STATE OF ARIZONA

Department of Revenue
Office of the Director
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Janet Napolitano
Governor

Gale Garriott
Director

CERTIFIED MAIL [Redacted]

The Director's Review of the Decision of the Administrative Law Judge Regarding:	)	**O R D E R**
[Redacted]	)	**Case No. 200500067S-REV**
ID No. [Redacted]	)	

On July 29, 2005, the Administrative Law Judge issued a decision on the protest of [Redacted]. ("Taxpayer"). Taxpayer appealed this decision on August 29, 2005. As the appeal was timely, the Director of the Department of Revenue ("Director") issued a notice of intent to review the decision.

In accordance with the notice given to the parties, the Director has reviewed the Administrative Law Judge's decision and now issues this order.

STATEMENT OF CASE

The Transaction Privilege Tax Section of the Audit Division ("Section") issued a deficiency assessment to Taxpayer for the period of [Redacted]. Taxpayer protested the assessment, a hearing was held in the Office of Administrative Hearings, and the Administrative Law Judge denied the protest, with the exception that the penalties were abated. On appeal, Taxpayer argues that it is not subject to tax on income derived from separately stated professional fees Taxpayer charges regardless of whether its customer actually purchases any prints or other tangible personal property. Taxpayer provides three alternate arguments to support its position: (1) Taxpayer is exempt as a professional or personal service occupation or service business, pursuant to A.R.S. § 42-5061(A)(1); (2) Taxpayer's professional fees are exempt as services in addition to retail sales under A.R.S. § 42-5061(A)(2); and (3) pursuant to A.R.S. § 42-5039, the Department's newly amended administrative rule on photography, Arizona Administrative Code ("A.A.C.") R15-5-150, constitutes a new interpretation or

application that is favorable to Taxpayer and must thus be applied to its business retroactively.

The Section argues that Taxpayer is engaged in the business of photography, the taxation of which is specifically addressed in the version of A.A.C. R15-5-150 in effect during the period at issue. The Section also asserts that Taxpayer is not engaged in a professional or personal service business or occupation under A.R.S. § 42-5061(A)(1) and does not provide services in addition to retail sales under A.R.S. § 42-5061(A)(2). Finally, the Section maintains that A.R.S. § 42-5039 is not applicable because the language changes in A.A.C. R15-5-150 are not changes in the application of the retail classification to Taxpayer's business, and is not a new interpretation that is more favorable to Taxpayer.

FINDINGS OF FACT

The Director adopts from the findings of fact made in the Administrative Law Judge's decision and, based on the record, makes additional findings of fact as follows:

1. Taxpayer is engaged in the business of "commercial event photography," which generally consists of taking and providing to customers photographs (*e.g.*, groups, still, candids) at large group events (*e.g.*, corporate meetings, conferences). Taxpayer's preparation for events may include site visits, background and prop set-up, and camera and lighting set-up. At the time of the event, Taxpayer takes photographs, which are thereafter developed and printed at a photographic processing lab or organized, downloaded, and prepared for the customer.

2. Taxpayer charges an hourly, daily, or set fee for the entire shoot, and customers can choose whether they wish to purchase photographs as photographic prints, proof sheets, or compact discs ("CDs"). Taxpayer invoices the customer for the entire job, including the shoot fee (hourly, daily, or set), any additional

photographic personnel, any rush processing fees, and the photographic prints, proof sheets, or CDs. [1] Taxpayer separately states each item on its invoices.

3. The Section audited Taxpayer's business activities for the period of [Redacted], and determined that Taxpayer was engaged in retail sales activity as a photographer. The Section determined that for this audit period all the proceeds of Taxpayer's business were subject to tax, *i.e.*, the shoot fee and the prints, proofs, or CDs purchased by customers, and assessed tax penalty and interest accordingly. The Section allowed reductions of gross receipts for sales for resale and out-of-state sales.

CONCLUSIONS OF LAW

The Director adopts from the conclusions of law in the Decision of the Administrative Law Judge and makes additional conclusions of law as follows:

1. Arizona levies transaction privilege tax on the privilege of conducting business in the state, measured by the gross receipts from the business. *See*, *e.g.*, *DaimlerChrysler Servs. N. Am., LLC* v. *Ariz. Dep't of Revenue*, 210 Ariz. 297, 302, 110 P.3d 1031, 1036 (Ct. App. 2005).

2. Arizona's policy is to construe tax statutes strictly *against* taxpayer deductions and exemptions. *See, e.g.*, *DaimlerChrysler*, 210 Ariz. at 304,110 P.3d at 1038.

3. The business of photography is not a professional or personal service occupation under A.R.S. § 42-5061(A)(1), as a photographer does not enter into the business by virtue of a state sanctioned or state-issued license. *See* Ariz. Transaction Privilege Tax Ruling TPR 90-2 (Aug. 1, 1990).

4. Taxpayer's photography business is not a service business under A.R.S. § 42-5061(A)(1) because the dominant purpose of hiring an event photographer is to

[1] This decision generally refers to Taxpayer's fees for services or transactions other than the conveyance of the final photographic prints, proof sheets, CDs, or images to the customer as Taxpayer's "professional fees."

have the right to purchase photographs, *i.e.*, tangible personal property. See, *Qwest Dex, Inc. v. Arizona Department of Revenue*, 210 Ariz. 223, 109 P.3d 118 (Ct. App. 2005).

5. "Gross receipts" means the "total amount of the sale…,including any services that are a part of the sales… without any deduction from the amount on account of the cost of the property sold, materials used, labor or service performed, interest paid, losses or any other expense…." A.R.S. § 42-5001(7).

6. The general presumption is that all of a person's gross receipts are part of the person's tax base. A.R.S. § 42-5023.

7. The proceeds from the sale of original photographs by a photographer are taxable under the retail classification. *Former* A.A.C. R15-5-150.

8. The cost of labor employed in manufacturing, processing, or fabricating tangible personal property shall not be allowed as a deduction from the gross receipts derived from a sale of such property. A.A.C. R15-5-126.

9. Services provided in addition to retail sales that fall within the scope of the A.R.S. § 42-5061(A)(2) exemption must be distinct from the activities of fabrication that result in the creation of tangible property that the fabricator subsequently sells at retail.

10. A photographer's gross receipts derived from fees for activities such as event fees, sitting fees, and equipment setup fees are a part of the fabrication labor necessary to supply a customer with a photographic image, and, therefore, are included in the photographer's taxable gross receipts under the retail classification.

11. A long-continued administrative construction by a state agency is entitled to considerable weight in construing a statute. When there is doubt as to the meaning of the law or when statutory language is not dispositive, the court will generally give considerable deference to an administrative agency's construction.

See, e.g., Walgreen Ariz. Drug Co. v*. Ariz. Dep't of Revenue*, 209 Ariz. 71, 73, 97 P.3d 896, 898 (Ct. App. 2004).

12. The amendments to A.A.C. R15-5-150 that became effective on February 6, 2006 and that relate to the taxation of photography do not constitute a "new interpretation or application," as defined in A.R.S. § 42-5039(D).

13. Even if the changes in A.A.C. R15-5-150 reflect a "new interpretation or application" under A.R.S. § 42-5039, the amendments made to A.A.C. R15-5-150 result in the same applicability of tax rather than a more favorable result for Taxpayer; therefore, A.R.S. § 42-5039 is inapplicable.

14. Taxpayer's "professional fees" are taxable under the retail classification.

DISCUSSION

The primary question presented in this Appeal is whether separately stated charges for activities that culminate in the creation and sale of photography may be deducted from the Taxpayer's tax base, pursuant to A.R.S. § 42-5061(A), paragraph (1) or (2). Taxpayer argues that it is either in a personal service occupation or business not subject to tax by virtue of paragraph (1) or the activities at issue constitute services rendered in addition to selling tangible personal property at retail that may be deducted pursuant to paragraph (2). The Section argues that the sale of photography is taxable as a retail sale, and that the activities Taxpayer contends are services rendered in addition to selling at retail are part of the sale because they are instrumental in producing the item to be sold.

Taxpayer also argues that the Department's revision of A.A.C. R15-5-150, effective February 6, 2006, is favorable to its position and thus, pursuant to A.R.S. § 42-5039(B)(1), the revision should be applied retroactively to it. The Section maintains that neither the revisions to the rule nor A.R.S. § 42-5039 are applicable to Taxpayer.

For the reasons stated below, the Director agrees with the Section.

The Transaction Privilege Tax is Levied on More than Just Individual Sales.

A.R.S. § 42-5061(A) imposes transaction privilege tax on "the business of selling tangible personal property at retail," the tax base of which is "the gross proceeds of sales or gross income derived from the business." As such, the tax is levied on, *inter alia*, "the value proceeding or accruing from the sale of tangible personal property," without any deduction on account of the cost of property sold, materials used, labor or service performed, interest paid, expense of any kind, or losses. A.R.S. §§ 42-5001(5) and (7). In addition, A.R.S. § 42-5023 provides that all gross receipts from a business that is subject to tax under a classification are presumed to be included within the business's tax base unless shown otherwise. Thus, Arizona levies transaction privilege tax not on individual sales or transactions, but on the privilege of conducting business in the state, as measured by the gross receipts of the taxpayer derived from the business. *See*, *e.g*., *DaimlerChrysler Servs. N. Am., LLC* v. *Ariz. Dep't of Revenue*, 210 Ariz. 297, 302, 110 P.3d 1031, 1036 (Ct. App. 2005) (citing *Arizona State Tax Commission v. Southwest Kenworth, Inc.*, 114 Ariz. 433, 436, 561 P.2d 757, 760 (Ct. App. 1977)).

Taxpayer sells photography, which is subject to tax under the retail classification. Former A.A.C. R15-5-150. Under the clear language of A.R.S. §§ 42-5001, paragraphs (5) and (7) and 42-5023, Taxpayer's entire gross income from its business is subject to tax unless one of the specific exemptions or deductions apply. In determining whether one of the exemptions or deductions claimed by Taxpayer applies, the statute granting the exemption or deduction from tax must be strictly construed against the exemption or deduction. *DaimlerChrysler*, *id*.

The A.R.S. § 42-5061(A)(1) "Service Occupation or Business" Exemption is Not Applicable in this Case.

Taxpayer claims its proceeds are exempt under A.R.S. § 42-5061(A)(1) because it is a professional service occupation or business with inconsequential delivery of tangible personal property. The nature of professional and personal service occupations and businesses was discussed in *Arizona Transaction Privilege Tax Ruling*

TPR 90-2 (Aug. 1, 1990). Professional and personal service occupations "are those wherein the professional is able to engage in the occupation by virtue of a state sanctioned or state issued license to engage in that occupation" (*e.g.*, lawyers, doctors, cosmeticians, barbers). A service business is one whose dominant purpose is to provide a service rather than to fabricate and sell the goods fabricated. Examples of service businesses include "vehicle maintenance garages, pest control, lawn maintenance and other like services."

The exemption generally covers those inconsequential sales or transfers of tangible personal property used by an occupation or business in the actual operation thereof or to facilitate the service provided (e.g., shampoo used by a hair stylist to wash a customer's hair). Assuming such sales and transfers meet the inconsequentiality test provided under A.A.C. R15-5-104(C), they may be exempt from transaction privilege tax under A.R.S. § 42-5061(A)(1). That is not the case here. The photographs are not inconsequential items of property used to provide a service, but are the substance of the transaction.

Even if the inconsequentiality test could be met, Taxpayer's business of photography is clearly not a professional or personal service occupation under A.R.S. § 42-5061(A)(1), as a photographer does not enter into the business of photography by virtue of a state sanctioned or state-issued license. It is also not a service business under A.R.S. § 42-5061(A)(1). Taxpayer produces and sells photographs. The dominant purpose of hiring an event photographer is to have the right to purchase photographs, *i.e.*, tangible personal property. See, *Qwest Dex, Inc. v. Arizona Department of Revenue*, 210 Ariz. 223, 109 P.3d 118 (Ct. App. 2005). Even though Taxpayer separately states the fees for attending the event and taking the pictures from the charge for the pictures themselves, the transaction itself cannot be parsed into multiple little transactions.

Taking and selling photographs has long been categorized as taxable under the retail classification by administrative rule[2]. This has been the Department's long standing position – the business of taking photographs for another is a retail and not a service business. Clearly, attending an event, setting up equipment, and taking pictures are merely parts of the process required to produce the desired tangible personal property, the pictures to be sold. Those activities do not render a photographer to be engaged in a service business.

The Department's long continuing administrative interpretation that the taking and selling of photographs by a photographer is taxable under the retail classification, as evidenced by the history of A.A.C. R15-5-150,[3] is entitled to considerable weight in construing the statute. If there is doubt as to the meaning of the law or when statutory language is not dispositive, the court will generally give considerable deference to an administrative agency's construction. *See, e.g.*, *Jenney* v. *Ariz. Exp., Inc*., 89 Ariz. 343, 346, 362 P.2d 664, 667 (1961); *Walgreen Ariz. Drug Co*. v. *Ariz. Dep't of Revenue*, 209 Ariz. 71, 73, 97 P.3d 896, 898 (Ct. App. 2004).

The legitimacy of the Department's long standing interpretation is further supported by the fact that the Legislature has amended A.R.S. § 42-5061(A) numerous times without excluding photographers' fees from taxation. There is a presumption when the Legislature reenacts a statute without change that the body knew of the

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[2] *See* A.A.C. R15-5-150 (amended effective Aug. 9, 1993) (a photographer's gross receipts derived from sales of photography—"the operation of taking, developing, processing, or printing pictures, prints, or images on or from film, video, or similar media"—are taxable under the retail classification); A.A.C. R15-5-1836 (Supp. 81-2), the predecessor to A.A.C. R15-5-150 ("[s]ales by photographers of pictures taken and printed by them are taxable as retail sales," and "developing of films and making of prints of pictures taken by others, are taxable sales").

[3] The version of A.A.C.R15-5-150 that was in effect until February 6, 2006, which includes the audit period, provided the following:

A. The following definitions apply for purposes of this rule:
   1. "Photographer" means a person who engages in the business of photography.
   2. "Photography" means the operation of taking, developing, processing, or printing pictures, prints, or images on or from film, video, or other similar media.

B. Gross receipts derived from sales of photography by a photographer are taxable under the retail classification.

C. Developing of films and making of prints of pictures taken by others are taxable. Developing and printing for drugstores and other retailers are sales for resale.

uniform construction of officers required to act under the statute and adopted it in reenacting the statute. *Hamilton* v. *State ex rel. Ariz. Dep't of Revenue*, 186 Ariz. 590, 595, 925 P.2d 731, 736 (Ct. App. 1996).

Consequently, Taxpayer is not engaged in a nontaxable professional or personal service occupation or service business entitled to an exemption under A.R.S. § 42-5061(A)(1).

The A.R.S. § 42-5061(A)(2) "Service in Addition to a Retail Sale" Exemption is Not Applicable in this Case.

As previously indicated, the Department also has a long standing interpretation of the scope of A.R.S. § 42-5061(A)(2), the second exemption Taxpayer claims is applicable to its business. The exemption generally applies to gross income derived from services that are in addition to a sale, and not activities that help create the item to be sold. These activities generally fall into one or more of three categories: (1) repair labor, (2) installation labor, and (3) instruction and training. However, these three categories "are not intended to be an exclusive listing." *Arizona Transaction Privilege Tax Ruling* TPR 93-31 (May 10, 1993). As such, the A.R.S. § 42-5061(A)(2) exemption could cover other services that are rendered in addition to a retail sale if, like the three categories of services listed, the services are performed separate from, and thus "in addition to," the sale of tangible personal property." *Id.*

In this case, the gross receipts are from the sale of tangible personal property. “Gross receipts" means the “total amount of the sale…, including any services that are a part of the sales… without any deduction from the amount on account of the cost of the property sold, materials used, labor or service performed, interest paid, losses or any other expense….” A.R.S. § 42-5001(7). Gross receipts that are exempt as derived from a “service in addition to a sale” under A.R.S. § 42-5061(A)(2) are distinct from those activities involved in the creation of the product to be sold. *Walden Books Co*. v. *Ariz. Dep't of Revenue*, 198 Ariz. 584, 587, 12 P.3d 809, 812 (Ariz. Ct. App. 2000); *In re Sales Tax Protest of West,* 979 P.2d 263 (Okla. Civ. App. 1998). Therefore, the fees for

the service of taking the photographs are not for services in addition to or independent from the sale of tangible personal property, but rather, are for a service necessary to create the tangible personal property sought, a picture. Without this activity, there would be no tangible personal property to sell in the first place. Consequently, the proceeds for providing any of these activities may not be deducted pursuant to A.R.S. § 42-5061(A)(2).

A.A.C. R15-5-150 and Its Application under A.R.S. § 42-5039

On appeal, Taxpayer also argues that the Department's revision of A.A.C. R15-5-150, effective February 6, 2006, is favorable to its position and thus, pursuant to A.R.S. § 42-5039(B)(1), the revision should be applied retroactively to it. Taxpayer is incorrect that the amended rule enunciates a more favorable position to Taxpayer. The revised rule simply clarifies the interpretation the Department has taken regarding the taxation of photography. The revised rule clarifies that the photography rule must be read in conjunction with A.A.C. R15-5-104 (Service Businesses) and A.A.C. R15-5-105 (Services in Connection with Retail Sales). This clarification was one of the objectives for amending the existing rule. However, while the former rule, A.A.C. R15-5-150, may not have addressed the applicability of A.A.C. R15-5-104 and A.A.C.R15-5-105 and their respective authorizing statutes, the provisions of A.R.S. §§ 42-5061(A)(1) and (2) were always applicable to retail sales, whether those sales were made by a photographer or some other retailer. The Department could not deny the application of the statutory provisions of paragraph (A)(1) or (A)(2) by rule. However, the recognition of the fact that the provisions of A.R.S. §§ 42-5061(A)(1) and (2) apply to retail sales does not mean they apply to Taxpayer’s intermediary activities such as event fees, sitting fees, and equipment setup fees, which are part of the process of supplying a customer with a photographic image.

A review of the language of revised A.A.C. R15-5-150 clearly confirms that Taxpayer’s activities are subject to tax under the retail classification, without any deduction under A.R.S. § 42-5061(A)(1) or (2). Revised A.A.C. R15-5-150(B) provides:

> Gross income or gross proceeds derived from a sale of photography are subject to tax under this Article, unless, under A.A.C. R15-5-104(C), the sale of such photography is considered an inconsequential element of nontaxable activities that are associated with the sale. Examples of nontaxable activities that are associated with a sale of photography include research; script consulting; director, crew, and equipment charges; preproduction or postproduction charges; location scouting fees; and music charges. Activities that are associated with the sale of photography are nontaxable if one of the following applies:
>
> 1. The vendor is engaged in both a professional or personal service occupation or service business under A.R.S. § 42-5061(A)(1) and the business of selling photography at retail; or
>
> 2. The activities are not part of the manufacture, creation, or fabrication of photography and are not otherwise subject to tax under another Article of this Chapter.

A.A.C. R15-5-150(B), as it currently reads, simply provides additional explanation of *exceptions* to the general applicability of tax under which A.R.S. § 42-5061(A)(1) or (2) could apply, namely those situations in which the sale of photography constitutes an inconsequential element of "nontaxable activities" associated with the sale. Sitting fees and event fees are neither listed, nor are they of the same character as those listed.

The rule continues by providing that, in order to constitute a nontaxable activity, one of two circumstances must be present. The first requires two separate businesses, the business for selling photography at retail and a business qualifying under A.R.S. § 42-5061(A)(1), which Taxpayer does not allege it has. The second circumstance requires that the activity from which the receipts arise (1) falls outside of the "manufacture, creation, or fabrication" of photography and (2) is not an activity that is subject to transaction privilege tax under another classification. Taxpayer's sole business appears to be that of commercial event photography.[4] The fees at issue do

[4] The current version of A.A.C. R15-5-150 does vary from the pre-February 6, 2006 version in that it no longer includes photographic or image developing or processing in the tax base for the retail classification. Such activities are now taxed under the job printing classification found at A.R.S. § 42-5066, which has the same tax rate as the retail classification. To the extent that Taxpayer performs or resells developing or processing activities, it is also engaged in the business of job printing. For purposes of Taxpayer's appeal, this determination would not affect the applicability of transaction privilege tax under the retail classification on the photographic service fees at issue.

not fall outside of the manufacture, creation, production, or fabrication of commercial photography for retail sale. The fees are associated activities that are the first step to creating or fabricating photographs.

Thus, the language of the new rule does not apply the law more favorably to Taxpayer than the former rule did. The result of applying the new version of A.A.C. R15-5-150 is identical to that under the earlier rule, and therefore, under A.R.S. § 42-5039(B), the rule language of A.A.C. R15-5-150 that was effective before February 6, 2006 is operative for considering the business activity at issue

The Administrative Law Judge properly held that Taxpayer's sales of photography are taxable under the retail classification and that Taxpayer failed to overcome the presumption of correctness of the Section's assessment. The Administrative Law Judge also held penalties should be abated. The Section did not appeal that issue; therefore, that issue is not addressed in this order.

O R D E R

The Administrative Law Judge's decision upholding the assessment of tax and interest and ordering the abatement of the penalties is affirmed.

This decision is the final order of the Department of Revenue. The Taxpayer may contest the final order of the Department in one of two manners. The Taxpayer may file an appeal to the State Board of Tax Appeals, 100 North 15th Avenue, Suite 140, Phoenix, AZ 85007 or may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003) within sixty (60) days of the receipt of this order. For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For

information from the Tax Court, call (602) 506-3763.

Dated this 17th day of July, 2006.

ARIZONA DEPARTMENT OF REVENUE

Gale Garriott
Director

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mailed to:

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