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McKay, Sherrill, Walker, Townsee & Wilkins (Columbia, SC)

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REAL ESTATE INVESTMENT TRUSTS IN SOUTH CAROLINA

Robert P. Wilkins *

Albert L. Moses **

BUSINESS TRUSTS GENERALLY

A business trust is an unincorporated business organization created under an instrument by which property is to be held and managed by trustees for the benefit and profit of such persons as may be or become the holders of transferable certificates evidencing the beneficial interests in the trust estate.¹

Prior to 1935, business trusts were taxed as ordinary trusts. Such trusts were therefore not taxed on income actually distributed to their beneficiaries. In 1935 the United States Supreme Court in *Morrissey v. Commissioner*,² held that such trusts should be taxed as corporations.

Business trusts, because of this unfavorable tax treatment, languished until 1960 when Congress added sections 856, 857 and 858 to the Internal Revenue Code.

Under these sections very favorable tax treatment was granted to a real estate investment trust, which is defined as a business trust or association which meets certain strict requirements. In its simplest form a real estate investment trust, by distributing 90% of its income to its shareholders, could avoid tax on the income thus distributed and only pay tax on its retained income. The enactment of this legislation has revitalized the business trust in this form.³

* Partner, McKay, Sherrill, Walker, Townsend & Wilkins, Columbia, S. C.; B.S. (1953), LL.B. (1954) University of South Carolina; LL.M. (1957) Georgetown University; Lecturer in Law, University of South Carolina Law School; Author, *Drafting Wills and Trust Agreements in South Carolina*.

** Partner, McKay, Sherrill, Walker, Townsend & Wilkins, Columbia, S. C.; B.A. (1961) Wofford College; LL.B. cum laude (1964) University of South Carolina; LL.M. in Taxation (1967), Georgetown University.

1. Annot., 156 A.L.R. 22 (1945).

2. 296 U.S. 344 (1935).

3. H.R. REP. No. 12559, 86th Cong., 2d Sess. (1960) indicates that this special treatment was designed to provide equality of tax treatment between the beneficiaries of real estate investment trusts and the shareholders of regu-

Although there are numerous legal questions which arise in connection with business trusts, the question which needs the most precise answer is whether the owners of the beneficial interest in the trust (the shareholders) are liable for the obligations of the trust. An almost equally important question is whether the trustees are personally liable for the obligations of the trust.

Generally speaking, the courts in the United States consider the degree of shareholder control over trustees in determining shareholder liability for obligations of the trust. If the control of the trust is vested in the trustees and not in the shareholders and it is a true trust, the shareholders will not be liable. If the shareholders have control over the trustees and the affairs of the trust, the shareholders will be liable. In a few jurisdictions, the shareholders have been held liable regardless of control.⁴

It has been generally held that a provision of a trust instrument requiring persons dealing with the trustees to look only to the trust estate and exempting shareholders from personal liability is not contrary to law or public policy.⁵

The well settled principle, applicable to trusts generally, that a trustee is personally liable on obligations incurred by him as trustee, applies to business trusts.⁶ The liability of trustees of business trusts to third persons may be affected by statute or by a contractual provision exempting the trustees from personal liability on contracts made by them on

lated investment companies, thus giving the small investor the advantages of a pooling arrangement for investments in real estate and mortgages. The Report also stresses that these investments should be passive and that a business trust engaging in active business operations, should continue to be subject to the corporate tax in the normal manner. To assure the passive investment by the trust there are stringent restrictions on a real estate investment trust's performing services or management functions for tenants of a real estate investment trust's property. A real estate investment trust must engage an independent contractor to perform these services. This independent contractor is usually a corporation which, under contract, supplies the trust with management services, advice and sometimes property inspections and appraisals, among other things. Where these activities occur within South Carolina, potential qualification and taxation problems for the manager may arise, depending upon the nature and extent of such activities. These matters are beyond the scope of this article.

4. See 13 AM. JUR. 2d *Business Trusts* §34 (1964).

5. *Id.* §37.

6. *Id.* §67.

behalf of the trusts.⁷ Such provision excluding personal liability in a contract is valid, and is not illegal or contrary to public policy. Creditors who stipulate against the personal liability of trustees or agree to look solely to the trust estate cannot recover against the trustees in their individual capacities.⁸

The question of personal liability of shareholders and trustees frequently depends on whether the entity is a true business trust or whether it is a partnership, association or joint stock company.⁹

Business trusts are created by the act and agreement of the parties (the trust instrument) and do not depend on statutory law for their validity.¹⁰ A business trust must, however, conform to statutory and other requirements relating to trusts generally.¹¹ Therefore the trust instrument generally will determine how a business trust operates.

BUSINESS TRUSTS IN SOUTH CAROLINA

The business trust is an adaptation of the common law trust for the purpose of carrying on a business enterprise. Generally known as a "Massachusetts Trust," the business trust was originally used to avoid that state's laws restricting corporate acquisitions of real property.¹²

The basis for the terminology, "common law trust," in this connection, is not that such organizations are the creatures of the common law, as distinguished from equity, but that they are created under the common law of contracts and do not depend on any statute.¹³

Until 1961 there were neither cases nor statutes dealing with the question of the validity of business trusts in South Carolina. In 1961 S.C. CODE ANN. §§52-201 *et seq.* (Supp.

7. *Id.* §66.

8. *Id.* §69.

9. See generally, 13 AM. JUR. 2d *Business Trusts* §11 (1964); Annot., 156 A.L.R. 22 (1945).

10. 13 AM. JUR. 2d *Business Trusts* §13 (1964).

11. *Id.* §14. For South Carolina statutes relating to trusts and fiduciaries, see S.C. CODE ANN. §67-1, *et seq.* (Supp. 1971) (Title 67).

12. 3 Z. CAVITCH, BUSINESS ORGANIZATIONS §43.01 (1) (1970).

13. Annot., 156 A.L.R. 22 (1945); 13 AM. JUR. 2d *Business Trusts* §68 (1964).

1970) were enacted. Section 52-201 appears to acknowledge the validity of a “business trust created at common law in this state” and provides that such a trust created in this state or a business trust doing business in this state must record the trust instrument and amendments with the clerk of court (or register of mesne conveyance)¹⁴ in the county in which it has its principal place of business and must file a verified copy of such instruments with the Secretary of State.

Section 52-202 of the Code provides that real estate may be acquired, conveyed and mortgaged by the trustees in the name given to or used by the business trust. Section 52-203 provides that a business trust shall not be affected by any rule against perpetuities. Section 52-205 provides that service of process may be made on any business trust organized in the state or doing business in this State in the same manner that domestic and foreign corporations, respectively, are served. Section 52-204 provides that a business trust may sue or be sued in the name and style by which it conducts business without naming the individual shareholders.

Section 52-204 also answers most of the critical questions involving the personal liability of shareholders and trustees:

. . . and the liability of such business trust shall extend to the whole of the trust estate, or so much thereof as may be necessary to discharge such liability, but the instrument creating such trust may provide that no personal liability will attach to the individual shareholders or trustees of the trust, and such provision shall operate to limit the liability of the individual shareholders and trustees as to the obligations of the trust itself, but provided in all cases the trustees shall be liable for breach of trust.¹⁵

From the foregoing it would appear that such a provision in the trust instrument would be valid and shareholders and trustees might be liable for obligations of the trust only if:

(1) The entity were not in fact a business trust, but a partnership, association or other business entity.

(2) The trustees or shareholders in dealing with a third person either failed to disclose that they acted on behalf of a business trust or the third person was unaware that he was dealing with a business trust.

14. Hereafter, the term “clerk of court” is used to include the term “register of mesne conveyances” where applicable.

15. S.C. CODE ANN. §52-204 (Supp. 1970).

(3) The provisions in the trust instrument limiting liability were unclear, or not in compliance with Section 52-204 of the Code.

It would appear from the language of Section 52-204 that the shareholders would not be liable to third persons for torts committed by the trustees.

The trustees of a business trust are personally liable for torts personally committed by them in conducting the business of the trust¹⁶ and this principle is probably not affected by Section 52-204. Whether or not Section 52-204 eliminates the personal liability of a trustee for tortious acts of the trustees' agents and employees is not clear, but Section 52-204 does not appear to relieve the trust estate of such liability.

Although Section 52-204 seems to provide adequate protection from liability for shareholders and trustees, if none of the aforesaid exceptions exist, it would be prudent to insert in all contracts the language of the trust instrument limiting personal liability of the shareholders and trustees. The authors of this article have recently had occasion to observe language similar to that set forth below on the letterheads and other documents of a foreign real estate investment trust:

The name XYZ Real Estate Investment Trust refers to the Trustees (as Trustees but not individually) under a Declaration of Trust dated January 1, 1972 as amended, to which reference is hereby made (and a copy of which is on file with the Secretary of the Commonwealth of Massachusetts), and, as provided therein, no Trustee, officer, agent or shareholder of said Trust shall be held to any personal liability in connection with any obligation entered into or incurred on behalf of said Trust, and any person dealing with said Trust shall look solely to the Trust for the payment of any claim or for the performance of any obligation thereof.

This language with slight modification could be adapted for use by a South Carolina business trust.

The language of Section 52-204 appears to put a creditor on notice that the trustees and shareholders may have no personal liability to him (if the creditor is aware that he is dealing with a business trust).

SOME BASIC PROBLEMS

Although there are many questions concerning business trusts which are unanswered because of the dearth of de-

16. 13 AM. JUR. 2d *Business Trusts* §68 (1964).

cisions and statutes on this subject in South Carolina, there are several basic problems which are immediately obvious. These apply mainly to foreign business trusts but some apply to both foreign and domestic trusts:

(1) What constitutes “doing business” in South Carolina for purposes of Section 52-201?

(2) What is the effect of “doing business” in South Carolina without meeting the requirements of Section 52-201?

(3) Once a foreign business trust files under Section 52-201, how does it subsequently withdraw?

(4) Is a foreign business trust required to record its trust instruments in any county?

(5) Can a business trust record a certified copy of its trust instrument and amendments in the office of the clerk of court?

(6) Can a mortgage or personal property be held in the name of the business trust under Section 52-202?

The solutions to these problems are probably in the main noncontroversial. In most cases portions of the language of the South Carolina Business Corporation Act of 1962¹⁷ could be adapted to provide essentially the same solution for business trusts as is provided for corporations.

(1) *What constitutes “doing business” in South Carolina for purposes of Section 52-201?* Section 52-201 provides that “every business trust . . . *doing business* in this state . . .” shall be subject to certain recording and filing requirements. The question of what is “doing business” and what is not is quite complex, and clear lines of demarcation are difficult to perceive.¹⁸ Under South Carolina cases¹⁹ it appears that a real estate investment trust making a loan to a resident of this state, secured by a mortgage on real property in this

17. S.C. CODE ANN. §12-11.1 *et seq.* (Supp. 1971).

18. See Wilkins, *Mortgage Investments by Foreign Corporations*, 16 S.C. L. REV. 399 (1964) for a discussion of “doing business” as it relates to foreign corporations.

19. See, e.g., *British Am. Mortgage Co. v. Jones*, 77 S.C. 443, 58 S.E. 417 (1907) and cases discussed in Wilkins, *supra* note 18. The rationale of the holding in *British American* was, at least in part, that the foreign corporation was performing within the state some of the functions for which it was created. See also note 28, *infra*.

state, with no other contact with this state might be "doing business" in this state within the terms of Section 52-201.

The South Carolina Business Corporation Act of 1962 contains a definition of certain activities, any one or more of which will not constitute doing business.²⁰ One of the most important activities excluded is "the creating or acquiring evidences of debt, mortgages, etc. and securing or collecting debts, etc."

In Appendix A hereto, proposed Section 1 is similar to Section 12-23.1 of the Code, which, among other things, defines those activities of a foreign business trust, any one or more of which would not constitute "doing business." Paragraph (10) of proposed Section 1(b), which in effect provides that filing or recording the trust instrument is an exempted activity, has been added so that a business trust which engages only in those activities named in the proposed section, but needs to file or record such instruments because of possible title requirements, can do so without any adverse presumptions of "doing business."

(2) *What is the effect of "doing business" in South Carolina without meeting the requirement of Section 52-201?* In considering this question, counsel must anticipate the worst that could happen, which would be that notes, mortgages or contracts entered into might not be valid and enforceable or that the South Carolina courts would not be available to enforce such rights.²¹ This, indeed, would be a harsh penalty.

The South Carolina Business Corporation Act considers this problem as it relates to foreign corporations and provides a more equitable solution.²² In its simplest terms, the contracts of a foreign corporation which has not qualified in South Carolina are valid. Such foreign corporation can defend a suit against it, but it cannot be a plaintiff until it qualifies and is in good standing.

In Appendix A, proposed Section 2 would establish essentially the same rule for business trusts.

20. S.C. CODE ANN. §12-23.1 (Supp. 1971).

21. See, Annot., 156 A.L.R. 22, 183-85 (1945). Cf. Galletley v. Strickland, 74 S.C. 394, 54 S.E. 576 (1906) and the discussion of that case in Wilkins, *supra* note 18 at 402.

22. S.C. CODE ANN. §12-23.15 (Supp. 1971).

(3) *Once a foreign business trust files under Section 52-201, how does it subsequently withdraw?* If the proposed filing requirements become an exempted activity as provided in Appendix A and if no recurring reporting or filing requirements are subsequently imposed, it does not appear that a provision for withdrawal would be necessary.

(4) *Is a foreign business trust required to record its trust instruments in any county?* Under Section 52-201 a business trust doing business in this state is required to record its trust instruments in the county in which it has a principal place of business. An amendment to this section is proposed in Appendix A which would relieve a foreign business trust which maintains neither a place of business nor agent in this state from any obligation to file its trust instruments in any county in this state.

(5) *Can a business trust record a certified copy of its trust instruments in the office of the clerk of court?* Section 52-201 requires a business trust to record "the trust instrument and any amendment thereto" in the office of the clerk of court. This section provides that "a verified copy of each instrument and any amendments thereto" shall be filed with the Secretary of State. Presumably an original must be recorded in the office of the clerk of court. This can be unduly burdensome and an amendment to Section 52-201 is proposed in Appendix A which would allow a copy of the trust instrument and any amendments thereto certified by a trustee of the trust to be recorded and filed.

(6) *Can a mortgage or personal property be held in the name of the business trust under Section 52-202?* Section 52-202 provides that real estate may be acquired, conveyed and mortgaged by the trustees in the name given to or used by the business trust. Whether mortgages or personal property can be so held becomes a matter of construction.²³ There seems to be no good reason not to allow "any property" of a business trust to be acquired, conveyed and mortgaged by the trustees in the name given to or used by the business trust. A proposed amendment to Section 52-202 to this effect is set forth in Appendix A. Also proposed is a provision allowing any one or more trustees or officers, authorized by

23. In the absence of Section 52-202, title to property of a trust probably would have to be taken in the names of the trustees.

the trust instrument, to execute on behalf of the trust, instruments acquiring, conveying or mortgaging property of the trust.

FEDERAL INCOME TAX TREATMENT OF REAL ESTATE INVESTMENT TRUSTS

It is not the purpose of this article to treat in detail the federal income taxation of real estate investment trusts. There are numerous excellent publications where this topic is explored. However, a brief explanation of the federal tax treatment is necessary to understand South Carolina's taxation of such trusts.

In 1960 Congress added three new sections to the Internal Revenue Code (Sections 856, 857 and 858) which provide a new method for taxing unincorporated trusts or associations which meet the requirements of such sections and which are defined as real estate investment trusts.

Prior to the enactment of these sections, a business trust was taxed as a corporation. Its income was taxed to the trust and distributions to the beneficiaries were taxed to the beneficiaries as dividends.

Under the new sections, if a business trust qualifies as a real estate investment trust by meeting the requirements of the new sections, it will be taxable only upon the income it retains each year. The income distributed to beneficiaries (which must be at least 90% of real estate investment trust taxable income of the trust) will be taxed directly to them and will not be taxed to the trust.

The requirements of Sections 856, 857 and 858 of the Internal Revenue Code are highly technical and the result of failure to qualify can be disastrous.²⁴ If in any year, the trust fails to meet each of the highly technical requirements of the Code, the trust will be denied its deduction for dividends paid to the shareholders for the entire year and will be liable for payment of tax at corporate rates upon its taxable income. The fact that the trust may have distributed all of its taxable

24. See Kelley, *Real Estate Investment Trusts After Seven Years*, 23 BUSN. LAWYER 1001 (July 1968) and Aldrich, *Real Estate Investment Trusts, An Overview*, 27 BUSN. LAWYER 1165 (July 1972), for a discussion of some of these problems.

income to shareholders in the good faith belief that it was a qualified trust is immaterial.²⁵

SOUTH CAROLINA INCOME TAXATION OF REAL ESTATE INVESTMENT TRUSTS

GENERALLY

The income taxation in South Carolina of an ordinary business trust, i.e., one which is not a real estate investment trust, is not clear. It may be taxed under Section 65-223 (Tax on Fiduciaries) or it may be taxed under Section 65-222 (Tax on Corporations).²⁶

Real estate investment trusts as defined in Section 856 of the INTERNAL REVENUE CODE are taxed under S.C. CODE ANN. §65-223.1 (Supp. 1971). This section imposes the South Carolina corporate tax on a real estate investment trust:

. . . only to that part of the net income of the trust which has not been distributed, provided, at least ninety per cent of its taxable income, for the taxable year, without regard to its capital gains, is declared and distributed as a dividend to shareholders or holders of certificates of beneficial interest within the taxable year or before the time prescribed by law for the filing of its return for the taxable year (including the period of any extension of time granted for filing such return), otherwise all of the net income of the trust shall be taxable.

The tax treatment of capital gains distributions of real estate investment trusts is provided for in the second paragraph of Section 65-223.1:

To the extent gains from the sale or exchange of capital assets, as defined in this chapter, after allowance for expenses relating to such sale or exchange are declared and distributed as a capital gains dividend to shareholders or holders of certificates of beneficial interest by the trust within the taxable year when such gain is realized or before the time prescribed by law for the filing of its return for the taxable year (including the period of any extension of time granted for filing such return), such distribution to the distributee shall be a gain from the sale or exchange of capital assets as defined in this chapter.

25. Kelley, *supra* note 24 at 1008.

26. The definition of "corporation" in S.C. CODE ANN. §65-202(4) (Supp. 1970) is identical to that found in Section 7701(a)(3) of the Internal Revenue Code: "The term 'corporation' includes associations, joint stock companies, and insurance companies." This definition was the basis for the holding in *Morrissey v. Commissioner*, 296 U.S. 344 (1935), that a business trust was an association and therefore taxable as a corporation.

It is not entirely clear how retained capital gains realized by a real estate investment trust are taxed. Capital gain treatment of income is granted only to individuals or fiduciaries under Section 65-258.²⁷ If a real estate investment trust qualifies as a fiduciary under Section 65-258, it would be allowed capital gain treatment on its retained capital gains. If, on the other hand, a real estate investment trust is an association under Section 65-202(4) and therefore taxable as a corporation, it might not be allowed capital gain treatment on its retained capital gains. This uncertainty could be corrected by appropriate amendment to Section 65-223.1.

INCOME TAX LIABILITY OF FOREIGN REAL ESTATE INVESTMENT TRUSTS

The same principles discussed above will apply to a foreign real estate investment trust doing business²⁸ in this State.²⁹

The South Carolina Tax Commission has considered certain activities in South Carolina of foreign corporate mortgage investors and has found such investors not to be subject to the South Carolina income tax in those situations. The Tax Commission has indicated in an informal opinion³⁰ that these same principles would be applicable to the activities of a foreign real estate investment trust. These principles are set forth below:

There are three basic situations under which foreign lenders make South Carolina mortgage investments. There are variations, but the three examples below have been limited to those situations in which the South Carolina Tax Commission has granted favorable income and franchise tax treatment.

In all three examples, the foreign corporation has no office in South Carolina and has not qualified to do business in this state. Its loans generally are serviced by an independent contractor located

27. S.C. CODE ANN. §65-258 (Supp. 1971).

28. The ownership of real estate in South Carolina (where such ownership is one of the principal purposes of the trust) would appear to constitute "doing business" in South Carolina.

29. If the trust has undistributed net income, presumably it is subject to allocation as provided in S.C. CODE ANN. §§65-222, 65-222.2 (Supp. 1971) and S.C. CODE ANN. §65-279, *et seq.* (Supp. 1971) (dealing with allocation or apportionment of income).

30. Letter from Arnell M. Coker, Sr., Director, Corp. Income Tax Div., S.C. Tax Comm'n to Robert P. Wilkins, December 6, 1972.

within the State of South Carolina; however, payments may be made directly to the foreign lender's office outside the state.

In the first situation a local lender makes a real estate loan which is secured by a mortgage on South Carolina real estate. Subsequently, a foreign lender purchases the note and mortgage by assignment from the local lender. This transaction is consummated at the foreign lender's office outside the state. The note and mortgage are held at the foreign lender's office outside the state. The local lender, prior to making the loan, generally will have solicited a commitment by the foreign corporation to purchase it.

In the second situation the procedure is almost identical to that set forth above but instead of purchasing the note and the mortgage, the foreign corporation purchases a participation in the loan, which participation is generally represented by a certificate of participation. The purchase is consummated at the foreign lender's office outside the state. The local lender remains the mortgagee of record.

The final situation is where the foreign corporation makes a mortgage loan directly to the borrower. Generally this loan is solicited in South Carolina by an independent broker (not an agent of the foreign corporation) who presents the application to the foreign corporation. This transaction will be consummated at the foreign lender's office outside the state.

The maxim *mobilia sequuntur personam* embodies the general principle in relation to situs for the purposes of taxation of intangible personal property, and the general rule is, in the absence of controlling circumstances to the contrary, that the situs of intangible property for the purposes of taxation is the state of the owner's domicile; but there is a well-established exception to this general rule to the effect that there may be a business situs of intangibles distinct from the domicile of the creditor. If the intangibles have gained "business situs" within the taxing state, then as an exception to the general rule, they may be subject to tax.

Applying the situs theory, the Tax Commission has consistently taken the position that income in the form of interest on notes (or participations therein) secured by mortgages on South Carolina real estate held by foreign lenders in accordance with the circumstances described above is not taxable in South Carolina.

If the foreign lender is engaged in wholesale overt solicitation of loans within the state from an office maintained by it within the state and is engaged in other similar activities, thus giving the intangibles a business situs within the state, then the Tax Commission might take the position that income tax is due on the interest income. In any event, the Tax Commission has held that a foreign lender, if it acquired the mortgaged property either by foreclosure or by deed in lieu of foreclosure, will be subject to income tax on the rent from the property or upon any gain upon its subsequent sale.³¹

The Tax Commission also in an informal opinion³² has

31. Wilkins, *supra* note 18 at 406-07.

32. Letter from Arnell M. Coker, Sr., *supra* note 30.

indicated that compliance with Section 52-201 by a foreign real estate investment trust does not, of itself, constitute doing business for tax purposes or give intangibles, otherwise not taxable in this state, a business situs within this state.

SOUTH CAROLINA CORPORATE FRANCHISE TAXES OR LICENSE FEES

With respect to the corporate license tax imposed by S.C. CODE ANN. §65-606 (Supp. 1971), the Attorney General of South Carolina has recently expressed the opinion³³ that a real estate investment trust is exempt from the tax, because it is not a corporation. His conclusion was apparently based on the fact that Section 65-223.1 imposes the tax levied by Chapter 5, Title 65, upon a real estate investment trust. The corporate license tax is imposed by Chapter 10, Title 65.³⁴ Accordingly, it does not appear that a foreign real estate investment trust is subject to the South Carolina corporate franchise tax.

LOCAL TAXES

If a foreign real estate investment trust owns real estate in South Carolina, then it will be subject to ad valorem taxes and may be subject to municipal business license taxes depending on its activity within the municipality. At least one municipality has asserted that the leasing of real estate by a foreign real estate investment trust is an activity subject to the municipal business license ordinance.³⁵

OTHER TAXES

In Chapter 12 (Other Business License Taxes) of Title 65 (Taxation) Section 65-941 imposes upon "foreign land associations" an annual license fee of \$100.00 payable to the Chief Insurance Commissioner. Although a foreign real estate investment trust might appear to be encompassed by the term "foreign land association," the South Carolina Insurance

33. 1968-69. ATT'Y GEN. OPIN. No. 2786 (December 15, 1969).

34. S.C. CODE ANN. §65-202 (4) (Supp. 1971), defining a "corporation" as including, *inter alia*, an association, is also limited to Chapter 5.

35. See, e.g., COLUMBIA, S.C., BUSINESS AND PROFESSIONAL LICENSE ORDINANCE §31 (H-63).

Department has expressed the opinion³⁶ that a foreign real estate investment trust is not required to pay the annual license fee, assuming that the trust does not engage in activities for which Title 37 (Insurance) requires licensing.

UNIFORM SECURITIES ACT

The South Carolina Securities Commissioner pursuant to the Uniform Securities Act³⁷ regulates the offering or sale of securities of real estate investment trusts in South Carolina.

He follows³⁸ the Statement of Policy adopted by the Midwest Securities Commissioners Association dated July 16, 1970,³⁹ (see Appendix B hereof) which states that the offering or sale of securities of real estate investment trusts may be deemed unfair and inequitable to public investors unless their declarations of trust or other organizational instruments contain provisions which satisfy the minimum conditions stated in the Statement of Policy.

CONSUMER FINANCE LAW

The Consumer Finance Law⁴⁰ generally is designed to regulate those lenders subject to its provisions who make loans of \$7500.00 or less. A very unfortunate and potentially dangerous provision is contained in Section 8-800.19 of the Consumer Finance Law. It provides that any person (other than those exempted under Section 8-798(b)) engaged in the business of lending which includes any person making more than ten loans per year shall annually obtain a certificate of registration from the State Board of Bank Control and shall be subject to the rigorous reporting and disclosure requirements of the Consumer Finance Law.

36. Letter from Glen E. Craig, General Counsel, S.C. Ins. Dep't to A. L. Moses, June 22, 1972.

37. S.C. CODE ANN. §§62-1, *et seq.* (Supp. 1971).

38. Letter from Bradley Heald, Deputy Sec. Comm'r to Robert P. Wilkins, November 16, 1972. Mr. Heald's letter indicates that: "If in the future the statement of policy should be revised, it is probable that this office would follow the revised statement."

39. The Statement of Policy was criticized in Kelley, *supra* note 24 at 1010. Most of the criticisms in the article no longer apply because the Statement of Policy adopted July 16, 1970 (after the article was published) eliminated many of the restrictive requirements of the earlier form.

40. S.C. CODE ANN. §§8-797, *et seq.* (Supp. 1971).

These reporting and disclosure requirements were not designed to protect individuals securing substantial commercial loans from non-regulated lenders. Under a literal interpretation of Section 8-800.19 a real estate investment trust (and possibly other non-regulated lenders) making loans of any size to individuals would be subject to its provisions. However, the office of the Attorney General of South Carolina has informally expressed the opinion that when only one or two loans in excess of \$7500 are made in this state by a foreign real estate investment trust, the trust would not be subject to §8-800.19.⁴¹ This section should either be repealed or amended so that it regulates only those Consumer Finance type loans.

CONCLUSION

From 1962 through 1970, only five real estate investment trusts filed their instruments in the office of the Secretary of State. During 1971 and 1972 twenty-one trusts filed in that office. With the growth reflected above, it is very likely that lawyers in South Carolina will be called upon with increasing frequency to consider the problems peculiar to real estate investment trusts. This article has attempted to highlight some of the most obvious problem areas in this field for the South Carolina lawyer.

APPENDIX A

PROPOSED NEW SECTIONS

SECTION 1

Certain Activities of a Foreign Business Trust Not Deemed Doing Business. (a) Upon compliance with Section 52-201 a foreign business trust shall be authorized to do in this state any business which it is authorized to do in the jurisdiction of its creation, and which may be done in this state by a business trust created under the laws of this state.

(b) Without excluding other activities which may not constitute doing business in this state, a foreign business trust shall not be deemed to be doing business in this state, for purposes of this chapter, solely by reason of carrying on in this state any one or more of the following activities:

41. Letter from Patricia O. Brehmer, Asst. Att'y Gen. of S.C., to A. L. Moses, December 11, 1972.

(1) Maintaining, defending or participating in any action or proceeding whether judicial, administrative, arbitral, or otherwise, or effecting the settlement thereof or the settlement of claims or disputes;

(2) Holding meetings of its shareholders, trustees, or committees;

(3) Maintaining bank accounts;

(4) Maintaining offices or agencies for the transfer, exchange, and registration of its certificates of participation, or securities, or appointing and maintaining trustees or depositaries with relation to its certificates of participation or securities;

(5) Creating or acquiring evidences of debt, mortgages, or liens on real or personal property;

(6) Securing or collecting debts or enforcing any rights in property covering the same;

(7) Effecting a transaction in interstate or foreign commerce;

(8) Owning and controlling a corporation incorporated in or transacting business within this state;

(9) Conducting within this state an isolated transaction which is completed within a period of thirty days and which is not in the course of a series or number of repeated transactions;

(10) Filing the trust instrument and amendments thereto with the Secretary of State or with the Register of Mesne Conveyances, or with the Clerk of Court in those counties where the office of the Register of Mesne Conveyances has been abolished, in any one or more counties of this state.

(c) The provisions of this Section shall not be deemed to establish a standard for activities which may subject a foreign business trust to service of process under this chapter or any other statute of this state.

SECTION 2

Effect of Foreign Business Trust Doing Business in the State Without Meeting the Requirements of Section 52-201.

(a) A foreign business trust which does business in this state without meeting the requirements of Section 52-201 shall be liable to this state for all fees, penalties, and taxes

for the years or parts thereof during which it did business in this state without such compliance. In addition, such foreign business trust shall be liable to a fine of \$10.00 per day for each day it fails to pay such fees, penalties, and taxes. The Attorney General shall bring proceedings to recover all such amounts due under the provisions of this Section.

(b) A foreign business trust doing business in this state without such compliance shall not maintain any action, suit or proceeding in this state unless and until such foreign business trust shall have met the requirements of Section 52-201 and shall have paid to this state all fees, penalties, and taxes required by the laws of this state. This prohibition shall apply to any assignee (except a subrogee), successor in interest (whether by merger, consolidation or otherwise) or purchaser of all or substantially all of the assets of such foreign business trust.

(c) The failure of a foreign business trust to comply with the requirements of Section 52-201 shall not impair the validity of any contract or act of such foreign business trust or the right of any other party to the contract to maintain an action or other proceeding thereon, and shall not prevent such foreign business trust from defending any action, suit or proceeding in this state.

PROPOSED AMENDMENTS TO EXISTING SECTIONS

Section 52-201—*Recording and Filing Instrument Creating Business Trust.* (a) Every business trust created at common law in this state or doing business in this state under an express trust instrument by which property is held and managed by one or more Trustees for the benefit and profit of such persons as may be or may become holders of transferable certificates evidencing beneficial interest in the trust estate shall record a certified copy of the trust instrument creating such trust and any amendments thereto with the Register of Mesne Conveyances, or with the Clerk of Court in those counties where the Office of Register of Mesne Conveyances has been abolished, of the county in which it has its principal place of business in this state, and shall also file a certified copy of such instrument and any amendments thereto with the Secretary of State. If the trust is created under the laws of a state other than the state of South Carolina, it shall not

be required to record a certified copy of the trust instrument and amendments thereto with the Register of Mesne Conveyances, or with the Clerk of Court, as the case may be, in any county of this state unless the trust has and maintains a place of business in such county and has an agent in such county engaged in conducting and carrying on the business for which the trust was created.

(b) A certified copy of the trust instrument or any amendments thereto for purposes of (a) hereof is a copy of the trust instrument or any amendments thereto certified as a true and correct copy thereof by any trustee of the trust and acknowledged before an officer authorized by law to administer oaths. Compliance with this section shall entitle such instrument or amendment to recordation in any county.

Section 52-202—*Name in Which Property May Be Acquired or Conveyed.* Any property may be acquired, conveyed or mortgaged (if authorized by the trust instrument) by any one or more of the trustees or officers of the trust, in the name given to or used by the business trust.

APPENDIX B

STATEMENT OF POLICY

Adopted by

Midwest Securities Commissioners Association

on July 16, 1970

The offering or sale of securities or real estate investment trusts, as defined in Sections 856, 857, and 858 of the Internal Revenue Code of 1954, may be deemed unfair and inequitable to public investors unless their declarations of trust or other organizational instruments contain provisions which satisfy the following minimum conditions.

A. *Trustees.* A majority of the trustees shall not be affiliated with the adviser of the trust or any organization affiliated with the adviser of the trust. The trustees shall be elected by the shareholders of the trust annually.

B. *Self Dealing.* No trustee, officer, or adviser of a trust, or any person affiliated with any such persons, shall sell any property or assets to the trust or purchase any property or assets from the trust, directly or indirectly, nor shall any such person receive any commission or other remuneration, di-

rectly or indirectly, in connection with the purchase or sale of trust assets, except pursuant to transactions that are fair and reasonable to the shareholders of the trust and that relate to:

1. the acquisition of property or assets at the formation of the trust or shortly thereafter that is fully disclosed in the prospectus;

2. the acquisition by the trust of federally insured or guaranteed mortgages at prices not exceeding the currently quoted prices at which the Federal National Mortgage Association is purchasing comparable mortgages;

3. the acquisition of other mortgages on terms not less favorable to the trust than similar transactions involving unaffiliated parties; or

4. the acquisition by the trust of other property at prices not exceeding the fair value thereof as determined by independent appraisal.

All such transactions and all other transactions in which any such persons have any direct or indirect interest shall be approved by a majority of the trustees, including a majority of the independent trustees. All commissions or remuneration received by any such person in connection with any such transaction shall be deducted from the advisory fee.

C. Fees and Expenses. The aggregate annual expenses of every character paid or incurred by the trust, excluding interest, taxes, expenses in connection with the issuance of securities, shareholder relations, and acquisition, operation, maintenance, protection and disposition of trust properties, but including advisory fees and mortgage servicing fees and all other expenses, shall not exceed the greater of:

1. $1\frac{1}{2}\%$ of the average net assets of the trust, net assets being defined as total invested assets at cost before deducting depreciation reserves, less total liabilities, calculated at least quarterly on a basis consistently applied; or

2. 25% of the net income of the trust, excluding provision for depreciation and realized capital gains and losses and extraordinary items, and before deducting advisory and servicing fees and expenses, calculated at least quarterly on a basis consistently applied; but in no event shall aggregate annual expenses exceed $1\frac{1}{2}\%$ of the total invested assets of the trust.

The adviser shall reimburse the trust at least annually for the amount by which aggregate annual expenses paid or incurred by the trust as defined herein exceed the amounts herein provided.

D. *Leverage.* The aggregate borrowings of the trust, secured and unsecured, shall not be unreasonable in relation to the net assets of the trust, as defined in paragraph C hereof, and the maximum amount of such borrowings in relation to the net assets shall be stated in the prospectus.

E. *Minimum Capital.* The net assets of the trust, as defined in paragraph C hereof, prior to the initial public offering shall be \$200,000 or 10% of the net assets of the trust upon completion of such public offering, whichever is less.

F. *Other Limitations.* A Trust shall not:

1. Invest more than 10% of its total assets in unimproved real property or mortgages on unimproved real property, excluding property which is being developed or will be developed within a reasonable period.

2. Invest more than 10% of its total assets in junior mortgages, excluding wrap-around type junior mortgages.

3. Engage in any material trading activities with respect to its properties.

4. Issue redeemable equity securities or equity securities of more than one class.

5. Issue debt securities to the public unless the historical cash flow of the trust or the substantiated future cash flow of the trust, excluding extraordinary items, is sufficient to cover the interest on the debt securities.

6. Issue options or warrants to purchase its securities to the adviser of the trust or any person affiliated with the adviser, or to any other persons at exercise prices less than the fair market value of such securities on the date of grant.

G. *Advisory Contract.* Any advisory contract entered into by the trust prior to the initial public offering shall be for a period not longer than three years, and any such contract entered into thereafter shall be for a period not longer than one year. Any such advisory contract shall provide that it may be terminated at any time without penalty, by the trustees or a majority of the holders of outstanding shares of beneficial interest, upon not less than 60 days written notice to the adviser.

H. *Reports and Meetings.* The trust shall prepare an annual report concerning its operations for each fiscal year ending after the public offering of its securities, including financial statements prepared in accordance with generally accepted accounting principles applied on a consistent basis and certified by independent public accountants. The annual report shall be delivered to each public shareholder and debenture holder within 120 days after the end of such fiscal year. There shall be an annual meeting of the holders of outstanding shares of beneficial interest of the trust, upon reasonable notice, following delivery of the annual report.