



HENRY McMASTER
ATTORNEY GENERAL

November 12, 2009

The Honorable David L. Thomas
Member, South Carolina Senate
23 Wade Hampton Blvd.
Greenville, South Carolina 29609

Dear Senator Thomas:

We received your letter requesting an opinion of this Office as to whether one-percent money can be used by local fire departments to fund participant directed 401(a) or 457 retirement plans.

Law/Analysis

Article 3 of chapter 9 of title 23 of the South Carolina Code (2007) establishes the Fireman's Insurance and Inspection Fund, which is funded by one percent tax levied on fire insurance premiums issued by fire insurers doing business in South Carolina. Pursuant to section 23-9-410 of the South Carolina Code (2007), the State Treasurer is then required to allocate this "one percent money," as you refer to it in your letter, to county treasurers in accordance with the premiums collected in that county. The county treasurers are then required to distribute these funds to the trustees of the local fire departments designated to receive such benefits. S.C. Code Ann. § 23-9-420 (2007).

As you mentioned in your letter, the provisions under article 3 place restrictions on how one percent money may be used. Section 23-9-410 states: "All monies so collected must be set apart and equitably used by each of the treasurers solely and entirely for the betterment and maintenance of skilled and efficient fire departments within the county." In addition, section 23-9-450 of the South Carolina Code (2007) requires written approval from the State Fireman's Association before funds are disbursed and the Fireman's Association is to ensure that "funds are being expended solely for the benefit of the firemen of each particular fire department in the State." Moreover, section 23-9-460 of the South Carolina Code (2007) provides as follows:

No funds of firemen's insurance and inspection fund may be divided among the firemen of any fire department in cash. When any fire department by a majority provides for the expenditure of any funds for the collective benefit and enjoyment of the entire department, it is mandatory for the local trustees and the state trustees of the South

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Carolina State Firemen's Association to approve the expenditure. None of the funds may be expended in any manner for any purpose for which any city, town, unincorporated community, or county may be legally liable.

In your letter, you informed us that the South Carolina Fireman's Association ("SCFA") established two retirement plan programs that local fire departments may participate in, one for paid firefighters and one for volunteer firefighters. The SCFA approved the use of the one percent money to make contributions to these plans. You state that although these plans are available, member fire departments are not required to participate in them and may establish their own retirement plans. In your letter, you informed us that "[r]ecently, several fire departments have requested that SCFA Trustees approve (a) the transfer of existing SCFA retirement plan funds which originated with one percent money and (b) future one percent money contributions to such fire department's newly created retirement plan which allows an individual firefighter to direct how and where his or her contributions from one percent money are invested." Accordingly, you are requesting an opinion "as to whether one percent money contributed into a retirement plan which allows a firefighter participant to individually direct his or her account is in violation of South Carolina law."

With your letter, you enclosed a copy of an opinion by a South Carolina attorney addressed to SCFA's Executive Director. This opinion addressed whether or not "contributions to a South Carolina fire department's retirement plan which allows an individual participant to self direct the investment of his or her account balance violates the restrictions imposed on the expenditure of 'one percent monies.'" This opinion states:

If a fire department retirement plan provides that an individual firefighter may direct how his or her account balance is invested and has the option to change such direction frequently, such provision is a factor of constructive receipt of the account balance and is not consistent with the collective benefit rule. Under the SCFA plans, all investment decisions are made by an investment firm approved by the trustees, and not by an individual firefighter. However, investment directions can be made by a fire department as a department, but not individually. We feel it is important to avoid individual control.

The opinion advised the SCFA not to approve the use of one percent monies for such plans as this "may be in violation of S.C. Code § 23-9-460."

In addition to this opinion, you also included copies of opinions from several retirement plan administrators indicating that allowing the firemen to self direct their investments does not constitute constructive receipt of the funds in the account and does not violate South Carolina law. These opinions cite two IRS regulations for support. Treasury regulation section 1.451-2 explains the

constructive receipt doctrine and addresses what year deferred compensation received by an employee should be included in income. This provision states in pertinent part:

(a) General rule. Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. Thus, if a corporation credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt. In the case of interest, dividends, or other earnings (whether or not credited) payable in respect of any deposit or account in a bank, building and loan association, savings and loan association, or similar institution
.....

Treas. Reg. § 1.451-2 (emphasis added). Because the contributions to the 401(a) and 457 plans are deposited in a trust with substantial limitations and restrictions on their withdrawal, the retirement plan administrators argue the contributions do not constitute the constructive receipt of income to the individual firefighters.

Treasury Regulation section 1.457-7(c) describes when contributions to an eligible plan of a tax-exempt entity are included in the participants gross income. This regulation states as follows:

(c) Amounts included in gross income under an eligible plan of a tax-exempt entity--(1) Amounts included in gross income in year paid or made available under an eligible plan of a tax-exempt entity. Amounts deferred under an eligible plan of a tax-exempt entity are includible in the gross income of a participant or beneficiary for the taxable year in which paid or otherwise made available to the participant or beneficiary under the plan. Thus, amounts deferred under an eligible plan of a tax-exempt entity are includible in the gross income of the participant or beneficiary in the year the amounts are first made available under the terms of the plan, even if the plan has not distributed the amounts deferred. Amounts deferred under an eligible plan of a tax-exempt entity are not considered made available to the participant or beneficiary solely because the participant or beneficiary is permitted to choose among various investments under the plan.

Treas. Reg. § 1-457-7(c) (emphasis added). According to these two regulations, just because a plan participant is allowed to self direct the investment of contributions into a qualified plan, the IRS does not view the participant as constructively receiving those contributions for purposes of including them in the participant's income.

In 1989, this Office issued an opinion addressing whether the proceeds from one percent money could be used to fund a pension plan. Op. S.C. Atty. Gen., March 14, 1989. With regard to pension and retirement plans in general, we stated "[a]ny pension plan or retirement benefit is designed to promote the general welfare of all employees even those who have not yet retired. By their nature, pension plans are designed to promote employee morale and give all employees peace of mind and security." Id.

Section 23-9-410 clearly prohibits the division of funds among the firemen in cash. Our courts have yet to address whether allowing firemen to self direct their investments in a retirement plan is equivalent to those firemen receiving cash. Both 401(a) and 457 plans require that contributions be deposited in a trust, which contains multiple restrictions on the participants' access to the funds. Thus, the guidance provided by the IRS through the regulations cited above certainly indicates from an income tax stand point, being allowed to self direct the investment of deferred compensation does not constitute constructive receipt of funds for income tax purposes. Therefore, we find some support for the proposition that just because plan allows its participants to direct their own investments, it is not tantamount to giving individual participants cash. Moreover, although the pension plan reviewed in our 1989 opinion was likely a defined benefit plan that would not have allowed investments under the plan to be self directed, we believe the reasoning of the opinion could apply to plans with a self directed investment option. Regardless of an individual participant's ability to self direct his or her investments, all of the plan's participants would benefit from the contribution. Thus, until further guidance is provided by our courts, we are inclined to advise that a firefighter's ability to self direct the investment of funds deposited into a 401(a) or a 457 plan would not violate section 23-9-460.

Conclusion

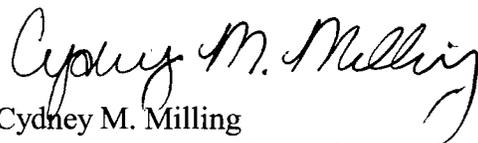
The provisions contained in article 3 of chapter 9 of title 23 clearly require one percent money to be used for the collective benefit and enjoyment of the entire department receiving the funds. Moreover, section 23-9-460 specifically prohibits the department distributing one percent money in cash to individual firefighters. With respect to the 401(a) and 457 plans you describe, we believe these plans, like any retirement plan, would be for the collective benefit of the department. Furthermore, although these plans, unlike the plans established by the SCFA, allow participants to self direct their investments, we do not believe by the fact that participants have the ability to self direct their investments causes the plan to no longer be for the collective benefit of the department. In addition, in accordance with the IRS's guidance on the constructive receipt doctrine, we do not believe the ability to self direct investments constitutes a constructive receipt of the contributions

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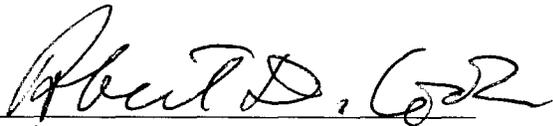
to the plan or is tantamount to receipt of cash by the participant. As such, we are of the opinion the ability to self direct investments does not violate the provisions in article 3 of chapter 9 of title 23.

Very truly yours,

Henry McMaster
Attorney General


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REVIEWED AND APPROVED BY:


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