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## Taxation

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**TAXATION****I. LEGISLATION**

Once again this year the South Carolina Tax Study Commission has made a number of forward-looking proposals to the General Assembly in order to improve, update, and streamline South Carolina's tax system. Of the recommendations, three are carry-overs from previous Commission reports: the Simplified Income Tax, the Tax Board of Review, and the Gift Tax.

*A. The Simplified Income Tax.*<sup>1</sup>

This very important proposal consists of two parts. First, the Federal Internal Revenue Code's definition of "taxable income" would be adopted by reference into the South Carolina Code. Second, income tax rates and exemptions would continue to be controlled by the General Assembly. The advantages of the proposed statute are said to be manifold. Primarily, the South Carolina taxpayer would have the advantage of a fully developed body of law, including the Federal Code, along with the applicable regulations and decisions.<sup>2</sup> Having already calculated his Federal taxable income, the state taxpayer would merely insert that figure on his one page state return, making the necessary adjustments to arrive at the South Carolina taxable income. South Carolina exemptions would then be subtracted and the South Carolina controlled rate applied to arrive at the tax liability. The obvious benefits of increased efficiency would accrue both in the preparation and administration of state tax returns.

In an effort to sell the proposal, the Commission has elicited comments from interested groups, from a public hearing, and from officials of states where similar plans are in effect<sup>3</sup> or under study.<sup>4</sup> The response has been enthusiastic and no unresolved defects have been uncovered.

1. SOUTH CAROLINA TAX COMM'N SEVENTH ANN. REP. 21-28 (1966) [hereinafter cited as REPORT].

2. *Santee Mills v. Query*, 122 S.C. 158, 115 S.E. 202 (1922) upheld the constitutionality of incorporation of the Federal Income Tax Act of 1921 with effectuating Internal Revenue Rules, but on the assumption that the Legislature intended to incorporate the law on the date of enactment and not future law.

3. 1966 REPORT 23-25. Favorable comments are quoted from West Virginia, Montana, New York, Vermont, Iowa, Minnesota, Indiana, and New Mexico.

4. 1966 REPORT 26-28. States commenting favorably after study are Utah, Delaware, North Dakota, Alabama, Wisconsin, North Carolina, Kansas, and Mississippi.

The lone drawback would seem to be that enactment of the bill, as drafted, would result in a loss of revenue. Some of this loss might eventually be made up by decreased accounting costs. However, the General Assembly might be understandably reluctant to enact the measure in its present form. Consequently, the Tax Study Commission would still favor enactment of a measure modified at the cost of some simplicity so as to preserve the present level of revenue.

### *B. The Gift Tax.<sup>5</sup>*

The Federal system serves as a pattern for another proposal renewed in this year's report—the Gift Tax. This loophole-closing measure would impose on inter vivos transfers of property a gift tax equal to seventy-five percent of the South Carolina Estate Tax rate.<sup>6</sup> The same yearly exclusion<sup>7</sup> and lifetime exemption<sup>8</sup> as in the Federal system would be included, and definitions in the Federal Code would be incorporated by reference.

### *C. The Tax Board of Review.<sup>9</sup>*

The Commission again this year proposes a reorganized Tax Board of Review. The scope of the Board would be broadened from its present purview, property tax appeals,<sup>10</sup> to include all non-administrative matters concerning *any* tax or license fee administered by the Tax Commission. The problem to be alleviated by the new independent board is the difficulty that the Commission faces in being impartial in a quasi-judicial proceeding where one of the adversaries is its own employee. The taxpayer is given additional protection by the plan's provision for a further appeal to the court of common pleas.<sup>11</sup> The Board would consist of two present members of the Tax Commission along with one new appointee. (The Tax Commission would be reduced from five to three members.) The balance between the need "to protect the fisc from the slow moving machinery of

5. 1966 REPORT 31-33.

6. S.C. CODE ANN. § 65-451 (1962).

7. INT. REV. CODE of 1954, § 2503(b).

8. INT. REV. CODE of 1954, § 2521.

9. 1966 REPORT 29-30.

10. S.C. CODE ANN. § 65-105 (1962).

11. The tax must first be paid.

the courts<sup>12</sup> and the taxpayer's right to due process of law<sup>13</sup> is a difficult one. In providing independent quasi-judicial appeal, as well as court appeal, the Tax Study Commission is to be commended in its effort to assure a substantial measure of both justice and efficiency.

#### *D. Public Service Corporation Income Tax.*<sup>14</sup>

Among the new proposals of the Study Commission is a plan, recently enacted into law with minor variations,<sup>15</sup> providing for the equalization of income tax treatment of public service corporations with all other corporations. Public service corporations, as a class, have borne a higher income tax liability primarily because they were not allowed to deduct interest payments. The original proposal would have lessened the revenue impact by incrementally effecting the change over a five year period. As enacted, the equalization is spread over a seven year period beginning in 1967 and becoming complete in 1973.

#### *E. Electric Power Industry Taxation.*<sup>16</sup>

Equalization of treatment is the subject of another new recommendation. Inequities exist between various segments of the electric power industry and their customers because of variations in tax treatment. To remove these inequities the Commission recommends (1) repeal of property tax exemption for electric cooperatives and a new simplified method of assessment to apply alike to all segments of the industry;<sup>17</sup> (2) application of the power tax to sales of electric power only, instead of to sales *and/or* generation of power; (3) application of a net margin tax to electric cooperatives and application as to them of the utilities franchise tax.<sup>18</sup>

12. HELLERSTEIN, STATE AND LOCAL TAXATION 634 (1961).

13. Where administrative review is provided, judicial review is not required as a matter of due process of law. *Hodge v. Muscatine County*, 196 U.S. 276 (1905).

14. 1966 REPORT 37-38.

15. S.C. CODE ANN. §§ 65-256.1 to -256.4 (1962), as amended.

16. 1966 REPORT 13-17.

17. The cooperatives are, however, given a break on their transmission and distribution systems through the use of a "valuation adjustment factor" which adjusts the assessment for average consumer density per mile of line.

18. The special franchise tax for cooperatives would be repealed.

*F. Tax Practitioner Credentials.*<sup>19</sup>

In recognition of the complexities of tax practice, the Study Commission recommends that the Tax Commission be given authority to issue credentials to those tax practitioners who meet minimum standards (also to be determined by the Tax Commission). The provision also provides for sanctions of fine or imprisonment if an individual for hire<sup>20</sup> prepares returns, offers advice, or represents a taxpayer before the Tax Commission without credentials. Certain groups would be entitled to accreditation without further evidence of qualification, including attorneys admitted to practice in the courts of South Carolina and certain accountants.

*G. Property Taxation.*<sup>21</sup>

One of the most difficult areas in the tax field is that of equitable property taxation. Recognizing this area as being "in greatest need of reform," the Tax Study Commission has, since its creation, worked to achieve equity, uniformity and constitutionality.<sup>22</sup> Assuming property is correctly valued at its true value in money,<sup>23</sup> there still remain two variables to be applied in the determination of the tax—assessment ratio and millage levy. The millage levy must and does vary according to revenue needs. But the assessment ratio—the factor applied to true value to obtain value for tax purposes—"has too often been dependent upon the whims of the taxing authorities."<sup>24</sup> Over the past several years, significant progress has been made toward achieving uniformity of assessment ratios, largely through the efforts of the Tax Study Commission.

The current proposal sets the target uniform assessment ratio at ten percent. The plan calls for the Tax Commission to review all valuation methods to assure conformance with the existing code's requirement.<sup>25</sup> In addition the Tax Commission would

19. 1966 REPORT 34.

20. An employee making his employer's return would not be affected.

21. 1966 REPORT 18-20.

22. "The General Assembly shall provide by law for a uniform and equal rate of assessment and taxation, and shall prescribe regulations to secure a just valuation for taxation of all property, real, personal and possessory." S.C. CONST. art. 10, § 1.

23. "All property shall be valued for taxation at its true value in money..." S.C. CODE ANN. § 65-1648 (1962).

24. 1966 REPORT 19.

25. S.C. CODE ANN. § 65-1648 (1962).

adjust all assessment ratios to arrive at ten percent for all property assessed by it. Any necessary changes in valuation methods or adjustments of assessment ratios would be made over a four year period, so that at the end of the period valuations would be in compliance with existing law and assessment ratios would be fixed at ten percent.

Other provisions of the property tax proposals require that personal property returns of professional men, as well as other businesses, be made directly to the South Carolina Tax Commission, and that the Tax Commission encourage and assist the various other taxing entities to work toward the uniform ten percent assessment ratio.

## II. JUDICIAL DECISIONS

### *A. Extent of Tax Commission Authority to Order Refund.*

Even when a taxpayer has a "meritorious" claim for a tax refund, the path may be fraught with pitfalls or administrative and judicial procedure. Among the obstacles is the necessity for involuntary payment<sup>26</sup> or for payment under protest. Underlying this general rule is the theory that the suit is in the nature of a tort action to recover taxes "wrongfully collected." In South Carolina this rule is reflected in the statutory requirement for payment under protest followed by suit within thirty days.<sup>27</sup> There is, however, an alternate to the basic route of recovery. Section 65-2682 of the code provides for refund of taxes "erroneously collected."<sup>28</sup> Here the necessity for payment under protest of taxes wrongfully collected, followed by suit, is eliminated, and the collecting official is directed to refund, following a favorable decision by the Tax Commission.<sup>29</sup>

In *Owings Mills, Inc. v. Brady*<sup>30</sup> the taxpayer followed the latter course of action to recover property taxes paid not under

26. For what circumstances constitute involuntary payment, see Annot., 64 A.L.R. 9 (1930).

27. S.C. CODE ANN. §§ 65-2661 to -2667 (1962).

28. Whenever after due hearing the Commission by majority vote shall determine that any tax has been paid under an erroneous, improper or illegal assessment, the Commission shall order the officer having custody of the tax so erroneously, improperly or illegally to refund it to the person from whom it has been unjustly collected, or other fund from which it may be fully refunded.

S.C. CODE ANN. § 65-2682 (1962).

29. In *City of Columbia v. Glens Falls Ins. Co.*, 245 S.C. 119, 139 S.E.2d 529 (1964) the court held that this remedy was only available for property tax refunds, thus narrowing its usefulness.

30. 246 S.C. 361, 143 S.E.2d 717 (1965).

protest, relying on the exemption provision of section 65-1570 of the code.<sup>31</sup> After a Tax Commission decision favorable to the taxpayer, the Spartanburg County Treasurer sought certiorari in the court of common pleas, contending that the Commission lacked jurisdiction to order a refund unless property *valuation* was at issue. In denying certiorari the lower court held that the Commission clearly had jurisdiction to order the refund. On appeal to the South Carolina Supreme Court, the judgment was reversed in an opinion by Mr. Justice Lewis, holding that a substantial question was raised as to the jurisdiction of the Commission. In holding that the Tax Commission's property tax refund authority was not unlimited,<sup>32</sup> the supreme court construed section 65-2682 of the code. The Commission has authority to order refund for payment under an erroneous, improper or illegal *assessment*; but, for purposes of these statutes, assessment means "the value placed upon property for the purposes of taxation. . . ."<sup>33</sup>

*B. The Extent of Court Authority to Correct Assessments.*

A controversial area of the law is the extent of judicial review over the actions of administrative bodies. Should the courts have unlimited authority to assure substantial justice by looking into the matter *de novo* and, in effect, "supervise" the judgment of the administrative body? Or should the review be narrowed to an examination of errors of law, allowing errors of judgment or prejudice to pass? This controversy pervades the tax field with its assessors, local review boards, state review boards, and courts, whose roles overlap, whose interests conflict and whose tax expertise vary. Ideally an autonomous, impartial, expert and effective board properly would require only narrow review of non-judgment type errors.<sup>34</sup> South Carolina's position is clear. "The court cannot substitute its judgment, or that of a jury, for the judgment of the tax assessor duly appointed for the purpose of making an appraisal and valuation of property for tax purposes."<sup>35</sup>

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31. The provision exempts certain industrial property in Spartanburg County from "all county taxes" except for school purposes.

32. *Owings Mills, Inc. v. Brady*, 246 S.C. 361, 143 S.E.2d 717 (1965).

33. *Id.* at 364, 143 S.E.2d at 718.

34. See text accompanying note 9 *supra*.

35. *Meredith v. Elliott*, 247 S.C. 335, 346, 147 S.E.2d 244, 249 (1966).

In *Meredith v. Elliott* the Richland County taxpayers, faced with valuation in excess of their investment, objected to the valuation. On reappraisal the valuation was lowered somewhat. Considering the amount still excessive, the taxpayers, after being advised of finality by the Board of Assessment Control, appealed to the Richland County Board of Assessment Appeals,<sup>36</sup> where they were denied relief. Proceeding under sections 65-2661 and 65-2662, the taxpayers paid under protest and filed suit for refund *without having appealed to the South Carolina Tax Commission*. From a decision of the court of common pleas favorable to the taxpayers, the county appealed. The Supreme Court of South Carolina reversed. In an opinion by Mr. Justice Moss the court held that sections 65-2661 and 65-2662 of the code do not confer on the court authority to "fix the valuation of property for taxation," or to substitute its judgment for that of the tax assessor.<sup>37</sup> Even had the statute conferred "supervisory" jurisdiction on the court, the suit still could not be entertained where the administrative remedies established by law<sup>38</sup> had not been exhausted.<sup>39</sup>

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36. S.C. CODE ANN. § 65-3645.7 (1962).

37. 247 S.C. 335, 346, 147 S.E.2d 244, 249 (1966).

38. S.C. CODE ANN. §§ 65-2681, -2682 (1962).

39. 247 S.C. 335, 346, 147 S.E.2d 244, 249 (1966).