May 11, 2015

***Via Electronic Submission, notice.comments@irscounsel.treas.gov (Notice 2015-07)***

***Via U.S. Mail***

CC:PA:LPD:PR (Notice 2015-07)
Room 5203
Internal Revenue Service
Post Office Box 7604
Ben Franklin Station
Washington, DC 20044

On behalf of the above-listed national public sector associations representing state and local government plans and sponsors we are writing in response to Notice 2015-07.

## PROCESS

First, we appreciate the process the Internal Revenue Service ("IRS") and the Department of Treasury ("Treasury") decided to use to define a "governmental plan." The outcomes of this process will potentially affect many individuals and employers. We think the deliberative nature of the project will lead to the best possible compliance results when final regulations are ultimately issued. We realize there are many state and local differences in charter school programs, and we are not attempting to make comments on all substantive areas of the proposals.

In addition, in this letter we will not be commenting on the appropriateness of different charter school structures or the relationship between traditional public schools and charter holders. Our members span the fifty states – and thus have many different charter structures that reflect decisions made by state legislatures and city governing bodies. Instead we will be focusing primarily on a few areas we believe could be clarified, certain possible transition rules, and possible "grandfathering" rules.

## REQUESTS FOR CLARIFICATION

### A. Section III.A.(e)

Section III.A. of Notice 2015-07 provides five fundamental requirements for a charter school. We think the one that is creating the most questions in our memberships is subsection (e). That subsection provides:

> (e) All financial interests of ownership in the entity are held by a State, political subdivision of a State, or agency or instrumentality of a State or of a political subdivision of a State. A State, political subdivision of a State, or agency or instrumentality of a State or political subdivision of a State is not treated as holding all financial ownership interests in an entity unless, upon dissolution or final liquidation of the entity, the entity's governing documents require the entity's net assets to be distributed to another public school that meets the requirements in (a) through (e) of this section III.A or to a State, political subdivision of a State, or agency or instrumentality thereof.

The financial ownership in a charter school entity can be constructed different ways, and potentially even many ways. One example is when a governmental entity (e.g., a City) awards a charter to a not-for-profit or a for-profit entity. That entity may be allowed the use (often via a lease or MOU) of an existing public school building owned by the City or by a public school corporation/district. The

furniture in that building owned by the City or a public school corporation/district may also be leased or covered by the MOU. In other cases, the charter holder may purchase a building and use it for the charter school.

We think there are not-for-profit rules under Internal Revenue Code that should be considered as an additional approach to meeting (e). For example, assume the charter holder is a not-for-profit entity who purchased a building (whether on land owned by the City or another entity, e.g., that charter school holder). Internal Revenue Code 501(c)(3) would require assets at dissolution of the not-for-profit to continue to be dedicated to an exempt purpose. Treas. Reg. § 1.501(c)(3)-1(a)(4) provides:

> An organization's assets will be considered dedicated to an exempt purpose, for example, if upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which was created to provide that its assets would, upon dissolution, be distributed to its members or shareholders.

This presents a broader range of possibilities for satisfying (e) above. It seems that if (e) could be broadened to include these additional approaches as an alternative it would be consistent and familiar in the not-for-profit community. The clarifying change would be to add as an alternative way of satisfying (e) the following:

> Distributed for one or more exempt purposes, or to a state or local government for a public purpose, or in such manner as in the judgment of a court will best accomplish the general purposes for which the dissolved organization was organized.

**B. Section III.A.(d)(2)(iii)(1)**

Some of our members are concerned that this requirement (one of three under the second way of meeting a "control" test) may raise questions about the "authorized public chartering agency" as defined in 20 U.S.C. §7221i(4). That section defines a charter school (in part) as a public school that has a "written performance contract with the authorized public chartering agency in the State . . .." See 20 U.S.C. §7221i(1)(L). The term "authorized public chartering agency" means a "State educational agency, local educational agency, or other public entity that has the authority pursuant to State law and approved by the Secretary to authorize or approve a charter school." See U.S.C. §7221i(4). Some states allow non-profit and for-profit entities to seek approval from the state to be a charter school "authorizer," whereby they may subsequently submit to the state an affidavit to charter a school. The state approves which entities may become an authorizer and the state must approve the affidavit submitted by the authorizer to charter a school. However, the entity authorized to submit an affidavit to the state to charter a school is not required to be a public entity. Could the section have an additional provision, i.e., "an agency as defined in 20 U.S.C. § 7221i(1)(L), or an entity approved by a state?"

## COMMENTS ON TRANSITION RULES

The ANPRN noted that "[g]enerally, amendment of a state or local retirement plan requires enactment of State legislation." The Department of Treasury and IRS intends to take into consideration the time required to complete the State legislature process when determining an effective date for these regulations." Notice 2015-07 reiterates the expectation that final regulations will apply prospectively and will include a delayed effective date. This delay will need to be similar to those used recently. For example, IRS Notice 2012-29 uses an effective date that is "the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is three months after the final regulations are published."

We believe this approach would be necessary to implement the final regulations changes and would need to accommodate both the plans primarily or solely contained in state statutory provisions, as well as those plans that are primarily or solely contained in city ordinances. We think a broader reference to state legislative action and local government law action would be helpful to clearly cover both the state statutory plans and the local ordinance plans.

## COMMENTS ON GRANDFATHER TREATMENT

In our earlier comment letter dated June 14, 2012, we noted that

> When the regulations are final, it will be very important for the regulations to provide grandfather treatment for certain entities and their employees who are participants in governmental plans, where the entities do not meet the standards in the final regulations. State and local governments should be permitted to extend grandfather treatment to current and/or future employees of the entity, as they deem fit. In this regard, we would suggest that the following entities be grandfathered such that they can continue to establish and maintain and/or participate in a governmental plan to the extent provided by state or local law:
>
> > An entity with a favorable private letter ruling under Rev. Rul. 89-49 or Rev. Rul. 57-128.
> >
> > An entity that is participating in the governmental plan pursuant to the specific terms of state or local law as of the effective date of the final regulations.
> >
> > With regard to a multiple employer plan, an entity that is participating in the plan as of the effective date of the final regulations, pursuant to a procedure provided for in the plan document. This would cover the situation where the plan document allows nonprofit instrumentalities to participate in a plan subject to approval by the plan's governing body. This grandfather would apply if the plan's governing body had followed a good faith, reasonable interpretation of IRC Section 414(d).
>
> The entity would be treated as a governmental employer for all purposes of the plan and plan qualification, and the employees of any entity that was grandfathered would be treated for all purposes as permissible

> participants in a governmental plan. For example, this would mean that the grandfathered entity would be allowed to have a pick-up plan and that contributions and benefits would be subject to the special rules applicable to governmental plans. In the case of a multiple employer plan, all participating employers, including grandfathered employers, would be governed by the terms of the plan.

We continue to think that grandfathering rules are needed for both employers and employees. For example, charter school employees who were members in a governmental plan on the effective date of the final regulation should be allowed to remain in the plan so long as they were employed by that charter school. Charter schools who were participating employers in a governmental plan on the effective date of the final regulations would be allowed to remain in the plan so long as they remained a charter school. We also think the charter school grandfathering in Notice 2015-07, Section IV.A. is very appropriate. In addition to the specific charter school provisions described in that section, we think that charter schools should also be included in any broader transition relief, as described in Notice 2015-07, Section IV.B.

## ADDITIONAL COMMENT

As part of this process, a timely robust ruling process will be necessary. Across the nation there will be charter schools with varied characteristics. There will undoubtedly be new charter school entities created which will need a workable and available process to secure appropriate rulings with regard to their specific situation. Additionally, should a plan include a charter school that is later determined not to be eligible to be in a government plan, and it is not grandfathered, there should be provisions to allow the removal of the school and its employees without jeopardizing in any way the larger plan of which the school was a member.

If you have any questions, please do not hesitate to contact the following representatives of our organizations:

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