

1976 S.C. Op. Atty. Gen. 359 (S.C.A.G.), 1976 S.C. Op. Atty. Gen. No. 4500, 1976 WL 23117

Office of the Attorney General

State of South Carolina

Opinion No. 4500

October 22, 1976

***1 (1) Amounts transferred by a corporation to its capital stock account from its earned surplus that is equal to the difference in par value of outstanding stock prior to and after recapitalization are not subject to taxation under Chapter 10 of Title 65 as either dollars paid to capital stock or dollars paid in surplus.**

(2) Amounts transferred by a corporation to its capital stock account from its earned surplus that is equal to the difference in par value of outstanding stock prior to and after merger are not subject to taxation under Chapter 10 of Title 65 as either dollars paid to capital stock or dollars paid in surplus.

(3) Where a corporation transfers earned surplus to 'paid in surplus', the amount so transferred is taxable under Chapter 10 of Title 65 as dollars paid in surplus.

Director
Income Tax Division
South Carolina Tax Commission

2. In a merger of two corporations, where the earned surplus of the merging corporation is transferred to the capital stock account of the surviving corporation, does the transfer of the earned surplus constitute funds 'paid to the capital stock or paid in as surplus' of the surviving corporation within the meaning of Section 65-606, as amended in 1971?

3. In a merger of two corporations, where the earned surplus of the merging corporation is transferred to the 'Paid-In-Surplus' account of the surviving corporation, does the transfer of the earned surplus constitute 'paid in as surplus' of the surviving corporation within the meaning of Section 65-606, as amended in 1971?

STATUTES INVOLVED

Section 65-606 and Section 12-11.2.

DISCUSSION

Question 1. It is understood that the 'recapitalization' referred to consists of a change in the corporation's classes of stock and the par value thereof. Prior to recapitalization the corporation had outstanding 52,822 shares of common stock of a \$10 per share par value which resulted in outstanding capital stock of \$528,000. We are not here concerned with the tax treatment of this amount, however, after recapitalization the corporation had outstanding 70,000 shares of common stock of a par value of \$50¢ per share, 70,000 shares of non-voting preferred shares of a par value of \$18 per share and 700,000 shares of voting preferred stock of a par value of 10¢ per share. The aggregate value of the outstanding stock after recapitalization was in the amount of \$1,365,000. The new stock was exchanged for the old stock in proportion to the ownership of the old stock and the difference in the par value of the old stock and the par value of the new stock was transferred to the corporation's capital stock account from the corporation's earned surplus account. The question therefore is whether the amount so transferred is subject to taxation as dollars paid to the capital stock or paid-in surplus of the corporation.

It is necessary for a better understanding of this question to consider the history of Section 65–606 as the same has been construed by our courts. Four cases have been decided and each is reviewed insofar as the same affects the question. The first case is that of [Pacolet Mfg. Co. v. Query, et al.](#), 174 S. C. 359, 177 S. E. 653, that was decided on November 22, 1934. The par value of stock issued as a stock dividend was transferred from the corporation's earned surplus account to the capital stock account and the amount so transferred was held taxable as dollars paid to the capital stock of the corporation.

*2 The second case is that of [Coble Dairy Products Cooperative v. Livingston](#), 239 S. C. 401, 123 S. E. 2d 301, a 1961 decision that held an incorporated nonprofit cooperative marketing association to be without the statute. The decision, however, sets forth a general rule of construction that was also favorably referred to by the court in the two later decisions, the same being:

‘[1] A tax statute is not to be extended beyond the clear import of its language, and any substantial doubt as to its meaning is to be resolved in favor of the taxpayer. [Colonial Life & Accident Ins. Co. v. South Carolina Tax Commission](#), 233 S. C. 129, 103 S. E. 2d 908.’

The third case is that of [Gulf Oil Corp. v. South Carolina Tax Commission](#), 248 S. C. 267, 149 S. E. 2d 642, a 1966 decision in which the court held that the excess above par value of stock distributed in a stock dividend, which amount was transferred from the earned surplus account to one of the corporation's capital accounts, did not constitute dollars paid in as surplus. The court there adopted the accepted meaning of the term and concluded that nothing had been paid the corporation.

The fourth case is that of [Deering-Milliken, Inc. v. South Carolina Tax Commission](#), 257 S. C. 185, 184 S. E. 2d 711. The court there held that the difference in the par value of the stock of two merging corporations prior to and after merger, which difference was transferred to the capital of the surviving corporation from the earned and other surplus accounts of the corporations was not dollars paid to the surviving corporation's capital stock.

It is clear from these decisions and the rule of construction quoted from [Coble Dairy Products Cooperative v. Livingston](#), supra, that the amount so transferred to the capital stock account of the corporation in question is not dollars paid to that corporation's capital stock.

To determine whether the amount transferred is paid in as surplus it is necessary to review Section 16 of Part II of Act 410, Acts of 1971, that defines the term ‘paid in surplus’ for purposes of Section 65–606 to mean:

‘* * * the entire surplus of a corporation other than its earned surplus as defined in Title 12, Chapter 1, Section 12–11.2(q), South Carolina Code of Laws of 1962, as amended, and shall include any charges against earned surplus reflected in the balance sheet except charges for reserves.’

‘Earned surplus’ is defined by the Section as:

‘* * * that portion of the surplus of a corporation equal in amount to the balance of its net profits, income, gains, and losses from the date of incorporation, or from the latest date when a deficit was eliminated by application of its capital surplus, after deducting subsequent distributions to shareholders and transfer to stated capital and capital surplus to the extent that such distributions and transfers are made out of earned surplus. Unrealized appreciation of assets shall not be included in earned surplus.’

*3 The term ‘surplus’ as used in that Section is also defined by the preceding Section, 12–11.2(p) as:

‘* * * the excess of the net assets of a corporation over its stated capital.’

The question therefore is whether the amount so transferred continues its identity as a surplus fund by whatever term it may be labeled after the transfer.

The term 'stated capital' as used in the definition of 'surplus' is also defined by Section 12-11.2(1) and includes the amounts so transferred therefore the amounts so transferred under this statutory definition has lost its identity as a surplus account. The terms as there defined includes, inter alia, 'the par value of all issued shares of a corporation having a par value.'

The term 'surplus' has also been defined as:

'The word 'surplus' is a term commonly employed in corporate finance and accounting to designate an account on corporate books. But this is not true of the words 'undivided profits'. The surplus account represents the net assets of a corporation in excess of all liabilities including its capital stock. This surplus may be 'paid-in surplus', as where the stock is issued at a price above par; it may be 'earned surplus', as where it was derived wholly from undistributed profits; or it may, among other things, represent the increase in valuation of land or other assets made upon a revaluation of the company's fixed property. See [La Belle Iron Works v. United States](#), 256 U. S. 377, 385, 41 S. Ct. 528, 65 L. Ed. 998.' [Edwards v. Douglas](#), 269 U. S. 204, 46 S. Ct. 85, 70 L. Ed. 235. See also [Gulf Oil Corp. v. South Carolina Tax Commission](#), supra.

CONCLUSION

As to Question 1. It is thus evident that the amount so transferred is not paid in surplus as the term is defined by Section 65-606.

As to Question 2. The same rationale and conclusion set forth for Question 1 are to be applied to this question. It is, however, assumed that the amount transferred is difference in the par value of the stock prior to and after merger.

As to Question 3. It is assumed that there is in fact a surplus and that the earned surplus transferred to a capital surplus account has no relation to the par value of any stock issued. Under such circumstances, the funds so transferred would be taxable as dollars paid in as surplus as the term is defined in Section 65-606.

Joe L. Allen, Jr.
Deputy Attorney General

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