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memorandum**

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subject: Wholly-Owned Instrumentality Status of Charter School

This responds to your request for advice on whether Charter School is a wholly-owned instrumentality of a state or of a political subdivision of a state within the meaning of Internal Revenue Code (Code) section 3121(b)(7)(F). This advice may not be used or cited as precedent.

Legend

= State A

Facts

Charter School X is a non-profit domestic corporation located in State A. Charter School X is also an entity recognized as exempt from federal income tax under Code section 501(c)(3). In accordance with the State A Charter Schools Act, Charter School X was chartered by the State A Charter School Board and opened in

Charter School X currently provides education for children in kindergarten through grade eight. Since its inception, Charter School X has been withholding and paying taxes under the Federal Insurance Contributions Act (FICA) on remuneration it pays to employees. Employees of Charter School X participate in various governmental

retirement plans. In order to determine how to proceed with regard to social security coverage for employees of charter schools in State A, the Director of the state's Division of Finance requested an opinion from the State A Attorney General on whether State A charter schools are governmental entities. The State A Attorney General responded with a letter dated \_\_\_\_\_, concluding that charter schools in State A are governmental entities under State A law. Charter School X subsequently filed several claims for refund of FICA tax.

### Charter Schools Act

State A laws regulate public schools, charter schools, private schools, home schooling, and on-line learning. In \_\_\_\_\_, the State A legislature passed the State A Charter Schools Act, which authorized the creation of charter schools in State A. (State A Code Annotated ( \_\_\_\_\_) §§ \_\_\_\_\_). \_\_\_\_\_ section \_\_\_\_\_ provides that \_\_\_\_\_ schools \_\_\_\_\_) provides that \_\_\_\_\_

Under the State A Charter Schools Act, the purposes of charter schools are to:

A proposal to establish a charter school in State A may be made by an individual or groups of individuals, including teachers and parents or guardians of students who will attend the school, or a not-for-profit legal entity organized under the laws of State A. ( \_\_\_\_\_ § \_\_\_\_\_).

A proposal to establish a charter school in State A may be authorized in any of ways. A charter may be authorized by the State A Charter School Board. ( \_\_\_\_\_ § \_\_\_\_\_)

\_\_\_\_\_). The State A Charter School Board consists of \_\_\_\_\_ members, each appointed by the Governor. \_\_\_\_\_ members are appointed based on recommendations made by State A's charter schools, and \_\_\_\_\_ are appointed based on recommendations from the State A Board of Education. The State A Charter School Board makes recommendations to the State A Legislature and State A Board of Education on bills and rules regarding charter schools and assists charter schools in understanding and

carrying out their charter obligations. Under State law, the State A Charter School Board, a local school board in the State, or a board of trustees of a higher educational institution in the State may authorize public chartering of a school (

§                   ;                   ). A charter school is different from a (                   ) which is a public school under the control of a local elected school board. (                   ). Charter schools are (                   ).)

All primary and secondary schools in State A, whether public, charter, or private (including parochial), are subject to various state regulatory requirements. For example, State A statute requires any public or private school student who participates in industrial education, a physics laboratory, or a chemistry laboratory in a way that may endanger his vision to wear (                   ). Similarly, the law relating to criminal background checks on school personnel is applicable to (                   ). In addition, State A Code section provides that electronic high school courses are provided to

Charter schools in State A have many of the same requirements and duties as district schools that may not apply to private schools.

(                   ). Charter schools may not charge tuition or fees, except those fees normally charged by other public schools. ( §                   ). Their curriculum, programs, admission policies and employment practices must all be nonsectarian. (

§                   ). Charter schools must make the same annual reports as district schools, including an annual financial audit. (                   ). In order to ensure that charter schools prepare the same annual financial audit that public schools must prepare, the law provides that each charter school's charter must include a written financial plan for the school and the provisions which will be made for the required annual audit of the school. ( §                   ). Charter School X's charter provides that it will, on                   basis, engage and participate in an independent, outside audit by a certified public accountant of its financial administrative operation and will provide the audit to the State A Charter School Board in written form. (Section of Charter). Charter schools must comply with rules and implementing statutes that prescribe how state appropriations may be spent. ( §                   ). Additionally, district schools and charter schools must participate in the statewide testing programs including at a minimum, the State A Performance Assessment System for Students ( §                   ). Charter schools submit all reports to the State A Board of Education. (                   section                   ). Charter schools must also

comply with the Open and Public Meetings Act, which requires that the state, its agencies, and its political subdivisions take their actions and deliberate in an open manner. ( § ). Finally, the rules concerning gang prevention apply to a

( ).

Charter schools in State A are entitled to appropriate portions of local school district revenues from the school districts in which the charter school students reside. ( ). Additionally, the State A legislature appropriates funds annually to charter schools to offset some of the local property tax revenues that are not available to them. Id. Like district schools, charter schools are also eligible to receive a portion of the State A School funds. (State A Admin. Code ). Additionally, charter schools in State A may apply for state or federal start-up funds, and may receive donations from private parties.

State A law, which concerns the makes distinctions between the statutory obligations of charter schools and district schools, including the following:

(1) Charter schools in State A, including Charter School X, are permitted more independence than district schools insofar as they are governed by boards that are independent from the local school districts and are exempt from certain State A Board of Education rules that govern public employment. ( ) Charter schools are exempt from State A Board of Education rules governing

( § ) State A statutory requirements relating to local school board budget procedures apply only to a public school controlled by a school district. ( ) For example, State A statute provides: “

( ). This purchase restriction is not imposed on charter schools.

(2) Unlike district schools, charter schools are not required to establish school community councils or school improvement plans ( § ).

(3) Charter schools are exempt from other statutory provisions that apply to district schools, including provisions pertaining to the use of school buildings as civic centers, provisions requiring the use of activity disclosure statements, provisions requiring notification of intent to dispose of textbooks, provisions requiring presentations on adoption, and provisions requiring an independent evaluation of instructional materials. ( § ).

(4) The fiscal procedures set forth in Chapter , Part of the State A Code, pertaining to fiscal procedures in district schools, do not apply to charter schools. ( ). These fiscal procedures include local school board budget procedures (requiring district schools to adopt and publish a budget annually), limits on appropriations (prohibiting district schools from making any appropriation in excess of estimated expendable revenue), and monthly budget reports (requiring district school business administrators to submit monthly reports to the local school board showing amounts of appropriations and disbursements).

(5) Unlike district schools, a charter school's governing body has authority to determine the level of compensation, and the terms and conditions of employment, for its employees. ( ).

Prior to of each year, a charter school may identify and report to the State A Charter School Board its innovative practices that fulfill the purposes of charter schools. ( § ). If any charter school in State A fails to comply with its charter or fails to comply with State A statutory requirements that apply to charter schools (including the requirements to meet all applicable federal, state, and local health, safety, and civil rights requirements, to file financial audit report, and to comply with the prohibition on charging tuition and fees not normally charged by district schools), the entity which chartered the school can exercise direct control over the school by (a) removing a charter school director or finance officer, (b) removing a governing board member, or (c) appointing an interim director or mentor to work with the charter school or (d) terminating the school's charter. ( § ). Upon termination of a charter school, any assets remaining after payment and discharge of the closing school's liabilities and obligations

( ).

### Charter School X

Charter School X was authorized by the State A Charter School Board, the

and was approved by the State A State Board of Education on

The charter was last renewed on . Charter School X is operated by a Charter School Governing Board (Governing Board), which is the board designated by the charter school (State A Administrative Code ). The requirements on the composition for the Governing Board are addressed in Charter School X's Charter, which is defined as a written contractual agreement between Charter School X and its chartering entity setting forth the terms and conditions for operation of the charter school. ( § ). Charter School X's Charter provides that its Governing Board will be comprised of members. No governmental approval of the composition of the

Governing Board is needed. The Charter further provides that the term of office for each Governing Board member is \_\_\_\_\_ years. The parents of currently enrolled students elect new Governing Board members to fill expiring positions at \_\_\_\_\_ parent meeting. Each family is given \_\_\_\_\_ vote in the election of Governing Board members. If a Governing Board member resigns or is dismissed, the Governing Board will select a replacement to fill the remainder of the unexpired term. (Charter section \_\_\_\_\_, and Bylaws section \_\_\_\_\_).

As a section 501(c)(3) organization, Charter School X files a Form 990, Return of Organization Exempt From Income Tax. Charter School X's \_\_\_\_\_ Form 990, item \_\_\_\_\_, indicates that all \_\_\_\_\_ of the Governing Board members serving on Charter School X's Board of Directors are \_\_\_\_\_ Charter School X also has a

\_\_\_\_\_ member Board of Trustees. The Governing Board elects the Trustees. (Bylaws \_\_\_\_\_). The majority of the trustees must come from the family units of students actively enrolled in the Charter School. (Bylaws \_\_\_\_\_). Charter School X's Bylaws permit up to \_\_\_\_\_ % of the Trustees to be \_\_\_\_\_ i.e., persons being compensated for services provided to the corporation or relatives of such persons. (Bylaws \_\_\_\_\_). Charter School X's Bylaws permit the Board of Directors to delegate the management activities of the school to others.

Charter School X's Bylaws were adopted by its Governing Board and are not part of the Charter or other agreement with Charter School X's chartering entity. The Bylaws provide that the “

(Bylaws \_\_\_\_\_). Charter School X's Governing Board is granted the powers to conduct, manage, and control the affairs and activities of the corporation, to make rules and regulations, and to carry on a business at a profit and apply any profit that results from the business activity to any activity in which the corporation may engage. (Bylaws \_\_\_\_\_ and \_\_\_\_\_). Moreover, Charter School X's Board may approve a

(Bylaws \_\_\_\_\_).

Enrollment preference in Charter School X may be given to \_\_\_\_\_ (\_\_\_\_\_) Charter School X's Charter provides that

If Charter School X is oversubscribed, the Charter states that admission will be offered based on the results of a lottery in accordance with state and federal requirements. (Charter, section \_\_\_\_\_).

Charter School X's Articles of Incorporation provide that

(Article \_\_\_\_\_, Articles of Incorporation). However, Article \_\_\_\_\_ of Charter School \_\_\_\_\_ Articles of Incorporation is inconsistent with the state statute governing charter school closures, which provides that after the satisfaction of charter school liabilities and obligations, the remaining assets shall be returned to the closing charter school's chartering entity. ( § \_\_\_\_\_ ).

In its Charter, Charter School X agreed, as is required by State A law, to engage and participate in an independent outside audit by a certified public accountant of its financial and administrative operations on \_\_\_\_\_ basis. (Charter, section \_\_\_\_\_). Charter School X is required by State A law to file its \_\_\_\_\_ financial audit with the Office of the State Auditor. ( \_\_\_\_\_ ) and Charter, section \_\_\_\_\_).

### Federal Tax Law

Code sections 3101 and 3111 impose taxes under the Federal Insurance Contributions Act (FICA) on the wages paid by employers to employees with respect to employment. Code sections 3101(a) and 3111(a) impose Old-Age, Survivors, and Disability Insurance (OASDI) taxes on the wages of employees. Sections 3101(b) and 3111(b) impose Hospital Insurance (HI) taxes on the wages of employees.

Code section 3121(b)(7) provides that, for purposes of the FICA tax, "employment" does not include service performed in the employ of a State, or of any political subdivision thereof, or any instrumentality of any one or more of the foregoing that is wholly owned thereby. Code section 3121(b)(7)(F) provides that this exception does not apply if the employee is not a qualified participant in a retirement system of the state, political subdivision, or instrumentality.

Code section 3121(u)(2) of the Code provides that, for services performed after March 31, 1986, Code section 3121(b)(7) does not relieve state and local government employers and employees of liability for the HI portion of the FICA tax imposed by Code sections 3101(b) and 3111(b).

The separate exemptions provided for hospitals and schools in Code section 3121(b) indicate that the state and local governmental exemption was not intended to apply to every organization that performs an important social or charitable function that is also sometimes performed by the government. See, e.g., Code section 3121(b)(7)(C)(i), (b)(10).

Revenue Ruling 57-128, 1957-1 C.B. 311, provides that the following factors will govern in determining whether an organization is an instrumentality of one or more

states or political subdivisions for purposes of Section 3121: (1) whether it is used for a governmental purpose and performs a governmental function; (2) whether performance of its function is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner; (4) whether control and supervision of the organization is vested in public authority or authorities; (5) if express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and (6) the degree of financial autonomy and the source of its operating expenses.

Although all of the above factors are considered in determining whether an entity is an instrumentality, such determination requires a balancing of all the factors. The fact that a State permits employees of the organization to participate in the State's retirement plan is not determinative of the organization's status as an instrumentality. Revenue Ruling 69-362, 1969-1 C.B. 254, provides that the term "instrumentality of the United States" as used in Code section 3121(b) is construed as meaning only such agencies as are made use of by the Government as an instrument through which it directly exercises some governmental power, and that it does not include private persons who, by contract with the Government, have undertaken to perform some services for the government. In this case, State A has contracted, through the State A Charter School Board, with Charter School X to provide educational services, and yet does not directly or indirectly exercise control over the government funds expended by Charter School X.

In Revenue Ruling 69-453, 1969-2 C.B. 182, the Internal Revenue Service (IRS) held that a Connecticut soil and water conservation district was not a wholly owned instrumentality of the state. The ruling found that the district was a corporation, formed by private individuals who had complete control over corporate operations; the control over revenues and expenditures being especially evident. The ruling stated that the Connecticut law concerning the district was regulatory in nature. The State Commissioner had the authority to assist private individuals in forming conservation districts but did not have the authority to operate them. The State Commissioner had issued regulations suggesting modes of procedure and requiring an annual report of the district's operations and financial status. The regulations were designed to insure the integrity of the corporation but not to direct its operation. The district, like any other corporation that has an effect on the public interest, is subjected to State regulations designed to protect the public interest. That ruling referred to Rev. Rul. 57-128, *supra*, in its analysis. In holding that the district was not a state instrumentality, the IRS relied on the fact that the district was formed by private individuals who have complete control of the corporation operations, particularly control over revenue and expenditures.

In Revenue Ruling 65-26, 1965-1 C.B. 444, the IRS found that a municipal league organized by individuals under the private, not-for-profit corporation laws of a state was not an instrumentality of a state or a political subdivision of a state within the meaning of Code section 3121(b)(7). Although the municipal league's governing body was a board of trustees comprised of municipal officers, the IRS concluded that control and



supervision of the league was not vested in any public authority or authorities because the trustees were acting as individuals with no power of agency from their respective municipalities.

In Unibrand Inc. v. Commissioner, 140 T.C. 230 (2013), the Tax Court relied upon the factors in Rev. Rul. 57-128 in concluding that a state-chartered corporation wholly owned by an Indian tribe was not an instrumentality of the tribe for federal tax purposes. Noting that the tribe, as sole shareholder of the corporation, had the power to control or abolish the corporation, the court nevertheless held that the corporation was not an instrumentality of the tribe because nothing in the corporation's charter or bylaws gave the tribe's council authority to directly manage the corporation's operations or supersede the action of the board of directors, nor was there any requirement that tribal members serve on the board.

Governmental entity determinations are used in many contexts of federal law and courts have used various tests—sometimes interchangeably—to determine whether entities are governmental or private for such purposes. Although not determinative of federal tax treatment, courts' determinations of government entity status in other contexts can be instructive. In such cases, the tests typically focus on whether the government has sufficient authority to manage and control entities. For example, in National Labor Relations Board v. Natural Gas Utility District of Hawkins County, Tennessee, 402 U.S. 600 (1971), the Supreme Court interpreted the term “political subdivision” for purposes of the National Labor Relations Authority (NLRA). Although the Supreme Court in Hawkins County analyzed whether the employer at issue was a political subdivision for purposes of the NLRA, courts have used the same analysis for determining whether an entity is an agency or instrumentality of a state or a political subdivision of a state for purposes of ERISA.<sup>1</sup> The two-prong test in Hawkins County analyzes whether the entity has been “(1) created directly by the state, so as to constitute departments or administrative arms of the government, or (2) administered by individuals who are responsible to public officials or to the general electorate.”<sup>2</sup> Other courts have used the test under Revenue Ruling 57-128 in determining whether an entity is an agency or instrumentality for purposes of the governmental plan definition under ERISA.<sup>3</sup>

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<sup>1</sup> “The NLRB guidelines are a useful aid in interpreting ERISA’s governmental exemption, because ERISA, like the National Labor Relations Act, ‘represent[s] an effort to strike an appropriate balance between the interests of employers and labor organizations.’” Rose v. Long Island Railroad Pension Plan, 828 F.2d 910, 916 (2nd Cir. 1987), cert. denied, 485 U.S. 936 (1988) (quoting H.R. Rep. No. 533, reprinted in 1974 USCCAN at 4647). See also, Shannon v. Shannon, 965 F.2d 542, 547 (7th Cir. 1992), cert. denied, 506 U.S. 1028 (1992) (stating that the proper test for determining whether an entity is an agency or instrumentality of a State or political subdivision for purposes of ERISA is the Hawkins test).

<sup>2</sup> Hawkins County, 402 U.S. at 604-05.

<sup>3</sup> See Rose v. Long Island Railroad Pension Plan, 828 F.2d 910 (2<sup>nd</sup> Cir. 1987) (stating that, in interpreting the definition of governmental plan under section 414(d) of the Code, IRS has used the six factors outlined in Rev. Rul. 57-128). See also, Berini v. Federal Reserve Bank of St. Louis, Eighth District, 420 F.Supp.2d 1021 (E.D. Mo. 2005), (in determining whether the employee benefit plans maintained by the Federal Reserve System were governmental plans within the meaning of section 3(32) of ERISA, the court used the six-factor test in Rev. Rul. 57-128),

More specifically, in determining whether an entity is governmental, either as a political subdivision of a state or an instrumentality of a state or political subdivision, many courts have focused on the government's ability (or lack thereof) to manage and control the entity in both tax and non-tax contexts. For example, in Philadelphia National Bank v. United States, 666 F.2d 834 (3rd Cir. 1981), the Philadelphia National Bank sued the United States for a refund of taxes paid on interest received on loans to Temple University, a private, non-profit corporation founded in 1888 as an educational institution. Interest on money borrowed by political subdivisions is exempt from federal income tax. The Bank argued that the interest on the loans was exempt from federal income tax because the university is a political subdivision acting on behalf of the State of Pennsylvania. Temple University was reorganized in 1965 as a public university. The Board of Trustees to Temple University consists of 36 members and 3 ex-officio public officials. Twelve of the 36 members are appointed by state officials. Temple is subject to regulatory control and the state sets the tuition schedules for the University. The court concluded that Temple University is not a political subdivision acting on behalf of the State of Pennsylvania. The court noted that public officials only control one-third of the Board of Trustees, leaving the majority of non-public trustees with the power to manage and control. The court stated that "if Temple were truly a state 'agency,' the state would wholly control the decisions to be made regarding it." *Id.* at 839.

As another example, in Chicago Mathematics & Science Academy Charter School, Inc., Employer and Chicago Alliance of Charter Teachers & Staff, IFT, AFT, AFL-CIO, Petitioner, 359 NLRB No. 41 (December 14, 2012), the National Labor Relations Board (NLRB) addressed the issue of whether a public charter school was exempt from the Board's jurisdiction because it is a political subdivision. The charter school was organized as a private, nonprofit corporation. The school was run by an independent board of directors, but the school received all of its funding from the city, state, and federal governments. Noting that no government entity has authority to appoint or remove a board member, and no member of the board of directors is a government official or works for a government entity, the NLRB concluded that the school is not a political subdivision.

Similarly, although all six of the factors described in Rev. Rul. 57-128 are relevant, whether an organization qualifies as a wholly-owned instrumentality of a state often hinges on whether the state has the interests and powers of an owner, manifested in the state's ability to control the organization. The state's power to appoint, and to remove and replace, a majority of the entity's governing board and body, is one factor that would support a conclusion that an entity is controlled by the state.<sup>4</sup> Rev. Ruls. 65-

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<sup>4</sup> Although not determinative of federal tax treatment, in numerous cases involving issues other than federal taxes, courts have held that the lack of state authority to appoint, remove and replace a majority of an entity's governing board negates instrumentality status. See, Shannon v. Shannon, 965 F.2d 542 (The court ruled that the plan of the West Allis Memorial Hospital, Inc., was not a governmental plan because the City did not have the requisite control of the entity's Board, in that the City could not remove

26 and 69-453, supra, stand for the proposition that an entity under the control of private individuals cannot be an instrumentality. Even though the purpose of the municipal league described in Rev. Rul. 65-26 was to improve municipal government and promote the general welfare of cities and villages, and the league was governed by municipal officers, the ruling concluded that the league was not an instrumentality because its officers were acting as individuals with no power of agency from their respective municipalities. Similarly, the unincorporated water district in Rev. Rul. 69-453 was denied status as an instrumentality because it was under complete control of private individuals. Landowners elected the board of supervisors, who had complete control over corporate operations, including revenue and expenditures. The state law was purely regulatory and the regulations were “designed to insure the integrity of the corporation but not to direct its operation.”

### Analysis

As a preliminary matter, we note that section \_\_\_\_\_ provides that State A charter schools are to be considered \_\_\_\_\_, and the State Attorney General has determined that charter schools in State A are governmental entities under State A law. However, although these characterizations are factors in determining the Charter School’s status for federal employment tax purposes, neither the State A statute nor the State Attorney General’s opinion is determinative. The IRS has consistently applied the factors in Revenue Ruling 57-128 for determining an entity’s status as an instrumentality for FICA purposes.

#### 1. Governmental Purpose

This factor concerns whether the entity’s purpose and function is one typically carried on by a government entity. Charter School X satisfies this first factor indicating state instrumentality status because it is used for a governmental purpose. Providing tuition-free elementary and secondary education is a governmental purpose and function. State A has promulgated rules and standards applicable to open-enrollment charter schools as an alternative to standard or traditional public education in State A that is provided by school districts. Note that private parties can serve governmental purposes.<sup>5</sup>

#### 2. Function Performed on Behalf of State

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any member of the Board and, having once approved the initial composition of the Board, the City could not appoint or reappoint any person to the Board). See also, NLRB v. Parents and Friends of Specialized Living Centers, 879 F.2d 1442 (7<sup>th</sup> Cir. 1989); Truman Medical Center Inc. v. NLRB, 641 F.2d 570 (8<sup>th</sup> Cir. 1981); and Brock v. Chicago Zoological Society, 820 F.2d 909 (7<sup>th</sup> Cir. 1987).

<sup>5</sup> “Public purpose . . . is more diffuse in the sense that a private party can engage in an activity that has a public purpose, such as offering private security or charter schools.” In re Las Vegas Monorail, 429 B.R. 770, 796 (2010).

This factor evaluates whether the entity performs functions on behalf of the state. Charter School X does not satisfy this factor. “In determining whether an entity is administered by individuals who are responsible to public officials or the general electorate, the ‘relevant inquiry’ is whether a majority of the individuals who administer the entity -- the governing board and executive officers -- are appointed by and subject to removal by public officials.”<sup>6</sup> There is no public official on Charter School X’s Board of Directors or on its Board of Trustees. Charter School X’s governing Board is elected by parents of children who attend the school, and its Board of Trustees is elected by its own Board of Directors. Neither the Directors nor the Trustees are acting as individuals with power of agency from any government entity. See Rev. Rul. 65-26, denying status as an instrumentality to an entity governed by a board under the control of private individuals. The mere fact that the operations of an organization may result in a benefit to the public or that the state or local government encourages the formation and activities of such organizations and may exercise some regulatory or other broad oversight and supervision of the organization, does not mean that the organization performs its function on behalf of the government.<sup>7</sup> As explained above, the State A charter school legislation exempts charter schools from many of the statutory requirements that apply to public school districts, and permits charter schools to be operated by a Board of Directors that is independent from the local school district with little governmental oversight of their day-to-day activities.

### 3. Private Interest Versus Government Ownership

This third factor looks to whether the government has the powers and interests of an owner, or whether private interests predominate and control. This factor does not support Charter School X’s status as an instrumentality. Although the entity receives State funds and State A law indicates that Charter School X’s assets would be transferred to a governmental entity upon dissolution (notwithstanding the inconsistent provision in the Articles), neither State A nor its agencies (State A Charter School Board or the State A Board of Education) have the powers and interests of an owner. Rather, control of Charter School X rests with a Board of private individuals elected by parents of children enrolled in the school, as opposed to governmental officials, and such individuals operate independently from the local school district or other public authority. Accordingly, Charter School X’s Board represents private as opposed to public interests. An entity under the control of private individuals cannot be an instrumentality. See Rev. Rul. 65-26; see also Revenue Ruling 69-453.

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<sup>6</sup> Chicago Mathematics & Science Academy Charter School, Inc., Employer and Chicago Alliance of Charter Teachers & Staff, IFT, AFT, AFL-CIO, Petitioner, 359 NLRB No. 41, 1, 8 (December 14, 2012).

<sup>7</sup> Even when regulation is extensive, such regulation does not rise to the level of control. The Las Vegas Monorail court stated that casinos are highly regulated but no one would argue that extensive regulation would make casinos governmental entities. See In re Las Vegas Monorail, 429 B.R. at 798.

Furthermore, Charter School X's bylaws permit the Governing Board to delegate the management activities of the school to others. Although the Governing Board has not delegated the school's management to others, the fact that the bylaws permit delegation of management to another entity, presumably even to a private management company, is significant because it further separates the control of the entity from the government. Additionally, the bylaws permit % of the membership of Charter School X's Board of Trustees to be composed of individuals receiving compensation for services performed for the school. Finally, the Governing Board has the specific power

(Bylaws ).

While charter schools are expected to report regarding their innovative practices and use of state funds, in these regards the state's role is largely one of oversight to ensure basic fulfillment of the purpose of charter schools and ensure integrity in use of state funds.

#### 4. Public Control and Supervision

The fourth factor is similar to the third factor but focuses more specifically on whether the control and supervision of the organization is vested in public authority or authorities. Does the state exercise a degree of control over the entity such that the entity essentially operates in place of the state? The fact that there are State A laws regulating Charter School's activities is not sufficient to satisfy this factor, as extensive governmental regulation does not equal governmental control. Charter School X is subject to the State A statute governing charter schools, as well as its own Articles of Incorporation, Charter and Bylaws. However, the State A law that concerns charter schools is largely regulatory, rather than proprietary in nature. Charter schools, like any other educational institutions that have an effect on the public interest, are subject to state regulations designed to protect the public interest and insure the public integrity of the entity, but not to direct its operations. See Rev. Rul. 69-453. Moreover, while Charter School X is subject to regulatory control from State A, it is exempt from many of the State Board of Education rules that apply to district schools.

Furthermore, as noted above, Charter School X is an independently run nonprofit corporation with an independent Governing Board. The Governing Board is composed of private individuals elected by parents of children enrolled in the school, on a self-perpetuating basis, and none of the Governing Board's members is appointed by a governmental entity. State A has no control over the composition and selection of Charter School X's Governing Board. In addition, no governmental entity controls or supervises the school in its day-to-day operations. State A statutes do not require that control and supervision of the Charter School be vested in a public authority or authorities. Rather, the control and supervision of the Charter School is vested in the

(State A Administrative Code

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Although State A law authorizes the chartering entity to remove directors, terminate Charter School X's Charter, or appoint an interim director if Charter School X is not in compliance with its Charter or with State A law, control and supervision of the organization is not vested in any public authority because nothing in Charter School X's charter or bylaws gives any governmental entity the authority to manage Charter School X's day-to-day operations, appoint its Governing Board, or serve on the Governing Board or the Board of Trustees. The authority to remove directors and appoint an interim director arises only if Charter School X fails to comply with its charter or with certain statutory provisions that apply to charter schools. State A has no authority to exercise control over Charter School X under ordinary circumstances where Charter School X is operating in compliance with its charter and with state law. This is similar to Uniband, supra, in which the Tax Court concluded that an Indian tribe, as sole shareholder of a state-chartered corporation had ultimate power to control or abolish the corporation and to name its officers and directors, but nevertheless the corporation did not satisfy the fourth factor of Rev. Rul. 57-128 because nothing in the corporation's charter or bylaws gave the tribal council authority to directly manage the operations of the corporation or supersede the action of the board of directors, nor was there any requirement that tribal members serve on the board.

#### 5. Statutory Authority

The fifth factor looks at whether express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality. Charter School X satisfies this factor. State A statutes authorize the State Charter School Board to grant a charter for an open-enrollment charter school to a Code section 501(c)(3) organization. Although there is no specific legislation creating Charter School X, Charter School X was chartered pursuant to the authority of State A statute. Express statutory authority is necessary for the creation and use of a charter school in State A and such statutory authority exists. See et seq.

#### 6. Financial Autonomy/Source of Operating Funds

The sixth factor of Rev. Rul. 57-128 evaluates the degree of financial autonomy and the source of the entity's operating expenses. This factor is neutral in this case. The State provides virtually all of Charter School X's funding. However, an entity is not governmental simply because it receives public funding or operates pursuant to a contract with a governmental entity. The overall financial planning, and day-to-day financial operations are in the hands of Charter School X's independent Governing Board. A governmental unit's provision of support to a private organization does not render that organization an instrumentality within the meaning of Code section 3121(b)(7)(F). Thus, although the Charter School receives the bulk of its operating funds from governmental entities, it is financially autonomous because it is not subject

to any meaningful governmental control, supervision, or oversight over the school's budget, salaries, employee terminations, contracts, student mix, and so on. Although Charter School X is required to engage and participate in an independent outside audit by a certified public accountant, and file the financial audit to the State Charter School Board, the State does not play a role in the School's financial planning. In this regard, unlike district schools, Charter School X is not required to publish a budget annually or submit monthly budget reports to the local school board and Charter School X determines the level of compensation for its own employees.

Conclusion:

Although all six factors described in Revenue Ruling 57-128 are considered in determining whether an organization is an instrumentality of a government, the mere satisfaction of one or more of the factors is not necessarily determinative. The determination ultimately requires consideration of the totality of the circumstances. Although Charter School X is publicly funded and performs the governmental function of providing public education in State A, it does not perform this function on behalf of State A because State A exercises no meaningful control over Charter School X's day-to-day operations or its budget and the laws of State A permit Charter School X to operate independently from the local school district. No governmental entity has the power to appoint Charter School X's governing board and the organization's bylaws permit management to be delegated to a private management company. Based on the above analysis, we conclude that Charter School X does not qualify as a wholly-owned instrumentality of the state or of a political subdivision of the state for purposes of FICA tax liability under Code section 3121(b)(7)(F) with respect to compensation paid to Charter School X's employees.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 317-4744 if you have any further questions.