



HENRY McMASTER
ATTORNEY GENERAL

February 16, 2006

The Honorable Dan Wideman
Sheriff, Greenwood County
528 Edgefield Street
Greenwood, South Carolina 29646

Dear Sheriff Wideman:

We issue this opinion in response to your letter regarding the tax exempt status of volunteer fire departments located in Greenwood County. By way of background, you informed us that due to a reorganization in Greenwood County's homeland security and public safety infrastructure, all emergency services are now part of the Greenwood County Sheriff's Office. Thus, you indicate the volunteer fire departments (the "VFDs"), which receive some county funding, are included in these emergency services. As such, you approve the VFDs' budgets through the Public Safety Division Commander. You indicate in your review of the VFDs' budgets, you

noticed that several of the VFDs plan to use a third party, commercial organization to collect insurance payments attendant to responses to fires. The payments represent a fee paid from an insurance company as reimbursement to the VFD to offset the costs incurred as they respond to fight fires at insured properties. Although partially county-funded, each of our VFDs in Greenwood County operates as a not-for-profit organization pursuant to IRC § 501(c)(3) and the related SC tax statutes.

Based on these facts, you request our opinion, on the following:

1. Does the fact that the insurance fees are designed to offset a portion of the costs incurred while fighting fires at insured properties effect or endanger the not-for-profit status of Greenwood County's VFDs?
2. Would the use of third party, commercial entities to collect the aforementioned fees from insurance companies change the

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status of those funds in any way as to effect or endanger the not-for-profit status of Greenwood County's VFDs"

In addition to your letter, you included a copy of a charter used by one of the Greenwood County VFDs. You indicate all of the VFDs in question have "almost identical documentation."

Law/Analysis

Pursuant to the South Carolina Income Tax Act, South Carolina taxable income is based upon federal taxable income, and except as otherwise provided, the South Carolina Income Tax Act makes all provisions of the federal Internal Revenue Code (the "IRC") applicable to South Carolina for state tax purposes. See S.C. Code Ann. § 12-6-10 et seq. (2000 & Supp. 2005). The South Carolina Income Tax Act does not supercede or exclude the provisions of the IRC in determining an organization's tax exempt status. Thus, we must look to the IRC, for both federal and state tax law purposes, in our analysis of your questions as presented above.

As a preliminary matter, because the questions you presented are matters of federal tax law, the federal courts conclusively determine the VFDs' status as tax exempt organizations. Thus, this opinion is advisory only, reflecting our analysis as to what we believe a federal court would conclude. Moreover, we note with respect to issues concerning federal tax law, while we may express an opinion regarding these provisions, the Internal Revenue Service (the "IRS") is in a far better position than we to determine the tax exempt status of an organization under the IRC. In addition, we note the determination of whether the VFDs meet the requirements as set forth in section 501(c) of the IRC for continuation of their tax exempt status involves a question of fact. Thus, this inquiry is beyond the scope of this Office. See Op. S.C. Atty. Gen. Op., June 1, 2005. However, we will attempt to provide you with general guidance under the applicable federal law.

Section 501(a) of the IRC provides an exemption from income taxes for organizations described in the subsections of section 501. I.R.C. § 501(a). The treasury regulations pertaining to section 501(a) mandate that an organization seeking tax exempt status must file an application with the district director of the internal revenue district in which it is located. Treas. Reg. § 1.501(a)-1(a)(2). Once approved by the district director, an organization may rely on its status unless the IRS Commissioner exercises his or her power to revoke rulings due "a change in the law or regulations or for other good cause" and "so long as there are not substantial changes in the organization's character, purposes, or methods of operation." Id. Your letter neither indicates a change in the law or regulations, nor a substantial change in the character or purposes of the VFDs. Thus, we presume any change in the tax exempt status of the VFDs would arise due to change in the operations as a result of collecting fees from insurance companies.

Section 501(c)(3) of the IRC describes one type of exempt organization as a corporation, community chest, fund, or foundation, "which is organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes" I.R.C. § 501(c)(3). In addition, section 501(c)(3) requires "no part of the net earnings of [the organization] inures to the benefit of any private shareholder or individual" *Id.* The treasury regulations promulgated under section 501(c)(3) described numerous requirements embedded in section 501(c). Treas. Reg. § 1.501(c)(3)-1. These requirements include both the requirement that the organization be organized exclusively for a charitable purpose and operated exclusively for a charitable purpose. Treas. Reg. § 1.501(c)(3)-1(a) - (c). Because the VFDs you illustrate in your letter already received 501(c)(3) status, we presume the IRS determined they met the organizational test and their purposes have been approved. Thus, we focus on the operational test.

The operational test essentially contains three requirements. First, in regard to the organization's primary activities:

An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(c)(1). The second requirement in the operational test is in regard to distribution of earnings. Treas. Reg. § 1.501(c)(3)-1(c)(2). The test states: "An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals." *Id.* Third and finally, the test provides that an organization is not operated exclusively for one or more exempt purposes if it is an action organization, meaning "a substantial part of its activities is attempting to influence legislation," "it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office," or its primary objective may be obtained only by the legislation or defeat of legislation and "it advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public." Treas. Reg. § 1.501(c)(3)-1(c)(3).

Despite the strict operational requirements, the treasury regulations recognize an organization seeking tax exempt status under section 501(c)(3) may be engaged in a trade or business.

An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance

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of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Treas. Reg. § 1.501(c)(3)-1(e). In addition, the United States Tax Court further recognized "the presence of profitmaking activities is not per se a bar to qualification of an organization as exempt if the activities further or accomplish an exempt purpose." Aid to Artisans Inc. v. Comm'r, 71 T.C. 202, 211 (1978). The existence of profits, however, may be a business purpose, rather than a exempt purpose. Easter House v. U.S., 12 Cl. Ct. 476, 486 (1987) aff'd, 846 F.2d 78 (Fed. Cir. 1988), cert. denied, 488 U.S. 907 (1988).

A VFD's receipt of fees from an insurance company does not appear to affect the VFD's status as an exempt organization under section 501(c)(3) of the IRC. The sample charter you provided with your request, which we presume is the same charter under which the IRS granted the VFD tax exempt status, states the purpose of the VFD is "to provide fire protection and rescue services in emergencies." As you stated, the fees paid to the VFD from the insurance companies are "reimbursement to the VFD to offset the cost incurred as they respond to fight fires at insured properties." Therefore, we believe the federal courts would find receipt of these fees comports with the VFD's exempt purpose. In addition, because the fees are to offset the cost of providing the fire protection and rescue services, we would also presume these fees would benefit the VFD, not a private shareholder or individual, by covering its operating expenses. Finally, your letter gave us no indication that the VFDs in question have become engaged in political activity. Therefore, based on our limited knowledge of the activities of the VFDs, we do not find an indication that receiving funds from the insurance carriers would affect their tax exempt status.

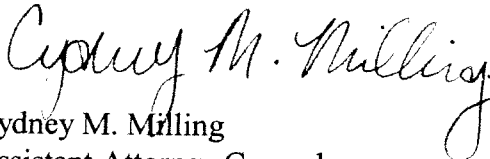
In addition, in our review of the relevant federal law, we do not find a VFD's decision to employ a third party to collect the fees from the insurance company would affect its tax exempt status. This type of activity would not, in and of itself, generate income for the VFD. Contrarily, employing a collector would create an expense. As the United States Court Claims Court pointed out in an opinion dealing with the tax exempt status of an adoption agency, "The term 'net earnings' in section 501(c)(3) allows an organization to incur ordinary and necessary expenditures in its operations without losing its tax exempt status." Easter House, 12 Cl. Ct. at 487. Thus, if a federal court found the collection of such fees by the VFD within the scope of its charitable purpose, payments to a third party to collect those fees likely would be an ordinary and necessary expense of the organization's operations.

In conclusion, whether or not the scenarios you presented in your letter would affect the tax exempt status of the VFDs would require an analysis of facts and circumstances, which is beyond the scope of an opinion of this Office. However, in reviewing the information you provided and the relevant federal tax law, we do not find an indication that a VFD's activities in collecting fees, either

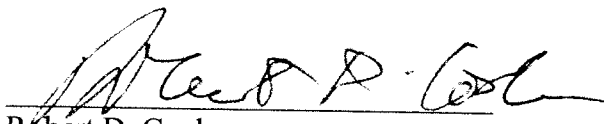
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directly or through a third party, as reimbursement for expenses incurred in responding to a fire emergency would affect the tax exempt status of the VFD.

Very truly yours,


Cydney M. Milling
Assistant Attorney General

REVIEWED AND APPROVED BY:


Robert D. Cook
Assistant Deputy Attorney General