



# COMMONWEALTH of VIRGINIA

## *Department of Taxation*

### **MEMORANDUM**

**TO:** Ronald L. Holt  
Assistant Tax Commissioner  
Office of Compliance

**FROM:** Howard T. Macrae, Jr.  
Assistant Tax Commissioner  
Office of Tax Policy

**DATE:** September 8, 2000

**SUBJECT:** Office of Tax Policy's Position on Retail/Photo-Processing Operations

The purpose of this Memorandum is to communicate to the Office of Compliance the Office of Tax Policy's position with respect to retail/photo-processing operations in light of the Circuit Court of Fairfax County decision in Ritz Camera Centers, Inc. v. Department of Taxation at Law No. 112550. The Circuit Court ruled in this case that Ritz Camera's photo-processing operation was not incidental to their retail operation and the industrial processing exemption was applicable to their photo-processing equipment.

### **BACKGROUND**

Ritz Camera Centers, Inc. (hereinafter "Ritz") is a retailer selling camera, film, and optical products and also provides photo-processing services at its retail locations. Ritz was assessed tax on its photo-processing operation as being incidental to their retail business [Golden Skillet v. Commonwealth, 214 Va. 276, 199 S.E.2d 511 (1973), VAC 10-210-920.B(1)]. Ritz took the position that due to the fact the photo-processing operation and retail operation were separated by dividing walls, and because separate accounting is performed for their processing and retail sales operation, their processing operation enjoyed the industrial manufacturing exemption.



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### COURT DECISION

The judge in this case ruled from the bench and found that Ritz had presented sufficient evidence that Ritz's photo-processing operation was, in fact, industrial in nature and would enjoy the industrial manufacturing exemption. The judge in this case felt that the Commonwealth had not presented enough evidence to establish that Ritz's photo-processing operation was incidental to their retail operation of selling cameras and photographic supplies. In addition, it was established during the court trial that, while under the same roof, Ritz's retail operation and photo-processing operation were separated by a wall and they maintain separate accountings of both operations. It was also established that had these operations been under separate roofs, there would be no doubt that the photo-processing operation would qualify for the exemption. The judge ruled in favor of Ritz and ordered the department to refund of taxes paid plus interest.

### OFFICE OF TAX POLICY'S POSITION

Despite the decision found in the Ritz case, the Office of Tax Policy's position is not to stray from the department's regulations and longstanding policy that when a retailer conducts a business that is not industrial in nature and manufactures or processes tangible personal property as an *incidental* part of the retail operation, then the manufacturing process is also non-industrial in nature and the exemption does not apply.

The department's policy set forth above hinges on the term "incidental". While the department's regulation does not define the term "incidental", the department has established the following factors to use in evaluating whether one function is incidental to another.

- Number of transactions attributable to each operation;
- Location of each operation within the confines of the business establishment;
- Percentage of floor space attributable to each operation;
- Percentage of activity attributable to each operation; and
- Percentage of revenue attributable to each operation.

The preponderance of each of these activities should be reviewed to determine whether one function is incidental to another. As in Ritz Camera, the courts found that their photo-processing operation was not incidental to their retail operation. However, it is the department's position that this may not necessarily be true in all situations and each case should stand on its own.