Internal Revenue Service

Department of the Treasury

Washington, DC 20224

200017053

S.I.N.: 414.07-00

Contact Person:

Telephone Number:

In Reference to:

Date: T:EP:RA:T2 Rm. 6233

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Legend:

State A =
System B =
Act C =
City Y =
Board D =
Board R =
Entity E =

Plan X =

Trustees T =

University U =

Dear:

This letter is in response to a letter dated April 28, 1999, as supplemented by letters dated June 7, 1999, July 20, 1999, September 1, 1999, September 8, 1999, September 23, 1999, and November 2, 1999, submitted by your authorized representative, in which rulings are requested under sections 414(d) and 414(h) of the Internal Revenue Code.

The following facts and representations have been submitted on your behalf:

System B is a retirement system established primarily for teachers and administrators of primary and secondary public schools of State A (employed outside City Y). System B is governed by Board D, a ten-member retirement board which sets policy and oversees operations consistent with applicable laws.

By letter dated November 19, 1945, the Internal Revenue Service stated that System B was an instrumentality of State A.

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System B provides service, deferred and disability retirement benefits, as well as member death benefits, for more than 302,000 members, including approximately 209,000 active members and 92,000 retired members and beneficiaries. To provide such benefits for its members, System B administers Plan X, a defined benefit program, qualified under sections 401(a) and 414(d) of the Code as a governmental plan. Plan X includes a mandatory employee contribution feature. You represent that each participating employer picks up the member contributions required to be made to Plan X in a manner consistent with section 414(h) of the Code.

There are four tiers of members determined by date of membership. Retirement benefits differ for each membership tier. Generally, Tier 1 and Tier 2 members who have made contributions to Plan X receive an annuity throughout retirement or a lump sum distribution of their annuity account, in addition to the employer-funded pension. The annuity is based on total member contributions, life expectancy, date of membership and form of retirement allowance chosen by the member. Contributions made by Tier 3 and Tier 4 members are combined with employer contributions to fund the pension. Each participating employer picks up the member's contributions required to be made to Plan X, in a matter consistent with section 414(h) of the Code. The employer's contribution rate is determined annually by Board D, based on the recommendation of the actuary, at the beginning of each school year, based on the actuarial valuation of plan assets and liabilities. The amounts due from each participating employer are premised on the rate of contribution, as established by Board D at the beginning of the school year, and on the amount of compensation paid by the employer during the year. The amounts of contributions are collected primarily from the state appropriations (or taxes levied by the employer, when applicable) during the months of September, October and November following the close of the school year for which such contributions are due.

State A's legislature recently passed, and the governor signed, Act C which affects System B and Plan X. The purpose of Act C is to:

> . . authorize a system of charter schools to provide opportunities for teachers, parents, and community members to establish and maintain schools that operate independently of existing schools and school districts in order to accomplish the following objectives:

(a) Improve student learning and achievement;

(b) Increase learning opportunities for all students, with special emphasis on expanded learning experiences for students who are at-risk of academic failure;

(c) Encourage the use of different and innovative teaching methods;

(d) Create new professional opportunities for teachers, school administrators and other school personnel;

(e) Provide parents and students with expanded choices in the types of educational opportunities that are available within the public school system; and

(f) Provide schools with a method to change from rule-based to performance-based accountability systems by holding the schools established under this article accountable for meeting measurable student achievement results.

Act C limits those who may make an application to establish a charter school to teachers, parents, school administrators, community residents, or any combination of these groups. Applications may be filed in conjunction with colleges, universities, museums, educational institutions, not-for-profit corporations under section 501(c)(3) of the Code, or for-profit business or corporate entities authorized to do business in State A. Act C requires 24 separate items of information, designed to assure that educationally appropriate programs are offered in a fiscally sound manner. These requirements include educational requirements, governance requirements, fiscal requirements and operational requirements.

Charters are issued by public entities. The criteria for approval are based on furtherance of the public purpose of education. Approval of a charter school application requires that: (a) the charter school described in the application meets the requirements set out in Act C and all other applicable laws, rules, and regulations; (b) the applicant can demonstrate the ability to operate the school in an educationally and fiscally

sound manner; and (c) granting the application is likely to improve student learning and achievement and materially further the purposes set out in Act C. In reviewing applications, Entity E is encouraged to give preference to applications that demonstrate the capability to provide comprehensive learning experiences to students identified by the applicants as at risk of academic failure. Entity E is not required to approve a charter; in fact, it may deny an application or require additional information as a condition of approval. Entity E is comprised of a local board of education, Trustees T of University U, and Board R. Board R also serves as the review body.

Board R is an umbrella state instrumentality which is responsible for educational functions and licensing in State A. Its members are appointed by State A's legislation sitting as a body of the whole. Board R has oversight responsibility for all state colleges and universities and is a state instrumentality. University U has direct responsibility for all state colleges and universities and is a state instrumentality.

Once the application has been approved by Entity E, the applicant and Entity E enter into a proposed charter. The proposed charter includes all 24 items of information required by Act C, and any other terms or conditions required by applicable laws and regulations.

Once the proposed charter has been agreed upon, it must be submitted to Board R for review. Board R may either approve and issue the charter or return it to Entity E for reconsideration with written comments and recommendations. If the proposed charter is returned by Board R, Entity E may resubmit the proposed charter with modifications, resubmit the charter without modifications, or abandon the charter.

Act C provides rules for charter schools similar to those of other public schools. Charter schools are exempt from taxation, fees, assessments, and levies under Act C. Charter schools must meet the same health and safety, civil rights, and student assessment requirements applicable to other public schools.

Charter school teachers shall be certified in accordance with the requirements applicable to other public schools; provided, however, that a charter school may employ as teachers (i) uncertified teachers with a least three years of elementary, middle or secondary classroom teaching experience; (ii) tenured or tenure track college faculty; (iii) individuals with two years

of satisfactory experience through the Teach for America program; and (iv) individuals who possess exceptional business, professional, artistic, athletic, or military experience, provided, however, that such teachers described in clauses (i),(ii), (iii), and (iv) of this paragraph shall not in total comprise more than thirty per centum of the teaching staff of a charter school, or five teachers, whichever is less.

A charter school must perform the same public educational purpose as any other public school in State A. Act C states "The powers granted to a charter school under this article constitute the performance of essential public purposes and governmental purposes of this state." Act C also states, although charter schools are "independent and autonomous school[s]," "Board R and Entity E have joint authority to oversee their operation." In particular, Board R and Entity E may "visit, examine into and inspect any charter school, including the records of such school." Under Act C, Entity E and Board R shall be deemed to be the public agents authorized to supervise and oversee the charter school. This authority is broad enough "to ensure that the charter school is in compliance with all applicable laws, regulations and charter provisions." This authority is vested in the local school district for a charter school that chose University U or Board R as its charter entity.

Act C provides:

> A charter school shall design its educational programs to meet or exceed the student performance standards adopted by Board R and the student performance standards contained in the charter. Students attending a charter school shall be required to take regents examinations to the same extent such examinations are required of other public school students. A charter school offering instruction in the high school grades may grant regents diplomas and local diplomas to the same extent as other public schools, and such other certificates and honors as are specifically authorized by its charter, and in testimony thereof give suitable certificates, honors and diplomas under its seal; and every certificate and diploma so granted shall entitle the conferee to all privileges and immunities which by usage or statute are allowed for similar diplomas of corresponding grade granted by any other public school.

Charter schools are subject to independent fiscal audits at least once annually. They are also required to have audit procedures and standards consistent with generally accepted accounting and auditing standards and comparable in scope to those of other public schools.

Individuals and groups play a role in overseeing the operation of charter schools. Any individual or group may bring a complaint to the board of trustees of a charter school alleging a violation of the provisions of Act C, the charter, or any other provision of law relating to the management or operation of the charter school. If, after presentation of the complaint to the board of trustees of a charter school, the individual or group determines that such board has not adequately addressed the complaint, they may present that complaint to Entity E, which shall investigate and respond. If, after presentation of the complaint to Entity E, the individual or group determines that the Entity E has not adequately addressed the complaint, they may present that complaint to Board R, which shall investigate and respond. The Entity E and Board R shall have the power and the duty to issue appropriate remedial orders to charter schools under their jurisdiction to effectuate the provisions of this section.

The primary source of funding for charter schools is State A. Under Act C, a local school district must "pay directly to the charter school for each student enrolled in the chartered school who resides in the school district an amount equal to one hundred percent of the amount calculated pursuant to paragraph f of subdivision one of section thirty six hundred two of this chapter for the school district for the year prior to the base year increased by the percentage change in the state total approved operating expense calculated pursuant to subdivision eleven of section thirty six hundred two of this chapter from two years prior to the base year." In other words, the local school district must pay its per pupil operating expense to a charter school for each pupil enrolled in the charter school, based on the per pupil expense of the previous year and adjusted to account for increases in state aid in the current year.

Beyond the mandatory funding provided by the preceding paragraph, the board of trustees of a charter school is authorized to accept gifts, donations or grants of any kind made to the charter school and to expend or use such gifts, donations or grants in accordance with the conditions prescribed by the donor; provided, however, that no gift, donation or grant may be

accepted if subject to a condition that is contrary to any provision, law or term of the charter.

Act C also creates a special fund to provide additional financing for charter schools from federal appropriations and other gifts, grants, and appropriations.

State A exerts additional control over charter schools through the charter renewal process described in Act C. A renewal application must include: "(a) A report of the progress of the charter school in achieving the educational objectives set forth in the charter. (b) A detailed financial statement that discloses the cost of administration, instruction and other spending categories for the charter school that will allow a comparison of such costs to other schools, both public and private. Such statement shall be in a form prescribed by Board R. (c) Copies of each of the annual reports of the charter school required by subdivision two of section twenty-eight hundred fifty-seven of this article, including the charter school report cards and the certified financial statements. (d) Indications of parent and student satisfaction." Charter schools operating outside the requirements of Act C, the charter, and other law on a day to day basis will likely be exposed through the renewal application process.

Either Entity E or Board R may terminate a charter on one of the following grounds:

(a) When a charter school's outcome on student assessment measures adopted by Board R falls below the level that would allow the commissioner to revoke the registration of another public school, and student achievement on such measures has not shown improvement over the preceding three school years;

(b) Serious violations of law;

(c) Material and substantial violation of the charter, including fiscal mismanagement; or

(d) When the public employment relations board makes a determination that the charter school demonstrates a practice and pattern of egregious and intentional violations of subdivision one of section two hundred nine-a of the civil service

law involving interference with or discrimination against employee rights under article fourteen of the civil service law.

Act C provides for further oversight in the form of required annual reports. Act C states:

Each charter school shall submit to Entity E and to Board R an annual report. Such report shall be issued no later than the first day of August of each year for the preceding school year. The annual report shall be in such form as shall be prescribed by the commissioner and shall include at least the following components:

(a) A charter school report card, which shall include measures of the comparative academic and fiscal performance of the school, as prescribed by the commissioner in regulations adopted for such purpose. Such measures shall include, but not be limited to, graduation rates, dropout rates, performance of students on standardized tests, college entry rates, total spending per pupil and administrative spending per pupil;

(b) Discussion of the progress made towards achievement of the goals set forth in the charter;

(c) A certified financial statement setting forth, by appropriate categories, the revenues and expenditures for the preceding school year, including a copy of the most recent independent fiscal audit of the school.

Section 2854-3(c) of Act C states that employees of a charter school may be deemed employees of a local school district for the purpose of providing retirement benefits, including membership in Plan X and other retirement systems open to employees of public schools. Also, Act C provides that the financial contributions for such benefits shall be the responsibility of the charter school and the school's employees.

Based on the foregoing facts and representations, you request the following rulings:

1. That, under the applicable terms and conditions of Act C, deeming certain employees of a charter school to be employees of the local school district for purposes of providing membership

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in Plan X will not adversely affect Plan X's status as a governmental plan under section 414(d) of the Code.

2. That the applicability of section 414(h)(2) of the Code to Plan X will not be adversely affected by including as members therein employees of a charter school, and that the mandatory contributions of such employees to Plan X which are assumed and paid by the employer will be considered picked-up pursuant to section 414(h)(2) to the same extent such contributions by other members of Plan X are so considered.

Section 414(d) of the Code provides that a governmental plan means a plan established and maintained for its employees by the government of the United States, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

Revenue Ruling 89-49, 1989-1 C.B. 117, provides that a plan will not be considered a governmental plan merely because the sponsoring organization has a relationship with a governmental unit or some quasi-governmental power. It holds that one of the most important factors to be considered in determining whether an organization is an agency or instrumentality of the United States or any state or political subdivision thereof is the degree of control that the state or federal government has over the organization's everyday operations. Other factors listed in Revenue Ruling 89-49 include: (1) whether there is specific legislation creating the organization; (2) the source of funds for the organization; (3) the manner in which the organization's trustees or operating board are selected; and (4) whether the applicable governmental unit considers the employees of the organization to be employees of the applicable governmental unit. Although all of the above factors are considered in determining whether an organization is an agency of a government, the mere satisfaction of one or all of the factors is not necessarily determinative.

Although Act C cannot be characterized as specific legislation in so far as it relates to any particular charter school, it is nevertheless specific in the sense that it is the enabling legislation under which all charter schools in State A are established. Act C was enacted with no other purpose than to specifically provide for the establishment of such schools.

The primary source of funds for a charter school is State A. Act C provides that the local school district must pay directly

to the charter school its per pupil operating expense for each student enrolled in the chartered school who resides in the school district. A charter school may receive gifts, donations or grants of any kind, but the mandatory funding will come from a local school district.

Although a charter school's board of directors is not directly appointed by State A or the local school administrative unit, the local board of education, Trustees T of University U, a state instrumentality, and Board R, a state instrumentality, exercise a significant degree of control over the make up and performance of charter school employees through reviewing complaints against a charter school, the granting or denial of charters and the auditing, and reporting requirements imposed on each charter school. In general, teachers employed by a charter school shall be certified in accordance with the requirements applicable to other public schools.

Charter schools are required to perform the same public educational purpose as any public school. As noted in Act C, "a charter school shall design its educational programs to meet or exceed the student performance standards adopted by Board R and the student performances standards contained in the charter."

The application for a charter school can be denied by a local board of education, Board R, or Trustees T of University U. Both Board R and University U are governmental instrumentalities. Even after a charter school's application is approved, it must submit annually a report that includes the measures of the comparative academic and fiscal performances of the school. Board R can investigate a charter school for any violations. Entity E, including Board R, can take what remedial action it deems necessary, including the revocation of a school's charter.

Thus, the local board of education, Board R, and Trustees T control charter schools through approving their charters and terminating them under certain circumstances.

For purposes not related to Plan X participation, Act C provides that an employee of a charter school shall be an employee of the education corporation formed to operate the charter school. However, for purposes of providing retirement benefits, including participation in Plan X, Act C specifically provides that employees of charter schools are deemed to be employees of the local school district and shall participate in Plan X in the same manner as other public school employees. The

local school district is a governmental unit and its employees are eligible to participate in Plan X. Act C by its terms deems employees of a charter school that is established and organized pursuant to the terms and conditions of Act C to be employees of the local school district, a governmental unit, for purposes of participation in Plan X. Such employees are therefore deemed employees of a governmental unit and can participate in Plan X, a governmental plan, in the same manner as other public school employees without adversely affecting Plan X's status as a governmental plan under section 414(d).

Accordingly, with respect to ruling request one, we conclude that under the applicable terms and conditions of Act C, deeming certain employees of a charter school to be employees of the local school district for the purpose of providing membership in Plan X will not adversely affect Plan X's status as a governmental plan under section 414(d) of the Code.

Section 414(h)(2) of the Code provides that contributions, otherwise designated as employee contributions, shall be treated as employer contributions if such contributions are made to a plan described in section 401(a), established by a state government or a political subdivision thereof, and are picked up by the employing unit.

You represent that Plan X includes a mandatory employee contribution feature. You also represent that each participating employer picks up the member's contributions required to be made to Plan X in a manner consistent with section 414(h) of the Code. In ruling request one, we concluded that deeming employees of a charter school established pursuant to the terms and conditions of Act C to be employees of the local school districts for purposes of establishing membership in Plan X would not adversely affect Plan X's status under section 414(d). We further conclude with respect to ruling request two that as members of Plan X, mandatory contributions of charter school employees made to Plan X which are assumed and paid by the participating employer will be considered picked-up pursuant to section 414(h) to the same extent such contributions by other members of Plan X are so considered, provided the pick-up arrangement of Plan X meets the requirements of section 414(h).

In view of the foregoing, we conclude that participation of employees of a charter school established pursuant to the terms and conditions of Act C will not adversely affect Plan X's status as a governmental plan within the meaning of section 414(d) of

the Code. No opinion is expressed as to the federal tax consequences of the transaction described above under any other provisions of the Code. Additionally, no opinion is expressed as to whether the pick-up arrangement of Plan X meets the requirements of section 414(h)(2).

These rulings are based on the assumption that Plan X meets the requirements for plan qualification under sections 401(a) and 414(d) of the Code. These rulings are further based on the assumption that mandatory employee contributions picked-up by the participating employers of Plan X meet the requirements of section 414(h)(2) of the Code.

These rulings are directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

In accordance with a power of attorney on file in this office, a copy of this ruling is being sent to your authorized representative.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Group 2
Tax Exempt and Government
Entities Division

Enclosures:
Deleted Copy of this Letter
Notice of Intention to Disclose

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