

**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 July 1, 1999 through April 30, )  
2002, by the Secretary of Revenue of )  
of North Carolina )  
vs. )  
[Taxpayer] )

**FINAL DECISION**  
Docket No. 2003-171

This matter was heard before the Assistant Secretary of Administrative Hearings, Eugene J. Cella, in the City of Raleigh, on May 1, 2003, upon application for hearing by the taxpayer wherein it protested the proposed assessment of tax, penalty and interest for the period July 1, 1999 through April 30, 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 M. D. Stephenson, Administration Officer. The Taxpayer was represented by [President of the Corporation].

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales and Use Tax Assessment on August 12, 2002 to the Taxpayer, assessing tax, penalty and interest in the amount of \$6,248.61. The Taxpayer objected to the proposed assessment in a letter dated August 28, 2002 and timely requested a hearing.

The record in this matter was held open for a period of two weeks from the hearing date in order to allow the Taxpayer to provide additional information supporting its case. Upon receipt thereof, the record remained open for two additional weeks in order for the Division to issue a response to the Taxpayer's additional information. The Taxpayer's letter dated June 26, 2003 and attachments as well as the Division's memorandum dated July 9, 2003 in response thereto were accepted and entered in the record.

**ISSUES**

The issues to be decided are:

1. Were the Taxpayer's sales of photographs included in the assessment properly subject to sales tax?
2. Is the assessment of tax on the Taxpayer's retail sales in July 1999 correctly proposed within the statute of limitations?

3. Did an officer of the Department provide the Taxpayer with protective advice barring the assessment?

### **EVIDENCE**

The following items were introduced into evidence by the Department at the hearing:

1. Memorandum dated May 16, 2001, from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings (Assistant Secretary), designated as Exhibit E-1.
2. Copy of audit report dated August 2, 2002, designated as Exhibit E-2.
3. Copy of Notice of Sales and Use Tax Assessment dated August 12, 2002, designated as Exhibit E-3.
4. Copy of letter dated August 28, 2002, from the Taxpayer to the Sales and Use Tax Division ("Division"), designated as Exhibit E-4 and the following attachments:
  - a. Document entitled "Official Protest of North Carolina Department of Revenue Sales and Use Tax Assessment," designated as Exhibit E-4 (a);
  - b. Copy of information printed from the Department's webpage, Frequently Asked Questions – Sales and Use Tax, marked "Example 1," designated as Exhibit E-4 (b);
  - c. Copy of G.S. 105-41 marked "Example 2," designated as Exhibit E-4 (c);
  - d. Copy of NCAC T17: 07B .4100 marked "Example 3," designated as Exhibit E-4 (d);
  - e. Copy of Sales and Use Tax Technical Bulletin Section 32, designated as Exhibit E-4 (e);
  - f. Copy of North Carolina Department of Revenue Auditor's Report – Audit Remarks, designated as Exhibit E-4 (f);
  - g. Copy of Notice of Sales and Use Tax Assessment dated August 12, 2002, designated as Exhibit E-4 (g).
5. Copy of letter dated October 1, 2002, from the Division to the Taxpayer, designated as Exhibit E-5.
6. Copy of letter dated October 9, 2002 and attachment, from the Taxpayer to the Division, designated as Exhibit E-6.
7. Copy of letter dated October 18, 2002, from the Division to the Taxpayer, designated as Exhibit E-7.
8. Copy of letter dated April 1, 2003 from the Assistant Secretary of Revenue to the Taxpayer, designated as Exhibit E-8.
9. Copy of Decision of Secretary of Revenue dated 24 March 1992, designated as Exhibit E-9.
10. Copy of Decision of Secretary of Revenue Dated January 12, 1962, designated as Exhibit E-10.

11. Copy of NCAC T17: 07B .4102, designated as Exhibit E-11.
12. Copy of Sales and Use tax Technical Bulletin Section 32, designated as Exhibit E-12.

The following items were introduced into evidence by the parties after the hearing:

13. Copy of letter dated April 12, 2003 from the Taxpayer to the Assistant Secretary of Revenue, received on May 21, 2003, designated as Exhibit TP-1.
14. Copy of letter dated June 26, 2003 from the Taxpayer to the Assistant Secretary of Revenue, designated as Exhibit TP-2 and the following attachments:
  - a. Affidavit of [a witness] dated June 27, 2003, designated as Exhibit TP-2 (a);
  - b. Copy of Fax Transmission Cover sheet from [a limited liability partnership], designated as Exhibit TP-2 (b);
  - c. Copy of Fax Communication Message from Auditor Darrell Walker of the Department's Greensboro, North Carolina office to [a witness], designated as Exhibit TP-2 (c);
  - d. Copy of Sales and Use Tax Technical Bulletins Sections 24 and 32, designated as Exhibit TP-2 (d).
15. Copy of memorandum dated July 9, 2003 from the Division to the Assistant Secretary, designated as Exhibit S-1.

### **FINDINGS OF FACT**

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

1. The Taxpayer sold photographs during the audit period.
2. Most photographs sold to customers in North Carolina were delivered to the customers in an electronic or digital format via Internet download or as an attachment to electronic mail. The Taxpayer also sold some photographs to customers that were delivered on paper.
3. The Taxpayer's sales of photographs that are not delivered on paper or by some other tangible means were not subject to sales tax. Sales of photographs delivered by the Taxpayer on paper or some other tangible form are subject to sales tax.
4. The Taxpayer did not collect and remit sales tax on any of its sales of photographs.
5. The Department assessed the additional sales tax due against the Taxpayer on charges for finished photographs delivered on a tangible medium (photographic paper) based on its taxable retail sales.
6. The Department did not furnish the Taxpayer with written advice that its transactions upon which the assessment is based are exempt from sales tax.

7. Notice of sales and use tax assessment was mailed to the Taxpayer on August 12, 2002.
8. The Taxpayer objected to the assessment and made a timely request for a hearing.

### **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 engaged in the business of making retail sales of photographs and photographic images.
2. A portion of the Taxpayer's sales did not involve the transfer of title or possession of tangible personal property, and the Department did not impose the sales tax on those transactions. However, the Taxpayer transferred taxable tangible personal property for consideration in some instances and the Department appropriately assessed the sales tax levied upon those sales.
3. The general rate of State tax and applicable local tax is due on the Taxpayer's sales of tangible personal property to customers in North Carolina.
4. 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, but it neither collected nor remitted the tax due.
5. The Taxpayer did not receive written advice from the Department that would estop an assessment under G.S. 105-264.
6. The Department's assessment of additional tax due is within the statute of limitations set forth in G.S. 105-241.1(e).
7. 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.
8. Notice of proposed assessment was issued pursuant to G.S. 105-241.1.

### **DECISION**

The Taxpayer was engaged in the business of making retail sales of photographs during the audit period. In the majority of instances when the Taxpayer sold commercial photographs, the images were transferred to its customers in a digital format as an electronic download or as an attachment to electronic mail via the Internet. In these cases, the Taxpayer did not convey "tangible personal property" for the consideration paid by its customers and these transactions

were therefore not subject to sales tax. In a minority of instances, the Taxpayer sold traditional photographs that were delivered on photographic paper. These sales are subject to tax; however, the Taxpayer did not collect and remit the tax due.

Since the Taxpayer did not charge, collect, or remit the appropriate tax due on its taxable retail sales of tangible photographs delivered to customers on photographic paper, additional sales tax was assessed.

The Taxpayer made the following arguments that its sales should be excluded from the sales tax assessment:

First, the Taxpayer argues that it did not convey tangible personal property with respect to the transactions at issue because the corporation retained the copyrights to the photographs. I disagree. The retention of copyrights has no direct bearing on the issue of whether the item sold constitutes tangible personal property. For example, a publishing company might retain copyrights to a book, but the retention of those copyrights in no way affects the application of sales tax when the book is sold at retail. Likewise, the photographs are no less a conveyance of tangible personal property than the retail sale of a book, which also bears the same copyright protections, that is clearly and indisputably subject to sales tax.

Secondly, the Taxpayer argues that the information published by the Department is not understandable to the common man because a few sentences included in basic, general information published on the Department's website might have led it and its tax advisors to the conclusion that all of the Taxpayer's transactions were not subject to sales or use tax. Exhibit E-4 (b) bears the language in question, which is "Generally services are exempt, but laundry and dry cleaning services are taxable at the combined 6½% (7% in [a North Carolina County]) State and local tax rates." It is regrettable that the Taxpayer and its tax advisors chose to perform only a cursory review of a few sentences of general information, which were taken out of context, and on this basis determined all of its transactions were exempt from sales tax. However, having made this choice, the Taxpayer must accept the consequences of that action.

Some of the Taxpayer's transactions are taxable, while others are not, based on how its photographs are delivered to its customers. Under Sales and Use Tax Administrative Rule .4102 and Sales and Use Tax Technical Bulletin Section 32, the Taxpayer's sales of photographs delivered to its customers in a tangible form are subject to sales and use taxes. Both the Rule and Technical Bulletin are available, as a part of the Department's website, and could have been furnished by the Department upon request at all times during the audit period. Further, the Taxpayer could have made a written inquiry to the Division concerning the taxability of its products to elicit a written response, but it did not.

Lastly, the Taxpayer argues that it contacted the Department and received erroneous advice as did its tax advisor concerning the application of sales tax to its sales. The information provided by the Department to the Taxpayer's attorney was verbal, except for copies of Sales and Use Tax Technical Bulletin Sections 24 and 32 which the Department published. The issue that verbal advice is not protective and does not estop an assessment has been settled. See Henderson v. Gill, 229 N.C. 313, 49 S.E.2d 754 (1948). It is observed that Sales and Use Tax Technical Bulletin 32-2 B. attached to the affidavit issued by the Taxpayer's attorney (Exhibit T-2) does provide specific advice that the "Gross receipts from sales of photographs including all charges for developing or printing by commercial or portrait photographers or others are subject to the 4% State tax and any applicable local sales or use tax." Based on this attachment to the affidavit, it is puzzling how one would conclude that the Taxpayer's sales of finished, tangible photographs are not taxable. Therefore, the information attached to the affidavit does not constitute specific written advice barring this assessment under G.S. 105-264.

The sales and use tax audit report and assessment were both completed on August 2 and August 12, 2002, respectively. Both of these items were placed in the mail for delivery to the Taxpayer prior to August 15, 2002. The return for the month of July 1999 was due on August 15, 1999. Therefore, the sales and use tax assessment, which begins with the month of July 1999, was issued within the time set by G.S. 105-241.1(e).

Therefore, I find that the proposed assessment of additional sales and use tax 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 of tax and interest is sustained and is declared to be final and immediately due and collectible.

This 29<sup>th</sup> day of August 2003.

Signature \_\_\_\_\_

Eugene J. Cella  
Assistant Secretary of Administrative Hearings