it disagreed with the interpretation of the rule. In effect, AARP turned itself in. Now I am going to put a period there. Is that the correct interpretation of what happened?

Mr. DEETS. Well, it is important to understand that the Postal Service is empowered to set rulings regarding the way the legislation covers what should be counted as nonprofit postal. For example, there is an absolute prohibition on mailing things regarding financial services. You cannot do that under the nonprofit rate. There is no such prohibition on insurance mail. There was a question over whether or not we could do it.

The exception was that, if the insurance you were promoting was not generally commercially available, you could use the nonprofit postal rate.

Now one of the disputes we had with the Postal Service is whether or not the program we had was generally commercially available. The key point was that our program did not require underwriting, which means it was guaranteed acceptance. Underwriting is a means of determining whether you are an acceptable risk. Quite often, it means that you do not get the insurance.

Now this is where we had our dispute. The Postal Service had proposed a rule change but it was not yet final. We were still in the debate, as far as we were concerned, trying to resolve that. We had thought it would be better, if they could not clear it up, to propose a legislative clarification. That was the reason for the letter that the Chairman referred to earlier, and the postal service witness did also. We wrote to the Postal Service saying maybe what is required is legislation. Do you want to join us in proposing legislation?

They responded that they could not. But it is interesting to note, in the language of their letter, "With regard to the legislative language you have suggested, we would not oppose the amendment." And they go on to say later, "Should Congress determine to adopt such a proposal, it is our opinion that it would be more efficient and desirable to do so as an amendment to 39 U.S. Code," and it goes on and gives the numbers.

When they insisted that we go back and pay from the time the rule change was proposed, rather than adopted as final, that is where we disagreed with them. And they assessed us a sum of \$5.6 million, based upon the date the rule change was proposed. We indicated that was worth going to court over, and we decided that there was a chance of mediation, which is where we ended up. And they agreed to a settlement—I think it is public knowledge—of \$2.8 million.

Senator PRYOR. You did not deliberately skirt the law?

Mr. DEETS. No. We felt that the Postal Service was issuing a regulation that we disagreed with, and it was based on a misinterpretation of what was generally commercially available.

As far as we were concerned, we were still in the debate over the validity of their regulation. And that is what we would have gone to court over, had we gone on with litigation.

Senator PRYOR. Let me ask another line of questioning. In your statement, you said that the running of some of your Federally-funded programs actually cost more than you receive from the Federal Government. Now how is this deficit covered?

Mr. DEETS. We pay for it out of our own revenue.

Senator PRYOR. I know Senator Simpson has expressed his concern—and it may be a legitimate concern—about Federal grants to nonprofit organizations. What would happen if Federal funding were cut off from AARP?

Mr. DEETS. Financially speaking, AARP would not really be impacted. It would mean that some of the matching funds and efforts that we have put into the grants would no longer be required. The sad effect would be that the programs that we are administering—the employment programs, the tax aid program, and the people

they help in the communities, the senior centers, the day care centers, the Red Cross and other groups—would no longer have the benefit of those community services.

By the way, on one of them Senator, the placement rate of the senior community service employment program, we are supposed to help people 55 and over, low-income, get into positions of unsubsidized employment. This is under the Older Americans Act, as you well know.

The guideline from the Labor Department is a 20 percent placement rate. In 1994, we had a 49 percent placement rate.

Senator PRYOR. Thank you.

Mr. Chairman, I think my time is about to expire, but I will yield back my time. Thank you.

Senator SIMPSON. Thank you very much, Senator Pryor.

I think that it was interesting, with regard to the AARP, rather than turn themselves in, they took the Postal Service to court. And the \$2.8 million was the settlement, and it was in no way a voluntary one, at least as I understand the facts.

But we are talking about profit over member interest. One of your members sent me a most fascinating article last week. It told a story in which the AARP negotiated a deal with the ASCNET Phone Company. It seems that AARP sold the mailing list to this company—I think that is an avowed no-no from everything I know—and provided a glowing letter of endorsement for a member of the panel, Horace Deets, saying, “This is just what elderly people have always needed—I think you will find this new service to be of great value.” And then each time this company sold this product to one of your members, AARP would pick up \$5.

The problem was, when your members got their phones, which cost them \$209 each, the line was really dead. That company had gone bankrupt. This article is dated October 16, 1994, so I trust that some of the information is perhaps no longer true. But, reportedly, AARP did not compensate its members in any way for their loss. I was incredulous.

In reading what your spokesman, Peter Ashkenaz, said, “The AARP could not afford to pay 500 people back \$100 apiece.” Is that a lighthearted aside, or a joke, or what? That would be a total of about \$100,000. I did a little calculating, and determined that AARP takes about 2 hours to pull in that amount of money.

So I trust that these good people, who are the “vulnerable senior citizens” that you pride yourself in representing have since been compensated. Have they?

Mr. DEETS. I think they have, Senator.

When we entered into the agreement with this company, every indication we had was that they were financially solid, as they represented themselves to us. And the purpose was to provide a cellular phone for emergency use. It was a need and an interest that had been expressed to us.

When they had financial difficulty, again because of competitive practices with some other company, they went bankrupt. We then worked to try to find ways to make sure these people were compensated.

One reason we felt that it was important not to take the responsibility for their going bankrupt is that there is always the poten-

tial for litigation in this. This is a very litigious society, as we know. And the primary obligation was on the company that provided the phone. We worked to instruct our members how they could get reimbursed, and stood ready to reimburse those who were not reimbursed through the process we suggested.

I am not sure of the intent or the context of the quote. I know the quote, but I am not sure of the context in which it was given. I know the math of it.

Senator SIMPSON. Well, I guess I am just saying that you speak for the elderly and the vulnerable. And the woman who was conned in the scam said, "I am sure I do not need to remind you that the majority of AARP members are elderly, and on a very limited budget." And she wrote directly to you, and said that a \$200 loss represents very real hardship. And she also said that AARP was not taking any responsibility for this at all. Others in the San Diego area said that they should take responsibility.

One doctor, a member of the AARP, said that the AARP should accept responsibility. This is one of your people—I assume one of the volunteers. The salaries paid to AARP people is \$59 million a year for some 1,700 employees, I do not know who all are listed. So this man, a member of your board, said why not pay them back. "AARP has 30 million members, and it is loaded with money."

I assume, under the bylaws, he will be dealt with. I intend to put in the record the bylaws, which call for dismissal of a person uttering such heresies.

[The bylaws appear in the appendix.]

Senator SIMPSON. But your person, Ashkenaz, said that the AARP did not provide the service. It recommended the phone system, just as it would recommend a rental company or a hotel, and he said, "We cannot afford to pay back 500 people at \$200 each. We ourselves are standing in line to collect."

I am just saying, is this the way it is done? You sold a list of numbers, or a mailing list, of these people so they could be contacted for this cellular phone. Yes, addresses of 29,171 San Diego AARP members went to this organization. What was received by you for that? Just the \$5 royalty?

Mr. DEETS. We did not sell the list to the company, Senator. When we enter into an agreement for licensing—in this case it was a pilot where we provided a list of names in that community—there was no sale of a list. And the only compensation would have been the \$5 per unit sold.

I would point out, in an earlier incident, where a travel company went bankrupt and had stranded people, we laid out some \$10 million to make sure that no one was left without being fully compensated. We do stand behind our products.

Senator SIMPSON. Well, my time has expired on this round. But, given that many cellular phone services offer the first year's use of the phone free, I was wondering why the AARP needed to steer members to this organization that would pay \$5 per sale.

Mr. DEETS. It is a rapidly changing market, Senator. At the time that came out, you did not have the low-priced availability of cellular phones that this one was offering.

Senator SIMPSON. Senator Chafee, thank you very much for coming. It has been a lonely vigil here from this side of the aisle.

My good colleagues from Arkansas and Louisiana have been stalwart, and I have been wondering where the hell you guys were. [Laughter.]

Senator CHAFEE. Well, it so happens that I am managing a bill on the floor of the Senate right now. But I came over to throw you a lifeline because I understand it has been a little lonely over here.

Thank you very much, Mr. Chairman. As I mentioned, I am handling a bill for the Environment Committee on the floor, so I will have to get back, so this will be relatively brief.

Mr. Deets, in AARP's written testimony it was mentioned that the tax law does not require membership dues for a social welfare organization such as AARP. There is nothing that requires that the dues constitute a certain percentage of total revenue.

Why should Congress not establish a test similar to that to ensure that a tax-exempt entity is organized primarily to serve its members? In other words, what I am seeking here, one of the things that might possibly come out of these hearings, is a guideline. And dues, as a percentage of the total revenue of the organization, might be one way to go. What do you think of that?

Mr. DEETS. I have no problem with something like that, Senator. We have not opposed that. What we were doing was responding to the question of what percent we have.

Around 40 percent of our income is from dues. I do have a budget directive given to me by my board of directors, which says that the single largest source of income should be dues income. That should be the one thing that we are most dependent upon. And that is what we try to observe.

Senator Breaux pointed out earlier that the average 501(c)(4) is hovering around 10 percent of its income from dues.

Perhaps a guideline would make it clear. I do not want to speak for other 501(c)(4)'s. I can only speak for ourselves. I think it would be important to hear from them what would be the impact of that, because many of them represent very low-income constituents and people who do not have a lot of money.

If the level of income from dues is set too high, it may frustrate their ability to carry out a purpose which we would all think is very important.

Senator CHAFEE. All right. I believe it was in your testimony—regrettably, I was not here. But was it your testimony wherein it was said that AARP agreed to make a “payment in lieu of taxes”?

Mr. DEETS. That is in our written testimony, Senator.

Senator CHAFEE. In the settlement with the IRS?

Mr. DEETS. Correct.

Senator CHAFEE. And this leaves me puzzled. Because it seems to me that a person or an entity either pays taxes or they do not.

And I assume you do not mean to imply that AARP made a donation to IRS. In other words, when you say a payment in lieu of taxes, what does that mean? It was a settlement, was it not?

Mr. DEETS. It was a settlement, yes, Senator.

Senator CHAFEE. So I suppose it is a tax?

Mr. DEETS. No. We had a dispute going over years 1985 to 1993 over the taxability of certain income for AARP. It was our contention that the income we were receiving was substantially related to our business purpose or, in the instance of the royalties, it was

excluded by law as being taxable for a nonprofit, when royalty income is included.

We were relying on a 1978 ruling that indicated, when IRS audited AARP and its other organization, NRTA, its parent organizations, they found that there was no unrelated business income. We were doing substantially the same thing, albeit on a larger scale, but the same thing.

We felt we were safe in relying on that. When IRS came up with a technical opinion saying that it was their inclination to consider that unrelated business income as taxable, that was where the dispute was. And they began in 1988; we were having this debate until 1993, through 1993. And we were trying to get a resolution of that. We still have not resolved that issue. We are still working with IRS on the question of the taxability of that income.

We thought it important to put those years behind us. And, as the IRS encourages groups like ours to do, we went into a settlement agreement, and that was the sum of money agreed upon. There was no tax assessment for the total, or for any of the years, no penalty, no interest was assessed. That payment was in lieu of taxes to put those years behind us so that we could focus on the present years.

It was not a donation, Senator. If we were donating money, I would give it to a lot of other places first.

Senator CHAFEE. I would call it a tax that you paid, but I am not going to go back and forth on that.

Thank you very much, Mr. Chairman. I want to thank Senator Breaux also for letting me cut in.

Senator SIMPSON. Thank you very much for coming, Senator Chafee. I appreciate it very much.

Senator Breaux?

Senator BREUX. I tried to see if there was a comparison between what AARP does for your members and what cooperatives do for their members.

I guess I have concluded that there really is a major difference. If you have a typical farmers' coop, it is a group of farmers who join the coop so that the cooperative can buy large amounts of products at a discount, and then sell them to their members at a lower rate because of the value of buying in large amounts. They get a better price; those better prices are given to their members.

It seems to me that what you do is not that. You endorse products that companies then sell directly to your members, and you earn a royalty and/or a fee from that transaction.

Do you have any differences with that analysis that I just gave?

Mr. DEETS. That analysis is correct.

Senator BREUX. Let me ask this question. The several articles indicated that only 1 in 7 of the members of AARP really are members, and have joined because of your lobbying efforts and informational products that you give to them to keep them informed.

That means an awful lot of them joined for other reasons. And I would daresay that the other reasons are being able to buy the products that you have endorsed.

Do you agree that there is a problem out there with all of these organizations, and that it has grown beyond the original intent of the Congress with regard to tax-exempt foundations and that it is

appropriate and proper for Congress to review all of these organizations?

Mr. DEETS. I think it is appropriate and proper that such a review take place. That is why we are pleased to be here. We have no objection to this scrutiny of our practices.

I am concerned that, given the kind of attention we have gotten in the media—some of it accurate and much of it inaccurate—we apparently need to do a better job of clarifying what that role is. But the perception does exist.

In response to an earlier question you asked, Senator Breaux, we do get a lot of unsolicited proposals for business. These are not things that the board normally has to work with, but we get at least 1,200 of these a year. Everyone sees the size of the membership, and says, wow, if we could just send something, you could make a lot of money off of it.

In the light of all the proposals and requests we get, the number of actual licensing agreements we have is really rather small. I agree, when you list them, it is a rather impressive list. But, compared to the things that are there, if we were simply out to make money, it really is rather small.

Senator BREAU. I am glad you clarified that. I was going to ask that as the next question because you were quoted as saying, "We get probably 1,200 unsolicited proposals a year to do things."

Mr. DEETS. Right.

Senator BREAU. "People see our membership as a market."

And, you see, that is the perception that a lot of us are concerned about. I am not just singling out your group because there are others who I think fit that pattern right to a "T."

But they look at these organizations as a financial market to increase their profits. There is nothing wrong with that. That is the marketplace, and it is the American system. But they are looking at AARP and similar organizations as a great way for us to sell our products and make a lot of money, if we can just get you to put your seal of approval on our products.

And I do not think that is what Congress intended. We did not intend to create organizations for marketing purposes, and give them tax-exempt status. And I think, when you look at the operations that are before this Committee, it seems to me that you are right in the middle of a concern that I have just tried to express. But you are not alone; there are others. And I think it is appropriate that we really take a hard look at this and make some decisions. Tell people yes or no. There is a lot of gray area here. Can we do this? Can we not? Let us try it; if we get sued, we will stop. There is nothing wrong with that, I guess. But I think there is a lot of gray area about what you can and cannot do.

Mr. DEETS. Senator, if I might answer. We know that some of the income we have is not related, and is therefore taxable. We paid \$5.4 million in taxes last year on some of the financial services, such as the licensing agreement from the credit card, from our investment services.

Also, we know that the advertising sales revenue in our magazine is unrelated business income. It has not been sufficient to offset the total cost of the editorial and production of the product. Therefore, we have not incurred any tax liability. But, should it get

to that phase, we know that is income on which we pay tax, and we have no objection to that.

Senator BREUX. Well, you see, that is a concern I tried to explain too. When you look at all the organizations 501(c) organizations, 97 percent of them do not pay the unrelated business income tax. Only 3 percent do. And you are talking about organizations that have really millions and millions of dollars of income that they receive as totally tax-exempt. According to GAO, only 3 percent really pays that unrelated business income tax. And that needs to be looked at.

Thank you, Mr. Chairman.

Senator SIMPSON. Thank you very much, Senator Breux.

Senator Pryor?

Senator PRYOR. Mr. Chairman, you have raised a point this morning which I think is very, very valid. You have raised a lot of valid points, I might say.

But one of the things that does concern me is a nonprofit organization that lobbies, that receives Federal dollars. I think this is an area that we are certainly justified in looking at. I am concerned about it. In fact, I have been concerned about it for a good while.

A couple of years ago, I spoke on the Senate floor— I do not think anyone heard it. This may be a little bit arcane, Mr. Chairman.

Senator SIMPSON. It was not about veterans, was it?

Senator PRYOR. No, it was not about veterans. That is a little private joke we have between ourselves. But this is just an example of how sometimes organizations can skirt the system, and can abuse the system. Let me go through this, and I will certainly try to make this very quickly.

There is an organization called the "Free Congress Foundation." We are all familiar with that. It has this very slick publication with their members, their board and their activities. I do not know if this is nonprofit. I do not know if it is 501(c)(3) or (4). I understand that it is a political action group. And I think Mr. Paul Weyrich is probably the president or the chairman of the board.

About 1991, the Free Congress Foundation, that preaches against perks, pork and all the rest, decided that they wanted to publish a magazine called the "Electric Railway Journal." There it is—a very slick publication.

Well, the Free Congress Foundation said, we do not accept Federal money, but we know how to get some Federal money. Now how did they get it? They got the then Department of Transportation to give a grant to George Mason University. George Mason University then gives the money to the Electric Railway Journal. Over a period of something like 3 years, Mr. Chairman, this magazine, published by Mr. Paul Weyrich which, by the way, sells for \$6.50, received over \$500,000 from Federal taxpayers, nonprofit, no taxes, and it is a part of subverting the system.

And I think that we need to look at so many of these organizations, and so many of the ways that some of these groups get by without paying taxes. If they are legitimately a tax-exempt organization, they are performing their mission, that is one thing. But, if they are another way of subverting the Tax Code, and getting by without paying their fair share of taxes, then I think that we have got to continue even deeper into this issue.

Mr. Chairman, I have no further questions to this particular panel. And, once again, thank you for allowing me to participate.

Senator SIMPSON. I want to thank you for participating. You are wonderful to do it. It is a little hazardous politically—we all know that. And I thank you. You have given us some good thoughts.

One of the interesting things that used to happen, once you get going, they figure it out. There was an issue which you have heard the Postal Service man speak of regarding cooperative mailings. This was where the profit-making organization would have a subsidiary of a nonprofit organization to do the mailing, to make money for the profit organization. That is a real scam, and they have pretty well busted that one up, I think. If not, they at least know how it is happening.

But you have asked some very provocative and thoughtful questions, and I appreciate it.

We will not go too long here, but let me tell you a curious little one. And these are often the ones that pique my interest. This organization has told me in their board meetings, and everywhere else, that they are above board and play by the rules. That is, they seem very proud of that, and I understand that.

I have a memo here from Elliott, dated May 5, 1995, subject: Simpson briefing transcript. It is addressed to Horace Deets, Steve Zaleznick, John Rother, Marty Corry, Jim Hall, Chuck Allen and Wayne Haefer. And it says, "Folks, Bulletin senior editor, Leah Glasschen, managed to wangle her way into Senator Simpson's Wednesday press conference and tape it. The tape was transcribed by Bulletin staffers Jackie Brown, Karen Walker and yours truly. Some of Senator Simpson's sentences read funny"—very true. My sentences are rather loopy, as someone described them one time. "But our version here is supported by the tape."

Now that is interesting because the U.S. Senate rules prohibit people who are not part of the gallery from being there. The tape is fine. Everything I said was public. I would have furnished that. But I was fascinated why you would have someone "wangle their way in" to a United States Senate press conference, when that person was prohibited by Senate rules from attending.

And I just wondered—are these rules just for other people, or do they apply to your organization too?

Mr. DEETS. Senator, any rules apply to us as well as anyone else. I was not aware we had someone there until I received the memo. And my assumption is that this person has press credentials that entitled her to get in. I do not know how otherwise to wrangle, wangle—

Senator SIMPSON. That was her phrase, wangle her way in.

Mr. DEETS. I am not sure how that was done, either with press credentials, or someone just decided she looked like a press person. I do not know.

Senator SIMPSON. I just wondered if those rules applied to you.

Mr. DEETS. We would not encourage, nor do we condone our staff doing this.

Senator SIMPSON. You did not know that took place?

Mr. DEETS. No.

Senator SIMPSON. We called the Senate Press Gallery, and we were told that this person was not credentialed.

Mr. DEETS. All right. You have answered my question. I would have tried to find out.

Senator SIMPSON. That probably will not happen again then, will it?

Mr. DEETS. I can assure you that it will not.

Senator SIMPSON. Well, I think it probably would be a good idea, just for odds and ends purposes. But I am sure there are others who received that information, that knew that occurred. And I was just very curious to how that happened, because we have rules that prohibit that kind of conduct.

And I guess it is the same kind of thing, when you say you play by the rules, I would like to go back to the postal thing and ask again why, if you were told in a letter in February to stop doing what you did, why did you continue until August to do what you did, which was to use the nonprofit rates to sell insurance. There was nothing going out to people that could be construed as anything else but selling insurance.

So what gave you the power, or the feeling of bigness, that you could also not follow that rule?

Mr. DEETS. It was not a sense of power or bigness, Senator. We were under the impression that we were still negotiating with the Postal Service. We felt we had a legitimate objection to the proposed rule. We felt it was inaccurate, and we were actively negotiating. Nothing was hidden from their view. They knew exactly where we stood on it. And they concluded later that they felt that we should have paid from the time they proposed the rule change. We felt that it should not have been from the time it was proposed, but from the time it was made final.

Senator SIMPSON. Well, in my submitted questions to you, I asked you about whether or not you mailed your nonprofit solicitations using nonprofit rates. And you replied that you paid a "blended rate" for the for-profit rate for the commercial content, and a nonprofit rate for the editorial content. And you did not say anything in the response about your recent practice of mailing insurance ads at nonprofit rates, which the Postal Service disagreed with, and I think most here on this panel would. So I had to read about this postal settlement in another source.

Was it not clear to you in our meeting that this was the sort of practice that I was interested in?

Mr. DEETS. Senator, at that time you specifically asked among your 53 questions, whether or not we sent commercial material through our publications at a nonprofit rate. And you had made that comment several times publicly that we were using our publication, filled with commercial material, at nonprofit rates. We were trying to point out that our magazine was not filled with commercial material. Sixty-five percent of it is editorial, and it went at a blended rate. So all of the ads were going at commercial rate. That was the gist of the question, and that is what we focused upon there.

Senator SIMPSON. Well, I was just interested in why you disregarded the Postal Service. You have explained that; I will not probe it further.

But, in my mind at least, Modern Maturity is a host of advertising. And is it not so that you prohibit any advertising in Modern

Maturity that competes with any one of the chosen ones that are listed for advertising in the magazine.

Mr. DEETS. We have advertising standards which we ourselves have set up, which prohibit advertising services which are similar or identical to services with which we have a licensing agreement.

There are other restrictions. We do not take tobacco advertising. And there are things that we will reject for a variety of reasons.

But to answer your question regarding some chosen few, we do not take ads that would compete with those with whom we have a licensing agreement.

Senator SIMPSON. That is the answer I was seeking. There is no competition in ads.

Well, my time has expired.

Senator Pryor, did you have any further questions?

Senator PRYOR. I do not think I have, Mr. Chairman, but thank you.

Senator SIMPSON. Just a few more questions, because they come to me in legions, and I not want to take any more time. Perhaps we will have a different group, or a similar group here, and try to probe this further.

But one question I want to ask, because it did not appear correctly in the record. I have a memo from your organization dated April 17, 1995, in which you say, "Senator Simpson asserted that the group's field representatives were subject to immediate dismissal if they disagreed with its national board. We all know these comments are totally without foundation." That is what you told me.

Mr. DEETS. Right.

Senator SIMPSON. If you want to know why it is difficult for me, and troublesome, it is because what you tell me is not so.

I am indeed willing to admit when I am wrong when I say something "without foundation". I will take my lumps. It would not be the first time for me or for you. But I had based those comments, and what I said about being informed by several of your AARP volunteers and employees, and I figured that what you were telling me was the truth. When I said you could be canned for not being aboard, you said it was totally without foundation. But then I have your bylaws. These are your bylaws?

Mr. DEETS. Right.

Senator SIMPSON. I have got my hands on those, from which I read, "Any member, agent, chapter or organization may be suspended or expelled from membership or affiliation, recognition or designation for cause, consisting in any statement or conduct deemed by the board of directors to be detrimental to the best interests of the association, or any of its services, upon 30 days written notice, ordinary mail." Then there is the delivery of it, and so on.

Then, "During this period, pending notification or action by the board, the president may summarily suspend forthwith any such person, group, affiliation or recognition, which shall be effective until action by the majority vote of the board of directors." Not much due process in that one.

So, that is certainly a puzzling one to me. You can be expelled. And why did you tell me that this was not so?

Mr. DEETS. We have never expelled a member.

Senator SIMPSON. What have you done with them?

Mr. DEETS. Served them well.

Senator SIMPSON. What?

Mr. DEETS. Served them well.

Senator SIMPSON. Served them well? I am asking you then, why is that in your bylaws? I have had letters from people in the AARP who tell me they were sacked. I will share them with record.

Mr. DEETS. All right. That would be fine, Senator.

We have not sacked anybody from membership. We have never dismissed a member for disagreeing with us. We have had many people disagree. You, yourself are a member. You have disagreed with us. The president has never invoked that option.

The paragraph in our bylaws is one that most organizations have, simply to protect themselves. That is standard language. And an organization has the right to protect its name. But I cannot think of a single instance. I have been with AARP for 20 years, check the records. I do not know of any instance where we have dismissed a member, thrown somebody out of membership. We have had people request that they would like to not be a member. That is fine. We have dismissed staff, but that is for something different. Usually it is for performance reasons. And that is different; that is not covered by the bylaws piece.

Senator SIMPSON. Speaking of that, I do not know if you were involved, but they sacked the executive director, Harriet Miller, who then brought a lawsuit which has an extraordinary complaint. I wish that we could see what happened in the lawsuit, as they discussed the trusts and the foundations, and where the money went, and how Leonard Davis set it up. He has now had his license removed for being untrustworthy as an insurance salesperson. And Harriet Miller received a settlement of \$480,000. And the court records were sealed, and remain sealed. Our course, there was a sense of great anguish to her.

According to her complaint, her reputation was ruined. This was done by Mr. Davis. She intended to show that the AARP was not on the up and up. And Leonard Davis said, you are not going to go back into any of these records, you are not going to find how the trust works, how the Colonial Penn and the insurance system works, and so on.

But I would just appreciate if you would be forthcoming with me. You say you have tried, and yet I think there are some breaches here.

And I would like to ask a final question. I have here a lease. This lease is as thick as the book, "In a Just and Caring Society". This is the lease on the building that you occupy. And I think I would like to know—and I am fully aware that I will receive all sorts of horrible results here for what I am trying to do, but I know what I am up to.

The AARP entered into this agreement with Oliver Carr to construct two buildings to be leased by the AARP. You agreed to rent the ground floor through the 10th floor. The square footage is apparent. Each year, the lease is adjusted for inflation, and the lease is for 20 years. The AARP has the right to extend the lease for up to 10 years. And the lease rental is \$17 million a year—\$17 million

a year for a single structure in the city of Washington. Your other lease rentals around the rest of the United States are another \$7 million, if I recall.

What do you tell your members that you work for, and the little people that you speak of? What do you tell them when you tell them that you have a lease that costs you \$17 million a year, and that just goes out, for no purpose for your membership, other than to provide a facility when they come to Washington, DC? Can you tell me about this, and why you expend precious money, precious money for seniors, on this?

Mr. DEETS. I will be very happy to, Senator.

I would note in the beginning that \$3 million of that \$17 million goes to real estate tax to the District of Columbia, as a direct pass-through.

The building is 500,000 square feet. It is used to house about 1,100 employees that provide the services to AARP. The rate that we negotiated when we moved into that building which we lease was then the going rate for property in that part of town—\$35 a square foot.

I think to get a building that would house the resources we need—including a research information center, a response center for our 800 number, to respond to members' interests, the various programs, a communications center, the data center, training facilities—we think that is the size we need, and it is going to carry us for many years to come.

If that is viewed as too much, to pay \$35 a square foot, then the message is to any nonprofit organization that you cannot do business in the District of Columbia, where the rents are very expensive.

We would love to have it much lower, but we do not think that is an exorbitant expense. We think that it is right in line with what real estate prices are, unfortunately. And it meets the need to provide the services that we offer to our members, and enables us to serve their needs and interests.

Senator SIMPSON. Well, I think if you really feel that—and I do not question your own personal thoughts about that—I think you really do believe that is something you are doing for your members, but it does seem to me that laying out \$340 million bucks in 20 years, when you represent people who toady up their \$8 bucks a year, there are some serious deficiencies in, perhaps, bigness in Washington, DC with 501(c)(4)'s. And I think there is a disconnect.

And I think Dave Pryor is absolutely right. There are many of them in this disconnect—big business, big salaries. You have 1,700 employees. You pay them \$59 million a year. Nineteen of them get over \$100,000 bucks a year in salary. And you are doing it for the little guy. And I think that needs some attention. We ought to say, if you are really representing your members, then exist on dues from the members. That might be a shocking thing, and we will pursue that. But we are certainly going to pursue the Federal funding of organizations that have a cash flow of \$382 million, or whatever cash flow it is.

And the things Senator Pryor discusses are well worth attention. We have a group that tells us it advises the public on various things for senior citizens, such as the tax. Program title one is

called "Tax Counseling for the Elderly," also known as tax aid, that this organization gives counsel to people, with regard to their taxes, and has had to pay \$135 million bucks in lieu of taxes. That is the ultimate irony to me. Someone misfired when the organization that is giving tax counseling has made an error of \$135 million. And we do not know what the original request for the money was. Was that negotiated down from \$300 million, or \$500 million? Where did it start? But maybe we can review that at some future time.

Did you have any further response? I do not want to cut you off.

Mr. DEETS. No, Senator. I thank you for the opportunity. We appreciated a chance to meet in your office ahead of time.

You were very fair in going through the questions with us. We would hope that the discussion does not stop there. We are not in any way trying to avoid encounters of scrutiny of AARP, and we would welcome the opportunity to do more.

I would say, in light of some of the prior testimony, that I am concerned with the implication that we do not represent our members' wishes. Certainly we disagreed with Senator McCain over catastrophic. You, yourself disagreed with him. We have reason to believe that easily over 60 percent of our members supported that, because they would not have paid a single cent more. That was a progressively funded program. That legislation has gone away, but the issue of health care has not gone away.

We also think that, on the issue of the earnings limitation on Social Security, we have testified for the House version of liberalizing the earnings limitation. We did not join Senator McCain's desire, his legislation to eliminate the earnings limitation because we feared for the financial impact on the Social Security trust.

So I think there are areas that we hope our testimony will clear up, and we can clear up later. But we do welcome the opportunity to meet with you.

Thank you for giving us this chance.

Senator SIMPSON. Let me just share with you, modern technology being what it is, something I have just received that shows you how Washington works. It is a memorandum of May 15, 1995, to the membership division department directors, the membership division section managers, from Keith Hardy, re: HCR impact study. That is health care reform. And it goes directly in opposition to what you are just telling us.

This is apparently a confidential document. It shows that 35 percent of those ending their AARP membership did so mainly because of AARP's position on health care. Another 15 percent said it was a very important reason. So 50 percent of your membership have said this. Sixty percent of your members did not even know AARP had taken a position on this issue. This is a fascinating document. It flies exactly in the face of what you have just told me.

So I think you are going to do well if you just stay on the up and up. I am not here to destroy the AARP, but I am here to get rid of hypocrisy and duplicity, and I am here to see that something and some organization does not get so big that they think nobody will take them on.

So I am going to insert this in the record, the HCR impact study. [The information appears in the appendix.]

Mr. DEETS. Senator, if I may comment on that. It is very interesting, in light of Senator McCain's comment and that particular memo, how many people were told that we endorsed President Clinton's health care plan? Because we know from the research we have done—we conducted over 54 surveys in 1994, we have done 25 so far this year—which indicate the desire for access to affordable quality health care that gives you a choice.

While we did not endorse the President's plan, we did feel that there was a need for health care reform. Having thousands of people turn in their membership, or say they were going to quit because you endorsed the Clinton plan, when you did not endorse the Clinton plan, is very frustrating because a lot of misinformation was spread about. I think what that is trying to explain is, of those who did cancel their membership, a big chunk of those who canceled was because of health care reform. And we did find massive disconnects and misunderstanding. It was just something we need to work on and do a lot of education.

People told us they did not want the Government involved with health care reform. Leave me alone with what I have got. And we would say, what do you have? They answered, I have Medicare. This tells us we have a lot of education to do.

Senator SIMPSON. Well, I think so. And, you see, people think that the Mitchell-Gephardt bill was the President's proposal, and that is what you did endorse.

Mr. DEETS. No, we did not, Senator. We recommended to our members that they support it. We did not endorse that bill because—

Senator SIMPSON. The Mitchell-Gephardt proposal?

Mr. DEETS. We did not endorse that.

Senator SIMPSON. I have documents that show you endorsed it.

Mr. DEETS. I would love to see them, because the AARP Board of Directors are the only people who set policy. We did not endorse that.

Senator SIMPSON. I certainly will. Mr. Rother was promoting it here on the Hill. I was there.

Mr. DEETS. We recommended that our members support it, because they were the only two plans that had long-term care and prescription drugs.

Senator SIMPSON. All right.

Mr. DEETS. We did not endorse it, or say on behalf of our members.

Senator SIMPSON. All right. But you really wanted them to go for that one.

Mr. DEETS. Given the alternatives, it was our best choice.

Senator SIMPSON. You really wanted them to go for it, but you did not endorse it. Now that is the kind of doublespeak that I think we can get through.

But you knew this document existed. This is dated May 15. And these are diverse and remarkable figures.

I hope that in the future we can get together, and I will look forward to visiting in my office.

Senator PRYOR. Mr. Chairman.

Senator SIMPSON. Yes, indeed, please.

Senator PRYOR. May I enter in here just a moment?

Senator SIMPSON. Yes.

Senator PRYOR. I would once again like to cite an example—in fact two examples—of how tax-exempt organizations trash other tax-exempt organizations, and use that special privilege of paying no taxes to do one another in.

Senator SIMPSON. Dave, there is a vote here. I am sorry. I did not see that.

Senator PRYOR. I did not know that either.

Could we have another hearing on all this one of these days?

Senator SIMPSON. We will. I can assure you, we will.

Senator PRYOR. But this is one from the Seniors Coalition spreading, in my opinion, false information about the AARP, which they used their tax-exempt status to abuse it. Then we have the United Seniors Association, another nonprofit organization. We have the United Seniors Association, Inc. taking on the AARP.

Senator SIMPSON. Did you get that other one, the one funded 96 percent by the Feds, the National Council of Senior—whatever.

Senator PRYOR. I do not know that one.

Senator SIMPSON. Well, we want to throw them in there too.

Senator PRYOR. Anyway, I just think we have got to look at all of these groups to see what they are doing with this very special privilege we give them.

Senator SIMPSON. It is a special privilege. And I thank you so much, Senator Pryor.

Senator PRYOR. Thank you, Mr. Chairman.

Senator SIMPSON. And I thank Horace Deets, Margaret Dixon, and Eugene Lehrmann. Thank you very much.

The hearing is concluded.

[Whereupon, at 12:25 p.m., the hearing was concluded.]



# APPENDIX

## ADDITIONAL MATERIAL SUBMITTED

### PREPARED STATEMENT OF NATWAR M. GANDHI

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to provide information to assist the Committee in its inquiry into the activities of tax-exempt organizations, the revenue resulting from these activities, and the extent to which the revenue may be subject to the unrelated business income tax (UBIT). Of particular interest are the activities of charitable and educational organizations (Internal Revenue Code section 501(c)(3)) and social welfare organizations (Internal Revenue Code section 501(c)(4)), as these organizations represent most tax-exempt assets.

On the basis of our past work and our analysis of 1991 Internal Revenue Service (IRS) data, which was the most recent available, we have the following major observations to offer:

- The tax-exempt community represents a large and diverse group of organizations organized and operated for a variety of purposes. However, the community has been characterized by concentration of resources among some large organizations. For instance, in 1989 about 1.6 percent of charitable and educational organizations controlled 70 percent of all such organizations' assets and 61 percent of their revenue.
- Many tax-exempt organizations have relied upon income-producing activities to fund their operations. IRS data show that these organizations received a substantial proportion of 1990 revenue from program service activities and other sources: 79 percent for charitable and educational organizations and 81 percent for social welfare organizations. The IRS data also indicate that contributions represented 20 percent of charitable and educational organizations' revenue and membership dues represented 11 percent of social welfare organizations' revenue.
- In 1950, concerns of competition between the tax-exempt community and taxable businesses led to enactment of UBIT. IRS data show that tax-exempt organizations have reported the bulk of their fee and business-like income as derived from activities related to exempt purposes and therefore not taxed. In 1991, 71 percent of charitable and educational organizations' revenue was reported as derived from activity related to exempt purposes.
- About 96 percent of charitable and educational organizations' 1991 income reported from unrelated activity was excluded from UBIT because the income fell under one or more of 40 exclusions. Similarly, about 75 percent of social welfare organizations' income was excluded. Exclusions include income from royalties, interest and dividends, and rents from property not financed by debt. Generally, exclusions were enacted because Congress did not believe such income, usually of a passive nature, was likely to generate competitive problems. In 1993, 37,045 tax-exempt organizations, about 3 percent of all such organizations, paid almost \$174 million in UBIT.
- Administration of and compliance with the UBIT require determining whether a business activity furthers an organization's exempt purpose and, if not, whether it falls within one of the statutory exclusions. This has historically posed difficult determinations for IRS and taxpayers. Current controversy surrounds the extent to which various income sources fit the royalty exclusion.

#### TAX-EXEMPT COMMUNITY IS DIVERSE

Federal tax law has always provided for exemption of charitable and educational organizations. While the basis for exemption of particular organizations is not al-

ways specific, various rationales exist for tax-exempt status. These include a belief that the concept of taxable income is not applicable to nonprofit organizations supported by donations or organized for mutual benefit, and that exemption (1) assists an organization to undertake a function that governments would otherwise provide, (2) is an appropriate subsidy for addressing social problems using approaches not available to government, and (3) compensates for restraint on capital raising. Tax-exempt status is predicated upon being organized and operated for valid purposes and does not preclude the organization from generating profit from activities in which it is engaged.

The number of tax-exempt organizations continues to increase, with over 1.1 million<sup>1</sup> entities recognized as tax-exempt by IRS in 1994. Organizations are recognized as tax-exempt under 25 categories in Internal Revenue Code (IRC) section 501(c). Each of these categories provides for generic or specific organizational purposes, such as charitable and educational, health, social welfare, and member benefit. Appendix I provides a list of the 25 categories and the approved purposes.

Charitable and educational organizations have historically made up the majority of the tax-exempt community. Social welfare organizations have been the second largest category of exempt organizations. These two categories represented 65 percent of the more than 1.1 million tax-exempt organizations in 1994 and 69 percent of all assets in 1990.

Although the 25 statutory exemption categories encompass diverse organizational and operational purposes, great diversity also exists within the categories. For instance, 501(c)(3) organizations include educational institutions, churches, and hospitals. Organizations may be approved for exemption in furtherance of over 160 specific activities, ranging from testing products for public safety to combatting community deterioration.

#### *Resources Have Been Concentrated*

We reported in a 1987 report<sup>2</sup> that financial resources have historically been concentrated among a small number of tax-exempt organizations. This concentration was still evident in 1989. IRS data show that in 1989 about 2,133 charitable and educational organizations, or 1.6 percent, controlled 70 percent of these organizations' assets and 61 percent of their total revenue. Similarly in 1989, about 291 social welfare organizations, or 1.4 percent, controlled 78 percent of assets and 69 percent of revenue.

#### BUSINESS ACTIVITIES LED TO UBIT

Prior to 1950, all income of exempt organizations was untaxed as long as the net profits were used to further their exempt purposes. In 1950, Congress enacted UBIT to address what was seen as competition between tax-exempt organizations and taxable entities. Tax-exempt status is predicated upon an organization being organized and operated for valid purposes and does not preclude the organization from generating profits from activities in which the organizations are engaged. However, Congress was concerned that tax-exempt organizations could expand their competitive businesses with untaxed profits while taxable entities could do so only with taxed profits. UBIT applies an income tax to a tax-exempt organization's income from an unrelated trade or business, less deductions directly connected to the production of the income. Income is subject to UBIT only if it is

- from a trade or business;
- regularly carried on, and
- not substantially related to the organization's exempt purpose.

While the basic structure of UBIT has not changed since 1950, the UBIT was extended to churches, social welfare organizations, local associations of employees, and social clubs in 1969. Currently, UBIT applies to most tax-exempt organizations with unrelated business income (UBI) of \$1,000 or more.

In 1993, 37,045 tax-exempt organizations, about 3 percent of all such organizations, paid \$173.6 million in UBIT. IRS 1991 data<sup>3</sup> show that less than 1 percent of the revenue of charitable and educational organizations and 1.4 percent of the revenue of social welfare organizations was taxable unrelated business income. Ap-

<sup>1</sup>This total does not include certain 501(c)(3) religious organizations that are automatically tax-exempt without applying to IRS, as well as a small number of other organizations, such as farmer cooperatives.

<sup>2</sup>Competition Between Tax-Exempt Organizations and Taxable Businesses (GAO/GGD-87-40BR, Feb. 27, 1987).

<sup>3</sup>These data are based on information reported by tax-exempt organizations on their annual information return (Form 990, Part VII). IRS officials advised us that these data were first reported for tax year 1989, and the reliability of the reporting has not been assessed.

pendix II contains additional information on the distribution of revenues for these organizations.

In the 1980s, complaints from small businesses of unfair competition with tax-exempt organizations made the issue a prominent one at the 1986 White House Conference on Small Business and the subject of extensive hearings before the Subcommittee on Oversight of the House Ways and Means Committee in 1987 and 1988. Numerous proposals for UBIT changes were generated, including tightening the criteria for what was considered related activity and eliminating some of the exclusions. However, these proposals were never included in a bill.

#### PAST RELIANCE UPON INCOME-PRODUCING ACTIVITY EVIDENT

Available IRS data through 1991 show the tax-exempt community continued to rely upon income-producing activity. This reliance has been attributed in studies by the community to increased fiscal pressure on tax-exempt organizations, particularly those in the social service area, which experienced reductions in federal funding. Studies of the tax-exempt community have distinguished between so-called traditional revenue sources, such as contributions and gifts for charitable and educational organizations and membership dues for social welfare organizations, and income-producing or commercial-type revenue. IRS 1991 data show the most common type of income is derived from program service revenue, representing 70 percent for charitable and educational organizations and 62 percent for social welfare organizations. See Appendix III for additional information on revenue sources. Program service revenue broadly refers to fees and income organizations generate while administering programs. For example, it includes hospital charges for patient care, entrance fees to museums, fees for service at YMCAs and day care centers, and tuition at schools. Program service revenue may also be generated from commercial activity not substantially related to the organization's purpose. Other income can be derived from passive activities, such as interest, dividend, and royalty income.

Contributions and dues have decreased as a percent of tax-exempt organizations' total revenue, while the percent from fee and other income-producing activity increased. Contributions declined from 23 percent to 17 percent of revenue from 1975 to 1990 among all tax-exempt organizations. The decrease was more dramatic among charitable and educational organizations, for which the decline was from 32 percent to 20 percent during the same period. Dues decreased from 21 percent to 5 percent of all organizations' revenue, and dues decreased from 58 percent to 11 percent for social welfare organizations during the same period. Appendix IV contains more information on revenue sources.

#### *1991 Data Indicate Most Revenue Reported From Related Activity*

The overwhelming majority of charitable and educational and social welfare organizations' revenue in 1991 was reported as income derived from activities related to the organizations' exempt purposes and not subject to UBIT. Our analysis of IRS data disclosed that this type of income accounted for 71 percent of all income reported by charitable and educational organizations in 1991. Social welfare organizations reported an even higher percentage (82 percent) of income related to exempt purposes. A breakdown of these data is shown in appendix II.

Before 1989, data were lacking on the nature and extent of tax-exempt organizations' activities, particularly how the activities related to their exempt purposes. In response to our and others' recommendations for better data, IRS revised the annual information report (Form 990) to better capture the extent to which income is derived from activities that are related or unrelated to exempt purposes. Form 990, Part VII, Analysis of Income Producing Activities, requires organizations to categorize their income, other than charitable contributions, as (1) related to their exempt purpose; (2) unrelated business income, but subject to UBIT exclusions under IRC section 512, 513 or 514; and (3) taxable unrelated business income.

#### *Most Unrelated Business Income in 1991 Reported as a UBIT Exclusion*

Much income derived from an activity considered unrelated to organizations' tax-exempt purposes in 1991 was not taxed as unrelated business income due to statutory exclusions to UBIT.

There are 40 exclusions to UBIT. For instance, UBIT does not apply to income from

- volunteer labor;
- services provided for the convenience of members of certain organizations;
- the sale of donated merchandise;
- royalties;
- certain kinds of research;
- interest and dividends of certain organizations; and

—rents, if not from debt-financed property.

Generally, the exclusions were enacted because Congress did not believe that such income was likely to generate competitive problems. Overall, 96 percent of charitable and educational organizations' 1991 unrelated business income was reported on the Form 990 as excluded from UBIT. Social welfare organizations reported about 75 percent of unrelated business income as excluded from UBIT. The most frequently mentioned exclusions cited by the largest social welfare organizations in 1991 included (1) dividends and interest, (2) proceeds from the sale of investments, (3) real property rental income, and (4) income from an activity not regularly carried on.

#### *Amount of UBI Reported Has Been Increasing*

IRS statistics show that the number of organizations engaged in UBI activity has been growing. Any tax-exempt organization with UBI gross receipts of \$1,000 or more must file a Form 990-T—Exempt Organization Business Income Tax return. Between 1985 and 1993 the number of Forms 990-T filed increased 58 percent from 23,433 to 37,045. The tax reported on these returns, not adjusted for inflation, increased approximately 343 percent during the same period, from \$39.2 million to \$173.6 million (in 1993 dollars), averaging \$1,675 in 1985 and \$4,686 in 1993. Appendix V contains more data on filings.

#### UBIT POSES COMPLIANCE AND ADMINISTRATIVE DIFFICULTIES

As with other tax code provisions, the UBIT framework is made complex by the numerous exclusions to what is considered UBI. Additionally, the facts and circumstances of each case drive the determination as to whether an activity is substantially related to an organization's exempt purpose, creating compliance and administrative difficulties.

Numerous IRS rulings and court cases have been handed down on these issues. Whether an activity is substantially related can depend not only upon the type of exempt organization, but upon the unique circumstances involved. For instance, laboratory testing of nonpatients by a hospital has been determined in most circumstances to generate UBI; in one case, it was determined to be a substantially related activity. Defining what activity fits an exception has also been controversial. IRS has recently taken the position that income that some organizations may categorize as royalty income—an exception to UBIT—is actually income from active business services, and hence taxable UBI.

The question of the scope of the royalty exception has been interpreted differently by the courts. In a 1981 case, a court ruled that revenues from the rental of mailing lists was not the type of passive income contemplated by the royalty exclusion. More recently, the Tax Court disagreed with IRS' position to disallow as a royalty the income from the rental of mailing lists and from a credit card affinity program.<sup>4</sup> IRS claimed that the royalty exclusion includes only passive income sources. The Tax Court, however, ruled that the royalty exclusion was not limited to passive income sources and that the income fit the royalty exclusion as payment for the use of intangible property. Increasingly, organizations are reported to be receiving royalty income from such sources as affinity credit cards, sales of logos, and mailing lists.

#### *IRS Has Undertaken Compliance Initiatives*

IRS' examination program for exempt organizations involves determining whether the organizations are operating in accordance with their basis for exemption and whether they are liable for any UBIT or various excise taxes. The Form 990 and/or Form 990-T are examined. In 1993, IRS examined 7,968 Form 990 returns and 1,930 Form 990-T returns.

We reported<sup>5</sup> in 1985 that IRS could improve its process of selecting Form 990-T returns for examination. IRS agreed and conducted a Taxpayer Compliance Measurement Program (TCMP)<sup>6</sup> on exempt organizations' 1986 and 1987 Form 990-T returns to estimate compliance with reported UBIT<sup>7</sup> and to develop criteria to better select noncompliant organizations for examination. Compliance problems among some types of tax-exempt organizations were disclosed. Estimated voluntary compli-

<sup>4</sup> Under affinity programs, organizations receive a payment for the use of their logos on credit cards.

<sup>5</sup> IRS' Examination Selection System for Exempt Organizations' Unrelated Business Income Tax (GAO/GGD-85-64, July 8, 1985).

<sup>6</sup> IRS uses TCMP data to measure compliance levels, identify compliance issues, estimate the tax gap, and develop formulas for objectively selecting returns for audit.

<sup>7</sup> TCMP did not measure the extent to which organizations might be nonfilers.

ance levels<sup>8</sup> ranged from 53 percent for social clubs to 75 percent for labor unions and 95 percent for various organizations under IRC 501(c)(1), (2) and (9)-(23) organizations. Estimated compliance levels for charitable and educational<sup>9</sup> and social welfare organizations were 56 and 58 percent, respectively.

Although design limitations in this TCMP made tax gap estimates unreliable, IRS believes that smaller organizations account for much of the UBIT noncompliance. In response to TCMP, IRS revised its audit selection criteria for Forms 990-T in 1990 and targeted specific types of organizations for educational outreach on Form 990-T filing requirements. Additionally, IRS is currently approaching its examinations by market segment, hoping to improve its examination and selection process.

In May 1994 the Subcommittee on Oversight of the House Committee on Ways and Means submitted recommendations for legislative and administrative changes to address difficulties in the administration of tax-exempt organizations. Among these recommendations were (1) an intermediate sanction short of revocation of tax-exempt status for violations of private inurement rules and (2) increased penalties for failure to file a complete and accurate Form 990. These recommendations were not acted upon at the Committee level.

In summary, the tax-exempt community represents a large and diverse community of over a million organizations that are organized and operated for varied purposes. Activity in furtherance of these purposes can often look like activity in which taxable businesses are engaged. The community has been characterized by a concentration of activities and resources among larger organizations. Tax-exempt status does not prohibit an organization from engaging in commercial activity, and data indicate that tax-exempt organizations rely upon income-producing activity, both related and unrelated to their exempt purposes, to finance operations. UBIT addresses competition arising when tax-exempt organizations conduct activities similar to those of taxable businesses by levying a tax on the income from activity not considered substantially related to an organization's exempt purpose. However, most revenue generated by tax-exempt organizations was reported as related to the purposes for which the organization was organized, or it was reported as revenue generated by an activity excluded from the UBIT.

Administration of and compliance with UBIT requires a facts and circumstances determination as to whether an activity furthers an organization's exempt purpose and, if not, whether it fits a UBIT exclusion. Controversy has continued to surround some of these decisions. The most recent controversy involves whether the royalty exception includes other than passive income.

This concludes my prepared statement. I will be pleased to respond to any questions.

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<sup>8</sup> Voluntary compliance level is the ratio of tax reported to the sum of tax reported and additional tax assessed.

<sup>9</sup> This does not include private foundations, whose compliance level was estimated at 96 percent.

Categories and Activities of Tax-Exempt Organizations

Section 501(c)	Type and activity of organization
(1)	Corporations organized under an act of Congress and operated as an instrumentalities of the United States.
(2)	Title-holding corporations organized to hold title to a tax-exempt organization's property, collect its income, and deliver to it the net proceeds.
(3)	Entities organized and operated exclusively for religious, charitable, scientific, public safety testing, literacy, or educational purposes, for the prevention of cruelty to children or animals, or to foster amateur sports.
(4)	Organizations operated exclusively for the promotion of social welfare or local associations of employees whose earnings are earmarked for charitable, educational, or recreational purposes.
(5)	Labor, agricultural, and horticultural organizations organized to provide education on improving working conditions and products.
(6)	Business leagues, chambers of commerce, real estate boards, and professional football leagues organized to improve business conditions.
(7)	Clubs organized for pleasure and recreational purposes.
(8)	Fraternal beneficiary societies and associations organized to provide for the payment of life, sickness, accident, or other benefits to members and operated under a framework of self-governing branches chartered by a parent organization.
(9)	Voluntary employee beneficiary association providing for payment of life, sickness, accident, or other benefits to members of the association.

Section 501(c)	Type and activity of organization
(10)	Domestic fraternal societies and associations operated exclusively for social, educational, religious, scientific, charitable, and fraternal purposes under a framework of self-governing branches chartered by a parent organization.
(11)	Teachers' retirement fund associations organized on a local basis.
(12)	Benevolent life insurance associations, and mutual companies, such as electric, irrigation, and cooperative companies organized on a local basis.
(13)	Cemetery companies owned and operated for the benefit of their members and not operated for profit.
(14)	Nonprofit credit unions and mutual reserve funds providing loans to members and reserve funds for domestic building and loan associations, cooperative banks, and mutual savings banks (must have been organized prior to 9/1/57 if a mutual).
(15)	Mutual insurance companies or associations with net premiums not exceeding \$350,000 providing insurance to members (other than life companies).
(16)	Cooperative organizations established to finance crop operations.
(17)	Trusts providing for the payment of supplemental unemployment benefits.
(18)	Trusts paying benefits under employee-funded pension plans if created prior to 6/25/59.
(19)	A post or organization promoting the welfare of past or present members of the Armed Forces.
(20)	An organization or trust providing legal services as part of a qualified group legal services plan.
(21)	Trust organized to pay black lung disability claims.

APPENDIX I

APPENDIX I

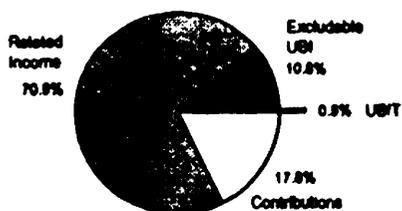
Section 501(c)	Type and activity of organization
(22)	Pension plan withdrawal liability trusts created to meet payments under section 4223(c) or (h) of the Employee Retirement Income Security Act of 1974.
(23)	Veterans' insurance associations created to provide insurance and other benefits to member veterans.
(24)	Trusts described in section 4049 of the Employee Retirement Income Security Act of 1974.
(25)	Title-holding companies with 35 or fewer entities exempt under IRC section 401 and 501(c)(3) and governmental units.

APPENDIX II

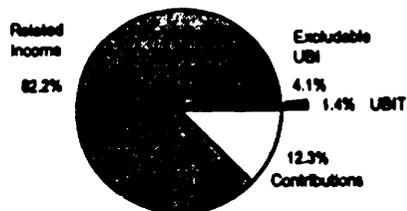
APPENDIX II

## Distribution of Revenues for 1991

Charitable and Educational Organizations



Social Welfare Organizations



Source: SOI data.

APPENDIX III

APPENDIX III

**1991 Revenue Figures for Charitable  
Educational Organizations and Social  
Welfare Organizations as per SOI Tables  
(in millions)**

	Charitable and educational organizations		Social welfare organizations	
	Amount	Percent	Amount	Percent
Total Revenue	489,595	100	21,073	100
Program Service	344,086	70.3	12,129	62.3
Contributions, gifts, grants	86,775	17.7	2,880	13.7
Dues/assessments	5,051	1.0	2,089	9.9
Other	53,683	11.0	2,975	14.1

Source: SOI data.

APPENDIX IV

APPENDIX IV

**Table IV.1: Major Revenue Sources for All Exempt Organizations 1975 and 1990 (1990 Dollars, in Billions)**

Year	Contributions		Dues and Assessments		Other Revenue		Total	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
1975	47.3	22.8	44.7	21.5	115.7	55.7	207.7	100.0
1990	93.4	16.7	30.3	5.4	435.9	77.9	559.6	100.0

Source: SOI data.

**Table IV.2: Major Revenue Sources for Charitable and Educational Organizations 1975 and 1990 (1990 Dollars, in Billions)**

Year	Contributions		Dues and assessments		Other Revenue		Total	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
1975	39.4	31.6	3.5	2.8	81.7	65.6	124.6	100.0
1990	80.9	19.9	5.0	1.2	320.5	78.9	406.4	100.0

Source: SOI data.

**Table IV.3: Major Revenue Sources for Social Welfare Organizations 1975 and 1990 (1990 Dollars, in Billions)**

Year	Contributions		Dues and assessments		Other Revenue		Total	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
1975	1.6	4.6	19.7	58.2	12.6	37.2	33.8	100.0
1990	1.7	8.9	2.0	10.6	15.3	80.5	19.0	100.0

Source: SOI data.

**Table V.1: Form 990-T Filed, UBIT Paid, 990-T Examinations, and Assessments**

(Dollars in millions)

Year	Number of Organizations	Filed	UBIT Paid	Exams	Assessments
1990	1,022,214	33,757	\$127.9	3,013	\$15.8
1991	1,053,250	34,936	155.6	2,954	19.3
1992	1,082,959	36,393	181.6	2,336	46.1
1993	1,116,015	37,045	173.6	1,930	19.6

Source: IRS.

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## PREPARED STATEMENT OF M. ROY GOLDBERG

Good morning Mr. Chairman and members of this honorable subcommittee. My name is M. Roy Goldberg, and I am an attorney with the Washington, D.C.-based law firm of Galland, Kharasch, Morse & Garfinkle, P.C. We represent Dr. Joseph Schiff, a retired doctor living in the Chicago suburbs, in his civil litigation against the American Association of Retired Persons. In addition to our law firm, Dr. Schiff is also represented by the Chicago-based law firm of Beigel Schy Lasky Rifkind Goldberg and Fertik.

Dr. Schiff filed his case against the AARP in Superior Court for the District of Columbia on March 21, 1995. Dr. Schiff seeks to represent both himself and the class of all other persons who were also injured by what he perceives to be deceptive and otherwise improper conduct by the AARP. In his complaint, Dr. Schiff contends that the AARP, among other things, violated the District of Columbia Consumer Protection Procedures Act ("CPPA"), D.C. Code §§ 28-3901, et seq., and committed common law fraud, through its failure to disclose to AARP members such as himself that the AARP was generating substantial profits on the sale of goods and services to AARP members.

In an order entered on May 3, 1995, D.C. Superior Court Judge Geoffrey Alprin dismissed Dr. Schiff's complaint. However, Dr. Schiff filed a timely motion for reconsideration of that order, which is currently pending. In addition, if the order of dismissal is not reversed on reconsideration, Dr. Schiff intends to pursue his appeal rights and whatever other federal or state causes of action exist to both halt and remedy the improper conduct by the AARP.

Dr. Schiff initially joined the AARP, and then remained a member, because, like countless others, he believed that the AARP was a not-for-profit organization which, among other things, could make available quality goods and services to senior citizens at prices which were unavailable anywhere else. He believed that the AARP's sole purpose was to serve the interests of its membership. He naturally assumed that the goods and services he bought through the AARP would not be marked up to reflect a profit to the AARP. After all, the earning of a "profit" is the very antithesis of a "non-profit" entity.

After Dr. Schiff became a member of the AARP, he purchased certain supplemental Medicare health insurance coverage through the AARP. Dr. Schiff also purchased through AARP certain long-term insurance coverage designed to provide home health care, adult day care, nursing home and other similar care coverage for himself and his wife. Dr. Schiff has been paying monthly premiums for the long-term care insurance coverage, and continues to do so.

Until the Wall Street Journal in the summer of 1994 revealed that the AARP had entered into a settlement agreement with the Internal Revenue Service to pay \$135 million in back taxes for profits generated by the AARP, Dr. Schiff and countless other similarly situated members of the AARP had no idea that the goods and services being sold under the auspices of the AARP were part of a such a profit-making operation. This revelation was completely contrary to the belief that the AARP was acting in a non-profit capacity with respect to the sale of goods and services such as pharmaceuticals and insurance. It was the discovery of the substantial tax payment which caused Dr. Schiff to have this action filed.

The crux of the complaint by Dr. Schiff and other AARP members is that, while the AARP has pretended to be a non-profit organization with the purported objective of helping its elderly membership, the reality is that the AARP is using its members to generate millions of dollars in profits. In plain words, Dr. Schiff claims that the AARP injured him and millions of other members by taking their money under false pretenses. He contends that the AARP engaged in a massive deception about what it really is and what it does with the money it gets from members. Specifically, the AARP misled members and prospective members into believing that it is a non-profit membership organization whose purpose is to serve the interests of persons 50 years old or older. In reality, the AARP has become an enormous profit-center which generates unrelated business income to fund lavish salaries for its officers and directors, and for the benefit of the affiliated entities which it owns or controls.

A primary example is the failure of AARP to disclose to Dr. Schiff and others the profits that it earns on the sale of the long-term care coverage purchased by Dr. Schiff. The information sent to Dr. Schiff by the AARP in connection with his purchase of the insurance represented that the policy was underwritten by the Prudential Insurance Company of America ("Prudential"); that AARP was a "non-profit membership organization;" that "on behalf of [AARP's] membership, the AARP Insurance Trust has entered into a group insurance contract with The Prudential Insurance Company of America;" and that "Income from the investment of monies on deposit in Trust accounts and an allowance of approximately 3% of insurance pay-

ments collected by the Trust are remitted by the Trust to AARP and used for the general purposes of [AARP] and its members." Dr. Schiff contends that these statements were false and misleading because this was the sole disclosure by the AARP of any such "allowance." Unbeknownst to Dr. Schiff, this "allowance," which was alleged to be for reimbursement of necessary expenses incurred by the AARP in operation the particular insurance program, was, in fact, a commission, royalty, fee, or unrelated business income paid to or earned by the AARP. Such a royalty, fee or commission was contrary to the AARP's representation that it is a non-profit organization.

Indeed, in 1993 alone, the AARP earned approximately \$85,000,000 from these so-called group insurance administrative allowances, net of the approximately \$17,000,000 costs incurred to solicit and monitor these plans, and exclusive of the nearly \$18,000,000 of interest that the AARP earned from investment of the members' premiums prior to remitting the premiums to Prudential. In his lawsuit, Dr. Schiff further takes issue with the fact that this purported "allowance" is not used for the general purposes of the AARP and its members. To the contrary, it is used for unrelated purposes such as directly or indirectly generating profits for AARP and paying extraordinary salaries to or providing other benefits to the officers and directors of the AARP.

Dr. Schiff's lawsuit against the AARP also targets the AARP's investment funds. In its bi-monthly publication entitled *Modern Maturity*, the AARP represented to its members that they can invest in the "AARP Investment Program from Scudder" which is a "conservative stock investment designed for AARP members" and that they will not "pay sales charges or commissions." The foregoing statements were false and misleading because the investment is not in any material manner designed for elderly or retired persons. Moreover, AARP Financial Services Corp., which is a wholly-owned subsidiary of the AARP, and which is a taxable entity that is not otherwise involved in the AARP's not-for-profit activities, is receiving a portion of the management fees paid to Scudder in connection with the AARP Investment Program. These fees to AARP Financial Services Corp. are paid from the AARP members' investments in the Investment Program, but this fact is not properly disclosed in the membership application materials or the AARP's annual financial statements. AARP Financial Services Corp. is thus another way that AARP earns profits and obtains benefits for those in control of the AARP at the expense of the AARP membership.

As reflected in his lawsuit against the AARP, Dr. Schiff contends that the AARP's failure to disclose the profit-motive behind the sale of goods and services under AARP auspices violates the District of Columbia consumer protection statute. In pleadings filed with the court, Dr. Schiff asserts that as long as the AARP is acting like a profit-motivated entity, it should be held accountable under the consumer protection laws which required such profit-making organizations to refrain from making material misrepresentations to actual and potential customers. When the AARP pretends that AARP goods and services are offered at price levels which reflect the purported non-profit status of the AARP but in fact offers these items at profit-making prices, it is engaging in the type of consumer misrepresentation which caused these consumer laws to be enacted in the first place.

Dr. Schiff similarly alleges that the AARP has engaged in common law fraud because of its failure to disclose the profits that it earns on transactions with its members. The representation being made by the AARP is that members should purchase its goods and services because the AARP offers the lowest price because the AARP does not make any profit from the sale of such goods and services. Such a representation is material to a member who in good faith and understandably believes that he or she is getting the lowest possible price from the AARP because the AARP is not in the business of selling such goods and services for a profit. Where, however, the AARP is in fact attempting to (and significantly succeeding at) generating a profit from its sale of a particular good or service, this is material information to the prospective purchaser. Thus, while the AARP in 1993 earned approximately \$85 million in fees or royalties relating to the sale of insurance, but only incurred administrative costs of \$17 million to make the sales, it failed to adequately inform members who purchased the insurance that it would be making a profit of nearly \$70 million that year the sales of insurance (or of the fact that the AARP would also earn millions of dollars in interest from the investment of the members' premiums.)

In closing, the lawsuit against the AARP was filed to challenge the practice of the AARP in, on the one hand, holding itself out as a non-interested, not-for-profit facilitator in the members' quest for the lowest possible price for quality goods and services; and, on the other hand, generating millions of dollars of profits each year from the sale of such goods and services to AARP members.

At a minimum, Dr. Schiff seeks to require the AARP to fully disclose its current profit motive and earnings to members who purchase pharmaceuticals, insurance, credit cards, travel, and other goods and services through the AARP.

PREPARED STATEMENT OF PAUL S. HEWITT

Mr. Chairman, thank you for inviting me to testify on the tax and political status of the American Association of Retired Persons. For those not acquainted with life inside the Beltway, AARP is the fabled "800 pound gorilla" of Capitol Hill. Its former Executive Director once proclaimed of AARP that "the fear level in Congress is just incredible." So, let me open, Mr. Chairman, by commending your courage. I hope AARP's members realize that you are doing them a great service by exposing the activities of their leadership to the bright light of day.

Two years ago the National Taxpayers Union Foundation (NTUF) conducted a study of AARP's lobbying agenda that raised troubling questions about the association's role in our democratic process. We found that AARP's agenda—which this year is 492 pages long—did not reflect the views of its membership. AARP advocated new spending that within a decade would cause annual federal outlays to explode by more than \$1 trillion dollars. AARP proposed not a single dollar of spending reduction. Yet it called for an end to the federal budget deficit. In short, AARP's vision was to raise taxes by more than \$1.3 trillion per year within a decade. To this end, AARP advocated a panoply of tax increases: a new consumption tax, higher gasoline taxes, higher income taxes, higher taxes on business, and so forth.

Mr. Chairman, AARP's lobbying agenda would have raised the annual tax bill of the average American household by more than \$13,000 within a decade. Of course, AARP likes to boast that Americans over the age of 50—who comprise about one-fifth of the U.S. population—enjoy half of the nation's discretionary income. AARP members tend to be well-off. So, incredibly, AARP is advocating a series of tax increases AARP advocates would fall heavily on its own membership.

Even though AARP's membership has never endorsed such policies, AARP's lobbyists exercise great influence over Congress. And that is the problem. To the extent that they are successful in thwarting the popular will—as they often are—they diminish the American people's faith in their government.

For example, in 1993 AARP helped convince the Clinton administration and the Democratic Congress to push through a giant package of tax increases. It then played a major role in crafting a health reform package that created 89 new ways for Americans to get fined or go to jail if they did not follow the dictates of federal health bureaucrats. Far from being popular, these two acts sparked what was arguably the greatest upsurge in public revulsion with Congress seen in this century.

Only a few years earlier, in 1988, AARP's lobbyists almost single-handedly stampeded Congress into passing the Catastrophic Health Care Act. This Act would have levied an additional \$9 billion in new taxes on seniors in return for expanded Medicare benefits. But AARP's members staged a tax revolt. They didn't want more government. Congress was forced to repeal the Act.

To put things in perspective, Mr. Chairman, that \$9 billion tax increase is equal to less than one percent of the total new taxes advocated in AARP's lobbying agenda. If AARP's members knew that their lobbyists were advocating tax increases 144 times larger than the tax increases they rejected in 1990, many members would quit AARP and do without the discounts.

ELDER ABUSE

One reason why AARP's lobbyists can get away with so much under the noses of their membership is that they stifle internal debate. AARP's political positions are so tightly controlled from the top that they permit little dissent by the association's 400,000 volunteers. You might be interested to know, Mr. Chairman, that in response to this hearing, AARP sent confidential memos to its staff warning them not to talk to the press. When AARP appears before you next week, I hope you will ask them if they sent similar warnings to the AARP volunteers. AARP's lobbyists are notorious for bullying the volunteers.

For example, under AARP's bylaws, members can be expelled for holding unauthorized meetings with other AARP members. They can be expelled for criticizing the association. They can even be forced out for uttering disparaging remarks about the products AARP hawk to its membership. For some, the prospect of expulsion is nothing less than elder abuse. Former AARP Chairman Kermit Phelps once put it this way: "As we get older, many of us discover our family and support groups . . . are gone. For many of us, AARP fills that role." Yet AARP holds over the heads

of emotionally vulnerable seniors the threat to expel them from their last remaining support group for the simple crime of voicing dissent.

To our knowledge, no other groups representing large, diverse memberships—from the Boy Scouts to the Democratic Party—impose such draconian sanctions on the exercise of free speech. Most either encourage broad, vocal participation in policy development, or they avoid taking stands on issues that divide their membership. We also note that AARP's staff is heavily concentrated in Washington, D.C., where they can lobby the Congress for more taxes, rather than serve senior citizens.

The conclusion we draw, Mr. Chairman, is that AARP is a profoundly undemocratic organization that is effectively controlled by, and for the benefit of its lobbyists. It does not represent its members, but uses them to push an unpopular agenda that would vastly expand the role of government. AARP has virtually no internal due process; few checks and balances; and a self-perpetuating power structure. Its impulses are dictatorial. And yet, as one of the most powerful lobbies in Washington, AARP exercises decisive influence in our democratic process.

#### THE POWER TO DESTROY

In the halls of this sacred institution it is no secret that AARP's lobbyists push an agenda that is unpopular with the association's membership. Their immense political influence grows not out of democracy, but, rather, from the power to propagandize. AARP is a dispenser of discounts and products. It is a voice for seniors. But, above all, AARP is a media giant dedicated to the exercise of raw political power.

AARP's two flagship publications—*Modern Maturity* and the *AARP Bulletin*—have a circulation larger than those of *TIME*, *Newsweek*, and *U.S. News and World Report* combined. In today's media age, such market penetration represents an immense concentration of power. Every word in these publications is subject to the editing of AARP's political staff. And I need not remind you that the power to print is the power to destroy. Every member of Congress lives in mortal fear of becoming the target of AARP's media machine.

AARP also sends out hundreds of millions of pieces of mail each year to its member households. The association is the nation's largest mailer. It is amazing to me, Mr. Chairman, that in this enormous economy of ours, in which marketing plays such a prominent role, one organization—AARP—should account for 1.5 percent of all mail delivered by the US postal service.

Much of this mail is designed to influence public policy by scaring senior citizens out of their wits. Listen to this 1992 attack on the Balanced Budget Amendment: "For a single elderly widow," goes AARP's scare letter, "the average [Social Security] check would fall from \$625 to \$533 per month, or a cut of \$1,104 in [1995]." Of course, this wasn't true. But the damage was done. We can only guess how many elderly widows responded by mailing in their last ten dollars to AARP. Or how many billions of dollars in debt we loaded onto our children because AARP came down on the side of deficits.

#### LEGISLATIVE REFORMS

Mr. Chairman, the National Taxpayers Union Foundation has no desire to curb the constitutional right of AARP's leadership to misinform and misrepresent their members. But we do believe that the scope of AARP's political, financial and media empires gives its lobbyists unparalleled power to intimidate members of Congress in ways that undermine representative government. In this, we find a compelling public interest in limiting the tax privileges and exemptions, and federal grants that have subsidized AARP's growth—subsidies which have totalled as much as a billion dollars since the late 1950s.

Americans have a long and rich tradition of opposing vast concentrations of power—and for good reason. In the words of Lord Acton: Power tends to corrupt, and absolute power corrupts absolutely. AARP's bigness makes it a special case in our political system, deserving of special action. To limit the potential for abuse, we recommend the following reforms:

1. Organizations that spend more than five percent of their budgets on lobbying Congress should not be eligible to receive or administer federal grants. This would help to ensure that grants are awarded on the basis of merit, rather than as political patronage for the powerful. In fact, we believe all 501(c)(4) advocacy organizations should be disqualified from receiving federal grants.

2. Congress should cap the amount of non-profit mail subsidies that any 501(c)(4) non-profit organization is eligible to receive in any given year. We recommend that subsidized mail rates apply to no more than five million pieces annually.

3. No more than 20 percent of a lobbying organization's operating budget should be funded by untaxed commercial activities. This will help to ensure that organizations depend on their members for support, rather than on selling things to those members.

In addition, we should provide the members of marketing conglomerates like AARP with a bill of rights. These might include the right to receive, on demand, a list of the association's lobbying positions; the right to grant the group's lobbyists the power to represent them before Congress—and the right to withdraw that grant of authority.

Finally, Mr. Chairman, we have a recommendation for the American people: Consumer beware. Don't sell your political soul for the price of an airline discount. AARP has no rightful claim to represent the vast majority of its members. Other businesses don't claim to speak for their customers before Congress. But AARP does. And because it does, AARP members bear a special responsibility to monitor and correct what is being said in their names.

In this, AARP members may have only one option. AARP Executive Director Horace Deets recently said that unhappy AARP members can vote with their checkbooks and feet. If you don't like AARP, he said, in effect, leave. So if you don't agree with AARP's message of spiraling taxes, of exploding government, and of pitting the political power of the old against the young, consider it your civic duty to deprive AARP of your voice.

Thank you for the opportunity to testify.

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## PREPARED STATEMENT OF EUGENE LEHRMANN

### INTRODUCTION

The purpose of this testimony is to describe the real American Association of Retired Persons (AARP). This is needed in light of efforts to categorize AARP as just a big business operation or an irresponsible, overly powerful lobby. To the contrary, AARP is a multi-dimensional membership organization that is truly motivated by its desire to improve the social welfare of the older population of this country. It seeks to do so in a manner that improves the quality of life for all generations.

AARP understands that Senator Alan Simpson has been a long time critic of this organization. It is clear that we have a different vision of the future of programs upon which the older population relies. The debate on these issues is a healthy one in which AARP expects to participate actively. In order to keep the debate focused on where it belongs—the issues of importance to the older population and the generations that follow—AARP submits this statement.

### THE HISTORY OF AARP

AARP was organized in 1958, primarily through the efforts of Dr. Ethel Percy Andrus, a retired high school principal. In 1947, Dr. Andrus founded the National Retired Teachers Association (NRTA), a nonprofit corporation created to help alleviate the general problems faced by retired teachers, such as inadequate teacher pensions, difficulty in obtaining health insurance, as well as the loss of self-esteem experienced by older people whom society at that time tended to ignore as having outlived their usefulness.

In 1958, Dr. Andrus and other NRTA leaders formed AARP to meet the needs of older Americans who were not eligible for membership in NRTA. In 1982, NRTA was merged into AARP.

A primary principle for AARP, as established by Dr. Andrus, is found in the motto "To Serve, Not To Be Served." Four purposes of AARP, which continue to be found in the current AARP bylaws, are:

1. To enhance the quality of life for older persons;
2. To promote independence, dignity and purpose for older persons;
3. To lead in determining the role and place of older persons in society; and
4. To improve the image of aging.

In order to fulfill these purposes and accomplish its mission, AARP pursues a variety of activities. It educates, informs and advocates on behalf of the membership and the older population in general. AARP sponsors community service and volunteer programs nationwide. Additionally, it makes available through contracts with commercial providers a number of service programs that are designed to meet the needs of the older population.

Membership in AARP is open to anyone age 50 and over who pays the annual dues of \$8 per year, \$20 for three years or \$45 for ten years. From the inception of AARP by Dr. Andrus, an operating philosophy has been maintained that dues

should be kept as low as possible. It was Dr. Andrus' belief, and continues to be a fundamental commitment of AARP, that membership should be accessible to any person who qualifies by age alone and expresses an interest by paying modest dues. Prior to the increase in the price of dues to \$8 in 1992, dues had remained at \$5 for approximately ten years.

#### GOVERNANCE OF AARP

The direction of the Association's affairs and funds is determined by its volunteer Board of Directors which meets, on average, four times a year. Decisions are made by a majority of the 21 members present at any meeting. The Board of Directors creates committees to advise and report to the Board with respect to special projects or activities. National Advisory Committees, composed of volunteers and board members, serve the Association on an ongoing basis. AARP staff support the Board and these committees.

The Association holds a national Biennial Convention every even-numbered year. The AARP President presides as chair of the convention, which is open to AARP members and the public. Elected delegates meet in business sessions to vote on and participate in deliberations and discussions of matters that affect the Association's members and all older Americans. Convention delegates, all of whom are volunteers, consist of the Board and Officers, all founding members, Area Vice Presidents, Associate Area Vice Presidents, State Directors, and 250 delegates elected by AARP members.

At each convention, delegates elect five members of the Board for a term of six years. They also elect the Association's Vice President, Secretary and Treasurer. At the Biennial Convention, the former Vice President becomes President-elect; the former President-elect becomes President; and the former President becomes Immediate Past President. The Officers have the authority to act as members of the Board.

Candidates for Board and Officer positions are recommended to the convention delegates by a National Nominating Committee, the members of which are appointed by the Board and represent the geographical regions of the country. The deliberations of the Nominating Committee do not involve AARP staff. Board nominees are representative of the membership and have a record of working on behalf of aging and community service issues.

#### EDUCATIONAL ACTIVITIES

The issues that affect the population as they age are numerous, and the public has come to rely on AARP as a source of reliable information on these matters. AARP informs all of its members through its two publications that go to all member households, *Modern Maturity*, with six issues per year and the AARP Bulletin, with eleven issues per year.

These AARP publications are designed to be informative to the members, with the Bulletin covering current events throughout the country, including Capitol Hill, and *Modern Maturity* geared toward feature length articles that inform and educate the reader. These publications also contain advertising, with approximately 65 percent of the publications devoted to editorial content.

Revenue derived from advertising in the publications helps to defray the cost of the publications, but significant costs remain beyond the advertising revenue. As a qualified nonprofit mailer, AARP mails the editorial content of the publications at nonprofit rates. However, the advertising content of each issue is calculated, and full commercial postage is paid for all advertising material.

AARP also publishes material for selected audiences. For example, *Highlights*, AARP's newsletter to Association volunteers is received by 200,000 people. *Working Age*, published for people who have an interest in the older work force is received by 65,000 people.

In addition to periodical publications, AARP creates and distributes educational brochures on a range of subjects that affect the older population. Over four hundred titles are available to the public free of charge. Topics covered include health, consumer affairs, crime prevention, retirement planning, lifelong learning and driver re-education. Information ranges from practical advice to "how-to" guides, and from demographics to resource publications.

As part of its mission to assist the older population, AARP's Consumer Affairs Program helps older people become more knowledgeable consumers of goods and services. It publishes information on finance, utilities, housing, funerals, products marketed to older persons, transportation, public benefits and mediation.

The Criminal Justice Services (CJS) section is the nation's leading source of information on aging for the law enforcement community. For twenty years, AARP has

trained personnel in police academies across the country on how to interact with older adults, and how to introduce volunteers into police work. CJS also disseminates over a million crime prevention brochures to the public each year and has developed widely accepted materials on elder abuse.

The Grandparent Information Center provides grandparents who are raising their grandchildren with information and referrals to local support groups and other programs. Other activities and services include a public awareness campaign, resource development, research on issues affecting these grandparent caregivers and linkages with the aging, child and family and social policy networks.

The Housing Program offers information on housing options to consumers and providers. This program also serves as a liaison with other private organizations and government agencies concerned with housing for the elderly.

Work Force Programs educates employers, employees and the general public about retirement and employment issues affecting older workers. This department also assists workers to make informed decisions about work and retirement; encourages employers to hire and retain mid-life and older workers and develop personnel policies that are age neutral; seeks to eliminate age discrimination in employment and informs persons of their rights under federal and state age discrimination and pension laws.

The Health Advocacy Services Program provides information about health promotion, disease prevention and long-term care. Program volunteers also help older consumers use the Medicare and Medicaid systems and the health care marketplace to their fullest advantage.

The Legal Counsel for the Elderly Program provides a national training program for legal advocates; home-study elder law courses; and legal publications and volunteer programs to assist incapacitated people with their financial affairs, monitor guardianships, conduct public benefit outreach and inspect nursing homes.

The Office of International Activities seeks ways to exchange information on and solutions to the problems of aging around the world, to raise the awareness of the contributions of older persons and to promote the concept of productive aging at the international level.

In fulfilling its educational role in the public policy arena, AARP conducts extensive research through its Public Policy Institute. The material produced by the Institute covers the leading subjects of debate in Congress and state legislatures, and it adds to the level of knowledge in the policymaking and research communities.

Another source of information within AARP is its Research Information Center. The Center, which is the nation's leading library specializing in social gerontology, maintains a computerized database, Ageline. The Research Information Center is open to the public.

#### COMMUNITY SERVICE

AARP offers a wide variety of community service programs for AARP members and older persons in general. Most of these programs are conducted by local AARP volunteers who contribute their time and talents to help others improve their lives.

The Widowed Persons Service provides organizational and training resources to local groups interested in developing community-wide programs to serve newly widowed men and women. Local services may include volunteer outreach, telephone referral, group meetings, public education and a resource directory.

The 55 ALIVE/Mature Driving Program is available to all drivers age 50 and over. It is an eight-hour course designed to sharpen driving skills. Since it began in 1979, the program has trained 6,000 volunteer instructors nationwide and has graduated more than 2,000,000 drivers. Insurance companies in 30 states and the District of Columbia offer reduced rates for drivers who successfully complete the program.

Tax-Aide offers free nationwide tax counseling and tax return preparation, including home visits to shut-ins and persons with disabilities and for older persons with low to moderate incomes. Under a cooperative agreement with the Internal Revenue Service (IRS), volunteer counselors are recruited and trained annually. More than 31,500 volunteers annually help approximately 1.5 million older taxpayers prepare their tax returns each year. This program operates in 9,785 sites around the nation.

AARP has developed a computerized nationwide referral service to match potential volunteers with volunteer opportunities in AARP and other selected national organizations. The Volunteer Talent Bank is open to all people age 50 and older who want to volunteer. It has made referrals to such organizations as the American Red Cross, the National Park Service and the Peace Corps.

More than 4,000 AARP chapters throughout the country provide opportunities for service and fellowship. To assist these groups and to provide leadership to AARP volunteers in their community, AARP maintains a network of regional and state of-

files. Volunteer leadership exists in every state, and the volunteers are supported by staff at the state and regional levels.

As an indication of the direction in which AARP is heading with its resources, a recently created program called AARP Connections for Independent Living has commenced. AARP Connections is based on the realization that the overwhelming majority of older Americans want to stay in charge of their lives as they age. AARP Connections will help people live independently in their homes and communities by enabling AARP members to provide direct service as volunteers with local organizations. The program also offers information and resources concerning independent living issues.

#### GOVERNMENT CONTRACTS

AARP is a party to a number of contracts with the federal government to provide services that are clearly specified in the documents that commit AARP and the government agencies. The three major agreements fund the following programs:

The Senior Community Service Employment Program (SCSEP) provides temporary, subsidized employment for persons age 55 and older whose incomes are at or below the federal poverty level. The program served approximately 14,000 older persons in 33 states and Puerto Rico during 1994. The program successfully placed 49 percent of the participants into unsubsidized employment during 1994. The Department of Labor, under the authority granted by Congress through the Older Americans Act of 1965, has renewed this program annually since 1969.

The Senior Environmental Employment (SEE) Program places persons age 55 and older in temporary full and part time employment with the Environmental Protection Agency (EPA). Enrollees are placed in EPA offices and laboratories at 30 locations across the country. The program served 941 older persons during 1994.

The Tax-Aide program was described in the Community Service section.

Because the operation of the programs pursuant to federal contract supports AARP's social welfare mission, AARP dedicates its own resources to these programs over and above its limited recovery for their administration. A subsidy does not take place in the other direction; in other words, the federal funds do not support AARP's other activities, including its legislative advocacy. No federal funds are used to engage in lobbying activity.

The method in which the federal contracts are structured and implemented at AARP would allow the federal funds to disappear with no real financial hardship placed on AARP. Thus, if a strategy is to "defund" AARP's contracts in order to silence its advocacy, that strategy will not be successful. However, defunding these programs would cause hardship to the population that is served by the programs, primarily lower-income older Americans.

#### ADVOCACY

Since the founding of AARP, the Association has taken steps to be an advocate on behalf of its members and has served as a key provider of information to the membership regarding issues of importance to the older population. The advocacy role is reflected in a variety of efforts. AARP provides input to legislative debates throughout the country. However, it also advocates on important issues that are before the judicial system and regulatory bodies. In a consistent manner, AARP serves as an advocate for the older population to the private sector. For example, in 1995, as a way of encouraging realistic portrayals of aging, AARP sponsored conferences evaluating the perception of the older population as seen by television and film.

The Association's legislative policy is set by its Board of Directors based on recommendations to the Board from its volunteer National Legislative Council. At the beginning of each year, AARP's National Legislative Council meets in Washington, D.C., to formulate recommendations on federal and state legislative and regulatory policies. This meeting is a culmination of a year's activity by the Council members, including issue forums held nationwide. The Council discusses issues that impact AARP members, focusing on such subjects as long-term care, consumer issues, health care, economic security, employment, Social Security and Medicare. They also consider member views through the presentation of a range of public opinion surveys. Speakers, including leaders of both parties, policy experts and prominent proponents of policy positions contrary to those taken previously by the Association are invited to ensure the Council is exposed to the full range of opinions.

In committee meetings and full sessions, the Council members discuss and vote upon a recommended AARP Public Policy Agenda and forward these recommendations to AARP's Board of Directors for approval. Once adopted by the Board, these recommendations direct AARP volunteers and staff throughout the year. Volunteer State Legislative Committees are responsible for interpreting the Association's legis-

lative and regulatory policies for local AARP leaders and offer guidance on strategy and techniques for reaching agreement with local governmental officials.

The Association, as a matter of policy, is strictly nonpartisan. While it encourages its membership to take part in the electoral process, AARP neither endorses nor opposes candidates for political office or any political party. AARP has no Political Action Committee.

AARP does express its views on issues that it believes are important to the older population. It does so after much consideration of the views of the membership through surveys and requests for member feedback. Positions are taken by AARP knowing that not all members can support a single point of view. However, we strive to engage members who disagree with the position taken in a discussion of their views and an analysis of why a position was taken by AARP.

Through its communication vehicles, AARP describes its position on important issues. However, these publications also often contain views that are different from our own. We believe we have a responsibility to expose the members to a variety of views. Although we do have opinions, we try not to display the view that AARP's is the only legitimate one. To that end, our publications have contained lengthy analyses of the entitlement debate from Senators Simpson and Kerrey, including a guest opinion article from Senator Simpson in the November/December 1994, issue of *Modern Maturity* magazine.

With respect to the current Medicare and budget deficit debate, AARP has been criticized by some for not acknowledging problems with the solvency of the trust fund and the deficit and for not telling the members that something must be done. In our view this is part of a consistent pattern to create a caricature of the AARP view in order to attempt to dismiss strong and principled advocacy.

AARP has long acknowledged the problems caused by health care inflation, including the impact of cost increases on Medicare. We have spent significant time and monetary and volunteer resources to work on a solution that would cut the escalating cost of health care nationwide and do so in a manner that would enhance coverage to a vulnerable population, most of whom are younger. A solution of this nature has not yet been adopted by the Congress, but the problems have not disappeared. AARP will continue to discuss these issues, and do so in a way that emphasizes the reliance that older persons have on a strong and adequate Medicare program.

With respect to the deficit, AARP has supported every major deficit reduction bill since 1981, save one, the 1993 Budget Act, which the Association neither supported nor opposed. These were both Republican and Democratic efforts, and they often required some sacrifice on the membership or parts of it. That sacrifice did not keep us from supporting something we thought was fair and balanced. AARP believes that continued deficit reduction is necessary, but that it must be accomplished in a manner that addresses the cause of the problem, asks for shared sacrifice across the population and protects the most vulnerable.

In the current climate of negative, attack politics, it may be temporarily convenient to marginalize the message that AARP brings. However, we strongly believe that message to be well within the mainstream of the thinking of Americans of all ages.

#### MEMBER SERVICES

Consistent with its purpose of improving the quality of life for the older population, AARP has entered into contractual arrangements with commercial providers which allow the providers to offer specified services to the membership. Through negotiated contracts, the service providers are allowed a license to use the AARP name when making the offer. AARP receives compensation for the use of its name in the form of a royalty or, in the case of the Group Health Insurance Program, an allowance for making the Program available.

A service that has filled a need extending back to the creation of AARP is the AARP Group Health Insurance Program. AARP pioneered the concept of group health insurance designed for older Americans in the pre-Medicare era. When the program was instituted, there was no such insurance generally available to this population. Insurance companies were reluctant to enter this field because of the exposure to major risks and the lack of any precedent proving the viability of such insurance on a major scale. Dr. Andrus, AARP's founder, was able to get a commercial insurer to take these risks and offer such coverage, with no health questions, modest pre-existing condition limitations, and reasonable rates for all members, whatever their age and wherever they resided.

Over the years, AARP has continuously made available to its members a group health insurance program. Following the passage of Medicare, a considerable risk

has remained on the beneficiaries, and over time the costs not covered by Medicare have grown. The AARP Group Health Insurance Program has been structured to fill the insurance needs of as many members as possible. As a result the Program is far more widely available than other choices in the marketplace. This is particularly true for the older group of Medicare beneficiaries.

AARP, through a trust established for this purpose, obtains group health insurance for its members from a commercial provider, currently Prudential Insurance Company of America. Prudential was selected by AARP in 1981 with the assistance of outside experts. AARP continues to utilize the services of outside experts to review the performance of Prudential under the contract and to assist AARP in evaluating its options with respect to the Program.

AARP monitors the performance of the provider and serves as an "ombudsman" to see that Prudential adequately resolves member complaints. The Program is also designed to maintain high loss ratios, which allows for a competitive price coupled with its wide-scale availability, even to higher risk individuals. AARP receives an allowance from the Program that amounts to just under three percent of the member contributions, which came to approximately \$102 million in 1994. This allowance is described to potential insureds in promotional material for the Program.

AARP also licenses its name to be used by an auto and homeowners insurance program, provided by ITT Hartford Insurance Company; a mobile home insurance program, provided by the Foremost Insurance Group; a motoring plan, provided by Amoco Enterprises Inc.; and a pharmacy program, provided by Retired Persons Services, Inc., a separate entity sponsored, but not owned or controlled, by AARP. Services that are designed for AARP members also include a family of mutual funds, provided by Scudder, Stevens & Clark and credit cards, provided by Bank One. In addition, AARP receives royalties from rental car operators who, by contract with AARP, are permitted to offer a discount to AARP members.

Two new member services are currently in the start-up stage. The first is a life insurance program, provided by New York Life Insurance Company. The second is an annuity program, provided by American Maturity Life, a company that was created by ITT Hartford and Pacific Mutual Life Insurance Company.

As is the case with the AARP Group Health Insurance Program, AARP enters into contractual relationships with commercial service providers after it has conducted exhaustive research regarding member needs in the marketplace. The research is frequently conducted with the assistance of outside experts in the relevant field, who also assist in the process of selecting the appropriate service provider.

#### SOURCES OF REVENUE

In order to fulfill its mission in the manner described in earlier sections, AARP requires significant financial resources. Since its founding, AARP has sought to achieve what it views as a proper balance between funding sources. AARP frequently reviews the revenue mix to judge whether the dues paid by members generate a sufficient percentage of total revenue to AARP. This side of the equation is balanced by the philosophical view that dues should be low enough to make the Association accessible to all segments of the eligible population and revenue should be sufficient to meet AARP's social welfare mission.

AARP's financial information will be presented in narrative form to AARP's members in the July/August 1995 issue of the AARP Bulletin, as has been done in prior years. In the article, members will be invited to write in for the complete audited financial statement, which has been prepared by AARP's independent auditors, Arthur Andersen LLP.

#### TAX ISSUES

In 1964, AARP received a determination letter from the Internal Revenue Service (IRS) concluding that AARP was organized and operated exclusively for the promotion of social welfare, and accordingly was exempt from tax under section 501(c)(4) of the Internal Revenue Code. Each of AARP's 4,000 chapters are similarly exempt. This exemption is for income taxes and does not allow contributors to AARP to take a charitable deduction. Nor does this designation exempt AARP from sales and use tax or from District of Columbia real estate tax, which the organization pays through its lease for the building it rents. The 501(c)(4) designation was well deserved when granted and continues to be earned in full by the myriad of activities in which AARP engages that are in support of its social welfare mission.

A suggestion has been made by Senator Simpson that a tax exemption should not be granted to an organization unless membership dues constitute an acceptable percentage of an organization's income stream. There is no such requirement in the law

governing 501(c)(4) organizations. Nor is there even a requirement that a 501(c)(4) organization have members.

Material produced by the American Society of Association Executives (ASAE) provides additional insight into the issue of revenue mix for tax-exempt membership organizations. In the *ASAE Operating Ratio Report*, a 1994 survey of 693 Associations, ASAE states, "Dues as a percentage of total income is 35%."

In AARP's case, having members allows a wide range of the eligible population to learn about issues that are important to them, and AARP's ability to speak to its members contributes directly to the role it has served in improving society's image of aging. In order to adequately perform its social welfare function, the policy that has existed from the origin of the organization to keep dues affordable continues to be important. A legislative change that would deny AARP other streams of revenue would be at odds with the goal of accessibility by forcing a substantial increase in dues.

Organizations that are tax exempt are required to pay tax on revenue that falls under the unrelated business income tax (UBIT) rules. Income from advertising in AARP's publications falls within the UBIT rules and is declared as taxable by AARP. AARP has to date not incurred tax liability with respect to this income because applicable deductions for editorial costs offset the revenue derived.

AARP has also created a taxable subsidiary, AARP Financial Services Corporation, which generates revenue from member service programs that results in tax liability. The programs operated through Financial Services Corporation are the credit card and mutual fund programs. Financial Services Corporation paid taxes amounting to approximately \$5,400,000 in 1994.

AARP's other member service income generating programs have been the subject of a disagreement between the Association and the IRS. An audit in the late 1970s found no UBIT for AARP; however, the more recent disagreement caused the parties to settle this matter for years 1985 through 1993. In a negotiated agreement, AARP agreed to make a one-time payment in lieu of taxes in the amount of \$135 million.

In reaching a settlement with the IRS, AARP did what the IRS encourages exempt organizations to do, to resolve differences through settlement. Resolving this issue also allowed AARP to focus on the issues that are important to it, without the concern about open tax years. The parties, however, have not resolved the underlying issue of what constitutes taxable forms of income. In fact a recent court decision holding in favor of a credit card program which paid a royalty to the Sierra Club indicates that AARP's view of this issue would likely be upheld. In the meantime, AARP has made a \$15 million payment in lieu of taxes for 1994 with the intention of continuing its dialogue with the IRS in order to achieve a certain determination of the tax treatment of the income it receives from the member service programs.

#### THE FUTURE

During the past several years, AARP has embarked on an ambitious plan to decentralize its activities in order to have a stronger presence in communities throughout the country. This move is designed to build on AARP's strengths as a provider of information and a source of volunteer opportunities that can enhance the quality of life for both the volunteer and the recipient of service.

As a sign of its commitment to integrate its activities into the local level, AARP has opened or will open within the next two years 21 state offices. The Board of Directors has also recently approved a restructuring of volunteer positions in order to provide greater flexibility for communities to determine how to identify and meet local needs while utilizing AARP's resources.

At its May 1995 meeting, the Board adopted a new vision statement that projects the future direction of AARP, while remaining true to the values that led to its founding and its operation for nearly forty years. The new vision statement is:

**AARP EXCELS AS A DYNAMIC PRESENCE IN EVERY COMMUNITY, SHAPING AND ENRICHING THE EXPERIENCE OF AGING FOR EACH MEMBER AND FOR SOCIETY.**

If AARP succeeds in the direction set forth by the Board, it will become an organization that will be able to have an even greater ability to provide leadership to the older population and to provide communities across the nation the experience and resources the older population has to offer.

#### CONCLUSION

The record shows that AARP takes its obligations to promote the public good seriously. No institution as visible as AARP should be beyond scrutiny. We, therefore, take this hearing very seriously. At the same time, we urge people who disagree

with AARP's policy positions to reject unfocused attacks on a solid reputation that has been earned. We consider ourselves a responsible member of the nonprofit community, and we expect to continue to be so in the future.

#### PREPARED STATEMENT OF SENATOR JOHN MCCAIN

I want to thank Chairman Simpson for allowing me this opportunity to testify before the Subcommittee on Social Security and Family Policy regarding the American Association of Retired Persons (AARP).

Since coming to Congress I have closely observed the power to shape government policy that many interest group organizations wield. I was surprised to find that some of these organizations pursue a policy agenda that their own constituencies oppose. While there are a number of organizations that fit this description, I am chiefly concerned about the growing trend among "super lobbying" organizations to disconnect their advocacy from the interests of the people they purport to represent.

I would like to relate my own experiences with one such group, AARP. Based on those experiences, I have concluded that AARP repeatedly fails to accurately represent the views, concerns and needs of their members on legislative issues.

I first observed this disconnect during debate over the Medicare Catastrophic Act of 1988.

Mr. Chairman, we held different opinions about the repeal of catastrophic health care, but I think you will agree that senior citizens came to resent—to resent with some vigor—the Medicare Catastrophic Coverage Act.

I want to briefly recount the chronology of the catastrophic health care debate:

- July 1, 1988—catastrophic became public law.
- June 7, 1989—JSM amendment to delay catastrophic for 1 year failed 51-49.
- July 27, 1989—JSM amendment to delay catastrophic failed.
- September 28, 1989—JSM amendment for partial repeal failed.
- October 6, 1989—JSM amendment passed 99-0 to repeal the surtax and unwanted portions of Catastrophic Health Care Insurance bill, but retained certain benefits (mammogram).

Mr. Chairman, as we all know, when seniors finally realized the impacts of the Catastrophic bill a veritable revolt among the "beneficiaries" forced Congress to repeal the Act. What is less remembered, is that the bill was, by and large, conceived, written and sold to Congress by the Washington lobbyists of the AARP.

According to an article by Mr. Hank Cox, in *Regardie's Magazine*, January 1991:

"The America Association of Retired Persons may be the only lobby in Washington with enough clout to bulldoze a massive new benefit program through Congress, only to have its own members force the repeal of the program less than a year later, and not experience so much a twinge of embarrassment or offer a hint of apology."

After the Catastrophic health care bill became law, when increasingly agitated seniors demanded it be revoked, the AARP fought all efforts to repeal it.

Local AARP chapters throughout the nation repudiated the national AARP organization for continuing to support the catastrophic legislation, but still the national AARP opposed repeal.

*Every local chapter* in my home state of Arizona opposed the catastrophic bill and called for its repeal, AARP would not listen and continued to support the bill.

44 national seniors organizations, including the National Committee to Preserve Social Security and Medicare and the National Association of Retired Federal Employees supported repeal, but not AARP. Although they occasionally conceded their membership's concurrence with my concerns about the bill, AARP's Washington leadership did not simply withhold their support of repeal efforts they actively opposed those efforts.

During the debate on my amendment to delay for one year the implementation of Catastrophic health care provisions, I received a letter from AARP which stated:

"AARP did not like the finance requirements of the Medicare Catastrophic Coverage Act when the law was being debated, and its position has not changed. We proposed alternatives but these were not acceptable to the present Congress. Since enactment, AARP has received tens of thousands of letters from our members voicing their strong objection to the financing act."

Despite this concession, the AARP did not support any of our efforts to address the very concerns of those members from whom they had received "tens of thousands of letters."

"Tens of thousands of letters." from their own members opposing this measure and still AARP would not support delaying implementation of the bill pending fur-

ther review or repeal of the surtax and all other benefits except core catastrophic benefits.

Mr. Chairman, I think it is also important to recognize that AARP is more than just a non-profit advocacy organization. It is in the prescription drug business and stood to make millions of dollars if prescription drugs remained a part of the Catastrophic bill. To my mind, this profitable sideline of AARP's clearly raised questions about whether AARP's advocacy represented a conflict of interest.

As I have said, an honest account of the adoption and repeal of the Catastrophic Act reveals the AARP lobbyists' complete and outright indifference to the interests of their members. Even today AARP Washington office rejects all responsibility for the mess occasioned by the adoption of that legislation.

AARP's executive director, Horace Deets claims, "Congress messed it up, not AARP."

It is unsurprising, then, that AARP lobbyists failed to apply any lessons from that experience to their consideration of current legislation. They never learned any.

AARP's national headquarters again ignored the views and concerns of their members during debate of the President's health care reform bill in the 103rd Congress.

- According to AARP's 1993 Executive Director's Financial Report: "Our chief focus in 1993 was—and still is—comprehensive health care reform. AARP's strong financial position allowed us to mount a highly effective campaign throughout the year in support of reform."

Mr. Chairman, over 75% of the letters, phone calls and correspondence that I received from AARP members in Arizona expressed their outrage that their Washington lobbyists had endorsed the Clinton health care bill—75%! I am sure I need not remind the committee that Arizona is home to a great many senior citizens, and I believe I hear from most of them quite regularly. There is no doubt in my mind, whatsoever, that the vast majority of senior citizens were unalterably, absolutely, single-mindedly, and at times quite bitterly opposed to the President's health care reform proposal.

Many of these seniors mailed me their AARP membership cards, denouncing their membership from AARP for endorsing President Clinton's health care bill.

These seniors were appalled that their opinions were being blatantly ignored by an organization which promotes itself as an advocacy organization for the nation's elderly.

Coincidentally, AARP would have stood to financially benefit—greatly benefit—from the mail order prescription drug section of the Clinton health care bill.

Let me also raise the issue of the AARP's hypocrisy concerning repeal of the Social Security Earnings Test. AARP has never fully endorsed legislation to repeal this onerous, depression era policy. Yet the AARP states in its 1993 Executive Report:

"With respect to AARP's work opportunities goal, the Association continued to defend the rights of workers as they age. Older workers make up a growing proportion of today's work force. In fact, more than one-third of AARP members are currently working full or part time."

One of the greatest disincentives discouraging the employment of seniors is the Social Security Earnings Test. If the AARP was really concerned about the "rights of workers as they age," it would be enthusiastically fighting to repeal the earnings test.

In reality, what the AARP means when it states it is fighting for work opportunities is that it is fighting to preserve the federal largess that funds its work programs. The AARP is much less interested in ensuring that working seniors can make ends meet than is concerned with its own bottom line, its very profitable bottom line.

As has been previously noted, last year AARP received over \$86 million in federal government grant money. It is the preservation of this money flow that occupies the able staff of the AARP's Washington office.

Mr. Chairman, in summary, it is disturbing that AARP has failed to listen to its own members, and appears to have deliberately acted in opposition to the desires of the members.

I am sure that the AARP will seek to demonstrate to this Committee by means of its questionnaires that it has represented its members. When that occurs, I hope the Committee members will closely look at the questions AARP asks in those surveys. As politicians, we are all familiar with how survey questions can be phrased to get the answer you want. I believe you will find that AARP often employs such tactics when securing rank and file opinions on legislation before Congress.

For example, the AARP questioned their members on the Balanced Budget Amendment by asking them, "A Balanced Budget Amendment will mean cuts in your Social Security. Do you favor the Balanced Budget Amendment?"

This is not the kind of policy advocacy that seniors need. Seniors—as with all Americans—can and should be able to join together to ensure that their collective voices are heard. That is the American way. But we must ensure that those collective voices are not muted by some Washington hierarchy that no longer listens to or cares about the concerns of its members.

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PREPARED STATEMENT OF MANCUR OLSON, JR.<sup>1</sup>

Government tax breaks and other types of support for lobbying organizations are a serious problem, not only for the fairness of our democracy but also for the prosperity of our economy. Government support for lobbying organizations, however subtle, indirect, or implicit it might be, aggravates an already very harmful asymmetry in our political system.

This asymmetry grows out of the very logic of collective action. If a citizen works in the political system to serve the interests of some large group, such as consumers or taxpayers, any benefits are shared by everyone in the relevant group, whether or not they have paid dues or borne any other cost of the collective action in their interest. Since it pays to be a free rider, most large groups of citizens with common interests are not organized for collective action. Some groups, however, are in special situations that enable them eventually to overcome the difficulties of collective action. Each of the large firms in a concentrated industry may obtain enough of the benefits of collective action so that it pays each firm to support a trade association or lobby for the industry.

Large groups can organize for collective action only if they can obtain a “selective incentive”—a selective punishment or reward—that gives their constituents an incentive to pay dues that the generalized benefits of collective action that automatically go to everyone in the group cannot provide. These selective incentives are sometimes punishments (as in the legal sanctions that make membership in the bar compulsory in most states) or loss of employment (as in a union shop) for those who do not pay dues. They are sometimes positive incentives, such as the opportunity to purchase tax-favored insurance policies, to obtain patronage dividends in farm cooperatives, to receive pertinent publications, or to be included in attractive social activities. The AARP provides a wide array of such “selective incentives” and they account for most of its membership. My 1965 book, *The Logic of Collective Action* (Harvard Univ. Press) showed that there are have never been any lasting mass-membership lobbying organizations that did not have selective incentives.

Because only some groups have the capacity for collective action, lobbying generates an asymmetric set of political pressures and to government that favors special interests rather than any general conception of the public interest. A huge scholarly literature on the logic of collective action has emerged since 1965 and this literature is overwhelmingly corroborative (much of this literature is cited in Russell Hardin *Collective Action* (Johns Hopkins U. Press) and in Todd Sandler, *Collective Action: Theory and Applications* (Univ. of Michigan Press).

Government support, whether in the form of favorable postal rates, tax-exempt status, or diverse other subtle forms, is exceptionally important in generating special-interest lobbying. If the “business” side of an association has no special advantages, then the potential constituents of the association have no special reason to patronize the association’s business arm and it then cannot generate the profits and motivate the dues payments that the association uses to finance its lobbying. Thus lobbying organizations often use their political power to make sure that their business organizations are in some way favored or subsidized and thereby also further augment their membership and political power.

Special-interest lobbying in turn does extraordinary damage to the productivity and dynamism of an economy. As time goes on, more groups can create the selective incentives needed to overcome the difficulties of collective action. Thus stable societies accumulate more such organizations as time goes on. This helps explain why the society that has had stability and freedom of organization the longest—Great Britain—has changed from being the society that brought the world the industrial revolution to the society with the “British Disease” of slow growth. Countries like Germany and Japan, where totalitarianism and allied occupation had destroyed special-interest organizations, enjoyed economic miracles after World War II. My 1982 book, *The Rise and Decline of Nations* (Yale University Press) shows that much of the variation in economic performance in modern times, and across the states with

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<sup>1</sup> I testify only as an individual citizen and do not speak here for the University of Maryland or any other organization or group, and I am solely responsible for all shortcomings of this testimony.

this country, is explained by the extent of special-interest lobbying and cartelization. Again, most of the subsequent literature (such as Jonathon Rauch's recent, *Demosclerosis* (Times Books), confirms the argument.

The AARP is, accordingly, a leading example of a fundamental and widespread problem, not only for the integrity of our political system, but also for the viability of our economy.

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PREPARED STATEMENT OF SENATOR ALAN K. SIMPSON

[JUNE 13]

I wish to welcome all to this hearing, most especially the witnesses who have been good enough to come and to testify. As I am sure all of you know, this is the first of possibly several hearings reviewing the practices and structure, and the tax-exempt non-profit status, of the American Association of Retired Persons, or AARP.

When I first announced that I was reviewing the AARP's operations, I was besieged with phone calls and mailings.

I was not surprised. I expected it. After all, it has long been assumed here in Washington that the AARP represents senior citizens. And no one would dare to "attack" America's most powerful, and sympathy-invoking, voter group.

And here indeed, in my hand, are letters from those who wrote to chastise me for "attacking" the AARP. These are apparently the people who believe that AARP represents the interests of senior citizens.

And here—are the mailings from those who fully support what I am doing. Many of these are from AARP members.

Take a good look at those two piles. They tell you just how far AARP has gone astray from truly representing the wishes of America's seniors.

We are here not only because AARP has drifted from its stated mission of representing senior citizens, but also because I believe the evidence is clear that AARP has also drifted considerably from any reasonable description of a non-profit organization that should enjoy a tax-exemption and unlimited lobbying privileges.

Although I have been a longtime critic of AARP, I must confess that I was surprised by this overwhelming rejection of AARP's actions by America's seniors. I knew that AARP had taken the revenues they had received, spent \$17 million on a lease of one building here in Washington, and that they'd shelled out \$58 million in salaries in 1993—\$63 million this last year—to their employees. I knew that they had taken \$86 million annually from the Federal Government in grants. And I knew that they could in no way claim to represent the interests of America's seniors, seeing as most of their money comes from elsewhere. But I nonetheless believed that the illusion persisted, that AARP represented senior citizens.

In addition to writing me, people called to jam my phone lines when I first announced this review. It was the same story. I had received only 12 phone calls in opposition to my inquiry, at the time that I received my 200th in favor of it.

So, people out there know that something is very wrong with the operations of the AARP. But, I am finding out, they do not yet know the whole story. Nor, I am discovering, do I. That is what I have proposed to find out—and it is a story that goes on and on.

They know that something is wrong when an organization that gets more than half of its income from commercial and business activities simultaneously spends millions annually to lobby with a claim that they represent the interests of America's elderly.

They know that something is wrong when the government pays \$86 million in one year to an organization that is lobbying for more spending and more debt—more money from D.C.

They know that something is wrong when a supposedly nonprofit organization has to pay the IRS \$135 million "in lieu of taxes"—and then has no problem simply writing a check for that amount.

They know something is very wrong when the IRS is simultaneously paying millions in grant money to the AARP to give—yes, indeed—tax counseling to America's elderly! This from an organization that continues to have substantial problems justifying its self-declared exemptions from taxation, and seems to have underpaid its taxes by more than \$100 million.

Those were the starting points, and I will certainly be looking into those questions. But I am also exploring several others which I believe are just as serious, but which have thus far been only dimly illuminated by much less public awareness.

I do not believe, for example, that most Americans are aware of the full extent to which the AARP has used the U.S. Postal Service improperly to mail for-profit solicitations (to sell things and policies.)

I do not believe that AARP's members know how AARP profits whenever they buy products advertised in their magazine, nor do I believe that they know the extent of AARP's influence in the boards of some of these supposedly independent organizations.

I do believe there is much to be learned about the full extent of AARP's commercial operations, above and beyond what is evident from their publicly disclosed IRS Form 990.

I further believe that only a few AARP members know fully the extent to which the AARP's national leadership imposes a policy agenda on an unwilling membership. I have been reviewing the public positions, organization by-laws, and membership surveys provided by the AARP, and I believe that they only reveal the extent to which the AARP's legislative council has put the vast resources of AARP behind efforts and goals that are fundamentally out of step with anything truly endorsed by AARP members.

There are also many other issues which I do not wish to raise as questions until the AARP is present here.

I do wish to firmly state that the goal of these hearings is to determine whether there is indeed a problem here, either of policy or propriety, and then, if appropriate, to seek a solution, possibly a legislative solution. If this empire is not what our nonprofit laws are intended to facilitate, then we may need to change the law.

This first hearing was originally conceived to disclose various sides of the AARP story fairly. AARP's absence from this hearing will unavoidably tilt the balance of today's discussion.

Our first panel is here to provide general academic expertise about activities such as AARP's. Paul Hewitt of the National Taxpayers' Union Foundation has previously published studies of AARP's legislative agenda and its effects. Natwar Gandhi and GAO have performed a general overview of nonprofit organizations and their sources of revenue and support. And Mancur Olson of the University of Maryland is an expert on special-interest-group politics in general.

Roy Goldberg will be here as our second panel. He represents AARP members who are dissatisfied with the way AARP has been run. I had hoped to have the "discontents" represented here just prior to the AARP leadership itself being represented. However, we will not get "their side" of the story today. I am disappointed by this, but AARP does have a long-standing schedule conflict which they felt would not enable them to be here. I do not completely understand this, as I believed that they would wish to rebut some of the things we knew well would be said about them today, so I urged them to come. They simply did not feel able to do so, and so I have scheduled a second hearing on June 20th, at which they have stated they will be present.

But enough from me. There are many, many issues which I wish to discuss with these witnesses and with AARP—far too many to cover in one opening statement.

So let us begin, please.

#### PREPARED STATEMENT OF SENATOR ALAN K. SIMPSON

[JUNE 20]

Good morning. Welcome to the second hearing of this subcommittee to review the structure and tax-exempt status of the American Association of Retired Persons.

I would like to begin by reviewing where I believe we are as a result of the first hearing. I was joined at that hearing by our Ranking Member, Senator John Breaux, and the erstwhile Chairman of the Aging Committee, Senator David Pryor. They each made a welcome contribution to that hearing with their statements and questions.

One of the points that I believe was properly raised by my colleagues at the first hearing, is that many of the items which concern us about tax-exempt organizations are not necessarily unique to AARP. Senator Pryor read from a mailing sent around by another tax-exempt organization, which apparently was attempting to capitalize—in an abhorrent and shameful way—on the tragic death of Vincent Foster. Truly, nothing more needs to be said about this mailing to provoke our indignation.

Certainly there are many tax-exempt organizations which engage in a variety of deplorable practices, not least of which is the dispensing of misleading or sensationalistic material in the course of fundraising. I would caution, however, that I am not reviewing AARP for reasons such as these, as much as we may disagree with some of the things AARP has said to, and in the name of, its members, we

must remember that distortion and misrepresentation is sometimes in the eye of the beholder, and in any case is fully protected by the First Amendment. I am chiefly interested in the statements of AARP's leadership only to the extent that they may signify that the leadership has used its vast resources to impose a policy agenda upon an unwilling or uninterested membership.

Certainly the topic of "outrageous, false, and inflammatory statements in non-profit fundraising," might be a worthy subject for another hearing someday. If Senator Pryor or Breaux would like to have separate hearings someday on that subject, that's a subject I might be willing—even eager—to explore.

However, we must bear in mind that the main reason we are here is not because of the things that AARP has in common with other tax-exempt organizations, but because of the ways in which it is completely unique. I still know of no other organization which operates quite in the manner of AARP.

For example, there are 501-C-3 organizations which receive Federal grant money, but as 501-C-3s they are currently limited by statute in the amount of lobbying that they can do. Furthermore, there are 501-C-4 organizations which, like AARP, have no statutory limit on how much they can lobby congress, but which also must depend on their members' signaling their support for such lobbying activities by giving contributions and dues. and there are also some 501-C-4 organizations which, like AARP, derive their income primarily from "program services" such as insurance sales, but which do not pose in their lobbying as selfless advocates for a sector of society.

In short, the AARP is still the one organization that I know of that manages to have it all ways at the same time. When they are criticized for refusing to accept advertising from products which are rated by consumer reports or money magazine as being superior to their own, their attitude is, "caveat emptor." Seniors can buy from someone else. It's not our job to look out for their consumer interest." But when we here in Washington wonder who it is that AARP really represents, given that their money comes primarily from commercial activity, we are told that they are an organization primarily concerned with the social welfare of elderly Americans, and thus should be tax-exempt. At all points, and in every application, the AARP adopts the posture that benefits those running AARP.

While I do believe that the AARP is absolutely unique, I also believe that we must heed Senator Pryor's admonition that any solution to this problem must be neutral, and must affect every similarly-situated organization. Thus, as a consequence of my review, and of the first hearing, I am giving strong consideration to introducing legislation to prevent any 501-C-4 organization—whether the AARP, or the National Rifle Association, or any other 501-C-4 organization—from being able to receive and to administer government grants. I simply believe that we are finding that the very construction of 501-C-4 law, with its "blank check" to lobby tax-free without limit, is incompatible with receiving Federal grant money. 501-C-4 is quite different from 501-C-3—in which there is a global cap of \$1 million on lobbying expenses. I do hope that I can garner the support of my colleagues for reforms such as these which do not single out any specific organization.

I do wish to clarify one matter, however. This month's Money Magazine, in an otherwise excellent article about AARP, indicated that I felt that giving grant money to AARP "creates a seeming conflict of interest." He—(meaning me)—"has charged that AARP lobbies for more Federal entitlement spending in part to collect more Federal contracts." While I do believe that a "seeming conflict of interest" is indeed created by this practice, I do not allege that acquiring grant money is the basis of AARP's lobbying efforts, and I want to take this opportunity to make that quite clear.

I further believe that testimony last week added additional weight to the contention that there should be a minimum level of financial dependence on direct membership dues and other contribution support in order to qualify as a 501-C-4. Because the 501-C-4 designation enables organizations to enjoy the ability to lobby without limit, we do need to find criteria to ensure that such organizations are indeed lobbying with the full support of the members they claim to represent.

It is my hope today to continue to build upon what we learned at our first hearing last week. We learned from GAO that, despite a declining number of IRS audits of tax-exempt organizations, settlement money collected from social welfare organizations, which had not exceeded \$5 million for years, suddenly shot up to \$138 million—a increase of more than 25-fold, almost solely due to one organization, the AARP. That tells you something about the uniqueness of AARP's size and activity.

We also learned that the AARP saved more than \$5 million in 1991 and 1992 by improperly mailing health insurance solicitations at nonprofit postal rates. And we learned that when the postal service attempted to stop this practice, AARP continued for months to send these mailings, and even tried to enlist the postal service

to agree not to enforce the regulations and instead to influence congress to change the law in AARP's favor.

I truly believe that AARP has become so big and so powerful, so accustomed to its almost super-legal status in many respects, that AARP's leaders genuinely do not see what is wrong with any of these actions. They feel that they are being "singled out." You can see in their responses to many questions that they believe that are only doing "what everybody else does." It's an old, time-honored defense, "everybody does it."

Well, everybody doesn't do it. When most people are alerted by the postal service that they are mailing items at the wrong rate, they stop. They feel neither the power nor the right to attempt to get the postal service to change the rules.

When most individuals or companies sell insurance policies, they pay taxes on the income. When most businesses want to provide a benefit to their employees or the customers, the government does not provide the funding to do it. When most 501-C-4 organizations lobby Congress, their members have endorsed their policy choices.

I believe that the last hearing, and this one, will continue to demonstrate that AARP was established from the beginning to hawk insurance products tax-free, a source of income which remains lucrative for AARP even today. However dedicated and sincere these individual AARP representatives might be, AARP the organization continues to act in a way that I believe is inconsistent with the intent of tax-exempt nonprofit law.

I continue to have many questions about how the AARP is run, which I believe are critical to determining whether or not AARP should continue to be treated as a nonprofit organization, or rather taxed as a business.

Attachments.

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## ARTICLE VIII

### Suspension or Expulsion

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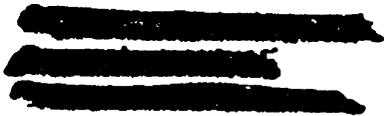
**Section 1.** Any member, agent, chapter or organization may be suspended or expelled from membership or affiliation, recognition or designation for cause, consisting in any statement or conduct deemed by the Board of Directors to be detrimental to the best interests of the Association, or any of its services, upon thirty (30) days notice by ordinary mail to the person or organization involved. Such notice shall be sent to his or its last known address and shall state the grounds of the proposed suspension or expulsion and afford the accused an opportunity to submit any reason or data and be heard on his or its own behalf. Pending notification or action by the Board of Directors, the President may summarily suspend forthwith any such person, group, affiliation or recognition which shall be effective until action by a majority vote of the Board of Directors.

**Section 2.** Any member, agent, chapter or organization shall be subject to summary suspension or expulsion from membership or affiliation, recognition, or designation by the Board of Directors if it shall appear to its satisfaction that any such person or group has made available or permitted publication or release of a complete or partial list of members of the Association or of any chapter thereof to any person or organization not having prior written authorization by the President of the Association to receive the same. Such suspension

**AARP**



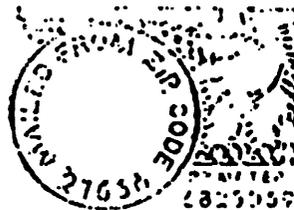
*Good News for  
New AARP Member:*



Honolulu HI 96826-2317



NONPROFIT ORG



U.S. POSTAGE

0.081

106

August 15, 1992

HKK

3866-00

16

# AARP's Long Term Care Plan (Plan FF)



Helps Pay for Home Health Care, Adult Day Care, and Nursing Home Expenses Not Covered by Medicare and Private Insurance Plans.

- Up to \$50.00 - \$70.00 per visit for Home Health Care and Adult Day Care - up to a lifetime maximum of 730 visits.
- Up to \$100.00 per day for Qualified Nursing Home Confinements for up to a lifetime maximum of 4 years (1,460 days).
- Pays for ALL LEVELS of Nursing Home Care ... Skilled, Intermediate and Custodial.

**PLUS These Additional Features**

- Individual Age Pricing - rates are based on your individual

age at the time your insurance becomes effective.

- Rates are guaranteed not to increase for at least 5 years for any reason.
- Opportunity to purchase increased daily and per visit benefit amounts at least once every 4 years.
- No prior nursing home stay required to collect home health care or adult day care benefits.
- No prior hospitalization required to collect nursing home benefits.

*Please reply before the date on your Application*

≈ AARP Group Health Insurance Program

ThePrudents

## EXHIBIT /

INSURANCE MAILINGS -  
AARP  
PERMIT 1  
1992*(Only some  
of AARP  
mailings)*

MAILING DATE	PIECES	NON PROFIT RATE PAID	NONPROFIT POSTAGE PAID	REGULAR 3RD CLASS RATE	REGULAR 3RD CLASS POSTAGE	REVENUE DEFICIENCY
01-17-92	21819	0.094	\$2,050.99	0.179	\$3,905.60	\$1,854.62
	1846	0.111	\$204.91	0.198	\$365.51	\$160.60
	19246	0.081	\$1,558.93	0.146	\$2,809.92	\$1,250.99
	13737	0.088	\$1,208.86	0.154	\$2,115.50	\$906.64
	2221	0.098	\$217.66	0.165	\$366.47	\$148.81
01-23-92	227	0.111	\$25.20	0.198	\$44.95	\$19.75
01-23-92	797	0.094	\$74.92	0.179	\$142.66	\$67.74
	52	0.111	\$5.77	0.198	\$10.30	\$4.52
	411	0.081	\$33.29	0.146	\$60.01	\$26.71
	696	0.088	\$61.25	0.154	\$107.18	\$45.94
	75	0.098	\$7.35	0.165	\$12.38	\$5.03
01-31-92	21819	0.094	\$2,050.99	0.179	\$3,905.60	\$1,854.62
	1846	0.111	\$204.91	0.198	\$365.51	\$160.60
	19246	0.081	\$1,558.93	0.146	\$2,809.92	\$1,250.99
	13737	0.088	\$1,208.86	0.154	\$2,115.50	\$906.64
	2221	0.098	\$217.66	0.165	\$366.47	\$148.81
01-31-92	797	0.094	\$74.92	0.179	\$142.66	\$67.74
	52	0.111	\$5.77	0.198	\$10.30	\$4.52
	411	0.081	\$33.29	0.146	\$60.01	\$26.71
	696	0.088	\$61.25	0.154	\$107.18	\$45.94
	75	0.098	\$7.35	0.165	\$12.38	\$5.03
01-31-92	227	0.111	\$25.20	0.198	\$44.95	\$19.75
02-03-92	17372	0.081	\$1,407.13	0.146	\$2,536.31	\$1,129.18
	13476	0.088	\$1,185.89	0.154	\$2,075.30	\$889.42
	2576	0.098	\$252.45	0.165	\$425.04	\$172.59
	22246	0.094	\$2,091.12	0.179	\$3,982.03	\$1,890.99
	2667	0.111	\$296.04	0.198	\$528.07	\$232.03
02-14-92	19051	0.094	\$1,790.79	0.179	\$3,410.13	\$1,619.34
	1432	0.111	\$158.95	0.198	\$283.54	\$124.58
	2589	0.081	\$209.71	0.146	\$377.99	\$168.28
	6324	0.088	\$556.51	0.154	\$973.90	\$417.38
	520	0.098	\$50.96	0.165	\$85.80	\$34.84
02-14-92	114	0.111	\$12.65	0.198	\$22.57	\$9.95
02-14-92	451	0.094	\$42.39	0.179	\$80.73	\$38.37
	40	0.111	\$4.44	0.198	\$7.92	\$3.48
02-17-92	257	0.111	\$28.53	0.198	\$50.89	\$22.36
02-17-92	17372	0.081	\$1,407.13	0.146	\$2,536.31	\$1,129.18
	13476	0.088	\$1,185.89	0.154	\$2,075.30	\$889.42
	2576	0.098	\$252.45	0.165	\$425.04	\$172.59
	22246	0.094	\$2,091.12	0.179	\$3,982.03	\$1,890.99
	2410	0.111	\$267.51	0.198	\$477.18	\$209.69
03-02-92	17763	0.094	\$1,669.72	0.179	\$3,179.58	\$1,509.86
	1737	0.111	\$192.81	0.198	\$343.93	\$151.11
	2467	0.081	\$232.23	0.146	\$418.58	\$186.21

3/11 is date of P.S. letter - BUT AARP NOT MAILING!

	6182	0.088	\$344.02	0.154	\$952.03	\$408.01
	620	0.098	\$60.76	0.163	\$102.30	\$41.54
03-02-92 -	128	0.111	\$14.21	0.198	\$23.34	\$11.14
03-02-92 -	16229	0.081	\$1,314.55	0.146	\$2,369.43	\$1,054.88
	12389	0.088	\$1,107.83	0.154	\$1,938.71	\$830.87
	2428	0.098	\$237.94	0.163	\$400.62	\$162.68
	22613	0.094	\$2,125.62	0.179	\$4,047.73	\$1,922.11
	2693	0.111	\$298.92	0.198	\$533.21	\$234.29
03-02-92 -	188	0.111	\$20.87	0.198	\$37.22	\$16.36
04-07-92 -	26623	0.081	\$2,136.63	0.146	\$3,887.25	\$1,730.62
	12005	0.088	\$1,056.44	0.154	\$1,848.77	\$792.33
	806	0.098	\$78.99	0.163	\$132.99	\$54.00
	20735	0.094	\$1,949.09	0.179	\$3,711.57	\$1,762.48
	876	0.111	\$97.24	0.198	\$173.45	\$76.21
04-07-92 -	180	0.111	\$19.98	0.198	\$35.64	\$15.66
04-08-92 -	633	0.081	\$51.27	0.146	\$92.42	\$41.14
	546	0.088	\$48.05	0.154	\$84.08	\$36.04
	22	0.098	\$2.16	0.163	\$3.63	\$1.47
	51	0.094	\$4.79	0.179	\$9.13	\$4.34
04-20-92 -	27258	0.081	\$2,207.90	0.146	\$3,979.67	\$1,771.77
	12551	0.088	\$1,104.49	0.154	\$1,932.85	\$828.37
	828	0.098	\$81.14	0.163	\$136.62	\$55.48
	20786	0.094	\$1,953.88	0.179	\$3,720.69	\$1,766.81
	876	0.111	\$97.24	0.198	\$173.45	\$76.21
04-20-92 -	180	0.111	\$19.98	0.198	\$35.64	\$15.66
05-04-92 -	255	0.111	\$28.31	0.198	\$50.49	\$22.19
05-04-92 -	10202	0.081	\$826.36	0.146	\$1,489.49	\$663.13
	6211	0.088	\$546.57	0.154	\$956.49	\$409.93
	123	0.098	\$12.05	0.163	\$20.30	\$8.24
	14852	0.094	\$1,396.09	0.179	\$2,658.51	\$1,262.42
	114	0.111	\$12.65	0.198	\$22.57	\$9.92
05-04-92 -	91	0.111	\$10.10	0.198	\$18.02	\$7.92
05-04-92 -	21068	0.081	\$1,706.51	0.146	\$3,075.93	\$1,369.42
	15448	0.088	\$1,359.42	0.154	\$2,378.99	\$1,019.57
	1387	0.098	\$135.93	0.163	\$228.86	\$92.93
	22712	0.094	\$2,134.93	0.179	\$4,065.45	\$1,930.52
	1282	0.111	\$142.30	0.198	\$253.84	\$111.53
05-18-92 -	20561	0.081	\$1,663.44	0.146	\$3,001.91	\$1,336.47
	14489	0.088	\$1,275.03	0.154	\$2,231.31	\$956.27
	1333	0.098	\$130.63	0.163	\$219.95	\$89.31
	21941	0.094	\$2,062.45	0.179	\$3,927.44	\$1,864.98
	1254	0.111	\$139.19	0.198	\$248.29	\$109.10
05-18-92 -	507	0.081	\$41.07	0.146	\$74.02	\$32.95
	959	0.088	\$84.39	0.154	\$147.69	\$63.29
	54	0.098	\$5.29	0.163	\$8.91	\$3.62
	771	0.094	\$72.47	0.179	\$138.01	\$63.53
	28	0.111	\$3.11	0.198	\$5.54	\$2.44
05-18-92 -	255	0.111	\$28.31	0.198	\$50.49	\$22.19
05-26-92 -	6893	0.081	\$558.33	0.146	\$1,006.38	\$448.05
	6948	0.088	\$611.42	0.154	\$1,069.99	\$458.57
	128	0.098	\$12.54	0.163	\$21.12	\$8.58
	17137	0.094	\$1,610.88	0.179	\$3,067.52	\$1,456.65
	249	0.111	\$27.64	0.198	\$49.30	\$21.66
05-26-92 -	127	0.111	\$14.10	0.198	\$25.15	\$11.05
06-01-92 -	20928	0.081	\$1,695.17	0.146	\$3,055.49	\$1,360.31

	13586	0.088	\$1,195.57	0.154	\$2,092.24	\$896.68
	1149	0.098	\$112.60	0.165	\$189.59	\$76.98
	21138	0.094	\$1,986.97	0.179	\$3,783.70	\$1,796.73
	1184	0.111	\$131.42	0.198	\$234.43	\$103.01
06-01-92	442	0.081	\$35.80	0.146	\$64.53	\$28.73
	435	0.088	\$38.28	0.154	\$66.99	\$28.71
	18	0.098	\$1.76	0.165	\$2.97	\$1.21
	188	0.094	\$17.67	0.179	\$33.65	\$15.98
	14	0.111	\$1.55	0.198	\$2.77	\$1.22
06-01-92	285	0.111	\$31.64	0.198	\$56.43	\$24.80
06-01-92	915	0.094	\$86.01	0.179	\$163.79	\$77.78
	52	0.111	\$5.77	0.198	\$10.30	\$4.52
06-02-92	357	0.081	\$28.92	0.146	\$52.12	\$23.21
	779	0.088	\$68.55	0.154	\$119.97	\$51.41
	37	0.098	\$3.63	0.165	\$6.11	\$2.48
	782	0.094	\$73.51	0.179	\$139.98	\$66.47
	35	0.111	\$3.89	0.198	\$6.93	\$3.05
06-15-92	1875	0.081	\$151.88	0.146	\$273.75	\$121.88
	2138	0.088	\$188.14	0.154	\$329.25	\$141.11
	141	0.098	\$13.82	0.165	\$23.27	\$9.45
	467	0.094	\$43.90	0.179	\$83.59	\$39.70
	22	0.111	\$2.44	0.198	\$4.36	\$1.91
06-15-92	285	0.111	\$31.64	0.198	\$56.43	\$24.80
06-15-92	442	0.081	\$35.80	0.146	\$64.53	\$28.73
	435	0.088	\$38.28	0.154	\$66.99	\$28.71
	18	0.098	\$1.76	0.165	\$2.97	\$1.21
	377	0.094	\$35.44	0.179	\$67.48	\$32.05
	16	0.114	\$1.78	0.198	\$3.17	\$1.39
06-15-92	357	0.081	\$28.92	0.146	\$52.12	\$23.21
	779	0.088	\$68.55	0.154	\$119.97	\$51.41
	37	0.098	\$3.63	0.165	\$6.11	\$2.48
	782	0.094	\$73.51	0.179	\$139.98	\$66.47
	35	0.111	\$3.89	0.198	\$6.93	\$3.05
06-15-92	726	0.094	\$68.24	0.179	\$129.95	\$61.71
	50	0.111	\$5.55	0.198	\$9.90	\$4.35
06-15-92	20928	0.081	\$1,695.17	0.146	\$3,055.49	\$1,360.32
	13586	0.088	\$1,195.57	0.154	\$2,092.24	\$896.68
	1149	0.098	\$112.60	0.165	\$189.59	\$76.98
	21138	0.094	\$1,986.97	0.179	\$3,783.70	\$1,796.73
	1184	0.111	\$131.42	0.198	\$234.43	\$103.01
06-29-92	1875	0.081	\$151.88	0.146	\$273.75	\$121.88
	2138	0.088	\$188.14	0.154	\$329.25	\$141.11
	141	0.098	\$13.82	0.165	\$23.27	\$9.45
	467	0.094	\$43.90	0.179	\$83.59	\$39.70
	22	0.111	\$2.44	0.198	\$4.36	\$1.91
06-29-92	884	0.094	\$83.10	0.179	\$158.24	\$75.14
	14	0.111	\$1.55	0.198	\$2.77	\$1.22
06-29-92	7191	0.081	\$582.47	0.146	\$1,049.89	\$467.42
	7259	0.088	\$638.79	0.154	\$1,117.89	\$479.09
	151	0.098	\$14.80	0.165	\$24.92	\$10.12
	14881	0.094	\$1,398.81	0.179	\$2,663.70	\$1,264.89
	179	0.111	\$19.87	0.198	\$35.44	\$15.57
06-29-92	160	0.081	\$12.96	0.146	\$23.36	\$10.40
	449	0.088	\$39.51	0.154	\$69.15	\$29.63
	9	0.098	\$0.88	0.165	\$1.49	\$0.60

	1246	0.094	\$117.12	0.179	\$223.03	\$105.91
	20	0.111	\$2.22	0.198	\$3.90	\$1.74
06-29-92	155	0.081	\$12.56	0.146	\$22.63	\$10.08
	306	0.088	\$26.93	0.154	\$47.12	\$20.20
	8	0.098	\$0.78	0.165	\$1.32	\$0.54
	104	0.094	\$9.78	0.179	\$18.62	\$8.84
	3	0.111	\$0.33	0.198	\$0.59	\$0.26
06-29-92	334	0.094	\$31.40	0.179	\$59.79	\$28.39
	4	0.111	\$0.44	0.198	\$0.79	\$0.35
06-29-92	143	0.111	\$15.87	0.198	\$28.31	\$12.44
08-19-92	1557	0.111	\$172.83	0.198	\$308.29	\$135.46
	37843	0.094	\$3,557.24	0.179	\$6,773.90	\$3,216.66
	1690	0.098	\$165.62	0.165	\$278.85	\$113.23
	19940	0.088	\$1,754.72	0.154	\$3,070.76	\$1,316.04
08-19-92	258	0.094	\$24.25	0.179	\$46.18	\$21.93
	7	0.111	\$0.78	0.198	\$1.39	\$0.61
08-20-92	1093	0.081	\$88.53	0.146	\$159.58	\$71.05
	670	0.088	\$58.96	0.154	\$103.18	\$44.22
	71	0.098	\$6.96	0.165	\$11.72	\$4.76
	418	0.094	\$39.29	0.179	\$74.82	\$35.53
	21	0.111	\$2.33	0.198	\$4.16	\$1.83
08-20-92	462	0.081	\$37.42	0.146	\$67.45	\$30.03
	551	0.088	\$48.49	0.154	\$84.85	\$36.37
	20	0.098	\$1.96	0.165	\$3.30	\$1.34
	2627	0.094	\$246.94	0.179	\$470.23	\$223.30
	98	0.111	\$10.88	0.198	\$19.40	\$8.53
08-20-92	36148	0.081	\$2,927.99	0.146	\$5,277.61	\$2,349.62
	2097	0.088	\$184.54	0.154	\$322.94	\$138.40
08-21-92	399	0.111	\$44.29	0.198	\$79.00	\$34.71
08-21-92	10107	0.094	\$950.06	0.179	\$1,809.15	\$859.10
	455	0.111	\$50.51	0.198	\$90.09	\$39.59
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TOTALS	951789		\$84,814.69		\$155,237.71	\$70,423.02

**DRAFT****AGREEMENT**

THIS AGREEMENT, effective as of the \_\_\_ day of \_\_\_\_\_, 1992, is by and between AMERICAN ASSOCIATION OF RETIRED PERSONS, Washington, D.C. ("AARP"), a nonprofit organization ("n.p.o."), and UNITED STATES POSTAL SERVICE ("USPS"), an independent agency of the U.S. Government.

**RECITALS:**

WHEREAS, AARP is a qualified third-class n.p.o. mailer of group health insurance materials which it maintains are in full compliance with a recent amendment (Pub. L. No. 101-509) to Section 3626 of Title 39, United States Code, limiting insurance mailings that qualify for the n.p.o. special third-class bulk rates to those which promote insurance which is "not generally otherwise commercially available"; and

WHEREAS, AARP and USPS are both concerned about the meaning, practical enforceability and administration of insurance mailings which are "not generally otherwise commercially available" as set forth in subsection (j)(1)(B) of Section 3626, Title 39, United States Code; and

WHEREAS, a greater measure of statutory certainty regarding the qualification of insurance mailings for the special third-class bulk rates will enable more efficient and predictable compliance with the law; and

WHEREAS, litigation may arise between n.p.o. special third-class bulk rate insurance mailers, including AARP, on the one hand, and USPS on the other hand, regarding the proper

interpretation and scope of the statutory provisions and regulations relating to insurance mailings because, inter alia, information impacting the general availability of health insurance for the elderly is not readily ascertainable and, to the extent available, is substantially in the hands of third parties;

NOW, THEREFORE, in consideration of the mutual promises contained herein, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. Commencing January 1, 1993, AARP will not submit for mailing ~~at n.p.o. special third-class bulk rates~~ any insurance mailing as defined in paragraph 6 of this Agreement, except where such matter contains, but is not primarily devoted to, references to or instructions for making inquiries concerning insurance services or benefits generally available as a result of membership in AARP.

2. USPS shall not bring any enforcement action charging violation of subsection (j)(1)(B) of Section 3626, Title 39, United States Code, to collect any postage deficiency from AARP for mailings which advertise, promote, offer, recommend, describe, or announce the availability of its existing group health insurance programs for mailings made prior to January 1, 1993.

3. The parties shall use their best cooperative efforts to secure an amendment, set forth in Appendix A to this Agreement, to Section 3626 of Title 39, United States Code, to replace the test of qualified insurance mailings being "not generally otherwise

commercially available" with statutory language eliminating the qualification of such insurance mailings for n.p.o. special third-class bulk rates as of January 1, 1993.

4. This agreement is for clarification purposes and does not constitute an admission by AARP that it has violated either subsection (j)(1)(B) of Section 3626, Title 39, United States Code, or the cooperative mailing regulations of the Postal Service set forth at section 625.5 of the Domestic Mail Manual.

5. Provided that AARP makes no material change in its current group health insurance program or in its mailing practices prior to December 31, 1992, USPS releases, forever discharges and promises not to sue or serve a deficiency notice on AARP, the AARP Insurance Plan or its directors, officers, trustees, agents, employees, representatives, attorneys, and beneficiaries with respect to any and all claims, actions, causes of action, suits, demands, rights, damages and costs under subsection (j)(1)(B) of Section 3626, Title 39, United States Code, which relate to any group health insurance mailings made by AARP which have been or will be sent on and between the effective date of Pub. L. No. 101-509 and December 31, 1992.

6. The term "insurance mailing" as used herein means a mailing containing matter which describes and makes available a specific insurance policy or policies to present or potential members of AARP, and is limited to the following areas of group health insurance: Medicare Supplement ("Medigap"), Hospital Indemnity, and Long-Term Care (nursing home). Should AARP make

available a policy or policies of any other type of insurance, those policies will not be subject to this Agreement.

7. This Agreement constitutes the entire agreement between the parties on this subject matter, and can be modified only by a written modification signed by the party to be bound.

8. Either party may enforce the provisions of this Agreement in a court of competent jurisdiction in Washington, D.C.

9. Each party warrants that its undersigned signatory has all authority necessary to execute this Agreement and that this Agreement, once signed, shall be fully binding on such party.

IN WITNESS WHEREOF, the parties to this Agreement have caused it to be executed by their duly authorized representatives.

AMERICAN ASSOCIATION OF ..  
RETIRED PERSONS

By: \_\_\_\_\_  
Steven Zaleznick  
General Counsel

Date: \_\_\_\_\_

UNITED STATES POSTAL SERVICE

By: \_\_\_\_\_

Date: \_\_\_\_\_

# Are you paying too much for your prescriptions?

As an AARP member, you're invited  
to mail the postpaid card or call  
for a FREE money-saving Rx price quote.  
Take advantage of this special offer  
and receive \$5.00 off  
your next new prescription of \$5.00 or more!

Call TOLL-FREE  
**1-800-456-2226**

Ask for Dept. 672835

8 am - 6 pm, M-F, 9 am - 1 pm, Sat.  
Mention Code 050 and save \$5.00  
on your next new prescription.



*The Drugstore at Your Door®*

Retired Persons Services, Inc., which administers the AARP Pharmacy Service, is a separate entity sponsored, but not owned or controlled, by AARP.

## PREPARED STATEMENT OF JEFFREY H. ZELKOWITZ

Good morning. Thank you for asking us to testify today. My name is Jeff Zelkowitz. I'm a Senior Counsel in the Postal Service Law Department. My duties include providing advice to officials responsible for deciding mail classification appeals and related matters, including the use of nonprofit mail rates. First, I'd like to give you a quick overview or history of special bulk third-class mailing rates.

Eligibility for the nonprofit rates, including the types of organizations authorized to use them and what may be mailed, is established by statute. Third-class nonprofit rates, as we know them, originated in 1951, when Congress created an exemption from a general rate increase for "matter mailed in bulk" by eight generic types of nonprofit organizations. Included in this number were such broad categories as "religious," "educational," and "philanthropic" organizations, as well as groups described as "scientific," "agricultural," "labor," "veterans," and "fraternal." In order to mail at the special rates, organizations had to meet two requirements. They had to be nonprofit and they had to meet the requirements of one of the eight categories.

In response to the explosive growth of the nonprofit sector in the 1960s, the Postal Service decided that it was necessary to adopt detailed definitions of qualified nonprofit organizations. This was accomplished in 1973. These definitions attempted to correlate the postal meaning of terms such as "educational" and "philanthropic" with those used by other agencies, most notably the I.R.S.

While postal officials focused their attention on the eligibility of organizations to mail at the nonprofit rates, a different set of enforcement problems arose concerning the material those organizations were mailing. In simple terms, some nonprofit organizations had decided to push the literal terms of the preferred rate statute to the limit by "mailing in bulk" the advertising matter of for-profit companies. In this they were assisted by commercial direct mail promoters who had discerned the competitive advantage offered by nonprofit postage rates.

The Postal Service responded to this development by revising its regulations in 1975 to limit the use of the special rates to an organization's "own" matter, and to forbid nonprofit groups to "delegate or lend" their permits, or to mail matter "on behalf of or produced for" an ineligible organization. These regulations, which are commonly called the cooperative mailing rule, have been challenged and upheld in Federal courts.

Eligibility issues remained controversial during succeeding years as concern regarding the Federal deficit stimulated closer inspection of the nonprofit mailing subsidy. That inspection focused on what groups are eligible for the subsidy, and what those groups are mailing.

More currently, enforcement activity by the Postal Inspection Service during the late 1980s focused on a variety of cooperative mailing ventures between nonprofit mailers and commercial firms. Typically, these ventures promoted the sale of "affinity" credit cards, group insurance, vacation travel plans, and other goods or services not typically associated with charitable activities.

Congress took action to address these concerns in the fall of 1990. As part of the Postal Service Appropriations Act for 1991, which was signed into law on November 5, 1990, Congress enacted significant changes affecting nonprofit rate mail. Before these provisions were enacted, there were no content-based restrictions on what might be sent at the special rates. That is, the only test was the cooperative mail rule which concerned whether the mail was that of the nonprofit party. However, for the first time, the 1990 legislation added restrictions on content. Thus, nonprofit third-class rates shall not apply to mail which, in the words of the statute, "advertises, promotes, offers, or, for a fee or consideration, recommends, describes, or announces the availability of:

"A. Credit, debit or charge cards, or similar financial instruments provided through or with an ineligible party;

"B. Insurance policies unless the policy is designed for and primarily promoted to members, donors, supporters, or beneficiaries of the eligible nonprofit organization, and it provides coverage not generally otherwise commercially available;

"C. Travel arrangements unless they contribute substantially to one or more of the eligible mailer's qualifying purposes (aside from fund-raising and cultivating new members, donors, or supporters) and they are designed for and primarily promoted to the organization's members, donors, supporters or beneficiaries."

These restrictions are sometimes referred to as the TIF restrictions. The restrictions on insurance solicitations are pertinent to our subsequent dealings with AARP.

The 1990 legislation was not Congress' final action in the area of content-based restrictions on nonprofit mail. In 1993 and 1994, as part of broader reforms concerning preferred rates, Congress enacted additional restrictions on nonprofit third-class

mail by establishing restrictions on other types of advertising as well as on certain products. Regulations implementing these provisions were published on May 6, 1995, and will become effective on October 1, 1995.

It is difficult to estimate the precise number of organizations now authorized to mail at the nonprofit third-class rates. It is estimated that at least 400,000 total authorizations have been issued by the Postal Service. However, because organizations must obtain an authorization at each post office where they mail, some organizations have multiple permits. Accordingly, as a rough guess, the number of organizations authorized to mail at the nonprofit rates is 300,000.

The nonprofit third-class rates have been and will remain lower than the regular third-class rates, although this gap is closing due to the changes enacted by Congress in the 1993 legislation. It is difficult to provide a single precise number to convey the relationship between the nonprofit and regular rates, since both vary due to mail preparation and other factors. However, as an approximate figure, the regular bulk third-class rates are nearly double the analogous nonprofit third-class rates.

As I mentioned, a dispute developed between the Postal Service and AARP after enactment of the TIF restrictions in 1990 concerning the scope of the restrictions against insurance solicitations, particularly group health insurance solicitations. Specifically, the dispute concerned the interpretation of the exception for policies that would be considered "not generally otherwise commercially available."

The law was declared effective 90 days from the date of enactment or February 3, 1991. On September 13, 1991, and June 25, 1992, the Postal Service published standards in the Federal Register to implement the statutory restrictions. AARP provided extensive comments during the rulemakings implementing the TIF restrictions. However, the Postal Service did not adopt the interpretations it proposed.

Additionally, in early 1992, AARP sent a draft agreement to the chief Postal Service mail classification official proposing a resolution to the dispute. Under this proposal, AARP proposed that AARP and the Postal Service jointly seek a statutory amendment eliminating the exception to the prohibition against mailing insurance solicitations at the nonprofit rates. This amendment would be effective January 1, 1993. Under AARP's proposal, it would stop mailing group health insurance solicitations as of January 1, 1993. In return, the Postal Service was supposed to agree not to pursue any back postage claims, which we refer to as postage deficiencies, on group health insurance mailings made before January 1, 1993, even if it was determined that the mailings violated the 1990 statute.

In a written response, the Postal Service refused to enter the proposed agreement. We explained that the Postal Service did not have the authority to permit an organization to make mailings at a rate which violated statutory provisions. With respect to the proposed statutory amendment, our letter stated that that was a matter within the discretion of Congress.

In August, 1992, approximately two months after the Postal Service concluded its second rulemaking, AARP wrote again to the Postal Service. AARP advised that it did not agree with the rules. It also advised that, while not waiving its rights to take legal action to challenge the rules, it would begin to mail its group health insurance solicitations at the regular rates.

A short time later that year, postal inspectors reviewed AARP's mailing practices. They found that AARP had started mailing the group health insurance solicitations at the regular rates. They also found that, prior to that change in August 1992, these types of mailings had been sent at the nonprofit rates. As a result of these findings, postage deficiency assessments were issued against AARP.

By statute, AARP had two levels of administrative appeals concerning these assessments, and it began the appeals process. In the meantime, however, it initiated settlement discussions with the Postal Service but no agreement was reached. In August, 1993, AARP filed suit against the Postal Service, challenging the validity of the regulations implementing the insurance restrictions in the 1990 legislation. Settlement discussions were initiated in this proceeding, and these discussions also involved the postage deficiency assessments, which were still the subject of administrative appeals and not part of the lawsuit. Eventually, the parties reached a settlement, under which AARP dropped its challenge to the Postal Service regulations and settled the postage deficiency assessments. This effectively ended the dispute between the parties. Thank you. I would be happy to answer any questions which you may have.

## COMMUNICATIONS

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### STATEMENT OF THE AGE DISCRIMINATION VICTIMS REPARATIONS REGISTRY

JUNE 7, 1995.

Senator ALAN K. SIMPSON,  
*Dirksen Building,*  
*U.S. Senate,*  
*Washington, DC*

Dear Senator Simpson: Although I will not be able to attend your hearings about the American Association of Retired Persons (AARP) scheduled for June 13, 1995, I would like to submit my testimony in this letter.

The main problem is not tax fraud which AARP admitted in paying \$135-million to the IRS. The main problem is that all of AARP is a counterproductive fraud, posing as a senior lobby but in fact pre-empting and preventing the organization of an effective senior lobby, all the while playing minion to the powers that be, mouthing support for anti-senior legislation and doing it in the name of 33 million members which it does not have and who neither know nor support AARP's self-serving positions.

The main question is not why AARP has abused its tax exempt status, although you should be aware that the Treasury and IRS have asked AARP to start paying taxes at least seven years ago (*Newsweek*, Aug. 15, 1988, p.38). *The main question is why AARP was given tax exempt status, by whom, when, and what AARP pledged to do in return.* I have reason to believe, and I firmly believe, that AARP's tax exempt status was protected by certain past members of Congress, in return for masquerading as a senior lobby, but neither having nor exercising any of the powers that the gun lobby or insurance lobby or tobacco lobby or doctors' lobby or labor lobby have and use. AARP "speaks on behalf of 33 million seniors" but in fact it cannot deliver even one vote for or against anything, and cannot elect or defeat even one member of Congress, and would not if it could. Rather, AARP is a racket which has unlawfully enriched its few proprietors and has illegitimately damaged millions of seniors who have no effective lobby precisely because AARP usurps that role and fills that vacuum with tax fraud and self-service and deception.

It is generally believed that AARP has 33 million names on its mailing list, but only a fraction are paid up members and the rest are prospects dunned for life and beyond. I am not in a position to name names because I lack documentation sufficient to counter libel and slander charges but you can and should appoint a Special Prosecutor to investigate the why, who and when of AARP's tax exempt sweetheart deal made behind closed doors and under the table.

Although AARP falsely claims to represent the interests of victims of age discrimination in employment, it does not even accept members under 40 when Congress has determined that age victimization starts at 40 as enacted in the Age Discrimination in Employment Act in 1967. AARP supported the euphemistically named Older Workers Benefit Protection Act which legalized age discrimination by involuntary early retirement in exchange for consideration of anything of value, which could be a nickel or one red cent in exchange for up to half a million of payroll savings for replacing a \$60,000 white collar employee with a \$30,000 youngster with similar paper qualifications.

AARP's misdeeds can fill a book and I hope someday they will. You can bring that day closer by appointing a Special Prosecutor to investigate. If so, I would like to be contacted by the Special Prosecutor to provide him with additional information and documentation. Personally, I believe the AARP should be liquidated and its assets, and the ill-gotten assets of its proprietors, divided evenly among the paid-up AARP members.

Thanks for your interest in our problems.

Sincerely,

PETER D. MOSS, *Public Information  
Officer.*

