



HENRY McMASTER
ATTORNEY GENERAL

August 16, 2006

The Honorable Alan D. Clemmons
Member, House of Representatives
518-A Blatt Building
Columbia, South Carolina 29211

Dear Representative Clemmons:

We received your letter requesting an opinion on behalf of one of your constituents, Frans Mustert. You also attached a letter from Mr. Mustert in which he described an issue pertaining to personal property taxes he wishes this Office to address. Mr. Mustert's letter provides as follows:

In March 2003, Patricia Holding, LLC entered into a lease agreement with Synovus Leasing Company for the lease of various furniture fixtures and equipment. The lease was for a total sum of \$602,975.00, five years with a \$1.00 purchase option at the end of the lease. A copy of the lease is enclosed.

Patricia Holding capitalized the purchase of the F. F. & E. and recorded the transaction on their books as a capital purchase, to be depreciated over the useful life of the assets and recorded the debt accordingly.

Prior to April 30, 2005 Synovus filed a personal property tax return and reported the personal property at the face value of \$602,975.00 while at the same time Patricia Holding filed their personal property tax return, including \$297,000.00 of F.F. & E. Which was financed through Synovus at the depreciated book value.

Horry County billed Synovus for personal property taxes in the amount of \$14,000.00 and billed Patricia Holding in the amount of \$7,000.00 as part of their total assessment.

Patricia Holding has taken the position that since the lease is not a true lease but rather a financing tool, hence the personal guarantees of two individuals guaranteeing the full financed amount, that the

Request Letter

recording on the books of Patricia Holding is correct and should prevail. It is further noted that the lease is silent on the issue of depreciation by the finance company.

Law/Analysis

Section 12-37-710 of the South Carolina Code (2000) addresses who must file a personal property tax return. This section provides:

Every person of full age and of sound mind shall annually list for taxation the following personal property, to wit:

- (1) All the tangible personal property in the State owned or controlled by him;

...

S.C. Code Ann. § 12-37-710.

According to the provisions of title 12 of the South Carolina Code, the South Carolina Department of Revenue (the "Department") is charged with the authority to enforce provisions of the South Carolina Code dealing with property tax valuation, assessment, and taxation. See S.C. Code Ann. § 12-4-530 (2000). In 1993, the Department issued a revenue ruling dealing with who is responsible for property taxes on leased property. S.C. Rev. Rul. 93-11. In this revenue ruling, the Department considered section 12-37-710 and stated as follows:

Although the lessor is usually the owner for personal property tax purposes, the above statute states that property "owned or controlled" by a person is required to be reported by him for property tax purposes. Thus, the statute states that if personal property is owned by one person and yet controlled by another, the one who controls the property may also be liable for any taxes due.

Id. The Department continued by examining under what circumstances someone other than the owner of the personal property would be responsible for its associated personal property taxes. Id. Ultimately, the Department concluded:

The liability for property taxes imposed upon leased personal property falls upon the lessor as owner of the property. However, the liability for the property taxes imposed upon leased personal property will fall upon the lessee if:

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1. it is impractical for the tax collector to enforce collection against the lessor;
2. the lease is a financing arrangement for income tax purposes whereby the lessee is treated as the owner of the property; or,
3. the Department values the property of the lessee using the unit valuation method (Section 12-4-540(E)).

Id. In describing the second exception, the Department stated:

South Carolina property tax laws do not define "financing lease". However, there are several situations in which the income tax treatment of an item is dispositive of the property tax treatment. For example, the fair market value of merchants' furniture, fixtures and equipment is the depreciated value as shown by the merchants for income tax purposes (SCTC Regulation 117-110). Likewise, the value of manufacturers' machinery and equipment is determined by the gross capitalized cost as shown on the taxpayer's income tax records (SC Code Ann. Section 12-37-930). Therefore, it makes sense to use well defined income tax concepts to determine the property tax consequences. So if the lessee is treated as the owner for income tax purposes because the lease is a financing arrangement, the lessee will also be treated as the owner for property tax purposes. As owner, the lessee is liable for any personal property taxes.

Id.

The Department expanded on the conclusions it reached in this revenue ruling in a subsequent private revenue opinion issued in 2004. S.C. Priv. Rev. Op. 02-4. In that letter, the Department confronted the issue of who is considered the "owner" for property tax purposes when two particular types of capital leases are entered into. Id. The Department described the two types of capital leases as follows:

Capital Lease Type A provides that Lessor retains legal title to the leased property as security until the end of the term of the lease and the completion by the Lessee of all lease payments. At this point in time, the Lessee has the option to purchase the property for one dollar. In practice, the Lessor does not require payment of the dollar and title automatically passes to the Lessee at the end of the lease term.

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Capital Lease Type B provides that the Lessor retains legal title to the leased property as security until the end of the lease term and the completion of all scheduled payments. At the end of the lease term, the Lessee has the option to purchase the property at a pre-stated price, however, that price is always significantly less than what the Lessor, at the time the lease was entered into, projected the fair market value of the property would be at the end of the lease term. The Lessee only receives title to the property if it exercises the purchase option and buys the property at the end of the lease term. For federal income tax purposes, the Lessor records both Capital Lease Type A and Capital Lease Type B as conditional sales and does not depreciate the leased property for federal income tax purposes.

Id. The Department also assumed "that the Lessee is the owner of the property for income tax purposes and that the Lessee of the personal property is entitled to income tax depreciation on the leased property subject to the leases." Id.

Considering its finding in Revenue Ruling 93-11 and the fact that the Lessor represented that the Lessee under both types of leases is treated as the owner, the Department determined that the Lessee is considered the owner of the property and is liable for the personal property taxes due on such property. Id. Furthermore, the Department determined pursuant to section 12-37-900 of the South Carolina Code, the Lessee is responsible for filing all personal property tax returns with the auditor listing the leased property for the property held under the lease. Id.

Although not binding, a court, as well as this Office, generally gives great deference to the opinion of a state agency's interpretation of a statute of which it is charged with the duty and responsibility of enforcing. Brown v. Bi-Lo, Inc., 354 S.C. 436, 440, 581 S.E.2d 836, 838 (2003); Georgia-Carolina Bail Bonds, Inc. v. County of Aiken; 354 S.C. 18, 26, 579 S.E.2d 334, 338 (Ct. App. 2003). Furthermore, "in our opinions, we do not second-guess an agency's policy decisions and interpretations of its own enabling statutes; we generally will leave such review to the courts." Op. S.C. Atty. Gen., September 8, 2005.

Based on our reading of section 12-37-710 of the South Carolina Code and the revenue ruling and private revenue opinion issued by the Department, we conclude the Department's interpretation of this provision with regard to leased property is reasonable. Accordingly, in order to determine who is responsible for filing and paying personal property taxes on leased property, we believe a court would consider whether the lease is a financing arrangement for income tax purposes. Such a determination is a factual in nature and thus, must be made by a court. Op. S.C. Atty. Gen., April 6, 2006 (stating investigations and determinations of facts are beyond the scope of an opinion of this Office and are better resolved by a court). However, based on the information provided by Mr. Mustert, we will attempt to provide you with guidance as to how a court may view who is responsible for the personal property taxes associated with the leased assets.

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Mr. Mustert indicated in his letter that he viewed the lease as "not a true lease but rather as a financing tool" Mr. Mustert also stated Patricia Holding capitalized the lease and is depreciating the leased assets for income tax purposes. Patricia Holding appears to be treating the lease as a financing arrangement for income tax purposes. Furthermore, several provisions of the lease agreement between Synovus and Patricia Holding indicate Patricia Holding's ownership. One provision pertaining to title to the equipment provides, in pertinent part:

Unless you are granted a \$1.00 purchase option under the applicable Schedule, this transaction will be a true lease and we are the owner of and will hold title to the Equipment. If you are granted a \$1.00 purchase option or if this transaction is deemed to be a lease intended for security for any reason, you grant us a first priority security interest in the Equipment.

According to the exhibits to the lease, Synovus granted Patricia Holding a \$1.00 purchase option. Therefore, we presume this is a lease intended for security. Moreover, another provision in the lease entitled "Tax Indemnity" states:

Unless you are granted a \$1.00 purchase option under the Schedule, it is the intent of both parties that the Master Lease and each Schedule constitutes a true lease and that we will be entitled to such deductions and other tax benefits calculated using applicable tax rates as we are provided as of the date of each Schedule by federal, state and local law to an owner or property (the "Tax Benefits"). You shall not take any action inconsistent with our ownership or which affects our right to claim any deduction, including depreciation or cost recovery deductions, attributable to the Equipment.

Because Synovus granted Patricia Holding a \$1.00 purchase option, this provision does not appear apply to Patricia Holding. Furthermore, because the lease contains an option to purchase for \$1.00, we find it similar to Capital Lease Type A in the Department's 2002 private revenue opinion, which the Department determined to be a financing lease.

However, attached to Mr. Mustert's letter is a letter from Synovus to a representative of Patricia Holding dated the same day as the execution of the lease, which explains:

Please be aware that Synovus Leasing Company, as owner of the equipment, will pay property taxes (if applicable) on the equipment. The equipment should be listed as "leased" and not "owned" on your property tax form. You will be billed at a later date as per section 5 "Taxes" of the Synovus Master Lease Agreement.

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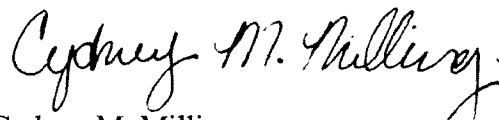
Consistent with this statement, the Synovus Master Lease Agreement contains a provision clearly providing that Synovus will file all tax returns and seek reimbursement from Patricia Holding. This portion of the lease, contrary to Patricia Holding's treatment of the lease for income tax purposes, indicates Synovus retains ownership of the leased property. Thus, the determination of whether Patricia Holding is the owner of the leased assets for purposes of personal property taxes is not clear. However, we believe given the fact that Patricia Holding is treating the assets as owned by capitalizing and depreciating them for income tax purposes and given the provisions of the lease implying that the parties are to treat Patricia Holding as the owner of the assets, we believe a court could find these facts persuasive in determining Patricia Holding is the owner and therefore, is primarily responsible for reporting and paying personal property taxes on the leased assets.

Nevertheless, we keep in mind the parties' agreement providing that Synovus is to file and pay personal property taxes on the leased assets. Presuming this provision is enforceable between the parties, Patricia Holding and Synovus are bound by this provision. Although their decision to enter into a private agreement with respect to the payment of personal property taxes does not affect their responsibility under section 12-37-710, if one of the parties acts in contravention of this agreement that party may be liable for acting in violation of the agreement.

Conclusion

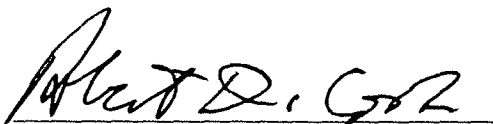
Based on the Department's interpretations of section 12-37-710 and the information provided by Mr. Mustert, although not free from doubt, we believe a court would find Patricia Holding is the "owner" of the leased assets for purposes of filing and paying personal property taxes. However, Patricia Holding's decision to file and pay personal property taxes on the leased assets may be in contravention of the terms of its agreement with Synovus.

Very truly yours,



Cydney M. Milling
Assistant Attorney General

REVIEWED AND APPROVED BY:



Robert D. Cook
Assistant Deputy Attorney General