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Taxation

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TAXATION

I. Legislation

While several statutes dealing with taxation were enacted during this past year, only a few appear to be of any general interest. A corporation no longer has to make a declaration of estimated taxes if the estimated taxes are less than one hundred dollars.[1] A new method has been devised to determine "in transit" property for property tax purposes.[2] Also the three year statute of limitations for assessment of additional income tax[3] was clarified by indicating that as between the time filed or the time due, it was the time which occurred later that controlled.[4]

The South Carolina Tax Study Commission was dissolved and most of its major recommendations[5] were not enacted this past year. The recommended plan passed last year for equalizing public service corporations with other corporations[6] was amended slightly[7]—in one place to conform to the Study Commission's original recommendation.[8] Also the Study Commission's recommendation for a uniform property tax assessment ratio of ten percent was adopted for merchant's inventory, equipment and furniture and fixtures,[9] and in line with the general theme of uniform property taxation of businesses, the Tax Commission was given the power to equalize and assess both real and personal property of a manufacturer except in the case of inventory not offered for retail sale.[10]

II. Judicial Decisions

A. Taxability of Excess Above Par of Stock Dividends.

A license is levied upon the "capital stock and paid-in as surplus" accounts of most chartered and domesticated corpora-

1. LV S.C. Stats. at Large 641 (No. 444 1967).
2. The "no situs" property is determined by dividing the total property shipped in South Carolina into the total property shipped outside of the state using a period not in excess of thirty-six months and applying this fraction to the ending inventory. LV S.C. Stats. at Large 553 (No. 382 1967).
3. S.C. Code Ann. § 65-322 (1962).
4. LV S.C. Stats. at Large 495 (No. 352 1967).
5. They included a gift tax, enlargement of the power of the Tax Board of Review, a simplified income tax coordinated with the federal income tax, supervision of tax practitioners, and taxation of electric cooperatives. *See generally Taxation, Survey of S.C. Law*, 19 S.C.L. Rev. 109 (1967).
6. S.C. Code Ann. § 65-256.1 to -256.4 (Supp. 1966).
7. LV S.C. Stats. at Large 495, 554 (Nos. 351, 383 1967).
8. South Carolina Tax Comm'n Seventh Ann. Rep. 72 (1966).
9. S.C. Code Ann. § 65-1668 (Supp. 1966). The Tax Study Commission's hope was to have all property assessed with a uniform assessment ratio.
10. LV S.C. Stats. at Large 710 (No. 476 1967).

tions in South Carolina.[11] These accounts generally appear on the books of a corporation using par-value stock when the stock of the corporation is issued for consideration, with the portion equal to the par value of the stock being credited to the capital stock account and the excess above par being credited to the paid-in surplus account.

In *Gulf Oil Corporation v. South Carolina Tax Commission*[12] the taxpayer had issued a stock dividend. There was no question that the amount equal to the par value of the stock distributed and therefore credited to the capital stock account was taxable; the litigation involved the taxation of the excess above par of the stock dividend which the taxpayer had classified as "other capital" on its books.

Since the statute[13] had not defined paid-in surplus, the court looked to *Webster's Dictionary* for the corporate understanding of the word and concluded that paid-in surplus resulted *only* from the "*sale*, or *exchange* or *issuance* at a price above par of the corporate stock"[14] and not from a stock dividend. Nor did the fact that section 65-607 expressly listed transactions that were not paid-in surplus[15] necessarily imply that just because a stock dividend was not included therein, it would create taxable paid-in surplus.

This case is important in that many stock dividends are issued using stock that has a nominal par value. In such cases, as a result of a stock dividend, a large amount is transferred from the earned surplus account to an account that is not taxable under section 65-606. This result may not be unjust since the same amount that escapes taxation was not taxed when that amount was in the earned surplus account.

B. Estoppel of the State and Deduction of Taxes and Insurance Reserves.

In *Colonial Life & Accident Insurance Company v. South Carolina Tax Commission*,[16] a case which raises four tax issues,

11. S.C. CODE ANN. § 65-606 (1962).
12. 248 S.C. 267, 149 S.E.2d 642 (1966).
13. S.C. CODE ANN. § 65-606 (1962).
14. Gulf Oil Corp. v. South Carolina Tax Comm'n, 248 S.C. 267, 271, 149 S.E.2d 642, 644 (1966).
15. Paid in surplus, for the purpose of this section, shall not include any capital surplus created by reason of a reorganization, consolidation, or merger except such surplus as may result from a decrease of capital as an incident to such reorganization, consolidation or merger.
S.C. CODE ANN. § 65-607 (1962).
16. 248 S.C. 334, 149 S.E.2d 777 (1966).

an agent of the Tax Commission had in 1958 agreed with Colonial on a method to compute its liability. Four years later this method was rejected by the Commission and a deficiency assessment plus interest was made based upon a new calculation. As a general rule a governmental authority cannot be estopped in enforcing its tax laws by previous acts of its agents[17] and the court held that the general rule should be followed even when reliance is based upon a method of computation rather than an erroneous calculation of the Tax Commission. The taxpayer was not charged interest on the deficiency, however, since the court viewed the interest statute[18] as a penalty.

The taxpayer also contended that it should be allowed a full deduction under section 65-259(4)[19] for South Carolina taxes paid mainly on property and employees at its South Carolina home office. The Commission asserted that taxes paid for the home office should be allocated to other states on the basis of income since the home office activities benefited the activities of the company in the other states. The court held that the Commission had full power and the duty to prescribe a method for arriving at a tax base which reasonably represented the proportion of business within the state and its determination would not be disturbed unless shown to be arbitrary, discriminatory or unreasonable.[20]

The court also disallowed as deductions certain additions Colonial had made to its insurance reserves. Section 37-130.1 allows a domestic life insurance company to deduct any additions to its policy reserves. All other insurance companies can deduct only an "addition to unearned premium reserves."[21] Colonial

17. *E.g.*, Heyward v. South Carolina Tax Comm'n, 240 S.C. 347, 126 S.E.2d 15 (1962); Baker v. South Carolina Highway Dept., 166 S.C. 481, 165 S.E. 197 (1932); Powell v. Board of Comm'n of Police Ins., 210 S.C. 136, 41 S.E.2d 780 (1947) (dictum); Annot., 1 A.L.R.2d 338 (1948).

18. "[*P*]*rovided,* that interest at the rate of six per cent per annum shall be paid on any tax due from the date that return and tax was originally due to the date of payment." S.C. CODE ANN. § 37-130.4 (1962).

19. The actual taxing statute is section 37-130.1; however, the license is limited to five percent of net income as determined by Chapter 5 of Title 65.

20. Section 65-222.2, upon which the court relied, provides that if a domestic corporation does business both within and without the state, the tax shall be imposed upon a base which reasonably represents the proportion of the trade or business carried on within the state.

21. S.C. CODE ANN. § 37-130.2 (1962).
"Unearned premium reserves" are basically and in general terms reserves set up or allocated by the insurance company representing such proportions of premiums as the unexpired portion of the period for which premium has been paid bears to the entire term covered by premium payments. For example, if a year's premium has been paid in advance

contended that since it did life insurance business,[22] it was a "life insurance company" and could deduct additions to reserves for unreported and unpaid claims for all its business. The court held that since the Legislature had expressly differentiated between the kinds of reserves, the Commission was correct in allowing Colonial a deduction of reserve additions only for its life insurance business and in limiting reserve deductions in connection with their other business to additions to unearned premium reserves.

Section 37-130.1 also specifies that additions to the reserves for life insurance business be "required by the Commissioner." One addition in question had been "required" by the Superintendent of Insurance of Missouri, but the portion of this addition allocable to South Carolina had only been "adopted" by the South Carolina Commissioner. Therefore, the South Carolina portion was not deductible in computing South Carolina tax.

C. Tax Procedure—Necessity of Paying Under Protest.

Under the main statutory approach to obtaining a South Carolina tax refund, the tax is paid under protest and a suit brought within thirty days.[23] Another provision[24] allows a refund without payment under protest when the Commissioner directs the refund after a hearing determining that the tax has been paid under an erroneous, improper, or illegal assessment. Attempts to make this latter section an administrative alternative to the payment under protest provision recently failed. Section 65-2681 was limited by the South Carolina Supreme Court as being applicable only to property taxes[25] and then only to issues involving the valuation of property taxes.[26]

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and six months of that time has elapsed the *unearned premium* would be one-half of the year's premium.

Brief for Appellant at 13, Colonial Life & Accident Ins. Co. v. South Carolina Tax Comm'n, 248 S.C. 334, 149 S.E.2d 777 (1966).

22. About three percent of its total business.

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

24. S.C. CODE ANN. §§ 65-2681 to -2685 (1962).

25. City of Columbia v. Glens Falls Ins. Co., 245 S.C. 119, 139 S.E.2d 529 (1964).

26. Owings Mills, Inc. v. Brady, 154 S.E.2d 560 (S.C. 1967). Owings Mills, Inc. v. Brady, 246 S.C. 361, 143 S.E.2d 717 (1965). The 1965 case decided there had been a substantial question raised as to the authority of the Tax Commission to order a refund under § 65-2682 when property valuation was not the issue. In the second case the supreme court reversed the circuit court's determination that the Commission had authority to order a refund, relying upon its first decision.

In *Vance v. South Carolina Tax Commission*[27] a tax refund issue was raised under the payment under protest provision and also under a section that has been repealed. The taxpayer was seeking a refund because the final determination of decedent's federal estate tax was considerably less than the tentative tax paid, thereby reducing the eighty per cent credit allowed on the federal tax return for state taxes paid.[28] The existing South Carolina estate tax structure was set up so that the state tax was dependent on this federal credit[29]—the state tax being equal to eighty per cent of the federal estate tax—thus allowing the state government to receive what would otherwise have gone to the federal government.

The court had little difficulty in holding that the state should base the South Carolina tax on the final federal determination and not on the amount paid under the tentative tax; however, the court was then faced with the more difficult question of what remedy the taxpayer could pursue to obtain this refund. A basic principle of tax law is that a taxpayer cannot sue a sovereign unless he has paid the tax involuntarily[30] or unless the sovereign consents by statute to be sued for a refund.[31] The state contended that the taxpayer had an adequate remedy under existing statutes, section 65-2661 or sections 65-509 to -510,[32] and not having pursued any such remedy, he should be barred. The court allowed the refund. The consent of the state to be sued arose by implication from the terms of the statute and it was upon this implied consent that the taxpayer could recover.

Whether this case is unique remains to be seen, but it might provide the court with a precedent for allowing a refund to a taxpayer with a meritorious claim who has not paid under protest or who cannot take advantage of the narrow administrative remedy of section 65-2681 open only to cases concerning valuation of property taxes.[33]

27. 153 S.E.2d 841 (S.C. 1967).

28. INT. REV. CODE OF 1954 § 2011. Since the additional estate tax has been combined with the basic estate tax, the credit is no longer eighty percent of the total tax; however, it is still eighty percent of the basic tax. INT. REV. CODE OF 1954 § 2011(d).

29. XXXIX S.C. STATS. AT LARGE 1768 (No. 960 1936) (repealed 1961).

30. Annot., 64 A.L.R. 9 (1930).

31. *See, e.g.*, S.C. CODE ANN. §§ 65-342.2, 65-386, 65-1457, 65-2661, 65-2681 (1962).

32. Code of 1952 (repealed 1961).

33. Note the trial court's grounds for a refund: (1) a common law right of action and (2) the retention of the taxpayer's funds by the state which constituted a taking of private property without just compensation and without due

D. Tax Accounting—Effect of Undetermined Consideration on Earning of Income.

When property is sold and part of the consideration is deferred, a problem arises as to whether the tax should be paid on the total purchase price in the year the transaction occurred or when the actual payment is received. For federal income tax purposes the proper treatment will generally depend upon the accounting method of the taxpayer.[34] The accrual method taxpayer will be taxed on the entire amount receivable in the year the transaction occurred,[35] but if the taxpayer is on the cash basis[36] or has qualified to use the installment method,[37] then income is taxable in the year payment is received. The South Carolina court, however, did not consider it "logical"[38] that the legislature should favor a cash basis taxpayer over an accrual one and in *Adams v. Burts*[39] the court, in determining the effective date of section 65-258(5), treated a cash basis taxpayer using the installment method as an accrual one and held that a taxpayer who had sold some timber with deferred payments had "earned" the income in the year the sale was made rather than in the years the payments were received.

Hunt v. South Carolina Tax Commission[40] involved a situation similar to the *Adams* case, *supra*, in that the cash basis taxpayer had made a sale with deferred payments prior to the effective date of section 65-258(5) and if the income was "earned" in the year of the sale, then the taxpayer would lose the benefit of an exclusion of one-half of the gain on payments received after 1960.

In *Hunt* the future compensation for the sale was to be determined by royalties based upon the number of items manufactured and sold, with each year having a minimum requirement

process of law. The supreme court felt it unnecessary to decide whether a refund could be obtained under these theories, since they had decided the case on the basis of implied consent.

34. *Cf.* Helvering v. Nibley-Mimnaugh Lumber Co., 70 F.2d 843 (D.C. Cir. 1934). Harold W. Johnston, 14 T.C. 560 (1950).

35. *Id.*, George L. Castner Co., 30 T.C. 1061 (1958) (repudiating *Titus, infra.*). *Contra,* C.W. Titus, Inc., 33 B.T.A. 928 (1936).

36. If, however, anything is given that is considered the "equivalent of cash" (*e.g.*, a note) then income will immediately be earned. P-H FEDERAL TAXES ¶ 6202, at 6166. A mere contractual obligation is not the "equivalent of cash". *E.g.*, Nina J. Ennis, 17 T.C. 465 (1951).

37. INT. REV. CODE OF 1954 § 453.

38. Adams v. Burts, 245 S.C. 339, 343, 140 S.E.2d 586, 589 (1965).

39. 245 S.C. 339, 140 S.E.2d 586 (1965).

40. 153 S.E.2d 321 (S.C. 1967).

of units that had to be paid for. It was on this basis that the court distinguished the *Adams* case, in which the payments were fixed when the contract was signed. Since in *Hunt* the consideration was dependent upon an unknown factor, it had not been fixed at the time the contract was consummated, and therefore the right to receive it had not accrued. The court rejected the trial court's theory that the amount equal to the minimum requirement had accrued at the execution of the contract since it felt that the obligation was not divisible.

While a very strict reading of *Adams* arguably might favor the lower court's approach, perhaps the supreme court was confining *Adams*. Although if the court had seriously questioned the correctness[41] of the *Adams* case and had noted that a cash basis taxpayer by definition earns income when payment is actually received,[42] the reasoning might have been based on sounder tax and accounting principles.

E. License Based on Prior Year's Business—Effect of Purchase of Another Business.

At 11:59 P.M. on December 31, 1962, Eagle Fire Insurance Company sold its Columbia business to Niagara Fire Insurance Company. The City of Columbia imposed a business license upon gross premiums collected during the preceding year, and a dispute arose as to whether the gross premiums of Eagle for 1962 should be included in Niagara's license computation. In *City of Columbia v. Niagara Fire Insurance Company*[43] the court followed every decision that had come to its attention from other jurisdictions[44] and held "that an insurance company which takes over another's business at the beginning of the license year or at the end of the preceding year is liable for a license fee based upon the volume of the business as so combined."[45] Implicit in the license was a purpose to use the prior year's volume not as

41. *See* Randall, *Taxation, Survey of S.C. Law,* 18 S.C.L. REV. 131, 138-40 (1966).

42. Johnson v. South Carolina Tax Comm'n, 235 S.C. 155, 160-61, 110 S.E.2d 173, 175-76 (1959).

43. 154 S.E.2d 674 (S.C. 1967).

44. Houseal v. Union Bankers Ins. Co., 277 Ala. 140, 167 So. 2d 708 (1964); Rinehart v. Reliance Ins. Co., 273 Ala. 535, 142 So. 2d 254 (1962); Lincoln Nat'l Ins. Co. v. McCarthy, 10 Ill. 2d 489, 140 N.E.2d 687 (1957); Insurance Co. of N. America v. Long, 215 Tenn. 642, 389 S.W.2d 245 (1965); Great American Ins. Co. v. Commonwealth, 197 Va. 449, 90 S.E.2d 108 (1955).

45. City of Columbia v. Niagara Fire Ins. Co., 154 S.E.2d 674, 676-77 (S.C. 1967).

the subject of the tax but as a reasonable, fair basis to estimate the volume of business during the license year.

F. Statutory Interpretation.

Since tax law is chiefly statutory, many cases can be decided by the normal process of statutory interpretation. In *Ryder Truck Lines, Inc. v. South Carolina Tax Commission*,[46] the principle of *ejusdem generis* was used by the court in holding that a motor carrier of freight was a business engaged in some "other form of public service"[47] within an income tax statute[48] taxing similar businesses. This caused the corporation to be taxed under this section rather than under the more favorable section 65-222.

In *York County Fair Association, Inc. v. South Carolina Tax Commission*[49] the taxpayer was not exempted from paying tax because it did not clearly fit within the language of the statute exempting from income tax any labor, agricultural or horticultural organization having no earnings which inure to the benefit of *any private stockholder or member*.[50] The fair association was owned by an American Legion Post—a "private" organization.

In *Beach v. Livingston*[51] there was no ambigiuty in the admission statute[52] which defined the taxable event, "admission," as "the right or privilege to enter into or *use* a place or location."[53] The taxpayer could not be refunded his five-cent tax after making "use" of a bowling facility in bowling a forty-five cent game.

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46. 248 S.C. 148, 149 S.E.2d 435 (1966).
47. "The basis of ascertaining the net taxable income of every corporation engaged in the business of operating a steam or electric railroad, navigation company, waterworks company, light or gas company, express telephone or telegraph business, sleeping car company or other form of public service . . . ."
48. S.C. CODE ANN. § 65-256 (1962). As mentioned in the Legislative section, public service corporations are now given a more favorable treatment.
49. 154 S.E.2d 361 (S.C. 1967).
50. S.C. CODE ANN. § 65-226(8) (1962).
51. 248 S.C. 135, 149 S.E.2d 328 (1966).
52. S.C. CODE ANN. § 65-802 (1962).
53. S.C. CODE ANN. § 65-801(1) (1962) (emphasis added).