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Taxation--Receipts from Extrastate Activity-- "Service" or "Collecting Income"

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The doctrine established a number of years ago and recently reaffirmed by which the benefit of inter-governmental tax immunities is not accorded to proprietary activities of the states involves a similar consideration that the exemption is to facilitate the discharge of public functions and not to subsidize the beneficiary of the exemption in competing with private business. *South Carolina v. United States*, 199 U. S. 437, 26 S. Ct. 110, 50 L. ed. 261 (1905); *Ohio v. Helvering*, 292 U. S. 360, 54 S. Ct. 725, 78 L. ed. 1307 (1934); *New York v. United States*, 66 S. Ct. 310, 90 L. ed. 265 (1946). True, an inconsistent position seems to have been taken in connection with some activities of the federal agencies specifically with the operation as landlord of housing agencies. To some extent, however, these cases have been rationalized on special grounds. *Chapman v. Huntington Housing Authority*, 121 W. Va. 319, 3 S. E. (2d) 502 (1939). Whatever their validity, in the instant case it is believed the result has behind it both the weight of reason and authority.

M. D. B., JR.

TAXATION—RECEIPTS FROM EXTRASTATE ACTIVITY—"SERVICE" OR "COLLECTING INCOME."—*T*, a West Virginia linen supply business, furnished towels and similar articles to customers locally and in Ohio, regularly collected soiled linen, and laundered it in West Virginia for its patrons. *T* omitted the Ohio revenue from its return of gross receipts for computation of the West Virginia privilege tax, and *D*, state tax commissioner, made a supplementary assessment to include such income. W. VA. CODE (Michie, 1943) c. 11, art 13, §2, provides: "There is hereby levied and shall be collected annual privilege taxes against the persons, on account of the business and other activities, and in the amounts to be determined by the application of rates against values or gross income as set forth in sections two-(a) to two-(i) inclusive of this article . . . (2h) . . . Upon every person engaging or continuing within this state in any service business or calling not otherwise specifically taxed under this law, there is likewise hereby levied and shall be collected a tax equal to one per cent of the gross income of any such business. (2i) . . . Upon every corporation or association engaging or continuing within this state in the business of collecting incomes from the use of real or personal property or of any interest therein, whether by lease, conveyance, or otherwise, and whether the return be in the form of rentals, royalties, fees, interest or otherwise, the tax shall be one per cent of the gross income of any such activity." *T* sued to enjoin collection of the additional tax claiming that gross income from interstate rental or lease of a chattel was not subject to tax. *D* asserted that a linen supply business is basically

one of providing service, that the service was performed in West Virginia, and so taxable. *Held*, two judges dissenting, that the Ohio gross receipts collected in Ohio were not taxable by West Virginia, as *T* was collecting income from the use of personal property. *Harper v. Alderson*, 126 W. Va. 707, 30 S. E. (2d) 521 (1944).

At the same term, the court sustained dissolution of a temporary injunction against imposing the privilege tax on gross income collected from customers in Ohio by a West Virginia dry cleaning business, as being income from a service performed and taxable in West Virginia, the interstate transportation of clothing being merely an aid of a local activity. *Arslain v. Alderson*, 126 W. Va. 880, 30 S. E. (2d) 533 (1944).

The privilege tax statute states that " 'Service business or calling' shall include all nonprofessional activities engaged in for other persons for a consideration, which involve the rendering of a service as distinguished from the production or sale of tangible property, but shall not include the services rendered by an employee to his employer." W. VA. CODE (Michie, 1943) c. 11, art. 13, §1. No attempt is made to define "collecting incomes from the use of real or personal property." Cf. MISS. CODE (1942) tit. 38. The salient feature of a dry cleaning business is labor performed, thus bringing it clearly within the statutory definition of service. Analogies from cases involving laundries support the holding that dry cleaning is a service. *Clark's Laundry & Dry Cleaning Co. v. Department of Treasury*, 103 Ind. App. 359, 5 N. E. (2d) 683 (1937); *Kansas City v. Seaman*, 99 Kan. 143, 160 Pac. 1139, 1917B L. R. A. 341 (1916).

A linen supply enterprise has been held exempt as a service business under the Fair Labor Standards Act. U. S. C. A. Tit. 29, c. 8, §213(a); *Lonas v. National Linen Service Corp.*, 136 F. (2d) 433 (C. C. A. 6th, 1943); *Hunt v. National Linen Service Corp.*, 178 Tenn. 262, 157 S. W. (2d) 608 (1941); contra: *Phillips v. Star Overall Dry Cleaning Laundry Co.*, 149 F. (2d) 416 (C. C. A. 2d, 1945). Moreover, that tangible property is supplied as part of a transaction, the main feature of which is labor performed, will not prevent its being regarded as a service. *Department of Treasury v. Ingram-Richardson Mfg. Co.*, 313 U. S. 252, 61 S. Ct. 866, 85 L. ed. 1313 (1941); *Indiana Creosoting Co. v. McNutt*, 210 Ind. 656, 5 N. E. (2d) 310 (1936). Citing no authority for the view that a linen supply business rents chattels and does not render services, the majority opinion in the *Harper* case argues that the customer bargains for linen, not laundering; being indifferent whether the company cleans it, has another clean it [see, for example, *Phillips v. Star Overall Dry Cleaning Laundry Co.*, 149 F. (2d) 416 (C. C. A. 2d, 1945)]; *Independent*

Linen Service Co. v. State ex rel. Rice, 169 Miss. 62, 152 So. 647 (1934)] or discards soiled linen and replaces it with new, and caring only that it be serviceable and clean. See 126 W. Va. at 711-712, 30 S. E. (2d) at 523-524. The assertion is not a convincing demonstration of the nature of the business. There is ground to believe the linen supply company more closely resembles a laundry than a linen warehouse. The bargain is for linen, but also for clean linen which involves linen cleaning; and over the life of a given item, it seems probable that cleaning charges will substantially exceed the cost price of the item. And as the dissent points out, there are many occasions when the rendering and receiving of services involve the use of real and personal service. 126 W. Va. at 716, 30 S. E. (2d) at 525.

An earlier decision on whether a transaction was a service or a rental of chattels had held the furnishing of tires to a bus company in West Virginia by an Ohio supplier who retained title and agreed to keep the tires in good repair to be providing a service, and subject to the West Virginia consumers gross sales tax. *Charleston Transit Co. v. James*, 121 W. Va. 412, 4 S. E. (2d) 297 (1939), (1940) 46 W. VA. L. Q. 173; W. VA. CODE (Michie, 1943) c. 11, art. 15. The majority opinion in the *Harper* case confines its discussion of that case to the statement that "... the court found it necessary to determine that the business there considered was neither a sale nor a hiring of chattels in interstate commerce in order to sustain the tax involved." 126 W. Va. at 714, 30 S. E. (2d) at 524. As definitions of "service," these cases would appear irreconcilable.

The *Harper* case denies the state's right to tax gross income from extrastate rental of a chattel. The United States Supreme Court has held that West Virginia cannot tax gross income from West Virginia film rentals by a New York movie distributor who neither maintained a place of business nor collected the income here, both being construed as necessary conditions for taxability under the statute, but the question was expressly reserved whether a state, by an aptly worded statute, could tax income derived from sources within its borders. The Supreme Court said: "The taxing provisions of section 2 are restricted in their application to various enumerated classes of activities within the state, one of which, specified in section 2 (i), is that of engaging there in the business of collecting incomes. The conduct of such a business or activity by appellee requires its presence there, or that of its agent, and the collection of income within the state by one or the other..." *James v. United Artists Corp.*, 305 U. S. 410, 414, 59 S. Ct. 272, 274, 83 L. ed. 256, 259 (1939).

A state may tax the gross receipts of an enterprise performing services within its borders, even though there is interstate transportation of

the personal property serviced. *Department of Treasury v. Ingram-Richardson Mfg. Co.*, 313 U. S. 252, 61 S. Ct. 866, 85 L. ed. 1313 (1941); *Indiana Creosoting Co. v. McNutt*, 210 Ind. 656, 5 N. E. (2d) 310 (1936); *Charleston Transit Co. v. James*, 121 W. Va. 412, 4 S. E. (2d) 297 (1939). Consequently, it was necessary to hold the linen supply business not a service business if the gross receipts earned in Ohio were to escape the tax. It was once thought that any state tax reaching gross receipts from interstate commerce imposed a direct burden on such commerce which made the tax invalid *per se*. *Bluefield Produce & Provision Co. v. City of Bluefield*, 120 W. Va. 111, 196 S. E. 568 (1938); see Lockhart, *Gross Receipts Taxes on Interstate Transportation and Communications* (1943) 57 HARV. L. REV. 40, 41; “. . . long before 1938 it had become axiomatic that no state could impose a tax directly upon the gross receipts from interstate commerce even though intrastate commerce bore the same burden, and it seemed quite probable that no state tax could be measured by gross receipts from interstate transportation except when imposed in lieu of an ad valorem property tax.” *Western Livestock Co. v. Bureau of Revenue*, 303 U. S. 250, 58 S. Ct. 546, 82 L. ed. 823, 115 A. L. R. 944 (1938), in sustaining a state tax on gross receipts from the sale of advertising by a magazine circulating widely in other states, suggests a change of thought in this connection. Recognizing that interstate commerce must pay its way, the opinion of Mr. Justice Stone intimates that a state tax measured by gross receipts from interstate commerce is good where the taxing state is so uniquely circumstanced with reference to the transactions productive of the income that other states cannot similarly tax them. “But there is an added reason why we think the tax is not subject to the objection which has been leveled at taxes laid upon gross receipts derived from interstate communication or transportation of goods . . . The tax is not one which in form or substance can be repeated by other states in such manner as to lay an added burden on the interstate distribution of the magazine . . .” 303 U. S. at 260, 58 S. Ct. at 551, 82 L. ed. at 830; accord: see *Gwin, White & Prince, Inc. v. Henneford*, 305 U. S. 434, 439, 59 S. Ct. 325, 328, 83 L. ed. at 276; *In re Globe Varnish Co.*, 114 F. (2d) 916, 919 (C. C. A. 7th, 1940), cert. denied, 312 U. S. 690, 61 S. Ct. 621, 85 L. ed. 1126 (1941). The majority opinion in the *Harper* case does not mention the *Western Livestock* case. It is submitted that state courts, in professing to give decisions on federal constitutional principles, are no longer justified in following discarded views, but should strive for conformity with later and better considered decisions of the United States Supreme Court, and furthermore that although, as here,

no federal constitutional point is directly decided, strained statutory constructions or exceptionable interpretations of fact grounded on avoidance of unconstitutionality should themselves be avoided where the United States Supreme Court has removed the constitutional threat. For a fundamental discussion of state taxes on gross receipts from interstate commerce see Powell, *Indirect Encroachment on Federal Authority by the Taxing Powers of the States* (1917-18) 31 HARV. L. REV. 321, 572, 721, 932, (1918-19) 32 HARV. L. REV. 234, 374, 634, 902; Powell, *New Light on Gross Receipts Taxes* (1940) 53 HARV. L. REV. 909; Morrison, *State Taxation of Interstate Commerce* (1942) 36 ILL. L. REV. 727.

E. I. E.

TAXATION—RECEIPT OF INCOME—SATISFACTION OF JUDGMENT AFTER ASSIGNMENT AS INCOME TO ASSIGNOR.—*T*, on the cash basis, acquired for \$928 an interest in a syndicate prosecuting a claim against the United States. In November 1936, judgment was rendered against the government for \$2,777,333. *Briggs & Turivas v. United States*, 83 Ct. Cl. 664 (1936). The Supreme Court denied certiorari in October 1937. *United States v. Briggs & Turivas*, 302 U. S. 690, 58 S. Ct. 9, 82 L. ed. 533 (1937). An appropriation to pay the judgment was approved by the President March 5, 1938. On December 31, 1937, *T* transferred by deeds of gift shares of his interest in the syndicate to his minor sons, and on January 12, 1938, like shares to his sons and his wife. The judgment was paid by the government, and *T*'s share, amounting to \$34,926, was divided by the judgment creditor among *T* and his transferees proportional to their interests. *Held*, that *T* is liable for income tax on the entire \$34,926. *Doyle v. Commissioner*, 147 F. (2d) 769 (C. C. A. 4th, 1945), affirming 3 T. C. 1092 (1944).

The tax court decided the case squarely on the ground that the transactions between the taxpayer and his wife and sons were mere assignments of expected gains. "We can see no escape from the proposition that the taxpayer never owned, and therefore never transferred to his wife and sons, anything but an interest in a possible future gain to be derived from the realization of proceeds of a judgment against the United States for its breach of contract." *Richard S. Doyle*, 3 T. C. 1092, 1098 (1944). The circuit court of appeals, while approving the reasoning of the tax court, laying stress on the certainty of gain and absence of any necessary activity on the part of the transferees to realize the gain, as well as the intra-familial nature of the transactions, seemed to feel that *Helvering v. Horst*, 311 U. S. 112, 61 S. Ct. 144, 85 L. ed. 75, 131 A. L. R. 655 (1940), *Harrison v. Schaffner*, 312 U. S. 579, 61 S. Ct. 759, 85