

INFORMATION BULLETIN #2

SALES TAX

NOVEMBER 2011

(Replaces Bulletin #2 dated December 2006)

DISCLAIMER: Information bulletins are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules, and court decisions. Any information that is not consistent with the law, regulations, or court decisions is not binding on either the Department or the taxpayer. Therefore, the information provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: Warranties and Maintenance Contracts

REFERENCE: IC 6-2.5-2-1; IC 6-2.5-3-2; IC 6-2.5-4-1; 45 IAC 2.2-4-2

SUMMARY OF CHANGES

Apart from nonsubstantive edits, this bulletin has been changed from the previous version to clarify that any subsequent payments made by the purchaser are included in the amount subject to tax regarding original manufacturer warranties or dealer warranties guaranteeing the condition of a product and providing that maintenance or replacement parts will be provided for either no charge or a flat charge.

I. ORIGINAL MANUFACTURER WARRANTIES OR DEALER WARRANTIES

Original manufacturer warranties or dealer warranties guaranteeing the condition of a product and providing that maintenance or replacement parts will be provided for either no charge or a flat charge are subject to sales tax. The amount subject to tax includes any subsequent payments made by the purchaser, such as deductibles or other fees. Original manufacturer warranties and dealer warranties not offered as an option when the product is sold are considered part of the selling price of the product. Any parts transferred to a buyer under the terms of an original manufacturer warranty or dealer warranty are not subject to sales tax because the parts and or property are considered to have been sold with the product as a part of the retail transaction on which sales tax was collected.

Examples:

1. An automobile dealer sells an automobile for \$20,000. Included in the selling price is a warranty that will cover any repairs for two years or 20,000 miles. This warranty is an original manufacturer or dealer warranty. Tax is collected on the full \$20,000.
2. Same warranty as in Example 1 above. The automobile needs a new engine after 5,000 miles and six months of driving. The dealer must provide and install the engine under the terms of the warranty. No sales tax is due on the price of the engine since tax was collected on the warranty when the automobile was purchased. NOTE: if the dealer charges the vehicle owner a deductible or other fee under the terms of the warranty, that amount is subject to sales tax.

If the dealer provides a vehicle for the person to use while a car is being repaired under the conditions of a warranty, the furnishing of the vehicle is not considered to be part of the repair or the replacement parts and the charge for the provided vehicle is subject to the sales or use tax. If the warranty explicitly states that a replacement vehicle will be provided while warranty work is being performed, then the rental transaction is considered to be part of the original warranty and is exempt from the sales or use tax. The exemption must be supported by written documentation of payment from the warranty provider.

NOTE: The fee charged for a rental vehicle provided for warranty work is **NOT** exempt from the auto rental excise tax under IC 6-6-9, but is exempt from the Marion County supplemental auto rental excise tax under IC 6-6-9.7-8.

II. OPTIONAL WARRANTIES AND MAINTENANCE AGREEMENTS

Optional extended warranties and maintenance agreements may be either purchased alone or purchased as an option with the sale of the covered product. Typically, the terms of these agreements provide assurances that any required service and parts will be provided in the event of a breakdown or malfunction of the covered product. However, some of these agreements also contain provisions for periodic inspection or preventative maintenance activities where tangible personal property will be supplied as a part of the unitary price.

Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are subject to sales tax if there is a reasonable expectation that tangible personal property will be provided. The amount subject to tax includes any subsequent payments made by the purchaser, such as deductibles or other fees. Any parts or tangible personal property supplied pursuant to this type of agreement is not subject to sales or use tax. The supplier of the parts or property is not liable for the use tax on the parts or property because the supplier is using the material to fulfill the service called for by the terms of the warranty or maintenance agreement. A merchant that maintains an inventory of parts for resale and uses some of the parts in fulfilling the

terms of the warranty or maintenance agreement is not required to self-assess use tax on any parts so used.

Example:

3. Same facts as in Examples 1 and 2, except that the automobile dealer offers to extend the warranty on the automobile for three additional years or 30,000 additional miles for a price of \$1,500. This type of warranty is optional and is in addition to the purchase price. There is a reasonable expectation that parts will be supplied to the buyer under the terms of the warranty, thus sales tax should be collected on the additional \$1,500. The automobile dealer is not liable for the use tax on any parts or property subsequently transferred to the buyer under the terms of the warranty or maintenance agreement. **Note:** If the dealer charges the vehicle owner a deductible or other fee under the terms of the warranty, that amount is subject to sales tax.

Optional warranties and maintenance agreements that also contain provisions for periodic services where tangible personal property will be supplied as a part of the unitary price fall within the ambit of Rule 45 IAC 2.2-4-2. This rule, interpreting IC 6-2.5-4-1, states that where, in conjunction with rendering services, a service provider also transfers tangible personal property for a consideration, this will constitute a retail transaction unless:

1. The service provider is in an occupation that primarily furnishes and sells services, as distinguished from tangible personal property;
2. The tangible personal property is used or consumed as a necessary incident to the service;
3. The price charged for the tangible personal property is inconsequential (not to exceed 10 percent) compared with the service charge; and
4. The service provider pays sales tax or use tax upon the tangible personal property at the time of acquisition.

IC 6-2.5-2-1 imposes the state gross retail tax on retail transactions made in Indiana. If the provisions contained in the warranties or agreements are in complete compliance with all provisions of Rule 45 IAC 2.2-4-2, then the periodic transfer of tangible personal property will not constitute a transaction of a retail merchant constituting selling at retail. If such is the case, the service provider is not obligated to collect sales tax on the unitary price of the warranties or maintenance agreements. However, the service provider of the parts or property will be liable for the use tax on the parts or property because the service provider is using the material to fulfill the service called for by the terms of the warranty or maintenance agreement.

If the provisions contained in the warranties or agreements are not in complete compliance with all provisions of Rule 45 IAC 2.2-4-2, this will constitute a transaction of a retail merchant selling at retail. Thus, the service provider must collect sales tax on the unitary price pursuant to IC 6-2.5-2-1. The amount subject to tax includes any subsequent payments made by the purchaser, such as deductibles or other fees. Any tangible personal property subsequently transferred to the buyer under the terms of the warranty or maintenance agreement is not subject to sales tax.

In the case of software maintenance agreements or optional warranties, the presumption is that tangible personal property in the form of updates or patches will be transferred. Software maintenance agreements and optional warranties are presumed to be subject to sales and use tax. The amount subject to tax includes any subsequent payments made by the purchaser, such as deductibles or other fees. This presumption can be rebutted if the taxpayer can demonstrate that no updates were actually received.

Examples:

4. A computer software company sells a taxable software package to a customer. The customer also purchases an optional maintenance agreement from the company. The maintenance agreement entitles the customer to a maximum of 20 hours of programmer help to deal with any problems the customer might have in using the software package. The maintenance agreement also entitles the customer to periodic software updates. The software maintenance agreement is subject to sales tax.
5. An office supply company sells a photocopier machine to a customer. The customer also purchases an optional maintenance agreement from the company. The maintenance agreement entitles the customer to service and parts at no charge in the event of a breakdown of the photocopier machine. The agreement also provides for quarterly inspections; replacement of the drum after 100,000 copies have been made; and toner to be provided on an as-needed basis. The office supply company calculates that the price charged for the tangible personal property is 35 percent compared with the service charge. The sale of the maintenance agreement is a transaction of a retail merchant selling at retail and is subject to the collection of sales tax.

A handwritten signature in black ink that reads "John Eckart". The signature is written in a cursive style with a large, looping initial "J".

John Eckart
Commissioner