

**STATE OF NORTH CAROLINA**  
**COUNTY OF WAKE**

**BEFORE THE**  
**SECRETARY OF REVENUE**

**IN THE MATTER OF:**

The Proposed Assessment of Sales and Use )  
Tax for the period March 1, 1998 through )  
May 31,2000, by the Secretary of Revenue )  
of North Carolina )  
vs. )  
[Taxpayer] )

**FINAL DECISION**  
Docket No. 2001-462

This matter was heard before the Assistant Secretary of Administrative Hearings, Eugene J. Cella, in the City of Raleigh, on May 9, 2002, upon application for hearing by the taxpayer wherein it protested the proposed assessment of tax and interest for the period March 1, 1998 through May 31, 2000. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, and W. C. Shelton, Administration Officer. The Taxpayer was represented by [a Partner in the Company].

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales and Use Tax Assessment to the Taxpayer on March 28, 2001, assessing tax and interest in the amount of \$6,093.54. The Taxpayer objected to the proposed assessment in a letter dated April 19, 2001, and timely requested a hearing.

**ISSUES**

The issues to be decided are:

1. Are the Taxpayer's purchases of film for use in the production of tangible personal property for resale subject to use tax?
2. Is the Taxpayer making retail sales of film?
3. Is the Taxpayer acting as an agent on behalf of its clients when it purchases film or other tangible personal property?
4. Does the fact that an issue was not addressed or included in a prior audit indicate approval from the Department and preclude the Department from assessing additional tax on the issue in subsequent audit periods?

## EVIDENCE

The following items were introduced into evidence:

1. Memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings, designated as Exhibit E-1.
2. Audit report dated March 14, 2001 covering the period March 1, 1998 through May 31, 2000, designated as Exhibit E-2.
3. Notice of Sales and Use Tax Assessment dated March 28, 2001 designated as Exhibit E-3.
4. Letter dated April 19, 2001 from the Taxpayer to the Department, designated as Exhibit E-4, along with the following:
  - a. Copy of Certificate of Resale dated March 26, 1985, designated as Exhibit E-4a.
  - b. Letter dated June 6, 1989 from the Department to the Taxpayer with attached Field Audit Report covering period June 1, 1986 through April 30, 1989, dated June 1, 1989, designated as Exhibit E-4b.
5. Letter dated May 18, 2001 from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-5.
6. Letter dated June 4, 2001 from the Taxpayer to the Sales and Use Tax Division, designated as Exhibit E-6.
7. Letter dated June 19, 2001 from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-7.
8. Letter dated August 6, 2001 from the Assistant Secretary of Revenue to the Taxpayer, designated as Exhibit E-8.
9. Redacted Final Decision dated August 16, 1994, Docket Number 94-138, designated as Exhibit E-9.
10. Redacted Final Decision dated December 1999, Docket Number 99-187, designated as Exhibit E-10.
11. Sales and Use Tax Technical Bulletin 24-1 dated October 15, 1998, designated as Exhibit E-11.
12. Copy of Long Mfg. Co. v. Johnson, 264 N. C. 12, 140 S. E. 2d 744 (1965), designated as Exhibit E-12.
13. Letter dated September 12, 2001 from the Assistant Secretary of Revenue to the Taxpayer, designated as Exhibit E-13.
14. Letter dated November 6, 2001 from the Taxpayer to the Assistant Secretary of Revenue, designated as Exhibit E-14.

15. Letter dated November 7, 2001 from the Assistant Secretary of Revenue to the Taxpayer, designated as Exhibit E-15.
16. Letter dated January 23, 2002 from the Taxpayer to the Sales and Use Tax Division, designated as Exhibit E-16.
17. Letter dated February 5, 2002 from the Taxpayer to the Sales and Use Tax Division, designated as Exhibit E-17.
18. Letter dated February 14, 2002 from the Assistant Secretary of Revenue to the Taxpayer's representative, designated as Exhibit E-18.
19. Letter dated February 14, 2002 from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-19.
20. Letter dated March 7, 2002 from the Taxpayer to the Sales and Use Tax Division designated as Exhibit E-20.
21. Letter dated March 7, 2002 from the Taxpayer to the Sales and Use Tax Division, designated as Exhibit E-21.
22. Letter dated March 14, 2002 from the Sales and Use Tax Division to the Taxpayer's representative, designated as Exhibit E-22.
23. Letter dated April 11, 2002 from the Sales and Use Tax Division to the Taxpayer's representative, designated as Exhibit E-23.
24. Letter dated April 30, 2002 with attachments, from the Taxpayer to the Sales and Use Tax Division, designated Exhibit as E-24.
25. Letter dated May 3, 2002 from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-25.
26. Brief for Tax Hearing from the Sales and Use Tax Division to the Assistant Secretary of Revenue, designated as Exhibit E-26.
27. Letter dated May 10, 2002 from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-27.

The following evidence was presented by the Taxpayer subsequent to the hearing:

28. Letter dated June 3, 2002 and attached affidavits from the Taxpayer to Assistant Secretary of Revenue, designated as Exhibit TP-1.

The following evidence was presented by the Sales and Use Tax Division subsequent to the hearing:

29. Memorandum dated June 6, 2002 from the Sales and Use Tax Division to the Assistant Secretary of Revenue, designated as Exhibit E-28.

## **FINDINGS OF FACT**

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. The Taxpayer operates as an advertising agency selling, among other things, printed matter to its customers.
2. The Taxpayer issued a Certificate of Resale to its vendor of film in North Carolina which caused the vendor to exempt sales of film to the Taxpayer from sales tax.
3. The Taxpayer used or consumed film purchased in its production of printed matter for customers.
4. When the Taxpayer billed its customers for printed matter, it separately stated the charge for film on its invoices.
5. The Taxpayer is an advertising agency, not a retailer of film.
6. No contemporaneous agency agreement or document was executed between the Taxpayer and its customers and even if there had been one, the film was subject to sales or use tax on the Taxpayer's cost price.
7. In a prior audit, the Taxpayer's film vendor did not honor a Certificate of Resale issued by the Taxpayer and charged and collected sales tax on its sales of film to the Taxpayer.
8. The Notice of Proposed Assessment was mailed to the Taxpayer on March 28, 2001.
9. The Taxpayer notified the Department that it objected to the assessment on April 19, 2001, and timely requested a hearing.

## **CONCLUSIONS OF LAW**

Based on the foregoing findings of fact, the Assistant Secretary of Revenue makes the following conclusions of law:

1. Certificates of Resale are to be issued to vendors only when the property is being purchased for resale. The Taxpayer has provided no evidence that the property (film) was being purchased for resale.
2. In the case of Long Mfg. Co. v. Johnson, 264 N.C. 12, 140 S. E. 2d 744 (1965), the Court stated that retail merchants may themselves make retail purchases and when they do, they must like any other purchaser, pay the retail sales tax.
3. The Taxpayer's utilization of the film in the production of printed matter for sale to its customers constitutes "use" as defined in G.S. 105-164.3(18).
4. "Sales price", as defined in G.S. 105-164.3(16) for tangible personal property must be paid by the purchaser and it cannot be fragmented to avoid the applicable tax. This interpretation has been sustained in at least nine prior Secretaries' final decisions.

5. Final Decision Docket Number 94-138 supports the assessment of sales tax on the purchase of film and other similar items used by advertising agencies in the creation of taxable tangible personal property for sale.
6. G.S. 105-264 provides Taxpayers with a measure of protection from the assessment of additional tax based on erroneous advice given by the Department. No such erroneous written advice was rendered upon completion of the prior audit of the Taxpayer's business or since that time.
7. The Taxpayer is liable for the applicable State and county additional sales tax assessed.
8. Notice of Proposed Assessment for the period March 1, 1998 through May 31, 2000 was issued pursuant to G.S. 105-241.1

### **DECISION**

The Taxpayer operates an advertising agency. In that capacity, it produces, or arranges for the production of, a variety of items for its clients including printed matter. When the Taxpayer invoiced its customers, it separately stated the charge for film even though it used or consumed the film in the production of printed matter sold to customers. The Taxpayer had issued a Certificate of Resale to its North Carolina vendor of film; therefore, the vendor exempted the film from sales tax. The Taxpayer's main objection to the assessment is that it was acting as an agent on behalf of its clients when it purchased the film and that it was, in fact, making retail sales of the film to its customers. Affidavits from some of the Taxpayer's customers have been provided which assert an agency relationship.

The Department counters that the film was used or consumed by the Taxpayer in producing the printed matter sold to its customers. Further, even if the film was purchased as an agent for its customers as the Taxpayer contends, sales tax was due. The basis for the proposed assessment is that tax should have been paid by the Taxpayer to its film supplier whether it was acting as an agent for its customer or not.

The Taxpayer has acknowledged that the tax was due on the purchase of the film in the same letter that it vigorously argues for the existence of the agency relationship. (Exhibit E-21, p. 3). Although no contemporaneous agency agreement was executed between the Taxpayer

and its customers, the Taxpayer responds that it utilized a unique three letter abbreviation identifying the client for whom the film was being purchased on its purchase order to the film supplier. The Taxpayer has had relationships with its clients for many years and claims that this type of agency relationship "is known by the parties to exist" when a job is initiated as part of the ordinary and lasting course of business.

Certificates of Resale are to be used when, and only when, property is purchased for resale. In this case, however, the Taxpayer used or consumed the film in the production of the printed matter, albeit for a specific customer known to the film supplier. Whether the Taxpayer was acting as an agent on behalf of its client or on its own behalf does not change the certainty that the film was taxable at the point of purchase. Further, the Taxpayer is an advertising agency, not a retailer of film; therefore, the Taxpayer erroneously issued the certificates of resale and is now liable for the use tax on its purchases of film.

The fact that the Taxpayer separately stated its charge for film on its invoices to customers for property produced and sold to them does not render the film and other items used in the production of the property exempt from tax. In the case of Long Mfg. Co. v. Johnson, 264 N.C. 12, 140 S.E. 2d 744 (1965), the Court stated "Retail merchants may themselves make retail purchases and when they do, they must like any other purchaser, pay the retail sales tax." The Taxpayer's utilization of the film constitutes "Use" under the definition of use in G.S. 105-164.3(18).

The Taxpayer also contends that the Department has been inconsistent in the interpretation of the sales and use tax laws with regard to purchases of film for use in producing the printed matter. The Taxpayer is referring to its prior audit for the period June 1, 1986 through April 30, 1989. In the prior audit, the examining auditor did not address the Taxpayer's practice of providing a certificate of resale to its film supplier. The Taxpayer's film supplier did have possession of a Certificate of Resale issued by the Taxpayer during the time of the prior audit. However, the film supplier was well experienced in its day to day sales of film to

advertising agencies and based upon the advice of the [Department's] audit office, the film supplier did not honor the Taxpayer's certificate of resale and charged the tax on its sales of film to the Taxpayer. Thus, during the prior audit, the examining auditor would not have made any reference to the film since the tax was being correctly charged by the film supplier. At some point, subsequent to the prior audit but before the current audit, the Taxpayer's film vendor's business was sold and the new owner began honoring the Taxpayer's certificate of resale and ceased charging sales tax on the Taxpayer's film sold to the Taxpayer.

G.S. 105-264 does provide taxpayers with a measure of protection from the assessment of additional tax based on erroneous advice given by the Department. However, the advice must be issued in writing in response to a taxpayer's written request and the taxpayer must furnish adequate and accurate information to the Department on which the advice is based. A reasonable person would conclude that the fact that certain areas were not addressed or included in a prior audit period does not preclude the Department from assessing additional tax in subsequent audit periods, nor does it indicate approval of a prior practice or procedure. During the previous audit, the examining auditor would have had no reason to question invoices on which tax was being properly assessed and remitted by the Taxpayer. Although the Department regularly advises registered taxpayers of legislative and administrative changes, it is the primary responsibility of a taxpayer to avail himself of information about his sales and use tax obligations.

There is ample support in prior hearings for the Department's longstanding position to tax sales of film and other property to advertising agencies and others for their use. The question of film purchased and used by advertising agencies has been addressed by the Department numerous times. For example, in Final Decision Docket Number 94-138, the Assistant Secretary of Revenue for Legal and Financial Services opined that "The taxpayer's purchase of proofs, negatives, film, photography prints, and similar items are taxable at the time of purchase since such items are being purchased for use in producing tangible personal

property which is resold." Although the Taxpayer set forth the film charges separately on its invoices to its customers, it is the Department's position that the "sales price" must be paid by a purchaser for tangible personal property and it cannot be fragmented to avoid the applicable tax. This position has been sustained in at least nine prior Secretaries' final decisions.

Therefore, the proposed assessment of use tax is deemed to be correct under the law and facts, is sustained, and is hereby declared to be finally determined and immediately due and collectible together with interest as allowed by law.

This 18<sup>th</sup> day of September, 2002.

Signature \_\_\_\_\_

Eugene J. Cella  
Assistant Secretary of Administrative Tax Hearings