No Respect!



How 115s are Overlooked in Federal Laws and Regulations

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Many state leagues are Section 115 organizations, which requires the leagues to have income be derived from the exercise of an "essential government function" or that the income accrue to the benefit of a governmental unit. Some 115 organizations also have tax exemptions under Section 501(c)(3) of the Internal Revenue Code, but many state leagues do not go down this path, meaning the state league is wholly reliant on the tax protections provided by Section 115 of the Internal Revenue Code.

Unfortunately, the federal government tends to forget about Section 115 organizations when setting forth laws and regulations governing non-profit organizations. This paper will analyze three different pressing issues as it relates to Section 115 organizations and how to navigate the lack of acknowledgement in federal laws and regulations.

Student Loan Forgiveness

The past few years have been challenging for a large variety of reasons. Among the challenges, many employers have had issues attracting and retaining employees, so any available advantage has been sought to achieve success in the employee recruitment and retention arenas. State leagues which are Section 115 organization have been no strangers to these issues in recent years and many have explored whether or not their employees or prospective employees would qualify for student loan forgiveness.

As to whether or not a state league which is a Section 115 organization can successfully navigate the student loan forgiveness waters, the analysis turns on two potential paths: whether the Section 115 organization can fit into a government box or whether the Section 115 organization can fit into the non-profit box.

The IRS has a searchable database of tax-exempt organizations but such database only appears to list organization which have filed an informational tax return on Form 990. (*See*: https://apps.irs.gov/app/eos/allSearch; accessed October 3, 2022). Since Section 115 organizations are not required to file a Form 990 if they are not also a Section 501(c), this

database does not appear to capture many (if any) state leagues. Treas. Reg. §1.6033-2(g)(v).

In order to participate in the Public Service Loan Forgiveness Program (PSLF) individuals must "enter and continue in full-time public service employment." 34 C.F.R. § 685.219(a). Under the Code of Federal Regulations an employee is defined as "an individual who is hired and pay by a public service organization." 34 C.F.R. § 685.219(b). A government employee "means an individual who is employed by a local, State, Federal, or Tribal government, but does not include a member of the U.S. Congress." Id.

The definition of public service organization has three relevant subparagraphs: Subparagraph (i) includes a "Federal, State, local, or Tribal government organization, agency, or entity;" Subparagraph (iii) includes a "non-profit organization under section 501(c)(3) of the Internal Revenue Code that is exempt from taxation under section 501(a) of the Internal Revenue Code;" and subparagraph (v)(A) includes a "private organization that provides the following public services: Emergency management, military service, public safety, law enforcement, public interest law services, early childhood education (including licensed or regulated child care, Head Start, and State funded pre-kindergarten), public service for individuals with disabilities and the elderly, public health (including nurses, nurse practitioners, nurses in a clinical setting, and full-time professionals engaged in health care practitioner occupations and health care support occupations, as such terms are defined by the Bureau of Labor Statistics), public education, public library services, school library or other school-based services." Id.

Starting with the possibility of a Section 115 organization to utilize it's non-profit status as a means to take part in the PSLF, there are some significant hurdles. First, if the Section 115 organization is not also a non-profit organization under section 501(c)(3) of the IRC then the plain language of the federal regulation would prevent the Section 115 organization from being categorized as a public service organization under this particular

subparagraph. The question would then turn to whether the Section 115 organization provides any of the public services listed under subparagraph (v)(A) and, unfortunately, it would be pretty unlikely that a state league is providing any of those services.

With the likelihood that a state league operating as a Section 115 organization being able to successfully navigate the non-profit waters to take part in the PSLF being thin, we must turn our gaze to the actual nature of Section 115 organizations being the employers of actual government employees under the definition of "government employee" or falls under subparagraph (i) under the "public service organization" definition as a "Federal, State, local, or Tribal government organization, agency, or entity."

First, a "public service organization" which includes local organizations, agencies, or entities seems like a promising route for borrowers to seek eligibility for student loan forgiveness under the framework of the federal regulations. However, in order to fully determine whether this path is a viable option for Section 115 local government leagues, we need to analyze whether there is any guidance as to whether such leagues fall within such definition.

According to rules promulgated by the Department of Education, the "term "public service organization" would be derived largely from the statutory definition of "public service job," but is clarified to include certain non-profit organizations that are not qualified under 501(c)(3) of the IRC, but that meet the other statutory requirements and qualify as public service employers under the [Higher Education Act]." Federal Perkins Loan Program, Federal Family Education Loan Program, and William D. Ford Federal Direct Loan Program, 73 FR 37694-01.

For its part, the Higher Education Act defines "public service job" as either:

> (i) a full-time job in emergency management, government (excluding time served as a member of Congress), military service, public safety, law

> enforcement, public health (including nurses, nurse practitioners, nurses in a clinical setting, and full-time professionals engaged in health care practitioner occupations and health care support occupations, as such terms are defined by the Bureau of Labor Statistics), public education, social work in a public child or family service agency, public interest law services (including prosecution or public defense or legal advocacy on behalf of low-income communities at a nonprofit organization), early childhood education (including licensed or regulated childcare, Head Start, and State funded prekindergarten), public service for individuals with disabilities, public service for the elderly, public library sciences, school-based library sciences and other school-based services, or at an organization that is described in section 501(c)(3) of Title 26 and exempt from taxation under section 501(a) of such title; or
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> (ii) teaching as a full-time faculty member at a Tribal College or University as defined in section 1059c(b) of this title and other faculty teaching in high-needs subject areas or areas of shortage (including nurse faculty, foreign language faculty, and part-time faculty at community colleges), as determined by the Secretary.

20 U.S.C.A. § 1087e.

While this is a seemingly broad definition, it is almost entirely circular because it really just takes Section 115 organizations back to whether or not they can qualify as a government. The definition of "public service job" in the "regulations have serious deficiencies. First, the regulations improperly define a public service job in a manner that is inconsistent with the statute by imposing a "public service organization" employer requirement that is not in the statute. This requirement works to disqualify some statutorily-listed forms of public service employment from debt forgiveness eligibility, in particular

public services employment provided on behalf of for-profit businesses or certain non-profit employers, and also improperly allows eligibility for debt forgiveness for some employees of private non-profit employers who are not employed to provide a qualifying public service. Second, the regulations fail to clarify vague statutory language regarding what constitutes "public" service, most importantly regarding the scope of "public interest law services." Gregory Crespi, The Public Service Loan Forgiveness Program: The Need for Better Employment Eligibility Regulations, 66 Buff. L. Rev. 819, 819–20 (2018).

The same law review asked the pressing question we are still asking today: "How broadly is "government" to be defined? For example, does "government" include not only federal, state, and local governments but also domestic intergovernmental or public regional agencies, and/or quasi-public local organizations supported in part by public funding, or only direct government employees? Does "government" also include foreign governments and/or international intergovernmental organizations?" Id at 824.

This is where the federal rule departs from what seems like the clear intent of the legislature. The Public Service Loan Forgiveness regulatory framework separately recognizes governments, section 501(c)(3) non-profits, and private organizations providing an enumerated list of public services. *See* 34 C.F.R. § 685.219. The federal regulations also specifically exclude businesses "organized for profit, a labor union[s], or a partisan political organization[s]." Id.

These same federal regulations define "government employee" as "an individual who is employed by a local, State, Federal, or Tribal government, but does not include a member of the U.S. Congress." Id. Clearly, the federal regulations just do not contemplate Section 115 organizations in any sort of clear manner. To quote Rodney Dangerfield: "No respect!"

Because of this complete disregard to even acknowledge Section 115 organizations we must go back to the start and take a look at the foundational statutory language for such

organizations. The federal code states that "gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a State or any political subdivision thereof, or the District of Columbia." 26 U.S.C.A. § 115.

Many Section 115 organizations have a letter from the IRS which denotes that such organization performs certain essential governmental functions which would otherwise be undertaken by a member local government itself and that the Section 115 organization merely streamlines such functions to reduce expenses. In determining if an entity is an "instrumentality" of a governmental unit the following factors are analyzed: "(1) whether it is used for a governmental purpose and
performs a governmental function; (2) whether it performs its function on behalf of one or more states or political subdivisions; (3) whether private interests are involved, or whether states or political subdivisions have the powers and interests of an owner; (4) whether control and supervision of the organization is vested in public authority or authorities; (5) whether express or implied statutory or other authority is needed to create and/or use the entity; and (6) the degree of the organization's financial autonomy and the source of its operating expenses." Rev. Rul. 57-128, 1957-1 C.B. 311.

Because Section 115 organizations are instrumentalities of local governments there is a strong argument to be made that such organizations should fall within the category of a government for purposes of the PSLF program. The IRS itself notes that a "wholly-owned instrumentality of one or more states or political subdivisions is treated as a state or local government employer for purposes of the mandatory social security and Medicare provisions." *See* https://www.irs.gov/government-entities/federal-state-local-governments/government-entities-and-their-federal-tax-obligations#:~:text=Indian%20Tribal%20Governments.-,Instrumentalities,authority%2C%20taxation%20and%20eminent%20domain. (Accessed, October 17, 2022).

The challenge, of course, is that the Higher Education Act itself does not reference instrumentalities. What is more challenging is that during the 2019-2020 Congressional session, Senate Bill 1203 was introduced to amend the Higher Education Act. Specifically, this legislation would have added a definition of "qualifying employer" which would have read, in part, "a Federal, State, local, or Tribal government organization or instrumentality, including any organization established in law as a body politic." *See* https://www.congress.gov/bill/116th-congress/senate-bill/1203/text?q=%7B%22search%22%3A%5B%22S.+1203%22%5D%7D&r=1&s=1 (Accessed October 17, 2022).

Unfortunately, this clarification, amongst others has yet to make it into law, meaning the statutory and regulatory frameworks currently in place just ignore the existence of Section 115 organizations. At this stage, it may be best for such organizations to specifically reach out to the United States Department of Education to seek clarification as to whether Section 115 organizations can qualify for the PSLF program either as an instrumentality of a government organization or as an organization that provides a qualifying public service. In terms of the latter, many Section 115 organizations provide services such as advocacy, policy development, benefits, and education and training.

In terms of education, "the regulations provide no guidance as to what services would qualify as "public" education services, or whether that "education" must be administered in a school or school-like setting for the employment to qualify." Gregory Crespi, The Public Service Loan Forgiveness Program: The Need for Better Employment Eligibility Regulations, 66 Buff. L. Rev. 819, 841 (2018). Who is the say that the education services we provide to elected officials, appointed officials, and even members of the general public should not count? After all, like much of everything else related to Section 115 organizations, the federal law and regulations are silent to this question, so why not make the argument?

Funding from a Section 115 to a 501(c)(3) and the Public Support Test

In order for a 501(c)(3) to obtain a public charity status it must show that it can reasonably be expected to be publicly supported. A failure to pass the public support test results in the 501(c)(3) having its public charity status revoked and having it reclassified as a private foundation.

IRS Publication 4221-PC provides that the "IRS will monitor a new organization's public charity status after the first five years of existence based on the public support information reported annually by the organization on Schedule A based on a five-year computation period that includes the current year and the four prior years (including short years)." (See: https://www.irs.gov/pub/irs-pdf/p4221pc.pdf at p.10; accessed October 3, 2022). The publication also states that if "a publicly supported charity fails the public support test for two consecutive years, it will be reclassified as a private foundation." Id.

26 C.F.R. § 1.170A-9(f)(4)(v) explicitly states that an "organization "normally" receives the requisite amount of public support and meets the 33 ⅓ percent public support test or the facts and circumstances test during its first five taxable years as a section 501(c)(3) organization if the organization can reasonably be expected to meet the requirements of the 33 ⅓ percent support test or the facts and circumstances test during that period."
It is important to note that the public support test will analyze each year in the five-year window, not just the final year. Particularly, an "organization "normally" receives the requisite amount of public support and meets the 33 ⅓ percent support test for a taxable year and the taxable year immediately succeeding that year, if, for the taxable year being tested and the four taxable years immediately preceding that taxable year, the organization meets the 33 ⅓ percent support test on an aggregate basis." 26 C.F.R. § 1.170A-9(f)(4).

According to the Code of Federal Regulations there are actually two methods to determine whether an organization if publicly supported:

The first method states that an "organization is publicly supported if the total amount of that the organization normally receives from governmental units referred to in section 170(c)(1), from contributions made directly or indirectly by the general public, or from a combination of these sources, equals at least 33 ⅓ percent of the total support normally received by the organization." 26 C.F.R. § 1.170A-9(f)(2).

The second method states in part that "[e]ven if an organization fails to meet the 33 ⅓ percent support test described in paragraph (f)(2) of this section, it is publicly supported if it normally (see paragraph (f)(4)(i) of this section) receives a substantial part of its support from governmental units, from contributions made directly or indirectly by the general public, or from a combination of these sources, and meets the other requirements of this paragraph (f)(3)." 26 C.F.R. § 1.170A-9(f)(3). This method provides that the percentage of support normally received by the organization from governmental units, from the general public, or a combination thereof must be at least 10% of the total support normally received by such organization. This method relies upon an attraction of public support as well.

In analyzing these methods of calculation we must first look at what "total amount of support" means. First, the IRS frowns upon a public charity receiving too much of its support from one source. As a result, the Code of Federal Regulations provides that at least 33.3% of donations must be given by individuals, trusts, or corporations in the period being analyzed "does not exceed two percent of the organization's total support for such period" unless otherwise provided in the CFR. 26 C.F.R. § 1.170A-9(f)(6). This limitation does not apply to support received from governmental units or to contributions from certain organizations which receive a substantial portion of their support from governmental units or the general public under a specific set of guidelines.

Looking further, the “total amount of support” does not include certain amounts received from the exercise or performance by an organization of its purpose or function or contributions for services for which a deduction is not allowable. 26 C.F.R. § 1.170A-9(f)(7). Additionally, the “total amount of support” certainly includes amounts received by governmental units. 26 C.F.R. § 1.170A-9(f)(8).

A governmental unit is defined in the federal code, for these purposes, as a “State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.” 26 U.S.C.A. §170(c)(1).

Furthermore, an IRS revenue ruling from 1965 involved a not-for-profit corporation formed to improve municipal government and promote the general welfare of cities in a state. Rev. Rul. 65-26. In that ruling, the IRS held that the entity was not an instrumentality of that state and that clear government control and oversight was not established. The corporation's board was comprised of governmental officials of various cities, like many state leagues. Also like many leagues, revenues were comprised of membership dues, publications, advertising, and conference income. In the 1965 situation, the corporation was not formed by the state or any political subdivision of the state and the Board independently made decisions -- not as agents of their representative governmental entities. The methods of calculation in the IRC are complicated, but the important takeaway seems to be that a donation from a Section 115 organization does not fall within an exception to the two percent rule, particularly not as a governmental unit.

State and Local Cybersecurity Grant Program

When the federal government enacted the Infrastructure Investment and Jobs Act (IIJA), within such framework Congress established the State and Local Cybersecurity Grant Program (SLCGP). Strangely, the federal statutory framework defines eligible entities as either states or tribal governments, but it also establishes the SLCGP itself. 6 U.S.C.A. § 665g. The statute itself references local governments frequently but does not seem to recognize Section 115 organizations.

On its face, this seems to be yet another instance where the federal law has forgotten about Section 115 organizations. However, when analyzing the FAQ associated with the SLCGP a much more detailed definition emerges: "Local governments are defined in the law as a county, municipality, city, town, township, local public authority, school district, special district, intrastate district, council of governments (regardless of whether the council of governments is incorporated as a nonprofit corporation under State law), regional or interstate government entity, or agency or instrumentality of a local government; an Indian tribe or authorized tribal organization, or in Alaska a Native village or Alaska Regional Native Corporation; and a rural community, unincorporated town or village, or other public entity." *See* https://www.fema.gov/fact-sheet/fiscal-year-2022-state-and-local-cybersecurity-grant-program-faqs (Accessed, October 17, 2022).

This wide-ranging definition seems to include nonprofit corporations such as Section 115 organizations and it seems that such organizations should be able to work with their respective state's Cybersecurity Planning Committee to potentially be grant recipients. Although the overall pot for this federal grant is not large, a minimum of 80% of the state allocations are required to be passed along to local governments. Additionally, 25% of the total funds available for grants must be passed through to rural communities. As we are all aware, smaller communities may struggle to put together any plan, let alone one related to cybersecurity, so the ability of state leagues to potentially assist and get grant funding to

these communities, regardless the of potentially small amount, could be a good model for the future.