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Taxation

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TAXATION

I. STATUTORY INTERPRETATION

A. *No Implied Limitation On Business License Tax For Cities Of Less Than 70,000*

South Carolina law authorizes cities to levy business license taxes according to their population. The municipalities are classified into three groups (towns of less than 1,000 persons,[1] towns from 1,000 to 70,000,[2] and cities over 70,000[3]), but only the statute dealing with the largest municipalities contains a limitation on the amount of such tax the city can impose. Section 47-407 of the South Carolina Code provides that the maximum license tax that a city with a population over 70,000 can impose is $2,500 annually.

Two Greenville insurance offices argued that since the legislature had placed a limit on the business license tax which could be imposed by cities of over 70,000 population, by implication, that limitation ($2,500) is the maximum tax which can be exacted under the two code sections that apply to smaller cities. That Greenville's population was less than 70,000 was not disputed. The companies contended, therefore, that the imposition of a license tax in excess of $2,500 was not authorized by section 47-271, that such a tax was "excessive and unreasonable," and that the imposition violated "the legislative intent as reflected in the foregoing statutes."[4]

Judicial approval had already been given the statutory classification on a population basis for the imposition of license taxes.[5] The only issue to be decided in *United States Fidelity & Guaranty Co. v. City of Greenville*,[6] therefore, was whether a city of less than 70,000 could impose, under section 47-271, a business license tax of $2,500 per year.

The court found no basis to assume that the legislature intended that the limitation of section 47-407 should apply to cities affected by section 47-271:

1. S.C. CODE ANN. § 47-173 (1962).
2. S.C. CODE ANN. § 47-271 (1962).
3. S.C. CODE ANN. § 47-407 (1962).
4. United States Fidelity & Guar. Co. v. City of Greenville, 250 S. C. 136, 156 S.E.2d 417 (1967).
5. Glens Falls Ins. Co. v. City of Columbia, 242 S.C. 237, 130 S.E.2d 573 (1963).
6. 250 S.C. 136, 156 S.E.2d 417 (1967).

> Under the plain and unambigous terms of Section 47-271, it is clear that the Legislature did not intend to impose a limitation of $2,500.00 upon the amount of the tax which could be collected by cities with a population of under seventy thousand. And, where it is clear that no limitation was intended, we cannot properly create one.[7]

B. Exemption to Use Tax Available to Producer-Processor of Tangible Personal Property

An issue involving a particular exemption to South Carolina's sales and use taxes was raised in *Monroe v. Livingston*.[8] The plaintiff Monroe owned machinery which he used to process the eggs he produced for wholesale. The state tax commission determined that the machinery was subject to the use tax.[9] Monroe contended that the machinery was exempt from the levy by section 65-1404(17) of the South Carolina Code, which eliminates "machines used in . . . processing tangible personal property" from the sales and use taxes.

The commission's only basis for asserting tax liability was that the particular exemption was available only to those engaged in business as a processor. Since Monroe was a poultry farmer and thus a producer, the commission asserted that he could not also be a processor within the meaning of the statute.

The supreme court discounted the commission's argument and found for the taxpayer. The court stated the commission had failed to show that Monroe was not a processor: "[T]here is no basis in the statute to warrant withholding the exemption from the plaintiff because he was the producer of the eggs which he was processing."[10]

The defendant commission weakly argued that the particular exemption had been construed by the commission over a long period of time as inapplicable to poultry farmers, and that such interpretation should continue. Administrative construction, the court replied, afforded no basis for the perpetuation of an erroneous application of the statute.

7. *Id.* at 140, 156 S.E.2d at 418-19.
8. 161 S.E.2d 243 (S.C. 1968).
9. S.C. CODE ANN. § 65-1421 (1962).
10. Monroe v. Livingston, 161 S.E.2d 243, 244 (S.C. 1968).

C. *Consolidated School District Assumes Liabilities of Constituent Districts*

On June 8, 1967, legislation was approved which consolidated, effective July 1, 1968, the eight existing school districts of Charleston County into one county-wide district.[11] At the time of the enactment of the law, four of the districts to be consolidated had outstanding bonded indebtedness, while the other four were relatively debt-free. Section 11 of the Act,[12] around which the controversy in *Smythe v. Stroman*[13] centered, provided that the new consolidated district would not assume the bonded indebtedness that the individual districts had incurred prior to consolidation.

If section 11 were given effect, the taxpayers of the old constituent districts would have to service the debts of their particular district after consolidation. This would amount to a levy of from five mills in District No. 10, to eight and a half mills in District No. 20.

The taxpayers of the districts with bonded indebtedness attacked the validity of section 11, contending that the total liabilities of the consolidated district, as well as the total assets, should be the responsibility of the entire consolidated district. If this argument were given effect and section 11 was declared invalid, a uniform tax (estimated to be three mills in 1968) would be imposed throughout the new district to service the consolidated debt.

The trial court ordered section 11 stricken as invalid, and the supreme court, in a four paragraph per curiam decision, adopted the trial court disposition, reporting the order of the lower court.

The lower court noted that the legislature must have been uncertain from the outset of the validity of section 11 because of a disclaimer in the section which denominated it

11. LV S.C. STATS. AT LARGE 470 (No. 340, 1967).
12. LV S.C. STATS. AT LARGE 470, 475 (No. 340, § 11, 1967) provides: The Charleston County School District shall not assume any bonded indebtedness incurred prior to July 1, 1968, by any of the present school districts. The bonded debt of the present school districts incurred prior to July 1, 1968 shall remain the obligations of the respective constituent districts after July 1, 1968 which shall continue to be taxed accordingly. The provisions of Section 11 are not an essential inducement to the enactment of this act.
13. 162 S.E.2d 168 (S.C. 1968).

"not an essential inducement to the enactment of this act."[14] It found ample authority in both case law[15] and in the code[16] for the proposition that upon consolidation of school districts whereby the consolidated district succeeds to all the assets of the former districts, the consolidated district also assumes all the liabilities and obligations of the constituent districts. The supreme court held that since the general statute[17] had declared that the liabilities of the original districts would be assumed by the consolidated district, "the general statute controls and invalidates the special provisions of section 11."[18]

The supreme court, therefore, struck section 11 from the Act, had the consolidated district assume all existing debts of the constituent districts, required the indebtedness existing prior to June 7, 1968, to be included in the amount of bonds the district could issue under the constitutional debt limitation,[19] and declared the remainder of the act to be valid after section 11 was stricken.

D. Tax on Soft Drink Syrup Construed as Sales or Use Tax

Reynolds v. South Carolina Tax Commission[20] involved the construction of a state tax statute in relation to federal law. The plaintiff Reynolds, a contractor for food services for the Marine Corps Air Station at Beaufort, refused to affix state tax stamps to the containers of syrup used to mix soft drinks as required by South Carolina law.[21] Reynolds contended that

14. LV S.C. STATS. AT LARGE 470, 475 (No. 340, § 11, 1967). As further precaution, the legislature inserted a saving clause in the act as section 15: "If any part of this act shall be held unconstitutional such unconstitutionality shall not effect the remainder of this act." LV S.C. STATS. AT LARGE 470, 476 (No. 340, § 15, 1967).
15. *E.g.*, Walker v. Bennett, 125 S.C. 389, 118 S.E. 779 (1923).
16. S.C. CODE ANN. § 21-114.3 (1962) provides:
> Upon consolidation of any two or more school districts, all property, real and personal, and all assets of the districts forming the consolidated school district shall become the property of the consolidated district and all liabilities of the consolidating districts shall become the obligations of such consolidated district. Each such consolidated district shall be a body politic and corporate and its board of trustees shall have such powers as are provided by law.
17. S.C. CODE ANN. § 21-114.3 (1962).
18. Smythe v. Stroman, 162 S.E.2d 168, 170 (S.C. 1968).
19. S.C. CONST. art. 10, § 5.
20. 162 S.E.2d 259 (S.C. 1968).
21. S.C. CODE ANN. § 65-752 (1962) provides:
> For each gallon of syrup for use at soda fountains in mixing any drink which when mixed would be classified as a soft drink, there shall be affixed to the original container soft drinks license tax stamps, at the rate of one dollar per gallon.

(1) his place of business had been ceded to the United States by law[22] and thus it was without the jurisdiction of South Carolina for tax purposes, and (2) that since his business was under contract with the Marine Corps Exchange, it was a federal instrumentality and immune from state taxation.

The trial court validated Reynolds' contentions and held that he was entitled to recover the taxes paid under protest. But the supreme court had little trouble refuting both arguments, finding the trial court in error, and reversing the decision.[23]

Disposing first of the second contention, the court found that "the mere fact that a private corporation conducts its business under a contract with the United States does not make it an instrumentality of the latter."[24]

To decide the first contention, the court had to consider the Buck Act,[25] which receded to the states sufficient sovereignty over the federal areas within its territorial limits to enable the state to levy and collect sales and use taxes.[26] The act defined "sales or use tax" as "any tax levied on, with respect to, or measured by, sales, receipts from sales, purchases, storage, or use of tangible personal property. . . ."[27]

The tax commission contended that the South Carolina statute was a sales or use tax within the meaning of the Buck Act, and thus jurisdiction to levy the tax had been receded to the state. Reynolds, noting that section 65-752 characterizes the imposition as a license tax, argued that that the Buck Act, applying only to sales or use taxes, was inapplicable to give the Commission jurisdiction. The court answered that

22. S.C. CODE ANN. §§ 39-51 to -54 (1962).
23. Reynolds v. South Carolina Tax Comm'n, 162 S.E.2d 259 (S.C. 1968).
24. *Id.* at 261.
25. 4 U.S.C. §§ 105-10 (1964).
26. The Buck Act provides:
> No person shall be relieved from liability for payment of, collection of, or accounting for any sales or use tax levied by any State, or by any duly constituted taxing authority therein, having jurisdiction to levy such a tax, on the ground that the sale or use, with respect to which such tax is levied, occurred in whole or in part within a Federal area; and such State or taxing authority shall have full jurisdiction and power to levy and collect any such tax in any Federal area within such State to the same extent and with the same effect as though such area was not a Federal area.

4 U.S.C. § 105(a) (1964).
27. 4 U.S.C. § 110(b) (1964).

the character of the tax was determined by its operation and effect and that the only issue was whether the tax was a sales or use tax as defined by the Buck Act:

> The tax levied and sought to be collected is clearly a tax upon the *use* of syrup at such fountains in mixing any drink which, when mixed, would be classified as a soft drink. We think the foregoing is made perfectly clear by Section 65-753 of the Code which defines the word "syrup" as being the compound mixture or basic ingredients *used* in making, mixing or compounding of soft drinks at soda fountains.[28]

Since the tax was obviously aimed at the use of the syrup and not at its licensing, the court concluded that the Buck Act contained substantial authorization for the commission to levy a tax measured by the storage or use of the syrup, and that section 65-752 is a use tax within the meaning of the Buck Act.

II. CONSTITUTIONALITY OF STATUTES

A. Tax on Fiduciary Does Not Discriminate Against Non-Resident Beneficiary

A trustee under a testator's will who distributed income from real property to nonresident beneficiaries of the trust attacked the constitutionality of an amended South Carolina tax statute in *Peoples National Bank of Greenville v. South Carolina Tax Commission.*[29]

The revised statute[30] levied a tax on fiduciaries with respect to the part of their net income derived from real property or tangible personal property in South Carolina which is distributable to a nonresident beneficiary. The tax imposed is charged against the trust.

Prior to the amendment the plaintiff trustee had distributed the net income to the nonresidents, made a fiduciary return to the tax commission, and reported no tax due. Re-

28. Reynolds v. South Carolina Tax Comm'n, 162 S.E.2d 259, 262 (S.C. 1968) (emphasis by the court).
29. 250 S.C. 187, 156 S.E.2d 769 (1967).
30. S.C. CODE ANN. § 65-223(b) (Supp. 1967), *amending* S.C. CODE ANN. § 65-223 (1962).

lying on the 1963 amendment,[31] however, the commission rejected the trustee's 1963 return and assessed a tax on the net income reported. The trustee paid under protest and brought the action to recover, contending that the effect of the amended statute is to discriminate against non-residents because only one $800 exemption is allowed to the fiduciary, even though the income in this instance is distributed to four nonresident beneficiaries. Since each resident is afforded an $800 exemption, the plaintiff's sole contention was that the statute worked to discriminate against the nonresident, whose trustee was not allowed an exemption for each beneficiary. This violated, the plaintiff argued, the uniform and equal rate provisions of the South Carolina constitution[32] and the equal protection guarantee of the fourteenth amendment of the United States Constitution.[33]

The court disagreed with the plaintiff and with the trial court which had found against the tax commission. Pointing out that although the levy is called a tax on the fiduciary, the tax is paid from funds otherwise distributable to the beneficiaries, and thus the practical effect of the law is to exact a tax from the beneficiary.

The court advised that a nonresident who receives income subject to taxation in South Carolina is required to file a return to the state tax commission,[34] but he is protected because his tax is calculated at the same rate as a resident,[35] and he may prorate the same exemption as a resident.[36]

Thus, the court concluded, the amended statute is only nominally a tax on the fiduciary — the beneficiary is the real taxpayer:

> In the light of these realities and of the legislative purpose to assure the collection of taxes on income distributable to nonresident beneficiaries, we think

31. LIII S.C. STATS. AT LARGE 279 (No. 245, 1963). The amendment rewrote the first paragraph and added sub-division "b" to § 65-223.
32. S.C. CONST. art. 10, § 1.
33. U.S. CONST. amend. XIV, § 1. The court does not reveal under which sections of the federal and state constitutions the plaintiff claims he was suffering discrimination. The author assumes that the fourteenth amendment and the South Carolina constitution section cited *supra* at note 32 are the applicable provisions.
34. S.C. CODE ANN. § 65-291 (1962).
35. S.C. CODE ANN. § 65-221 (1962).
36. S.C. CODE ANN. § 65-225(6) (1962).

> that the challenged provision of the statute should be construed as a withholding tax device, rather than as a tax on the fiduciary.[37]

Such a construction, the court continued, allows the nonresident beneficiary, when filing his South Carolina return, to take credit for the amount paid to the state by the fiduciary. Thus, the issue of discrimination was resolved in favor of the statute's constitutionality. Under the court's construction, the nonresident beneficiaries are afforded equality of treatment under the state tax statutes.

The court appeared to have some doubt whether the statute could be approved solely as a tax on the fiduciary, without construing the levy as a withholding device. After citing several principles of statutory construction which indicate that a statute should be construed to be valid whenever possible, the court concluded that its duty "to sustain the validity of an act of the General Assembly, on any ground fairly appearing from the record, requires that we follow this course."[38]

B. The Industrial Revenue Bond Act

Probably the most important decision in a tax-related area in the past year was *Elliott v. McNair*,[39] which declared the Industrial Revenue Bond Act[40] to be constitutional. The Act, which enabled state public agencies (County Boards) to give assistance to new or expanding industries through the use of tax-exempt revenue bonds, withstood a withering barrage of attacks on its validity, including contentions that the law violated the constitution by creating a public debt, by pledging the state's credit for the benefit of a particular company, by failing to serve a public purpose, and by affording special privileges to a private corporation. The court patiently studied each contention before concluding that "[t]he Act here under consideration is a valid exercise of the legislative power of the General Assembly of this State."[41]

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37. Peoples Nat'l Bank of Greenville v. South Carolina Tax Comm'n, 250 S.C. 187, 156 S.E.2d 769 (1967).
38. *Id.* at 193, 156 S.E.2d at 772.
39. 250 S.C. 75, 156 S.E.2d 421 (1967). For a detailed discussion of this decision see 20 S.C.L. REV. 106 (1968).
40. S.C. CODE ANN. §§ 14-399.21 to -99.35 (Supp. 1967).
41. Elliott v. McNair, 250 S.C. 75, 98, 156 S.E.2d 421, 433 (1967).

One issue not decided in *Elliott* was the applicability of the Act with respect to projects begun prior to the act's passage (March 21, 1967) or its effective date (January 1, 1967). The question was raised in *Nuessner v. McNair*,[42] which involved two Greenville County projects begun in 1966. The plants had arranged for temporary financing in anticipation of obtaining industrial revenue bond financing when it became available. The court, concerned with whether it was the legislature's intention to confer the benefits of the Act on industries which located in the state prior to the Act's passage but not then completed or financed, found that the General Assembly did not limit the counties to the acquisition of projects commenced after the effective date:

> It is our conclusion that the Legislature intended the benefits of the Act to be as far-reaching as possible and that the time of the commencement of the construction of a project had no significance as to whether the provisions of the Act were available if the projects were essential to the state's economy and the welfare of its people. The effective date of the Act, in our opinion, applies solely to the time when the county could exercise the powers granted therein.[43]

III. Effect of State Trial Court's Determination of a Property Interest in a Federal Court Tax Controversy

Lakewood Plantation, Inc. v. United States,[44] an action for the refund of federal income taxes in the United States District Court, is an important extension of the doctrine of the much-heralded Supreme Court decision of *Commissioner v. Bosch*.[45] Although it is not within the scope of this survey to consider federal tax cases, *Lakewood* is reviewed because of its importance in determining the significance that a state trial court adjudication may have in a subsequent federal tax litigation.

The Supreme Court held in *Bosch* that when federal estate tax liability turns on the character of a property interest

42. 250 S.C. 257, 157 S.E.2d 410 (1967).
43. *Id.* at 263, 157 S.E.2d at 412-13.
44. 272 F. Supp. 290 (D.S.C. 1967).
45. 387 U.S. 456 (1967).

held and transferred by a decedent under state law, federal authorities are not conclusively bound by the determination made of such property interest in a proceeding in which the United States is not a party.[46] But the doctrine of the decision has been expanded beyond the relatively narrow holding into the previously chaotic realm of the effect of a previous state trial court's determination of a property interest in a federal court tax controversy.

In *Lakewood,* the grantor conveyed timber lands in 1953 to Lakewood Plantation, a corporation. When the grantor, who was virtually the sole owner of Lakewood at that time, sold the timber off the land, he reported the income on his personal federal tax return but not as any income to the corporation. Upon investigation in 1957, the Internal Revenue Service determined that the income was that of the corporation, not of the grantor personally. The grantor first obtained a correction deed, then instituted a nonadversary civil action, in which the United States was not a party, to reform the original deed *ab initio* to reflect that a mutual mistake had been made, and that the grantor had intended to reserve to himself for twenty years the timber rights on the property. In a 1960 decree, the state trial court ordered that the reformation be made effective as of the date of the original deed. Lakewood then brought action to recover the federal income taxes paid from 1954 through 1956, and the overriding issue in the litigation was the admissibility of the state court decree reforming the deed.

In ruling on the admissibility of the reformation decree, the district court considered *Bosch* and found that there the correctness of the local adjudications depended on whether the proper state law had been applied to the undisputed facts. In *Lakewood,* however, the validity of the state trial court ruling hinged on a disputed factual question — whether there had really been a mutual mistake when the 1953 deed was made without reserving timber rights to the grantor. Noting that *Bosch* decided that the federal court must make an independent review of the state law under the principles of *Erie Railroad v. Tompkins*[47] and adjudicate the disputed property rights accordingly, the district court stated the *Lake-*

46. *Id.* at 457. For a detailed comment on *Bosch, see* 20 S.C.L. REV. 477 (1968).
47. 304 U.S. 64 (1938).

wood issue: "If the government in accordance with *Bank of New Haven*[48] and *Bosch* is not bound by a state trial court decree of property rights based on a misapplication of state law, is it bound by such a decree based on erroneous findings of fact?"[49]

The court's answer to its own question added a new dimension to *Bosch:*

> If a state court decree is not binding on the government on erroneous findings of state law the resultant logic of the *Bank of New Haven* and the *Bosch* decisions is that by a like token the government is not bound by a decree based upon erroneous findings of fact. The mandate of *Bank of New Haven* and *Bosch* appears to be that federal tax liability should be litigated exclusively in the federal courts with proper regard to state law when property rights are disputed.[50]

Thus the court ruled that the 1960 reformation decree and the underlying testimony and evidence would be inadmissible in the federal action, and the case was set over for trial on the merits.

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48. Second Nat'l Bank of New Haven v. United States, 387 U.S. 456 (1967). *Bank of New Haven* is the companion case to *Bosch.*
49. Lakewood Plantation, Inc. v. United States, 272 F. Supp. 290, 294 (D.S.C. 1967).
50. *Id.*