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August 27, 1975

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ARIZONA ATTORNEY GENERAL

Mr. James D. Wiley, Chairman
Deferred Compensation Governing Committee
Personnel Division
1831 West Jefferson
Phoenix, Arizona 85007

Dear Mr. Wiley:

In your letter of July 22, 1975, you posed the following question:

The Arizona State Employees Credit Union and the Grand Canyon State Employees Federal Credit Union have expressed a desire to become a funding media for the State of Arizona Deferred Compensation Plan. Is there any legal impediment to either state or federal law to their being approved as funding media?

In order that the stated question might be more meaningful to those who may read this letter, who are unfamiliar with deferred compensation plans, a very brief description of the concept of non-qualified deferred compensation plans and the funding of future liabilities will be helpful.

The Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans established a non-qualified deferred compensation plan for employees of the State of Arizona. The plan provides that employees who make application to join the plan, and whose applications are accepted by the Committee, may have a specified portion of the income deferred until a later date, typically after retirement. The plan is not authorized by any specific section of the Internal Revenue Code (26 U.S.C.), but rather is allowed by Internal Revenue Service rulings and interpretations in the general area of constructive receipt.

Under the terms of the plan, money deferred by the employees becomes an assets of the state and the state incurs a contingent future liability for payment of the salary so deferred. Internal Revenue Service rulings



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allow such contingent future liabilities to be funded by the use of diverse investment or interest bearing accounts, so long as the legal and equitable title are held in the name of the State of Arizona. The employee may, in addition to requesting participation in the plan, request the salary deferred be placed in a particular type account.

In the initial enrollment in the plan, a significant number of employees requested the salary deferred be invested in a savings account established with the Valley National Bank. The two credit unions mentioned above had requested the Committee establish savings accounts with them, but the Committee declined to do so because it felt neither credit union could accept such funds because of state law, the Arizona Constitution and federal regulations. Recent changes in state law and federal regulations may have altered these former impediments.

In the first regular session of the 32nd Legislature, A.R.S. § 6-509 was amended (Ch. 59, Laws 1975) to allow state chartered credit unions to ". . . receive the funds of its members, employers of members, sponsors or profit or pension trusts of such members, employers or sponsors in special investment accounts." (Emphasis indicates amendatory language.) This statute will become effective September 12, 1975. More recently, 12 Code of Federal Regulations, Part 721.4, was amended to allow federally chartered credit unions to accept pension funds qualified under § 401(d) or 408, 26 U.S.C. (Keogh Plans or Individual Retirement Accounts [IRA]) either as custodian or trustee.

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Turning first to Grand Canyon State Employees Federal Credit Union, it is observed that 12 C.F.R. 721.4^{1/} restricts its right to accept funds as custodian or trustee to plans set up under 26 U.S.C. §§ 401(d) and 408. Since the state plan was not created pursuant to either of those sections, it is concluded this credit union may not accept moneys deferred by participants in the plan. This conclusion is based upon two reasons: (1) state law regulating state chartered credit unions has no application to federally chartered unions and (2) by limiting acceptance of funds to those arising from Keogh or IRA plans, all other plans are excluded.

The amendment to A.R.S. § 6-509 appears on its face to allow a state chartered credit union to accept funds deferred under the state employees deferred compensation plan so long as the individual selecting this investment media is a member of that credit union and so long as the money is the employer's. Under the terms of the plan, the money deferred belongs to the state,

1/ § 721.4 Trustees and Custodians of Pension Plans.

(a) A federal credit union is authorized to act as trustee or custodian, and may receive reasonable compensation for so acting, under any written trust instrument or custodial agreement created or organized in the United States and forming part of a pension plan which qualifies or qualified for specific tax treatment under section 401(d) or 408 of the Internal Revenue Code, for its members or groups or organizations of its members, provided the funds of such plans are invested solely in share accounts of the federal credit union. All funds held in a trustee or custodial capacity must be maintained in accordance with applicable laws and rules and regulations as may be promulgated by the Secretary of Labor, the Secretary of the Treasury, or any other authority exercising jurisdiction over such trust or custodial accounts. The federal credit union shall maintain individual records for each participant which show in detail all transactions relating to the funds of each participant or beneficiary.

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and not the employee. The qualification of membership in the particular credit union is not specifically covered in the state's deferred compensation plan, but it is concluded this should have no adverse effect on the determination made by the Internal Revenue Service with regard to the plan, any more so than the plan's requirement that participants be employees of the State of Arizona.

The constitutional provision involved in the Committee's original decision is Article 9, § 7, which provides in part:

Neither the State, . . . or other subdivision of the State shall ever give or loan its credit in the aid of, or make any donation or grant, by subsidy or otherwise, to any . . . association, . . . or become a subscriber to, or a shareholder in, any company or corporation, or become a joint owner with any person, company, or corporation, except as to such ownerships as may accrue to the State by operation or provision of law.

No loan of credit, donation or grant to a credit union would arise by the Committee investing deferred compensation in a special account of the credit union. The credit union would be in no different position than a bank, insurance company or any other business as to its obligation to the Committee. The credit union would be merely a repository for the money with an obligation to pay out the money upon the Committee's demand. While there is a debtor-creditor relationship created thereby, this does not make the deposit a loan. Our Supreme Court drew a succinct, but well stated, distinction between a deposit and loan in Valley National Bank v. First National Bank, 83 Ariz. 286, 320 P.2d 689 (1958), when it said:

. . . A deposit is for the benefit of the depositor and a loan is for the benefit of the borrower; that it is also true that a deposit may also benefit a depository but such is not the primary object of the transaction. The essential distinction between a deposit and a loan

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of public funds hinges on the right to demand the return of the money. If the money must remain for a fixed period there is a loan in the strict legal sense and not a deposit in the sense the term is ordinarily used. 83 Ariz. at 294.

So long as the Committee were to preserve its right to withdraw the moneys deposited on demand, deposits would not be prohibited on the basis it was loaning the credit of the state to the credit union.

The above-quoted section of the Constitution also prohibits the State being a subscriber or shareholder in any company or corporation. Even if a state chartered credit union were to be construed a company, the Committee would not be a subscriber to the credit union, as it is not required to be a member thereof. The amendment allows the state chartered credit union to accept the moneys of member employers without requiring membership therein as would be true of an individual. The only requirement is that the money deposited be deferred from the compensation of a member.

It is, therefore, concluded the Committee may lawfully deposit money in state chartered credit unions which is deferred by members of the particular credit union and the credit unions may accept those funds.

Sincerely,



BRUCE E. BABBITT
Attorney General

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