A PAGE OF HISTORY: THE PENNSYLVANIA SUPREME COURT SUSTAINS GROSS RECEIPTS TAX, REJECTING VERIZON'S CHALLENGE

Posted on **November 24, 2015** by **Jim Malone**

Sometimes, "a page of history is worth a volume of logic." *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921).

Since 1866, Pennsylvania has imposed a gross receipts tax on a variety of businesses, including every "pipeline company, conduit company, steamboat company, canal company, slack water navigation company, [and] transportation company" operating within the Commonwealth. 72 P.S. § 8101(a). The tax reaches revenue derived from a variety of business activities, including gross receipts received from "telegraph or telephone messages transmitted wholly within this State and telegraph or telephone messages transmitted in interstate commerce where such messages originate or terminate in this State and the charges for such messages are billed to a service address in this State." 72 P.S. § 8101(a)(2).

Last week, a divided Supreme Court addressed the application of the gross receipts tax in a long-running dispute between the Department of Revenue and Verizon. *Verizon of Pa., Inc. v. Commonwealth*, Nos. 70 MAP 2013, 74 MAP 2013 (Pa. Nov. 18, 2015). The Court was tasked with determining whether gross revenues from three types of activities were derived from the transmission of "telephone messages." The relevant services were:

- The provision of private lines;
- The provision of directory assistance services;
- The provision of installation and repair services, such as installing telephone lines, moving and changing telephone lines, and repairing telephone lines.

Verizon, slip op. at 14-15.

The case arose out of Verizon's gross receipts tax return for 2004. *Id.* at 5. After extensive administrative review, Verizon appealed to the Commonwealth Court, which sustained the application of the tax to private lines and directory assistance services, but rejected its application to the various installation and repair services. *Verizon of Pa., Inc. v. Commonwealth*, 72 A.3d 799, 805-07 (Pa. Commw. 2013).

On appeal, the Supreme Court sustained the Commonwealth Court's determination that the revenues from private lines and from directory assistance services were taxable, but the majority also concluded that the installation and repair services were also taxable. *Verizon*, slip op. at 26-30, 33-35. Two dissenting justices concluded that the installation and repair charges were not taxable. *Verizon of Pa., Inc. v. Commonwealth*, Nos. 70 MAP 2013, 74 MAP 2013, Saylor op. at 4 (Saylor, C.J. concurring and dissenting); *Verizon of Pa., Inc. v. Commonwealth*, Nos. 70 MAP 2013, 74 MAP 2013, Eakin op. at 3-5 (Eakin, J. concurring and dissenting).

The Supreme Court's analysis focused on three main cases:

- *Commonwealth v. Bell Telephone Co.*, 12 Pa. D & C 617 (Dauphin County 1926) (Bell I);
- *Commonwealth v. Bell Telephone Co.*, 14 Pa. D & C 675 (Dauphin County 1930) (Bell II); and
- *Commonwealth v. Bell Telephone Co.*, 34 A.2d 531 (Pa. 1943) (Bell III).

Bell I dealt with the taxability of gross receipts from the sale of directory advertisements, the physical installation of phones, and repairs and rearrangement of telephone equipment; these receipts were held to be taxable under the 1889 version of the gross receipts tax, which taxed gross receipts from "telephone business" conducted in Pennsylvania. *Verizon*, slip op. at 7.

Bell II addressed the impact of a 1925 amendment to the gross receipts tax that limited its scope to revenues derived from "telephone traffic." Under this version of the tax, the advertising and installation services were held to be non-taxable. *Id.* at 8.

Bell III involved a 1929 amendment limiting the tax to revenues derived from "telephone messages transmitted." *Id.* at 9. At issue were so-called code calling and enhanced signaling systems that could be installed throughout a business to alert subscribers of telephone calls through flashing lights and remote bells. *Id. Bell III* also involved special equipment, including "'hands free' transmitter sets worn by switchboard operators on their chests." *Id.* at 9 & n. 8. The case also involved revenues from auxiliary phone lines, when the messages that traveled on them were billed to primary phone line. *Id.* In concluding that all three of these services were taxable, the *Bell III* Court observed that "revenue derived from a telephone subscriber for the use of facilities making telephone communications more satisfactory must be regarded as being part of the charge for transmission of messages." *Bell III*, 34 A.2d at 533. This standard would drive the result in *Verizon*.

Verizon's position rested upon a "volume of logic." It made a well-developed argument that *Bell III* was wrongly decided in light of a variety of factors, including plain language, similar legislation, and the relevant economics of the telecommunications industry (the subject of expert testimony). *Verizon*, slip op. at 15-20. While eliciting some sympathy from the Court, this argument was unavailing.

The problem was straight-forward: the Court's opinion in *Bell III* was a long-standing one, and the relevant statute had been amended twenty-eight times, "including a complete reenactment . . . as part of a comprehensive overhaul of the tax code in 1971." *Verizon*, slip op. at 21. Since there had been no intervening change in the language of the statute, the Court saw no reason to deviate from its prior holding on the scope of the tax. This position was bolstered by the Statutory Construction Act. *Id.* at 22 (citing 1 Pa. C.S. § 1922(4)) ("when a court of last resort has construed the language used in a statute, the General Assembly in subsequent statutes on the same subject matter intends the same construction to be placed upon such language").

Applying the lessons of history, the majority readily concluded that the revenues derived from installing private lines and directory assistance were taxable under *Bell III. Id.* at 27-30. The other two justices agreed, although Chief Justice Saylor indicated that he might have treated the leasing of private lines differently "if we were writing on a clean slate." *Verizon*, Saylor op. at 2 (Saylor, C.J. concurring and dissenting).

As for the installation and repair charges, the majority concluded that they fell within the broad standard set in *Bell III*: "Movement of the customer's lines or alteration of the customer's phone service to better suit the customer's needs and wishes, makes the customer's use of the telephone service more satisfactory, much like the installation of the line in the first instance." *Verizon*, slip op. at 35. Accordingly, in the majority's view, the installation and repair charges were taxable revenues.

In contrast, Chief Justice Saylor perceived the majority's holding as "a significant broadening of the scope of taxable items." *Verizon*, Saylor op. at 4 (Saylor, C.J. concurring and dissenting). Justice Eakin distinguished these charges from *Bell III* because they were not intended to improve upon telephone service they were intended to make the transmission of messages "*possible*." *Verizon*, Eakin op. at 3 (Eakin, J. concurring and dissenting) (emphasis in the original).

Essentially, this is a case where history dictated a result that might otherwise seem counter-intuitive.

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