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Taxation

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TAXATION

I. FEDERAL INCOME TAX

A. *Deductions*

In *Carey v. Commissioner*[1] the Fourth Circuit Court of Appeals affirmed per curiam the holding of the United States Tax Court[2] that expenses incurred by the taxpayer in his campaign for reelection as president of the International Union of Electrical, Radio, and Machine Workers were not deductible in computing federal income tax liability, either as trade or business expenses or as expenses paid or incurred for the production of income.[3] In *Graham v. Commissioner*[4] the Fourth Circuit Court of Appeals allowed the deduction of proxy expenses designed in part to elect the taxpayer to a corporate board of directors under section 212 of the Internal Revenue Code of 1954. However, in *Mays v. Bowers*[5] the same court had refused to permit a similar deduction to a city councilman for expenses incurred in his political campaign.

A majority of the Tax Court in *James B. Carey*[6] felt that the taxpayer's situation fitted "precisely in the mold" of *McDonald v. Commissioner,*[7] the leading case in the area. In *McDonald* the United States Supreme Court refused to allow a candidate for a state judgeship to deduct his campaign expenses on grounds of public policy.

On appeal the Fourth Circuit Court of Appeals contented itself with affirming the Tax Court and discussed neither *McDonald* and its Fourth Circuit progeny, nor the issues raised in the opinion of a minority of the lower court.[8] By this decision the court of appeals apparently limited *Graham* to its facts and

1. 460 F.2d 1259 (4th Cir.), *cert. denied*, 93 S. Ct. 325 (1972).

2. James B. Carey, 56 T.C. 477 (1971) (7-5 decision).

3. INT. REV. CODE OF 1954, § 162(a) states: "In General — There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ."

Section 212 of the Code specifies: "In the case of an individual, there should be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—(1) for the production or collection of income . . . ."

4. 326 F.2d 878 (4th Cir. 1964).

5. 201 F.2d 401 (4th Cir. 1953).

6. 56 T.C. 477 (1971).

7. 323 U.S. 57 (1944).

8. 460 F.2d at 1259.

joined four other circuits in holding campaign expenses generally non-deductible.[9]

B. *Exclusions*

In *Hembree v. United States*[10] the Court of Appeals for the Fourth Circuit held that payments received by an intern from the Medical College of South Carolina Hospital[11] were not excludible from gross income as a fellowship within the meaning of section 117 of the Internal Revenue Code.[12]

The district court had concluded that these payments were excludible because they were made for the primary purpose of furthering the taxpayer's education and training and did not rep-

9. Maness v. United States, 367 F.2d 357 (5th Cir. 1966); Shoyer v. United States, 290 F.2d 817 (3d Cir. 1961); Vernon v. Commissioner, 286 F.2d 173 (9th Cir. 1961) (involved a union official); Long v. Commissioner, 277 F.2d 239 (8th Cir. 1960).

10. 464 F.2d 1262 (4th Cir. 1972).

11. This is now called the Medical University of South Carolina Hospital.

12. The relevant portions of the INT. REV. CODE OF 1954, § 117, and the corresponding Treasury Regulations are:

§ 117. Scholarships and Fellowship Grants.

(a) General Rule.—In the case of an individual, gross income does not include—

(1) Any amount received—

. . . .

(b) as a fellowship grant, including the value of contributed services . . . .

Treas. Reg. § 1.117-4 (1956). Items not considered as scholarship or fellowship grants.

The following payments or allowances shall not be considered to be amounts received as a scholarship or fellowship grant for the purpose of section 117:

. . . .

(c) amounts paid as compensation for services or primarily for the benefit of the grantor.

(1) . . . . [A]ny amount paid . . . to . . . an individual to enable him to pursue studies or research, if such amount represents . . . compensation for past, present, or future employment services . . . .

(2) any amount paid . . . to . . . an individual to enable him to pursue studies or research primarily for the benefit of the grantor. *However, amounts paid . . . to . . . an individual . . . are considered to be amounts received as a . . . fellowship grant for the purpose of section 117 if the primary purpose of the studies or research is to further the education and training of the recipient in his individual capacity and the amount provided by the grantor for such purpose does not represent compensation or payment for the services described in subparagraph (1) of this paragraph.* [Emphasis added.]

resent compensation for services.[13] To reach this conclusion the lower court employed the "primary purpose" test, first applied in this circuit in *Reese v. Commissioner*,[14] and found that, because the primary purpose of the hospital was to train physicians,[15] and because the amount of payment was considerably lower than the compensation received by a practicing physician,[16] the payments were excludible from the taxpayer's income as a fellowship grant within the meaning of section 117.[17]

On appeal the circuit court first held that the "primary purpose" test had been misapplied below. Citing *Reese* for the proposition that "[t]he purpose test requires a determination of the *raison d'etre* of the payment," the court said that it is the primary purpose of the payment, not of the facility making the payment, which is controlling and that the purpose of the payment was to compensate the taxpayer for services rendered to the hospital facility.[18] Second, the circuit court pointed out that the Supreme Court in *Bingler v. Johnson*,[19] although sustaining the validity of section 1.117-4(c) of the Treasury Regulations, had avoided discussion of the "primary purpose" test and had, in effect, adopted a different test.[20] This test as formulated by the court of appeals in *Hembree* is: "[I]f there is any substantial *quid pro quo, i.e.*, compensation for services, the payments cannot qualify for exclusion from income as 'fellowship' funds."[21]

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13. Hembree v. United States, CCH 1971 STAND. FED. TAX REP. (71-2, at 87,518) ¶ 9636 (D.S.C. March 3, 1971).

14. 373 F.2d 742 (4th Cir. 1967), *aff'g per curiam*, 45 T.C. 407 (1966). The "primary purpose" test is derived from Treas. Reg. § 1.117-4 (c)(2) (1956), *supra* note 12.

15. CCH 1971 STAND. FED. TAX REP. (71-2, at 87, 519-20). The district court placed much emphasis on the language of Act No. 920, [1948] S.C. Acts & Jt. Res. 2430, which authorized the acquisition of land for a "teaching hospital."

16. CCH 1971 STAND. FED. TAX REP. (71-2, at 87, 520).

17. *Id.* at 87, 552.

18. 464 F.2d at 1264-65.

19. 394 U.S. 741 (1969).

20. Evidently, the circuit court was considering the language at 394 U.S. 751, 757.

21. 464 F.2d at 1265. This case puts the fourth circuit in agreement with the other courts which have considered such payments. Rundell v. Commissioner, 455 F.2d 639 (5th Cir. 1972), *aff'g* 30 CCH TAX CT. REP. 177 (1971); Wertzberger v. United States, 441 F.2d 1166 (8th Cir. 1971), *aff'g per curiam*, 315 F. Supp. 34 (W.D. Mo. 1970); Quast v. United States, 428 F.2d 750 (8th Cir. 1970); Kwass v. United States, 319 F. Supp. 186 (E.D. Mich. 1970); Coggins v. United States, CCH 1970 STAND. FED. TAX REP. (70-2 at 84, 753) ¶ 9687 (N.D. Tex. 1970). *Cf.* Ward v. Commissioner, 476 F.2d 766 (8th Cir. 1971); Woodail v. Commissioner, 321 F.2d 721 (10th Cir. 1963); Shuff v. United States, 331 F. Supp. 807 (W.D.Va. 1971).

C. Accumulated Earnings

In *Industrial Life Insurance Co. v. United States*[22] the taxpayer corporation was held subject to the federal accumulated earnings tax[23] despite its contention that the accumulations were required to maintain its status as an insurance company under South Carolina law.[24]

Since its acquisition by a single family, Industrial Life had not paid a dividend; its earnings and profits had simply been allowed to accumulate. The Government contended that Industrial Life was a "corporation . . . availed of for the purpose of avoiding the income tax with respect to its shareholders [the family] . . . by permitting earnings and profits to accumulate instead of being divided and distributed."[25] The taxpayer contended that as a state-chartered insurance company it was only trying to meet and anticipate increased requirements of capital and surplus for insurance companies under state law and that therefore this accumulation was a "reasonable need of the [insurance] business."

A two-step process must be applied in order to subject a corporation to the accumulated earnings tax. First, the Government must prove that the accumulation is in excess of "the reasonable needs of the business."[26] Second, if excess accumulation is established, the burden shifts to the corporation, which must prove that the accumulation is not for the purpose of avoiding the income tax on its shareholders.[27]

The Government's strategy was to prove that the taxpayer was not an insurance company; if it were not, then the accumulation could not be justified as an attempt to meet state requirements for capital and surplus imposed on insurance companies. Under the Regulations, "The term 'insurance company' means a company whose *primary and predominant* business activity dur-

22. 344 F. Supp. 870 (D.S.C. 1972).
23. INT. REV. CODE OF 1954, §§ 531-33.
24. S.C. CODE ANN. §§ 37-181, 37-183 (Cum. Supp. 1971).
25. INT. REV. CODE OF 1954, § 532(a).
26. *Id.* § 533.
27. *Id.* § 533(a) provides:
[T]he *fact* that the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of the business *shall be determinative* of the purpose to avoid the income tax with respect to shareholders, *unless* the corporation by a preponderance of the evidence shall prove to the contrary. [Emphasis added.]

ing the taxable year is the issuance of insurance . . . contracts . . . ."[28] Certainly, if the test of predominant business activity is simply whether 50% of the taxpayer's income was derived from premiums, as the court suggests,[29] then the taxpayer is not an insurance company for section 801 purposes. If this is the case, and the court so held, the Government has succeeded in showing that the taxpayer's accumulations are beyond the reasonable needs of the business. In other words, if it's not an insurance company, it need not build its reserves.

The taxpayer corporation tried to meet its burden of proving that the accumulation was not for the purpose of avoiding the income tax of its respective shareholders by arguing that its shareholders were in a lower income tax bracket than the corporation; if it were trying to avoid taxes, it would have paid its shareholders. The court rejected this argument, pointing out that dividends are taxed twice—as a part of the corporation's and as a part of the shareholder's income—leaving over-all tax avoidance intact as a plausible motive for the accumulation.[30]

To the taxpayer's contention that the accumulation was made in anticipation of stiffer capital and surplus requirements for insurance companies under state law[31]—not for tax avoidance—the court replied that it might do this more reasonably by selling more insurance and stock.[32]

Finally, the court ruled that land, originally bought by the taxpayer for investment purposes, was held and sold in the ordinary course of business because the corporation had subdivided and sold lots quite regularly over a number of years. Thus, the gain from the sale of this property was taxable at ordinary rates.

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28. Treas. Reg. § 1.801-3(a) (1972). The court neglected to point out that these definitions are to be used for determining the taxability of corporations as life insurance companies. Arguably, such restrictive definitions—used to limit the size of the class eligible for the tax benefits accorded to life insurance companies—should have little weight in determining what is an insurance company for other purposes. This seems especially true when *the same Regulation* states that a corporation's "name, charter powers and subjection to state insurance laws are significant in determining the business which a company . . . intends to carry on . . . ." *Id.*

29. 344 F. Supp. at 877. The court relies heavily on Bowers v. Lawyers' Mortgage Co., 285 U.S. 182 (1932).

30. United States v. Donruss Co., 393 U.S. 297 (1969), requires only that tax avoidance be one of the motives behind such accumulations.

31. S.C. CODE ANN. §§ 37-181, 37-183 (Cum. Supp. 1971). In view of the frequency and direction of change in these laws, taxpayer's expectations do not seem unreasonable.

32. 344 F. Supp. at 874. It is interesting to note that the taxpayer had no insurance sales force.

D. Insurance Company Defined

In *Superior Life Insurance Co. v. United States,*[33] the Court of Appeals for the Fourth Circuit reversed the decision of the district court[34] and held that Superior was not a life insurance company for federal income tax purposes.[35] Superior is a wholly-owned subsidiary of Stephenson Finance Company engaged in the business of selling credit life and credit health and accident insurance, primarily to the debtors of its parent company.

Superior sold this credit insurance to Stephenson's debtors by means of a group policy under which Stephenson was authorized to sell credit insurance and to issue to each insured debtor a certificate of insurance from Superior. The face amount of the loan from Stephenson was increased by an amount sufficient to pay the full premium for the life, health, and accident coverage. The debtor received only the amount he originally wanted to borrow. In reciting the facts, the court stated:

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33. 462 F.2d 945 (4th Cir. 1972).

34. Superior Life Ins. Co. v. United States, 322 F. Supp. 921 (D.S.C. 1971).

35. INT. REV. CODE OF 1954, § 801, provides:

(a) Life Insurance Company Defined.

[T]he term "life insurance company" means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with health and accident insurance), or noncancellable contracts of health and accident insurance, if—

(1) its life insurance reserves (as defined in sub-section (b)), plus

(2) unearned premiums, and unpaid losses (whether or not ascertained), or noncancellable life, health, or accident policies not included in life insurance reserves, comprise more than 50 percent of its total reserves (as defined in subsection (c)).

(b) Life Insurance Reserves Defined.

(1) In General

. . ."[L]ife insurance reserves" means amounts—

(A) which are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, and

(B) which are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance) involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies.

. . . .

(c) Total Reserves Defined.

. . .[T]he term "total reserves" means—

(1) life insurance reserves

(2) unearned premiums, and unpaid losses (whether or not ascertained) not included in life insurance reserves . . . .

> On the first day of the month immediately following the month in which the certificate of insurance was issued, Stephenson paid to taxpayer (Superior) the full premium for the life insurance coverage and one month's premium for the accident and health coverage. Thereafter, on the first day of each month during the entire remainder of the term, Stephenson paid to the taxpayer one month's premium for the accident and health coverage . . . .
>
> . . . The remainder of the unearned premium paid by the insured-borrower was shown by Stephenson in a liability account called "Reserve for Unearned A & H Premiums."[36]

The primary issue in the case was whether and how this unearned premium account held by Stephenson should be included in Superior's reserves, for the disposition of this account determined whether Superior was a life insurance company within the meaning of the Internal Revenue Code. The circuit court held the gross amount of this account (1) *includible* in Superior's total insurance reserves, and (2) *not includible* in its "life insurance" reserves. In the court's view, Superior's life insurance reserves comprised less than the fifty percent of its total reserves required to qualify it as a life insurance company.[37]

The circuit court reasoned that Stephenson, a South Carolina corporation, was the agent of Superior, also a South Carolina corporation, under state law.[38] Therefore, the account, although held by Stephenson, had nonetheless been "received" by Superior and should be included in its total reserves.[39] Furthermore, the account could *not* be included in Superior's "life insurance reserves," because only amounts "set aside . . . from . . . *noncancellable* health and accident insurance contracts"[40]

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36. 462 F.2d at 948-49.

37. INT. REV. CODE OF 1954, § 801(a). Superior had contended that "the cost of carrying the insurance risk" (Treas. Reg. § 1.801 - 3(e) (1960)), was only the morbidity portion of the unearned premiums (the amount necessary to cover the insurance risk) and did not include the loading portion (the amount designed to cover costs and profits). The court of appeals held that both portions are "costs" of insuring, hence the gross amount of the unearned premiums must be included.

38. S.C. CODE ANN. § 37-233 (1962).

39. Maryland Cas. Co. v. United States, 251 U.S. 342 (1920). "[P]ayment of the premium to the agent discharged the obligation of the insured and called into effect the obligation of the insurer as fully as payment to the treasurer of the claimant could have done; . . . receipt by an agent is regarded as receipt by his principal." *Id.* at 347. That *Maryland Casualty* could be easily distinguished from *Superior Life* in terms of the respective agents' obligations to turn over funds received did not alter the circuit court's opinion.

40. INT. REV. CODE OF 1954, § 801(b)(1)(B) (emphasis added).

could be so included, and Superior's accident and health contracts did not fall within the definition of "noncancellable" insurance.[41]

To reach the merits in *Superior,* the circuit court first had to hold that the Government's appeal was timely. Relying on the standards set forth in *United States v. F. & M. Schaeffer Brewing Co.*,[42] the court concluded that an earlier order for judgment was not "intended by the judge to be his final act" and that the formal judgment later entered was so intended. Since the government had filed a notice of appeal within sixty days after the latter "entry of judgment," it had met the timeliness requirement.[43]

E. Permissible Limits of an Internal Revenue Summons

In *United States v. Theodore*[44] the vice-president of an accounting firm and the firm itself were ordered to comply with an Internal Revenue Service summons by producing corporate records relating to tax returns the firm had prepared. Previously they had objected, asserting that such compliance would violate their fifth amendment privilege. The district court found that under South Carolina law the firm was not a partnership but a corporation by estoppel.[45] Under well-settled doctrine a corporation may not avail itself of the fifth amendment privilege, nor may a corporate officer invoke it, either on the corporation's or on his own behalf, to bar the production of corporate records.[46]

The respondents also questioned the authority and the necessity of the summons. The court, however, finding adequate

41. Treas. Reg. § 1.801-3(c) (1960).

42. 356 U.S. 227 (1958).

43. FED. R. APP. P. 4(a).

44. 347 F. Supp. 1070 (D.S.C. 1972).

45. Dargan v. Graves, 252 S.C. 641, 649-50, 168 S.E.2d 306, 310 (1969); *cf.* Bethea v. Allen, 177 S.C. 534, 181 S.E. 893 (1935). *See generally* 18 C.J.S. *Corporations* § 110 (1939). The accounting service in this case not only held itself out to the public as a corporation, but filed corporate, not partnership, tax returns.

46. Oklahoma Press Publishing Co. v. Walling, 327 U.S. 186, 208 (1946); United States v. White, 322 U.S. 694, 699 (1944); Wilson v. United States, 221 U.S. 361 (1911). An interesting collateral issue not raised in this case is whether the taxpayers whose returns were being turned over to the Government would have been able to invoke the privilege. Some courts have permitted this, at least where criminal prosecution is likely. *Compare* Donaldson v. United States, 400 U.S. 517, 536 (1971) (The Internal Revenue summons was upheld since it was issued in good faith and prior to criminal prosecution.), *with* United States v. Tsukuno, 341 F. Supp. 839 (N.D. Ill. 1972) (taxpayer prevailed where he had some proprietary interest in the records), *and* United States v. Kleckner, 273 F. Supp. 251 (S.D. Ohio), *appeal dismissed,* 382 F.2d 1022 (6th Cir. 1967).

authority under sections 7601 and 7602 of the Internal Revenue Code,[47] had little patience with their argument that since the Government already had the taxpayers' returns on file, it did not need the respondents' copies.[48]

II. CONSTITUTIONAL LIMITATIONS: SEPARATION OF POWERS AND THE TAXING AUTHORITY

In *Gunter v. Blanton*[49] the South Carolina Supreme Court held unconstitutional a statutory provision requiring approval by the Cherokee County legislative delegation of any tax increase adopted by the Board of Trustees of Cherokee County School District No. 1[50] as a violation of the separation of powers provision of the South Carolina Constitution.[51]

Originally, "[i]n all budgetary matters of the school district, the Board of Trustees [had possessed] the sole . . . power, authority, and responsibility."[52] However, their original power to "determine and fix the amount of levy needed to operate the schools"[53] was limited by a proviso that: "[N]o such tax levy shall be increased in any year without the approval of a majority

47. INT. REV. CODE OF 1954, § 7601, provides for a "canvass of districts for taxable persons . . .," pursuant to which the Government had instituted the Tax Preparers Project. 347 F. Supp. at 1073. Respondents had improperly prepared the tax return of an undercover revenue agent sent to them as part of the project. The summons was to obtain the names and returns of all those taxpayers whose returns respondents prepared, and INT. REV. CODE OF 1954, § 7602, authorizes a summons "[f]or the purpose of ascertaining the correctness of *any* return . . . ." [Emphasis added.]

48. INT. REV. CODE OF 1954, § 7605(b), prohibits "unnecessary examination(s) or investigations(s). . . ." United States v. Powell, 379 U.S. 48, 58 (1964), prohibits an investigation where the information sought . . . is already within the Commissioner's possession . . . ." The court seemed to think that the ease with which the respondents could supply the information, and the supposed difficulty and expense the Government would have in searching its own files for the names of the taxpayers whose returns the respondents had prepared outweighed any concerns over the necessity or over-breadth of the summons. 341 F. Supp. at 1075.

49. 259 S.C. 436, 192 S.E.2d 473 (1972).

50. No. 542, [1969] S.C. Acts & Jt. Res. 922, *amending* No. 685, [1967] S.C. Acts & Jt. Res. 1408.

51. S.C. CONST. art. I, § 8. This section provides:

> In the government of this state, the legislative, executive, and judicial powers of the government shall be forever separate and distinct from each other, and no person or persons exercising the functions of one of said departments shall assume or discharge the duties of any other.

52. No. 685, [1967] S.C. Acts & Jt. Res. 1409.

53. *Id.* at 1408.

of the resident members of the Cherokee County Legislative Delegation."[54]

The court reasoned that, although determination of a tax levy is a legislative power, members of the legislature may exercise such power only as members of the General Assembly. Here they acted as corporate authorities of the school district—a dual role in violation of the separation of powers clause of the constitution.

Justice Bussey in his dissenting opinion made a two-pronged attack on the court's holding. The first may be characterized as a classic argument for judicial restraint in examining the constitutionality of the acts passed by the General Assembly, lest the court itself, ironically, be guilty of a violation of the separation of powers clause.[55] The second attack was directed at the court's logic in saying simultaneously that the determination of the tax levy is a *legislative* function delegable to the corporate authorities of the school district[56] and that legislators, acting as such "corporate authorities," violate the separation of powers clause in performing this legislative function.[57]

Both the majority and the dissenting opinions disagreed with the lower court's holding that the function of the legislative delegation under the challenged statute was executive, not legislative in nature.[58] They simply differed in the conclusions to be drawn from holding the function to be a legislative one.

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54. No. 542, [1969] S.C. Acts & Jt. Res. 922. This proviso was made subject to a referendum and approved in an election in April, 1970.

55. 192 S.E.2d at 476-77.

56. S.C. CONST. art. X, § 5, provides: "The corporate authorities of . . . school districts . . . may be vested with power to assess and collect taxes for corporate purposes . . . ."

57. 259 S.C. at 443-44, 192 S.E.2d at 476.

58. The lower court felt bound to follow Gould v. Barton, 256 S.C. 175, 181 S.E.2d 662 (1971), which declared unconstitutional a provision requiring the legislative delegation's approval of another "corporate authority's" budget. *Id.* at 201-02, 181 S.E.2d at 674. In *Gould* the supreme court felt that such participation in the budgetary process by the delegation constituted a legislative encroachment on the executive branch prohibited by the separation of powers clause. It seems logical that if the legislative delegation may not have the power to approve the budget, it may not have the power to approve or disapprove an increase in the tax millage rate, since approval of one, in effect, is approval of the other. Though the majority opinion in *Gunter* reached the result which logically follows from *Gould,* it did so without accepting the theory underlying *Gould*—that such power is *executive,* not legislative in nature—and, in fact, did not even refer to *Gould* by name. In slightly over a year, the *entire* court has changed its mind about the nature of such power.

III. INVENTORY VALUATION

In *Belk Department Stores v. Taylor*[59] the taxpayer had divided its inventory for tax purposes into four classifications, two of which were valued at original cost (new season and basic merchandise) and two of which were valued below original cost (previous season and damaged merchandise). In so doing, the taxpayer followed its traditional accounting method of "cost or market, whichever is lower."[60] The South Carolina Tax Commission contended that the proper valuation for *all* classes of taxpayer's inventory was the original cost of the merchandise.[61] The Tax Board of Review agreed with the Tax Commission, but the court of common pleas held for the taxpayer. On appeal, the supreme court reversed the lower court's decision on the grounds that there was sufficient evidence to support the Tax Commission's finding that the value of the inventory for tax purposes was the original cost.[62] While ostensibly declining to decide "what formula should

59. 259 S.C. 174, 191 S.E.2d 144 (1972).

60. This method of inventory valuation is acceptable for federal income tax purposes. "The bases of valuation most commonly used by business concerns and which meet the requirements of section 471 are (1) cost and (2) cost or market, whichever is lower." Treas. Reg. § 1.471-2(c) (1958). Arguably, this method was challenged unsuccessfully when used by the same taxpayer once before. *See* Wasson v. Mayes, 252 S.C. 497, 167 S.E.2d 304 (1969); 21 S.C.L. REV. 655 (1969). Grimball, J., the trial judge in both cases, felt *Wasson* had "[an] authoritative influence on the issues." However, the majority of the South Carolina Supreme Court, speaking through Justice Lewis, dismissed *Wasson* without discussion as "not dispositive of the issues here involved." It is interesting to note that Justice Bussey, the minority opinion writer in this case, authored the unanimous opinion in *Wasson.*

61. Although the Tax Commission has the legal duty of determining the value of merchants' inventories, S.C. CODE ANN. § 65-1669 (Cum. Supp. 1971), there are constitutional and statutory standards to which it must adhere. Wasson v. Mayes, 252 S.C. 497, 499, 167 S.E.2d 304, 305 (1969).

> The test for determining the actual value of the inventory for taxation is "the actual value of the property taxed," Article III, Section 29, Constitution of South Carolina, which has been defined in Section 65-1648, 1962 Code Supplement, as "its true value in money which in all cases shall be held to be the price which the property would bring following reasonable exposure to the market, where both the seller and the buyer are willing, are not acting under compulsion, and are reasonably well informed as to the uses and purposes for which it is adapted and for which it is capable of being used." 259 S.C. at 176, 191 S.E.2d at 145.

62. If the original cost of an item represents its "true value" for tax purposes when it is new and/or fashionable—something all parties agreed upon with regard to some of taxpayer's merchandise—it seems somewhat illogical to hold that the "true value" of an item which is damaged or out of style is not thereby diminished even though its sales price has not been reduced below original cost at a certain point in time. However, it should be

be used in determining value for tax purposes," the supreme court adopted the Tax Commission's position that the fair market value of the merchandise for tax purposes is its cost.

The majority derived the requisite evidentiary support for the Tax Commission's use of the original cost as the actual value of the inventory from two sources: first, the fact that records in the five (out of sixty-four) stores audited by the Tax Commission showed that in many cases damaged and out-of-style merchandise was being offered for sale at prices roughly 35% above the original cost; second, the fact that the taxpayer's assistant controller testified that it was unwilling to sell the aggregate of the damaged and out-of-style merchandise at a price equivalent to its own appraisal.[63]

Justice Bussey entered a vigorous dissenting opinion in which Justice Brailsford concurred. The dissent pointed out that the Tax Commissioner had failed to apply its own formula.[64] But the scope of the dissent was broader than that, for it was directed at the Tax Commission's formula itself, both conceptually and practically. Conceptually, the minority felt that the formula did not adequately allow for obsolescence and depreciation.[65] Practically, it placed the merchant on the horns of a dilemma—he must either re-price his entire inventory at the end of December in accordance with its actual value, despite seasonal demand, or be penalized by being taxed upon an excessive valuation.

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emphasized that the court refused to hold the taxpayer's accounting method, "cost or market, whichever is lower," unacceptable for inventory tax valuation. The court simply interpreted it as "wholesale cost or *retail* market *on a given date,* whichever is lower," and then determined whether the taxpayer had met the heavy burden of proof upon one contesting an assessment.

63. In the aggregate there was a roughly eight-million dollar difference between the taxpayer's records and the Tax Commission's valuation.

64. 259 S.C. at 183, 191 S.E.2d at 149. The Tax Commission's own audit of the taxpayer's records had revealed many instances of retail pricing below original cost, but they had not made a corresponding reduction in taxpayer's assessment.

65. "[C]ost is not synonymous with or representative of actual or true value . . . proved obsolescence and depreciation must be taken into account." *Id.* at 182, 191 S.E.2d at 148 (emphasis deleted); *accord,* Colorado & Utah Coal Co. v. Rorex, 149 Colo. 502, 369 P.2d 796 (1962); J.I. Case Co. v. Chambers, 210 Ore. 680, 314 P.2d 256 (1957).