

ILLINOIS SALES TAX MANUAL AND ADVISORY FOR PROFESSIONAL PHOTOGRAPHERS

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INTRODUCTION

To better understand the difference between how the Illinois Sales Tax affects photographers in Illinois brief review of the history of how the tax was initiated is needed.

In the late 1980's the Illinois legislature inserted a clause into a bill that, if allowed to go unchallenged it would have caused photographers to be the only service industry in the state required to charge sales tax on services.

While at first there was reluctance by Associated Professional Photographers of Illinois (APPI) members to challenge the state government the membership was persuaded to challenge the law as unconstitutional.

Basically, the tax to be applied to photographers was a trade off between the state and the Photo marketing Association (PMA). The PMA was seeking special privileges for its members that would allow them to write amortize equipment expenses over a much shorter time and also exclude them from sales tax on the equipment. At the same time the state was seeking ways to meet the cost of a water treatment project costing \$17,000,000. By photographers charge sales tax it was estimated that the state would generate between \$14 million and \$18 million. A small group of legislators had this rule inserted in a bill the night prior to the legislature voting on the bill and it slipped through without due diligence.

To allow this to go unchallenged would have been a failure to meet our obligations to our membership and especially as the Department of Revenue had already won a judgment that shot the idea down when it had been raised previously by PMA and supported by legislators.

Over a period of nearly two years a group of members, assisted by attorney Diane Anderson, challenged both PMA and the state on what we believed to be grossly unfair as well as unconstitutional. PMA had much to lose had we sought court action to eliminate an unconstitutional tax and APPI would have entered into an very expensive litigation that we would have had difficulty in financing.

Several of us spent many months and incurred out of pocket expenses working with our attorney to ultimately reach a compromise that resulted in a benefit for both the state and our members and non-members. The writer worked closely with Diane Anderson to frame the rules that now govern the sales tax as it now relates to professional photographers. Having worked on the language of the rules I have been able to assist many colleagues over the years in how they resolved issues with state auditors, none less than saving Fred Fox Studios over \$75,000 in alleged sales tax arrears, even though the studio still spent over \$40,000 in legal fees.

When we get to how the sales tax applies to photo prints you will possibly wonder why it is at 10% of the state or Self Rule community. This was negotiated because the process of applying images to photographic paper is the result of a service and it is only the paper that is a product for sale. In other words, the paper is the only substantial part provided to the end user. The image is a service. The action of applying the image to the original paper does not change the value of the paper used. As a sheet of 8 x 10 paper it is not a tangible product of a value more than a few cents.

RED FLAGS AND AUDITS

The purpose of this manual is to assist you in avoiding red flags that may cost you your solvency. A red flag may well result in a comprehensive audit that would result in an auditor spending days in your establishment and involving you in discussions and questions that consume a great deal of your time, thereby reducing the time you spend conducting business.

CAUTION

The great majority of accountants are not familiar with the following rules as they apply to photographers and is suggested that you contract with an accountant recommended by a colleague who has used such a service.

Also, many agents of the Revenue Department are also not familiar with these rules and should you receive a visit from such an agent you will provide him or her with this manual.

THESE ARE THE RULES.

* REGISTRATION

If you are selling photographs, frames and photography services with annual revenue of \$10,000, you must register with the State of Illinois Department of Revenue. The department of Revenue will then issue you a certificate that exempts you from taxes on taxable supplies that are for resale.

This privilege does not apply to purchase of equipment or items that are normally subject to tax that are not for resale at the time of purchase unless the intent is to sell the item. In other words, if such purchase are for personal or business use.

The certificate requires you to present the certificate or a copy thereof to any suppliers required by the state to charges sales tax.

When you have received your Certificate the Department of Revenue will require you to complete a ST-1 Sales and Use Tax Return. At first the returns will monthly, but later this may change to either quarterly or annually, depending on your gross sales and the amount of tax collected.

*FAILURE TO REGISTER

If you do not register and the Department of Revenue discovers your failure to register you will be liable for any and all uncollected taxes plus penalties and interest.

*NON TAXABLE SALES.

As is the case with accountants, lawyers, doctors, hospitals, etc., your services, such as service fees, session fees, charges for time provided, traveling expenses, shipping and postages are not taxable and will be entered on the sales tax return you will be required to remit to the state as "sales at prior rates (8a)" on your sales tax return.

*OUT OF STATE SALES

Sales billed and shipped to out of state addresses (unless you are previously advised of a reciprocal arrangement between Illinois and another state), are not charged sales tax.

IMPORTANT is that the sale must be SHIPPED and not carried by a purchaser to an out of state address. If your client visits your studio for photography and then orders prints from an out of state address and you then ship the order tax is due on an invoice written while the client is on your premises. Essentially, the order was initiated on your premises and it is taxable at the rate later shown in this manual. Subsequent orders, either via phone, email or by USPS mail from another state and shipped out of state are not taxable.

However, other persons, related or not related to the primary client may order from an out of state address, email, mail or online and the sale is not taxable. Such sales are noted as Interstate Commerce and applied as a deduction on the worksheet provided on your return.

If you have a website from which you receive orders the basket should have the ability to differentiate in state and out of state tax rates. If you are unable to create this function then it is advisable to apply tax as if it is all in state.

*TAX RATES

There are two tax rates that will be applied to sales. One is that which is charged for photographic prints and one that applies to sales of what is termed TANGIBLE MERCHANDISE.

*PHOTOGRAPHIC PRINTS, INCLUDING PRINTS OF WEDDING S

The matter of sales of work resulting from wedding photography is dealt with separately. This section deals with photography of portraiture, sports photography and COMMERCIAL PHOTOGRAPHY.

The rate charged on photo prints is that which was the result of the compromise negotiated when tax was first legislated by the state. If the community in which you do business applies a tax rate of *8%, then the rate charged for the photo prints you provide to the purchaser is 0.0800, or 10% of the required tax.

There are two ways you can calculate this tax. You can simply apply the 0.0800 to the total value of the prints sold. This means a \$100 sale of prints $\times 0.0800 = \$8$ divided by 10 = \$0.80. An alternative is to divide the total sale of prints by 10 and charge the tax at 8%. A \$100 sale divided by 10 = \$10. Taxed at 8% = \$0.80.

This rate of tax applies also to images presented on canvas or any other specialty surface.

AVOID THIS COMMON ERROR

There are numerous instances in which photographers have applied the 10% rule to packages, which includes albums that will be discussed later,

DO NOT CHARGE THE FULL RATE OF TAX TO PHOTO PRINTS

If you charge the full rate of tax to photo prints you create two separate problems.

First, you will overcharge your client a tax that cannot be refunded by the state. However, if the client should learn that you have over charged then you will be responsible for correcting the error. Second, you undermine the whole concept of the compromise negotiated with the state. Over charging taxes is wrong and the state is not entitled to receive revenue not due. Additionally you create a precedent that may cause all photographers problems in the future.

FRAME SALES

There are several issues when it comes to taxing the sale of frames. By definition a frame is a tangible product as it is resalable and not limited to the singular use by the purchaser.

A frame may be packaged with the photograph that will be fitted in the frame. When this is the case the "package" is taxed at the same rate as the photograph as discussed under PHOTOGRAPHIC PRINTS at 10% of the pertaining tax rate.

Frames sold separately are deemed tangible products and taxable at 100% of the pertaining to your community.

FRAMES INCLUDED IN PACKAGES

Packaging prints with frames is a simple and convenient sales technique that takes away the need to sell frames separately and insures that your work is appropriately framed.

A frame sold separately from prints, such as after the sale of the photograph and now invoiced separately will be charged at 100% of rate pertaining in your community.

BUT, it is not recommended that you sell frames separately and in packages. Doing so disassembles your packages by identifying the value of the frame and an auditor may deem that the full rate of the frame included in a package is to be taxed as a tangible product. This means that on an audit you will be responsible for the additional tax not collected from the client. Such an audit would result in back taxes, penalties and interest going back to the date you were registered and you received your certificate. This could well result in your being insolvent.

It is strongly advised that you either invoice your images packaged with frames or without frames and invoice the frames separately and make either choice your corporate policy.

Many studios offer frames to non-photography customers and while this are a laudable business it means that you will be identifying the value of frames that you include in packages.

If casual frame sales were a viable and profitable business for your company it would be advisable to incorporate separately for the purpose of selling frames. If you do not see this as an option it is advised that to incorporate casual frame sales you sell ALL frames separately from prints and charge the 100% tax rate.

If the latter is your choice you may invoice the frame separately and itemize the FITTING FEE separately. A fitting fee is a service and EXEMPT from sales tax.

CAUTION. If you package prints and frames it is important that the assumed value of the photograph should be greater than the value of the frame; i.e. if your portrait is valued at \$500 the frame should not be of a greater value. An appropriate value for the frame in this case would not exceed \$300. The reason for this is that an auditor may see you hiding the value of the frame to avoid appropriate sales taxes.

If you are packaging your prints with frames DO NOT separately list the difference in the prices of a better quality frame, simply list your packages in upgrades, such as standard, deluxe and superior with an incremental price increase. Identifying the price of a frame disassembles the package and makes the frame taxable at the 100% tax rate.

TRAVEL, SHIPPING AND HANDLING AND HOURLY FEES

Travel, shipping and handling and hourly rates are invoiced separately and are EXEMPT from sales tax. When creating an invoice list service fees such as shipping, postage and handling fees clearly separate. If these items are to be listed on the same invoice it is recommended they be highlighted or asterisked as NON TAXABLE and the total value of non taxable items added as a sub-total on the invoice so that an auditor will not include these as taxable charges.

It is recommended that the total of non-taxable charges be identified within the "items to be charged" area of an invoice. You may arrange the layout of your invoices either pre-printed or handwritten at the time of creating the invoice in your own style as long as taxable and non-taxable charges are clearly defined so there is no chance that they may be misinterpreted at an audit.

*INVOICING THE TAXABLE AND NON-TAXABLE ITEMS

It is essential that items that are to be taxed at different rates are clearly itemized and the totals clearly stated so that the taxes are properly applied and understood by an auditor.

Note the different taxes to be applied so that the total taxes charged cannot be improperly interpreted. It is helpful if the actual tax to be charged for any item on an invoice is referenced on the same line as the item to be taxed. It is also helpful to keep all the different taxable items together in their own category. This will be advantageous should you be audited or have your accounts reviewed by a state agent.

INVOICING CD'S AND DVD'S /COMMERCIAL OR NO-COMMERCIAL

Since digital files have been available many photographers offer images to clients/customer on a CD or DVD. These media can and should be termed as PHOTOGRAPHS and therefore are taxed at the same rate as photo prints. A CD or DVD is similar in value as photographic paper and inherits the images as does photo paper. The disk is the same after the images have been burned. This is the same issue that was the basis of the original compromise when the tax was originally negotiated.

The sale or release of digital media is therefore treated as photo prints and the amount the photographer charges is discretionary. If the delivery of such media includes the release of the images to the client for the client's "Right to Use", then the release of copyright for full or limited use is a service and non-taxable. Therefore if the CD or DVD includes images that are released to the client and there is either full or limited copyright release included the release element should be listed separately and then it is non-taxable. Any fees charged for the creation of the images is also a non-taxable service.

COMMERCIAL PHOTOGRAPHY

Traditionally, commercial photographers bill clients based on the amount of time to be allocated to the project and then charge a fee for the release of the work created. This normally means that the client is quoted a total price for the project to be executed. Unless the quote is in writing and itemized the client does not see the items and their taxable rates until they are invoiced.

The dominant item on the invoice is the time used to complete the project and many photographers have simply bundled the total into one non-itemized price on the invoice. The red flag in this method is how an auditor might interpret the unwritten items included on the invoice. The correct method is to invoice the fee allocated to the project and then itemize the add-ons, such as prints and other items that make up the total media to be delivered.

The fee is non-taxable. Any image media is listed separately and taxed either as prints or disk.

WEDDING PHOTOGRAPHY

Many of the rules that govern how sales tax is to be charged is the same as those that apply to other categories discussed in this manual. But there are other considerations that are problematic if not correctly applied. Some of these may be covered in the manner in which a wedding contract is written. The contract between a service provider (photographer) and the client may well dictate how sales tax will be applied.

If a contract does not delineate between services and product then it may cause sales tax to be incorrectly applied. In this document we do not want to discuss the legal implications of a contract but if the contract inadvertently describes services and products ambiguously there may be sales tax issues too.

If a wedding contract commits the photographer to provide an album with a specific number of photographs as a total package then the amount to be invoiced will be taxed at the 10% rule. This means a contract that provided an album of 50 images for \$1,000, and the tax is at 8% the invoice will require sales tax in the amount of \$8.00, as it is a package that contains both the album and the 50 images.

However, it is not incorrect for the contract to describe the service as a service and product, one of which is taxable and one that is taxed at the 10% rule. This requires the contract to describe the service to the client as \$300 photography service and the album of 50 photographs. This then permits the photographer to invoice the photography fee as a non-taxable service and then the album of images taxed as a package, then the album is taxed at the 10% rule.

But, what if the client then wishes to order additional images in the album? It is here that you could create a sales tax problem. Adding images to the album requires a specific language to retain the 10% rule. The charge for adding images to the album should include the cost of any pages or other elements in adding the image and there should be no reference to a charge for the page or other elements required for adding the image. Identifying the cost of an album page or other element needed to add an image will disassemble the album.

YOUR LIABILITY FOR DISSEMBLING THE ALBUM

Disassembling an album that has been taxed at the 10% rule results in the entire cost of the album being taxed at 100% of the pertaining tax rate. If this is an ongoing policy of your business practice and you are the subject of an audit or review by a Department of Revenue agent you will receive a demand for taxes that you have not collected, plus penalties and interest. There will be an audit to determine ALL your costs of albums and parts of albums and this is totaled and the demand will be for the difference between taxes collected and those due.

Photographers have added images to albums that require additional pages to accommodate the additional images and have itemized a charge for the additional page and then the charge

for the image. This essentially disassembles the package and the album is then liable for sales tax at the 100% rate. But, had the charge for the additional page and print been bundled together the package would not be disassembled and the 10% rule would apply.

Let us provide an example. The original package of an album and 50 images is \$7000 and the client wishes to add 10 images to the album. You then cost both the additional image and the additional page required as one item, say \$20. The word "page" is NOT used and is not published in your price schedule. By omitting the word page and incorporating its charge in the charge for the images the 10% rule applies, as the album has not been disassembled.

What this means is that the album with additional prints and pages is taxed at the 10% rule.

To maintain the billing at the 10% rule there must NOT be any reference in your brochures, price lists, contracts or invoices that refer to the price of an album page as to do so you will have disassembled the album as a package. Additionally, any charges for upgrading an album package that refers to a specific album cover or style will also disassemble the album package. Instead it is advised that album packages be referred to, for example as standard, better, best, or superior or by any other description you prefer and the charges simply escalate accordingly.

An example of this is the original contract referred to the album package as Limited @ \$700 and the client wishes to upgrade to a better album cover and selects one of her choice. The selected cover now upgrades the package to deluxe and the package is now invoiced at \$850 and there is no mention of the cost of the cover thereby retaining the package status of the album. It is not disassembled.

DO NOT offer albums to non-photography clients unless you are also including images in the album and you are required to produce the images in which case you can include all within the same package. To provide an album to a non-photography customer requires you to charge the sales tax at 100% and also indicates the cost of an album, thereby identifying the cost of albums and disassembling album packages.

INDIVIDUAL PRINTS FROM WEDDINGS

Individual prints produced from a wedding assignment are taxed at the 10% rule. This is for all orders whether invoiced at the time of an original order or at a later date.

Photographers have erred by taxing such orders at two different rates, at the 10% rule on the first order and at the 100% rate for later orders. ALL photo prints, mounted or uncounted, are taxed at the 10% rule.

FRAMED WEDDING PRINTS

Framed wedding prints should be taxed as a package and listed as packages to retain the 10% rule. Therefore it is again important not to list the price of an individual frame. Brochures and price lists will refer to prints framed or unframed. However, with regard to framed prints smaller than those to hang risks a red flag as the difference between the charges for an unframed print of the same size unframed may indicate the price of the frame.

It is advised that small frames (4 x 6, 5 x 7, 8 x 10) be not part of your offering as packages with orders for these size prints. Instead the sale of such frames should be sold as tangible products and taxed at the 100% rate and only to photography customers

With regard to the latter, a survey by the writer in 2004, suggested that photographers who specialize in weddings and portraiture, on average the sale of small frames is equal to less than 4% of their total revenue. If a studio generates \$250K annual revenue this figure is equal to \$10k. Assuming this generates a bottom line of 25%, it is questionable whether annual return of \$2,500 is worth the risk of creating a serious sales tax problem.

It is not uncommon for consumers to assume that photographers have frames for sale for small prints and while this might result in additional revenue it may result in you being the subject of an audit that could be very costly.

It is the opinion of the writer, ALL frame sales, other than those of large prints in which the value of the print far exceeds the value of the frame, be sold as tangible merchandise and taxed at 100% of the pertaining tax rate.

The reason for this advice is that any indication of the price of a frame leads to the potential disassembling of a package, which at an audit could potentially result in serious financial cost. However, should it be a policy to sell prints framed as packages it is critical that the policy never wavers and there is no indication in any advertising, brochures, price lists, invoices, quotes, estimates, verbal or in writing that refers to the price of a frame or frames.

To sell small prints framed as packages requires a considerable and varied stock of frames styles and an inventory that over time has proved to be a financial liability to countless studios. But if offering such a selection to clients as both a service then it would be better to sell ALL frames, regardless of size at the 100% rate.

EXEMPT ORGANIZATIONS

Exempt organizations are those registered as schools, hospitals, and charitable organizations and enterprises who are able to present a sales tax certificate. This might also be a fellow photographers who purchases surplus product from you.

COMPLETING YOUR SALES TAX RETURN

As previously stated, when you have been registered for sales tax you will receive a certificate, which will allow you to purchase supplies and products exempt from tax when such products are for resale. Equipment or purchases for your own or your company's use are not exempt from sales tax unless they are purchased from out of state and there is no reciprocal arrangement between the states.

Initially, you will be required to complete a sales tax return monthly. However, depending on your sales volume and tax collected may result in your being required to make the return either quarterly or annually.

The return is **ST-1 Sales and Use Tax Return**. On the reverse side of the form is a **WORKSHEET**.

Most of the numbered items do not refer to photographers. You begin your return by completing **1a**. On this line you state the total sales taxes from tangible items.

1b On this line you state your total sales taxes of service, such as session or creation fees, hourly charges, shipping charges and the non-tangible items you have invoiced if they were taxed.

Item **2**. On this line you enter the total of 1a and 1b. This represents the **TOTAL SALES TAX COLLECTED**

You will now enter your deductions on lines 3 through 16d.

These are entered in items 3 through 16. You will enter your deductions as follows:

3 Resale. On this line enter the total sales of tangible valued items, such as frames and other accessories.

4. Interstate commerce. On this line enter total sales to out of state clients/customers.

5. Refunds. On this line enter total cash refunds, not credits or trade off items.

6 through 8 do not apply.

9.c. On this line you enter your total sales of non-taxable sales (session and creation fees, travel, shipping, postages, hourly charges, etc.

On this line state, i.e., photography services, personal services, etc.

10. On this line state the total sales to exempt organizations.

11 through and 12 do not apply

13. This will only apply if you have sold equipment from you inventory that has been acquired tax free.

14 and 15 do not apply

16. On this line you will enter the total sales of photographic prints and albums sold at the 10% rule. This you enter as follows: \$200,000 @ 90% + \$180,000.

This means that you are applying \$180,000 deductions that results in \$20,000 to be taxed at 100% of the tax rate.

You now add the totals as indicated on the lines 17 and 18.

Now you have all the totals of your deductions to enter on the front of the return.

On the front of the return you begin with **Step 2:** On line 1 enter your total receipts including tax collected. The wording of this is somewhat ambiguous, but never the less proceed to **line 2.**

On this line enter the amount stated on line 18 of the worksheet.

Now deduct line 2 from line 1 and enter it on line 3.

STEP 3. In this step you are identifying the different rates of tax that you have applied and when you total them they should equal the amount of tax you have collected. If there is a discrepancy then you have to pay the total due regardless of whether you collected adequate taxes. The lines you will complete are **4a, and 8a.**

On line 9 you enter the total taxes collected.

You now go to NET TAX DUE, in the right hand column. This is now very simple and you complete the return and sign it. If you have your accountant or another agent, employed by you will both sign it, write the check and mail it so that it reaches the state by the due date.

SELF RULE COMMUNITIES

It is possible that if you operate in a self rule community the treasurer of the community may demand that the sales of photo prints and album packages should have been taxed at the full rate pertaining to the community. If this should arise there is a letter available via the APPI that you will present to the agency demanding the difference in tax collected. Alternatively, you may present this document as evidence of the correct tax to be collected.