AUVID PRODUCTIONS INTL, INC. P.O. Box 1933 Huntsville, AL 35807,	'	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	'	DOCKET NO. S. 97-475
v.	'	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	'	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed sales tax against Auvid Productions International, Inc. for June 1994 through May 1997. Paul Kennamer (ATaxpayer@) appealed to the Administrative Law Division pursuant to Code of Ala. 1975, '40-2A-7(b)(5)a. A hearing was conducted on June 7, 2000. The Taxpayer represented himself. Assistant Counsel Wade Hope represented the Department.

ISSUE

The Taxpayer produces and sells video tapes. The issue is whether the Taxpayer is liable for sales tax on his separately stated charge for services performed in producing the videos. That issue turns on whether the transfer of the tapes is incidental to the services performed by the Taxpayer, and thus not subject to sales tax.

FACTS

The Taxpayer owned and operated a video production business, Auvid Productions International, Inc., during the period in issue. The Taxpayer produced videotaped television commercials, dance recitals, or other special events for his customers, and then sold the video tapes to the customers. The Taxpayer charged the customers based on the amount and type of equipment used, whether a technical director or other individual was

needed, how much editing was required, and how long the production took. The Taxpayer billed the customers for the video tapes, and a separately stated amount for services. The Taxpayer failed to collect sales tax on the separately stated charge for services.

The Department audited the Taxpayer for the subject period. The Taxpayer failed to keep complete records. Consequently, the Department examiner computed the Taxpayer=s liability using his available invoices and deposit records. The examiner used the deposit records because in several instances the Taxpayer had deposited money received from a customer, but had no invoice concerning the customer.

If the Taxpayer produced a Acustom@ commercial for a television station that required production and editing work, the Department treated that job as a non-taxable service. If the job did not involve a television commercial, the examiner taxed the entire amount received by the Taxpayer, including the separately stated production charges. The examiner also taxed several jobs on which the Taxpayer claimed the customer was exempt because the Taxpayer failed to prove that the customer was exempt.

ANALYSIS

The Department=s distinction between taxable generic videos and non-taxable custom videos is based on a 1992 letter from a Department supervisor. That letter, Dept. Ex. 2, reads in pertinent part as follows:

> The production and sale of special event/occasion video tapes and film-to-video transfer tapes, whether original master tapes or copies, are taxable sales of tangible personal property. The measure of tax would be the total price charged to the customer with no deduction for labor, mileage, video tapes, or other materials used.
>
> It is the Department=s position that the object of the above type transactions

> is not the intangible images or information contained on the tapes, but the medium in which the customer wants those images or information placed, i.e. videotape.
>
> Production and sale in mass quantity of Ageneric@ tapes, such as motivational films, safety films, and training films, etc., would be subject to tax on the selling price to the customer. However, the production of Acustom@ video tapes, such as commercials or training films, etc., where the services include script development, direction, editing, hiring of actors and speakers, etc., would be treated as a service similar to advertising agencies. Tax would be due on the purchase or withdrawal of materials, etc. used in the production of the end product.
>
> You should purchase all video tapes, albums, and other items for resale tax free. Tax would then be due on the sale of tangible personal property at the selling price and on the cost of merchandise withdrawn and used in providing a service.

It is assumed that the reference to Aadvertising agencies@ in the above letter relates to *State v. Harrison*, 386 So.2d 460 (Ala.Civ.App. 1980). Harrison operated an advertising agency and produced custom catalogs and brochures for his customers. The Court of Civil Appeals held that Harrison had provided the tangible brochures and catalogs incidental to the performance of his professional services, and thus had not made taxable retail sales.

For purposes of this appeal, the Department=s distinction between taxable generic videos and non-taxable custom videos is accepted.[1] The issue thus is whether the Taxpayer=s transfer of the videos to his customers was only incidental to his non-taxable professional services.

As indicated, the Department examiner did not tax the proceeds derived from the production and sale of custom television commercials produced by the Taxpayer. However, the examiner was sometimes unable to determine the exact nature or complexity of a job because of the Taxpayer=s inadequate records. The Taxpayer also did not explain

the nature of his business to the examiner. Consequently, unless the examiner could identify the job as a television commercial, he treated the transaction as a sale, and taxed it accordingly.

The undisputed evidence indicates, however, that the Taxpayer=s jobs for The Dance Company, North Alabama Dance Center, Backstage, the Village School, and Frank Ryder involved more production and editing services than a typical television commercial. Applying the Department=s custom video rationale, those jobs should be removed from the audit. The Taxpayer=s job for the Community Bank involved editing a film of a football game that had been filmed by a third party. That job clearly involved a non-taxable service, and also should be deleted from the audit.[2]

The Taxpayer also claims that no tax is owed on his jobs with a barbershop quartet and Pointe Station because those entities were tax-exempt. However, the Taxpayer failed to present evidence that the entities were exempt. The tax on those jobs is affirmed. The Taxpayer also failed to present evidence that the other jobs included in the audit constituted non-taxable services, and not taxable retail sales. Tax on those jobs is also affirmed.

The Department is directed to recompute the Taxpayer=s liability as indicated above. A Final Order will then be entered for the adjusted amount due.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, '40-2A-9(g).

Entered November 14, 2000.

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1. Whether a transfer of tangible personal property for a price involves a taxable sale or a non-taxable service is one of the most difficult issues in state taxation. The Alabama Supreme Court first addressed the Asale v. service@ issue in three cases decided in 1937. *Doby v. State Tax Comm.*, 174 So. 233 (Ala. 1937); *State Tax Comm. v. Hopkins*, 176 So. 210 (Ala. 1937); and *Long v. Roberts & Son*, 176 So. 213 (Ala. 1937). Justice Bouldin, in his concurring opinion in *Long*, stated the rule of law as follows:

> . . . if the transaction is essentially one for service, the fact that some materials are used as an incident to such service, and consumed in the using, does not render it a sale of tangible property within the act. But, where the aim and end of the transaction is the passing of a tangible article from one to the other for the later=s use or consumption, the fact that service or materials, or both, have been put into the article, or that it is useful only to the party who received it, does not remove such business from the scope of the act.

Long, 177 So. at 219.

The Supreme Court next addressed the issue in *Haden v. McCarty*, 152 So.2d 141 (Ala. 1963). The Court held that a dentist was a practitioner of a Alearned profession,@ and consequently that the transfer of dentures and prosthesis was only incidental to the professional service provided by the dentist, and thus not subject to sales tax. The rationale in *McCarty* was affirmed in *Hamm v. Proctor*, 198 So.2d 782 (Ala. 1967), and *Crutcher Dental Supply Co. v. Rabren*, 246 So.2d 415 (Ala. 1971).

As discussed, the Court of Civil Appeals in 1980 held in *Harrison*, supra, that an advertising agency that produced advertising brochures and catalogs for its customers was providing a professional service. The transfer of the brochures and catalogs to the customer was only incidental to the service, and thus not a taxable retail sale.

In *Alabama Board of Optometry v. Eagerton*, 393 So.2d 1373 (Ala. 1981), the Alabama Supreme Court held that optometry was not a Alearned profession,@ and consequently that the transfer of eyeglasses by an optometrist to a patient was a taxable retail sale. Chief Justice Torbert dissented, arguing that optometry should be considered a Alearned profession.@ *Alabama Board of Optometry*, 393 So.2d at 1378. In response to the above case, the Alabama Legislature specified that the dispensing of eyewear by licensed opthomologists shall not be considered a taxable retail sale. Code of Ala. 1975, '40-23-1(d).

Alabama=s appellate courts next addressed the issue in *State Dept. of Revenue v. Kennington*, 679 So.2d 1059 (Ala.Civ.App. 1995). The Court of Civil Appeals held in *Kennington* that an artist that painted and sold portraits was providing a professional service. The transfer of the portrait to the customer was incidental to that professional service, and thus did not constitute a taxable retail sale. I respectfully, but strongly, disagree with the Court=s rationale in *Kennington* for the reasons explained in *Selma Animal Hospital v. State of Alabama*, S. 95-231 (Admin. Law. Div. Preliminary Order Denying Application for Rehearing 3/26/96), at n. 4. See also, Hellerstein & Hellerstein, *State Taxation* (3rd Ed.) &12.07(2), at 12-73. (AAnd usually, whether the painting is done on commission or otherwise, the artist transfers title and possession to the purchaser, along with the right to exhibit and resell the painting, typically for a lump-sum payment. Such transactions have all the customary characteristics of a sale of goods, so that one tends to view the artist as making sales of paintings, including works painted on commission.@)

The legal principle that a transfer of tangible personal property for a price is only incidental to a professional service, and thus not a taxable retail sale, should be applied only in very limited circumstances. I agree with Justice Bouldin=s statement in *Long* that if the end product sought by the purchaser is the tangible property that is transferred, a taxable sale has occurred regardless of the skill, labor, or artistry used in producing the tangible product. On the other hand, the intangible services provided by doctors and lawyers are the end product sought by their patients and clients. The tangible property transferred as part of their services is incidental to the services, and thus not subject to sales tax. The same rationale also applies to accountants, stenographers, and similar professional service providers. The difficulty, obviously, is where to draw the line. For a good discussion of the different tests applied by the states, see Hellerstein & Hellerstein, *State Taxation* (3rd Ed.) &12.07.

See also, *Thigpen Photography v. State of Alabama*, S. 95-127 (Admin. Law Div. Opinion and Preliminary Order 8/30/95) (sale of photographs taxable because photography is not a Alearned profession@); *State v. Design Forum, Inc.*, S. 87-169 (Admin. Law Div. 10/15/87) (sale of furniture by interior designer taxable because interior designing is not a Alearned profession@).

2. The holding that some of the Taxpayer=s jobs should be deleted from the audit does not indicate that the Department examiner did not conduct a good audit. To the contrary, he did the best he could with the information provided by the Taxpayer.