

**CALIFORNIA CHARTER SCHOOL ELIGIBILITY MEMO  
EMPLOYEE RETENTION CREDIT – GOVERNMENT INSTRUMENTALITY QUESTION**

Below is a summary analysis of whether a California charter school (“School”) should be considered a “government instrumentality” for purposes of its eligibility to file and successfully receive Employee Retention Credit (“ERC”) refund claims. Note that this analysis is based on the premise that the School had fewer than 500 full-time employees in calendar year 2019.

**Short Answer**

Based on available IRS definitions and certain prior guidance, a School should not be considered a “government instrumentality” for purposes of the ERC. Assuming a School can demonstrate it meets the eligibility requirement of having experienced a “partial suspension”<sup>1</sup>, it should have a reasonable reporting position to file a claim for ERC refund.

**ERC Regulatory Background**

The ERC is a refundable tax credit created as part of the CARES Act. The ERC is available to both for-profit and tax-exempt employers that experienced either:

- 1) fully or partially suspended operations due to federal, state or local governmental orders or proclamations limiting commerce, travel, or group meetings due to COVID-19; or
- 2) a significant decline in gross receipts during the calendar quarter.

The ERC is available to eligible employers for qualifying wages paid during the periods March 13, 2020 – September 30, 2021. IRS rules state that a state or local government instrumentality is not an eligible employer for purposes of the ERC.<sup>2</sup> The question of which organizations may be considered a government instrumentality is answered on a case-by-case basis and determined according to a six-factor analysis.<sup>2</sup> No one factor is determinative; government instrumentality status is based on the totality of the circumstances.<sup>3</sup>

**School Analysis**

The IRS has not released specific guidance regarding whether a School is considered a government instrumentality for purposes of ERC eligibility. The IRS has, however, previously examined whether a charter school was considered a government instrumentality for purposes of liability for payroll taxes on payments made to its employees.<sup>4</sup> In that matter, the charter school was an entity exempt from federal income tax under IRS Code Section 501(c)(3), chartered pursuant to the authority of State<sup>5</sup> statute, independently run as a nonprofit corporation with an independent Governing Board, and operationally and financially autonomous from the State (*i.e.*, the State exercised no meaningful control over either its day-

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<sup>1</sup> IRS Notice 2021-20 at Section B.

<sup>2</sup> See IRS Notice 2021-20 at Question 2 (adopting the six-factor analysis from Rev. Rul. 57-128, 1957-1 C.B. 311). The six factors taken into consideration are: (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.

<sup>3</sup> *Id.*

<sup>4</sup> CCA 201519027 (05/8/2015). This case is of particular interest given that it deals with the imposition and collection of payroll tax, which is a foundational element of the ERC’s purpose and administration. An IRS Chief Counsel Memo may not be used or cited as precedent, however these memos contain legal analyses of substantive issues and can be helpful in understanding the reasoning behind a particular ruling and the IRS’ response to similar issues in the future. See, IRM § 4.10.7.2.10.

<sup>5</sup> Note: CCA 201519027 does not indicate the state in which the charter school subject to the memo was chartered. The history of the matter indicates that the request originated as the state’s attorney general concluded that charter schools in that state were governmental entities under that state’s law. The IRS overturned that conclusion in its memo, noting that distinctions exist between the statutory obligations of charter schools and district schools; given the six-factor analysis required in making a determination. As the ERC is a federal tax matter, it should follow that regardless of any state’s opinion of whether a charter school serves a governmental function, the IRS guidance in this matter indicates charter schools should not be considered government instrumentalities, provided the schools’ facts and circumstances align with the stated six-factor analysis.

to-day operations or its budget).<sup>6</sup> Utilizing the aforementioned six-factor analysis, the IRS concluded that the charter school in that case was not a government instrumentality.<sup>7</sup>

Though circumstances for each School would need to be scrutinized according to these six-factors as a matter of federal tax law, generally the legal requirements of Schools as enshrined in California Education Code (“CEC”) appear to closely parallel those facts as presented in the aforementioned case.<sup>8</sup> CEC states that it is the intent of the California Legislature that charter schools operate independently from the existing school district structure as a method to improve pupil learning, provide parents and pupils with expanded choices, provide vigorous competition within the public school system and encourage the use of different and innovative teaching methods, and create new professional opportunities for teachers, including the opportunity to be responsible for the learning program at the school site.<sup>9</sup>

Furthermore, a “charter school may elect to operate as, or be operated by, a non-profit public benefit corporation”.<sup>10</sup> Nonprofit corporations operating charter schools in California are subject to the laws governing nonprofit corporations in the California Corporations Code and all charter school laws.<sup>11</sup> A charter is “issued by a chartering authority,” but real and substantial authority over the operation of the school, educational decisions, and staff must be retained by the School’s board of directors. For example, “the charter school’s governing board is responsible for developing policies and procedures to address the proper maintenance of student records”.<sup>12</sup> Significantly, “a chartering authority that grants a charter to a charter school to be operated as or by a nonprofit public benefit corporation is not liable for the debts or obligations of the charter school or for claims arising from the performance of acts, errors, or omissions by the charter school”.<sup>13</sup>

### **Conclusion**

Based on the similarity of a School’s legal requirements with those circumstances found dispositive in the aforementioned IRS decision, a School should not be considered to be a government instrumentality for purposes of the ERC. Assuming it can meet other eligibility requirements, a School has a reasonable reporting position to file ERC refund claims.

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<sup>6</sup> CCA 201519027 (05/8/2015).

<sup>7</sup> *Id.*

<sup>8</sup> As noted by the CCA, state law is not relevant to the IRS’ determination of “instrumentality.” We note the CEC here to demonstrate that adherence to CEC’s black letter law is further persuasive that a School would not be considered an “instrumentality” given the similar language to the six-factor test.

<sup>9</sup> CEC §§ 47601.

<sup>10</sup> CEC §§ 47604(a).

<sup>11</sup> Charter School FAQ Section 3, California Department of Education, <https://www.cde.ca.gov/sp/ch/qandasec3.asp>.

<sup>12</sup> CEC §§ 47605(c)(5).

<sup>13</sup> CEC §§ 47604(d).