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TAX LAW

I. Refund of State Income Taxes to Federal Retirees Denied and State's Tax Refund Statute Narrowly Construed

In *Bass v. State*[1] the South Carolina Supreme Court prospectively applied the United States Supreme Court decision in *Davis v. Michigan Department of the Treasury*[2] and denied approximately 62,000 federal retirees a refund of state income taxes paid for the years 1985 through 1988.[3] The cost of this refund would have exceeded $200,000,000.[4]

Since 1945 South Carolina has exempted up to three thousand dollars of a federal retiree's pension from state income tax, while totally exempting retirement pensions of the State of South Carolina.[5] After the *Davis* decision the state legislature eliminated this unconstitutional preferential treatment by limiting the exemption of state pensions to three thousand dollars.[6] Several federal retirees brought a class action pursuant to section 12-47-440 of the South Carolina Code[7] to recover the state income taxes paid for the previous three years. The trial court certified the class action, granted summary judgment in favor of the federal retirees, and ordered the issuance of refunds with interest. The South Carolina Supreme Court reversed.[8]

Because the United States Supreme Court did not decide the issue of retroactivity in *Davis*, the dispositive issue that faced the *Bass* court was whether to apply *Davis* retroactively or prospectively in South Carolina.[9] The court relied on the test articulated in *Chevron Oil Co. v. Huson*[10] in deciding this issue. The court concluded that *Davis* should be applied prospectively from the date it was decided.[11] The court

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1. 395 S.E.2d 171 (S.C. 1990) (per curiam), *vacated*, 111 S. Ct. 2881 (1991).

2. 489 U.S. 803 (1989). In *Davis* the Court held that the state taxation of federal retirees' income at a different rate than state retirees violated the constitutional doctrine of intergovernmental tax immunity. *Id.* at 817.

3. *See* Record at 51.

4. *Bass*, 395 S.E.2d at 174.

5. *Id.* at 172.

6. *See* S.C. Code Ann. §§ 9-1-1680, 12-7-435 (Law. Co-op. Supp. 1990).

7. *Id.* § 12-47-440 (Law. Co-op. 1976). The statute of limitations on tax refund actions under section 12-47-440 is three years. *Id.*

8. *Bass*, 395 S.E.2d at 172.

9. *Id.*

10. 404 U.S. 97 (1971).

11. *Bass*, 395 S.E.2d at 175. *See* Ragsdale v. Department of Revenue, 11 Or. Tax 440

found that retroactive application of *Davis* would produce inequitable results because the federal retirees had already received the benefits of state public services paid for by their illegally collected taxes.[12] Additionally, the court noted that the burden of the refund on the state budget would be so severe as to endanger the state's financial integrity.[13]

The *Bass* court cited *James B. Beam Distilling Co. v. State*[14] in support of its decision.[15] In *Beam* the Georgia Supreme Court considered whether to apply the United States Supreme Court's decision in *Bacchus Imports, Ltd. v. Dias*[16] retroactively or prospectively. In *Bacchus* the Court held that Hawaii's exemption of certain locally produced liquors from an excise tax imposed on sales of liquor at wholesale violated the Commerce Clause.[17] Shortly thereafter the Georgia legislature amended a state statute that imposed a higher tax on alcoholic beverages imported into the state than on those manufactured in the state.[18] James B. Beam Distilling Company (Beam) sued to recover the extra taxes it paid pursuant to the old statute. The Georgia Supreme Court decided that the old statute violated the Commerce Clause, but refused to grant Beam a refund.[19] The court employed the *Chevron* test and concluded that *Bacchus* should be applied prospectively.[20] Following the South Carolina Supreme Court's decision in *Bass*, the United States Supreme Court reversed the Georgia court and held that *Bacchus* should be applied retroactively.[21] The Court then vacated *Bass* and remanded *Bass* to the South Carolina Supreme Court for reconsideration in light of *Beam*.[22]

In addition to reconsidering its retroactivity analysis, the South Carolina Supreme Court must now readdress its construction of the state tax refund statutes. Shortly after rendering its decision in 1990, the *Bass* court amended its original opinion and added that even if it applied *Davis* retroactively, the federal retirees were barred from receiving a refund because they did not pay under protest.[23] The court

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(1990) (refusing to apply *Davis* retroactively after declaring a tax statute very similar to that involved in *Bass* unconstitutional).

12. *Bass*, 395 S.E.2d at 174.
13. *Id.*
14. 259 Ga. 363, 382 S.E.2d 95 (1989), *rev'd*, 111 S. Ct. 2439 (1991).
15. *Bass*, 395 S.E.2d at 173.
16. 468 U.S. 263 (1984).
17. *Id.* at 273.
18. *Beam*, 259 Ga. at 363, 382 S.E.2d at 95.
19. *Id.* at 364, 382 S.E.2d at 96.
20. *Id.* at 364-67, 382 S.E.2d at 96-97.
21. James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991).
22. Bass v. South Carolina, 111 S. Ct. 2881 (1991).
23. Bass v. State, 395 S.E.2d 171, 175 (S.C. 1990) (per curiam), *vacated*, 111 S. Ct.

declared that sections 12-47-210[24] and 12-47-220[25] of the South Carolina Code, and not section 12-47-440,[26] controlled this action.[27] The court noted, "We have previously stated that the exclusive remedy for the recovery of the erroneous assessment of income taxes is through these 'pay under protest' statutes."[28]

The *Bass* court relied upon the recent United States Supreme Court decision in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*[29] for the proposition that a state may "establish procedural requirements which must be complied with before a refund action is permitted."[30] In *McKesson* the Court reversed the Florida Supreme Court's decision that a state need not refund or provide relief for taxes collected pursuant to an unconstitutional statute.[31] The Court held that "the Due Process Clause requires the State to afford taxpayers a meaningful opportunity to secure postpayment relief for taxes already paid pursuant to a tax scheme ultimately found unconstitutional."[32]

The *Bass* court correctly recognized that *McKesson* permits states to establish procedural requirements for the refund of taxes.[33] However, the court's narrow interpretation of section 12-47-440 will have a devastating impact on the opportunity for postpayment relief by taxpayers. Section 12-47-440 provides:

> Notwithstanding any other provisions of this Title, whenever it shall appear to any taxpayer that any license fee or tax imposed under this Title has been erroneously, improperly or illegally assessed, collected or otherwise paid over to the [South Carolina Tax] Commission, the taxpayer . . . may make application to the Commission to abate or refund in whole or in part such license fee or tax. . . . The provisions of this section shall apply whether or not the license fee or tax in question was paid under protest . . . .[34]

The *Bass* court interpreted section 12-47-440 to apply only to license fees and license taxes, not to refunds of unlawfully collected in-

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2881 (1991).

24. S.C. CODE ANN. § 12-47-210 (Law. Co-op. 1976).

25. *Id.* § 12-47-220.

26. *Id.* § 12-47-440.

27. *Bass*, 395 S.E.2d at 175 & n.5.

28. *Id.* at 175 (citing Perpetual Bldg. & Loan Ass'n v. South Carolina Tax Comm'n, 255 S.C. 523, 180 S.E.2d 195 (1971)).

29. 110 S. Ct. 2238 (1990).

30. *Bass*, 395 S.E.2d at 175.

31. *McKesson*, 110 S. Ct. at 2242.

32. *Id.*

33. *See id.* at 2254-55, 2257.

34. S.C. CODE ANN. § 12-47-440 (Law. Co-op. 1976).

come taxes.[35] The court's narrow interpretation may not completely bar taxpayers from securing refunds, but in the case of the federal retirees, the burden of payment under protest effectively denies the "meaningful opportunity" for the refund envisioned by the *McKesson* Court. Furthermore, the court's interpretation of section 12-47-440 is contrary to the legislature's intent to provide a method for taxpayers to obtain refunds of unlawfully collected taxes without entering a "minefield of technicality."[36]

Section 12-47-440's reference to "any license fee or tax" was not intended to limit the section to license fees and license taxes; rather, the "license" language merely distinguishes section 12-47-440 from other sections within Title 12 that require payment under protest. The South Carolina Supreme Court has addressed this section before. In *City of Columbia v. Glens Falls Insurance Co.*[37] the court stated that "by the enactment in 1960 of [section 12-47-440] the Tax Commission is granted authority to order refunded certain taxes, including State license fees, which have been 'erroneously, improperly or illegally assessed, collected, or otherwise paid over to the (Tax) Commission.' "[38] The *Bass* court's interpretation of section 12-47-440 is a considerable retreat from the *Glens Falls* position.

The South Carolina legislature's enactment of section 12-47-445[39] less than three months after the *Davis* decision provides evidence that section 12-47-440 was understood to govern the federal retirees' proposed refund. Section 12-47-445 provides, "The provisions of Section 12-47-440 do not apply to claims for abatement or refund resulting from a decision of a court of competent jurisdiction declaring a tax law of this State unconstitutional or otherwise unlawful."[40] Because the General Assembly did not create this new section until after the *Davis* decision, the federal retirees are entitled to relief through the state's previous refund law, section 12-47-440. The *Bass* court did not reach

35. Bass v. State, 395 S.E.2d 171, 175 n.5 (S.C. 1990) (per curiam), *vacated*, 111 S. Ct. 2881 (1991). This narrow interpretation of section 12-47-440 is contrary to the expectations of the State Tax Commission and practitioners in the state. *See* F. BOYLE & J. VON LEHE, SOUTH CAROLINA INCOME TAXATION I-5 (3d ed. 1987) ("Section 12-47-440 was added 'on top of' the provision of Section 12-47-220 and is believed to have been enacted to provide a remedy when payment was inadvertantly [sic] made without written protest."); *see also* South Carolina Tax Comm'n, SC Information Letter No. 90-37 (Oct. 12, 1990) (advising caution because of the unknown impact of *Bass* on refunds of taxes not paid under protest).

36. Quirk, *Taxpayer Remedies in South Carolina*, 37 S.C.L. REV. 489, 512 (1986).

37. 245 S.C. 119, 139 S.E.2d 529 (1964).

38. *Id.* at 126, 139 S.E.2d at 531-32 (1964) (quoting the predecessor of section 12-47-440, S.C. CODE ANN. § 65-2684 (1962)).

39. S.C. CODE ANN. § 12-47-445 (Law. Co-op. Supp. 1990).

40. *Id.*

the issue of retroactive application of section 12-47-445.

In *Beam* the United States Supreme Court was far from united in its retroactivity analysis, but it clearly signaled the *Bass* court to apply *Davis* retroactively. The South Carolina Supreme Court must then revise its interpretation of section 12-47-440 to provide the meaningful relief for taxpayers that the General Assembly intended. Finally, the court must fashion a remedy for the federal retirees, through future tax setoffs or otherwise, that truly compensates them for the taxes that were unconstitutionally assessed against them.

R. Patrick Flynn

II. CONSTITUTIONALITY OF AD VALOREM TAX REDUCTIONS FOR LARGE INDUSTRIAL ENTERPRISES UPHELD

In *Quirk v. Campbell*[41] the South Carolina Supreme Court upheld the constitutionality of section 4-29-67,[42] a 1988 amendment to the Industrial Revenue Bond Act (the Act).[43] Section 4-29-67 allows industries that make capital investments of at least eighty-five million dollars to negotiate a reduced fee in lieu of the ad valorem taxes otherwise required by article X, section 1(1) of the South Carolina Constitution.[44]

The original Act permitted counties to buy and then lease back industrial properties to private industrial enterprises as a means of passing to these enterprises the benefits of the lower interest costs of county bonds, which were exempt from federal income taxation. Section 4-29-60 of the original Act required the industrial lessee to pay a fee in lieu of ad valorem taxes that was equal to the amount of ad valorem taxes that the industrial lessee would have paid if it owned the property.[45] Section 4-29-67, the new provision challenged in *Quirk*, permits a particular class of industries, those making capital investments exceeding eighty-five million dollars, to negotiate a fee in lieu of taxes that is lower than previously allowed under section 4-29-60.

The permitted fee reduction takes three forms.[46] First, section 4-29-67 permits a lower assessment ratio of not less than six percent of the market value of the property. This compares to an assessment ratio of ten and one-half percent otherwise required by article X, section 1(1) of the South Carolina Constitution. Second, the amendment al-

41. 394 S.E.2d 320 (S.C. 1990) (per curiam).
42. S.C. CODE ANN. § 4-29-67 (Law. Co-op. Supp. 1990).
43. *Id.* §§ 4-29-10 to -150 (Law. Co-op. 1986 & Supp. 1990).
44. S.C. CONST. art. X, § 1(1).
45. S.C. CODE ANN. § 4-29-60 (Law. Co-op. 1986).
46. *See id.* § 4-29-67(B)(2)(a) (Law. Co-op. Supp. 1990).

lows the private enterprise to apply a millage rate not less than the rate applicable at the time of execution of the agreement to the twenty-year allowable term of the lease agreement. Ordinarily, all property in a taxing jurisdiction is subject to the millage rate determined by county governing authorities. This rate is subject to change and generally increases over time. Third, the amendment allows the private enterprise to freeze the fair market value of the property throughout the term of the lease agreement. All other taxable property is subject to a reappraisal of its fair market value as property values change over time.

Pursuant to this new statutory authority, Richland County and Union Camp Corporation entered into a sale and leaseback transaction in connection with a proposed seven hundred million dollar expansion of Union Camp's existing manufacturing facilities. The expansion was to be financed by the issuance of industrial revenue bonds by the county. The arrangement included an inducement agreement, under which Union Camp agreed to pay a fee in lieu of ad valorem taxes. The parties agreed to calculate the fee by using an assessment ratio of six percent with the millage rate in effect on the date the county issued the bonds. The lower fee was fixed and not subject to increase throughout the twenty-year term of the agreement. William J. Quirk, a resident and taxpayer of Richland County, challenged the constitutionality of section 4-29-67 and alleged that the statute violated not only provisions of the South Carolina Constitution relating to uniformity of ad valorem taxation, but also the Equal Protection Clause of the South Carolina and United States Constitutions.[47]

The supreme court rejected Quirk's uniformity challenge. The court based its decision on article X, section 3(a) of the South Carolina Constitution,[48] which exempts all county-owned property from ad valorem taxation "if the property is used exclusively for public purposes."[49] Because Richland County was to be the record owner of the Union Camp expansion property, the only issue discussed by the court was whether the property was to be used exclusively for public purposes. In deciding the issue, the court followed established precedent[50] and exhibited great deference to the legislative determination of public purpose. The court noted that "it is the *purpose* for which property is used, not the *method* of accomplishment, which determines whether

47. Quirk v. Campbell, 394 S.E.2d 320, 321-22 (S.C. 1990) (per curiam).

48. S.C. CONST. art. X, § 3(a).

49. *Id.*

50. *See Quirk*, 394 S.E.2d at 322 (citing South Carolina Pub. Serv. Auth. v. Summers, 282 S.C. 148, 318 S.E.2d 113 (1984); Taylor v. Davenport, 281 S.C. 497, 316 S.E.2d 389 (1984); Charleston County Aviation Auth. v. Wasson, 277 S.C. 480, 289 S.E.2d 416 (1982) (per curiam)).

use is exclusively for public purposes, notwithstanding incidental benefit [that] will accrue to a particular private business."[51]

The court considered the 1967 case of *Elliott v. McNair*,[52] which upheld the constitutionality of the Act, as dispositive of the issue presented in *Quirk*. In *Elliott* the court found that promoting industrial development is a public purpose and, importantly, that a private enterprise's receipt of a special benefit does not destroy the public purpose.[53] The *Quirk* court noted that the special tax benefits challenged in the present case, like those in *Elliott*, served the "public purpose of promoting industrial development."[54]

The court similarly disposed of an equal protection challenge by relying on United States Supreme Court and South Carolina precedent that applied a rational relationship test to economic legislation. In determining whether the classification was reasonably related to the legislative purpose, the court simply stated that classifying industries based on their capability and willingness to make capital investments of at least eighty-five million dollars is "rationally related to [the] legislative purpose of attracting large capital-intensive industries to this State."[55] In determining whether the constituents of the class were treated equally, the court noted, "All such businesses are granted the opportunity to negotiate for fees in lieu of taxes, provided the requirements of the Act are met."[56]

The result reached in this case is consistent with the reasoning of earlier South Carolina cases. However, several factors make the decision reached in *Quirk* notable for the effect of permitting to "be done by indirection that which is specifically prohibited to be done directly."[57] The South Carolina Constitution clearly specifies the taxation applicable to industrial property[58] and the tax benefits given to new or expanding industry.[59] Prior to the adoption of section 4-29-67, the fee-in-lieu-of-taxes provision of the Act was essentially revenue neutral for the county treasury because the Act had no effect on the

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51. *Id.*

52. 250 S.C. 75, 156 S.E.2d 421 (1967).

53. *Id.* at 88-89, 156 S.E.2d at 428.

54. *Quirk*, 394 S.E.2d at 323.

55. *Id.*

56. *Id.*

57. *Elliott*, 250 S.C. at 86, 156 S.E.2d at 427.

58. Article X, section 1(1) states, "All real and personal property owned by or leased to manufacturers . . . and used by the manufacturer . . . in the conduct of such business shall be taxed on an assessment equal to ten and one-half percent of the fair market value of such property." S.C. CONST. art. X, § 1(1).

59. Article X, section 3(g) grants a five year exemption from ad valorem taxation to all businesses establishing new manufacturing facilities or making additions costing more than fifty thousand dollars to existing facilities. *Id.* § 3(g).

amount of local ad valorem taxes that the county would receive.[60] Section 4-29-67 permits, for the first time, a reduction in the amount of the fee in lieu of taxes.

Obviously, the amendment permits large capital-intensive enterprises to negotiate a fee in lieu of the ad valorem taxes that is much more favorable than the ad valorem taxes it would otherwise pay if article X, section 1 of the South Carolina Constitution controls. The court justified the result, however, by holding that the public purpose doctrine of article X, section 3(a) exempts the property from ad valorem taxation, and the property, therefore, is not subject to any of the constitutional provisions relating to ad valorem taxation.[61]

Even though section 4-29-67 seems to contravene the plain language of the constitution,[62] *Quirk* is consistent with prior decisions and shows great deference to the legislature's determination of a public purpose. A showing that South Carolina's property taxes are second highest among twelve southeastern states[63] and that the tax concessions were a "decided factor" in the expansion decision of Union Camp[64] apparently convinced the court of the need for the county taxing flexibility enacted by section 4-29-67.

Section 4-29-67 grants favored tax treatment to industries making large capital investments in South Carolina. The supreme court continues to exhibit a high degree of deference towards the legislature's determination that this type of preferential treatment ultimately will result in net benefits to the state by improving employment levels and overall economic performance, notwithstanding the losses to county tax revenues.

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60. *See* S.C. CODE ANN. § 4-29-60 (Law. Co-op. 1986).

61. Quirk v. Campbell, 394 S.E.2d 320, 322 (S.C. 1990) (per curiam).

62. The supreme court's decisions in this area have produced some anomalous results. For example, in Powell v. Chapman, 260 S.C. 516, 197 S.E.2d 287 (1973), the court held that county-owned property leased to industry pursuant to the Act is taxable property for determining the county's bonded indebtedness limits for school purposes. *Id.* at 522, 197 S.E.2d at 290. Under *Elliott* and *Quirk*, the very same property would not be considered taxable property for the purposes of complying with the uniformity provisions of the state constitution.

63. *Quirk*, 394 S.E.2d at 321 n.3.

64. *Id.* at 321.