JACLYN L. ROBINSON D/B/A ROBINSON STUDIO & DESIGN 3313 DUNDEE COURT MOBILE, AL 36695-6210	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 13-807
v.	§ §	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Jaclyn L. Robinson ("Taxpayer"), d/b/a Robinson Studio & Design, for State sales tax for January 2008 through October 2012. [1] The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on June 10, 2014. The Taxpayer and CPA Emmett Philyaw attended the hearing. Assistant Counsel Duncan Crow represented the Department.

The Taxpayer is a full-service wedding photographer located in Mobile, Alabama. She opened her business in 2007 or 2008.

The Taxpayer offers various packages to potential customers. The packages range from a $2,500 "Wedding Collection" package that includes five hours of wedding day coverage, one photographer, and an online gallery for viewing and purchasing photographs, up to a $7,500 "Ultimate Wedding Collection," which includes complete wedding day coverage, two photographers, engagement and bridal sessions, two hour rehearsal dinner coverage, a $500 credit toward the future purchase of prints, a DVD of

[1] The Department also assessed the Taxpayer for use tax in the amount of $156.85, which the Taxpayer does not dispute.

edited images, a 10 x 10 album and two 5 x 5 parent albums, and a 16 x 20 gallery wrapped canvas. Intermediate packages for $3,500 to $5,500 and custom packages are also available. See, Taxpayer Ex. 2.

If a customer hires the Taxpayer, the parties enter into a contract identifying the event date, the type of package selected, and the total amount due. The contract also specifies whether the Taxpayer will provide the customer with a disc containing the photographs, or an album of selected photographs, or a print credit that the customer can use to order printed photographs from the Taxpayer, or any combination of the above. The Taxpayer testified that when a contract is executed, the customer has “the option to give me a seven hundred and fifty dollar retainer fee and that will lock that (wedding) day in.” (T. 15). The customer sometimes pays the full contract amount up-front, but the contract usually requires the customer to pay in installments. In all cases, however, the customer is required to pay the contract amount in full at least one month before the wedding date.

Taxpayer Ex. 1 is an example of a contract entered into by the Taxpayer. The total contract price is $3,500, including “a non-refundable retainer of $750 required at the time of booking.” The balance is to be paid in installments. The contract further specifies that “[t]here are no refunds.” The Taxpayer testified, however, that if a customer cancels within four months of the wedding date, she will refund the contract amount that represents her charge for the tangible disc, album, and/or printed photographs that were not provided to the customer. She gave the example that if a customer chose the $3,500 package that included a disc, and the customer subsequently canceled within four months of the wedding, she would refund $500 to the customer and keep the $3,000 balance, which she considers a nonrefundable charge for reserving or saving the date.

Q. The day before the wedding the bride and groom have called it off.

A. Uh-huh.

Q. What do they get back?

A. Only whatever the tangible products that were in the package that they would have gotten that they will never get.

Q. I'm just going to order a disc.

A. They'd get five hundred dollars back. That's it. Period.

Q. So they would be refunded five hundred dollars. They'd paid thirty-five hundred?

A. Yes.

Q. The day before the wedding they cancel and you refund them five hundred dollars?

A. Yes.

Q. So three thousand dollars is guaranteed lost?

A. Absolutely. Because that's my day. And I can never get that money back ever. Like once they cancel on me – and that's even in my contract too. If they cancel on me within four months of their wedding day, that three thousand is not refundable.

(T. 20 – 21).

After the wedding, the Taxpayer edits the photographs and then mails the disc, album, and/or the printed photographs ordered by the customer to the in-state or out-of-state address provided by the customer. The customer and others can also later order additional photographs from the Taxpayer's online gallery. The Taxpayer also mails those additional photographs to the in-state or out-of-state address provided by the purchaser.

The Department audited the Taxpayer for sales tax for the period in issue and discovered that she did not have a sales tax account with the Department. The Taxpayer

explained at the June 10 hearing that she thought she was providing a nontaxable service, and thus not subject to sales tax.

The Department examiner included as taxable the gross receipts derived from all discs, albums, and printed photographs sold by the Taxpayer and mailed to a customer or other purchaser in Alabama. The gross receipts included the full prepaid contract amounts, and all additional amounts paid for any additional discs, albums, or prints subsequently sold and delivered to a purchaser in Alabama. The examiner did not tax the proceeds from sales closed outside of Alabama, or the prepaid amounts where the customer canceled before the wedding.

The Taxpayer concedes that she owes sales tax on the tangible discs, albums, and printed photographs that were delivered to her customers in Alabama during the audit period. She argues, however, that she should not be taxed on most of her prepaid contract proceeds because those proceeds are not for the tangible items she sells to her customers, but rather, are for her saving the wedding date on her calendar. In the above Taxpayer Ex. 1 example, the Taxpayer argues if the customer did not cancel, she would owe tax on the $500 charge for the tangible disc, but not on the $3,000 balance. As discussed below, the Taxpayer also complains that the Department has been unable to explain to her how she should charge sales tax in certain instances, and also that none of her competitors are paying sales tax on their "service" charges.

This case involves a difficult issue that again illustrates that the sales tax is sometimes the most difficult state and local tax to correctly apply and administer. It is undisputed that the sale of photographs by a professional photographer constitutes a

taxable sale of tangible personal property.[2] As stated by Professor Walter Hellerstein in his oft-cited treatise on state taxation – "Although photography is often a custom service, tailored to the needs or interests of the customer, and requires training and skill, virtually all states treat a photographer as selling tangible personal property rather than rendering a nontaxable service." , J. Hellerstein & W. Hellerstein, *State Taxation*, ¶ 13.05(2).

The difficult issue is determining the taxable gross proceeds derived from the sale. That is, can the total amount received by a photographer be divided into a taxable amount derived from the sale of the tangible discs, albums, and/or printed photographs, and a nontaxable amount derived from nontaxable services provided by the photographer.

In *Thigpen Photography v. State of Alabama*, Docket S. 95-127 (Admin. Law Div. 8/30/1995), the issue was whether a professional photographer was liable for sales tax on various fees charged in conjunction with his business. The Division generally explained when a fee or charge for labor or services provided by a retail business should be included in taxable gross proceeds.

> Taxable "gross proceeds" is defined at Code of Ala. 1975, §40-23-1(a)(6) as "[T]he value proceeding or accruing from the sale of tangible personal property . . . without any deduction on account of . . . labor or service costs . . . or any other expenses whatsoever . . . ". That is, labor or services performed by the seller as a part of and necessary to complete the sale are taxable. The difficult question is determining what labor or services are performed as a necessary part of the sale.
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> Clearly, labor and services necessary to manufacture or otherwise prepare an item for sale are taxable. For example, separately stated engraving services performed by a trophy shop have been held to be taxable because the engraving was necessary to prepare the plaques, trophies, etc. for sale.

[2] In Alabama, a taxable sale occurs when the photographs are mailed or otherwise physically delivered to the customer in Alabama, including when they are digitally transmitted to the customer in Alabama. See, *Robert Smith d/b/a Flip Flop Foto v. State of Alabama*, Docket No. S. 05-1240 (Admin. Law Div. 11/17/2006).

> *State v. Mary B. Montgomery*, Admin. Docket No. S. 94-132, decided December 29, 1994. Transportation and delivery charges are also taxable if performed by the seller prior to the close of the sale. *East Brewton Materials, Inc. v. State, Department of Revenue*, 233 So.2d 751 (Ala. Civ. App. 1970). See also, *State v. Pinkston*, Admin. Docket No. S. 94-294, decided January 30, 1995, in which separately stated gravel loading charges performed by a third party acting as agent for the gravel seller were held to be taxable.
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> On the other hand, labor or services not required or necessary to manufacture, prepare or deliver the sale item, or not otherwise performed by the seller as a part of the sale, are not taxable.
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> A fixed rate fee for services or labor that is not based on or contingent on the subsequent sale of property is not taxable. For example, fixed rate consultation fees charged by an interior decorator that are not contingent on the sale of property by the decorator are not taxable, even if the decorator subsequently sells tangible personal property to the customer. See, Department Reg. 810-6-1-.81.01(4). (footnote omitted)
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> In summary, the general rule is that service or labor performed by a seller is taxable, even if separately stated on the invoice, if the service or labor is necessary to manufacture, complete, or otherwise prepare the item for sale or for delivery by the seller, or if the charge is based on a percentage of the sale price and is contingent on the sale of the item. (footnote omitted)

Thigpen at 4 – 6.

One of the service fees in issue in *Thigpen Photography* was a fixed rate consulting fee. Applying the above general rule, the Division held that the consulting fees were not taxable because they were not for labor or services necessary to prepare, develop, or otherwise produce the photographs sold by the photographer.

> The Taxpayer charges his customers a fixed hourly or daily rate fee for his consultation services. The fee is charged whether or not a sale ever occurs. Like the fixed rate decorator fees in Reg. 810-6-1-.81.01(4), the Taxpayer's consulting services are separate and apart from the later sale of the photograph, if a sale occurs at all, and thus are not subject to Alabama sales tax.

> Department Reg. 810-6-1-.119 provides that gross proceeds from the sale of photographs are taxable, "without any deduction for any part of the cost of production, . . . ". "Cost of production" as used in the regulation should be construed to include only the labor and services necessary to actually prepare and develop the photograph.

Thigpen at 10 – 11.

In his treatise, again at ¶ 13.05(2), note 275, Professor Hellerstein cites two sales tax cases involving "sitting fees" charged by photographers. In *Voss v. Gray*, 298 N.W. 1 (1941), the North Dakota Supreme Court held that separately stated sitting fees were not subject to that State's sales tax.

> We have referred to the testimony of the plaintiff as to the practice followed by him in the making of charges for the taking and finishing of photographs. He makes two charges, one for the sitting, which must be paid whether the photographs are finished and delivered or not, and a further charge if and when the photographs are finished and delivered to the customer. Where, as in the instant case, such a practice is followed in good faith and not for the purpose of evading tax, we are of the opinion that the tax is not collectible on account of the charge for the sitting, but it should be imposed and collected on account of the charge made for the finished photographs.

Voss, 298 N.W. at 17.

The North Carolina Court of Appeals reached a different result in *Carolina Photography, Inc. v. Hinton*, 674 S.E.2d 724 (2009). As in *Voss*, the photographer in *Carolina Photography* charged a separately stated sitting fee, regardless of whether the customer subsequently purchased photographs from the photographer. The State argued that the sitting fee involved the photographer's labor necessary to complete the ultimate sale of the photographs, and was thus taxable. The Court agreed.

> Indeed, Carolina Photography was assessed additional sales tax only for "sitting fee" charges that preceded a sale of printed photographs. Therefore, following the reasoning in *Young Roofing*, the Bulletin, and the Department of Revenue's administrative decisions, the "sitting fee" charges preceding the

> sale of printed photographs must be considered charges for labor to fabricate the printed photographs. Stated another way, Carolina Photography could not produce, or ultimately sell, a printed photograph if it did not first arrange the "sitting" to take the picture. Accordingly, we hold that the "sitting fees" Carolina Photography charged each senior student before the student ordered printed photographs, are part of the sale price of those printed photographs.

Carolina Photography, 674 S.E.2d at 727.

I agree with the North Carolina Court's rationale in *Carolina Photography*.[3] Snapping pictures while the customer is sitting or posing for photographs is a necessary and required step in producing the finished photographs that are sold to the customer. As stated by the Court in *Carolina Photography*, a photographer "could not produce, or ultimately sell, a printed photograph if it did not first arrange the 'sitting' to take the picture." *Carolina Photography*, 674 S.E.2d at 727.

The Taxpayer's prepaid fees in issue can in some respects be distinguished from the sitting fees in issue in *Carolina Photography* because the Taxpayer receives and sometimes retains the prepaid fees without taking any action towards producing the tangible photographs. That is, unlike the sitting fees, which involve the photographer beginning to produce the photographs by snapping pictures at the sitting, the Taxpayer may retain at least a part of the fees in issue when the wedding is canceled, without ever snapping pictures or otherwise beginning the process of producing the tangible photographs.

But the prepaid contract amount also obligates the Taxpayer to take and edit the pictures, and to thereafter deliver the disc, album, and/or printed photographs to the

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[3] Professor Hellerstein also notes in his treatise, at ¶ 13.05(2), note 275, that "the current prevailing rule is that the entire charge (including the sitting fee) is made for the photograph

customer. In that regard, the fees are in substance the same as sitting fees paid for a photographer's labor in taking and editing the pictures that later become the tangible photographs. And although the fees are by contract nonrefundable after a certain date, and thus not contingent on the sale of the tangible photographs, they are still for the Taxpayer's labor in taking and editing the photographs.

I find that the prepaid fees constitute a part of taxable gross proceeds because they are for the Taxpayer's labor in planning, shooting, and editing the photographs, which, as discussed, are required and necessary steps in producing the finished, tangible products being sold by the Taxpayer. Like the sitting fees in *Carolina Photography*, however, the prepaid contract amounts in issue are taxable only if the Taxpayer subsequently sells a disc, album, and/or printed photographs to a customer in Alabama. That is, if a customer cancels before the wedding day, any prepaid fees collected by the Taxpayer would not be subject to sales tax.[4]

The above does not apply, however, to any retainer fee separately stated on the Taxpayer's contracts. As testified to by the Taxpayer, it is that $750 retainer fee that will

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itself," and is thus taxable.

[4] If the prepaid fees paid by a customer included sales tax and the customer later canceled, the customer would be due a refund of that sales tax erroneously paid. How the Taxpayer (or any photographer) should administratively handle the refund is addressed below.

"lock that (wedding) day in." That separate fee is unrelated to the production of the finished photographs, and is accordingly not taxable per the rationale of *Thigpen Photography*.

Unfortunately, the above holding does not resolve various other difficult issues involved in this case. The Taxpayer claims that she repeatedly asked the Department when and how much sales tax she should charge in certain situations, and that the Department was unable to give her guidance. She offered the following scenario in her appeal letter:

> Let's say I book a client today for their wedding in a year. They choose a $3500 package but on their contract it breaks down the following – service fee $3000, disc of images - $250, print credit - $250.
>
> After their wedding they ask me to mail them their disc to their new home in Colorado and they ask me to send their parents $250 worth of prints to their home in Alabama.
>
> How much sales tax should I send to the state once I have delivered/mailed the tangible items in Alabama?

The $250 disc mailed out-of-state would constitute a nontaxable sale closed outside of Alabama. The $250 worth of prints mailed to the parents in Alabama would be taxable. The difficult issue is whether the remaining $3,000 prepaid fee can and should be divided or attributed in part to the taxable sale of the photographs in Alabama and in part to the nontaxable sale of the disc outside of Alabama.

If the $3,000 charge included a separately stated retainer fee, that amount would not be taxable in any case. As discussed, the remaining fee is for the Taxpayer's labor in producing the finished photographs, and is taxable in full if the final product is sold to a purchaser in Alabama. And because the Taxpayer's labor was necessary to produce the

items sold in Alabama, the entire labor fee would be taxable, even if the Taxpayer also sold additional photographs, in whatever form, outside of Alabama.

In summary, except for any separately stated retainer fee, the Taxpayer's prepaid fee for taking, editing, and otherwise preparing the discs, albums, or printed photographs for sale is for the Taxpayer's labor associated with those activities, and is a part of taxable gross proceeds. Consequently, in the above example, while the $250 disc delivered outside of Alabama would be nontaxable, the Taxpayer would owe Alabama sales tax on the $3,250 balance, less the amount designated as a retainer, if applicable. If the Taxpayer subsequently sells additional discs, albums, or photographs that were not included in the contract, the proceeds from those sales would be taxable if delivered in Alabama and nontaxable if delivered outside of Alabama.

The Taxpayer argues that when she contracts with a customer a year or more before the wedding date, she may not know whether the tangible disc, album, and/or photographs will be delivered to the customer or other purchaser in Alabama (taxable) or outside of Alabama (nontaxable). She thus cannot know whether to charge sales tax on the prepaid contract amounts.

If a customer has an Alabama address or the contract specifies that the Taxpayer will mail the tangible photographs to an Alabama address, the Taxpayer should collect sales tax on all prepaid fees, except any separately stated retainer fee. The Taxpayer must then remit the sales tax included in the prepaid amounts to the Department with the returns for the months in which the tax was paid. If the customer subsequently directs the Taxpayer to deliver the photographs outside of Alabama, the sale would be nontaxable, and the customer would be due a refund of the sales tax erroneously paid. The Taxpayer

and the customer could jointly petition the Department for a refund, see Code of Ala. 1975, §40-2A-7(c)(1), but as a practical matter it would be administratively feasible, and simpler, for the Taxpayer to refund the tax to the customer and then claim a credit for the amount refunded on the next monthly return. The same refund and credit procedure should also be followed if the Taxpayer collects prepaid sales tax and the customer later cancels.

If the customer gives the Taxpayer an address outside of Alabama or the contract specifies that the Taxpayer will mail the photographs to an address outside of Alabama, the Taxpayer may elect not to collect sales tax on what she expects to be a nontaxable out-of-state sale. To protect herself, however, the Taxpayer should specify in the contract that if the customer later directs her to mail or otherwise deliver the photographs to an Alabama address, the customer would be liable to pay the sales tax due on the total contract amount, less any separately stated retainer fee.

I sympathize with the Taxpayer because she in good faith believed that she was not required to charge and collect sales tax from her customers. She is thus being required to pay sales tax that she did not collect from her customers.

The Taxpayer also indicated at the June 10 hearing that she had contacted various other wedding photographers in Alabama, and that none of them are collecting sales tax on their "service fees." Consequently, because the Taxpayer has been adding ten percent sales tax to her fees since being audited, she claims that she has been at a price disadvantage and, according to the Taxpayer, has lost a number of customers to her competitors.

All similarly situated taxpayers should be subjected to the same tax burden. The Department is accordingly encouraged to notify all professional photographers in Alabama

that they are liable for sales tax on all sitting and other fees they may charge for planning, arranging, taking, editing, and otherwise preparing photographs for sale. Again, any separately stated retainer would not be taxable.[5] The Department should also promulgate a regulation explaining how wedding photographers and other professional photographers should charge and collect sales tax.

The Taxpayer should notify the Administrative Law Division by September 30, 2014 if she has records showing the amounts of any retainer fees she charged and collected during the audit period. If so, the Department will be directed to remove those amounts from the taxable measure and reduce the tax due accordingly. The negligence penalty will also be waived for cause. The Taxpayer should contact the Administrative Law Division if she has any questions.

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 September 8, 2014.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Duncan R. Crow, Esq.
Jaclyn L. Robinson
Emmett D. Philyaw, Jr., CPA

[5] In *Voss*, the South Dakota Supreme Court found that the separately stated sitting fees were not taxable because separately charging for the sitting fees was done "in good faith and not for the purpose of evading the tax,. . ." *Voss*, 298 N.W. at 17. Likewise, any amount separately designated as a retainer must be reasonable, done in good faith, and not primarily for tax avoidance. Whether that is the case must be determined on the particular facts of each case.