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STATE AND LOCAL GOVERNMENT

I. TAX LIABILITY OF MULTISTATE CORPORATIONS SELLING LAND IN SOUTH CAROLINA

In *Hercules, Inc. v. South Carolina Tax Commission*,[1] the South Carolina Supreme Court considered the state tax liability incurred by a multistate corporation in the sale of real property located in South Carolina. The court held that taxable gain resulting from recapture of depreciation is to be apportioned[2] among the states in which the business is taxed. In dicta, however, the court indicated that any true gain resulting from a sale of real property located in South Carolina would be allocated[3] entirely to South Carolina. The result of this case appears to contradict the holding of *Boyle Utilities v. South Carolina Tax Commission*,[4] in which the supreme court interpreted the personal property section[5] of the same South Carolina statute and concluded that all gains associated with such sales, including the recapture of depreciation, are allocable to South Carolina. The holding of *Hercules* will completely alter the Tax Commission's method of taxing gains[6] from sales of real property under section 12-7-1120(4)[7] of the South Carolina Code.

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1. 279 S.C. 177, 304 S.E.2d 815 (1983).

2. To apportion income means to distribute it, on a percentage basis, among the states in which the multistate taxpayer does business.

3. Under South Carolina tax law, to allocate income means to assign it, for tax purposes, to a particular state.

4. 273 S.C. 93, 254 S.E.2d 308 (1979).

5. S.C. CODE ANN. § 12-7-1120(6)(1976)(deleted by amendment in 1977) provided in part:

> Gains and losses from the sale of tangible personal property, other than tangible personal property held for sale to customers in the regular course of business, are allocable to this State, if:
>
> (a) The property had a situs in this State at the time of the sale. . . .

S.C. CODE ANN. § 12-7-1120(6)(1976)(deleted by amendment in 1977).

6. Before this decision, all taxable gains, whether resulting from actual appreciation or from recapture of depreciation, were considered allocable to the situs state. Record at 99.

7. The Code provides in pertinent part:

> The following items of income shall be specifically and directly allocated in accordance with the following provisions before apportionment of the re-

Hercules, Inc. is a multistate corporation domiciled outside of South Carolina. The corporation owned a plant facility in South Carolina, which it depreciated for income tax purposes from 1966 to 1970, apportioning the depreciation among the forty states in which it does business. Approximately 1.5% was apportioned to South Carolina.[8] In 1970 Hercules, Inc. sold the facility at an actual loss, but with a taxable gain due to recapture of depreciation.[9]

The sales contract provided for installment payments in 1972, 1973, and 1974. Hercules, Inc. elected, without specifically notifying the Tax Commission, to report the sale on the installment plan. The 1972 return was thus the first to reflect the sale. Approximately 1.5% of the taxable gain from the first payment was apportioned to South Carolina, in keeping with the apportionment of depreciation.[10]

Relying on South Carolina Code section 12-7-1120(4), which provides that gain or loss from sales of real property should be allocated to the situs state, the Tax Commission maintained that the gain should not have been apportioned—that the entire gain from the sale was taxable in South Carolina—and it ordered Hercules, Inc. to pay taxes on the entire gain realized from the sale.[11] Hercules, Inc. complied in 1976, paying the taxes

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maining net income, and such items shall not be included in any factor of the apportionment formula:

> . . .
>
> (4) Gains and losses from the sale of real property located in this State are allocable to this State, and the gains and losses from the sale of real property located outside this State shall be allocated to the state in which the real property is located.

S.C. CODE ANN. § 12-7-1120(4)(Supp. 1982). Subsection (4) was formerly S.C. CODE ANN. § 12-7-1120(5) (1976).

8. 279 S.C. at 179, 304 S.E.2d at 817.

9. In 1966, Hercules bought the facility for $15,039,331. From 1966 to 1970, the corporation deducted a total of $7,493,964 for depreciation. Of this amount, $111,115 was deducted from income reported in South Carolina; the remaining 98.5% of the depreciation claimed was apportioned to other states. In 1970, the plant sold for $13,750,000. The adjusted tax basis for federal income tax purposes at this time was approximately $7,550,000 (original purchase price minus depreciation deductions allowed). Therefore, the sale resulted in a taxable gain of approximately $6,200,000 (sales price minus adjusted basis). Record at 33-34. A true gain would result only if the sales price were higher than the original purchase price of $15,039,331.

10. 279 S.C. at 179, 304 S.E.2d at 816-17.

11. *Id.*

under protest.[12]

Hercules, Inc. brought suit to recover these taxes, and the trial court determined that the taxable gain indeed should have been apportioned. In an opinion issued on May 3, 1983, the South Carolina Supreme Court agreed with the trial court that the taxable gain should be apportioned, not allocated,[13] but held that the trial court's decision was erroneous concerning the amount due.[14] On June 27, the supreme court denied a petition for rehearing, but withdrew the previous decision and substituted its final opinion.

In that opinion, the supreme court held that Hercules, Inc. was correct in apportioning the taxable gain among the forty states because the depreciation had been apportioned.[15] If the entire amount of the gain were allocated to South Carolina, this state would recapture all the depreciation taken, either denying other states the right to recapture or subjecting Hercules, Inc. to double taxation.[16] The court reasoned that apportionment of depreciation had resulted in higher tax revenues for South Carolina from 1966 to 1970,[17] so that it would now be inequitable to allocate to South Carolina all of the gain based on recapture.[18]

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12. The Tax Commission also contended that the entire sale should have been reported in 1970, and that the taxpayer could not use the installment reporting method because there was no formal "election" to do so. Record at 7. The supreme court held that Hercules, Inc. properly treated the transaction as an installment sale, and that the trial court had correctly relied upon Hay v. South Carolina Tax Comm'n, 273 S.C. 269, 255 S.E.2d 837 (1979), which held that an election could be made simply by "inserting in the return the amount reportable as taxable income." *Id.* at 273, 255 S.E.2d at 840.

13. S.C. CODE ANN. § 12-7-1120, which provides for allocation of gain to the state, was first enacted in 1926. The courts agreed that the newer statute, S.C. CODE ANN. § 12-7-250, which provides for apportionment, was controlling.

14. Hercules, Inc. v. South Carolina Tax Comm'n, No. 21914, slip op. at 12-13 (S.C. May 3, 1983), *reh'g. denied, withdrawn*, 279 S.C. 178, 304 S.E.2d 815 (1983). The trial court had relied on a formula suggested by a representative of the Tax Commission, emphasizing "equitable" considerations and based on computations of depreciation taken on Hercules, Inc.'s *worldwide* assets. Record at 16-18. The supreme court stated that the specific terms of S.C. CODE ANN. § 12-7-250, rather than equitable principles, should control. 279 S.C. at 181, 304 S.E.2d at 817-18.

15. 279 S.C. at 181, 304 S.E.2d at 818.

16. *Id.*

17. The method of reporting resulted in greater income tax to South Carolina because only 1.5% of total depreciation from the South Carolina plant was used to decrease reported South Carolina income.

18. 279 S.C. at 181, 304 S.E.2d at 818. The court also decided how much interest was due Hercules, Inc. and stated that S.C. CODE ANN. § 12-7-2310 specifically controls the payment of interest in this case, so that the 1979 amendment of S.C. CODE ANN. §

The result in *Hercules*, apportioning rather than allocating the gain, appears inconsistent with that in *Boyle Utilities v. South Carolina Tax Commission.*[19] The cases are factually distinguishable because *Hercules* concerns real property and *Boyle* deals with personal property. However, both cases fall under subdivisions of section 12-7-1120,[20] which allocates to South Carolina gains and losses derived from sale of property in the state. The taxpayer[21] in *Boyle,* in liquidating its business, brought all its equipment to its home office in South Carolina to be sold. The corporation realized a taxable gain on this sale due to recapture of depreciation.[22] In computing its taxes, the corporation subtracted the amount of this gain from its overall loss for the year and then apportioned the remaining loss between Georgia and South Carolina. The Tax Commission contended that the entire gain should have been allocated to South Carolina before the loss was apportioned between the states. The taxpayer argued that the treatment of income should match the treatment of deductions.[23] The main thrust of the taxpayer's argument, however, was that section 12-7-1120(4) should be interpreted to apply only to non-business income.[24] The supreme court rejected this contention and held that the entire gain should have been allocated to South Carolina.

While *Hercules* seems inconsistent with *Boyle*, there are at least two reasons for its different result. First, the taxpayer in *Hercules* emphasized that the gain was due only to recapture of depreciation, and stressed that states which had allowed depreciation deductions on the plant should be allowed to tax their shares of the gain resulting from recapture of depreciation. The

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34-31-20, regarding the rate of interest on judgments, was irrelevant. *Id.* at 182, 304 S.E.2d at 818.

19. 273 S.C. 93, 254 S.E.2d 308 (1979).

20. *Compare* text of S.C. CODE ANN. § 12-7-1120(6), set out *supra* note 5, *with* text of S.C. CODE ANN. § 12-7-1120(4), set out *supra* note 7.

21. Boyle Utilities, Inc. installed sanitation pipelines in South Carolina and Georgia in the year in question. It was incorporated in and had its principal place of business in South Carolina. 273 S.C. at 94, 254 S.E.2d at 309.

22. Brief of Appellant at 18-19, *Boyle.*

23. As in *Hercules*, depreciation deductions had been apportioned among the states where the company did business. Brief of Appellant at 19-21, *Boyle.*

24. Brief of Appellant at 4-18. Appellant's brief gives a detailed analysis of the background and legislative history of the statute, as well as some comparison with similar statutes in other jurisdictions.

court apparently responded to this appeal to "fairness." Second, the taxpayer argued the unconstitutionality of double taxation.[25] Hercules, Inc. had already apportioned 98.5% of the gain to other states and had paid taxes there. Now it was being asked to pay South Carolina tax on the same gain. Although the court did not directly address the constitutional argument, it stated that its decision apportioning the gain made the constitutional issue moot.[26]

Although the taxpayers in *Boyle* and *Hercules* did not realize an actual gain,[27] the court in *Hercules* stated, "We . . . hold that the gain which is allocable to South Carolina under § 12-7-1120(4) is gain represented by a true and actual profit as contrasted with a profit brought into being by reason of recapturing depreciation."[28] The court thus indicates that when an actual gain takes place, the taxpayer should apportion to the various states any gain represented by recapture of depreciation, and then allocate the balance to South Carolina. Dealing with taxation in this manner can lead to several problems. First, corporate record keeping will be very cumbersome if the specific amount of depreciation apportioned yearly from each piece of property to each state must be shown. Second, the opinion does not address the possibility of a *loss* occurring even after recapture, but considered in light of the language of section 12-7-1120(4),[29] the opinion seems to mandate South Carolina's allocating all of the loss to itself in such a case. Third, as emphasized by the taxpayer in *Boyle*, the statutes of most other states require apportionment of the gains and losses from business related sales, and allocation only of those from *non-business* sales of real property. The South Carolina statute does not make this

25. 279 S.C. at 181-182, 304 S.E.2d at 818. Both issues were raised in *Boyle*, but were overshadowed by the much more strongly argued issue of statutory interpretation, and the supreme court opinion did not even allude to them. The trial court treated them perfunctorily. Record at 15-16, 20-21, *Boyle*.

26. 279 S.C. at 182, 304 S.E.2d at 818-19. In interpreting the statute, the court commented that there could be no serious contention that the South Carolina legislature intended the result of § 12-7-1120(4) to be either a denial of depreciation recapture to other states or double taxation of Hercules, Inc. *Id.* at 181-82, 304 S.E.2d at 818. This analysis reflects a concern for the constitutional issues.

27. *I.e.*, the excess of sales price over purchase price.

28. 279 S.C. at 182, 304 S.E.2d at 818.

29. *See supra* note 7.

distinction.[30] The South Carolina Tax Commission's policy has been to require no recapture of the depreciation taken in South Carolina upon the sale of *any* real property with a situs outside the state.[31] The result in *Hercules* could lead to a decision to attempt to recapture depreciation from corporate sales of both business and non-business real property in other states.[32] The disparity in treatment between South Carolina and other states could result in double taxation for multistate corporations doing business in South Carolina.[33]

Because of the difficulties in administering section 12-7-1120(4) under the rule established in *Hercules*, the legislature may consider amending it.[34] Section 12-7-1120 was last amended in 1977, although the section allocating gain from the sale of real property was not changed. Under the present code, the problem in *Boyle* would never arise since the material formerly appearing in section 12-7-1120(6),[35] dealing with tangible personal property, was completely deleted.[36] The amendment also changed the

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30. The South Carolina Allocation and Apportionment of Income Act, Pub. L. No. 732, 1958 S.C. Acts 1574 (now codified at S.C. CODE ANN. §§ 12-7-1110 to -1200 (1976 & Supp. 1983)), included parts of the Uniform Division of Income for Tax Purposes Act (UDITPA), but did not include the language specifically relating to business income. Record at 17-18, *Boyle*; Brief of Appellant at 5-6, *Boyle*.

31. Record at 99, *Hercules*.

32. Business property would present no problem, since most other states provide for these gains to be apportioned. A source at the Tax Commission indicates that South Carolina does intend to recapture depreciation on sales of real property in other states. *See infra* note 34.

33. *See, e.g.*, the following provision:

> Gains from the sale of tangible or intangible property *not held, owned, or used in connection with the trade or business of the corporation* nor held for sale in the regular course of business shall be allocated to this state if the property sold is real or tangible personal property situated in this state or intangible property having an actual situs or a business situs within this state. Otherwise, the gains shall not be allocated to this state.

GA. CODE ANN. § 48-7-31(c)(3) (1982)(emphasis added). Unlike its South Carolina counterpart, this section does not indicate that gains from sales of similar property located in other states shall be allocated to those states. It is possible to conclude that Georgia will tax, by apportionment, gains on the sale of non-business property located in other states and sold by corporations doing business in Georgia.

34. The South Carolina Tax Commission plans to recommend changes in the law, but has not yet formulated specific proposals. Telephone interview with Charles B. Brown, Supervisor, Research and Review of Income and Estate Division, South Carolina Tax Commission (Sept. 23, 1983).

35. *See supra* note 5.

36. This amendment was effective April 19, 1977, for tax years beginning on or after January 1, 1977. The action in *Boyle* was not commenced until November 9, 1977 and

section dealing with gains from sales of intangible personal property, so that now only non-business income is allocated.[37] An amendment to section 12-7-1120(4) could also provide that only gains from non-business real property would be allocated. Another possibility would be to consider land and improvements separately, allocating all gains from land sales to the situs state. Since land is not depreciable, such an amendment would avoid the problem presented in *Hercules*.

II. APPLICABILITY OF LIENS FOR AD VALOREM TAXES TO AFTER-ACQUIRED INVENTORY

In *Chrysler Credit Corp. v. Lee*,[38] the South Carolina Supreme Court interpreted sections 12-49-10,[39] 12-49-20[40] and 12-49-30[41] of the South Carolina Code as a unit, determining that liens for *ad valorem* taxes on a merchant's inventory take precedence over the security interests of inventory creditors. The

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the supreme court opinion was dated April 18, 1979. However, the change in the law was not considered, even by analogy, at any level of the litigation.

37. "Gains and losses from sales of intangible personal property *not connected with the business of the taxpayer* other than any intangible personal property held for sale to customers in the regular course of business . . . shall be allocated to the state of a corporation taxpayer's principal place of business. . . ." S.C. CODE ANN. § 12-7-1120(5)(Supp. 1983) (emphasis added). The sections were renumbered and the emphasized words added by the 1977 amendment.

38. 278 S.C. 565, 299 S.E.2d 488 (1983).

39. All taxes, assessments and penalties legally assessed shall be considered and held as a debt payable to the State by the person against whom they shall be charged and such taxes, assessments and penalties *shall be a first lien in all cases whatsoever upon the property taxed*, the lien to attach at the beginning of the fiscal year during which the tax is levied. . . . The *county treasurer may enforce such lien by execution against such property* or, if it cannot be levied on, he may proceed by action at law against the person holding such property (emphasis added).

S.C. CODE ANN. § 12-49-10 (1976).

40. As of December thirty-first a first lien shall attach to all real and personal property for taxes to be paid during the ensuing year, and in case such property is about to be removed from the State by bankruptcy proceedings or otherwise or is about to be taken from the jurisdiction of the county before taxes are due in the county and payable for any year, the treasurer of such county shall immediately issue his execution on such property and the sheriff of the county shall proceed to collect the taxes due on such property.

S.C. CODE ANN. § 12-49-20 (1976).

41. "The lien for unpaid taxes on personal property shall also attach to any personal property subsequently acquired by the delinquent taxpayer." S.C. CODE ANN. § 12-49-30 (1976).

court made clear that the tax liens are applied to the general inventory of a delinquent taxpayer, including inventory acquired after the tax lien attaches to the merchant's current inventory.

In April 1973, Chrysler Credit entered into a security agreement with Freeman Dodge, Inc., secured by all "existing or hereafter acquired inventory on[42] parts and accessories, including all proceeds thereof. . . ."[43] The financing statement was duly recorded April 17, 1973. On January 30, 1975, Freeman defaulted and Chrysler Credit repossessed several cars, proposing to sell them to satisfy the debt. Asserting rights established by the filing of a tax lien, the Tax Collector of Sumter County then seized several of these cars to be sold to pay Freeman's delinquent taxes for the years 1974 and 1975.[44]

In the summer of 1975, Chrysler Credit brought suit to stop the county from proceeding with the sale.[45] The circuit judge ordered the vehicles sold and the taxes paid under protest. Chrysler Credit then brought suit to recover these taxes. The lower court granted summary judgment to Sumter County, and Chrysler Credit appealed.

The South Carolina Supreme Court held that the tax lien was superior to that of the secured creditor, Chrysler Credit, and that this lien applied to Freeman's entire inventory, including subsequently acquired property.[46] The court noted that treating automobile dealers differently from other merchants, by applying tax liens to specific cars rather than to inventory generally, would hinder the sale of new automobiles because customers would fear buying cars which might be subject to a tax lien.[47]

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42. This word appears as "on," Record at 10, 22, and as "or," *id.* at 47.

43. Record at 10, 22, 47.

44. Record at 46.

45. The case was heard upon a temporary restraining order and a Rule to Show Cause directed to Sumter County by Judge Laney, who issued an Order dated June 13, 1975. Record at 46.

46. 278 S.C. at 567, 299 S.E.2d at 489.

47. *Id.* Chrysler Credit was able to identify the individual cars in inventory at the close of Freeman Dodge's fiscal year, and insisted that the county's lien should apply only to these. Record at 26-27. The Appellant also argued that the trial court erred in treating automobiles as fungible goods, when they are by law individually titled and registered as separate pieces of property. Record at 63. The county argued that to apply the lien to individual cars, rather than to inventory as an entity, would be to exempt automobile dealers from the statutory provisions applicable to other merchants. Brief of Respondent at 11. The trial court emphasized that merchants are required to return a value, in a single dollar figure, to the Tax Commission, Record at 55, and that there is no

In this case, although the cars seized by the county were inventory, they were not necessarily the same vehicles that were in inventory when the tax was assessed.[48] Chrysler did not dispute the validity or amount of the taxes due,[49] and agreed that a first lien attached to those cars in inventory at the time of the 1975 tax assessment.[50] Chrysler's contention was that a first lien did not attach to cars which entered the Freeman Dodge inventory after Freeman filed its tax return; rather, Chrysler argued that a first lien attached only to the original property on which taxes were unpaid.[51] Chrysler asserted that the county's remedy was to follow the specifically taxed cars into the hands of their new owners, customers of Freeman Dodge.[52] Chrysler relied upon the language of section 12-49-10, which states that the first lien shall be upon the property taxed,[53] and noted that section 12-49-30, which allows attachment of a tax lien to subsequently acquired personal property, does not specify a first lien.[54]

The county, on the other hand, asserted that the "property taxed" was not each individual car, but inventory, which would automatically include subsequently acquired automobiles.[55] The court agreed that the language of section 12-49-30 gave the county a lien on Freeman Dodge's after-acquired property.[56]

The county also argued that a merchant-vendor which extends credit to a merchant is in a better position to protect itself than is a consumer-purchaser.[57] The court, in refusing to allow

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more reason to break down inventory of a car dealership to show when individual items came into possession than there would be to do so with inventory of a grocery or hardware store. *Id.* at 59.

48. Record at 1-2.

49. Record at 47-49.

50. Record at 26-27.

51. Brief of Appellant at 4.

52. Brief of Appellant at 11 (citing 1970 Ops. Att'y Gen. S.C. 177, No. 3199).

53. *See supra* note 39.

54. *See supra* note 41.

55. Brief of Respondent at 6.

56. 278 S.C. at 567, 299 S.E.2d at 489. The court noted use of the words "the lien" rather than "a lien" and the word "also." These words in § 12-49-30, they concluded, referred to the first lien created in §§ 12-49-10 and 12-49-20. *See also* Brief of Respondent at 7. For text of Code, see *supra* notes 39-41.

57. Brief of Respondent at 12. Placing the burden on the vendor merely suggests that such creditors should assure themselves, before extending credit, that taxes are not in arrears. Brief of Respondent at 9 (citing International Harvester Credit Corp. v. Goodrich, 350 U.S. 537 (1956)).

Chrysler's contention that the county should assert its liens against automobiles sold to Freeman's customers, apparently accepted this policy argument.

The propriety of a first priority lien for *ad valorem* taxes upon the property taxed is unquestioned.[58] Although this decision adds nothing startling to the law in South Carolina, it does clarify the application of sections 12-49-10 through 12-49-30. Both secured parties and merchants, particularly automobile dealers, must be aware that liens for *ad valorem* taxes attach to all of a merchant's personalty as of the end of the tax year, although the taxes were computed on the basis of inventory at an earlier date.

The result reached by the court seems reasonable, especially considering that the priority of tax liens is well established.[59] The only alternative to this decision would be for the Tax Commission to forego collection or to assert liens against automobiles purchased from a delinquent dealership by private customers.

III. Challenges to Reasonableness of Utility Rate Structures Must Be Supported by Evidence of Utility's Excess Profits

In *Mims v. Edgefield County Water & Sewer Authority*,[60] the South Carolina Supreme Court considered a consumer's challenge to a utility rate structure. In South Carolina, an individual consumer has little chance of successfully challenging utility rates. South Carolina is typical of most states in determining the reasonableness of utility rates by considering the utility's overall profits. In *Mims*, the court refused to address the plaintiff's individual situation because she did not present evidence of the financial condition of the defendant water authority.

The plaintiff owned a retirement home which was equipped with a fire prevention system consisting of a six-inch water line servicing 350 sprinkler heads. The defendant utility distin-

58. Record at 55-56 (citing U.S. v. Clover Spinning Mills Co., 244 F. Supp. 796 (D.S.C. 1965), *rev'd and remanded*, 373 F.2d 274 (4th Cir. 1966); Holmes v. Weinheimer, 66 S.C. 18, 44 S.E. 82 (1903)).

59. *See supra* note 57.

60. 278 S.C. 554, 299 S.E.2d 484 (1983).

guished between its 3,400 paying domestic customers, which it charged at a meter rate, and its 12 sprinkler system customers, which it charged at $2.00 per sprinkler head.[61] All sprinkler customers, with the exception of plaintiff, were industrial users.[62] Plaintiff contended that her $700 bill was unreasonable because there was no rational basis for a charge per sprinkler head. Water pressure sufficient to activate the entire sprinkler system is never supplied because all the sprinklers are never in operation at once; only those sprinklers located in the area of a fire will be activated.[63] Plaintiff compared her rates with those charged to the Town of Edgefield for water service to fire hydrants, and contended that a reasonable charge would be an annual charge for the water line, similar to the line serving a fire hydrant, which served her building.[64]

Defendant countered that a particular rate is unreasonable only if the utility garners excess profits. Any single utility bill may be "viewed in solitary isolation from the perspective of the consumer and made to appear onerous."[65] Because every customer's use is unique, each would be entitled to an individual rate structure.[66] The defendant utility argued that "by its nature, the charge can only be unreasonable to all of the customers of a particular class or to none of them."[67] Although the trial court found for plaintiff, the South Carolina Supreme Court held that plaintiff had not met her burden of proof. Plaintiff presented evidence only from her perspective, but the reasonableness of rates must be determined by the amount of the utility's return on its investment.[68]

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61. Brief of Respondent at 3. Case law indicates that a charge for the mere availability of water for fire service is legal. *See, e.g.*, Gordon & Ferguson v. Doran, 100 Minn. 343, 349-50, 111 N.W. 272, 274 (1907); Keystone Inv. Co. v. Metropolitan Utils. Dist., 113 Neb. 132, 135-37, 202 N.W. 416, 417 (1925).

62. Brief of Respondent at 3.

63. *Id.* at 5.

64. Plaintiff asserted unfairness in a $25 charge per fire hydrant served by a line the same size as that which served her sprinkler heads at $700. Defendant contended that the comparison should be $25 per hydrant versus $2 per sprinkler, or $2,900 charged to the city for 116 fire hydrants compared to $700 for plaintiff's entire sprinkler system. Brief of Appellant at 9. *See also* Keystone Inv. Co. v. Metropolitan Utils. Dist., 113 Neb. 132, 137, 202 N.W. 416, 417 (1925).

65. Brief of Appellant at 12.

66. *Id.*

67. *Id.* at 13.

68. 278 S.C. at 555-56, 299 S.E.2d at 486.

In support of this proposition, the court cited one South Carolina case, *Southern Bell Telephone and Telegraph Co. v. Public Service Commission*,[69] and two United States Supreme Court cases, *Bluefield Water Works & Improvement Co. v. Public Service Commission*[70] and *Smyth v. Ames*.[71] These cases, however, are suits by utilities which claimed that the rates set by the government were too low and resulted in unconstitutional confiscation of property.[72] None of the decisions set forth analyses from a consumer's standpoint, beyond the general statement that the public should pay only the amount the service is worth.[73] In relying only on these cases, the court in *Mims* did not address the effects of the rate schedule upon the individual, but required that the plaintiff prove the utility's overall profit was unreasonable. The court ignored plaintiff's argument that a charge based on the amount of water made available through the line would be more appropriate.

Instead of asserting that the charges were "unreasonable" and "excessive", which the court finds determined by the reasonableness of the utility's profit, plaintiff might have alleged discrimination—that she was wrongfully classified as an industrial user.[74] The success of such a charge is doubtful, for as long as the user classification is not arbitrary and is based on real differences among consumers, it is generally upheld.[75] For example, in *City of Kermit v. Rush*,[76] the municipal water company assessed one minimum water rate per month against hotels and motels, but classified apartment houses and trailer parks as multiple-unit users, charging the complexes a monthly minimum for each occupied living unit.[77] This classification was upheld. In

69. 270 S.C. 590, 244 S.E.2d 278 (1978).

70. 262 U.S. 679 (1923).

71. 169 U.S. 466 (1898).

72. 262 U.S. at 683, 690; 169 U.S. at 523; 270 S.C. at 595, 244 S.E.2d at 280-81.

73. 169 U.S. at 547; 270 S.C. at 595, 244 S.E.2d at 281.

74. Brief of Respondent at 3. A classification consisting of a single consumer is not necessarily discriminatory. Annot., 40 A.L.R.2d 1331, 1333, 1338 (1955). Plaintiff might have argued that she occupied a unique position, as the only non-industrial sprinkler user. However, the fact that she *could* legitimately be classified separately would not compel the utility to so classify her absent evidence that the present classification was arbitrary and unduly discriminatory.

75. Annot., 40 A.L.R.2d 1331, 1332, 1333, 1338 n.3.

76. 351 S.W.2d 598 (Tex. Civ. App. 1961).

77. *Id. See also* St. Clair v. Harris County Water Control and Improvement Dist., 474 S.W.2d 545 (Tex. Civ. App. 1971).

general, courts have held that, "The interests and needs of the numerous water users served by a city are such that it is improbable, if not impossible, that any classification or rate basis could be devised which would not in some way discriminate against some of the users."[78] Therefore, a utility may discriminate against an individual consumer as long as the discrimination is not unjust or oppressive.[79] The classification of "sprinkler users" is probably reasonable because it is based on a difference in use, although an industrial versus residential distinction is often made.[80]

The result in *Mims*, although decided without specifically addressing all the issues, is consistent with opinions in the majority of jurisdictions, refusing to uphold an individual consumer's challenge to utility rates when that challenge is based upon the effect of the rate structure upon the individual.

IV. TAX TREATMENT OF BUILDINGS DONATED TO CHARITABLE INSTITUTIONS

The South Carolina Court of Appeals, in *Citadel Development Foundation v. County of Greenville*,[81] noted that a building deeded to an educational institution is tax exempt under section 12-37-220 of the South Carolina Code.[82] However, the

78. 351 S.W.2d at 599-600 (quoting Caldwell v. City of Abilene, 260 S.W.2d 712, 714 (Tex. Civ. App. 1953)). The court also points out that the difference in water rates need not be based upon the economic factor of cost. *Id.*

79. *E.g.*, Indiana Natural & Illuminating Gas Co. v. State *ex rel.* Ball, 158 Ind. 516, 522-23, 63 N.E. 200, 222 (1902); Fretz v. City of Edmund, 66 Okla. 262, 265, 168 P. 800, 802, 803 (1917); City of Kermit v. Rush, 351 S.W.2d 598, 599-600 (Tex. Civ. App. 1961); Annot., 40 A.L.R.2d 1331, 1333, 1339 (1955).

80. *See generally* Annot., 40 A.L.R.2d 1331 (1955).

81. 279 S.C. 344, 308 S.E.2d 797 (S.C. Ct. App. 1983).

82. The Code exempts from ad valorem taxation:

(1) all property of the State, counties, municipalities, school districts, Water and Sewer Authorities and other political subdivisions, if the property is used exclusively for public purposes, and it shall be the duty of the Tax Commission and county assessor to determine whether such property is used exclusively for public purposes;

(2) all property of all schools, colleges and other institutions of learning and all charitable institutions in the nature of hospitals and institutions caring for the infirmed, the handicapped, the aged, children and indigent persons, except where the profits of such institutions are applied to private use;

(3) all property of all public libraries, churches, parsonages and burying grounds;

court held that a building donated to a charitable corporation which raises money to benefit the school is not exempt. *Citadel,* the first decision by the court of appeals, has serious ramifications. A tax exempt organization will now have to choose between limited liability and tax exempt status in deciding how to conduct activities peripheral to its main function.

The Citadel Development Foundation is a charitable corporation which receives and spends funds to benefit The Citadel, a state-supported college. In 1979 the Daniel Building in Greenville, South Carolina, was donated to the Foundation. During the 1979 and 1980 tax years, the building was leased to Daniel International Corporation, which later bought it from the Foundation. The Foundation paid, under protest, 1979 and 1980 city and county taxes on the building, which it sought to recover in this action.[83] The Foundation, characterizing itself as part of The Citadel,[84] contended that it was tax exempt under South Carolina Code section 12-37-220(2)[85] as a school, college, or other institution of learning. The Foundation argued that although legal title was in the Foundation, beneficial ownership of the Daniel building was in The Citadel.[86]

The South Carolina Court of Appeals followed the general rule that statutes creating tax exemptions are to be construed strictly.[87] Calling attention to public policy in support of this rule, the court noted that government services must be paid for and that each tax exemption increases the burden upon other taxpayers.[88] The court dismissed the beneficial ownership argu-

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(4) all property of all charitable trusts and foundations used exclusively for charitable and public purposes. . . .

The exemptions provided in items (3) and (4) for real property shall not extend beyond the buildings and premises actually occupied by the owners of such real property.

S.C. CODE ANN. §12-37-220(A) (1976).

83. 279 S.C. at 346, 308 S.E.2d at 799.

84. *Id.* at 347, 308 S.E.2d at 798. The Foundation offices are located at The Citadel, and its employees are paid by the college. The Vice President of Development for The Citadel supervises the Executive Director of the Foundation and several trustees of The Citadel are also trustees of the Foundation. The charter of the Foundation provides that upon dissolution all assets will be transferred to a tax exempt entity—but not necessarily to The Citadel or to an organization benefiting the school. *Id.* at 346, 308 S.E.2d at 798.

85. *See supra* note 82.

86. 279 S.C. at 347, 308 S.E.2d at 799.

87. *Id.* at 348, 308 S.E.2d at 799.

88. *Id.* at 348, 308 S.E.2d at 800. "This principle is sometimes expressed as the first

ment as tenuous, and stated that, "It is one thing to say the Foundation benefits The Citadel, but quite another to claim The Citadel is the beneficial owner of Foundation property."[89] The court noted that the Foundation did not hold the deed in trust, distinguishing cases relied upon by plaintiff.[90]

The court further noted that, "[T]he Foundation is an entity separate from The Citadel and itself has none of the usual characteristics of a school, college or other institution of learning."[91] The decision did not specify what ties would suffice to support a finding that "the Foundation's relationship with The Citadel renders it an institution of learning in its own right"[92] and therefore tax exempt.

The court compared the case with *City of Ann Arbor v. University Cellar, Inc.*,[93] which considered taxability of the inventory of a campus bookstore at the University of Michigan. The University's board of regents had approved the store's general plan and had provided its initial capital. The board also retained the power to terminate the store's right to operate on campus, and to liquidate its assets which, at dissolution, were to go to the board of regents. The board of directors of the store consisted exclusively of university student government members, faculty, and administrators.[94] The Michigan Appeals Court noted that other corporations established by the University of Michigan had been declared exempt by the Tax Commission,[95]

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law of economics, to wit: 'There's no such thing as a free lunch.'" *Id.* at 348 n.1, 308 S.E.2d at 800 n.1.

89. *Id.* at 349, 308 S.E.2d at 800.

90. *Id.* at 348-49, 308 S.E.2d at 800.

91. *Id.* at 346, 308 S.E.2d at 798.

92. *Id.* at 348, 308 S.E.2d at 800.

93. 65 Mich. App. 512, 237 N.W.2d 535 (1975), *rev'd*, 401 Mich. 279, 258 N.W.2d 1 (1977).

94. 65 Mich. App. at 514-15, 237 N.W.2d at 537.

The Michigan court used a totality of circumstances test to determine whether the university exercised enough control over the corporation. The elements were:

a) makeup of the corporation's managing board and the method of their selection;
b) initial and continuing financing;
c) degree of control over operations and existence of the corporation;
d) responsibility for corporation's liabilities;
e) stated purpose in the articles of incorporation; and
f) location of the premises.

Id. at 520, 237 N.W.2d at 539.

95. 65 Mich. App. at 518-19, 237 N.W.2d at 539 (referring to City of Ann Arbor v.

and held that the University store was likewise tax exempt. However, the Michigan Supreme Court reversed, stating that, "[E]xemption of the [store's] stock-in-trade is consistent with the purpose of the exemption but does not touch the question whether the [store's] property is, in substance, the property of the University."[96] Such a determination, the court held, depends upon "whether the Regents or persons acting for and responsible to them so dominate the management and operation of the [store] that its separate corporate identity should be ignored."[97] The court answered in the negative,[98] and emphasized that a major purpose of incorporating the bookstore was to insulate the university from liability to the store's creditors.[99] The court refused to "disregard the corporate entity and treat the [store] as the alter ego of the University for tax exemption purposes, and yet regard it as a separate entity for purposes of determining . . . liability."[100] The South Carolina Court of Appeals did not address this aspect of the Foundation's assertion that it was part of The Citadel, but instead noted that, as in the Michigan case, *University Cellar,* the "school did not maintain managerial and operational control of the board of directors of the organization seeking exemption."[101]

The relationship between The Citadel and the Foundation is more tenuous than the connection at issue in *University Cellar.* While assets of the bookstore were to revert automatically to the Michigan Board of Regents, there is no such provision in the Foundation's charter. If the Foundation had been dissolved in 1980, the Daniel Building would not necessarily have become the

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State Tax Comm'n, 393 Mich. 52, 223 N.W.2d 1 (1974)).

96. 401 Mich. 279, 285, 258 N.W.2d 1, 3 (1977).

97. *Id.* at 285-86, 258 N.W.2d at 3.

98. *Id.* at 286, 258 N.W.2d at 3. The court disagreed with the conclusion by the appeals court that, "The University . . . is alone represented on the defendant's board of directors, as the board is selected only by institutional bodies officially recognized by the Regents as integral parts of the university." 65 Mich. App. at 520-21, 237 N.W.2d at 540. The supreme court pointed out that although the Student Government Council and Faculty Assembly are part of the University Community, both are independent organizations not under the control of the Regents. 401 Mich. at 287, 258 N.W.2d at 3. The court found it irrelevant that the inventory would be exempt if the university itself conducted the business. *Id.* at 293, 258 N.W.2d at 6.

99. 401 Mich. at 287-88, 258 N.W.2d at 4.

100. *Id.* at 291, 258 N.W.2d at 5. Neither tort nor contract liability was actually at issue in this case.

101. 279 S.C. at 349, 308 S.E.2d at 800.

property of The Citadel, or of any organization holding it in trust for The Citadel. In light of *University Cellar*, the court's finding that The Citadel was not the beneficial owner of the property is correct. While the board of directors of the University Cellar were all directly connected with the University of Michigan as students, faculty or administrators,[102] the directors of the Foundation are not necessarily tied to The Citadel. On the other hand, the Foundation and The Citadel share several trustees, which indicates a close, informal relationship. Although not mentioned by the court of appeals, *District of Columbia v. Catholic Education Press*,[103] cited in *University Cellar*, found that a corporation established by a university was tax exempt. The Press offices were located in the administration building of the University, and all the corporation's revenues went into the University treasury. Most importantly, the board of trustees of the Press consisted of the executive committee of the board of trustees of the University, and the officers of the Press and of the University were identical.[104] This form of direct control might support a finding of tax exempt status under the South Carolina statute.

Following the decision in *Citadel*, tax exempt organizations in South Carolina should be on notice that fund raising or other activities conducted through separate corporate entities may cost these activities their tax exempt status.

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102. 65 Mich. App. at 514-15, 237 N.W.2d at 537.

103. 199 F.2d 176 (D.C. Cir. 1952).

104. *Id.* at 178-79. In *University Cellar*, the Supreme Court of Michigan rejected the reasoning of the court in *Catholic Educ. Press*, which stated:

> If The Catholic University of America, in its own name, should engage in activities identical with those of its subsidiary, the Catholic Education Press, we suppose its right to exemption from taxation on the personal property used in such activities would not be questioned. We see no reason for denying the exemption to the University merely because it chooses to do the work through a separate non-profit corporation.

199 F.2d at 179. The dissent in *Catholic Educ. Press* more closely parallels the *Citadel* and *University Cellar* decisions. *Id.* at 180.