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NOTES

THE IMPLICATIONS OF THE SPECTOR MOTOR SERVICE CASE

By

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The recent decision in the Spector Motor Service case decided by the Supreme Court of the United States on March 26, 1951, has caused a flurry in those states having similar taxing statutes, among which is the State of Pennsylvania.

The legislators are busy trying to devise means to tax those companies now made "exempt" by the Spector decision. Administrative, as well as the Attorney General's offices, are busy trying to determine whether their statutes are broad enough to include companies like the Spector Company within its confines.

We must say that the decision in the Spector case has at least tended to clarify and perhaps better understand the present trend of the decisions with respect to the commerce clause effecting those companies engaged exclusively in interstate commerce.

There is no problem involved when a company is engaged in both intra and interstate commerce in the operation of its business. The cases are clear on this point. If the tax is properly apportioned to avoid multiple taxation, it has been upheld.

The serious problems arise in those cases where the companies are engaged solely and exclusively in interstate commerce. The early doctrine that the various states could not impose a tax on a company exclusively engaged in interstate commerce was based on the theory that a state could not keep a foreign company so engaged out of its jurisdiction nor could a state require or exact a tax as a condition precedent to its entrance in such state of a company solely engaged in interstate commerce. It followed, therefore, that since it could not impose a tax as a condition to its beginning business, it would not impose a tax for the privilege of doing any exclusive interstate business. The State of Connecticut sought to impose on foreign corporations a tax or excise upon its franchise for the privilege of carrying on or doing

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business within the state under the Connecticut Corporation Business Tax Act of 1935.¹

The tax was measured by the entire net income at the rate of 2%, but reasonably and properly apportioned to the company's activities in that state. It was authorized by the Interstate Commerce Commission to do certain interstate trucking and by the Connecticut Public Utility Commission to do part of such interstate trucking in Connecticut. The company filed with the Secretary of the State of Connecticut a certificate of its incorporation in Missouri and designated an agent in Connecticut for service of process and also paid a state fee required in that connection. It was not authorized by the State of Connecticut to do intrastate trucking and did not engage in such activity.

The company transports freight by motor truck between the East and West, maintained two terminals in Connecticut which it leased, and owned eight pickup trucks used for less than truckload shipments to bring freight from its shipper to either of the two terminals. It employed 27 full-time workers in Connecticut with a weekly payroll of $1,200.

The Supreme Court of Connecticut sustained the imposition of the tax even though the tax was held by that court to be a tax for the privilege of engaging in interstate commerce. The U. S. Supreme Court reversed the decision of the Connecticut court on the theory that since the tax was a franchise for the privilege of carrying on or doing an interstate business within the state, it was offensive to the commerce clause of the Federal Constitution.

It is interesting to note that the U. S. Supreme Court relied heavily on the fact that the state court unequivocally determined the tax to be a tax on the corporation's franchise for the privilege of carrying on exclusively interstate transportation in the state.² It went on to say that it made no difference that Connecticut might have obtained the same tax had it imposed one for the privilege of using its highways or imposed an ad valorem property tax, saying:

"The answer in the instant case has been made clear by the courts of Connecticut. It is not a matter of labels. The incidence of the tax provides the answer. The courts of Connecticut have held that the tax before us attaches solely to the franchise of petitioner to do interstate business. The State is not precluded from imposing taxes upon other activities or aspects of this business which, unlike the

¹ Sec. 418c. Imposition of Tax. "Every mutual savings bank, savings and loan association and building and loan association doing business in this state, and every other corporation or association carrying on business in this state which is required to report to the collector of internal revenue for the district in which such corporation or association has its principal place of business for the purpose of assessment, collection and payment of an income tax (with exceptions not material here) . . . shall pay, annually, a tax or excise upon its franchise for the privilege of carrying on or doing business within the state, such tax to be measured by the entire net income as herein defined received by such corporation or association from business transacted within the state during the income year and to be assessed at the rate of two per cent; . . ."
² Stanley Work v. Hackett 122 Conn. 547, 551, 190 A. 743.
privilege of doing interstate business, are subject to the sovereign power of the State. Those taxes may be imposed although their payment may come out of the funds derived from petitioner's interstate business, provided the taxes are so imposed that their burden will be reasonably related to the powers of the State and non-discriminatory.

"This court heretofore has struck down, under the Commerce Clause, state taxes upon the privilege of carrying on a business that was exclusively interstate in character. The constitutional infirmity of such a tax persists no matter how fairly it is apportioned to business done within the state." 8

The decision in this case came as a welcome surprise to the practitioners, especially in Pennsylvania, because since the inception of this case the taxing officers of the Commonwealth have made every effort to seek out those companies who were doing the same type of business as the Spector Motor Service Company and who did not register and of course did not file tax returns in Pennsylvania. To assist them in this search, the Department of Revenue requested the Bureau of Employment and Unemployment Compensation of the Department of Labor and Industry to submit lists of employers against which lists they checked to ascertain which companies were registered in Pennsylvania.

Let us leave this case for the moment to see how it can be reconciled with the Memphis Natural Gas Company case decided by the U. S. Supreme Court on June 21, 1948. 4 In this case the State of Mississippi imposed a franchise or excise tax on all foreign corporations doing business in that state to $1.50 for each $1000 of the value of the capital used, invested, or employed within the state. The Act defines "doing business" as including "each and every act, power or privilege exercised in this state, as an incident to, or by virtue of the powers and privileges acquired by the nature of such organization". The Mississippi Act further provided "it being the purpose of this section to require the payment of a tax measured by the amount of capital or its equivalent for which such organizations receive the benefit and protection of the government and the laws of the state." 5

The statute defined "doing business" to "mean and include each and every act, power or privilege exercised or enjoyed in this State, as an incident to, or by virtue of the powers and privileges acquired by the nature of such organization, whether the form of existence be corporate, associate, joint stock company or common law trust."

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8 The court cited with approval the Alpha Portland Cement case which is discussed here later.
4 Memphis Natural Gas Company v. Stone, 335 U. S. 80, 92 L. Ed. 1832.
5 9314: "For the year 1940 and annually thereafter, there shall be and is hereby imposed, levied and assessed upon every corporation, association or joint stock company, as hereinbefore defined, organized and existing under and by virtue of the laws of some other state, territory or country, or organized and existing without any specific statutory authority, now, or hereafter doing business within this state, as hereinbefore defined, a franchise or excise tax equal to $1.50 of each $1,000 or fraction thereof of the value of capital used, invested or employed within this state, except as hereinafter provided. It being the purpose of this section to require the payment of a tax by all organizations not organized under the laws of this state, measured by the amount of capital or its equivalent, for which such organization receives the benefit and protection of the government and laws of the state."

The statute defined "doing business" to "mean and include each and every act, power or privilege exercised or enjoyed in this State, as an incident to, or by virtue of the powers and privileges acquired by the nature of such organization, whether the form of existence be corporate, associate, joint stock company or common law trust."
The facts in this case were stipulated and were not in dispute. The Memphis Natural Gas Company is a Delaware corporation, which owns and operates a pipe line for the transportation of natural gas. The line runs from the Monroe Gas Field in Louisiana through the States of Arkansas, and Mississippi to Memphis and other points in the State of Tennessee. Approximately 135 miles of the pipe line lie within Mississippi. At two points within that state are compressing stations. The company has never engaged in any intrastate commerce in Mississippi. The company has never qualified to do an intrastate business in Mississippi. It has no agent for the service of process and has no office in that state. The only employees and representatives in Mississippi are those necessary to maintain the pipe line and its auxiliary appurtenances. The company in opposing the tax argued that the state of Mississippi was without authority to impose tax because it was engaged exclusively in interstate commerce. This fact was not denied by the state. The Mississippi Supreme Court however sustained the tax on the theory that it was not a tax on interstate commerce as such, but a recompense for the protection of the lawful activities carried on in the state by the company, these local activities being the maintenance, repair and the manning of the facilities of the system throughout the 135 miles of its line in that state.

The U. S. Supreme Court in affirming the decision of the state court agreed that the tax imposed was not a tax on the privilege of engaging in interstate commerce in Mississippi, but a tax imposed for the protection of the property and activities of the company for which the state and not the U. S. gives protection, and therefore the state is entitled to compensation when the tax cannot be said to be an unreasonable burden or a toll on interstate business. It would be interesting to note here the reasoning of Justice Reed who wrote the opinion and that of Justice Rutledge in his concurring opinion. Justice Reed said:

"The Mississippi excise has no more effect upon the commerce than any of the instances just recited. The events giving rise to this tax were no more essential to the interstate commerce than those just mentioned or ad valorem taxes. We think that the state is within its constitutional rights in exacting compensation under this statute for the protection it affords the activities within its borders. Of course, the interstate commerce could not be conducted without these local activities. But that fact is not conclusive. These are events apart from the flow of commerce. This is a tax on activities for which the state, not the United States, gives protection and the state is entitled to compensation when its tax cannot be said to be an unreasonable burden or a toll on the interstate business."

Justice Rutledge, in agreeing with the result, reasoned:

"So here I do not think that the local activities for the protection of which the Mississippi tax purports in terms to be laid become separate from the interstate business which petitioner conducts in Mississippi, either by reason of the apportionment or otherwise. But they are incidents of carrying on that business
taking place in Mississippi and only there, for which Mississippi affords protection
received from no other state or the United States. Nor can any other state give
that protection. For that portion of the business and the protection given it, I
think the state is entitled to levy such a tax as has been placed here."

Now, let us examine these two cases. In the Spector case the maintenance of
terminals, pickup trucks, employees, etc. was primarily for the purpose of facilitating
the flow of freight from Connecticut across its borders. In the Memphis case,
the maintenance of compressing stations, maintenance men and other employees
was for the sole purpose of facilitating the flow of gas across its border. What then
is the difference in these two cases? Obviously, it is by reason of the fact that
in the Spector case the tax was imposed on the privilege of engaging in interstate
commerce, whereas in the Gas Company case the tax was imposed as a recompense
for the protection of the property of the company in that state, the former illegal;
the latter valid, the former objectionable to the commerce clause of the U. S. Con-
stitution; the latter not objectionable.

It therefore appears that where a company is engaged solely in interstate
commerce, a state cannot exact a tax for the privilege of engaging in such commerce,
but can exact a tax as previously mentioned for the protection afforded the company
in the taxing state.

If the Spector Motor Company operated in Mississippi, the U. S. Supreme
Court would have been compelled to hold the tax valid. On the other hand, if
the Memphis Natural Gas Company had operated in Connecticut, the U. S. Supreme
Court would have been compelled to hold that the tax was invalid.

The Pennsylvania Franchise and Corporate Net Income Tax laws are not de-
signed according to the Mississippi statute, but according to the Connecticut statute. Let us examine a more or less similar situation and try to reconcile it with
the previous two cases if we can.

You are all probably familiar with the Alpha Portland Cement Company
case decided in 1925 involving an income tax imposed by the State of Massachu-
setts. This company was a corporation organized under the laws of New Jersey.

Its business was manufacturing and the sale of cement with its principal office
at Easton, Pennsylvania. Its mills were located in several states other than Massa-
chusetts from which shipments were made to various parts of the U. S. and foreign countries. It maintained an office in Boston with a district manager in
charge and several clerks where its correspondence and other natural business ac-
tivities in connection with the receipt of orders and shipments of goods were con-
ducted. This office was frequently used by traveling salesmen who solicited orders
in Massachusetts and the other New England States.

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6 Alpha Portland Cement Co. v. Massachusetts 268 U. S. 203, 69 L. Ed. 916.
Orders were taken and transmitted at the Boston Office to the principal office in Easton, Penna., and after being passed upon and accepted, the goods were shipped and invoiced directly to the customer.

The State of Massachusetts sought to impose on all foreign corporations with respect to the carrying on or doing of business in that commonwealth, an income tax based upon net income properly apportioned. The tax was sustained by the Massachusetts Supreme Court on the theory that the same tax was levied on domestic as well as foreign corporations and fairly apportioned to the business done within the commonwealth and that the tax was not discriminatory and was not offensive to the commerce clause of the U. S. Constitution. The Commonwealth admitted, however, that the tax was for the privilege of doing business in Massachusetts and since properly apportioned, it was valid.

The U. S. Supreme Court in overruling the decision of the Massachusetts court stated that even though the tax is properly apportioned, since it was imposed for the privilege of engaging in interstate commerce and even though it was not made a condition precedent to the doing of business, it still was invalid, saying:

"The local business of a foreign corporation may support an excise measured in any reasonable way, if neither interstate commerce nor property beyond the state is taxed. Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113, 65 L. Ed. 165, 41 Sup. Ct. Rep. 45, approved such an excise measured by income reasonably attributed to interstate business; but nothing there said was intended to modify well-established principles. It must be read with the essential facts in mind. Local business was a sufficient basis for the excise, and there was no taxation of interstate commerce or property beyond the state . . .

"The excise challenged by plaintiff in error is not materially different from the one declared unconstitutional in Cheney Bros. Co. v. Massachusetts, and cannot be enforced against a foreign corporation which does nothing but interstate business within the state. The introduction of an extremely complicated method for calculating the amount of the exaction does not change its nature or mitigate the burden."

Now, we turn to the West Publishing Company case decided by the U. S. Supreme Court in 1946. As you know this company was in the law book publishing business, a Minnesota corporation. The company shipped books and other publications into California pursuant to orders taken by its salesmen who devoted their full time to their jobs in California. These employees had space in lawyers' offices

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7 Section 39, "Every foreign corporation shall pay annually, with respect to the carrying on or doing of business by it within the Commonwealth, an excise equal to the sum of the following . . . (1) An amount equal to $5 per thousand upon the value of the corporate excess employed by it within the Commonwealth. (2) An amount equal to 2½ per cent of that part of its net income, as defined in P. 30 and in this section, which is derived from business carried on within the Commonwealth . . ."

8 West Publishing Co. v. McColgan 328 U. S. 833.
in exchange for the use of books stored there. The California employees were authorized to and did receive payments on orders, collected delinquent accounts and made adjustments on complaints of customers.

The State of California cognizant of the fact that a state may not exact a tax for the privilege of doing an exclusively interstate business, imposed an income tax on those corporations not subject to its franchise tax. It made net income the subject as well as the measure of its Corporation Income Tax. It limited the measure of the tax to income from California sources which was understood to mean income from sources of books and periodicals delivered in California. The California Supreme Court sustained the assessment holding that "a tax on net income from interstate commerce as distinguished from a tax on the privilege of engaging in interstate commerce does not conflict with the commerce clause." The U. S. Supreme Court unanimously affirmed this decision by a per curiam opinion.

Here we have two cases again where the activities are alike, both subjected to state taxes and both engaged solely in interstate commerce and yet we find that in the Cement case the tax was invalid as again it was imposed for the privilege of doing business. And, in the Publishing Company case, the tax was valid because it was a tax on net income and not on the privilege of engaging in interstate commerce.

In contrast to the above taxes which were imposed by the various states on businesses exclusively engaged in interstate commerce, it is interesting to note the case of Joseph D. McGoldrick v. Berwind-White Mining Company, 309 U. S. 33, 84 L. Ed. 565. In that case the City of New York imposed a tax upon purchasers for consumption of tangible personal property.

The tax was fixed at "2 percentum upon the amount of the receipts from every sale in the City of New York," "sales" being defined as "any transfer of title or possession or both . . . in any manner or by any means whatsoever for a consideration or any agreement therefor." The act further provided that the tax "shall be paid by the purchaser to the vendor for and on account of the City of New York." The act authorized the vendor to bill the purchaser separately for the tax and collect the same and if not paid to the seller, the buyer was required to file a return and pay the tax within a certain time.

9 The Corporate Income Tax Act provided: "There shall be levied, collected and paid for each taxable year, a tax at the rate of 4 per cent upon the net income of every corporation derived from sources within this state on or after January 1, 1937 . . . income from sources within this state includes income from tangible or intangible property located or having a situs in this state and income from any activities carried on in this state, regardless of whether carried on in intrastate, interstate or foreign commerce."
10 West Publishing Co. v. McColgan, 166 P. 2d 861.
The ultimate burden of the tax, both in form and in substance was thus laid upon the buyer for consumption of tangible personal property and measured by the sales price.

The Berwind-White Company was a Pennsylvania corporation engaged in the production of coal from its mines in that state and in selling the same to consumers and dealers. It maintained a sales office in New York for the use of its New York customers. The coal moves by rail from mine in Pennsylvania to dock in New Jersey, and then by barge to the point of delivery in New York. All the sales contracts with the New York customers were entered into in New York City and called for the delivery of the coal by the company by barge along side the purchaser's plants or steamships.

The Supreme Court of New York decided in favor of the taxpayer. The Supreme Court of the United States in reversing the decision of the Supreme Court of New York said, speaking of the act, "it does not aim at or discriminate against interstate commerce. It is laid upon every purchaser within the state of goods for consumption, regardless of whether they have been transported in interstate commerce. Its only relation to the commerce arises from the fact that immediately preceding transfer of possession to the purchaser within the state, which is the taxable event regardless of the time and place of passing title, the merchandise has been transported in interstate commerce and brought to its journey's end. Such a tax has no different effect upon interstate commerce than a tax on the 'use' of property which has just been moved in interstate commerce or the familiar property tax on goods by the state of destination at the conclusion of their interstate journey."

From an examination of these cases, it is apparent that companies engaged exclusively in interstate commerce cannot be taxed for the privilege of engaging in interstate commerce even though the tax is properly apportioned, but may be taxed otherwise on those activities.

In conclusion, we can say that states that desire to collect a fair share from those companies engaged solely in interstate commerce, can do so by carefully worded legislation.

Pennsylvania has in part done so by House Bill 1303 which has been signed by the Governor and enacted into law.

(This Bill has not received an Act Number up to this time.)

The Act imposes "a property tax" based on net income derived from sources within Pennsylvania of certain corporations doing business in the State. The tax is properly apportioned by the use of a formula in some respects similar to that contained in the Corporate Net Income and Franchise Tax Acts.
This Act was fashioned after the California and Mississippi statutes which imposed the tax on companies engaged exclusively in interstate commerce and which acts were sustained by the Supreme Court of the United States in the *West Publishing Company* and the *Memphis Natural Gas Company* cases referred to above. It is to be noted that the Tax is not on the "privilege" of doing business in Pennsylvania but on the activities carried on and on the rights enjoyed by virtue of the powers granted to the corporation by the Commonwealth.

It seems that, therefore, those companies who have enjoyed immunity from taxation either under the Franchise or Corporate Net Income Tax Acts will now be liable under this "property tax act". There might be some food for thought as to the proper classification of companies engaged both in intra and interstate commerce and those solely engaged in interstate commerce where the former group are liable for the Corporate Net Income Tax and Franchise Tax and the latter group being liable only for the so-called "property tax".