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The Manufacturing Exemption From The Capital Stock Tax

The legal test of what constitutes a manufacturing operation, so as to entitle the property invested therein to exemption from the Pennsylvania capital stock tax in accordance with the proviso contained in Section 21 of the Act of June 1, 1889,¹ as finally amended by the Act of April 25, 1929,² has not been easily susceptible of consistent application.

The purpose of the manufacturing exemption was undoubtedly to encourage new industries to locate in Pennsylvania.³ It is interesting to keep this purpose in mind in studying the various decisions construing the exemption proviso.

The word "manufacturing" has been used in many

¹P. L. 420.

²P. L. 657, which reads "and provided further, That the provisions of this section shall not apply to the taxation of the capital stock of corporations, limited partnerships, and joint-stock associations, organized for laundering, for the processing and curing of meats, their products and by-products, or for manufacturing purposes, which is invested in and actually and exclusively employed in, carrying on laundering, the processing and curing of meats, their products and by-products, or manufacturing within the State * * *".

³*Com. v. Custer City Chemical Co.*, 16 Dauphin 46, 49; *H. M. Rowe Co. v. Beck*, 131 Atl. 509, 511 (Md.), where the court said, with respect to the manufacturing exemption, "The purpose and intent of such statutes as those under consideration is to augment the wealth and prosperity of the State by inducing the establishment, expansion, and development of industries which will produce by hand or mechanical labor, in commercial quantities, articles suitable or desirable for the necessities, comfort, convenience or pleasure of the public, afford employment to its own citizens and attract others whose skill and industry will add to its wealth and resources".

statutes and defined in scores of cases. A representative definition of the term as used in the statute under consideration is to be found in *Commonwealth v. Weiland Packing Company*,⁴ where the court, at page 449, quoted from 26 Cyc. 520, as follows: "Manufacturing is: (1) the application of labor or skill to material whereby the original article is changed to a new, different and useful article, provided the process is of a kind popularly regarded as manufacture or the product of such process".

Again at page 450: "* * * Or, in other words, the process of manufacture brings about the production of some new article by the application of skill and labor to the original substance or material out of which such new product emerges. If, however, there is merely a superficial change in the original materials or substances and no substantial and well-signalized transformation in form, qualities and adaptability in use, quite different from the originals, it cannot properly and with reason be held that a new article or object has emerged,—a new production been created".

In the older case of *Norris Brothers v. Commonwealth*,⁵ the court said, page 496, "It generally consists in giving new shapes, new qualities or new combinations to matter * * *".

Probably the most liberal decision on what constitutes "manufacturing" is to be found in *Commonwealth v. Filbert Paving and Construction Co.*⁶ This case was decided in 1910 and since then the courts have been careful not to extend its application. In fact, since this decision there has been rather a notable judicial tendency to discourage the constant effort to spread the application of the exemption.

Briefly stated, the Filbert Paving and Construction Co. was engaged in the building of concrete roads and concrete and asphalt floors. In reaching the conclusion that such operations constituted manufacturing, the lower court

⁴292 Pa. 447.

⁵27 Pa. 494.

⁶229 Pa. 231. Accord *People ex rel. Fruin-Bambrick Paving Co. v. Knight*, 90 N. Y. Supp. 537.

seems to have been impressed by the fact that what was done resulted from the mixing and preparing in combination some or all of the following ingredients: cement, sand, crushed stone, cinder, asphaltum, asphaltic, bitumen, silica grit, carbonate of lime, petroleum residuum and various coloring materials. The result was, of course, a new composite substance distinct from any of its ingredients. While this alone would not make the process manufacturing, the appellate court apparently adopted in aid of its conclusion the following very broad definition as applied by the lower court:⁷ "A term employed to designate the change or modification made by art or science in the form or substance of material articles in the view of rendering them capable of satisfying some want or desire of man; and manufacturing industries consist in the application of art, science or labor to bring about certain changes or modifications of already existing materials. It includes all branches of industry, with the exception of fishing, mining and such industries as have for their object to obtain possession of material products in the state in which they are fashioned by nature".

And on page 63: "The original meaning of the word 'manufacture' (made by hand) has been greatly enlarged by statutory enactments and judicial interpretations until it is now generally understood to include 'every product fabricated by the hand of man by his act or his skill, the labor which he directs or the machinery which he controls'".

While these definitions seem too broad to be scientifically accurate, it is still questionable whether even their adoption justified the conclusion reached. The definitions had to do solely with "articles" or "products". Do these terms not apply to personal property only? Can they be construed to include real estate? When a concrete pavement or road is laid it becomes real estate. The same is true of a floor.

The manufacturing exemption, we must remember, was intended to encourage new industries to locate in Penn-

⁷12 Dauphin 57, 64.

sylvania. Is this purpose furthered by the Filbert decision? The fact that it is not is, of course, not conclusive that a real estate improvement may not constitute a manufacturing operation, but it is, at least, persuasive when it is considered that it is the first Pennsylvania appellate court decision taking this view.⁸ A prospective manufacturer of silk may well consider whether it would be more advantageous to locate in Pennsylvania or New Jersey, but a road construction company has no choice as to where a road is to be built.

As might have been expected to happen much sooner, the court in the case of *Commonwealth v. Wark Company*⁹ was asked to extend the exemption, under the doctrine of the Filbert case, to include general building and construction work; that is, the erection of buildings of all types, whether of reinforced concrete, brick, stone, sheet metal, frame or what not. In fact, the appellant company argued that it did not require an extension of the principle of the Filbert case to hold that the exemption embraced the construction of buildings.

In the Filbert case the concrete pavement was laid horizontally. In the Wark case the concrete was poured into molds, or forms, and took shapes both horizontal and

⁸In the lower court case of *Com. v. William Swindell & Bros. Co.*, 22 Dauphin 184, the court held that the making of large "gas-producers and furnaces" was a manufacturing operation. The company assembled its materials on the ground—structural steel, steel plates, rough iron castings, fire brick, fire clay, sand, cement and wooden forms—and then constructed a furnace or gas producer. The court found as a fact that "they are of a size so large and of a weight so great that it would be impossible to ship the same after completion". Thus, they apparently became immovables which could not be considered articles of commerce in the popular sense, although the Commonwealth always took the view that they were machines; the court having defined a gas-producer as "a machine for making artificial gas", which machines were simply too large to be portable under present means of transportation.

⁹32 Dauphin 286, affirmed by the Supreme Court of Pa., June 21, 1930 (not yet reported). This case held that the erection of concrete and other buildings was an act of construction as distinguished from a manufacturing operation.

vertical. It took a much greater degree of skill to lay or set the concrete above the ground whether in horizontal or vertical shapes than on the ground in horizontal form. The result seemed almost inevitable that the court to be consistent would have to hold that such building operations constituted manufacturing.

The lower court, in its well considered opinion, criticized the Filbert decision for applying what appeared to be an erroneous rule as to the burden of proof in exemption cases. The Filbert Company alleged that its operations were manufacturing; the Commonwealth that they were, at least in large part, construction as distinguished from manufacturing. The court held that the burden was on the Commonwealth to prove what part of the operations was not manufacturing. All other decisions on this question hold that exemptions from taxation are to be construed strictly and that the burden of proof is on the company claiming the exemption to show what part of its operations is entitled to it.¹⁰ The court, after making it quite clear that it did not agree with the Filbert decision, stated that it would not be responsible for extending its effect beyond the letter of its terms.

The lower court in the Wark case, however, was bound by the decision in the Filbert case whether it agreed with it or not; hence, it attempted to distinguish it on the ground that the Filbert Company had its own "plant" where it "manufactured" the products which it then used in making cement floors, asphalt floors, pavements, roadways and structural concrete. The possession of a "plant" seemed to have some importance, since the exemption proviso read, in part, "it being the object of this proviso to relieve from State taxation only so much of the capital stock as is invested purely in the * * * manufacturing plant and business".

¹⁰Callery's appeal, 272 Pa. 255; Academy of Fine Arts v. Phila. County, 22 Pa. 496; Com. v. Sunbeam Water Co., 284 Pa. 180; Com. v. Lackawanna I. & C. Co., 129 Pa. 346; Com. v. Westinghouse Air Brake Co., 151 Pa. 276; Miller v. Kirkpatrick, 29 Pa. 226; Harrisburg v. Cemetery Association, 293 Pa. 390.

It is questionable, however, whether this factor really had much to do with the decision in the Filbert case. The language of the Supreme Court is very vague and, as the lower court in the Wark case said, "loose". For an opinion which had so much pioneering to do, Mr. Justice Elkin's is not a fortunate one. You may read it through and not know what the business of the Filbert company was. Its actual operations are neither described nor mentioned. The opinion lays great emphasis upon the fact that the word "manufacturing" was contained in the purpose clause of the charter. The court states that presumptively this made the appellant a manufacturing company and, hence, lead directly to the application of an erroneous rule as to the burden of proof. As a matter of fact, the inclusion of the word "manufacturing" in a purpose clause means almost nothing in the determination of such an issue as was before the court, particularly in the case of a Delaware corporation. It is very doubtful, therefore, whether the Supreme Court did not *assume* rather than *determine* that the operations of the Filbert Company constituted manufacturing.

Later attempts to justify the Filbert decision have emphasized the fact that the company had a plant for producing the products used in its construction work. In this connection reliance is placed upon the cases of *Commonwealth v. Keystone Bridge Co.*¹¹ and *Commonwealth v. Pittsburgh Bridge Co.*¹² There is little likeness between the processes in the two classes of cases. The decisions in the bridge cases are predicated upon the fact that the companies themselves manufactured the component parts of the bridge, and, in the opinion of the court, a manufacturer has a right to dispose of his product even if the profitable disposition includes its assembly in place for the purchaser. It would be unfair, in such a case, to consider the manufacturing process broken at any given point. The erection of the bridge was thus merely the *completion* of what was

¹¹156 Pa. 500.

¹²156 Pa. 507.

admitted by all to be a manufacturing process.¹⁸

To apply this as an analogy to the process by which either roads or houses are built of concrete would seem, to resort to a homely expression, to represent an attempt to make the "tail wag the dog". Possibly every construction company, whether of roads or buildings, has some sort of "plant", in a sense. It must in some way *prepare* the ingredients which form the raw materials going into the construction of the road or building. It may do it in a plant detached from the construction operation, or it may do it in an improvised plant on the ground. To make the test of manufacturing depend upon whether it adopts the one method or the other would seem to represent a resort to a most unsound criterion to determine whether the building of the road or the house is a manufacturing operation.

As a matter of fact, a company engaged in constructing reinforced concrete buildings or concrete roadways never has a "plant" in the sense that the Keystone Bridge Company had. The latter really manufactured the component parts of the bridge; such as, beams, girders, rods, bolts, etc. The assembly in place by it of these component parts made their sale easier. In the Wark and Filbert cases, component parts, as such, were not produced for the gen-

¹⁸This is made clear by the opinion of the lower court where Judge McPherson distinguishes such a case from the construction of houses and says, page 502 of Supreme Court Report, "It is quite true that in common speech we do not say that a bridge or viaduct or house or roof is manufactured, but built or erected or constructed, and it might perhaps be true that a corporation, whose only business was the erection of such structures after the parts had been fashioned and fitted by others, would not be accurately described as engaged in 'manufacturing'. However that may be—and the question is not free from doubt—the case before us is very different. The defendant is unquestionably a manufacturing company up to the point when the various parts—beams, girders, rods, bolts and the rest—are ready to be put together in order to form the complete structure for which they were intended. The preparation of these parts from material, either raw or unfinished, is clearly manufacturing within any accepted definition of the word; and if in all cases the transaction was finished by a sale of the parts to a purchaser who would himself put them together and thus complete the structure for use, the exclusively manufacturing character of the corporation could not be questioned".

eral market. In order to lay the pavement or erect the building, these companies simply had to "mix" or "prepare" certain ingredients as required by the particular specifications under their contracts.

The Supreme Court's opinion in the Wark case makes no attempt to distinguish it from the Filbert case; in fact, it makes no reference to it. Nor does there appear to be any other ground upon which the Filbert and the Wark cases can be distinguished. It will do to say that the roadway consists entirely of concrete and is a complete product in itself when finished, while the apartment house consists only in part of reinforced concrete, because in the Filbert case floors were laid and they do not in themselves constitute a complete "article" or "product". In the case of many manufactured articles certain component parts are independently manufactured.

The court may have been influenced somewhat in reaching its decision in the Filbert case by the fact that the State and its political subdivisions must pay for the construction of practically all roadways and, if the operations were not held to constitute manufacturing, the tax would simply be passed on to the public, resulting largely in a useless accounting procedure. This, however, could have nothing to do with the legal question involved and, from all that appears of record, had nothing to do with the decision.

How, then, are we to determine what constitutes manufacturing within the meaning of the statute? There are several reliable guides.

Any sound test of the meaning of the word manufacturing, keeping in mind the purpose of the exemption, would seem to comprehend the *character* of the thing produced as well as the *method* or *process* by which it is produced. As stated by the lower court in the Wark opinion: "Out attention has been attracted to the fact that in practically all of the cases, the definitions deal with something movable, merchantable, and that passes by delivery; and in a number of cases in defining manufacture, the word

'article' is used".¹⁴ Thus the thing produced must be personally, a movable, a portable article of commerce. If it were otherwise, how could the purpose of the statute be accomplished? If the Pennsylvania Department of Highways contracts for the building of a concrete road through Clearfield County, the contractor has no choice as to where he shall carry on his operations.

Then, too, in determining whether a given operation is manufacturing, regard should be had to the manner in which the public generally considers it.¹⁵ As stated by Mr. Justice Frazer in the Wark opinion, "words in a legislative enactment are to be taken in their ordinary and general sense; and unless the act sufficiently explains or qualifies the terms so as to necessitate an interpretation out of the current and popular signification, they must be deemed to have been used by the Legislature in the former sense".

In *City of Lexington v. Lexington Leader Co.*¹⁶ the court, having under consideration the proper definition of the word "manufacturing" as contained in a tax exemption statute, said, "Usually that meaning will be attached to them (words) which correspond with 'the common understanding of mankind', in view of the subject-matter in con-

¹⁴Citing *Com. v. Sunbeam Water Co.*, 284 Pa. 180, 181; *Com. v. Weiland Packing Co.*, 292 Pa. 447, 450; *Norris & Bros. v. Com.*, 27 Pa. 494, 496; *Tidewater Oil Co. v. U. S.*, 171 U. S. 210, 216; *Columbia Iron Works v. National Lead Co.*, 127 Fed. 99. Some of these "articles" or "movables" are, however, of considerable size. Thus the Commonwealth has never challenged the decisions of the lower court in holding that the building of ships is manufacturing. *Com. v. William Cramp & Sons Ship & Engine Building Co.*, 1 Dauphin 95, note; *Com. v. Delaware River Iron Ship Building and Engine Works*, 2 Dauphin 232; *Com. v. Phila. Repair Co.*, 21 Dauphin 44.

¹⁵In *Com. v. Sunbeam Water Co.*, 284 Pa. 180, the Supreme Court, quoted approvingly from the opinion in *Com. v. J. Frank Boyer Plumbing & Heating Co.*, 23 Dauphin 296, 297, as follows: "The words of the statute (manufacture) are indeed so familiar in use and meaning that they are confused by attempts at definition. Their first sense as used is fabrication or composition,—a new article is produced of which the imported material constitutes an ingredient or part. When we go further than this in explanation we are involved in refinements and in impracticable niceties".

¹⁶235 S. W. 31, 32 (Ky.).

nection with which they are used. In other words, that interpretation is to be adopted which agrees with the popular sense in which they are used and understood, rather than according to their scientific meaning; and this is especially so in the construction of tax laws including exemptions therefrom * * *".

Is the construction of a concrete road any more "manufacturing" in the popular sense than the construction of a concrete factory building? If only the scientific meaning of the term were resorted to, possibly the roasting of coffee¹⁷ or the distilling of water¹⁸ would have been held to be manufacturing, because experts called to testify can make the simplest operation sound most complex by detailing in technical terms each chemical or physical change in the process. Popular meanings were not lost sight of by the court, however, and the roasting of coffee was viewed as little more than a cooking process and the distilling of water as a cleaning process.¹⁹ In the popular sense, are the laying of pavements and the erection of buildings construction or manufacturing operations?

As stated by the lower court in the Wark case, "this Act was amended in 1913 to exempt laundering business. If the Legislature intended to exempt what is commonly known as construction business, it could have said so". Incidentally, the laundering exemption has an interesting history. An attempt was first made to have the courts declare laundering to be a manufacturing process.²⁰ Certainly, it was not such in the popular mind, nor did it meet the requirements of the definition. Briefly stated, the process consisted of making clothes clean rather than of making clean clothes. Not discouraged by this rebuff, the

¹⁷Com. v. Glendora Products Co., 297 Pa. 305; Com. v. Lowry-Rogers Co., 279 Pa. 361.

¹⁸Com. v. Sunbeam Water Co., 284 Pa. 180.

¹⁹It is not the purpose of this article to review all the decisions involving the Pa. manufacturing exemption. They will be found collected, with a brief statement of the holdings, in Pa. Corp. Taxes, by Ruslander & Main, 2nd Edition, pps. 187 to 201.

²⁰Com. v. Keystone Laundry Co., 203 Pa. 289.

appellant took his case to the Legislature, which, in 1913,²¹ wrote the laundering exemption in alongside the manufacturing exemption.²²

The same thing happened with respect to the processing and curing of beef, ham, bacon, pickled meat, and hides. This was held not to be manufacturing,²³ within the meaning of the mercantile tax statute. The appellant carried its case to the Legislature of 1929, and what had originally been the manufacturing exemption proviso was again amended and extended to include "the processing and curing of meats, their products and by-products".²⁴

There are, of course, great possibilities for the expansion of this policy, so long as unsuccessful appellants have sufficient influence with the Legislature to secure amendments granting additional exemptions. The courts, on the one hand, presently seem more disposed than ever to construe the manufacturing exemption strictly. They are not being confused by technical definitions of terms, nor by expert testimony which tends to make simple processes most complex when scientifically explained. They are keeping in mind popular meanings; the sense in which the Legislature originally used the term manufacturing and the purpose admittedly desired to be accomplished by it at that time.

The Legislature, on the other hand, appears to be becoming more liberal in its outlook. How long this trend can be continued without the necessity for legislation imposing new or additional taxes is entirely problematical. It is of incidental interest in this connection, however, because it is highly probable that the Commonwealth will at once follow the lead which the court has given it in the Wark case and begin to tax many operations which seem not to be manufacturing in the popular sense, but which appear to meet most or all of the other requirements of the usual definitions of the term.

²¹P. L. 903.

²²Note 2, *supra*.

²³*Com. v. Weiland Packing Co.*, 292 Pa. 447.

²⁴Note 2, *supra*.

Some of these now doubtful operations the Commonwealth had exempted upon its own construction of the law, others had received the sanction of the lower court²⁵ only and will probably, in effect, be retried. If the cases should be lost on retrial, the unsuccessful appellants would still be able to try their good fortune with the Legislature, as did the laundry and meat interests. Assuming that the exemption is doubtful in a given case, it would seem that the Legislature rather than the courts should decide to grant it, and apparently this method of solving these problems can be seen in the trend of recent court decisions and legislative enactments.

²⁵The dyeing of cotton and woolen goods (which goods were manufactured by others) is commonly referred to as the dyeing business, but the lower court has held it to be a manufacturing process; *Com. v. Quaker City Dye Works*, 5 Pa. C. C. 94; *Com. v. Littlewood & Sons*, 44 Pa. C. C. 310.

The repairing of ships had been held to be manufacturing by the lower court; *Com. v. Phila. Ship Repairs Co.*, 21 Dauphin 44.

The preserving of fruit was held to be manufacturing in *Com. v. Ritter Conserve Co.*, 1 Dauphin 97, note.

Harrisburg, Pa.

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