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 January 1, 2001 through July 31, 2002, by the Secretary of Revenue of North Carolina	)	**FINAL DECISION** Docket No. 2003-262
vs.	)	
[Taxpayer]	)	

This matter was heard by the Assistant Secretary of Administrative Hearings, Eugene J. Cella, upon application for hearing by the Taxpayer wherein they protested our proposed assessment of tax, penalty, and interest for the period January 1, 2001 through July 31, 2002. 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 Richard C. Stewart, Administration Officer. The Taxpayer was represented by [a Certified Public Accountant].

Pursuant to G.S. 105-241.1, a Notice of Sales and Use Tax Assessment was mailed to the Taxpayer on January 3, 2003 and, per the Taxpayer's request, was mailed again on March 3, 2003, assessing tax, penalty and interest in the amount of $17,501.01. The Taxpayer's accountant, in a letter dated March 17, 2003, objected to the assessment and timely requested a hearing before the Secretary of Revenue.

ISSUE

The issue to be decided in this matter is as follows:

Are the design and creative services incurred in conjunction with the production and sale of tangible personal property subject to sales and use tax?

EVIDENCE

The following items were introduced into evidence by the parties:

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

2. Audit report dated December 20, 2002 covering the period January 1, 2001 through July 31, 2002, designated Exhibit E-2.

3. Notice of Sales and Use Tax Assessment dated January 3, 2003, designated Exhibit E-3.

4. Notice of Sales and Use Tax Assessment dated March 4, 2003, designated Exhibit E-4.

5. Letter dated March 17, 2003 from the Taxpayer's accountant to the Sales and Use Tax Division, designated Exhibit E-5.

6. Letter dated March 26, 2003 from the Sales and Use Tax Division to the Taxpayer's accountant, designated Exhibit E-6.

7. Sales and Use Tax Bulletin 24, dated June 1, 2002, designated Exhibit E-7.

8. Redacted Secretary of Revenue Final Decision, Docket No. 99-187, designated Exhibit E-8.

9. Copy of Taxpayer’s sales invoice Number 1188, dated February 16, 2002, designated Exhibit E-9.

10. Letter dated May 30, 2003, from the Assistant Secretary of Revenue to the Taxpayer’s accountant, designated Exhibit E-10.

11. Brief for Tax Hearing prepared by the Sales and Use Tax Division, designated Exhibit E-11.

The Taxpayer presented the following information into evidence at the hearing:

12. Uniform Commercial Code, Part 4. Title, Creditors and Good Faith Purchases, and Part 5. Performance, designated Exhibit TP-1.

FINDINGS OF FACT

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

1. The Taxpayer at all material times made retail sales of trade booths, displays and printed materials.

2. The Taxpayer made separate charges for the tangible personal property and creative/design services on invoices given to customers.

3. The Taxpayer collected and remitted sales and use tax on materials it produced and sold to clients in some cases, but did not charge sales tax on its creative/design services associated with the production and sales of tangible personal property.

4. The Department did not assess sales tax on creative/design services charged to customers that did not result in the sale of tangible personal property.

5. The Taxpayer was assessed sales tax on the total amount of its sales of tangible personal property, including the creative/design services charged in the creation of the finished product.

6. The Taxpayer paid sales tax to its in-state vendors on the materials purchased that became a component part of the finished product sold by the Taxpayer. Credit was given for the sales tax paid in error to in-state vendors on materials that became a component part of the finished product sold by the Taxpayer.

CONCLUSIONS OF LAW

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

1. The Taxpayer's charges for creative services and design labor and other services made in connection with the sale of tangible personal property constitute part of the sales price of the property sold pursuant to G.S. 105-164.3 (16) and G.S. 105-164.3 (37) and the Taxpayer is liable for sales tax on these charges.

2. The Taxpayer as a retailer made retail sales of tangible personal property subject to sales tax on the total sales price of the property, including charges for the labor or creative services associated with the production of the property.

3. In Final Decision No. 99-187, the Assistant Secretary of Revenue concluded that creative services cannot be separated from other costs or services going into the manufacture and production of tangible personal property for sale at retail.

4. The Notice of proposed assessment for the period January 1, 2001 through July 1, 2002 was properly issued pursuant to G.S. 105-241.1.

DECISION

The Taxpayer is engaged in the business of making retail sales of trade booths, displays, and printed material. The Taxpayer also performs creative services for its clients which do not involve the sale of personal tangible property. Although the Taxpayer, in some cases, did collect and remit sales tax on the materials that it produced and sold to its clients, it never charged sales tax on what the Taxpayer characterizes as "creative services" rendered in association with the production of the items that were sold. It is the Taxpayer's position that the charges for these creative services are not part of the sales price subject to sales tax.

The Department's assessment included sales tax on the amount charged its clients for "creative services" that were performed in association with the production of the tangible personal property sold, but were deemed not taxable by the Taxpayer. It is the Department's contention that the "sales price" of the items sold upon which sales tax should have been computed includes, by statute, Technical Bulletin, and well-established Departmental interpretation, the charges for these creative services.

The Department argues that the "true object" of the agreements between the Taxpayer and its clients in these transactions was the trade booths, displays, or other tangible personal property that was received and therefore a retail sale of that property took place. Accordingly, the Statutes, G.S. 105-164.3 (16) prior to January 1, 2002 which was recodified under G.S. 105-164.3 (37) January 1, 2002, require that, although creative services may have been rendered in association with the production of the items, because the sales price to which the tax applies should be the total amount for which the property is sold, including all charges for services rendered in the fabrication, manufacture or delivery of the property, then the amount charged for the creative services is considered part of the sales price properly subject to the tax. The Department further argues that its position is supported by Sales and Use Tax Technical Bulletin 24-1 B. which provides, in part, that where advertising agencies make retail sales of tangible personal property, " . . . The sales price to which tax applies is the total amount for which tangible personal property is sold including all charges for services rendered in the production, fabrication, manufacture or delivery of the property, . . . " (underlining added) Sales and Use Technical Bulletin 24-2 B., provides, in part, ". . . When an advertising artist creates 'paste-ups' and 'mechanicals' for use by him in producing other tangible personal property which he sales at retail, the total charge for the tangible personal property sold at retail is subject to tax at the general rate of State tax and any applicable local sales or use tax including any charge for materials or services rendered in creating the 'paste-ups' or 'mechanicals.'" (underlining added) Because the Taxpayer sold tangible personal property not for resale to its

clients in the transactions in question, it was acting as a retailer and was therefore responsible for collecting and remitting sales tax on the total price of these items, including the charges for creative services associated with their production.

The Taxpayer's argument is that since the creative services were performed to develop a concept they should be considered separate, not related to the fabrication or production process and therefore not part of the sales price of the tangible personal property produced and sold. The Taxpayer also argues that Sales and Use Tax Technical Bulletin 24-2 provides that charges for such services are not taxable when a company performs only creative services for a client and does not concomitantly sell tangible personal property to the client. The Taxpayer contends that the design services are complete and given to the client, at which time title to the designs passes to the client. If the customer, after reviewing the designs, decides to have the Taxpayer fabricate the tangible personal property, the Taxpayer continues, that is a second and discrete transaction and for the Department to assess tax on the design charges is a repudiation of the Uniform Commercial Code.

Taxpayer's interpretation and analysis of the application of the Uniform Commercial Code to the transactions included in this assessment is incorrect. Section 2-401 (2) of the Uniform Commercial Code provides that title passes to the purchaser at the point the seller completes his performance with reference to the physical delivery of the goods. However, the section cited by the Taxpayer relates to goods and other types of tangible personal property, while the transactions in question are for creative services rendered in the production of tangible personal property. The Statutes, except in specific levies, do not tax rendering of professional services, unless the services are rendered in the attendant sale of tangible personal property. Sales and use tax is a transaction oriented tax and the application of the tax is dependent upon the nature of the transaction entered into between the parties. G.S. 105-164.3(16), prior to January 1, 2002, and G.S. 105-164.3 (37), subsequent to January 1, 2002, and Sales and Use Tax Technical Bulletin 24 are unambiguous in their requirement that the sales price upon which

the tax is to be imposed includes the total amount for which tangible personal property is sold. The true nature of the transactions in question entered into between the Taxpayer and its clients involved the acquisition of certain items of tangible personal property, not solely the providing of creative services. Therefore, those transactions were retail sales of tangible personal property and as such the charges incurred for the creative services cannot be artificially separated from charges for other costs or services that went into the manufacture and production of the tangible personal property. In those transactions, the creative services provided by the Taxpayer are clearly an integral, necessary and inseparable function of the fabrication process that produced the tangible personal property sold.

This long-standing position of the Department with regard to the inclusion in the sales price of the cost of creative services performed in association with the fabrication of tangible personal property that is sold not for resale has abundant support in North Carolina law, including several previous final decisions of the present and prior Secretaries of Revenue that are on point and that have never been reversed upon appeal.

Wherefore the assessment is sustained in its entirety, and is declared to be final and immediately due and collectible.

This 9th day of October 2003.

Signature_____

Eugene J. Cella
Assistant Secretary of Administrative Hearings