

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, 1999 through)
January 31, 2002, by the Secretary of Revenue)
vs.)
[Taxpayer])

FINAL DECISION
Docket No. 2003-124

This matter was heard before the Assistant Secretary of Administrative Hearings, Eugene J. Cella, in the City of Raleigh, on September 3, 2003, upon application for hearing by the Taxpayer wherein it protested the assessment of tax and interest for the period March 1, 1999 through January 31, 2002. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1. The Taxpayer was represented by [an attorney, a CPA, and the Vice President of the Corporation]. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, and Amy A. McLemore, Administration Officer.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales & Use Tax Assessment to the Taxpayer on June 10, 2002. The Taxpayer objected to the assessment in a letter dated July 2, 2002 and timely requested a hearing.

ISSUE

The issues to be decided are as follows:

- (1) Are the sitting fees, copyright fees, and retouch fees the Taxpayer charges in conjunction with its sales of photographs subject to sales tax?
- (2) Are the Taxpayer's purchases of disks and order forms from out-of-state vendors subject to use tax?

EVIDENCE

The following items were introduced into evidence by the Department:

1. Memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings, designated as Exhibit E-1.

2. Copy of audit report dated May 15, 2002, covering the period March 1, 1999 through January 31, 2002, designated as Exhibit E-2.
3. Copy of Notice of Sales and Use Tax Assessment dated June 10, 2002, designated as Exhibit E-3.
4. Letter dated July 2, 2002, from the Taxpayer to the Department, designated as Exhibit E-4.
5. Letter dated August 29, 2002, from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-5.
6. Letter dated September 18, 2002, from the Taxpayer's representative, a Certified Public Accountant, to the Sales and Use Tax Division, designated as Exhibit E-6.
7. Letter dated October 1, 2002, from the Sales and Use Tax Division to the Taxpayer's representative, designated as Exhibit E-7.
8. Letter dated November 7, 2002, from the Sales and Use Tax Division to the Taxpayer, designated Exhibit E-8.
9. Letter dated December 16, 2002, from the Sales and Use Tax Division to the Taxpayer, designated Exhibit E-9.
10. Letter dated February 4, 2003, from the Taxpayer's representative to the Sales and Use Tax Division, designated Exhibit E-10.
11. Copy of Section 32-2.B of the North Carolina Sales and Use Tax Technical Bulletins, designated Exhibit E-11.
12. Redacted copy of Final Decision Docket Number 92-3 dated March 24, 1992, designated Exhibit E-12.
13. Letter dated March 4, 2003, from the Assistant Secretary of Administrative Hearings to the Taxpayer's representative, designated Exhibit E-13.
14. Letter dated March 24, 2003, from the Assistant Secretary of Administrative Hearings to the Taxpayer's representative, designated Exhibit E-14.
15. Letter dated April 30, 2003, from the Taxpayer's representative to the Assistant Secretary of Revenue, designated Exhibit E-15.
16. Letter dated May 7, 2003, from the Assistant Secretary of Revenue to the Taxpayer's representative, designated Exhibit E-16.
17. Letter dated May 30, 2003, from the Assistant Secretary of Revenue to the Taxpayer's representative, designated Exhibit E-17.

The following items were introduced into evidence by the Taxpayer during the hearing:

18. A memorandum submitted by [an association] at the request of its member, the Taxpayer, designated as the Taxpayer's Brief.
19. Copy of sample letter Taxpayer provides to senior high school students to whom the Taxpayer may sell photographs, designated Exhibit TP-1.
20. Copy of sample order form Taxpayer provides to customers, designated Exhibit TP-2.
21. Copy of sample preview photographs, or proofs, the Taxpayer provides to customers, designated as Exhibit TP-3.
22. Copy of sample preview photographs, or proofs, the Taxpayer provides to customers, designated as Exhibit TP-4.
23. Copy of sample preview photographs, or proofs, the Taxpayer provides to customers, designated as Exhibit TP-5.
24. Copy of sample ordering information sheet the Taxpayer provides to its customers, designated as Exhibit TP-6.
25. Copy of photograph taken by the Taxpayer which has not been retouched, designated as Exhibit TP-7.
26. Copy of photograph which the Taxpayer has retouched, designated as Exhibit TP-8.
27. Copy of the copyright license the Taxpayer provided to its customers during the audit period, designated as Exhibit TP-9.
28. Copy of the copyright license the Taxpayer currently provides to its customers, designated as Exhibit TP-10.

FINDINGS OF FACT

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

1. The Taxpayer was a corporation engaged in business as a portrait photographer with a specialty in photographing school students during the audit period.
2. The Taxpayer charged sitting fees to some of its customers who sat to have their portraits taken. The sitting fees were normally collected from students who were high school seniors at the time the senior portraits were taken, but the customers were not given invoices reflecting these charges.
3. Once the portrait photographs were developed, the Taxpayer sold them to students in packages.

4. The Taxpayer's customers completed order forms to indicate which packages they wished to purchase and to inform the Taxpayer if they wanted to purchase any additional photographs not in the package ordered.
5. The customers were offered the option to pay an \$8.00 copyright fee which would give them the legal right to make unlimited copies of the portraits purchased. They were also given the option to pay an \$8.00 retouching fee if they wanted the Taxpayer to reduce the appearance of facial blemishes in the photographs.
6. The Taxpayer collected and remitted sales tax on the fees it charged for the portrait photograph packages and any additional photographs its customers purchased.
7. The Taxpayer failed to collect or remit any sales tax on the sitting fees, copyright fees, or retouch fees it charged its customers in connection with the photographs sold. These fees were listed as nontaxable receipts on the Taxpayer's sales and use tax reports.
8. During the audit period, the Taxpayer made numerous purchases of tangible personal property, such as film, order forms, and disks, from out-of-state vendors that did not collect North Carolina sales or use tax from the Taxpayer. These items were used in operating the Taxpayer's business.
9. A notice of proposed sales and use tax assessment was mailed to the Taxpayer on June 10, 2002.
10. The Taxpayer objected to the assessment and timely requested a hearing to resolve the matter.

CONCLUSIONS OF LAW

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

1. All gross receipts of retailers are presumed to be subject to the retail sales tax until otherwise established.
2. As a retailer engaged in the business of making retail sales of tangible personal property, the corporation was liable for collecting the applicable State and local sales tax on its sales pursuant to G.S. 105-164.4, G.S. 105-467, G.S. 105-483, and G.S. 105-498.
3. The sitting fees, copyright fees, and retouching fees are directly related to the sale of the photographs; therefore, the fees are considered part of the sales price of the photographs and are subject to sales or use tax.
4. The tangible personal property purchased by the Taxpayer from out-of-state vendors that did not collect North Carolina sales or use tax from the Taxpayer is subject to this State's use tax if the property was purchased for the Taxpayer's use in its business operations in this State.
5. The Taxpayer is liable for the additional State and applicable county tax.

6. Notice of proposed sales and use tax assessment for the audit period was issued pursuant to G.S. 105-241.1
7. The Taxpayer timely protested the Notice of Sales & Use Tax Assessment dated June 10, 2002.

DECISION

The Taxpayer contends that the sitting fees, copyright fees, and retouch fees are separate fees it charges its customers for services the corporation provides, and they do not represent sales of tangible personal property subject to sales or use tax. Most of the school students photographed do not pay sitting fees. However, high school seniors are required to pay sitting fees, because the photographer spends more time photographing the seniors and more photographs are taken of each senior student. A senior's payment of the sitting fee by itself does not entitle him or her to any prints, proofs, or finished products. The Taxpayer feels that, since the seniors have to pay the sitting fee regardless of whether or not they later purchase photographs, the sitting fees are clearly for services provided by the Taxpayer to the senior during the photo session and are not to be construed as sales of tangible personal property.

The Taxpayer further argues that because the order forms its customers complete clearly list the retouch fee separately from the photo package fees, the retouch fees represent services provided. The Taxpayer also contends that the copyright fees represent a transfer of copyright ownership, an intangible property interest, from the "author," or the photographer, to the customer. As such, the sale or transfer of copyright interest does not constitute the sale or transfer of tangible personal property, and it is, therefore, not subject to sales or use tax.

I must disagree with the Taxpayer's characterization of the sitting, copyright, and retouch fees in question. All of these fees are associated with the photographs the Taxpayer sells to its customers; therefore, they are a portion of the gross receipts the Taxpayer, a commercial photographer, derives from its sales of those photographs. The retouch fees and the copyright

fees, in particular, would never even be invoiced to a customer if that customer was not also purchasing photographs from the Taxpayer. As for the sitting fees, the Department has not assessed tax on any sitting fees charged to a high school student who did not also purchase photographs. With such a clear correlation between each of the fees and the tangible personal property (photographs) sold, I find that these fees are subject to tax as part of the Taxpayer's gross receipts derived from the sale of photographs.

The Taxpayer has not presented any evidence to support its protest of the use tax assessed on its purchases of order forms and disks from out-of-state vendors that did not collect North Carolina sales or use tax on the purchases. The statutes clearly provide for a use tax to be collected on the storage, use, or consumption in this State of tangible personal property purchased inside or outside this State for storage, use, or consumption within the State. I find that the Department has correctly assessed the use tax on the items in question.

Therefore, the assessment of tax and interest is deemed correct under the law and the facts and is hereby declared to be finally determined and immediately due and payable as allowed by law.

Made and entered this 2nd day of December, 2003.

Signature_____

Eugene J. Cella
Assistant Secretary of Revenue