



SC REVENUE RULING #91-7

SUBJECT: Definition of Inventory for Property Tax Purposes

TAX ANALYST: Malane Pike

EFFECTIVE DATE: Applies to all periods open under statute.

SUPERCEDES: All previous documents and any oral directives in conflict herewith.

REFERENCE: S. C. Code Ann. Section 12-37-450 (Law. Coop. Supp. 1990)
S. C. Code Ann. Section 12-37-220(B)(30) (Law. Coop. Supp. 1990)

AUTHORITY: S. C. Code Ann. Section 12-3-170 (Law. Coop. 1976)
SC Revenue Procedure #87-3

SCOPE: A Revenue Ruling is the Commission's official interpretation of how tax law is to be applied to a specific set of facts. A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.

Question:

What is the definition of "inventory" for property tax purposes?

Discussion:

South Carolina Code Section 12-37-450 provides a phase out of the property tax on inventory of business establishments and reads, in part:

(A) The inventory of business establishments shall be exempt from property taxation as follows: for the 1985 tax year, seventeen percent; for the 1986 tax years, fifty percent; for the 1987 and subsequent tax years, one hundred percent. The exemption herein provided is conditional upon the appropriation by the State to the municipalities and counties for each year an amount equal to tax revenue not collected by reason of the exemption. If the appropriation for any year is less than the amount equal to the tax revenue not collected, the exemption shall be proportionately reduced in the manner provided in (C) below. The exemption provided in this section is not allowed if the return is received by the Commission after the date due or the tax due is received by the county or municipality after the date due.

Because inventory is no longer taxed, it has become necessary to define what is to be encompassed within this term for purposes of the exemption. South Carolina property tax statutes do not define the term "inventory". 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. (S. C. Code Ann. Section 12-37-930 (Law. Coop. Supp. 1989)). Therefore, it makes sense to use South Carolina income tax definitions which, in turn, conform to federal income tax law. Administrative interpretation of the term "inventory", as discussed below, is consistent with this approach.

For federal income tax purposes, inventory is defined as merchandise purchased for resale. The purpose for which merchandise was bought governs in determining whether it is inventory, not the fact that it may subsequently be resold (Pierce-Arrow Motor Car Co. v. U. S. (9 F. Supp. 577 (Court of Claims 1935))).

Another federal income tax concept which is helpful in defining whether an item is considered inventory is its treatment on sale. When inventory is sold, the resulting income is treated as ordinary income. In contrast, when trade or business assets held for more than one year are sold, capital gain may result after recapture for depreciation. (Internal Revenue Code Sections 1221 and 1231). This issue was examined in the case of McWilliams v. Godwin, 54-2 USTC §9514 (E.D. Ark. 1954) where sales of used typewriters by a partnership engaged primarily in the rental of typewriters and sales of new machines resulted in capital gain. The typewriters were specifically found to be depreciable assets used in the dealer's business, and not property held for sale in the ordinary course of business. Similarly, rented personal property was held primarily for rental rather than for sale, and hence gains from its sale were treated as capital gains (A. Bennetti Novelty Co., Inc., 13 TC 1072). Thus, the rental property was deemed to be a business asset rather than inventory.

Another situation in which this principle has been utilized is leased automobiles. Internal Revenue Service Revenue Ruling 75-544, 1975-2 CB 343, states that the capital gains provisions of Section 1231 are applicable (subject to the recapture provisions of Section 1245) to taxpayers who:

1. are primarily engaged in the business of leasing motor vehicles, and
2. sell their used motor vehicles at wholesale prices that do not contemplate a dealer's profit to dealers, wholesalers, or jobbers, and
3. do not maintain facilities for the retail sale of motor vehicles, such as showrooms, used car lots, or sales forces.

Materials and supplies are also not deemed to be "inventory" for purposes of federal income tax law. Pursuant to Treasury Regulation 1.162-3 (1958), the cost of materials and supplies are to be deducted as they are consumed. Thus, these items are not includable in inventory, but rather, are expensed as consumed.

Based upon this analysis, the South Carolina Tax Commission has consistently treated materials and supplies used in a business and equipment which is rented out in a rental business to be excluded from the definition of inventory. Therefore, no exemption is provided for those items under Section 12-37-450.

In addition, administrative interpretations of the statutes by the agency charged with their administration and not expressly changed by the legislative body are entitled to great weight. Marchant v. Hamilton, 297 S.C. 497, 309 S.E. 2d 781 (1983). When as in this case, the construction or administrative interpretation of a statute has been applied for a number of years and has not been changed by the legislature, there is created a strong presumption that such interpretation or construction is correct. Ryder Truck Lines, Inc. v. South Carolina Tax Commission, 248 S.C. 148, 149 S.E.2d 435 (1966); Etiwan Fertilizer Company v. South Carolina Tax Commission, 217 S.C. 354, 60 S.E. 2d 682 (1950).

Conclusion:

Merchandise purchased for resale is "inventory" for purposes of the business inventory tax exemption (Section 12-37-450) and South Carolina income taxation. The purpose for which merchandise was bought and held governs in determining whether it is inventory, not the fact that it may subsequently be resold. Equipment which is rented out by rental businesses and materials and supplies used in a business are examples of property which are not inventory and therefore, not exempt from property taxation under Code Section 12-37-450 and 12-37-220(B)(30).

SOUTH CAROLINA TAX COMMISSION

s/S. Hunter Howard, Jr.

S. Hunter Howard, Jr., Chairman

s/A. Crawford Clarkson, Jr.

A. Crawford Clarkson, Jr., Commissioner

s/T. R. McConnell

T. R. McConnell, Commissioner

Columbia, South Carolina
April 18 _____, 1991

NOTE: This ruling is not intended to change the items deemed to be inventories of manufacturers in S. C. Code Ann. Section 12-37-220(A)(6).