STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
FANNON & OSMOND PHOTOGRAPHY, INC. AND FANNON & OSMOND, INC.	:	DECISION
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1980 through May 31, 1984	:	

Petitioners, Fannon & Osmond Photography, Inc. and Fannon & Osmond, Inc., 1071 6th Avenue, New York, New York 10018, filed an exception to the determination of the Administrative Law Judge issued on May 25, 1989 with respect to their petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1980 through May 31, 1984 (File Nos. 803093 and 803094). Petitioners appeared by Gerald A. Navagh, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel).

Petitioners filed a brief on exception. The Division of Taxation submitted a letter in opposition to the exception. Oral argument, at the request of petitioners, was heard on January 31, 1990.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioners' purchases of materials and services, including artwork, use of scriptwriters, graphic designs, photocopying, artwork illustration and layouts, which were then used to produce a taxable product were purchases for resale and, therefore, not subject to sales or use taxes.

II. Whether petitioners' purchases of these products constituted tax-exempt purchases of equipment for use directly and predominantly in the production of tangible personal property.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are stated below.

Fannon & Osmond Photography, Inc. ("F&O Photography") and Fannon & Osmond, Inc. ("F&O"), petitioners herein, were New York corporations with an identical place of business at 1071 6th Avenue, New York, New York 10018, during the audit period March 1, 1980 through May 31, 1984. The record reveals that one James Fannon was the president of F&O and that Gerald Osmond was vice president for the period March 1, 1980 through November 30, 1983. With regard to F&O Photography, James Fannon was vice president and Gerald Osmond was president for the period June 1, 1981 through May 31, 1984. There are no other facts in the record which indicate a more substantial corporate interrelationship.

On December 20, 1985, the Division of Taxation issued to F&O a Notice of Determination and Demand for Payment of Sales and Use Taxes Due setting forth tax due in the sum of $26,268.44, penalty of $6,567.13 and interest of $16,362.80, for a total of $49,198.37 for the period March 1, 1980 through August 31, 1983. A second notice was issued to F&O on the same date for the period September 1, 1983 through November 30, 1983 setting forth tax due of $1,900.98, penalty of $475.24 and interest of $588.91, for a total amount due of $2,964.89.

On December 20, 1985, the Division issued to F&O Photography a Notice of Determination and Demand for Payment of Sales and Use Taxes Due setting forth a total tax due of $3,994.81, penalty of $991.39 and interest of $1,700.03, for a total amount due of $6,686.23 for the period June 1, 1981 through May 31, 1984.

F&O, by its president and vice president, executed consents extending the period of limitation for assessment of sales and use taxes for the period March 1, 1980 through August 31, 1982 to December 20, 1985.

F&O Photography, by its president and vice president, executed consents extending the period of limitation for assessment of sales and use taxes for the period June 1, 1981 through August 31, 1982 to December 20, 1985.

The assessments issued against F&O and F&O Photography set forth above, were the result of field audits and the amount of tax assessed represents use tax.

With regard to F&O Photography, for the audit period June 1, 1981 through May 31, 1984, it was found that F&O Photography had adequate records, and that gross receipts per ST-100's, Federal returns and books and records of the corporation were reconciled for the fiscal years 1981, 1982 and 1983. Furthermore, a test of nontaxable sales indicated that all were substantiated and the Division disallowed none of said sales. A detailed analysis was made of purchase invoices for the entire audit period with regard to production expenses and the Division found use tax due on said purchases in the sum of $2,777.72. Additionally, a detailed analysis of fixed asset purchases for the audit period resulted in a use tax due of $1,217.12.[1] The use tax assessed on fixed asset purchases was not contested by F&O Photography.

With regard to F&O, an audit was performed for the period March 1, 1980 through November 30, 1983 and it was found that F&O maintained an adequate set of books and records and that its gross receipts per its ST-100's, Federal returns and books and records were reconcilable for the fiscal years 1981 and 1982. A test of F&O's nontaxable sales indicated that it could substantiate said sales and therefore no disallowance was made by the auditor. However, as with F&O Photography, a detailed analysis of purchase invoices for production expenses was made for the entire audit period as it was for the purchase of fixed assets. Additional use tax was found due on purchases of production materials in the sum of $27,823.53. With regard to the purchase of fixed assets, the Division of Taxation found additional use tax due in the sum of

[1]Although not at issue herein, the amount of tax due per the audit worksheets was $3,994.84, while the assessment stated $3,994.81.

$346.03.[2] As in the case of F&O Photography, F&O did not contest the use tax found due on the purchase of fixed assets for the audit period.

Both petitioners are audio-visual production companies which specialize in producing filmed and written communications for use primarily between corporate management and sales forces. Petitioners have a complete facility for creation and production of audio-visual communications. Their productions consist mainly of multi-image slides which utilize film, videotape and sound. Both petitioners employ a variety of specialists including artists, scriptwriters, designers, illustrators and mechanical specialists. These specialists are independent contractors who work for petitioners on a job-by-job basis.

An examination of invoices issued by both petitioners to their customers during the audit period indicated that, on many occasions, production expenses were not itemized separately from such charges as design and storyboards, slide production, assembly processes, art, photography, direction, and lab and production procedures. However, testimony at hearing revealed that when a fee was charged for a presentation, which included scriptwriting, typing and copying designs on a storyboard, the figure on the invoice included supplies and materials used in producing the artwork such as a storyboard, and also included labor for doing the work, a cost estimate of supplies for performing the work and a markup. It is uncontroverted that tax was charged by petitioners on the total amount listed on the invoice at the prevailing rates.

Petitioners produced what is generally known as a "presentation", which is a meeting attended by a corporate audience at which various corporate officers present new products to nationwide sales forces assembled at a meeting place for this purpose. It was petitioners' responsibility to create an entire production from concept through completion, including the production of all visuals, soundtracks, scripts, storyboards, etc., and delivery of the final product to the audience. The client essentially purchased an effective communication with its sales force.

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[2]Although not at issue herein, the amount of tax due per the audit worksheets was $28,169.56, while the assessment stated $28,169.42.

Generally, petitioners were referred to new clients as producers of such presentations or invited to compete with other producers for specific projects. After receiving an account, petitioners met with the client, outlined the parameters of the project, established schedules, budgets, communications and otherwise initiated groundwork for the project.

The first step in the production process was the establishment of budgets and schedules. The second step was assigning a scriptwriter who prepared a draft of an audio-visual script. A storyboard was produced simultaneously with the script and was cued to the script. Storyboards were produced by technical employees with graphic design abilities and knowledge of audio-visual production.

After the storyboard was approved, numerous skilled personnel in graphics and photography produced mechanicals or product photographs which ultimately became slides used in the final presentation. The slides were then cued to a soundtrack, a task which was sometimes performed by computers.

As part of its production costs, petitioner purchased photostats and prints, typography and artwork. Petitioner did not show what part of its production costs included materials which became part of the final product and were passed along to the customer and what part was equipment used in the production of its product. However, the Division deemed such purchases to be equipment used in production and assessed tax at the New York City local rate only.

OPINION

In the determination below, the Administrative Law Judge held that petitioners produced no evidence to show exactly which purchases in issue were passed along to their customers as physical component parts of the finished audio-visual products. He further held that although petitioners transferred some of the materials which they purchased to their customers, it was equally clear that petitioners used some of the materials and supplies they purchased in the preparation of their audio-visual products. Thus, the purchases were not for resale within the meaning and intent of Tax Law § 1101(b)(4). The Administrative Law Judge further held that

the Division properly assessed penalty as petitioners did not establish that their failure to comply with the Tax Law was due to reasonable cause and not due to willful neglect.

On exception, petitioners present the same argument they did below. The essence of this argument is that because petitioners collected sales tax on their entire charge to their customers, tax has been charged on all of the items at issue. Therefore, petitioners argue, they purchased all of the items for resale and do not owe any tax on the purchases. Lastly, petitioners assert that there is no reason to penalize petitioners with penalty and interest when they collected and paid the tax.

The Division, while not submitting a brief or memorandum of law in response to petitioners' brief, by letter advised of its substantial agreement with the determination of the Administrative Law Judge and requests that it be sustained in full.

We affirm the determination of the Administrative Law Judge.

Tax Law § 1105(a) imposes a sales tax on the receipts from every retail sale of tangible personal property, except as otherwise provided in this Article.

Section 1101(b)(4)(i) defines a retail sale as "A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property, . . ."

The Division's regulations provide that a resale exclusion is permitted:

> "[w]here a person, in the course of his business operations, purchases tangible personal property or services which he intends to sell, either in the form in which purchased, or as a component part of other property or services, the property or services which he has purchased will be considered as purchased for resale, and therefore, not subject to tax until he has transferred the property to his customer." (20 NYCRR 526.6[c][1].)

A compensating use tax is imposed under Article 28 of the Tax Law:

> "Except to the extent that property or services have already been or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax for the use within this state on and after June first, nineteen hundred seventy-one except as otherwise exempted under this article, . . . " (Tax Law § 1110).

In the matter at hand, an audit of the books and records of petitioners examined purchases of materials, supplies and services. It is these purchases which are the subject of the assessments at issue. Petitioners submit in their brief on appeal that in their work as producers of audio-visual material, they were required to purchase certain materials and services to produce the products for their clients. We do not disagree with this assertion. However, in and of itself, it does not assist petitioners in meeting their burden of proving that the purchased materials and services at issue were sold to their clients so as to fall within the resale exemption.[3] Nor is it relevant that petitioners collected tax on the full price of the final product, including production costs, since the resale exemption applies only to the materials or services purchased for resale and not for purchases which are, in fact, "production costs", i.e., expenses.

It is clear in reviewing the invoices submitted in evidence for Fannon & Osmond, Inc. and Fannon & Osmond Photography, Inc., that some of the items enumerated on the invoices were not passed along to the customers as physical component parts of their finished audio-visual products as required by § 1101(b)(4)(i) of the Tax Law. For example, the invoices detail the purchase of records to make a soundtrack and typography to produce graphics. These are examples of purchases used by petitioners to produce their products. Further, petitioners acknowledge that some of the purchases were production expenses. A letter (5-18-88) transmitting copies of client billings to the Administrative Law Judge stated, "Costs were entered against each production on a daily basis. These costs were for employee time, vendor billings and an estimated percent of in-house supplies used such as art supplies, copying paper for scripts, etc." (Petitioners' Exhibit 1, emphasis added.)

Thus, the record before us is clear that some of the purchases in question were used by petitioners as part of their production process and it is apparent that their primary utility to

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[3]The degree of specificity in the area of the resale exclusion is illustrated by the guidelines published by the Division of Taxation to assist persons engaged in the photographic industry (TSB-M-79[4]S). The guidelines list several hundred items of tangible personal property which are or are not actually transferred in the final product produced by a photofinisher.

petitioners and their customers was exhausted prior to any transfer to the customers (see, Matter of Cut-Outs, Inc. v. State Tax Commn., 85 AD2d 838, 446 NYS2d 436). Some of petitioners' purchases were, therefore, taxable as they were not for the primary purpose of reselling them to their customers, but rather for petitioners' own use in making the final product, (Matter of Laux Adv. v. Tully, 67 AD2d 1066, 414 NYS2d 53) and any resale would have been merely incidental (see, Matter of Albany Calcium Light Co. v. State Tax Commn., 44 NY2d 986, 408 NYS2d 333). Since petitioners have failed to prove exactly which purchases were for resale and which were used in production, we conclude that the Administrative Law Judge properly refused to treat any of them as purchases for resale.

The artwork, typography, photostats and prints purchased by petitioners constitute equipment used directly and predominantly in the production of their audio-visual products within the meaning and intent of Tax Law § 1115(a)(12) and are, therefore, exempt from New York State sales and use taxes, but said purchases are subject to the New York City local sales tax pursuant to § 1107(a) of the Tax Law. Therefore, the Division properly assessed tax pursuant to § 1107(a) on these purchases.

Petitioners complain that the result of this conclusion is to subject some items to tax twice: once when purchased by petitioners and once when sold by petitioners to their customers. If this is to any extent true, it is a problem entirely of petitioners' own making and not a flaw in the application of the tax. Petitioners failed to provide records that would allow their purchases for resale to be accurately segregated from their purchases used in production. Thus, if any of petitioners' purchases have been taxed twice it is simply because petitioners failed to sustain their burden of proof.

Finally, we note that petitioners' argument about whether the instant assessment is a sales or use tax attempts to introduce unnecessary confusion into the analysis. The purchases were subject to the sales tax imposed by § 1105(a) if purchased at retail in the State. If purchased outside the State, or if purchased in the State for resale, the purchases became subject to use tax

when put to a taxable use in the State by petitioners (Tax Law § 1110; 20 NYCRR 525.2[b], 531.3[a][2]). Thus, each purchase was subject to the sales tax or the use tax depending on the circumstance of its acquisition.

Since it has been determined that petitioners are liable for the taxes assessed, the refund question is rendered moot.

Finally, Tax Law § 1145(a)(1)(i) states that any person who fails to file a return or to pay over any tax to the Commissioner of Taxation and Finance within the time required by Article 28 shall be subject to a penalty. Since petitioners have not established that their failure to comply with the Tax Law was due to reasonable cause and not due to willful neglect, the Division properly found and assessed penalty pursuant to Tax Law § 1145(a)(1)(i) and 20 NYCRR 536.1.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of Fannon & Osmond Photography, Inc. and Fannon & Osmond, Inc. is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Fannon & Osmond Photography, Inc. and Fannon & Osmond, Inc. is denied; and

4. The notices of determination dated December 20, 1985 are sustained.

DATED: Troy, New York
July 19, 1990

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner