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THE CHARTER LAW FIRM

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ATTORNEY/CLIENT PRIVILEGED &
CONFIDENTIAL COMMUNICATION

Joe Schickman
AMERICAN INDIAN MODEL SCHOOLS
171 12th Street
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**Re: Charter School Facility Grant Program (SB 740)
Governance Structure Sequence**

Dear Joe:

It is our understanding that American Indian Model Schools (“AIMS”) desires to obtain funding from the Charter School Facility Grant Program (“CSFGP” or “SB 740”) for the lease of a school facility. As such, AIMS is considering the appropriate method of holding legal title to the property and a school facility with the goal of allowing AIMS to qualify for rent reimbursement pursuant to CSFGP.

Charter School Facility Grant Program

The CSFGP provides that eligible schools are entitled to receive an amount of up to seven hundred fifty dollars (\$750) per unit of average daily attendance, to provide an amount of up to, but not more than, seventy-five (75) percent of the annual facilities rent and lease costs for the charter school. (Ed. Code §47614.5.) The term “eligible charter school” includes:

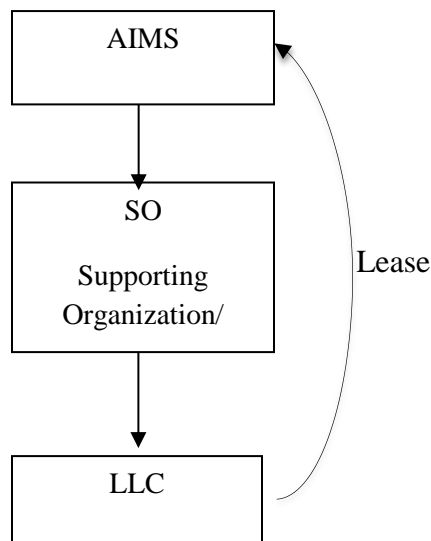
(A) The charter schoolsite is physically located in the attendance area of a public elementary school in which 55 percent or more of the pupil enrollment is eligible for free or reduced-price meals and the charter schoolsite gives a preference in admissions to pupils who are currently enrolled in that public elementary school and to pupils who reside in the elementary school attendance area where the charter schoolsite is located.

(B) Fifty-five percent or more of the pupil enrollment at the charter schoolsite is eligible for free or reduced-price meals.

The California Code of Regulations, Title 4, section 10170.4. provides that CSFGP funds may be applied toward a Charter School’s facilities rent or lease costs, including costs associated with facility rents or leases as evidenced by an executed rental or lease agreement, consistent with generally accepted accounting standards for accounting for rent or lease costs, for Charter School facilities. CSFGP funds may not be claimed for any average daily attendance generated by non-classroom based instruction. (Ed. Code §47614.5(e)(1).) Any portion of a lease payment attributable to the purchase of a facility is not an allowable cost under the CSFGP.

Corporate Structure Sequence

As noted, payments towards the purchase of a facility are not allowable costs under the CSFGP. As such, AIMS cannot hold title to property directly and receive SB 740 funding for its mortgage payments. However, if AIMS leases a school facility from another legal entity it can apply for reimbursement of these lease payments, subject to the dollar and percentage limits defined in Education Code section 47614.5. To achieve this result, an IRC 501(c)(3), 509(a)(3) supporting organization (“SO”) would be created and would serve as the single member/manager of a Limited Liability Company (“LLC”) that would purchase the new facility. AIMS would lease the new school buildings from the LLC. The following is a chart of the proposed governance structure:



As further noted below, AIMS will be able to indirectly control the SO who will be able to directly control the LLC; while AIMS will not own the buildings it will ensure that the buildings are dedicated to the use of AIMS.



Corporate Entities:

Supporting Organization

As a supporting organization, AIMS would control the SO by its power to nominate, appoint, and remove the Board of Directors of the SO. The purpose of the SO will be “to operate exclusively for the benefit of, to perform the functions of, or to carry out the purposes of American Indian Model Schools.”

Please note that while we don’t anticipate that the SO will create any liabilities in its operation, the control that AIMS has over the SO could result in liability to AIMS if the appropriate corporate formalities are not followed by AIMS. The alter-ego doctrine is equitable in nature and is applied when it is determined that a corporation has come under the control of a person to further his or her own interests. In applying the alter-ego doctrine courts will determine whether there is such unity of interest and ownership that the separate personalities of the entities no longer exist. (*Automotriz del Golfo de Cal. v. Resnick* (1957) 47 Cal.2d 792, 796) As such, in an effort to reduce the potential for the applicability of the alter-ego doctrine, the SO should follow the requisite corporate formalities, such as holding regular board meetings and maintaining adequate corporate records and the separate existence of SO should be respected by AIMS to the greatest extent possible.

In addition to serving as the single member/manager of the LLC (a separate legal entity from the SO and AIMS), the SO could also serve as a fundraising arm of AIMS. If substantial fundraising will be conducted it is recommended that this be done through a separate SO to protect these assets from the liability of AIMS. Many charter schools and their granting agencies experience misunderstandings as to which entity owns the assets purchased by the charter school. In those cases where a charter school has been closed, the charter granting agency often argues that it should be given the assets of the charter school. However, if the charter school’s supporting organization has purchased the assets, the assets clearly belong to the supporting organization and not the charter school and are therefore not available to satisfy the debts and obligations of the charter school’s operations. If the charter is revoked or non-renewed, the assets are insulated from the liabilities of the charter school.

The following must be done to create and obtain recognition of tax-exemption for the SO:

- 1) Articles of Incorporation must be prepared and filed with the California Secretary of State (“SOS”). The Secretary of State charges a \$30.00 filing fee and a \$15.00 counter fee for documents filed in person. The SOS takes approximately two weeks to process Articles of Incorporation filed in person through regular processing. If the Articles of Incorporation must be filed sooner than two weeks, the Articles of Incorporation can be filed on an expedited basis. The SOS charges a \$350.00 filing fee for processing documents with a 24 hour turnaround time.
- 2) A Statement of Information must be filed within 90 days of incorporation of the SO listing the names of the officers, corporate address and Agent for Service of Process. We



estimate that it will take approximately 30 minutes of legal time to prepare the Statement of Information. The SOS charges a \$20.00 filing fee to file this document. The SO can also prepare and submit this document online.

- 3) Bylaws must be prepared and adopted by the SO. The bylaws for the SO provide that the Board of AIMS has the right to nominate, appoint, and remove (with or without cause) the Board members of the SO and that the bylaws of the SO cannot be amended without the approval of the AIMS Board.
- 4) AIMS will appoint the initial Board members; the Board must hold an initial meeting and adopt bylaws, establish a bank account, retain legal counsel and take other initial actions.
- 5) The Form 1023 Application for Recognition of Exemption ("Form 1023") must be prepared and submitted to the Internal Revenue Service ("IRS"). We estimate that it will take between 15-20 hours of legal time to prepare the Form 1023. The IRS charges an \$850.00 filing fee to file the Form 1023.
- 6) The Application for State Tax Exemption ("Form 3500A") must be prepared and submitted to the Franchise Tax Board ("FTB"). We estimate that it will take between 1-3 hours of legal time to prepare the Form 3500A. The FTB does not charge a fee for filing the Form 3500A.

Limited Liability Company

The SO will then create a limited liability company ("LLC") and will serve as the single member/manager of a LLC (essentially owner/manager). As the single member/manager of the LLC, the SO will manage the business and affairs of the LLC. The following must be done to create the LLC:

- 1) Articles of Organization must be prepared and filed with the SOS. We estimate that it will take between 1-3 hours of legal time to prepare the Articles of Organization. The Secretary of State charges a \$70.00 filing fee and a \$15.00 counter fee for documents filed in person. The SOS takes approximately two weeks to process Articles of Organization filed in person through regular processing. If the Articles of Organization must be filed sooner than two weeks, the Articles of Organization can be filed on an expedited AIMS. The SOS charges a \$350.00 filing fee for processing documents with a 24 hour turnaround time.
- 2) A Statement of Information must be filed within 90 days of filing the Articles of Organization listing the names of the CEO, if any, manager, LLC address, Agent for Service of Process and purpose of LLC. We estimate that it will take approximately 30 minutes of legal time to prepare the Statement of Information. The SOS charges a \$20.00 filing fee to file this document.



- 3) An Operating Agreement must be prepared and adopted by the LLC. We estimate that it will take between 5- 10 hours of legal time to prepare the Operating Agreement.

Conclusion

AIMS should carefully consider the creation of a supporting organization and limited liability company as the existence of these legal entities will result in additional legal and administrative burdens. Additionally, if a lender is involved with any facilities purchase the lender will need to approve the type of organization that will be the borrower. To prevent last minute structural changes the proposed corporate structure should be presented to the lender for review and approval. Please note that while the proposed corporate model is intended to maximize the ability of AIMS to obtain CSFGP funding, this model has not been closely scrutinized by the California School Finance Authority, the entity that is responsible for administering SB740. Additionally, we strongly recommend that you consult with a tax attorney to discuss the potential tax consequences of any proposed corporate structure.

I hope this discussion adequately addresses your concerns. If you should have any further questions regarding this matter, please feel free to contact me at (916) 646-1400.

Sincerely,

**LAW OFFICES OF
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Kimberly Rodriguez
ATTORNEY AT LAW

