

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

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

**In the Matter of:**

The Proposed Assessment of Additional Sales )  
and Use Tax for the period September 1, 2000 )  
through June 30, 2003, by the Secretary of )  
Revenue of North Carolina. )

**FINAL DECISION**  
Docket No. 2004-348

vs. )

[Taxpayer] )

This matter was heard before the Assistant Secretary of Administrative Hearings, Eugene J. Cella, in the City of Raleigh, on October 28, 2004, upon application for hearing by the Taxpayer wherein it protested a proposed assessment of sales and use tax, penalty and interest for the period September 1, 2000 through June 30, 2003. The hearing was held by the Assistant Secretary pursuant to G.S. 105-260.1 and was attended by W. Timothy Holmes, Assistant Director, and M. D. Stephenson, Administration Officer, representing the Sales and Use Tax Division. [President], President of the Corporation, and [Taxpayer's Representative], CPA, represented the Taxpayer.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales and Use Tax Assessment to the Taxpayer on October 15, 2003 and the Taxpayer notified the Department of its objections to the assessment and requested a hearing on October 21, 2003.

**ISSUES**

The issues to be decided in this matter are as follows:

1. Are the Taxpayer's transactions involving wedding videos taxable retail sales of tangible personal property or nontaxable services?
2. Are the Taxpayer's "sitting fee" and "overtime charges" in connection with sales of photographs, portraits, picture albums, and video tapes included as part of the taxable "sales price" of tangible personal property?
3. Is the Taxpayer liable for sales tax on "unaccounted for income" based on the presumption that the gross receipts of a retailer are deemed taxable unless the contrary is established by proper records?

4. Is the penalty and interest included in the assessment against the Taxpayer proper?

### **EVIDENCE**

The Sales and Use Tax Division introduced the following items into evidence at the hearing:

- (1) Copy of Memorandum dated May 16, 2001, from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings, designated Exhibit E-1.
- (2) Copy of sales and use tax audit report for the period September 1, 2000 through June 30, 2003 dated September 26, 2003, designated Exhibit E-2.
- (3) Copy of notice of proposed assessment dated October 15, 2003, designated Exhibit E-3.
- (4) Copy of letter from the Taxpayer to the Department dated October 21, 2003, designated Exhibit E-4.
- (5) Copy of letter dated December 3, 2003 from the Sales and Use Tax Division to the Taxpayer and attached Decisions of the Secretary of Revenue; (1) Final Decision dated December 28, 1970 and (2) Final Decision Docket No. 92-3 dated March 24, 1992, designated Exhibit E-5.
- (6) Copy of letter dated May 27, 2004 from the Sales and Use Tax Division to the Taxpayer, designated Exhibit E-6.
- (7) Copy of redacted Final Decision of the Secretary of Revenue, Docket Number 90-42 dated April 18, 1991, designated Exhibit E-7.
- (8) Copy of redacted Final Decision of the Secretary of Revenue, Docket Number 93-39 dated August 4, 1993, designated Exhibit E-8.
- (9) Copy of redacted Final Decision of the Secretary of Revenue, Docket Number 95-1 dated January 24, 1995, designated Exhibit E-9.
- (10) Copy of letter dated August 4, 2004 from the Assistant Secretary of Revenue to the Taxpayer, designated Exhibit E-10.
- (11) Copy of letter dated September 7, 2004 from the Taxpayer to the Assistant Secretary of Administrative Tax Hearings, designated Exhibit E-11.

- (12) Copy of letter dated September 8, 2004 from the Assistant Secretary of Revenue to the Taxpayer, designated Exhibit E-12.

The following item was introduced into evidence at the hearing:

- (13) Sales and Use Tax Regulation 38 (amended 11-22-65), designated Exhibit E-13.

The following items were introduced into evidence post-hearing:

- (14) Amended Sales and Use Tax Audit Report for the period September 1, 2000 through June 30, 2003 dated January 14, 2005, designated Exhibit E-14.
- (15) Copy of notice of amended sales and use tax assessment dated January 25, 2005, designated Exhibit E-15.
- (16) Memorandum dated January 25, 2005 and attachment from the Division to the Assistant Secretary of Administrative Tax Hearings, designated Exhibit E-16.
- (17) Copy of letter dated February 18, 2005 from the Sales and Use Tax Division to the Assistant Secretary of Administrative Tax Hearings, designated Exhibit E-17.
- (18) Copy of letter dated February 24, 2005 from the Assistant Secretary of Administrative Tax Hearings to the Division, designated Exhibit E-17.

### **FINDINGS OF FACT**

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

- (1) The Taxpayer sold photographs and video tapes of weddings during the audit period.
- (2) The Taxpayer was registered and had collected and remitted sales tax on some of its sales of photographs, portraits, and photo albums during the audit period.
- (3) The Taxpayer had not collected and remitted sales tax on "sitting fees" and "overtime charges" associated with the production of photographs.
- (4) The Taxpayer did not collect sales tax on the wedding videos included in the original agreements with customers. When additional copies of wedding videos beyond those included in the original agreement were requested, the Taxpayer collected and remitted sales tax on the charges for the additional video tapes.

- (5) The Taxpayer's retail sales were understated on sales and use tax returns based on the difference between gross receipts reported on income tax returns and taxable sales reported on sales and use tax returns plus the additional taxable receipts per the audit.
- (6) Additional sales tax was assessed against the Taxpayer on wedding videos and on the sitting fees and overtime charged in connection with sales of photographs, as well as unaccounted for income.
- (7) Additional use tax was assessed on the Taxpayer's purchases of tangible personal property from out-of-state vendors for use who did not collect the tax from the Taxpayer.
- (8) During the hearing, it was determined that the Department had not reduced the unaccounted for income by the amount of tax that might have been collected by the Taxpayer on such additional receipts. Therefore, the audit was amended on June 30, 2003 to adjust the additional taxable receipts subject to sales tax.
- (9) The Notice of Sales and Use Tax Assessment was mailed to the Taxpayer on October 15, 2003.
- (10) The Taxpayer notified the Department that it objected to the assessment on October 21, 2003 and requested a hearing.
- (11) The notice of amended sales and use tax assessment was mailed to the Taxpayer on January 25, 2005.

### **CONCLUSIONS OF LAW**

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

- (1) The Taxpayer was, at all material times, a retailer within G.S. 105-164.3(35) engaged in business under G.S. 105-164.3(9) making retail sales of photographs and wedding videos.
- (2) The general rate of State tax and applicable local tax is due on the Taxpayer's sales of tangible personal property not exempt from tax to customers in North Carolina pursuant to G.S. 105-164.4, G.S. 105-467, G.S. 105-483, G.S. 105-498, and G.S. 105-517.
- (3) The Taxpayer does not meet the definition of "production company" as defined in G.S. 105-164.3(30); therefore, its video tapes are not exempt from tax as an "audiovisual master" pursuant to G.S. 105-164.13(22a).

- (4) The term “sales price” is defined by G.S. 105-164.3(37), and the term specifically includes “labor or service costs” and “Charges by the retailer for any services necessary to complete the sale.” Sitting fees and overtime charged for the Taxpayer’s presence at a wedding to film video or to take photographs are services necessary to complete the sales contract and represent the passage of labor costs associated with the production of a video tape or photographs on to the purchaser.
- (5) The Taxpayer was liable for collecting and remitting the sales tax on its taxable retail sales of tangible personal property under G.S. 105-164.7, and its failure to collect and remit the tax due on any part of the sales price of photographs and wedding video tapes does not affect its liability.
- (6) Several Final Decisions have been rendered which uphold the application of sales tax to a photographer’s sitting fee charges and other similar charges for taking photographs.
- (7) The Taxpayer did not maintain records of all receipts of its business, and the Taxpayer’s unaccounted for income must be considered as taxable gross receipts pursuant to G.S. 105-164.26.
- (8) After amending the audit and adjusting the assessment for the sales tax the Taxpayer might have collected in connection with unaccounted for income, the Division has assessed the additional tax due on an estimation of sales based on the best information available within G.S. 105-164.24.
- (9) The Taxpayer did not receive any written advice from the Department that would estop an assessment under G.S. 105-264.
- (10) Under G.S. 105-236 and G.S. 105-241, when a tax or additional tax is not timely paid, the Secretary of Revenue is required to assess the 10% penalty for failure to pay the tax when due and interest due. It is the Division’s standard that when there is a tax deficiency assessed greater than 25% of the total tax due by a Taxpayer, the deficiency is considered large and the 25% negligence penalty is applicable. The Taxpayer’s deficiency represents more than 70% of their sales and use tax liability for the assessment period; therefore, the 25% negligence penalty has been appropriately applied.
- (11) Notice of Sales and Use Tax Assessment was issued to the Taxpayer pursuant to G.S. 105-241.1(a).
- (12) The additional tax assessed is presumed to be correct under G.S. 105-241.1(a), and the burden is upon the Taxpayer to overcome the presumption of correctness.

## DECISION

The Taxpayer was engaged in the business of making retail sales of photographs and wedding videos during the audit period. The entire charge for the sale of photographs and wedding videos is subject to sales tax, including the Taxpayer's sitting fees and overtime charges. The Taxpayer excluded sitting fees and overtime charges from the sales price when computing the sales tax due. Thus, the Department has assessed additional tax thereon.

The Taxpayer claims that its sales of wedding video tapes were non-taxable services instead of tangible personal property because the value of the video film is negligible in relation to the total charges. Furthermore, the Taxpayer believes it should be exempt from sales or use taxes due to the amount of creative time and labor necessary to complete production. The Taxpayer notes that significant shooting and editing work goes into the production of a master copy of the video, and states that two "complementary" copies of the video are provided to the customers. When additional copies beyond the master and two additional copies were requested, the Taxpayer collected and remitted sales tax on the charges for the additional video tapes. The Taxpayer contends that what is provided to its customers should be characterized as a nontaxable "service." I disagree. The value of the medium on which video-filmed images is supplied to the customers is not a material consideration, and there is no distinction to be made between sales of completed video film and photographs relative to the values of the media upon which each are transferred. The Taxpayer is not a

“production company,” as defined, and its receipts from sales of wedding videos are therefore not exempt from sales tax under G.S. 105-164.13(22a).

With respect to “sitting fees and overtime charges” to customers, the Taxpayer takes the position that such charges should be excluded from the “sales price” of the photographs as a nontaxable service. The Taxpayer notes that the firm collected and remitted sales tax on taxable retail sales of photographs, portraits, and photo albums. The Division contends that all “services” which the Taxpayer provides are an integral part of the production of the “true object” of the transaction, which is a sale of fungible goods, such as a video tape, a photograph, a portrait, or a complete photo album consisting of a number of photographs. The tangible personal property is what the Taxpayer’s customers seek, is the object of their contract, and is what they receive in exchange for the consideration paid. The Taxpayer is liable for the tax due on the retail sales price, which includes the sitting fees and overtime charges made by photographers.

The Taxpayer argues that the information published by the Department is not understandable and there is a lack of a clear understanding within the industry or trade concerning the application of sales tax to the items included in the assessment. NCAC T17:07B .4102 has been in effect since February 1, 1976 and sets forth the application of sales and use taxes to sales of photographs by photographers. Sales and Use Tax Technical Bulletin 32-2 B. restates the application of sales tax to sales of photographs by photographers. Under these Rules and Technical Bulletins, the Taxpayer’s gross

receipts from sales of photographs as well as video tapes delivered to its customers are clearly subject to sales and use taxes. The term “gross receipts” includes overtime charges and sitting fees. All of the above-mentioned information is available through the Department’s website and was available upon request at all times during the audit period. The Taxpayer could have also made a written inquiry as to its sales and use tax liability to the Division and would have received a written response, but it did not.

The Taxpayer objects to being held liable for past liabilities and to the assessment of penalties and interest on the additional tax due, holding that if the firm had known to collect and remit the additional tax the State would not have been in a position to collect the penalties and interest. The Taxpayer argues that because of its misunderstanding regarding the application of sales tax to its charges to customers, it was not in a position to collect the sales tax and therefore should be given relief. The Taxpayer cannot evade the assessment of tax due to failure to collect and remit the tax on previous sales. The sales tax must be added to the purchase price and constitutes a debt from the purchaser to the retailer until paid. The Taxpayer’s failure to charge or collect tax from its customers cannot affect its liability under G.S. 105-164.7. Accordingly, the penalties and interest assessed are within G.S. 105-236 and G.S. 105-241.1(i).

During the hearing, it was discovered that the sales tax assessed on the Taxpayer’s unaccounted for income was not reduced by the amount of sales tax the Taxpayer should have collected on such receipts. To resolve this issue, the Division

agreed to presume the Taxpayer collected tax on all of the taxable receipts recorded in the audit as “unaccounted for income” and the audit report was amended accordingly.

Numerous similar cases have come before the Department involving photography, and those cases were presented and are marked as Exhibits E-7, E-8, and E-9. In each instance the total amount charged by the retailer for photography, including sitting fees and similar charges for services necessary to complete delivery of a photograph, was held subject to the sales tax imposed on retail sales of tangible personal property.

Therefore, I find that the proposed assessment of additional sales and use tax as amended plus accrued interest is deemed to be correct under the law and the facts and is hereby sustained. Because the failure to pay the tax was not the result of intentional disregard of the North Carolina statutes, I find reasonable cause to waive penalties.

Wherefore the assessment is sustained, as amended, and is declared to be final and immediately due and collectible.

This 18th day of May, 2005.

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Eugene J. Cella  
Assistant Secretary of Revenue For  
Administrative Tax Hearings