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Taxation

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TAXATION

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The Supreme Court of South Carolina decided only a very few taxation cases this past year. Despite the complexity of tax law most tax arguments between taxpayers and the State are settled by administrative procedures and compromise or, in some cases, by a revision of certain sections of the taxing statutes.

South Carolina, along with most states having income tax statutes, provides for non-recognition of gain realized in certain corporate reorganizations. The admitted gain is not recognized, and hence not taxed at the time of the reorganization on the policy grounds that the investment of the parties to the reorganization substantially continues, even though in a somewhat different form. The South Carolina statute provides " . . . the exchange of stock or property for stock of a corporation a party to a reorganization, consolidation or merger shall not be deemed to result in a gain or loss."[1] But the Code also provides that gain or loss incurred in a liquidation shall be recognized.[2] The dividing line between "reorganization, consolidation or merger" on the one hand and "liquidation" on the other is an exceedingly difficult one to draw. It is an obvious truism that the statutory words provide only a little help in drawing this line. In its most important tax case of the past year, *Henry P. Moses Company v. South Carolina Tax Commission*,[3] the Supreme Court of South Carolina decided that a given transaction, though the corporations and parties involved attempted a merger or consolidation, was in reality a liquidation and distributions were taxable as gain. The decision was based on the now time-honored and reasonable theory that those claiming exemption from tax must prove they are clearly within the exemption provided by statute.

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1. CODE OF LAWS OF SOUTH CAROLINA, 1952 § 65-275. § 65-276 provides for a carryover of the basis of the old stock or property to the new stock.
2. CODE OF LAWS OF SOUTH CAROLINA, 1952 § 65-277.
3. 224 S.C. 193, 78 S.E. 2d 187 (1953). The case might well be subtitled "Hire a Lawyer for a Lawyer's Job." The attempted merger or consolidation, the parties claiming either or both, was attempted with the advice of an accountant only.

Since the gain realized was clearly the earnings and profits of the dissolved corporation, it was the same as a dividend and taxable as such. The opinion is of further interest in that it did not consider the rather tempting argument of the Attorney General that complete compliance with statutory merger and consolidation statutes was essential.[4] This would make a relatively easy line to draw but any such line would seem to be a poor one for these purposes. Even a statutory merger or consolidation may well result in distributions which should be taxed as gain or dividends and the converse would also seem to be correct. The proper test would seem to be two-fold. First, is the distribution really, no matter what its form, merely a method of getting earnings and profits to various parties to the transaction? Second, is the transaction, again no matter what its technical form, designed basically to maintain the same investment though in perhaps somewhat different guise? While these two tests cannot be perhaps effectively separated, they provide the means of arriving at a solution consistent with the statutory purpose. The instant case is undoubtedly correctly decided, and decided adequately if a bit cryptically on the correct grounds.

The only other major tax case decided by the Supreme Court of South Carolina in this past year, *United States v. Scovil*,[5] involved conflicting claims of priority in an insolvent's estate. The United States claimed priority, under the effective priority statutes,[6] for all of its claims against the insolvent, particularly claiming priority ahead of the claim for rent by the landlord of the insolvent. The various pertinent events had occurred in the following order. On April 7, 1952, the landlord distressed on the insolvent's property and this, under South Carolina law, was held by the Supreme Court to be a perfected lien as of that date. On April 8, 1952, a receiver was appointed and two days later, April 10, 1952, the United States filed notice of its claim in the Register of Mesne Conveyances. It was held that, under either priority statute, the landlord's lien preceded the claim of the United States. The "debt" priority of the United States could not take effect until the appointment of a receiver and the United States

4. Brief of Appellant, pp. 2-3, and Reply Brief of Appellant, pp. 2-3, Henry P. Moses Co. v. S. C. Tax Commission, 224 S.C. 193, 78 S.E. 2d 187 (1953).

5. 224 S.C. 233, 78 S.E. 2d 277 (1953).

6. REV. STAT. § 3466 (1797), 31 U.S.C. § 191 (1946), and INT. REV. CODE §§ 3670 through 3672, 26 U.S.C. §§ 3670 through 3672 (1946).

could thus have no greater interest in the insolvent's property than the insolvent did itself at the time of this appointment. As to the priority of the United States under the "tax" priority statute, such priority did not take effect until the United States filed notice of its claim under State law, since the holder of a perfected lien was a "purchaser" under the federal statute. While there might be some argument as to whether this is a desirable statutory result, the decision is certainly correct under the present statutory law.

Certain tax issues were decided in *Watson v. Little.*[7] In an action for partition of certain property held in cotenancy, the cotenant in possession claimed ownership by adverse possession, partly as a result of a tax deed and the payment of taxes over a number of years. The procurement and recordation of the tax deed was considered by the Court to be the first indication to the other cotenants that the cotenant in possession was holding adversely to them, and the 10 year statute of limitations had not run since that time. Payment of taxes for a period of some few years prior to the obtaining of the tax deed, as well as after, was held not to be notice to the other cotenants of intent to hold adversely, under the facts of the case. A further argument, based on those sections of the Code making a sheriff's deed *prima facie* evidence of ownership,[8] was rejected summarily on the basis that these provisions related to defects in tax deeds and the proceedings antecedent thereto.

In *Simonds v. Simonds,*[9] the Supreme Court had to consider whether an award of temporary alimony pending divorce proceedings was excessive. In argument before the circuit judge, the wife's counsel stated that the alimony would be taxable to the wife and deductible by the husband under the Federal income tax statute. While it was not certain that the circuit judge considered this fallacious argument as one of his bases for determining the amount of the alimony, the Supreme Court remanded for reconsideration of the amount granted, stressing the importance in granting temporary alimony of considering the husband's net income after income taxes, not his gross income, as well as other expenses which he had and resources which his wife had. It is interesting to note that the

7. 224 S.C. 359, 79 S.E. 2d 384 (1953).
8. S. C. CODE, 1942 §§ 2160, 2827 (applicable in this case, since case commenced in 1950), now CODE OF LAWS OF SOUTH CAROLINA, 1952 §§ 65-2779, 65-2857, 65-2859.
9. 81 S.E. 2d 344 (S.C. 1954).

Court, in stressing what factors the lower court should consider, did not mention the rather large fortune of the husband but only his income, despite the suggestion by the wife's counsel that this was an important factor.[10]

Tax Legislation

While the purpose of this issue of the *Law Quarterly* is to review case law of the past year, a brief review of tax legislation enacted by the 1954 General Assembly is included. New tax legislation seldom gets into litigation, if at all, until some years after passage, but a knowledge of recent statutory developments is essential to the tax adviser. Taxation being essentially a statutory subject, the cases themselves generally interpret the statutes.

South Carolina income tax provisions were not substantially changed during the year but there were several minor changes. From the standpoint of the number of taxpayers affected, the more important was the provision that, when the income tax liability of a taxpayer is 25 dollars or less, the entire sum is payable at the time prescribed for filing the return.[11] This provision simplifies administration of the income tax law without being unduly harsh on any taxpayer.

Considerably more important dollar-wise to the State and to certain taxpayers, is the Act declaring that income received by any individual as the result of the sale of property being taken under the powers of eminent domain is not subject to the State income tax.[12] This Act could well raise rather interesting problems of interpretation, particularly where sales are made under threat of eminent domain proceedings, or even perhaps without such threat but to a body with powers of eminent domain. Clearly, it seems unwise to require governmental units, and others possessing the power, to have to go through the not inexpensive eminent domain proceedings just to help a person avoid tax. It also seems that the policy behind the Act is unsound. The only possible reason for exempting this type of sale from taxation is the involuntary nature of the transaction. Of course, the owner had no choice as to the date of sale, or in fact even as to the sale itself, but that does not make the receipt of a sale price any the less income. It

10. Brief of Respondent, pp. 4-5, Simonds v. Simonds, 81 S.E. 2d 344 (S.C. 1954).
11. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 644, p. 1566.
12. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 580, p. 1471.

would certainly be quite proper not to recognize the gain at the time of this involuntary conversion, which would be similar to the treatment under the Federal income tax statute.[13] But to make what is income not income for tax purposes gives unwarranted favoritism to a small group who may need some relief but hardly need exemption from taxation.

Two changes in the State sales tax were adopted in 1954. The section defining "sales" subject to the sales tax[14] was amended to clarify the inclusion as "sales" of sales to contractors purchasing tangible personal property for use in performing contracts with the United States or its instrumentalities, despite the form of such purchase either as agents of the United States or as individual contractors.[15]

A much more important and debatable amendment to this tax makes collection of the sales tax from the purchaser optional with the retailer, rather than compulsory as previously required.[16] Since the tax is laid on the retailers in terms of a tax on the gross proceeds of their businesses, with certain exceptions,[17] this will make it legally possible for retailers to retain any excess of tax collected on individual sales over total tax due on their gross sales. Because of the rates set by statute for individual purchases of less than one dollar, this amendment to the law will be quite profitable to those retailers who make numerous sales for less than one dollar.

13. INT. REV. CODE § 112 (f) provides that gain shall not be recognized where property is involuntarily converted (including eminent domain or threat thereof) to the extent that the amount realized is invested in property similar or related in service or use to the property converted. Such investment must be made with a period, the beginning of which is the date of the disposition of the converted property or the date of the beginning of the threat of requisition or condemnation of the converted property, and the end of which is one year after the close of the first taxable year in which any part of the gain upon the conversion is realized. An extension of this last date is possible when the Commissioner of Internal Revenue concurs with a taxpayer's request. INT. REV. CODE § 117 (j) provides some further relief, but, because the South Carolina income tax system does not provide for differing tax rates for ordinary and capital gain, the device would not be effective for adoption by the State.

14. CODE OF LAWS OF SOUTH CAROLINA, 1952 § 65-1361.

15. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 644, p. 1566.

16. See note 15, *supra*. Interesting, and perhaps not easily solvable, problems of interpretation may arise because § 65-1708 was not amended by this Act at the same time § 65-1407 was amended.

17. CODE OF LAWS OF SOUTH CAROLINA, 1952 § 65-1401. Limitations imposed by this section limit tax collected on an individual article to $25 on article prices up to and including $1,500, $40 on articles sold at prices from over $1,500 to $3,000, and $75 on articles selling for over $3,000. In effect this means that retailers will pay taxes on gross sales, except for articles selling for over $833.33, when the tax due from them will be in accordance with the amounts set by statute.

The State Tax Commission has now been given the powers and duties of collecting State taxes, including the powers of attachment, levy, and sale.[18] Prior to this statute's being adopted, these powers were in the hands of sheriffs or tax collectors of the various counties of the State. The provisions for payment of taxes under protest, and recovery of such taxes,[19] were repealed and new sections added replacing them.[20] These new sections do not change the procedure for payment and recovery but clarify the position of the State Tax Commission in the procedure in accordance with the change in the law giving them the powers and duties of collection.[21] These provisions should make for some increased efficiency in carrying out these duties, since centralization of the authority in the hands of one body in a State this size is feasible administratively and will make somewhat easier the uniform application of the laws involved.

Certain license taxes were changed in part by the 1954 statutes. The motor vehicle dealer license tax was reduced from twenty-five to five dollars annually.[22] Motor vehicle driver training schools, when a fee is charged for the training, are now subject to an annual license tax of fifty dollars, as part of a new system of regulation of such schools.[23]

Motion picture theatre license taxes were considerably altered during the legislative session.[24] "Drive-in" motion picture theatres are now specifically covered and an annual license tax is laid in accordance with a schedule based on the number of speakers, theatres in various brackets determined by number of speakers being taxed at set rates in each bracket. Regular motion picture theatre license taxes are now laid in accordance with a bracket system based on the number of seats, similar in form to the "drive-in" theatre schedule. This replaces a system which based the tax on the actual number of seats in the theatre with varying rates per seat being charged depending on the population of the town in which the theatre was located. Other provisions of the changes provide for annual instead of quarterly collection of this tax, and change the determination of the seating capacity from a quar-

18. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 644, p. 1566, Part III, § 14.
19. CODE OF LAWS OF SOUTH CAROLINA, 1952 §§ 65-2661 and 65-2662.
20. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 673, p. 1720.
21. See text supported by note 18, *supra.*
22. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 696, p. 1760.
23. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 619, p. 1536.
24. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 623, p. 1539.

terly to an annual determination. The new tax rates result in a very substantial reduction in theatre license taxes. A theatre in a city of more than 30,000 paid a tax of two dollars a seat under the old law so that, if it had 1,000 seats, the annual tax was $2,000. Even in the smallest town, the tax would have been $1,000 for a theatre of this seating capacity. Under the new law, this theatre, no matter where it is located, will pay an annual tax of $150.

The South Carolina Fertilizer Act of 1954[25] provides for somewhat differing license taxes than had henceforth been prescribed,[26] but the changes are not substantial, applying primarily to fertilizer sold in packages of 10 pounds or less.

Certain other taxes were changed in minor ways. The statute covering license taxes on fishing appliances used in salt water fishing[27] was amended to include an annual license tax of six dollars per hundred crab pots.[28] The definition of "pure fruit and vegetable juices" was amended to permit the addition of sugar and vitamins to the juice obtained from the pressing of sound ripe fruit.[29] These juices are exempt from the soft drink tax.[30] The definition of bottled drinks was also amended so as to include drinks in any closed container.[31] Neither of these last two Acts changed the law but only made it certain that the definitions applied to the entire statute rather than just portions of it. The General Assembly also authorized the State Tax Commission to permit the use of business license meter impressions in lieu of the revenue stamps required by State law on cigarettes and certain other commodities.[32] In the temporary provisions of the Appropriation Act the General Assembly, following its custom, again exempted gasoline used in airplanes from the State gasoline tax but made such gasoline subject to the State sales and use taxes.[33] This exemption is now effective through fiscal year

25. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 609, p. 1509.
26. CODE OF LAWS OF SOUTH CAROLINA, 1952 § 3-566.
27. CODE OF LAWS OF SOUTH CAROLINA, 1952 § 28-935.
28. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 566, p. 1442.
29. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 644, p. 1556, Part III, § 11.
30. CODE OF LAWS OF SOUTH CAROLINA, 1952 c. 10, Art. 5.
31. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 644, p. 1566, Part III, § 9 (b), amending CODE OF LAWS OF SOUTH CAROLINA, 1952 Title 65, c. 10.
32. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 644, p. 1566, Part III, § 10.
33. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 644, p. 1566, Part I, § 93. Since this exemption is given largely because gasoline taxes are used for highway purposes, it would seem that making this exemption permanent should be considered.

1954-55. The Code provision giving exemption from taxation for properties of certain rural electric cooperatives was extended to include property owned by all rural electric cooperatives organized under State law.[34]

The tax legislation passed during the 1954 session of the General Assembly in only a few instances has any very general application and, where it does, it is not particularly important to the many taxpayers affected. As indicated, certain provisions will favorably affect the administration of the tax system, and other provisions give tax relief to certain groups and individuals where proper tax policy does not favor giving such relief. A completely fair and wise system of taxing cannot and should not be expected of any government, but in turn any changes made in a given tax system should be analyzed to see if they improve or undermine the over-all tax structure. A tax statute is seldom the proper instrument to give individuals or groups special relief from burdens not particularly connected with the tax structure, since it is seldom that relief is consistent from one group to the other, or from one individual to the other. As an example, consider the effect of the provision previously discussed which exempts the sales price of property taken under eminent domain from inclusion as income. It is easy to see that one man, in a lower tax bracket than another also selling, will obtain considerably less relief than the man in the upper bracket, yet who is to say that, given the same sales price, one man suffered only one-half or three-fourths as much as the other. The same holds true of the new sales tax provision which, in effect, permits the retailer to retain that part of the tax collected which is in excess of what he owes on his gross sales. As pointed out, this favors the retailer who makes small sales as compared to the one whose sales are nearly always of at least a dollar. Retailers, of whom there may be some, who need subsidies should be given them directly, rather than indirectly in a manner which after all bears no relation to their need of a subsidy. It would also seem fairer to the customers, who are the taxpayers and generally citizens of this State, that all funds collected as taxes be turned over to the State for educational purposes, except for the statutory amount permitted to cover cost

34. S. C. ACTS AND JOINT RESOLUTIONS 1954, No. 644, p. 1566, Part III, § 16, amending CODE OF LAWS OF SOUTH CAROLINA, 1952 § 65-1552.

of collection and record keeping.[35] If that amount is inadequate, it should be increased directly, not indirectly in such a way that the cost to the retailer of handling this tax for the State and the amount of extra compensation he receives for so doing bear little if any relation to each other.

35. CODE OF LAWS OF SOUTH CAROLINA, 1952 § 1447. This permits retention of 3% of the tax due.