

April 1983

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Recommended Citation

Robert G. Lathrop, *Due Process and Commerce Clause Considerations under the West Virginia Business and Occupation and Carrier Income Taxes--J.C. Penney to Milacron*, 85 W. Va. L. Rev. (1983).
Available at: <https://researchrepository.wvu.edu/wvlr/vol85/iss3/4>

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West Virginia Law Review

Volume 85

Spring 1983

Number 3

DUE PROCESS AND COMMERCE CLAUSE CONSIDERATIONS UNDER THE WEST VIRGINIA BUSINESS AND OCCUPATION AND CARRIER INCOME TAXES - *J.C. PENNEY TO MILACRON*

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I. INTRODUCTION

From December 1979, when it decided *J.C. Penney Co. v. Hardesty*,¹ to mid-February 1982, when it decided *Cincinnati Milacron Co. v. Hardesty*,² the West Virginia Supreme Court of Appeals was unusually active in the state taxation area. The court handed down eleven opinions, on seventeen cases, dealing primarily with the West Virginia Business and Occupation Tax (B & O Tax) and secondarily with the West Virginia Carrier Income Tax.³ That the B & O Tax was the subject of the bulk of the litigation is not surprising since it is by far the most pervasive broad-based business tax in the state. The tax reaches nearly all businesses and professions and of all state taxes, it raises the greatest amount of revenue for the general fund.⁴ Although the Carrier Income

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The author wishes to acknowledge the invaluable assistance of his student researcher, Joseph J. Miller, in preparing this article.

¹ 264 S.E.2d 604 (W. Va. 1979).

² 290 S.E.2d 902 (W. Va. 1982).

³ *Id.*; *West Virginia Tractor & Equipment Co. v. Hardesty*, 280 S.E.2d 270 (W. Va. 1981) (includes *Wright-Thomas Equip. Co. v. Hardesty*); *Capitol Cablevision Corp. v. Hardesty*, 285 S.E.2d 412 (W. Va. 1981); *Southern States Coop., Inc. v. Dailey*, 280 S.E.2d 821 (W. Va. 1981); *Western Md. Ry. v. Goodwin*, 282 S.E.2d 240 (W. Va. 1981) (includes *West Virginia Motor Delivery Co. v. Goodwin*; *Union Barge Line Corp. v. Hardesty*); *Martha White Mills v. Dailey*, 280 S.E.2d 238 (W. Va. 1981); *Koppers Co. v. Dailey*, 280 S.E.2d 248 (W. Va. 1981); *Gilbert Imported Hardwoods, Inc. v. Dailey*, 280 S.E.2d 260 (W. Va. 1981); *Bishop Coal Co. v. Dailey*, 276 S.E.2d 220 (W. Va. 1981); *Newell Bridge & Ry. Co. v. Dailey*, 266 S.E.2d 453 (W. Va. 1980), *cert. denied*, 451 U.S. 942 (1981); *J.C. Penney Co. v. Hardesty*, 264 S.E.2d 604 (W. Va. 1980) (includes *Pittsburgh-Des Moines Steel Co. v. Goodwin*; *Richardson, Gordon & Assoc. v. Hardesty*; and *Sturgeon v. Roberts*).

The Office of Hearings and Appeals of the State Tax Department also has been active. Several administrative decisions which relate generally to the subject at hand are Administrative Decisions 82-16-B, 82-9-B, 82-5-B, 81-32-B, 81-30-B, 81-16-B, 81-12-B.

⁴ For the fiscal year ending June 30, 1982, the B & O Tax generated \$518,502,546.72. Total

Tax contributes far less to the general fund than does the B & O Tax,⁵ it is, nevertheless, a significant tax considering the revenue it does raise. Furthermore, the B & O Tax and Carrier Income Tax are similar to the extent that they both are imposed on gross receipts.⁶ However, the Carrier Income Tax is imposed on net income which arises from interstate activities⁷ while no such modification exists under the B & O Tax.

The goal of this article is to analyze and comment upon the due process and commerce clause issues raised in these decisions with an eye to apprising attorneys who do not deal with taxes on a continuing basis of the present posture of the court in this area. A consistent pattern will emerge out of the analysis which can be used as a rough guide for practical handling of often confusing and troublesome concepts.

II. GENERAL NATURE OF B & O TAX AND CARRIER INCOME TAX

The B & O Tax is a tax on the gross receipts of a business for the privilege of engaging in that business for profit in West Virginia.⁸ The statute imposing the tax enumerates various taxable activities and sets a rate for each. The B & O Tax is not considered a series of separate taxes, however, but rather is viewed as a single privilege tax imposing different rates on different activities.⁹ Properly categorizing particular activities is the major source of controversy between taxpayers and the State Tax Department, aside from questions over constitutional issues.¹⁰

general fund revenues for the same period were \$1,265,913,052.45. Letter from Herschel H. Rose, III., State Tax Commissioner, to Robert G. Lathrop, October 8, 1982.

⁵ For the fiscal year ending June 30, 1982, the Carrier Income Tax generated \$21,736,351.87. *Id.*

⁶ The B & O Tax is levied on certain privileges "in the amounts to be determined by application of rates against values or gross income. . . ." W. VA. CODE § 11-13-2 (1974 & Supp. 1982). The Code then defines "gross income" to mean "the gross receipts of the taxpayer. . . ." W. VA. CODE § 11-13-1 (1974). Likewise, the Carrier Income Tax imposes an annual tax on "the gross income from all business." W. VA. CODE § 11-12A-2 (1974 & Supp. 1982).

⁷ W. VA. CODE § 11-12A-3 (1974 & Supp. 1982) provides: "In addition to the tax imposed in the preceding section [§ 11-12A-2], every motor vehicle carrier operating on the public highways of the State . . . shall pay an annual tax for each calendar year on the net income earned within the State. . . ."

⁸ W. VA. CODE § 11-13-2 (1974 & Supp. 1982).

⁹ *Owens-Illinois Glass Co. v. Battle*, 151 W. Va. 655, 659, 154 S.E.2d 854, 856 (1967).

¹⁰ The obvious reason for the categorization disputes is the taxpayer's desire to minimize its taxes. If an enterprise is able to treat its business activity, or one of its business activities, as taxable at the manufacturing rate of .0088 (W. VA. CODE § 11-13-2b (1974 & Supp. 1982)), rather than at the coal extraction rate of .035 (W. VA. CODE § 11-13-2a(1) (Supp. 1982)), then that business will realize a substantial tax saving. Occasionally the interplay of the value of a particular item at a certain stage in its movement toward a final disposition and the value of it at the time of disposition may induce the taxpayer to classify its business activities in more than one category. For example, in *Gilbert Imported Hardwoods, Inc. v. Dailey*, 280 S.E.2d 260 (W. Va. 1981), the court held that the taxpayer was involved in both the production of coal and the manufacturing (the tipping operation) of coal. In response, the legislature amended the law to clarify that, in this type of integrated operation, the only category under which the taxpayer should be taxed is as a coal producer. W. VA. CODE § 11-13-2a(1) (Supp. 1982) (effective April 1, 1980).

A problem similar to the one in *Gilbert Hardwoods* arose in *Bishop Coal Co. v. Dailey*, 276

The Carrier Income Tax is imposed upon the gross receipts of certain transportation companies generated by their transportation activity within West Virginia. Telephone and telegraph companies doing business within the state are also subject to the Carrier Income Tax.¹¹ The rates are .033 on gross receipts from transportation and telegraph companies and .0374 on gross receipts from telephone companies.¹² Trucking companies, in certain situations, are subject only to tax on their net incomes.¹³

Where a taxpayer's business activities cross state lines, a tax is imposed on the net income attributed to West Virginia activity by means of mileage formulas.¹⁴ The rates are .066 of net income for transportation and telegraph companies and .0374 of net income for telephone companies.¹⁵ If the gross receipts portion of the Carrier Income Tax is applicable to a taxpayer, then the total net income of the taxpayer is reduced when computing the net income portion of the tax. The reduction is accomplished by a fraction, the numerator of which is the gross income subject to the gross income tax, and the denominator of which is total gross income.¹⁶

Since the Carrier Income Tax is a hybrid between a pure gross receipts tax, such as the B & O Tax, and a pure net income tax, such as the Corporate Net Income Tax,¹⁷ issues arise under it which are associated with both kinds of taxes.

III. DUE PROCESS AND COMMERCE CLAUSE ISSUES

While challenges to the imposition of the B & O Tax and Carrier Income Tax under the United States Constitution can be, and often are, based upon

S.E.2d 270 (W. Va. 1981), where coal was mined in Virginia but tipped in West Virginia. The court held that the entire receipts from the sale of coal were subject to the manufacturing rate because all the manufacturing occurred in West Virginia, none occurring in Virginia. Whether the change in the law arising out of *Gilbert Hardwoods* will change the result in *Bishop Coal* is questionable because the language in the amended version of W. VA. CODE § 11-13-2a(1) (Supp. 1982) applies only to "coal mined and produced in this State in the exercise of the production privilege. . . ." (emphasis added).

See also *West Virginia Tractor & Equip. Co. v. Hardesty*, 280 S.E.2d 270 (W. Va. 1981) (the issue was whether the taxpayer was selling tangible property carrying a rate of .0055 (wholesale .0027), W. VA. CODE § 11-13-2c (1974), or leasing it, carrying a rate of .0115, W. VA. CODE § 11-13-2i (1974)); *Martha White Mills v. Dailey*, 280 S.E.2d 238 (W. Va. 1981) (the alternative rates at issue were .0088 for dressing and processing food, or .0027 for dressing and processing food to be sold at wholesale, W. VA. CODE §§ 11-13-2b and 11-13-2c (1974 & Supp. 1982)); *Koppers Co. v. Dailey*, 280 S.E.2d 248 (W. Va. 1981) (the alternative rates at issue were contracting at .022, W. VA. CODE § 11-13-2e (1974) or services at .0115, W. VA. CODE § 11-13-2h (1974)).

Another reason for attempting to categorize a business activity as "manufacturing" is to take advantage of the credits for industrial expansion or revitalization. W. VA. CODE § 11-13C-1 to -5 (1974 & Supp. 1982), and W. VA. CODE § 11-13D-1 to -6 (Supp. 1982) (effective July 1, 1981).

¹¹ W. VA. CODE § 11-12A-2 (1974 & Supp. 1982).

¹² *Id.*

¹³ W. VA. CODE § 11-12A-2 (second proviso) (Supp. 1982) (effective March 8, 1980).

¹⁴ W. VA. CODE § 11-12A-3 (1974 & Supp. 1982).

¹⁵ *Id.*

¹⁶ W. VA. CODE § 11-12A-3(g) (1974 & Supp. 1982).

¹⁷ W. VA. CODE § 11-24-1 to -40 (1974 & Supp. 1982).

several clauses in that document, the two most common challenges are based upon the due process clause¹⁸ and the commerce clause.¹⁹ Due process and commerce clause considerations are relevant in state taxation of interstate transactions because they establish certain limits beyond which a taxing jurisdiction may not go in imposing its tax on out-of-state enterprises which carry on business within its borders.²⁰

A. *Due Process Clause*

Due process involves two elements: finding jurisdiction to tax at all, and finding a "rational relationship" between the income taxed and the activities carried on in the taxing state.²¹ Ordinarily, the jurisdictional question presents no difficulty because the threshold is easily met. It is the "rational relationship" which normally creates the due process hurdle inviting scrutiny by the courts. "Rational relationship" problems traditionally arise in a net income tax setting.²² Even so, a gross income tax, such as the B & O Tax, still lends itself, in some instances, to the question whether jurisdiction to tax exists at all; or if it does exist, whether it exists only with respect to particular activities.²³

¹⁸ "[N]or shall any State deprive any person of life, liberty, or property, without due process of law." U.S. CONST. amend. XIV, § 1.

¹⁹ "The Congress shall have Power . . . To regulate commerce with foreign Nations, and among the several States. . . ." U.S. CONST. art. I, § 8.

²⁰ Numerous articles have been written on the subject of due process and commerce clause considerations with respect to gross receipts taxes. One of the best compact discussions appears in *Report of Special Subcommittee on State Taxation of Interstate Commerce*, H.R. REP. No. 565, 89th Cong., 1st Sess. 1033-61 (1965) [hereinafter cited as the *Willis Subcommittee Report*]. In the course of the discussion the major articles written up to 1965 are cited.

For a general treatment of this area one should not overlook J. HELLERSTEIN & W. HELLERSTEIN, *STATE AND LOCAL TAXATION* 274-306 (4th ed. 1978 & Supp. 1982).

Additional articles worthy of note are Dunham, *Gross Receipts Taxes on Interstate Transactions (Ain't God Tough on Indiana)*, 47 COLUM. L. REV. 211 (1947); W. Hellerstein, *State Taxation and the Supreme Court: Toward a More Unified Approach to Constitutional Adjudication*, 75 MICH. L. REV. 1426 (1977); W. Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline*, 62 VA. L. REV. 149 (1976); J. Hellerstein, *State Tax Discrimination Against Out-of-Staters*, 30 NAT'L TAX J. 113 (1977); J. Hellerstein, *State Taxation Under the Commerce Clause: An Historical Perspective*, 29 VAND. L. REV. 335 (1976); Lockhart, *A Revolution in State Taxation of Commerce?*, 65 MINN. L. REV. 1025 (1981); Simet, *The Concept of "Nexus" and State Use and Unapportioned Gross Receipts Taxes*, 73 NW. U. L. REV. 112 (1978); *State Taxation of Interstate Commerce: An Analysis of Current Standards Promulgated by the United State Supreme Court-Department of Revenue v. Association of Washington Stevedoring Cos.*, 28 DE PAUL L. REV. 205 (1978); *Developments in the Law — Federal Limitations on State Taxation of Interstate Business*, 75 HARV. L. REV. 953 (1962).

²¹ See, e.g., *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 445 U.S. 425, 436-37 (1980).

²² *Id.*

²³ This is essentially the problem presented in *J.C. Penney* which is discussed later in this article.

B. Commerce Clause

1. General

The framers of the United States Constitution designed the commerce clause to prevent states from inhibiting the free flow of commerce among them.²⁴ It is clear today, though it was not always so, that states may impose not only a net income tax on fairly apportioned net income derived solely from interstate commerce²⁵ but also may impose a privilege tax on income derived solely from interstate commerce.²⁶ However, the tax must be applied to an activity "with a substantial nexus with the taxing state, [be] fairly apportioned, . . . not discriminate against interstate commerce, and [be] fairly related to the services provided by the State."²⁷ Generally speaking, the major consideration now under the commerce clause is whether the particular business activity is actually taxed in more than one state. To avoid or correct multiple taxation, states must either apportion the tax base among themselves or forego taxation so that another state may tax the activity *in toto*.

The vice of multiple taxation is the imposition of tax on the same income arising from activities which happen to take place in more than one state. Multiple taxation thus places a burden on the interstate business not borne by the solely intrastate business. For example, as noted in *Western Live Stock v. Bureau of Revenue*,²⁸ "a state may not lay a tax measured by the amount of merchandise carried in interstate commerce [citation omitted], or upon the freight earned by its carriage."²⁹

If the tax is fairly apportioned to the in-state activity generating the tax base, then the vice of multiple taxation does not exist. *Western Live Stock* was one of the earlier decisions setting forth this principle. In *Western Live Stock*, a New Mexico newspaper publisher sold advertising to out-of-state advertisers and circulated the paper to in-state and out-of-state subscribers. The state imposed a 2% tax on advertising receipts upon one engaged in the business of publishing newspapers. The Court found that the tax fell only on the in-state activity of publishing the newspaper and that the sales price of the advertising was only the measure of the tax, not the activity taxed. The Court held there could be no multiple burden because the publishing activity was purely local and could be taxed by no state other than New Mexico.³⁰

²⁴ *Bibb v. Navajo Freight Lines*, 359 U.S. 520 (1959).

²⁵ *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959).

²⁶ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). *Complete Auto* overruled *Spector Motor Service v. O'Connor*, 340 U.S. 602 (1951), which had held that a franchise tax, though measured by net income, could not be imposed on income generated solely in interstate commerce. There was a minor question whether the income was really from an intrastate business (430 U.S. at 275-76, n.2), but the Court viewed the income as arising solely from interstate commerce (*Id.* at 276 n.4) and reaffirmed that characterization of it in *Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 745 and 748-49 (1978).

²⁷ *Complete Auto*, 430 U.S. at 279. This test, based on economic reality, has been the touchstone for all interstate taxation cases following *Complete Auto*.

²⁸ 303 U.S. 250 (1938).

²⁹ *Id.* at 256.

³⁰ *Id.* at 260.

2. Summary of Recent Gross Receipts Tax Decisions

At this juncture it will be helpful for later reference to summarize the more recent United States Supreme Court decisions involving commerce clause issues under a gross receipts tax.

In 1951, the Court decided *Norton Co. v. Department of Revenue*.³¹ In *Norton*, the Court found that while some sales were local in nature and therefore taxable by Illinois, certain sales of property were purely interstate, unrelated to any local activity, and thus could not be subjected to Illinois' gross receipts tax.

In 1964, in *General Motors Corp. v. Washington*,³² the Court held in a 5-4 decision that Washington could tax, in full, receipts from sales with interstate elements without any apportionment. The Court reached this conclusion because the interstate sales activities were so intertwined with General Motors' local activities. Activities constituted the subject of the tax; the sales proceeds were simply the measure of that tax.

In 1975, *Standard Pressed Steel Co. v. Department of Revenue*³³ followed the holding of *General Motors*. In this case, a single resident salesman "held the market" in Washington for Standard Pressed Steel, which supplied Boeing Corporation with various kinds of fasteners. Again, although the sales were interstate, the Court found that the in-state activity taxed could be permissibly measured by the total, unapportioned sales price since the sales were to "a local consumer" and thus apportioned to the activities.³⁴

In 1977, the Court held in *Complete Auto Transit v. Brady*³⁵ that the gross receipts at issue were apportioned to the commerce engaged in within the state. Because those receipts were for transportation services rendered entirely within Mississippi, no apportionment problem really existed.

Finally, in 1978 the Court held in *Department of Revenue v. Association of Washington Stevedoring Cos.*³⁶ that receipts from stevedoring activities carried on within the state were apportioned exactly to those activities. This case involved facts quite analogous to *Complete Auto* in that the income was generated by services performed entirely within the taxing state.

By 1978, then, a clear trend existed at the United States Supreme Court level to find that gross receipts taxes were self-apportioning in response to multiple taxation challenges brought by taxpayers.

IV. WEST VIRGINIA B & O TAX DECISIONS

The B & O Tax decisions to be considered may be categorized by the activities taxed: sales of property, sales of services, and contracting. Each cate-

³¹ 340 U.S. 534 (1951).

³² 377 U.S. 436 (1964).

³³ 419 U.S. 560 (1975).

³⁴ *Id.* at 564.

³⁵ 430 U.S. 274 (1977).

³⁶ 435 U.S. 734 (1978).

gory presents problems which require slightly different analysis under the due process and commerce clauses. The *J.C. Penney* trilogy³⁷ is the primary focus of the B & O Tax discussion. While several cases involving the due process and commerce clauses were decided after *J.C. Penney*,³⁸ only *Cincinnati Milacron v. Hardesty*³⁹ raised a substantial due process question. An analysis of that decision will follow comment on the *J.C. Penney* series.⁴⁰

A. Sales of Property

J.C. Penney involved the imposition of tax on gross receipts from sales of dry-goods and on gross receipts in the form of finance charges. The sales at issue were direct mail-order sales where the West Virginia customer sent his order through the mail to an out-of-state catalogue center, and the center sent the merchandise directly to the customer either through the mail or by interstate carrier. The company made two other types of catalogue sales. In the first, the customer ordered at a local catalogue desk and the merchandise was sent directly to the customer from out-of-state by mail or common carrier. In the second type of catalogue sale, the customer ordered by mail through the local catalogue center and the merchandise was shipped to the local center where the customer picked it up. Neither of the latter two categories was part of the controversy.

Income from finance charges was also at issue and arose in association with the direct out-of-state mail-order sales.⁴¹ Records of these credit sales were sent to the Pittsburgh, Pennsylvania, credit office, the responsibility of which was to collect the accounts.

The court found a number of minimum contacts between West Virginia and *J.C. Penney* to support the jurisdictional nexus, contacts which related to both the sales and the finance charges. These contacts included *J.C. Penney's* use of West Virginia collection agencies, its customers' ability to obtain credit applications from local *J.C. Penney* stores, and its customers' option to make direct mail-order payments to local *J.C. Penney* stores.

Initially, the majority considered the legal issue to center upon the existence of those contacts; that is, whether there was a nexus between the company and West Virginia. That question was thus essentially one of due process. But a nexus was found almost without discussion. The court further found that *J.C. Penney* had not proven multiple taxation; the balance of the commerce clause test set forth in *Complete Auto* was held summarily to have been met.⁴²

³⁷ See *supra* note 3. *Sturgeon* is omitted since it did not involve the B & O Tax but the Titling Privilege Tax found in W. VA. CODE § 17A-3-4 (Supp. 1982).

³⁸ See *infra* notes 125-28 and accompanying text.

³⁹ 290 S.E.2d 902 (W. Va. 1982).

⁴⁰ See *infra* notes 125-32 and accompanying text.

⁴¹ However, the concurring opinion took the view that the dispute was not limited to those particular finance charges. *J.C. Penney*, 264 S.E.2d at 616. So far as analysis of this issue is concerned, though, in both the majority and concurring opinions the finance charges were treated as those arising solely from the direct out-of-state mail-order sales. *Id.*

⁴² *Id.* at 610.

The majority opinion left a more detailed and meaningful analysis of the facts and law to the concurring opinion.

1. Sales

a. *General.* While the majority opinion made no mention of *Norton Co. v. Department of Revenue*,⁴³ a case factually quite similar to *J.C. Penney*, the concurring opinion centered upon it. Justice Miller distinguished *Norton* on its facts and noted it apparently had been weakened by subsequent United States Supreme Court cases.⁴⁴ *Norton* involved a Massachusetts company which maintained a warehouse and branch office in Chicago, Illinois. The company sold its goods in Illinois in three ways. First, some sales were made at retail directly through the Chicago branch office. Second, some sales involved at least some direct contact between the Illinois customer and the Massachusetts company, but still the orders or shipments were routed through the Chicago office. The third category involved sales based on orders made directly to Massachusetts by Illinois customers where Norton then shipped the goods directly to the customer.⁴⁵ These latter sales were the subject of the dispute between the Illinois Department of Revenue and Norton.

The Illinois court held that receipts from all sales to Norton's Illinois customers were subject to Illinois' gross receipts tax.⁴⁶ The United States Supreme Court affirmed the lower court's decision for all categories except the direct, out-of-state mail-order sales. The Court found no connection between Norton and Illinois with regard to those sales. Since the sales were solely interstate, the Court found them to be protected from Illinois tax by the commerce clause.⁴⁷

The Court decided *Norton* at a time when, in interstate taxation disputes, commerce clause issues were more in the forefront than due process issues. However, the knotty issue in *J.C. Penney* and the real issue in *Norton* were ones of due process.

Certainly the *Norton* decision would appear to have required the West Virginia court to sustain *J.C. Penney's* position on its out-of-state direct mail-order sales. But the majority must have implicitly considered that *Complete Auto* had eroded the *Norton* teaching. Justice Miller, in his concurring opinion, found explicitly that two cases arising under Washington state's B & O

⁴³ 340 U.S. 534 (1951).

⁴⁴ In Justice Miller's words:

It can be readily seen that *Norton's* test, whether there is some local service to support the state tax on a particular transaction, has been transformed by General Motors and Standard Pressed Steel into an inquiry as to the extent of the local business of the taxpayer. . . . Once a substantial local connection is found, then a tax will be upheld if it bears some reasonable apportionment to the local activity.

J.C. Penney, 264 S.E.2d at 617.

⁴⁵ *Norton*, 340 U.S. at 536.

⁴⁶ *Norton Co. v. Dep't of Revenue*, 405 Ill. 314, 90 N.E.2d 737 (1950), *modified*, 340 U.S. 534, *modified*, 409 Ill. 216, 99 N.E.2d 346 (1951).

⁴⁷ *Norton*, 340 U.S. at 539.

Tax, *General Motors* and *Standard Pressed Steel*,⁴⁸ had indeed softened *Norton's* requirement of a direct relationship between the particular transaction generating the income being taxed and the in-state activities supporting that tax.⁴⁹ *General Motors* and *Standard Pressed Steel* require "an inquiry as to the extent of the local business of the taxpayer Once a substantial local connection is found, then a tax will be upheld if it bears some reasonable apportionment to the local activity."⁵⁰

Justice Miller, in his concurring opinion, continues:

The taxpayer cannot escape taxation by attempting to isolate his local activities into compartments and by concluding that each compartment must be viewed separately without regard to the taxpayer's entire activities within the state. In both *General Motors* and *Standard Pressed Steel* the taxpayer's in-state activities were thought to be sufficient to uphold the tax even though these activities did not have a substantial direct relationship to the activity taxed.⁵¹

General Motors and *Standard Pressed Steel* were decided before it was permissible to impose a tax on the privilege of engaging in interstate commerce.⁵² In order to support the tax, it was necessary to find enough connection between the out-of-state company and the in-state activity to warrant including in the tax base receipts from all sales (including those with interstate elements). Such a finding was required for the tax to survive a commerce clause challenge. While neither case emphasized the fact, the parts of the opinions dealing with in-state activity under the commerce clause are equally applicable to due process considerations.

The apportionment issue, which has been the focus of commerce clause concerns in gross receipts tax cases, is just as much a due process problem and should be addressed in that context: whether a rational relationship exists between the activity carried on in-state and the income which is the measure of the amount taxed by the state. In *J.C. Penney*, commerce clause tests were employed to find a rational relationship sufficient to satisfy due process essentially in a *Norton* setting.

After finding an erosion of *Norton* and hence no current application of it, the concurring opinion in *J.C. Penney* sets forth a second basis for determining that the disputed sales generated receipts taxable in accordance with due process. Justice Miller indicated that "the record demonstrates that [J.C. Penney's] out-of-state direct catalog sales are so closely entwined with its local presence that any attempt to isolate these sales would do violence to customary retailing concepts."⁵³ *J.C. Penney* had argued that its direct mail-order sales were isolated from any other activity it carried on in West Virginia.⁵⁴

⁴⁸ See *supra* notes 32-34 and accompanying text.

⁴⁹ See *supra* note 44.

⁵⁰ *Id.*

⁵¹ *J.C. Penney*, 264 S.E.2d at 617.

⁵² See *supra* note 26 and accompanying text.

⁵³ *J.C. Penney*, 264 S.E.2d at 617.

⁵⁴ Appellee's Brief at 13-29, *J.C. Penney*, 264 S.E.2d at 604.

Justice Miller's comment does not support that isolation concept.

According to the concurrence, perhaps more important than the ability of direct out-of-state mail-order customers to return merchandise so acquired to West Virginia stores or have the merchandise repaired at those stores, the very fact that J.C. Penney operated local stores greatly influenced its volume of direct out-of-state mail-order sales. "The customer receives advertising through all forms of local media and the local store is a showcase for the catalog merchandise, and provides to its customers the catalog itself. Thus, to contend that out-of-state catalog sales have no local connection is to ignore business reality."⁵⁵

This second basis for sustaining the tax is the cleaner and stronger ground. Not surprisingly, it is the precise rationale put forth by the dissenters in *Norton* to sustain the Illinois tax on direct out-of-state mail-order sales.⁵⁶ It may not be too foolish to suggest that both bases are grounded in economic reality. A factual finding that allegedly isolated interstate activity is, in reality, an integral part of admitted local activity underlies the legal conclusion that due process is satisfied. That is, a sufficient relationship exists between the transaction taxed and the taxpayer's activities in West Virginia. Such an analysis squares *J.C. Penney*, *General Motors*, *Standard Pressed Steel*, and the *Norton* dissent except for one particular issue — the question of apportionment.

What should be made of the conclusion reached by the *Norton* majority that direct out-of-state mail-order sales can be isolated from in-state activity and thus are not subject to tax because of their purely interstate character? Though *Norton* has never been formally overruled, it would appear to be substantially weakened by the decisions in *General Motors* and *Standard Pressed Steel*, as well as after the sweeping decision in *Complete Auto*, despite the suggestion in *Standard Pressed Steel* to the contrary.⁵⁷ The *J.C. Penney* concurrence certainly relies on the demise of *Norton* at the West Virginia level. The "economic reality" reasoning expressed in the *Norton* dissent and in the *J.C. Penney* concurring opinion should prevail today. The commerce clause, so important in *Norton*, no longer presents an insurmountable hurdle, particularly after *Complete Auto*.

b. *Apportionment*. We have concluded that direct out-of-state mail order sales are properly the subject of taxation in West Virginia because the taxation of these sales comports with the commerce clause tests of *Complete Auto* and the due process requirement of a business presence. But the rational relationship prong of due process must also be satisfied. The rational relationship re-

⁵⁵ *J.C. Penney*, 264 S.E.2d at 617.

⁵⁶ *Norton*, 340 U.S. at 541 (Clark, J., dissenting, joined by Justices Black and Douglas). The last paragraph of the dissent states, in part:

In maintaining a local establishment of such magnitude, the petitioner has adopted the label of a hometown merchant. After it has received the manifold advantages of that label, we should not give our sanction to its claim made at taxpaying time that with respect to direct sales it is only an itinerant drummer.

⁵⁷ "The disagreement by the Court was not over the governing principle. . . ." 419 U.S. 560, 563 (1975).

quired is the relationship between the activities of the taxpayer within the taxing jurisdiction and the income giving rise to the tax base, here, sales receipts.⁵⁸

Sales made by J.C. Penney exclusively through its local stores were sales consummated entirely in West Virginia. Clearly, receipts from those sales need not be apportioned to any other state. However, receipts from sales involving non-West Virginia elements, such as direct out-of-state mail-order sales and sales of merchandise ordered at a local store but sent directly from an out-of-state warehouse to the West Virginia customer may have to be isolated and apportioned to meet the rational relationship requirement of due process.⁵⁹ To whatever extent activities outside West Virginia contribute to effectuating the two types of interstate sales mentioned, justification exists to apportion those sales receipts between West Virginia and non-West Virginia activities before applying the B & O Tax. If gross receipts are apportioned, then only West Virginia activities would attract the West Virginia tax. J.C. Penney would compensate West Virginia for its provision of government services and the benefits of a civilized society only in some relation to its use of those services in plying its trade.⁶⁰

General Motors and *Standard Pressed Steel* would support the proposition that J.C. Penney's entire gross receipts are subject to West Virginia's B & O Tax because the local business activity bears a fair relation to the income taxed. Though not speaking in terms of a rational relationship, the Court

⁵⁸ It is interesting to note that the court in every case under discussion found not only that the threshold business presence existed but also that the tax was self-apportioning. In other words, so far as the apportionment question was concerned, the court found that the entire tax base was attributable to West Virginia. That is tantamount to requiring no apportionment whatsoever.

In a case involving a West Virginia taxpayer, *Dravo Contracting Co. v. James*, 114 F.2d 242 (4th Cir. 1940), the court held that if the statute itself did not call for apportionment and if apportionment were required to comport with constitutional restraints, then the statute would be totally void and therefore no tax could be imposed. (In fact, this point was argued by Pittsburgh-Des Moines. Reply Brief of Appellant at 9, *J.C. Penney*, 264 S.E.2d at 604.) While the *Dravo* opinion seems to skirt that particular issue by saying that the activity there involved was one which was taxable by the state of West Virginia and therefore apportioned, the West Virginia Supreme Court of Appeals may have been concerned that, once having found the required business presence, it would have to find either that the tax was totally void or that the entire tax base was subject to the West Virginia tax.

While the B & O Tax provisions do not mention apportionment generally, it is permitted in the production of natural resources and manufacturing if that activity is begun in West Virginia and completed outside the state. W. VA. CODE § 11-13-2 (2d para.) (1974 & Supp. 1982). However, B & O Tax Reg. § 3.2 provides for apportionment generally, emphasizing apportionment in the "service" classification, but specifically mentioning also sales and contracting. This regulation was never referred to by the court in any of the cases under discussion, perhaps because it was not raised by the parties.

⁵⁹ One dissenter in *Norton* would have held these latter kinds of interstate sales not taxable by Illinois. 340 U.S. at 541 (Reed, J., dissenting). However, three other Justices concluded that such sales should be taxable by Illinois. 340 U.S. at 541 (Clark, J., dissenting, joined by Justices Black and Douglas).

⁶⁰ As Justice Frankfurter put it, "[t]he simple but controlling question is whether the state has given anything for which it can ask return." *Wisconsin v. J.C. Penney Co.* 311 U.S. 435, 444 (1940).

held in *Wisconsin v. J.C. Penney* that a tax is proper under due process considerations if it is in fair proportion to the taxpayer's activities and enjoyment and use of protection and opportunity afforded by the state.⁶¹

The strong dissent in *General Motors* centered upon this precise issue of what is "fair" recompense for government protection and services.⁶² Apportionment of net income is necessary to attribute to a state an amount of net income rationally related to the taxpayer's activities in that state, from which amount is extracted a tax which in turn bears a rational relationship to the opportunities and benefits afforded by the taxing state.⁶³ The *Wisconsin J.C. Penney* test is satisfied. In an interstate setting, an exact determination of what a particular taxpayer "owes" a state in return for protection and other government benefits is almost impossible. The only practical alternatives are apportionment by formula or specific allocation. Apportionment of interstate gross receipts would ensure that the gross receipts tax base bears the rational relationship to in-state activities required by due process.⁶⁴

For commerce clause purposes both the United States Supreme Court and the West Virginia Supreme Court of Appeals have described gross receipts taxes as self-apportioning because that the activity taxed occurs only within the state.⁶⁵ Hence, for due process purposes, the tax should bear the requisite rational relationship to the activity or income taxed. In most instances under the B & O Tax, the self-apportioning description is accurate, but it is suggested here that the description is not accurate with respect to interstate sales such as direct out-of-state mail-order sales. The activities generating such sales do not occur only within West Virginia. These activities involve non-West Virginia elements.⁶⁶

c. *Penney in Indiana*. *J.C. Penney* took its case to Indiana, a state which also imposes a gross receipts tax. However, Indiana's tax differs from West Virginia's in that it is not a tax on the privilege of engaging in business.⁶⁷

⁶¹ *Wisconsin v. J.C. Penney*, 311 U.S. at 444.

⁶² *General Motors Corp. v. Washington*, 377 U.S. 436, 457 (1964) (Goldberg, J., dissenting).

⁶³ See *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978).

⁶⁴ The Willis Subcommittee Report notes apportionment as one way of resolving the problem. It also states that apportionment has not, however, been used by the Court. *Supra* note 20, at 1037-38. Interestingly, the final recommendation of the Subcommittee was to permit only the state of origin to impose a gross receipts tax, since it had the strongest ties to the business of any jurisdiction. *Id.* at 1195-96.

⁶⁵ See *Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 746-47 (1978); *J.C. Penney*, 264 S.E.2d at 619 (Miller, J., concurring).

⁶⁶ On the other hand, certain services or transportation in interstate commerce may occur only in West Virginia and properly be subject to an unapportioned gross receipts tax because, in fact, the tax in that instance is truly self-apportioning. See *Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734 (1978) (services), and *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) (transportation). See also *Columbia Gas Transmission Corp. v. Hardesty*, AP-CA-72, 79-89 (Cir. Ct. of Kanawha Cty March 2, 1981), *appeal denied*, (W. Va. Sept. 29, 1981, Nov. 10, 1981, March 11, 1982), *appeal dismissed*, 103 S. Ct. 32 (1982).

⁶⁷ IND. CODE ANN. § 6-2-1-2 (Burns 1978) imposes "a tax upon the receipt of gross income, measured by the amount or volume of gross income, and in the amount to be determined by such application of rates on such income. . . ."

Almost a year after the West Virginia decision in *J.C. Penney*, Indiana's intermediate appeals court held in favor of the company on both the direct out-of-state mail-order issue and the finance charge issue.⁶⁸ The opinion appears to be nothing more than an interpretation of the Indiana statute itself. While it is difficult to determine what the court considered critical, clearly the *Norton* approach was lurking in the wings. The court cited *Mueller Brass*,⁶⁹ an Indiana case similar to *Norton* in the sense that certain activity of the taxpayer could be isolated from its clearly in-state activity. The isolated activity in *Mueller* was found to be solely interstate in nature and therefore totally outside the taxing jurisdiction of Indiana.⁷⁰ In *Mueller*, nonresident salesmen solicited sales which were accepted outside Indiana and which were consummated by interstate shipments directly to the customer inside Indiana. The court held in *J.C. Penney* that the company's income from its direct mail-order sales and finance charges simply did not involve enough in-state contacts to support the Indiana tax.⁷¹ The court never reached the constitutional issues.⁷²

d. *Application to Mail-Order Business.* If the West Virginia court had deemed it appropriate to treat the direct out-of-state mail-order sales in isolation from the other sales, as did Indiana, would it have held such direct mail-order sales to be beyond the taxing jurisdiction of the state under due process? In other words, would the protection for mail-order houses mentioned by Justice Goldberg, dissenting in *General Motors* in 1964,⁷³ still be available today, or should it be?

One can only speculate. It may be tempting to follow legal precedent without taking into account changing times and theories. But by virtue of holding a substantial market through a mail-order business, the seller has established a business presence in that market state in satisfaction of the threshold requirement of due process. For, as is true of any other seller, the mail-order seller is taking full advantage of a civilized society in which to ply its trade. Moreover, to the extent that government costs are incurred to maintain that civilized society, those who benefit from it should share in the cost of supporting it.

The next question concerns the measure of the tax. Clearly there must be some sort of apportionment to reflect the activity of the seller in the state so that the out-of-state activity will not be part of the basis for the West Virginia tax.

Neither *General Motors* nor *Standard Pressed Steel* went this far because the facts in those cases did not force the Court to do so. But the opinions are based on the concept of "holding the market,"⁷⁴ as is the West Virginia *J.C.*

⁶⁸ Department of State Revenue v. J.C. Penney Co., 412 N.E.2d 1246 (Ind. App. 1980).

⁶⁹ *Mueller Brass Co. v. Department of State Revenue*, 255 Ind. 514, 265 N.E.2d 704, appeal dismissed, 403 U.S. 901 (1971).

⁷⁰ 255 Ind. at 593, 265 N.E.2d at 717.

⁷¹ *J.C. Penney*, 412 N.E.2d at 1251.

⁷² *Id.* at 1252.

⁷³ 377 U.S. at 462.

⁷⁴ *General Motors*, 377 U.S. at 448; *Standard Pressed Steel*, 419 U.S. at 562.

Penney opinion.⁷⁵ Today "holding the market" may be, and often is, accomplished without physical presence of offices or persons; however, that technicality should not avoid some tax. Apportionment is the realistic way in which to recognize a threshold nexus but tax only in-state activities.

The strong dissent in *National Bellas Hess, Inc. v. Department of Revenue*⁷⁶ took the position that exploiting the market to a substantial degree established sufficient nexus for requiring a mail-order house to collect Illinois' use tax.⁷⁷ There is no reason why that rationale should not apply to a direct

⁷⁵ "[t]he activities of the taxpayer are greatly facilitated by its overall operations in West Virginia. . . ." *J.C. Penney*, 264 S.E.2d at 610.

⁷⁶ 386 U.S. 753 (1967). Illinois attempted to force National Bellas Hess, an out-of-state mail-order firm, to collect the Illinois use tax on sales to Illinois residents. According to the majority, the only connection of any jurisdictional significance which National Bellas Hess had with Illinois was via the United States mail or common carrier. The majority held that these two contacts with Illinois were insufficient to establish jurisdiction in Illinois to require use tax collection.

⁷⁷ After reciting the salient facts reflecting \$2,000,000 worth of sales in Illinois, mailings of substantial numbers of catalogs and fliers and selling on credit, Justice Fortas, joined by Justices Black and Douglas, wrote:

There should be no doubt that this large-scale, systematic, continuous solicitation and exploitation of the Illinois consumer market is a sufficient "nexus" to require Bellas Hess to collect from Illinois customers and to remit the use tax, especially when coupled with the use of the credit resources of residents of Illinois, dependent as that mechanism is upon the State's banking and credit institutions. Bellas Hess is not simply using the facilities of interstate commerce to serve customers in Illinois. It is regularly and continuously engaged in "exploitation of the consumer market" of Illinois (*Miller Bros. Co. v. State of Maryland*, 347 U.S. 340, 347, 74 S. Ct. 535, 540, 98 L. Ed. 744 (1954)) by soliciting residents of Illinois who live and work there and have homes and banking connections there, and who, absent the solicitation of Bellas Hess, might buy locally and pay the sales tax to support their State. Bellas Hess could not carry on its business in Illinois, and particularly its substantial credit business, without utilizing Illinois banking and credit facilities. Since the case was tried on affidavits, we are not informed as to the details of the company's credit operations in Illinois. We do not know whether it utilizes credit information or collection agencies, or similar institutions. The company states that it has "brought no suits in the State of Illinois." Accepting this is true, it would nevertheless be unreasonable to assume that the company does not either sell or assign its accounts or otherwise take measures to collect its delinquent accounts, or that collection does not include local activities by the company or its assignees or representatives.

Bellas Hess enjoys the benefits of, and profits from the facilities nurtured by, the State of Illinois as fully as if it were a retail store or maintained salesmen therein. Indeed, if it did either, the benefit that it received from the State of Illinois would be no more than it now has — the ability to make sales of its merchandise, to utilize credit facilities, and to realize a profit; and, at the same time, it would be required to pay additional taxes. Under the present arrangement, it conducts its substantial, regular, and systematic business in Illinois and the State demands only that it collect from its customer-users — and remit to the State — the use tax which is merely equal to the sales tax which resident merchants must collect and remit. To excuse Bellas Hess from this obligation is to burden and penalize retailers located in Illinois who must collect the sales tax from their customers. In Illinois the rate is 3 ½ %, and when it is realized that in some communities the sales tax requires, in effect, that as much as 5% be added to the amount that customers of local, tax-paying stores must pay, the importance of the competitive discrimination becomes apparent. While this advantage to out-of-state sellers is tolerable and a necessary constitutional consequence where the sales are occasional, minor and sporadic and not the result of a calculated, systematic exploitation of the market, it certainly should not be extended to instances where the out-of-state com-

tax (imposition of tax on taxpayer as opposed to only a collection requirement on taxpayer) in spite of the traditional distinction between the nexus requirement for direct taxation and only a collection responsibility.⁷⁸

2. Finance Charges

a. *Penney in West Virginia*. The facts surrounding this issue were set forth earlier along with the facts relating to the sales issue.⁷⁹ West Virginia taxed J.C. Penney's gross receipts from finance charges which the company collected on credit sales in West Virginia.⁸⁰ The majority opinion lumped the sales and finance charges issues together and concluded with little discussion that they were all subject to the B & O Tax. As in the case of the sales controversy, we must look to Justice Miller's concurring opinion for any analysis.

According to that opinion, sufficient nexus existed to tax the finance charges on direct out-of-state mail-order sales. "[O]nce its substantial local presence is established, Penney is subject to a fairly apportioned tax on all of its activities within the state, regardless of whether a particular aspect, in isolation, may have fewer local connections."⁸¹ It is difficult to tell whether Justice Miller found the required nexus because the finance charges arose out of the sales and therefore were inextricably tied up with them, or whether the finance charges were viewed in isolation and had their own set of connections to West Virginia.⁸² The latter appears to be the case even though language in his opinion appears to the contrary.⁸³ One might wonder whether the court may, in future cases, isolate various activities to determine whether those activities themselves are of such a nature as to permit West Virginia to tax them in accordance with due process requirements. While neither the majority nor concurring opinion is clear in this regard, the tenor of *J.C. Penney* leads one to believe that no such isolation would be part of the court's analysis.

The key to Justice Miller's reasoning is that the tax is by nature apportioned in accordance with activities carried on in West Virginia. The opinion dogmatically follows the *General Motors* and *Standard Pressed Steel* generalization that B & O Taxes are self-apportioning because the activity taxed oc-

pany is engaged in exploiting the local market on a regular, systematic, large-scale basis. In such cases, the difference between the nature of the business conducted by the mail order house and by the local enterprise is not entitled to constitutional significance. 386 U.S. 753 at 761-63.

⁷⁸ See *National Geographic Soc'y v. State Bd. of Equalization*, 430 U.S. 551, 556-58 (1977). However, the Court in *National Bellas Hess*, 386 U.S. at 753, noted the fact that, under the Illinois statute, National Bellas Hess was liable for the use tax whether or not it collected the tax, essentially a direct liability. *Id.* at 757 n.9.

⁷⁹ See *supra* notes 41-42 and accompanying text.

⁸⁰ *J.C. Penney*, 264 S.E.2d at 609. Even though the finance charges were taxed under the "service" classification (W. VA. CODE § 11-13-2h (1974)), this issue will be discussed here because it arose out of the sales of property. The next section of this article will deal more generally with the due process and commerce clause problems which the "service" classification raises.

⁸¹ *J.C. Penney*, 264 S.E.2d at 618.

⁸² *Id.* at 618. After the broad statement (cited *supra* note 81) Justice Miller set out in two paragraphs the West Virginia elements of the finance charges.

⁸³ See *supra* note 81 and accompanying text.

curs only within the taxing state.⁸⁴ This view is an oversimplification. The fact is that the finance charges had both in-state and out-of-state elements, just as the sales themselves had. By not according any weight to the out-of-state elements through specifically allocating or apportioning gross receipts, the decision in this case permits West Virginia to attribute to itself some income which relates to activities carried on outside the state. That position violates due process. Although there is not the slightest doubt that the first prong of due process, jurisdictional nexus, was satisfied with respect to the finance charges, the second prong, the rational relationship between the income taxed and the activities generating that income, requires part of the finance charges to be attributed to activity out of West Virginia. Income from that out-of-state activity cannot be taxed here.

b. *Penney in Indiana*. J.C. Penney, as noted above in connection with the sales issue, brought a similar case in Indiana.⁸⁵ The intermediate Indiana appellate court held that the finance charges were not subject to the Indiana gross receipts tax because they were intangibles which had not obtained a situs within Indiana. Since Penney was a non-resident of Indiana, such intangibles were not subject to the Indiana tax.⁸⁶ As in the case of the mail-order sales, this part of the opinion is based more on statutory construction than constitutional analysis and so is of limited value here.⁸⁷

c. *Penney in Washington*. Nearly two years after the West Virginia Supreme Court of Appeals had decided *J.C. Penney*, the Supreme Court of Washington decided a *Penney* case on the finance charge issue.⁸⁸ It reached a middle ground.

The court in Washington found that not all activities giving rise to the finance charges occurred in Washington but that some of those activities took place in Oregon. Apparently the finance charges in this case did not involve finance charges to direct out-of-state mail-order sales.⁸⁹ The bulk of the opinion recited the activities that underlie the finance charge income and listed the situs of those activities. The court found that all Penney's activities related to credit sales gave rise to finance charge income.⁹⁰

The activities which took place outside Washington included credit approval, billing and bookkeeping. These elements of credit sales were handled in Portland, Oregon.⁹¹ The activities which took place within Washington included the underlying sales at Washington stores, in-state employee assistance with the application for credit privileges, credit approval by Washington em-

⁸⁴ *J.C. Penney*, 264 S.E.2d at 618-19.

⁸⁵ *J.C. Penney*, 412 N.E.2d at 1246.

⁸⁶ *Id.* at 1251.

⁸⁷ See *supra* notes 71-72 and accompanying text.

⁸⁸ State Dep't of Revenue v. *J.C. Penney Co.*, 96 Wash. 2d 38, 633 P.2d 870 (1981). The underlying sales were not in issue. For a very recent, short note on this point, see Piper, *Gross Receipts Taxes Applied to Credit Financing*, 2 INTERSTATE TAX REP'T 14 (1982).

⁸⁹ 96 Wash. 2d at 44, 633 P.2d at 874.

⁹⁰ *Id.*

⁹¹ *Id.* at 40, 633 P.2d at 871-72.

ployees reversing the initial Portland office decision not to grant credit, payment on some credit accounts directly to Washington stores, and use of Washington collection companies. The Washington usury laws were also applicable, and the Washington courts provided the forum for enforcement of collection matters.⁹²

The court affirmed the *Norton* teaching that activities must be tested in isolation to determine if the gross receipts which they produce are taxable.⁹³ The court found due process nexus and the due process rational relationship, but it required apportionment in order to meet that second prong, which the state had conceded was proper.⁹⁴ The court remanded on the apportionment issue, citing the West Virginia *J.C. Penney* case with approval and dismissing the Indiana *J.C. Penney* controversy as being only a case of statutory interpretation.⁹⁵

Justice Dolliver wrote a rather strong dissent⁹⁶ based upon a discussion of *Rena-Ware Distributing, Inc. v. State*⁹⁷ which he believed, as did Penney, was the "mirror image" of Penney's situation. Essentially the dissent found, based upon *Rena-Ware*, that all the activities giving rise to the finance charges took place in Portland, Oregon. Therefore, Washington had no jurisdiction to tax them in the first place.⁹⁸

The approach of the majority seems to square more with economic reality. The activities generating the finance charges had interstate elements. The nexus to tax was clear, and the rational relationship between the activity and the income taxed could be met here only through apportionment.

d. *The West Virginia Solution.* As in the case of mail-order sales, the choices are three. West Virginia could tax the finance charges completely, not at all, or partially. The last alternative appears to be the fairest and least offensive. The fact that the Washington case did not involve direct out-of-state mail-order sales should not in any way lessen its applicability to the finance charges which were the subject of the West Virginia litigation. The principle established in the Washington *Penney* case should be applicable to finance charges arising from any kind of sale.

B. Services

In *Richardson, Gordon and Associates v. Hardesty*,⁹⁹ an engineering partnership operating out of Pittsburgh, Pennsylvania, entered into various con-

⁹² *Id.* at 44, 633 P.2d at 874.

⁹³ *Id.* at 47, 633 P.2d at 875.

⁹⁴ *Id.* at 48, 633 P.2d at 876. Probably the state conceded that apportionment was proper because the Washington B & O Tax law contains an apportionment provision dealing with the "service" classification. WASH. REV. CODE ANN. § 82.04.460 (1981). Washington's statute is quite similar to West Virginia's B & O Tax Reg. § 3.2 referred to in *supra* note 58.

⁹⁵ 96 Wash. 2d at 46-47, 633 P.2d at 876.

⁹⁶ *Id.* at 49, 633 P.2d at 876.

⁹⁷ 77 Wash. 2d 514, 463 P.2d 622 (1970).

⁹⁸ *J.C. Penney*, 96 Wash. 2d at 55, 633 P.2d at 879.

⁹⁹ 264 S.E.2d 604 (W. Va. 1980).

tracts with the West Virginia Department of Highways, pursuant to which the firm performed services and received payment of professional fees therefore. The taxpayer contended that only 5% of the services rendered took place in West Virginia; hence only that percentage of its fees should be subject to the B & O Tax. The court concluded that 100% of the fees was subject to the tax.¹⁰⁰

The firm produced engineering drawings and reports. It would survey a proposed highway route from aerial photographs, prepare a location report on the route, and later draft final engineering plans once the route had been selected by the Highway Department. Each one of these activities took place in Pittsburgh.¹⁰¹

In West Virginia, the firm would retain a sub-contractor to bore holes, send in a survey team to site the holes and supervise the boring, occasionally make a field inspection of a project, send in personnel to determine number and location of property owners on the route, and attend community meetings and other meetings in Charleston. It also established a branch office in Wheeling.¹⁰² While 5% may have been a low estimate of the percentage of total services performed in West Virginia, it is clear that "[t]he bulk of all the work, however, was performed in Pittsburgh. . . ."¹⁰³

The court found "sufficient contacts to meet the [general jurisdictional nexus] requirements of *Standard Pressed Steel* and *National Geographic*. . . ."¹⁰⁴ The court then recognized that the major issue was "one of apportionment and fair relationship to the services rendered by the State of West Virginia."¹⁰⁵ Unfortunately, the analysis which followed limited itself to commerce clause considerations. The court noted that the taxpayer had not proven multiple taxation. It allowed the entire service income to be subjected to West Virginia's B & O Tax. Though the court recognized the need for apportionment in many cases, it seemed to rely on the fact that, in a number of sales-of-property cases, the question is resolved by permitting the destination state to tax the entire sales price. Concomitantly, the state of manufacture

¹⁰⁰ *Id.* at 612. The court reached this decision without mention of B & O Tax Reg. § 3.2 dealing with apportionment. See *supra* notes 58 and 94.

¹⁰¹ *Richardson, Gordon*, 264 S.E.2d at 611.

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.* *National Geographic*, 430 U.S. at 551, is a use tax collection case cited by Justice Neely in the main body of the opinion. The United States Supreme Court upheld California's position, finding sufficient contact between the out-of-state taxpayer magazine and the State to impose the burden of collecting the use tax from California residents who purchased maps, atlases, globes and books from National Geographic's District of Columbia mail-order business.

¹⁰⁵ *Richardson, Gordon*, 264 S.E.2d at 611. While apportionment can, and does, involve due process, language is taken from *Complete Auto* which set forth commerce clause standards except for the reference to nexus generally. See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Apportionment there had to do with the avoidance of multiple taxation; the relationship to services involved the challenge that a business in interstate commerce might pay more tax than a solely intrastate business compared to the services each receives from the taxing state. Cf. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 620-29 (1981), which emasculated this part of the *Complete Auto* test, discussed further *infra* note 152.

would forego taxation of any part of the sales price.¹⁰⁶

The concurring opinion offers more analysis. As in *Penney* when Justice Miller determined that *Norton* had been undermined by *General Motors* and *Standard Pressed Steel*, the concurrence relied on the same two cases to distinguish *Baton Coal Co. v. Battle*,¹⁰⁷ an older West Virginia case factually similar to *Richardson, Gordon*, and to find that the business presence test had been enlarged. Even though the value of the activities giving rise to the income was meager, the income itself was substantial and could be fully taxed because those "receipts [were] derived from the local transaction."¹⁰⁸

The majority and concurring opinions both appear to misapply or pass over the rational relationship required by due process. So do *General Motors* and *Standard Pressed Steel*.¹⁰⁹ Once having found jurisdictional nexus, the opinions fail to take into account the out-of-state elements of the sales or services, even though out-of-state activities gave rise to some of the tax base. Those out-of-state activities would always be taken into consideration under a net income tax, yet in gross receipts tax cases, the courts have taken an all-or-nothing approach - ignoring the fact that only apportionment of some kind will reach the most reasonable result in our current sophisticated economy. "Local" transactions simply did not give rise to all the receipts taxed.

The West Virginia court inappropriately used sales-of-goods cases (*General Motors* and *Standard Pressed Steel*) to support the taxation of income from services. In *General Motors* and *Standard Pressed Steel*, wholly local activities of various personnel established the taxing jurisdiction. Those local activities resulted in sales, the receipts from which were taxed. The fact that the sales were clearly interstate seems to have been forgotten; the wholly local activities of certain personnel brought the entire interstate sales price under the tax which seems to violate the rational relationship requirement of due

¹⁰⁶ *Richardson, Gordon*, 264 S.E.2d at 612.

¹⁰⁷ 151 W. Va. 519, 153 S.E.2d 522 (1967).

In *Baton* a Pittsburgh mining consulting firm provided managerial services to a West Virginia coal mining company. Testimony indicated that about 15% of the working days of some of *Baton's* employees was spent in West Virginia. Also, a very small portion of the managerial services resulted from the time spent in West Virginia by those employees. But for these forays into West Virginia, all other services were performed in Pittsburgh. The fact that *Baton* had its principal place of business and offices outside of West Virginia, however, was not the ground for holding the company not liable for the B & O Tax. The court decided "that, in view of the comparatively meager business activity of *Baton* within West Virginia in the tax years in question, performed incidentally to the business in which it was engaged in Pennsylvania, *Baton* was not engaging in a service business or calling 'within this State'. . . ." *Id.* at 525, 153 S.E.2d at 526.

¹⁰⁸ *Richardson, Gordon*, 264 S.E.2d at 622.

What Justice Miller seems to be saying is that while the in-state activity itself (the subject of the tax) may not be particularly valuable, the income to which it gives rise (the measure of the tax) can be of a much higher value and be fully taxed. While this may be somewhat true of a sales situation where the activity of a single salesman gives rise to a substantial amount of income from the sales which are completed because of his activity, this theory is inapplicable to services. Services are too directly related to the receipts generated to have the same kind of effect which might arise out of the relationship between the activity of the salesman and the subsequent sale.

¹⁰⁹ *General Motors*, 377 U.S. 436, 449-51 (Brennan, J., dissenting). See also J. HELLERSTEIN & W. HELLERSTEIN, *STATE AND LOCAL TAXATION* 301-03 (4th ed. 1978), agreeing with this dissent.

process. Unlike cases where goods are sold, services involve activities which themselves generate the tax base. For example, professional fees, generated directly by the services rendered, are the tax base in the instant case. It would appear relatively easy to determine the situs of any particular personal service and allocate the income generated by it to the particular state in which the service took place. Sales-of-goods cases present a much more difficult task of apportionment or allocation.

Cases dealing with gross receipts taxes and services in interstate commerce settings indeed exist.¹¹⁰ In both *Complete Auto* and *Washington Stevedoring*, the service income arose from activities which took place entirely within the taxing jurisdiction albeit as part of interstate commerce.¹¹¹ The receipts in *Complete Auto* arose from transportation services occurring entirely within Mississippi.¹¹² The receipts in *Washington Stevedoring* arose from stevedoring services performed within the State of Washington.¹¹³ No apportionment was necessary. The clear implication in both of these cases is that apportionment would have been required had the receipts at issue been attributable to services performed outside the taxing state.

The West Virginia court appears to have ignored economic reality and misconstrued and misapplied *General Motors* and *Standard Pressed Steel in Richardson, Gordon & Associates*, permitting West Virginia to tax gross receipts generated partly by activities which bore no rational relationship to the State of West Virginia, clearly in violation of due process.

C. Contracting

*Pittsburgh-Des Moines Steel Co. v. Goodwin*¹¹⁴ involved a corporation which designed and fabricated large steel structures in Pennsylvania. These structures were then brought into West Virginia in pieces because of their size and weight. Once in West Virginia, the structures were erected by the taxpayer, usually as elevated water storage tanks and flat bottom storage tanks. West Virginia imposed its B & O Tax on the entire contract price despite the out-of-state design and fabrication. The court upheld the tax.¹¹⁵

The court found that Pittsburgh-Des Moines had established a presence in West Virginia sufficient to warrant its being liable to B & O Tax. While the taxpayer had no office, warehouse or plant in West Virginia, it was clearly carrying on its business of erecting large steel structures in the state. It also inspected the tanks after erection and determined site selection and foundation design. Certainly Pittsburgh-Des Moines had established a business presence

¹¹⁰ *Washington Stevedoring*, 435 U.S. at 734; *Complete Auto*, 430 U.S. at 274.

¹¹¹ *Complete Auto* involved a tax similar to West Virginia's Carrier Income Tax discussed later in this article.

¹¹² 430 U.S. at 276.

¹¹³ 435 U.S. at 750. The Court said: "Nor have respondents successfully attacked the apportionment of the Washington system. The tax under challenge was levied solely on the value of the loading and unloading that occurred in Washington." *Id.*

¹¹⁴ 264 S.E.2d 604 (1979).

¹¹⁵ *Id.* at 611.

based upon these facts which should, and did, attract the B & O Tax.¹¹⁶ However, whether the entire contract price should have been subjected to the tax is questionable.

The majority found that the requisite nexus arose out of the West Virginia contacts above noted and upheld the tax on the entire contract price because

all construction in West Virginia involves the assembling of parts manufactured outside of the State of West Virginia. While the prefabrication of a storage tank out-of-state to be assembled in West Virginia is a spectacular example of out-of-state parts being assembled by a contractor, nonetheless, most of the toilets, hardware, kitchen equipment, carpet, windows, and heating systems installed in buildings constructed in West Virginia have been manufactured elsewhere.¹¹⁷

The court intended that this comparison support the state's subjecting the entire contract price to the tax rather than only the part of the contract price which actually related to West Virginia activities, that part being erection activities.

Again the court seems to have incorrectly construed the requirement that a rational relationship exist between activities carried on within the state and the income taxed. On the assumption that the contract contemplated payment for design and fabrication, as well as for erection of the tank, logic would suggest that part of the contract price should be attributed to design and fabrication. Surely the taxpayer contemplated such payment in negotiating the contract. Then, if "contracting" is limited to "erection,"¹¹⁸ only the price attributable to putting together the tank and the other incidental West Virginia activities should constitute the base for the tax. Design and fabrication clearly occurred outside the state of West Virginia.

The majority's comparison of this taxpayer to a building contractor who performs his contract with hardware made outside West Virginia is misleading. Presumably, the point of the comparison was to suggest that the taxpayer had been paid the entire contract price only for erecting a water tank in West Virginia and where or how it acquired the materials to perform the contract was immaterial. Moreover, since the "erecting" took place here, the entire contract price was taxable. That reasoning is superficially attractive. But here the taxpayer itself designed and manufactured the materials which it later erected. That fact alone nullifies the validity of the court's suggestion.

A building contractor who agrees to erect a building for \$100,000.00, which

¹¹⁶ *Id.* at 610-11.

¹¹⁷ *Id.*

¹¹⁸ See *Koppers Co. v. Dailey*, 280 S.E.2d 248 (W. Va. 1981), which held that certain activity constituted "contracting" and not "services." *Koppers* involved building coke ovens for Weirton Steel, among other things. There were three contracts: one for the cost of material, one for the cost of erection, and one for the cost of engineering. The lower court treated all three contracts as one. The finding was not disputed by the taxpayer.

Koppers installed precipitators to remove fly ash for Ohio Power. Some of the components of the precipitators were fabricated out of state. Whether this fabrication was unconstitutionally made part of the tax base was not in issue.

price includes the cost and installation of toilets and other hardware, is indeed paid for the gathering of the materials and putting them all together as the final building. In that case, the entire \$100,000.00 should be subject to tax under the "contracting" category. If the building is built in West Virginia, then the entire \$100,000.00 is subject to West Virginia's taxing jurisdiction. On the other hand, if the contractor (the erector) fabricates or manufactures some of the materials to be erected, and if the parties to the contract contemplate that the total price is attributable in part to erection, in part to design, and in part to fabrication, it cannot be said the full price is paid for erection. Fabricators are both manufacturers and contractors. How to tax them has always been a troublesome question, particularly where state tax statutes have separate categories as does the B & O Tax¹¹⁹ and the Sales and Use Tax.¹²⁰ Pittsburgh was paid for several different activities. To the extent that some of these activities took place in Pennsylvania, they should not attract the West Virginia tax. No rational relationship exists between those activities and the income taxed so far as West Virginia is concerned. Hence, the imposition of tax violates the requirements of due process.

The concurring opinion, however, lends some substantial support to the majority. It relies upon *Dravo Contracting Co. v. James*¹²¹ which held, in the case of a dam contractor, that certain fabricated materials made in Pennsylvania would not escape the West Virginia B & O Tax "if they were used in the performance of the contract in West Virginia and payments made the contractor were dependent upon such use."¹²² Apparently this is the general rule.¹²³ But the statute at the time of *Dravo* was not as specific as it is today. Today, the definition of "contracting" includes the erection or construction of real property. If the difference in definition is at all limiting, then arguably *Pittsburgh* can be distinguished. However, one might counter just as forcefully that no significant change has been made; hence, the tax was properly applied

¹¹⁹ Compare W. VA. CODE § 11-13-2b (Supp. 1982) (manufacturing) with W. VA. CODE § 11-13-2c (1974) (contracting). See also West Virginia State Tax Dep't Administrative Decision 82-19-B dealing with the manufacturing and service categories under the B & O Tax.

¹²⁰ W. VA. CODE § 11-15-1 (1974) and § 11-15A-1 (1974). The problem under a sales and use tax is whether the person is a contractor who is the consumer and thus taxable, or one who merely provides services in performing a contract. Another difficulty is the distinction between a manufacturer who allegedly sells at retail (no sales tax on his purchases) and a fabricator who makes custom pieces and then installs them. Is the latter a "contractor," subject to sales tax on his purchases, or a retailer (no tax on his purchases) selling products with a separate charge for installation?

Sales of computer software raise a similar issue, that is, whether tangible personal property is manufactured and sold as such or whether merely services are being provided which result in tangible personal property. Several states take the position that the sale of canned programs are taxable sales of tangible personal property while the sale of specially designed custom programs constitute non-taxable sales of services. See Note, *Sales and Use Tax of Computer Software — Is Software Tangible Personal Property?* 27 WAYNE L. REV. 1503 (1981); Politi, Babiarz & Ferrante, *Sales Taxation of Computer Software and Hardware: A Massachusetts Perspective*, 1 J. ST. TAX'N 329 (1983).

¹²¹ 114 F.2d 242 (4th Cir. 1940).

¹²² *Id.* at 246. This position is reflected in B & O Tax Reg. § 3.2. See *supra* note 58.

¹²³ See cases cited for this proposition at 264 S.E.2d 604, 620 (W. Va. 1979).

against the entire contract price even though the result seems wrong from the due process point of view.¹²⁴

The validity of the taxation of the Pittsburgh firm was premised on the assumption that the activity being taxed occurred entirely within West Virginia, namely, the erection of fabricated materials. Thus, since the activity was deemed to have taken place solely in West Virginia, no need for apportionment existed. Apportionment was automatic. While taxation based upon the entire contract price does not seem fair or proper, the concurring justice certainly had precedent upon which to base his decision.

D. B & O Decisions Following the Penney Trilogy

After the *Penney* trilogy, only one West Virginia case prompted any significant analysis of either the due process or commerce clauses. That case is *Cincinnati Milacron Co. v. Hardesty*.¹²⁵ Several other cases touched on those clauses, but not to any great degree nor on facts of any general application. They are *Newell Bridge and Railway Co. v. Dailey*,¹²⁶ *Bishop Coal Co. v. Dailey*,¹²⁷ and *Capitol Cablevision Corp. v. Hardesty*.¹²⁸

Milacron involved another sales-of-property question under the B & O Tax. Two divisions of an Ohio company sent nonresident regional salesmen into West Virginia. The salesman from the Machine Tool Division spent 45% of his time here and obtained about 45% of his total sales receipts from West Virginia sales. He would discuss and recommend tools. If his company had no appropriate tools, he would have the Cincinnati shop design and make them. The Cincinnati home office decided whether to accept or reject West Virginia orders. The customer normally visited the factory and checked the machine,

¹²⁴ Had all the activities in *Pittsburgh-Des Moines* taken place in West Virginia, that is, the fabricating and designing as well as the erection of the tanks, the State Tax Department would categorize all activities as "contracting." See *Armstrong Inc. v. Hardesty*, CA 78-C-256 (Cir. Ct. of Randolph County, 1979). Hence, there would appear to be no discrimination between the out-of-state contractor and the in-state contractor, insofar as classification is concerned.

However, the apportionment regulation (B & O Tax Reg. § 3.2) indicates the contrary where fabrication occurs in West Virginia for out-of-state construction. In that case, the fabrication would be taxed in the manufacturing category according to the regulation. Still, the question whether West Virginia has the power to tax activities occurring outside the state is not resolved.

¹²⁵ 290 S.E.2d 902 (W. Va. 1982).

¹²⁶ 266 S.E.2d 453 (W. Va. 1980), *cert. denied*, 451 U.S. 942 (1981). In this case the taxpayer was assessed B & O Tax on gross receipts derived from operation of a toll bridge spanning the Ohio River and connecting Newell, West Virginia with E. Liverpool, Ohio. The court held that operation of the bridge was not "interstate commerce" and was thus not exempted from state taxation.

¹²⁷ 276 S.E.2d 220 (W. Va. 1981). The taxpayer's mine extended across state lines. The taxpayer severed coal in Virginia, but cleaned and tipped it in West Virginia. The court held Bishop Coal Co. subject to the B & O Tax in the manufacturing category on its total gross receipts from the sale of coal. The court did not allow any apportionment of gross receipts for activities which took place in Virginia.

¹²⁸ 285 S.E.2d 412 (W. Va. 1981). Here the court held a cable television system subject to the B & O Tax on its gross receipts derived from business in West Virginia. Although the court recognized the system to be an integral part of interstate commerce, it reasoned that the company's income came from activities conducted wholly within the borders of the state.

then the machine would be shipped by Milacron and installed by the customer. After installation, a sales engineer would field-check the equipment. If any problems arose, a service representative would be sent to the site to correct the problem. The Products Division operated in the same fashion as the Machine Tool Division, but three of its salesmen spent only 3% of their time in West Virginia, where they made 5% of their total sales.

The court had no difficulty finding a taxable presence in West Virginia with respect to both the sales receipts and service receipts. The court cited *General Motors* and *Standard Pressed Steel* to support the nexus occasioned by the Products Division salesmen but set forth little analysis. The gist of the opinion is that Milacron was plying its trade in West Virginia and holding a market by virtue of the presence of its salesmen, hence, the taxable presence which forms the threshold nexus requirement under due process.¹²⁹

The court discussed the apportionment issue only long enough to characterize the tax as "self-apportioned."¹³⁰ But just as it failed to do in *J.C. Penney*, the court did not address the rational relationship requirement adequately. The discussion would have been appropriate since the case concerned interstate sales, the proceeds from which probably should have been apportioned to satisfy the rational relationship requirement of due process. After all, both in-state and out-of-state activities gave rise to the sales receipts. The service receipts clearly should be subject to the B & O Tax in their entirety because the services were performed in West Virginia.

Despite its failure to adequately attend to the rational relationship requirement of due process, the court in *Milacron* touched on an interesting aspect of the threshold requirement of a business presence.

Courts traditionally have held that mere solicitation does not establish a sufficient connection between the out-of-state seller of goods and the state of destination to support a gross receipts tax.¹³¹ Nonetheless, in *Milacron*, the

¹²⁹ *Milacron*, 290 S.E.2d at 903-04.

¹³⁰ *Id.* at 904.

¹³¹ See *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327 (1944).

In *Mueller Brass*, 255 Ind. 514, 265 N.E.2d 704 (1971), sales which were solicited by out-of-state salesmen, as opposed to sales which were connected with in-state offices, were held not subject to Indiana's gross receipts tax on the theory that the in-state activity in those instances was insufficient to take such sales out of the interstate sales category. So long as the sales were characterized as being interstate, they were not subject to taxation by the state because to do so would violate the commerce clause. The main concern of cases like *Mueller* is the commerce clause, although it appears that the courts inadvertently slip into due process analysis even though the actual holding is based squarely and only on the commerce clause.

For an earlier Indiana case similar to *Mueller* and holding the same way, see *Department of State Revenue v. Owens-Corning Fiberglass Corp.*, 263 Ind. 102, 251 N.E.2d 818 (1969). See also *B.F. Goodrich Co. v. State*, 38 Wash. 2d 663, 231 P.2d 325 (1951), which followed *Norton* and is similar to *Mueller* and *Owens-Corning*. The *Goodrich* decision immediately followed *Norton*. *Norton* was handed down after the argument in *Goodrich* but before the Washington court had reached its decision. These cases rested largely on commerce clause considerations, as did *Norton*. But see *Reynolds Metal Co. v. Indiana Department of State Revenue*, 433 N.E.2d 1 (Ind. App. 1982); *Indiana Department of State Revenue v. General Foods Corp.*, 427 N.E.2d 665 (Ind. App. 1981). In *General Motors* and *Standard Pressed Steel*, the United States Supreme Court found

West Virginia court took a position based on economic reality. The court's premise was that if a taxpayer generates income through activities in West Virginia, whatever those activities are, it has a business presence here sufficient to satisfy due process. Businesses must pay a price for carrying on a business in West Virginia; namely, paying their share of the cost of the government which permits their activities to be carried on freely.

The question that must be focused upon more clearly is how much of the income generated by any activity should be attributed to the state as the base from which that liability is discharged. For if the business presence test is expanding,¹³² then the rational relationship requirement becomes commensurately more important as the only real due process limitation.

V. CARRIER INCOME TAX DECISIONS

The court decided three cases through one opinion dealing with the application of the Carrier Income Tax.¹³³ This tax is a gross receipts tax on receipts arising from transportation and telephone and telegraph activities between points in West Virginia.¹³⁴ Where the activities are interstate, an additional tax

such substantial in-state activity that it associated sales with that activity and found all sales to be taxable in their entirety, in spite of *Norton* and without any apportionment.

When *Complete Auto* put to rest the notion that activities which constituted solely interstate commerce could not be taxed by the states, the *Mueller* and *Norton* line of cases lost a good deal of force. For if a threshold nexus exists, the fact that the transaction is an interstate sale is not alone enough to avoid state taxation. So long as the *Complete Auto* standards are met, a tax on the sale should withstand a commerce clause challenge.

In the *Mueller*-type of situation either the "isolated" sales activities are not, in fact, isolated from the other activities of the taxpayer; or, if they are isolated, they themselves establish a sufficient threshold due process nexus. With the interstate commerce immunity clearly dismantled after *Complete Auto* (and perhaps before in *Western Live Stock*, *General Motors*, and *Standard Pressed Steel*) *Mueller*-type sales should be subject to state taxation. The only remaining difficulty is the problem of apportionment to meet the rational relationship requirement of due process.

Of course, in the case of a net income tax, or a tax measured by net income, if the only activity of the out-of-state business is merely solicitation, Pub. L. No. 86-272, 73 Stat. 555 (1959) codified as amended at 15 U.S.C. § 381 (1976), prohibits the host state from imposing its tax on such out-of-state business. For a recent case giving a broad interpretation to "solicitation," see *U.S. Tobacco Co. v. Commonwealth of Pennsylvania*, 478 Pa. 125, 386 A.2d 471 (1978), cert. denied, 439 U.S. 880 (1978).

¹³² In his dissent in *Cincinnati Milacron*, Justice McHugh observed that "[t]here has been a steady erosion in the [threshold] nexus required." 290 S.E.2d 902, 905 (W. Va. 1982). Rather than view this requirement as being eroded, it is suggested that threshold nexus has expanded as our economy and business have become more sophisticated. Two cases involving *Mueller*-type situations and the question of threshold nexus are presently before the West Virginia Supreme Court of Appeals. *Armco, Inc. v. Hardesty*, Circuit Court of Kanawha County, Civ. Action No. AP-CA-78-8 (1980), and *Williams and Co., Inc. v. Dailey*, Circuit Court of Kanawha County, Civ. Action No. AP-CA-76-100 (1981). Both cases were argued on January 11, 1983.

¹³³ *Western Md. Ry. v. Goodwin*, 282 S.E.2d 240 (W. Va. 1981), appeal dismissed, 102 S. Ct. 2025 (1982). The other cases decided in the opinion were *West Va. Motor Delivery Co. v. Goodwin* and *Union Barge Line v. Hardesty*. Both *Western Maryland* and *Union Barge* appealed to the United States Supreme Court, but the appeal was dismissed for want of a substantial federal question.

¹³⁴ W. VA. CODE § 11-12A-2 (1974 & Supp. 1982).

is imposed on net income apportioned to West Virginia on a mileage basis.¹³⁵ When net income is determined, an adjustment is made if tax is due under the gross income provision.¹³⁶ Of the three cases decided together, only the third raised significant constitutional questions. Nevertheless the first two involved issues worthy of note.

A. *Western Maryland*

In *Western Maryland Railway Co. v. Goodwin*, the major issue was whether receipts from demurrage¹³⁷ arising from railroad cars in West Virginia as well as receipts from switching railroad cars in West Virginia should be taxed under the gross income provision or the apportioned net income provision. The taxpayer, Western Maryland, argued that if the receipts arose from interstate commerce, only the net income from those activities should be taxed. Western Maryland treated the revenues from these activities as being from interstate commerce whenever the railroad cars involved had either begun their movement or ended it outside West Virginia. But if the origin and destination of the cars were both in West Virginia, the taxpayer included those demurrage and switching charges in the gross income portion of the Carrier Income Tax.

The court held that demurrage for undue retention of cars in West Virginia constituted business beginning and ending in this state, regardless of the ultimate origin or destination of the cars. Thus the court rejected the taxpayer's argument that a two-point West Virginia activity which is part of interstate commerce must be taxed under the net income provision. The demurrage was therefore subject to the gross income part of the tax.¹³⁸ The court also held that switching is a local activity and deemed it business beginning and ending in West Virginia. Hence, all West Virginia switching charges were held subject to the tax on gross income.¹³⁹

The court easily disposed of the constitutional issues. Nexus obviously was present. No multiple taxation could exist, said the court, because the activities taxed took place only in West Virginia.¹⁴⁰ Since the activities attracting the tax took place solely within West Virginia, the rational relationship required by due process also was met, although the court did not specifically address this

¹³⁵ W. VA. CODE § 11-12A-3 (1974 & Supp. 1982).

¹³⁶ W. VA. CODE § 11-12A-3(g) (1974) provides:

(g) In computing the tax imposed by this section, the total net income of a taxpayer who shall have been taxed under the preceding section [§ 11-12A-2] shall be reduced by an amount bearing the proportion to such total net income that the gross income of the taxpayer which is the measure of the tax under the preceding section [§ 11-12A-2] bears to its total gross income from all business done wherever conducted. No county, city, town, village or other political subdivision of the State shall levy a license, net income or any other kind of tax on the business taxed under this article.

¹³⁷ Demurrage is the charge made for retention of the railroad car beyond the scheduled departure date because of loading or unloading.

¹³⁸ *Western Md.*, 282 S.E.2d at 247.

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 247-48.

aspect of due process. Thus, where the activity takes place entirely within the state, as in *Complete Auto* and *Stevedoring*, the tax is self-apportioning even though the activity is a part of interstate commerce.¹⁴¹

B. Motor Delivery

West Virginia Motor Delivery Co. v. Goodwin,¹⁴² the second case decided of the three, involved a factual pattern similar to that in *Complete Auto*.¹⁴³ West Virginia Motor delivered refrigerated meat by truck. It received shipments at its West Virginia warehouse from out-of-state packers. Then the company either transferred the meat to its own trucks or stored the meat overnight in its warehouse. West Virginia Motor then delivered the meat to both in-state and out-of-state customers. Eighty-eight percent of its business was attributable to in-state delivery.

The taxpayer took the position that its business was part of a continuous interstate shipment of goods and paid tax only on a net income basis. The court agreed that the taxpayer was involved in interstate business, but it held that the receipts from its deliveries to West Virginia customers were from activity conducted from points entirely within West Virginia and were subject to the gross receipts portion of the tax.¹⁴⁴ With respect to eighty-eight percent of its business, West Virginia Motor was paid for transporting meat from one point in West Virginia to another point in West Virginia. The fact that the transportation occurred in an interstate setting was not material.

As far as due process is concerned, this case deserves the same comments as *Western Maryland*. The business presence was clear. The rational relationship was obvious because activity generating the income took place entirely within West Virginia. *Complete Auto* clearly controls any commerce clause question since its factual situation is so close to that of *West Virginia Motor*.¹⁴⁵

¹⁴¹ *Western Maryland* also argued for equal protection, claiming that since trucks were exempt from the gross tax "when the activity is part of an uninterrupted continuation of interstate transportation," it should be exempt also. The court found this appealing argument to be premature because the provision for trucks cited by *Western Maryland* was an amendment applicable only after the tax years in question. *Id.* at 248.

In addition, *Western Maryland* argued that the net income tax base for West Virginia should be the same as the federal in all respects. It therefore carried back and forward a net operating loss and showed no West Virginia net income for two years. The court held here that such a benefit was not intended and referred to the commissioner's discretionary authority to consider federal income in establishing the net income base for the Carrier Income Tax. *Id.*

¹⁴² 282 S.E.2d 240 (W. Va. 1981).

¹⁴³ In *Complete Auto*, cars were shipped from outside the state into Mississippi. The taxpayer picked up the cars at a point within Mississippi and delivered them to a point within Mississippi. It was the taxation of the compensation received for that transportation which was the issue.

¹⁴⁴ *Motor Delivery Co.*, 282 S.E.2d at 249.

¹⁴⁵ The court ruled against the taxpayer on the collateral issue whether the Tax Department was estopped from making the assessment involved since under an earlier, but similar, version of the tax, the Tax Department had taken a position favorable to the taxpayer, which position it had now abandoned. *Id.* at 249.

C. *Union Barge*

The last case in this trio is *Union Barge Line Corp. v. Hardesty*.¹⁴⁶ The barge company engaged in two-point business (origin and destination in West Virginia), one-point business (either origin or destination in West Virginia) and pass-through business (neither origin nor destination in West Virginia). The two-point business income was not in issue, but the income from the other businesses was.

Union Barge was a Pittsburgh company with no office, employees, agents, or place of business in West Virginia. Nonetheless, the court found that Union Barge's wholly in-state business was carried on principally to maintain its one-point and pass-through business. One-point and pass-through business generated significantly more income than the relatively small in-state operation.¹⁴⁷ Furthermore, the court found a number of West Virginia contacts: the barges, owned by the taxpayer for the most part, docked in West Virginia; the taxpayer charged demurrage; the taxpayer bought food and fuel for its crews and tugboats from West Virginia businesses; the company sometimes used West Virginia as a drop-off and pick-up point for its employees, some of whom lived in West Virginia; the company had repairs done in West Virginia, or, if necessary, sent in its own repair crews.

Relying primarily on *Ott v. Mississippi Valley Barge Line, Co.*,¹⁴⁸ the court had no difficulty finding a business presence in West Virginia.¹⁴⁹ In *Ott*, the barge business was of the one-point variety. But even without *Ott* and the other cases cited, it is clear enough that a business presence existed in the case of the one-point business.

Extending a *Penney*-type approach to *Union Barge*, the court viewed the total activity as establishing a sufficient threshold nexus. The court did not isolate each activity for this analysis. Had the court done so, perhaps the pass-through business would have lacked the threshold nexus to subject it to West Virginia's tax. Yet the tenor of the opinion suggests that the opposite result may have been reached. While not actually being paid for delivery of goods in West Virginia, nevertheless Union Barge was plying its trade in that state. It took advantage of a civilized society to move its barges through West Virginia as part of its business operation. After finding threshold nexus, the rational relationship test of due process was easily met because the mileage formula established that relationship between activities carried on in West Virginia and the income taxed.¹⁵⁰

Union Barge also challenged the tax on the basis that it was not in relation

¹⁴⁶ 282 S.E.2d 240 (W. Va. 1981).

¹⁴⁷ The court noted that traffic between two points within West Virginia comprised only one fifteen-hundredth (1/1,500) of all of Union Barge's traffic everywhere in 1977. *Id.* at 251.

¹⁴⁸ 336 U.S. 169 (1940).

¹⁴⁹ *Union Barge*, 282 S.E.2d at 253.

¹⁵⁰ *Id.* The court was not really dealing with due process but with the apportionment requirement under the *Complete Auto* commerce clause test to avoid multiple taxation. However, apportionment for that purpose should be equally applicable to due process.

to benefits received from the state — the fourth prong of the *Complete Auto* commerce clause test. The court concluded that the taxpayer had not carried its burden “to show that the inferences of benefits received through its in-state activities are unfounded.”¹⁵¹ The court then proceeded to set forth benefits which the taxpayer appeared to receive from the state and for which the state could ask return, citing *Wisconsin v. J.C. Penney*.¹⁵²

The last part of the opinion contains a plea for taxpayers to come forward with the kind of evidence necessary to overcome the presumption of constitutionality of the tax laws. The court urged the legislature to rethink its interstate commerce tax policy with an eye to fairness under the *Complete Auto* standards.¹⁵³ This gratuitous discussion seems to be an invitation to West Virginia taxpayers not to give up the fight even though every one of them who has so far come before the court on constitutional interstate taxation issues, starting with *J.C. Penney*, has lost. The court also seems to acknowledge implicitly that it perhaps has reached the outer limits of constitutional permissiveness in the area of interstate taxation. The court may be signaling that it will take a slightly different direction in the future.¹⁵⁴

VI. CONCLUSION

As evidenced by the cases discussed here, it is clear that a business presence to satisfy fourteenth amendment due process will be found almost always and may well not be limited to the more traditional approach referred to in the analysis of *J.C. Penney*, *Milacron*, and *Union Barge*. The simple test is

¹⁵¹ *Id.* at 253.

¹⁵² 311 U.S. 435, 445 (1940).

While the challenge was phrased in terms of the relation between benefits received and tax paid, the fourth prong refers to a fair relation between tax paid and “services provided.” In an attempt to show that Montana’s severance tax on coal was unconstitutional, Commonwealth Edison interpreted this test to mean that it must not pay any more tax than the state incurred in service costs because of the mining. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 620-29 (1981). The court rejected this interpretation because it would permit interstate business to support only its specific in-state activity while intrastate business would not be so limited and would have to support the general well-being of the state. The Court went on to find, in so many words, that the fourth prong was nothing more than an extension of the first prong threshold nexus, a due process requirement. That extension is simply the rational relationship between the in-state activities and the measure of the tax. This is the due process rational relationship test. Therefore, the fourth prong in the *Complete Auto* test virtually has been wiped out, leaving as commerce clause issues multiple taxation or some other form of discrimination favoring intrastate business over interstate business. *Union Barge* was remanded on the apportionment issue to determine the correct number of miles because the taxpayer alleged that the Ohio River had shifted so that the taxpayer traveled more Ohio miles than had been accounted for in the formula.

¹⁵³ *Union Barge*, 282 S.E.2d at 254-55. There is certainly hope for the legislature’s involvement because a Tax Study Commission was established in 1982 to review the entire tax structure in West Virginia. Its final report is due for the 1984 General Session. House Concurrent Resolution No. 18, adopted Mar. 13, 1982.

¹⁵⁴ Indeed the United States Supreme Court, after a series of victories for state tax administrators, appears to have put on the brakes in the “unitary business” and “foreign source dividend” areas under state net income taxes. See *ASARCO, Inc. v. Idaho State Tax Comm’n*, 102 S. Ct. 3103 (1982), *reh’g denied*, 103 S. Ct. 275 (1983) and *F.W. Woolworth Co. v. Taxation and Revenue Dep’t*, 102 S. Ct. 3128 (1982), *reh’g denied*, 103 S. Ct. 274 (1983).

whether the taxpayer is to be found plying its trade in West Virginia.¹⁵⁵ Such a test is valid and should even reach an interstate mail-order business. However, expanding the threshold requirement means that the rational relationship test must be rigorously enforced.

The rational relationship, though, appears not to have been sufficiently analyzed by the West Virginia court. Most of the court's discussions of apportionment have arisen in the context of, or at least with the emphasis upon, the commerce clause — avoidance of multiple taxation. The court has easily found that almost every activity subject to the B & O Tax took place wholly within West Virginia, and that therefore, the tax was self-apportioning, with all proceeds subject to tax by West Virginia. Self-apportionment was an applicable concept in the Carrier Income Tax cases where the gross tax was imposed; it was not always applicable in the B & O Tax cases involving interstate sales, services, and contracting.

The rational relationship required by due process is usually met when net income is apportioned. But it does not follow that income generated by activities taxed under a gross receipts tax is self-apportioning, especially when part of the activity takes place outside the taxing state. Either apportionment or specific allocation is necessary in those cases to truly meet the rational relationship requirement — a relationship between the activities taxed and the income they generate. Those activities generating income in a gross receipts tax setting must be confined to the taxing state with only the consequent amount of income thus being taxed.

While apportionment would probably create problems of its own, as was suggested in the Willis Subcommittee Report,¹⁵⁶ it seems to be the most logical way of satisfying the rational relationship required by due process. Furthermore, apportionment will also avoid multiple taxation and go a long way to avoid discrimination against interstate business, the second and third *Complete Auto* commerce clause tests. Another result would be to maintain parity between intrastate and interstate business because apportionment would avoid granting interstate business tax exempt status; that business would support government, as does the local business, but only to the extent to which it operates in that state.¹⁵⁷

Justice Neely's practical approach set out at the end of *Richardson, Gordon*¹⁵⁸ has much to commend it. That is, in sales-of-property cases, let the destination state impose the tax on the entire sales price. So long as the state of origin imposes no tax on the same activity or income, no multiple taxation

¹⁵⁵ This approach was not adopted by the Willis Subcommittee. It recommended that a gross receipts tax on sales of tangible personal property not be permitted "unless the company owns or leases realty in the State or has an employee whose services are performed entirely in the State." *Willis Subcommittee Report, supra* note 20 at 1196.

Over the years bills have been introduced in Congress generally reflecting the Subcommittee's position. The latest of such bills is H.R. 6042.

¹⁵⁶ *Willis Subcommittee Report, supra* note 20, at 1037.

¹⁵⁷ See *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981).

¹⁵⁸ 264 S.E.2d at 612.

can occur.¹⁵⁹ The nasty problem of apportionment disappears.

While this practical approach is sufficient and supportable for commerce clause purposes,¹⁶⁰ it cannot be accepted as a method of satisfying the rational relationship requirement of due process. Unlike the multiple taxation issue, when one state can tax all if no other does, due process is an absolute constraint on a state's taxing power. Because a business presence in a state is so easily found, the only remaining real and practical due process limitation on state taxation of interstate commerce is the rational relationship requirement. If the rational relationship does not exist in the taxing state between activities carried on there and the income taxed, the fourteenth amendment absolutely prohibits that state from imposing its tax—whether some other state forgoes taxation or not.

¹⁵⁹ One of the difficulties with the multiple taxation issue is that the taxpayer seldom proves there is in fact a tax imposed by more than one state on the same activity or income. If the proof is so difficult, one might wonder whether in many instances multiple taxation really exists.

¹⁶⁰ Technically, both the commerce clause and due process clause require apportionment of some sort. The commerce clause requirement is "fairly apportioned to activities" and the due process requirement is a "rational relationship." See *General Motors*, 377 U.S. 436, 449-51 (Brennan, J., dissenting). While these requirements embody much the same test, the commerce clause test seems generally to have been satisfied where there is no multiple taxation. Compare the majority opinion in *General Motors* with Justice Brennan's dissent in the same case.

