
Tax Compliance Guide

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Warranties Topic 362

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A warranty is a guarantee that an article of property will be free of defects for a specific period of time. Usually, the warrantor indemnifies the purchaser of the property by agreeing to replace or repair defects that arise without cost. The primary distinction between a warranty and a maintenance agreement is that work is performed under a warranty only if a defect is discovered.

Manufacturer's Warranty

Many articles of property will be sold with a warranty by the manufacturer against defects. This warranty is usually included in the purchase price paid for the property. Authorized dealers or repair agents subsequently remove property from inventory in order to replace the defective parts. This inventory, presumably purchased tax free for resale, is not subject to additional sales/use tax because it was included in the taxable purchase price paid for the original product.

Extended Warranties

Extended warranties are normally offered by the manufacturer and/or the seller in conjunction with the sale of the warranted property. Such warranties expand the initial warranty by indemnifying the purchaser for an extended period of time. Such warranties may also cover additional losses not warranted by the manufacturer.

Extended warranties are not subject to sales/use tax provided that they are optional and provided further that the price of the warranty is stated separately from the price of the property. Parts or materials used in fulfilling optional "extended warranties" are subject to Westminster sales/use tax. The person making the repair is required to remit sales or use tax on any parts used, even if such person is making the repair pursuant to a contract with the warrantor.

Sellers must collect Westminster sales tax on charges for separately stated parts and supplies sold subsequent to the warranty. The seller may not avoid collecting sales tax on parts by paying sales or use tax on such parts upon purchase, or by taxing all or part of the warranty charge.

Examples

1. Dealer A sells all new cars with a 3,000 mile manufacturer's warranty. After only 1,500 miles, Customer B finds that the air conditioner does not work. He takes the car to the dealer who has to replace a condenser. The

dealer removes this part, which cost \$200, from resale inventory and installs it in Customer B's car at no charge. There is no use tax due on this transaction.

2. Company C purchases a copy machine from Seller D. Company C also purchases a 12-month, optional extended warranty. Company C pays a flat, monthly charge plus charges for parts, if any, used to repair the machine. The monthly charge for the agreement is not subject to tax. Seller D must collect sales tax on any parts sold to Company C to repair the copy machine. Seller D should not pay sales tax when purchasing parts for repair inventory, because the parts will be taxed upon their resale.
3. Customer E purchases a new computer from Retailer F. The computer comes with a standard, 90-day warranty for defective parts. Customer E also purchases an optional, 1-year extended warranty that covers all parts and labor. The optional warranty is not subject to tax. Retailer F must pay use tax on any parts it uses in servicing the extended warranty.

Related Topics

Automotive Service & Repair
Maintenance Agreements

Citations

Westminster Municipal Code

§ 4-2-2. Definitions

§ 4-2-3. Rate; Imposition and Collection; Distribution

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