NORTH CAROLINA LAW REVIEW

Volume 56 | Number 5 Article 2

7-1-1978

State Jurisdiction to Tax Tangible Personal Property

Joseph S. Ferrell

Michael R. Smith

STATE JURISDICTION TO TAX TANGIBLE PERSONAL PROPERTY

JOSEPH S. FERRELL†
MICHAEL R. SMITH††

North Carolina is among the states that subject tangible personal property to ad valorem taxation.[1] By its nature, this species of property can be moved about from place to place. This characteristic means that it is often necessary to determine whether North Carolina has the power to subject certain tangible personalty to taxation at all[2] and, if so, which of the state's numerous taxing jurisdictions has this power under the tax situs rules laid down in the statutes.[3]

It is especially difficult to determine the tax status of goods and merchandise that are in North Carolina on tax day[4] in the course of manufacture, processing or shipment. This difficulty was amply illustrated by the recent decision of the North Carolina Supreme Court in *In re Hanes Dye & Finishing Co.*[5] There, the court held that the North Carolina statutes do not purport to tax tangible personal property owned by a nonresident that is

---

† Professor of Public Law and Government, Institute of Government, University of North Carolina at Chapel Hill; B.S. 1960, J.D. 1963, University of North Carolina; LL.M. 1964, Yale.

†† B.A. 1975, University of Michigan; Summer Law Clerk, 1977, Institute of Government, University of North Carolina at Chapel Hill; J.D. 1978, University of North Carolina.

1. The ad valorem tax is a "tax on property . . . based or measured by the value of the property as a marketable item." H. LEWIS, THE PROPERTY TAX IN NORTH CAROLINA 1 (Institute of Government, University of North Carolina at Chapel Hill, 1975).

2. The State of North Carolina has not regularly levied a property tax for general state purposes since 1921, but this tax remains the major source of revenue for local government. In the 1975-1976 fiscal year, the total property tax levies of North Carolina counties, municipalities and special districts amounted to about $682 million. TAX RESEARCH DIVISION, NORTH CAROLINA DEP'T OF REVENUE, STATISTICS OF TAXATION 117 (1976). By contrast, the state individual income tax collections for the same period were $604 million, *id.* at 39, and state sales tax collections were $465 million, *id.* at 63.

3. N.C. GEN. STAT. § 105-304 (1972 & Cum. Supp. 1977).

4. With minor exceptions, the value, ownership and situs of taxable property is determined annually as of January 1. *Id.* § 105-285 (Cum. Supp. 1977). This date is known among tax officials as "tax day."

5. 285 N.C. 598, 207 S.E.2d 729 (1974); *see* Ferrell & DeBaets, *Recent Legal Developments of Interest to Property Tax Administrators*, PROP. TAX BULL., No. 43, Mar. 3, 1975, at 1-5 (Institute of Government, University of North Carolina at Chapel Hill, 1975); Note, *Taxation—Personal Property Owned by Nonresidents: Taxable While at a North Carolina Manufacturing Plant?*, 53 N.C.L. REV. 1132 (1975); note 68 *infra*.

brought into the state solely for manufacturing or processing leading toward the production and sale outside the state of a finished, usable product. It is possible to interpret the statute differently, however. This article will offer an analytical framework for determining when North Carolina has the power to tax goods and merchandise that have no "more or less permanent"[6] location in this state but that happen to be here on tax day.

The property tax base is defined by North Carolina General Statutes section 105-274 as follows: "All property, real and personal, within the jurisdiction of the State shall be subject to taxation unless it is (1) [e]xcluded from the tax base by a statute of statewide application . . . or (2) [e]xempted from taxation by the Constitution or by a statute of statewide application . . . ."[7] Thus, a county assessor ordinarily has jurisdiction[8] to tax any personal property he finds within his taxing jurisdiction on tax day unless the owner can establish that it is specifically exempted or excluded from taxation.[9]

The key phrase in the statute is "within the jurisdiction of the State."[10] Does this mean "more or less permanently located" in North Carolina, as implied by the North Carolina Supreme Court in *Hanes*,[11] or does it have a broader meaning? It appears that the General Assembly intended to exercise the full power to tax property possessed by the State of North Carolina under the state constitution and the United States Constitution.

It was once thought that the concept of jurisdiction to tax property was bound up with the idea of domicile on the one hand and with the physical presence of the property within the borders of the state on the other.[12] The

6. The quoted phrase was used by the North Carolina Supreme Court in *In re* Pilot Freight Carriers, Inc., 263 N.C. 345, 351, 139 S.E.2d 633, 638 (1965), and was subsequently adopted by the General Assembly to determine intrastate situs of personal property. *See* N.C. GEN. STAT. § 105-304(b)(1) (1972); H. LEWIS, THE ANNOTATED MACHINERY ACT OF 1971, at 89 (Institute of Government, University of North Carolina at Chapel Hill, 1971).

7. N.C. GEN. STAT. § 105-274(a) (1972).

8. Jurisdictional analysis has frequently been complicated by a failure to recognize that the basic concept takes on a different meaning in a variety of relatively distinct contexts. "[T]he word 'jurisdiction' covers a multitude of ideas. It is indeed a chameleonic word, a cloak of many colors." A. EHRENZWEIG & D. LOUISELL, JURISDICTION IN A NUTSHELL—STATE AND FEDERAL 7 (3d ed. 1973). The meaning of jurisdiction adopted in this article is limited to determining when particular tangible personal property can be constitutionally subjected to ad valorem taxation.

9. Technically, there is a difference between exemption from taxation and exclusion from the tax base through exercise of the classification power. The practical result is, however, the same and the distinction is not pertinent to this discussion. *See* H. LEWIS, BASIC LEGAL PROBLEMS IN THE TAXATION OF PROPERTY (Institute of Government, University of North Carolina at Chapel Hill, 1958).

10. *See* text accompanying note 7 *supra*.

11. 285 N.C. at 610, 207 S.E.2d at 737.

12. *See* text accompanying notes 20-22, 36-41 *infra*. Professor Beale, in a classic article, declared that "[t]he power to tax is one of the attributes of sovereignty; and the jurisdiction to

domiciliary state of the owner of personal property, tangible and intangible, was said to have exclusive jurisdiction to tax that property without regard to its actual location, while the state of location of real property had exclusive jurisdiction to tax that property without regard to the domicile of the owner. The second part of this dichotomy still holds true.[13] The first has a certain naive charm and logical symmetry, but it has long been abandoned by the United States Supreme Court in favor of a more sophisticated approach grounded on the concept of fundamental fairness embodied in the due process clause[14] and the prohibition of state interference with the free flow of interstate commerce.[15] In the absence of clear evidence in the statute of a contrary intent, then, the preferable view is that the General Assembly intended to exercise all the power it has. Since the state constitution does not restrict the taxing power in ways relevant to the subject under consideration,[16] it is necessary to look to the federal constitution for the

exercise the power is coterminous with the bounds of the sovereign's jurisdiction." Beale, *Jurisdiction to Tax*, 32 HARV. L. REV. 587, 587 (1919). In 1921, another respected figure urged that "[t]he fundamental test which should be applied is whether or not the property is situated within the territorial jurisdiction of the state." Landis, *The Commerce Clause as a Restriction on State Taxation*, 20 MICH. L. REV. 50, 80 (1921).

13. *See, e.g.*, N.C. GEN. STAT. § 105-301 (1972).

14. *See* text accompanying notes 43-47 *infra*. *See also* W. BEAMAN, PAYING TAXES TO OTHER STATES 1·9 (1963); P. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 13-15 (1953); Nash, *Situs for Taxation of Tangible and Intangible Personalty*, 19 ORE. L. REV. 309, 316 (1940); Powell, *Taxation of Things in Transit*, 7 VA. L. REV. 167, 261 (1920). In Shaffer v. Heitner, 433 U.S. 186 (1977), the United States Supreme Court recently emphasized the importance of this requirement in a personal jurisdiction context in overruling the case of Pennoyer v. Neff, 95 U.S. 714 (1877). Rather than retain the strict territorial limits to jurisdiction imposed by *Pennoyer*, the Court held "[t]he standard for determining whether an exercise of jurisdiction . . . is consistent with the Due Process Clause is the minimum-contacts standard elucidated in *International Shoe*." 433 U.S. at 207 (citing International Shoe Co. v. Washington, 326 U.S. 310 (1945)).

15. *See* text accompanying notes 49-79 *infra*. *See also* W. BEAMAN, *supra* note 12, at 1·10, 14·9-·11; P. HARTMAN, *supra* note 14, at 73-79; Nash, *supra* note 14, at 316; Powell, *supra* note 14, at 192.

16. N.C. CONST. art. V, § 2(2), (3) provide that the General Assembly may exercise its power to define the tax base only by general laws uniformly applicable in every taxing jurisdiction and may not delegate these powers. These subsections do not address the extent of the taxing power. *Id.* § 2(1) provides that the taxing power shall be "exercised in a just and equitable manner," but there are no cases using this command as the basis for defining the extent of the power. *Id.* art. I, § 19 provides that no person may be deprived of "life, liberty, or property, but by the law of the land" and guarantees to all persons "equal protection of the laws." These provisions have been held repeatedly to be equivalent to the due process and equal protection clauses of the United States Constitution. *See, e.g.*, *In re* Moore, 289 N.C. 95, 221 S.E.2d 307 (1976) ("law of the land" is synonymous with "due process of law"); S.S. Kresge Co. v. Davis, 277 N.C. 654, 178 S.E.2d 832 (1971) (equal protection principle of fourteenth amendment now incorporated into Constitution of North Carolina). While decisions of the United States Supreme Court construing the due process and equal protection clauses are not controlling with respect to interpretation of N.C. CONST. art. I, § 19, the North Carolina Supreme Court has generally looked to federal case law in this regard. *See* Bulova Watch Co. v. Brand Distrib., Inc., 285 N.C. 467, 206 S.E.2d 141 (1974); Horton v. Gulledge, 277 N.C. 353, 177 S.E.2d 885 (1970).

dimensions of a state's power to tax tangible personal property and, hence, for the meaning of the statute.

The courts have generated different analytical approaches to jurisdiction for each of the four general categories of personalty: instrumentalities of commerce; intangibles; goods and merchandise; and equipment and machinery.[17] While North Carolina statutes[18] endeavor "to provide the machinery for the listing, appraisal, and assessment of property and the levy and collection of taxes on property by counties and municipalities,"[19] they offer no guidance for making the preliminary and necessary determination of jurisdiction to tax specific property. This omission seems well advised. The application of complex constitutional concepts to the wide variety of fact situations involved in jurisdictional determinations is more suited to the judicial than the legislative process.

Although this article focuses on the analytical approach taken by the courts with respect to state jurisdiction to tax goods and merchandise, a basic understanding of the jurisdictional approaches taken with respect to two of the other categories of personal property—instrumentalities of commerce and intangibles—is useful in accurately identifying and understanding the separate legal tests applicable to fact patterns involving goods and merchandise.

The courts have continually modified their approach in determining the jurisdiction of a state to impose a property tax on ships, planes, railroad cars and other instrumentalities of commerce. These vessels are constantly moving from place to place and are not in fact sufficiently settled to be considered as permanently located anywhere. Relying on an approach long since abandoned, the early cases in this area ignored constitutional issues and relied on the maxim of *mobilia sequuntur personam* to establish a more or less fictional tax situs for instrumentalities of commerce.[20] This jurisdictional fiction empowered the owner's domicile or the corporation's state of charter to tax property that had no actual situs elsewhere or was incapable of acquiring such situs. With respect to California's ability to tax New York

17. With respect to machinery and equipment, establishing jurisdiction to tax has generally paralleled the treatment afforded real property. Although potentially movable, this category of personal property is almost always permanently located and likewise satisfies the requirements of territoriality and makes inapplicable the limitations of the commerce clause in establishing the state's jurisdiction to tax the property at its permanent situs.

18. N.C. GEN. STAT. §§ 105-271 to -395 (1972 & Cum. Supp. 1977) (the Machinery Act).

19. *Id.* § 105-272 (1972).

20. *See* Beale, *The Situs of Things*, 28 YALE L.J. 525, 528 (1919). Situs, according to Professor Beale, "does not include the mere temporary location of a thing, but refers solely to a location which has such a degree of permanence that the thing may fairly be described as *settled* within the place and as forming a *part of the mass of property* in that place." *Id.* at 525.

ships in port several days for repairs, for example, the United States Supreme Court articulated the essence of this approach:

> We are satisfied that the State of California had no jurisdiction over these vessels for the purpose of taxation; they were not, properly, abiding within its limits, so as to become incorporated with the other personal property of the State; they were there but temporarily, engaged in lawful trade and commerce, with their *situs* at the home port . . . where the owners were liable to be taxed for the capital invested, and where the taxes had been paid.[21]

Where property became sufficiently settled in a place to have acquired actual situs, the owner's domicile no longer enjoyed the right to tax.[22] The early cases,[23] then, established two propositions: (1) without situs any attempt to tax would be beyond the power of the state, and (2) temporary presence within the borders of the state alone would not establish situs.

The conception of situs that allowed the domiciliary state to tax all instrumentalities of commerce in the absence of a specifically established situs elsewhere was abandoned near the turn of the century in favor of a fourteenth amendment/due process approach.[24] Following this constitutional approach, courts have permitted the taxation of instrumentalities by two or more states based on a fair apportionment of the commerce carried on within each state.[25] This line of jurisdictional analysis has developed to such an extent that "the domiciliary State is precluded from imposing an ad valorem tax on any property to the extent that it *could* be taxed by another State, not merely on such property as *is* subjected to tax elsewhere."[26] The ultimate question under the modern approach to determining jurisdiction to tax the means of transport has been clearly stated by the Supreme Court as "whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing State."[27] A property tax imposed under this approach more closely corresponds to the benefits actually received than a levy under the fictional situs analysis.

21. Hays v. Pacific Mail S.S. Co., 58 U.S. (17 How.) 596, 599-600 (1855); *see* Morgan v. Parham, 83 U.S. (16 Wall.) 471 (1873); St. Louis v. Wiggins Ferry Co., 78 U.S. (11 Wall.) 423 (1871); North Cent. R.R. v. Jackson, 74 U.S. (7 Wall.) 262 (1869).

22. Beale, *supra* note 20, at 528.

23. *See* cases cited note 21 *supra*.

24. *See* Union Refrigerator Transit Co. v. Kentucky, 199 U.S. 194 (1905); Old Dominion S.S. Co. v. Virginia, 198 U.S. 299 (1905); Louisville & Jeffersonville Ferry Co. v. Kentucky, 188 U.S. 385 (1903); Powell, *supra* note 14, at 249-50.

25. *See* W. BEAMAN, *supra* note 14, at 14-12, -13; P. HARTMAN, *supra* note 14, at 84-95. Instrumentalities of commerce in interstate transit are not immune from property taxation. Pullman Co. v. Richardson, 261 U.S. 330, 331 (1923).

26. Central R.R. v. Pennsylvania, 370 U.S. 607, 614 (1962) (emphasis in original).

27. Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169, 174 (1949).

A somewhat similar approach has been adopted by the courts with respect to a state's jurisdiction to tax various forms of intangible personal property. As with instrumentalities of commerce, the owner's domicile was originally presumed the proper taxing authority via the maxim *mobilia sequuntur personam*.[28] This concept also operated to avoid double taxation. Later, the Supreme Court abandoned this fiction and recognized the special nature of intangible property rights:[29]

> Such rights are but relationships between persons, natural or corporate, which the law recognizes by attaching to them certain sanctions enforceable in courts. The power of government over them and the protection which it gives them cannot be exerted through control of a physical thing. They can be made effective only through control over and protection afforded to those persons whose relationships are the origin of the rights.[30]

Eventually the Supreme Court adopted a fourteenth amendment analysis that permitted more than one state to levy a tax on intangible property that could not be reduced to a single location.[31] In order to satisfy the due process requirements that establish the power of each state to tax intangible personalty it must be determined "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return."[32] As with instrumentalities of commerce, then, the judicial approaches to determining whether a state has the power to tax intangible personal property have evolved from a beginning reliance on general principles of territoriality to an application of basic constitutional concepts.

Contrary to the specialized lines of jurisdictional analysis adopted with respect to instrumentalities of commerce and intangibles, the approach for determining jurisdiction to tax goods and merchandise has centered around the commerce clause. The Supreme Court articulated the rather formal distinction between the constitutional analysis applicable to merchandise and that applicable to instrumentalities of commerce in *Braniff Airways, Inc. v. Nebraska State Board of Equalization & Assessment*:[33]

> While the question of whether a commodity en route to market is sufficiently settled in a state for purpose of subjection to a property

28. *See* text accompanying note 20 *supra*.
29. *See* P. HARTMAN, *supra* note 14, at 80.
30. Curry v. McCanless, 307 U.S. 357, 365-66 (1939).
31. *See* State Tax Comm'n v. Aldrich, 316 U.S. 174 (1942); Curry v. McCanless, 307 U.S. 357 (1939).
32. Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940); *see, e.g.*, Rhode Island Hosp. Trust Co. v. Doughton, 270 U.S. 69 (1926).
33. 347 U.S. 590 (1954).

> tax has been determined by this Court as a Commerce Clause question, the bare question whether an instrumentality of commerce has tax situs in a state for the purpose of subjection to a property tax is one of due process.[34]

Judicial confusion and misunderstanding of key concepts have historically made it difficult to arrive at a confident determination of jurisdiction to tax different types of merchandise. While this article attempts to make some order out of chaos, the advice of Justice Frankfurter should always be kept in mind:

> The power of the States to tax and the limitations upon that power imposed by the Commerce Clause have necessitated a long, continuous process of judicial adjustment . . . .
>
> The history of this problem is spread over hundreds of volumes of our Reports. To attempt to harmonize all that has been said in the past would neither clarify what has gone before nor guide the future. Suffice it to say that especially in this field opinions must be read in the setting of the particular cases and as the product of preoccupations with their special facts.[35]

With this warning and the emphasis on the commerce clause in mind, the following outline and analysis are suggested as a checklist for determining whether or not the imposition of the North Carolina ad valorem tax on goods and merchandise in the state will be upheld:

(1) Do the goods and merchandise have sufficient contacts with the state to give the sovereign the fundamental power to levy a tax without violating principles of situs or substantive due process?

(2) If so, are the commodities outside interstate commerce and therefore subject to the property tax? To answer this question in the affirmative it must be ascertained that the facts of a given case fall within one of the following patterns:

> (a) *Before transit begins*: Do operations affecting the goods or merchandise represent sufficiently local and preparatory acts so as not to constitute interstate commerce?
>
> (b) *Interruption of transit*: Do the reasons for the break in transit—business or safety—constitute a stoppage sufficient to remove the goods from interstate commerce?
>
> (c) *Termination of transit*: Do the surrounding circumstances indicate that interstate transit is completed so that the goods and merchandise are no longer immune from tax?

---

34. *Id.* at 598-99 (footnotes omitted).

35. Freeman v. Hewit, 329 U.S. 249, 251-52 (1946); *see* Page, *Jurisdiction to Tax Tangible Movables*, 1945 WIS. L. REV. 125, 154-55.

Both the due process and the commerce clause phases of the test must be answered affirmatively if North Carolina is to legally have the power and authority to levy a tax upon the particular goods or merchandise.

PHASE 1—SITUS AND DUE PROCESS

Although cases involving goods and merchandise rarely address the initial territorial question of state power, it is clear that the generally abandoned situs concept provides some limited guidance in establishing the Phase 1 requirement fundamental to jurisdiction.[36] Situs "refers solely to a location which has such a degree of permanence that the thing may fairly be described as *settled* within the place and as forming a *part of the mass of property* in that place."[37] Situs to tax exists if it can be established that certain goods or merchandise are within the state for a period of time under circumstances that would enable a reasonable person to consider them more or less permanently settled. A particular item only temporarily in the state does not satisfy this loosely described territorial requirement of jurisdiction.[38]

The practical difficulty of finding actual situs stems from a combination of the fictional nature of the concept and the inability of the courts to announce relatively clear criteria. Nevertheless, a basic understanding of situs should promote greater confidence in anyone able to satisfy the Court's earlier criteria in that a finding of actual situs will positively satisfy the Phase 1 requirement without requiring consideration of the more recent due process test. This method can be utilized, despite the abandonment of the situs concept by the courts, because it is difficult to envision a set of facts in which items of personalty could be more or less permanently in the state without at least enjoying the minimum benefits and protections of the sovereign necessary to satisfy the due process requirements[39] so essential to the state's power to tax.

It is important, however, to remain keenly aware of the inherent limitations in a situs-oriented approach to analyzing Phase 1 of the test. An inability to establish a sufficiently permanent relationship between the sovereign and various goods is not dispositive of the state's ability to impose a property tax. As a practical matter, goods or merchandise temporarily in

36. In spite of the fact "that the requirement of *situs* was definitely made part of the mandate of the Fourteenth Amendment," it is not unusual for courts to use the term "situs" when they actually mean due process. Powell, *supra* note 14, at 249. Nevertheless, "it seems reasonable to treat all talk of *situs* as related to the present-day conception of due process of law." *Id.* at 250.

37. Beale, *supra* note 20, at 525.

38. *See id.*

39. See text accompanying notes 42-48 *infra*.

the state may enjoy sufficient benefits to be taxable under a due process approach without being sufficiently "settled" to form a "part of the mass of property" taxable under the more stringent situs approach.[40] The concepts of situs and due process involve somewhat different points of emphasis and the courts have generally relied on one or the other as a means of answering this fundamental question of territoriality.[41] Flexibility and care are essential in this area, however, for it has traditionally involved the application of vaguely defined criteria to a wide variety of facts. In the event the situs requirement cannot be satisfied, the cautious and thoughtful tax attorney or assessor will always employ a due process test in answering this preliminary jurisdictional issue.

While the general concept of situs once formed the first basic territorial requirement for a state's jurisdiction to tax, today that requirement is applied as a mandate of the due process clause of the fourteenth amendment. It is settled that a state may not exert dominion over property beyond its borders without offending notions of due process as well as essential concepts of governmental and sovereign power. The Supreme Court has consistently declared that "no state may tax anything not within her jurisdiction without violating the Fourteenth Amendment"[42] and that a "state may not tax real property or tangible personal property lying outside her borders."[43] Thus, the threshold question is whether a particular commodity has sufficient contacts within the state to give the sovereign the essential power to tax.

The Supreme Court's clearest expression of the evolution from a situs to a due process analysis came in the case of *Wisconsin v. J.C. Penney Co.*,[44] in which the Court merged earlier tests by declaring that " '[t]axable event,' 'jurisdiction to tax,' 'business situs,' 'extraterritoriality,' are all compendious ways of implying the impotence of state power because state power has nothing on which to operate."[45] Justice Frankfurter, writing for the Court, then discussed the basic Phase 1 inquiry regarding state power or jurisdiction to tax:

---

40. *See* Beale, *supra* note 20, at 525.

41. In cases involving goods and merchandise, the courts often begin their jurisdictional analysis with the commerce clause limitations and assume that the preliminary due process requirements have been satisfied. These requirements are clearly an element of jurisdiction, however, and must be addressed in determining whether particular tangible personal property is subject to taxation. Consequently, the analysis in this section applies the basic concept of situs to tangible personalty and borrows applicable due process requirements from cases involving other forms of personal property.

42. Farmers Loan & Trust Co. v. Minnesota, 280 U.S. 204, 210 (1930).

43. A & P Co. v. Grosjean, 301 U.S. 412, 424 (1937).

44. 311 U.S. 435 (1940).

45. *Id.* at 444.

> That test is whether property was taken without due process of law, or . . . whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.[46]

Like the situs-oriented analysis, the due process approach presents a rather broadly drawn test that lacks helpful guidelines. Again, tax attorneys and assessors should concentrate on each fact situation in looking for relevant state contacts with the particular goods or merchandise. It is extremely important in making an accurate analysis to realize that satisfaction of the due process requirements is not keyed as strongly to the concept of permanence as is situs. The emphasis has generally been on the qualitative significance of the contact with the state, rather than the duration of that contact. Perhaps a better feel for this substantive due process analysis and some guide for discretion can be drawn from Justice Brown's opinion in *Union Refrigerator Transit Co. v. Kentucky*:[47]

> The power of taxation, indispensable to the existence of every civilized government, is exercised upon the assumption of an equivalent rendered to the taxpayer in the protection of his person and property, . . . or in the creation and maintenance of public conveniences in which he shares, such, for instance, as roads, bridges, [and] sidewalks . . . . If the taxing power be in no position to render these services, or otherwise to benefit the person or property taxed . . . the taxation of such property . . . partakes rather of the nature of an extortion than a tax, and has been repeatedly held by this court to be beyond the power of the legislature, and a taking of property without due process of law.[48]

While many of the cases that expressly consider these minimum substantive due process requirements involve the taxation of intangible property, the preliminary satisfaction of these requirements is equally necessary with regard to the taxation of goods and merchandise.

The apparent practical effect of such a broad due process analysis is to provide Phase 1 authority and jurisdiction to tax nearly all goods and merchandise within the physical borders of North Carolina. To the extent that various law enforcement practices join to ensure safe storage or passage, all goods in North Carolina are "protected" by the state. By providing

46. *Id.* The Court ultimately decided that the privilege of carrying on a business under the protection of Wisconsin law was sufficient to satisfy Justice Frankfurter's jurisdictional test and support the tax. *Id.* at 446.
47. 199 U.S. 194 (1905).
48. *Id.* at 202.

the roads and bridges over which merchandise is transported, North Carolina is arguably providing "something for which it can ask a return." Assessors and consulting attorneys should, nevertheless, carefully evaluate the facts and circumstances of each situation in light of the broad standards promulgated by the courts.

The previous analysis provides a general guide for making the preliminary territorial determination of whether the state has sufficient jurisdiction to tax particular goods and merchandise. If for some reason Phase 1 cannot be resolved in the affirmative, the state will have absolutely no authority to tax the items of personalty and Phase 2 will be irrelevant. The commerce clause variables considered in Phase 2 are best thought of as limiting factors that become a proper matter for consideration only after original jurisdiction to tax based on Phase 1 has clearly attached. If jurisdiction to tax goods or merchandise is found under the due process test of Phase 1, however, one must address the commerce clause limits imposed by Phase 2.

PHASE 2—THE COMMERCE CLAUSE

The United States Constitution provides that "[t]he Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."[49] In 1872, the Supreme Court refused to allow Pennsylvania to levy a property tax on freight transported interstate by rail or water because the tax was regarded as a "regulation" of commerce among the states.[50] In so holding the Court reasoned that since freight transportation is part of commerce,[51] a tax on the interstate transportation of such freight would be a regulation of commerce among the states.[52] But,

> whenever the subjects over which a power to regulate commerce is asserted are in their nature national, or admit of one uniform system or plan of regulation, they may justly be said to be of such nature as to require exclusive legislation by Congress. Surely transportation of passengers or merchandise through a State, or from one State to another, is of this nature.[53]

Thus, a state tax on freight moving into or out of the state interferes with this exclusive congressional power and violates the commerce clause. This significant precedent has been uniformly followed and the states have

49. U.S. CONST. art. I, § 8, cl. 3.

50. Reading R.R. v. Pennsylvania, 82 U.S. (15 Wall.) 232 (1873) (case of the State Freight Tax).

51. *Id.* at 275.

52. *Id.* at 275-76.

53. *Id.* at 279-80 (footnote omitted).

consistently been denied the power to tax goods and merchandise in transit.[54]

In determining whether a particular item of personalty is in interstate commerce and exempt from tax, the Court has generally relied on the concepts of time and motion. At three different points, goods and merchandise that have satisfied the preliminary Phase 1 substantive due process test are no longer exempted from the property tax by operation of the commerce clause: (1) before transit begins; (2) during an interruption of transit; and (3) following a termination of transit. At all other times the freight is presumed to be in interstate commerce and protected from the impediments of state taxation. To determine whether specific goods are in interstate commerce, one should select the basic approach outlined below that provides the closest analog to the facts at hand. Once within a specific pattern, the legal analysis should be applied that corresponds with that area to resolve whether the goods and merchandise are constitutionally beyond the state's ultimate jurisdiction or power to tax.

A. *Before Transit Begins*

In recognizing that goods and merchandise in interstate commerce cannot be taxed, the Supreme Court has necessarily acknowledged that such property is subject to the power of the state of origin prior to the final movement out of that state. In *Coe v. Errol*,[55] the Supreme Court held that logs cut in New Hampshire and detained either in the river or along the bank until higher water would permit shipment downstream were subject to taxation in New Hampshire. The Court's opinion emphasized:

> There must be a point of time when [goods destined for other states] cease to be governed exclusively by the domestic law and begin to be governed and protected by the national law of commercial regulation, and that moment seems to us to be a legitimate one for this purpose, in which they commence their final movement for transportation from the State of their origin to that of their destination.[56]

54. Instrumentalities of commerce do not enjoy the same commerce clause immunity, but are instead required to pay taxes on an apportioned basis. *See* text accompanying note 25 *supra*.

55. 116 U.S. 517 (1886). For an excellent and detailed discussion of the commerce clause limitations in a variety of areas concerning state taxation, see P. HARTMAN, *supra* note 14.

56. 116 U.S. at 525; *see* Walton v. Westwood, 73 Ill. 125 (1874); Ayer & Lord Tie Co. v. Keown, 122 Ky. 580, 93 S.W. 588 (1906); Maurer v. Cliff, 94 Mich. 194, 53 N.W. 1055 (1892); State v. Burlington Lumber Co., 118 Minn. 329, 136 N.W. 1033 (1912); State v. Taber Lumber Co., 101 Minn. 186, 112 N.W. 214 (1907); Winkley v. Newton, 67 N.H. 80, 36 A. 610 (1892); State v. Rose, 67 N.J.L. 86, 50 A. 364 (1901). *But see* Blount v. Munroe, 60 Ga. 61 (1878); Standard Oil Co. v. Bachelor, 89 Ind. 1 (1883).

This case clearly established the basic principle that a mere intention to ship is not sufficient to terminate established tax situs.[57] The Court recognized that an owner who plans to export his goods is under no duty to actually do so, with the result that the merchandise "may be sold or otherwise disposed of within the State and never put in course of transportation out of the State."[58] Thus, an unequivocal action to sever the existing situs relationship and mark the beginning of the actual journey is necessary to place a product in interstate commerce and protect it from state taxation.

A somewhat similar problem was presented to the Court in *Diamond Match Co. v. Ontonagon*.[59] Logs cut in Michigan were put in a stream and floated to a point within the state to be held until they were shipped out by rail on demand. In upholding a tax on the logs at that point, the Court established that motion itself will not determine situs, regarding the movement of logs to another point within the state as merely preparatory to interstate commerce. This case confirms that certain operations, such as assembling the goods and merchandise at a depot pending final shipment, are preparatory and local in character and do not constitute interstate commerce. Manufacture and processing are also generally regarded as local in nature.

B. *Interruption of Transit*

Though questions have been raised regarding goods that have not yet entered the stream of commerce, most problems regarding property taxation arise when manufacturing and processing interrupt interstate commerce. The Supreme Court has consistently held that if interstate transit is interrupted and the items of personalty are halted, they may be taxed. It nevertheless remains difficult to determine precisely what sort of stoppage amounts to an interruption. The purpose of the stoppage is generally considered crucial;[60] if the interstate transit is halted for business reasons of the owner or to enjoy some independent local advantage, the goods and merchandise are no longer protected by the commerce clause and are subject to taxation.

Interruptions in transit relating to processing, manufacturing or storage generally subject the goods to taxation because of the local nature of the function and the specific advantage to the owner. The case of *American Steel & Wire Co. v. Speed*,[61] for example, involved products owned by a

57. *See, e.g.*, Minnesota v. Blasius, 290 U.S. 1 (1933).
58. 116 U.S. at 528.
59. 188 U.S. 82 (1903).
60. *See, e.g.*, Kelley v. Rhoads, 188 U.S. 1 (1903).
61. 192 U.S. 500 (1904).

New Jersey corporation that were sent to a warehouse in Tennessee and found to be within its taxing jurisdiction. It was considered immaterial that the warehouse was a major distribution point and that a large percentage of the goods were destined to leave the state in a short time. It was extremely significant to the Court, however, that the interruption in transit was not occasioned by the exigencies of interstate travel, but instead by the commercial needs of the owner.

Somewhat similarly, in *General Oil Co. v. Crain*[62] the Court ruled that Tennessee was allowed to tax oil that had been removed from the cars bringing it into the state and stored in tanks for later shipment to other states. In holding that the interstate transit was broken and the oil was liable to taxation, the Court emphasized:

> The company was doing business in the State, and its property was receiving the protection of the State. . . . It had reached the destination of its first shipment, and it was held there, not in necessary delay or accommodation to the means of transportation, . . . but for the business purposes and profit of the company.[63]

The majority stressed the business and profit motives of the company as overriding the fact that a percentage of the oil had actually been committed to sale before arriving in Tennessee.

The interruption of transit doctrine continued to develop in *Susquehanna Coal Co. v. South Amboy*,[64] in which coal shipped from Pennsylvania to a storage dump maintained by the railroad in New Jersey was held taxable in that state. The coal was either immediately transferred to ships or kept at the dump until the ships were available. The Court reasoned that taxation of the coal was justified because:

> [T]here was something more than the submission to delay in transportation and the acceptance of its consequences. . . . There was something more than an incidental interruption of the continuity of its journey through the state . . . . There was . . . a business purpose and advantage in the delay which was availed of, and while it was availed of, the products secured the protection of the state.[65]

These cases clearly demonstrate the Court's focus on the *purpose* of an interruption in deciding whether the goods involved have been sufficiently removed from commerce to be subject to taxation.

In *Bacon v. Illinois*,[66] the Supreme Court extended this doctrine

62. 209 U.S. 211 (1908).
63. *Id.* at 230-31.
64. 228 U.S. 665 (1913).
65. *Id.* at 668-69; *see, e.g.*, Burlington Lumber Co. v. Willitts, 118 Ill. 559, 9 N.E. 254 (1886); Pocomoke Guano Co. v. Biddle, 158 N.C. 178, 73 S.E. 996 (1912).
66. 227 U.S. 504 (1913).

beyond the simple storage of goods and merchandise. The owner of a substantial amount of grain contracted with a carrier through bills of lading to ship it from the West to New York and Philadelphia. The owner, however, reserved the right to remove the grain at Chicago for inspection, weighing, cleaning, grading and mixing. Although none of the grain was sold or intended for sale in Illinois, the Court nevertheless found a break in the interstate transport and sustained an Illinois ad valorem tax on grain. Focusing on the benefit to the owner and his control over the commodities, the Court declared:

> [N]either the fact that the grain had come from outside the State nor the intention of the owner to send it to another State and there to dispose of it can be deemed controlling when the taxing power of the State of Illinois is concerned. The property was held . . . in Chicago for his own purposes and with full power of disposition. . . . He might sell the grain in Illinois or forward it, as he saw fit. . . . He had established a local facility in Chicago for his own benefit and while, through its employment, the grain was there at rest, there was no reason that it should not be included with his other property within the State in an assessment for taxation . . . .[67]

The cases reveal that tax day is an expensive time for goods to be at rest in any state for a purpose not clearly incidental to their transit. The courts have generally been willing to find state jurisdiction to tax the goods in question, even though their stay is temporary and they are destined to move on.[68]

Conversely, the courts have consistently held that interstate transit is not interrupted so long as the stop is considered necessary or incidental to the journey. The case of *Kelley v. Rhoads*,[69] for example, involved a flock of sheep being driven from Utah to Nebraska through Wyoming. Because the sheep grazed along the way, the State of Wyoming invoked a statute designed to tax all livestock brought into the state to graze. The Court ruled

---

67. *Id.* at 515-16. State courts have consistently held that interruptions in transit for manufacturing and processing purposes take the property out of interstate commerce and place it within the jurisdiction of the state to tax. *See, e.g.*, Southern Kraft Corp. v. Hardin, 205 Ark. 512, 169 S.W.2d 637 (1943); Brown County v. Standard Oil Co., 103 Ind. 302, 2 N.E. 758 (1885); Standard Oil Co. v. Combs, 96 Ind. 196 (1884); Myers v. Baltimore County, 83 Md. 385, 35 A. 144 (1896); Jorgensen-Bennett Mfg. Co. v. Knight, 156 Tenn. 597, 3 S.W.2d 668 (1928). *But see* People *ex rel.* Kursheedt Mfg. Co. v. Feitner, 32 Misc. 84, 66 N.Y.S. 179 (App. Term 1900).

68. In a case remarkably similar to *Bacon v. Illinois*, however, the North Carolina Supreme Court utilized a mistaken analysis and therefore exempted goods undergoing a manufacturing process within the state from taxation without reaching this issue. *In re* Hanes Dye & Finishing Co., 285 N.C. 598, 207 S.E.2d 729 (1974). The confusing jurisdictional analysis resorted to by the supreme court in *Hanes* emphasizes the need for a clear test to determine jurisdiction to tax tangible personal property. *See* Note, *supra* note 5.

69. 188 U.S. 1 (1903).

the tax violated the commerce clause of the federal constitution because the grazing was a necessary incident of the flock's journey. It was significant to the Court that the primary purpose of the trip was transportation.

Similarly, the particular goods or merchandise remain immune from taxation as long as the stop is occasioned by considerations of safety. In *Champlain Realty Co. v. Brattleboro*,[70] a case similar to *Coe v. Errol*,[71] logs cut in Vermont were placed in a stream to be floated to the Connecticut River and on into New York. Due to the unusually high water in the river, however, the logs were caught in a boom near the mouth of the tributary and held until conditions were safe. Vermont levied a tax on the logs, arguing that under *Coe v. Errol* the movement had been preparatory and that the interstate transit of domestic products did not begin until they left the state. Distinguishing *Coe v. Errol* on grounds that the delay there was for the owner's convenience, the Court disallowed the tax[72] and declared:

> The logs were not detained to be classified, measured, counted or in any way dealt with by the owner for his benefit, except to save them from destruction in the course of their journey that but for natural causes, over which he could exercise no control, would have been actually continuous.
>
> . . . .
>
> . . . If the interruptions are only to promote the safe or convenient transit, then the continuity of the interstate trip is not broken.[73]

In determining whether interstate transit is interrupted and its protection lost, tax attorneys and assessors should consider the following factors: "the intention of the owner, the control he retains to change destination, the agency by which the transit is effected, the actual continuity of the transportation, and the occasion or purpose of the interruption."[74] It must be realized, however, that these purpose-oriented guidelines for determining whether commerce has been interrupted do not always accommodate reality. The purposes are often intermingled and the goods may be halted for both business and transportation considerations. For example, in *Kelley v. Rhoads*,[75] involving the sheep being driven through Wyoming, it was virtually impossible to determine whether the grazing was incidental to the travel or if the travel was incidental to the grazing. In close cases of this sort,

70. 260 U.S. 366 (1922).
71. 116 U.S. 517 (1885); *see* text accompanying notes 55-58 *supra*.
72. 260 U.S. at 377; *accord*, Hughes Bros. Timber Co. v. Minnesota, 272 U.S. 469 (1926). The facts were almost identical except the delay was occasioned by ice rather than high waters.
73. 260 U.S. at 373-74, 376; *see* Connecticut River Lumber Co. v. Columbia, 62 N.H. 286 (1882).
74. 260 U.S. at 377.
75. 188 U.S. 1 (1903); *see* text accompanying note 69 *supra*.

the assessor should resolve the issue by balancing all of the relevant factors to determine the primary purpose of the journey.

C. Termination of Transit

The final Phase 2 analysis is premised on the fact that goods and merchandise are no longer immune from taxation at the close of an interstate journey. Generally speaking, courts have considered the journey ended at whatever point the goods are offered for sale. In *Brown v. Houston*,[76] for example, coal that had been shipped in barges from Pennsylvania down the Mississippi River to Louisiana was offered for sale while still in the barges. In upholding the Louisiana ad valorem tax on the coal, the Court decided that the tax

> was imposed after the coal had arrived at its destination and was put up for sale. The coal had come to its place of rest, for final disposal or use, and was a commodity in the market of New Orleans. It might continue in that condition for a year or two years, or for only a day. It had become a part of the general mass of property in the State, and as such it was taxed for the current year . . . .[77]

In the somewhat peculiar case of *Pittsburgh & Southern Coal Co. v. Bates*,[78] the Court went so far as to find the journey ended even though the goods had not been offered for sale. Pennsylvania coal shipped in barges down the Mississippi River was taxed while the barges were in Louisiana but still a few miles from their destination. After upholding the Louisiana tax, the Court stated:

> The property in this case . . . still belongs to the original owners in Pennsylvania, but is brought on the navigable waters of the United States, in boats and barges to Louisiana for the purposes of sale, and is subject to taxation and sale as any other property of the citizens of the United States is subject when it becomes incorporated into the bulk of the property of the country, unless there be some special exemption set forth why it should not be thus taxed and sold, of which there is none here.[79]

---

76. 114 U.S. 622 (1885).

77. *Id.* at 632-33. Quite similarly, in the case of Minnesota v. Blasius, 290 U.S. 1 (1933), a man purchased eleven head of cattle in the St. Paul, Minnesota, stockyards on the day before tax day in order eventually to dispose of them for his own profit. Minnesota was allowed to tax the cattle because they were part of the general mass of livestock locally owned in the state and subject to the complete dominion of the new owner. Again, the basis for the Court's ruling was that all transit had ended when the goods were offered for sale in the St. Paul market period.

78. 156 U.S. 577 (1895).

79. *Id.* at 589.

So long as the circumstances clearly indicate that the goods are to be finally located and sold in the taxing state the Court's analysis is little more than a practical recognition that transit is completed and commerce will not be disturbed by an accelerated imposition of the property tax. The farther the goods are from their destination, even though within the taxing state, the less likely a court will consider the journey ended and subject the goods to taxation. Consequently, this case establishes no more than that the line of demarcation between rest and motion is thinner when the items of personalty are physically located within the taxing jurisdiction and in close proximity to their final destination.

CONCLUSION

The aim of this article is to provide attorneys and assessors with a two-pronged test that will enable them to determine when goods and products are within the state's jurisdiction to tax personal property. While the courts frequently speak of the due process and commerce clauses as fairly parallel limitations, it must be realized before applying the two-pronged test that situations permitting taxation under the one will not always satisfy the other. Thus, before one can hope for an accurate determination of jurisdiction to tax each phase of the test must be carefully applied to the specific facts at issue.