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The State of South Carolina
# OFFICE OF THE ATTORNEY GENERAL

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ATTORNEY GENERAL

February 1, 1996

Burnet R. Maybank, III, Director
South Carolina Department of Revenue
Post Office Box 125
Columbia, South Carolina 29214

Dear Mr. Maybank:

By your recent letter, you have sought an opinion regarding the constitutionality of two aspects of the recently enacted Enterprise Zone Act.

Background

The Enterprise Zone Act was adopted by the General Assembly as Act No. 25 of 1995,[1] to encourage economic development, particularly in rural areas as well as those parts of the state affected by the closing of federal military installations. The Act accomplishes this purpose by providing several tax and financial incentives.

You advise that the major financial incentive is the Job Development Fee, as described in new S.C. Code Ann. §12-10-80. Under this section qualifying businesses may collect and expend Job Development Fees by retaining certain employee withholdings. In order to collect the fee, the business must enter into a revitalization agreement which allows such withholdings, and the funds must be held in an escrow account with an FDIC insured bank. Employers may use the withheld amounts for any of the following purposes: (1) training costs; (2) acquiring and improving real estate; (3) improvements to utility systems, including water and sewer; and (4) constructions and improvements for the purpose of complying with environmental laws. If the provisions of the Act are

[1]The Enterprise Zone Act is to be codified at S.C. Code Ann. §12-10-10 et seq.



Request Letter.

complied with, both the employer and the employee receive a dollar for dollar credit for their liability for employment taxes.

Issues

1. Whether the Job Development Fee provisions of the Enterprise Zone Act satisfy the public purpose test enunciated in Elliott v. McNair, 250 S.C. 75, 156 S.E.2d 421 (1967)?

2. Whether Job Development Fees are public, as opposed to private, funds for purposes of S.C. Const. Art. X, §11, which constitutional provision prohibits the pledge or loan of the credit of the State for the benefit of a private individual or company?

Discussion - Issue 1

Of paramount importance in responding to your first question is §12-10-20, which section sets forth the findings of the General Assembly in its adoption of the Enterprise Zone Act. That section provides the following:

> The General Assembly finds:
> (1) that the economic well-being of the citizens of the State will be enhanced by the increased development and growth of industry within the State, and that it is in the best interest of the State to induce the location or expansion of manufacturing, processing, services, distribution, warehousing, research and development, corporate offices, and certain tourism facilities within the State in order to promote the public purpose of creating new jobs within the State;
> (2) that the inducement provided in this chapter will encourage the creation of jobs which would not otherwise exist and will create sources of tax revenues for the State and its political subdivisions;
> (3) the powers to be granted to the Advisory Coordinating Council for Economic Development by this chapter and the purposes to be accomplished are proper governmental and public purposes and that the inducement of the location or expansion of manufacturing, processing, services, distribution, warehousing, research and development, corporate offices,l and certain tourism facilities within the State is of paramount importance. [Emphasis added.]

Clearly the General Assembly has found, in the preamble to the Enterprise Zone Act, that the provisions of the act are proper governmental and public purposes, that the act will promote the public purpose of creating new jobs within this State.

Constitutional Concerns

Your first concern was whether the Job Development Fee provisions satisfy the public purpose test enunciated in Elliott v. McNair, supra. Citing to former Art. I, §5 of the State Constitution,[2] the Supreme Court stated:

> All legislative action must serve a public rather than a private purpose. There is no doubt that the economy of South Carolina has undergone a startling change in the last few years. The inhabitants of this state were for many years dependent almost entirely upon agriculture and related industries for their livelihood. Agriculture no longer provides the livelihood of those who only a few years ago were almost entirely supported by it. The Act here under consideration recites that South Carolina has promoted industrial expansion and has actively supported the State Development Board, for which public moneys have been appropriated, and through it has endeavored to promote the industrial development of the state for the welfare of its inhabitants. This has been done as a matter of state policy. [Emphasis added.]

Elliott v. McNair, 250 S.C. at 86-87. The act of the General Assembly under consideration therein was the Industrial Revenue Bond Act, an act authorizing bonds to be issued, to be repaid only from revenues derived from the industrial project to be built by bond proceeds; the Court determined that such act was constitutional. As to the public purpose issue, the Court stated:

> The Legislature has found the Act here is for a public purpose and thus a proper function of government. The question of whether an act is for a public purpose is primarily one for the Legislature, and this court will not interfere unless the determination by that body is clearly wrong. ...
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> ....
>
> We conclude that the Act here was for a public purpose and represents merely an expansion of the established legislative policy of

[2]Now Art. I, §3 of the State Constitution, the language of which is identical to the former constitutional provision.

> improving the industrial climate of South Carolina in order to provide for the welfare and prosperity of its inhabitants and the mere fact that special benefits result by reason of its existence does not destroy the public purpose which promoted its enactment.

Elliott v. McNair, 250 S.C. at 88-89. The Court in Elliott v. McNair cited with approval and quoted from a Virginia decision, Fairfax County Industrial Development Authority v. Coyner, 207 Va. 351, 150 S.E.2d 87 (1966):

> In the case of Fairfax County Industrial Development Authority v. Coyner, 207 Va. 351, 150 S.E.(2d) 87, it was held that the legislative determination that the promotion of industrial development is for a public purpose and thus a proper governmental function is presumed to be correct. It was further said that courts cannot interfere with what the General Assembly has declared to be a public purpose and thus a function of government unless the judicial mind conceives that the legislative determination is without reasonable relation to the public interest or welfare and is beyond the scope of legitimate government. We quote the following from the cited case:
>
> > "The fact that the Authority proposes to issue revenue bonds for the financing and construction of an industrial facility to be leased to a private user does not make the Act unconstitutional. Even though some private individual or corporation incidentally benefits from the financing, construction and use of the proposed facility, its public purpose and character are not destroyed. [Cites omitted.] ...
> >
> > "Having held that authorities created for the purpose of acquisition and development and operation of produce markets, harbor and port facilities, and marinas for public use were for a public purpose and a proper governmental function, it would indeed be an anomaly for us to say that an authority created for the purpose of stimulating and promoting industrial development, which would contribute to the economy of the State and create jobs for its people, was not for a public purpose and thus not a proper function of government." [Emphasis added.]

Elliott v. McNair, 250 S.C. at 88-89.

Since the decision in Elliott v. McNair, other decisions have been rendered by our Supreme Court which have commented upon the public purpose served by legislation which enhances economic or industrial development. In Nichols v. South Carolina Research Authority, 290 S.C. 415, 351 S.E.2d 155 (1986), the Supreme Court examined in depth the concept of "public purpose":

> Courts and legal scholars alike agree that "a public purpose has for its objective the promotion of the public health, morals, general welfare, security, prosperity and contentment of all the inhabitants or residents within a given political division. Caldwell v. McMillan, 224 S.C. 150, 157, 77 S.E.(2d) 798, 801 (1953) (quoting other authority).
>
> Public purpose is "a fluid concept which changes with time, place, population, economy and countless other circumstances. It is a reflection of changing needs of society." [Emphases supplied]. Bauer v. S.C. State Housing Authority, 271 S.C. 219, 227, 246 S.E.(2d) 869, 872 (1978).
>
> This concept of fluidity was earlier approved in Caldwell, supra. "[T]he courts also recognize that customs and usages may change so that a purpose which was formerly conceded to be private may now be public; and therefore the novelty of purpose does not render it the less a public purpose." Caldwell, 224 S.C. at 158, 77 S.E.(2d) at 801, quoting 73 C.J.S. Public, p. 334 (1983).
>
> "Times change. The wants and necessities of the people change ... On the one hand, what could not be deemed a public use a century ago may, because of changed economic and industrial conditions, be such today." [Emphasis supplied]. State ex rel. Warren v. Nusbaum, 59 Wis.(2d) 391, 208 N.W.(2d) 780, 798 (Wis. 1973).
>
> "The consensus of modern legislative and judicial thinking is to broaden the scope of activities which may be classes as involving a public purpose. 37 Am.Jur., Municipal Corporations, Sec. 132. It reaches perhaps its broadest extent under the view that economic welfare is one of the main concerns of the city, state and the federal governments." [Emphasis supplied]. State ex rel. Jardon v. Industrial Development Authority of Jasper County, 570 S.W.(2d) 666 (Mo. 1978).
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> ....
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> Finally, legislation may subserve a public purpose even though it (1) benefits some more than others and, (2) results in a profit to individuals. "Legislation does not have to benefit all of the people in order to serve a public purpose. At the same time legislation is not for a private purpose merely because some individual makes a profit as a result of the enactment." Anderson v. Baehr, 265 S.C. 153, 162, 217 S.E.(2d) 43, 47 (1975).

Nichols v. South Carolina Research Authority, 290 S.C. at 425-426. The Nichols court expressly held industrial development to be a valid public purpose.

The South Carolina Supreme Court most recently commented on economic or industrial development legislation serving a public purpose in Quirk v. Campbell, 302 S.C. 148, 394 S.E.2d 320 (1990). In Quirk, the constitutionality of an amendment to the Industrial Revenue Bond Act, allowing a negotiated fee in lieu of taxes for projects involving initial investments of a minimum of $85 million, was challenged. The Quirk court reviewed prior decisions relative to industrial or economic development constituting a public purpose and concluded, based on Elliott v. McNair, that the legislation was constitutional; the court concluded that the specific transaction examined in Quirk served the public purpose of promoting industrial development, as well. Thus, the legislative policy established since the days of Elliott v. McNair and continued through decisions such as Nichols and Quirk has been adapted to keep up with current economic trends and remains the policy of the State at this time.

Your letter further points out that the Enterprise Zone Act contains several statutory requirements which appear to ensure that the public purpose test will be met on a continuing basis. Section 12-10-50 sets forth the criteria to be met by a business located in an enterprise zone to qualify for the benefits of the Act; subsection 4 provides:

> the [Advisory Coordinating Council for Economic Development] shall determine that the available incentives are appropriate for the project, and the council shall certify to the [South Carolina Department of Revenue and Taxation] that the total benefits of the project exceed the costs to the public, and that the qualifying business otherwise fulfills the requirements of this chapter. ...

Similarly, §12-10-100(A), in the second paragraph, requires the Advisory Coordinating Council for Economic Development to do the following:

> With respect to each business and project, the council shall request the materials and make the inquiries necessary to determine whether the business and its proposed project satisfy the council's announced criteria and to conduct an adequate cost/benefit analysis with respect to the proposed project and the incentives proposed to be granted by the council with respect to the project. After a review of the relevant materials and completion of its inquiries and analysis, the council may by resolution of its members designate an applicant business as a qualifying business and authorize the undertaking of its project according to the revitalization agreement.

In addition, §12-10-100(C) requires that the Council, by March first of each year, prepare "a public document that itemizes each revitalization agreement concluded during the prior calendar year. The report shall list each revitalization agreement, the results of each cost/benefit analysis, and receipts and expenditures of application fees. ..."

Based on the foregoing considerations, including statutory language, legislative findings, and the continually expanding concept of economic or industrial development as being for a proper public purpose, I am of the opinion that the Job Development Fee created within the Enterprise Zone Act would meet the public purpose test as outlined above. I am further of the opinion that a court faced with the issue would give great weight to the legislative findings that the Enterprise Zone Act promotes the public purpose of creating new jobs in this State and that the purposes to be accomplished by the Advisory Coordinating Council for Economic Development are proper governmental and public purposes.

Discussion - Issue 2

Your second question is whether Job Development Fees would be public, as opposed to private, funds for purposes of S.C. Const. Art. X, §11, which provision prohibits the pledge or loan of the credit of the State for the benefit of a private individual or company.[3]

New §12-10-80 provides for the Job Development Fees by way of a qualifying business retaining employee withholding taxes pursuant to §12-10-80. Subsection (A) provides in relevant part that "[e]ach qualifying business retaining employee withholding under this section is allowed a credit against the withholding tax liability provided in Chapter 9 of this title otherwise owed the State, the credit not to exceed the lesser of the amount of such tax or the aggregate amount of employee withholding retained." This subsection requires that the funds withheld be placed in an escrow account with a bank insured by the Federal Deposit Insurance Corporation. Subsection (B) describes the

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[3]Art. X, §11 provides in relevant part:

> The credit of neither the State nor any of its political subdivisions shall be pledged or loaned for the benefit of any individual, company, association, corporation, or any religious or other private education institution except as permitted by Section 3, Article XI of this Constitution. Neither the State nor any of its political subdivisions shall become a joint owner of or stockholder in any company, association, or corporation. ...

conditions under which a qualifying business may collect and retain a job development fee and specifies the permissible expenditures of such fees; that subsection mentions the escrow account into which such fees are to be placed. Subsection (E) further provides that "[e]ach qualified business which has retained employee withholding under this section, shall report each employee's state withholding to the United States, this State, and the employee as if the retained withholding had been paid over to the State pursuant to Chapter 9 of this title." Subsection (F) specifies when such job development fee will permanently lapse and provides:

> In the event of termination [of the revitalization agreement], the qualifying business shall immediately cease to retain employee withholding and immediately cease spending funds from the escrow account. Within thirty days of the expiration or termination of the revitalization agreement, the qualifying business shall pay over all the funds remaining in the escrow account to the department as withholding taxes.

Thus, it is apparent that these funds are retained by the qualifying business in an escrow account, and never actually come into the state treasury, from the plain language of the statute.

From the proposed regulations relative to the determination of proper governmental purpose, paramount importance, and benefits and costs for fee-in-lieu of property taxes and enterprise zone incentives, published in the State Register on November 24, 1995, it is observed, in the section relative to the application form captioned "PUBLIC COSTS INCLUDED IN EVALUATION," in line 4a that the Job Development Fee (Individual Income Withholding) is described as a cost to the general revenues of the state, reaffirming the conclusion that the funds thereunder never actually come into the state treasury:

> If a business enters into a revitalization agreement with the Coordinating Council for Economic Development, the corporation can withhold a percentage of an employee's gross wages based upon a sliding scale (shown below) according to the employee's hourly wage rate for each job created by the project. For the purpose of calculating future fees, the hourly wage is adjusted annually by the rate of inflation and the amount of the credit is adjusted accordingly. <u>This is a cost to the general revenues of the state.</u> [Emphasis added.]

In another line of the application form, under the caption "REVENUE BENEFITS TO THE STATE," line 19 states as to Job Development Fees:

> A company with a revitalization agreement with the Coordinating Council for Economic Development may retain a Job Development Fee for the training of workers or infrastructure improvements. This is a reduction to the General Fund because the amount of withholding is included in the 7.5 percent factor. (See Job Development Fees under the section entitled Public Costs Included in Evaluation for a description.) [Emphasis added.]

Clearly, while a cost to the state is involved, in that the employee is treated as having had all withholding paid on his behalf relative to the United States and the State of South Carolina, the state has not received the funds from the qualifying business and such is a cost to the general revenue of the State of South Carolina.

"Public funds" are defined generally as

> moneys belonging to the United States or a corporate agency of the Federal Government, a state or subdivision thereof, or a municipal corporation. They represent moneys raised by the operation of law for the support of the government or for the discharge of its obligations. In other words, they constitute "revenue," which in turn is defined as "the income of the government arising from taxation, duties, and the like."
>
> The fact that the state has taken possession of moneys pursuant to law is sufficient to constitute them state funds, even though they are held for a special purpose. ...

63A Am.Jur.2d Public Funds §1. The term "public funds" is further defined in Droste v. Kerner, 34 Ill.2d 495, 217 N.E.2d 73 (1966), as "[m]oneys belonging to a government, or any department of it, in the hands of a public official." 217 N.E.2d at 78. For purposes of a statute permitting recovery of public funds illegally expended, the term "public money" was defined as "all money received or collected under color of office, ... ." State v. Kearns, 129 N.E.2d 547, 549 (Ohio Common Pleas 1955). Here, the job development fees, as withholding for income tax purposes of the employees of the qualifying business, would ordinarily have passed to the State of South Carolina, to be used by the State as general revenue. As has been shown in the preceding paragraphs, however, when a qualifying business enters into a revitalization agreement pursuant to the Enterprise Zone Act, the funds do not pass to the State but instead are retained by the business to be used for purposes in the Act, as reflected in the agreement.

It is observed that the Job Development Fee retained by the qualifying business is a tax credit. The Supreme Judicial Court of Maine, in Boulet v. State Tax Assessor, 626 A.2d 33 (Me. 1993), stated as to the legislative act of providing credits against tax

liability, that "[t]he state is free, ... to provide a credit against any income tax owed it, with no constitutional ramifications to creating either a broad or narrow credit provision. Tax credits are a matter of legislative grace that can be broadened, constricted or eliminated at any time." 626 A.2d at 35. The concept of a tax credit is explained by the Court of Appeals of Kentucky in Kupper v. Fiscal Court of Jefferson County, 346 S.W.2d 766 (Ky. Ct. App. 1961):

> A tax credit ... relieves the taxpayer from direct payment of all or a portion of the particular tax on the theory that it has been satisfied by some other method. The taxpayer remains subject to all of the requirements of the tax law and is only permitted to set off against his tax liability any amount with which he has been properly credited.

346 S.W.2d at 767. Moreover, it has been recognized that "tax credits do not constitute a right to a payment of money, have no independent value, and are not freely transferable upon receipt." City of Chicago v. Michigan Beach Housing Cooperative, 242 Ill. App.3d 636, 182 Ill. Dec. 343, 609 N.E.2d 877, 886 (1993).

The General Assembly, by legislative act, created employee income tax withholding as well as the income tax structure to which withholding is applied. The General Assembly has also created various exceptions and credits relative to the state tax structure; among those, as examples, would be a tax credit for the establishment of a corporate headquarters in this State, see S.C. Code Ann. §12-6-3410, and a job tax credit, see S.C. Code Ann. §12-6-3360, both of which potentially have the effect of enhancing economic development in this State. Similarly, the General Assembly has chosen to permit certain qualifying businesses (and their employees) to receive credit for taxes which would otherwise have been remitted to the State, which will be charged against the general revenue of the State.

As the Act is presently written, and considering the definitions of "public funds" discussed above, it is apparent that the job development fees do not pass into the hands of any public official of the State, as long as the business is a qualifying business and the revitalization agreement is being followed. From the State and the employer's perspectives, the funds do not appear to become "public funds." At best, the State would appear to have an inchoate interest in the job development fees until such time as the business no longer qualifies for the fees or the revitalization agreement should be terminated (by the passage of time or the occurrence of certain events). The Job Development Fees are, instead, tax credits which are a matter of legislative grace and which may be amended by the legislature at any time. I am of the opinion that the Job

Development Fees as enacted within the Enterprise Zone Act of 1995 would not be considered public funds for purposes of Art. X, §11 of the State Constitution.

With kindest regards, I am

Sincerely,

Charles Molony Condon
Attorney General