

Seattle Rule 5-133

Warranties and maintenance agreements.

(1) Introduction. This rule explains the Business License Tax reporting responsibilities of persons selling or performing services covered by warranties, service contracts, and mixed agreements for tangible personal property. For additional information on computer software maintenance agreements see Seattle Rule 5-500, Computer Software.

Examples included in this rule identify facts and then state a conclusion; they should be used only as a general guide. The tax consequences of all situations must be determined after a review of all facts and circumstances. Additionally, each fact pattern in each example is self-contained (i.e., "stands on its own") unless otherwise indicated by reference to another example. Examples concluding that business license tax applies to the transaction assume that no exclusions or exemptions apply, and the sale is sourced to Seattle.

(2) Definitions. For the purposes of this rule, the following terms will apply:

(a) Agreement. Unless otherwise stated, "agreement" means "service contract," "warranty," or "mixed agreement" as those terms are defined.

(b) Insurance rider. An insurance rider is an attachment to an insurance policy that modifies the conditions of the policy by expanding or restricting its benefits or excluding certain conditions from the coverage.

~~(4) Mixed agreements. If an agreement contains warranty provisions but also requires the actual specific performance of inspection, cleaning, servicing, altering, or improving the property on a regular or irregular basis, without regard to the operating condition of the property, such agreements are fully taxable as maintenance agreements.~~

(c) Mixed agreement. A mixed agreement is an agreement that contains provisions of both warranty and service contracts. The sale to a consumer of a mixed agreement for tangible personal property, which by definition contains provisions of both a warranty and a service contract, is a "bundled transaction."

(d) Seller. "Seller" means every person making sales to a buyer, purchaser, or consumer, whether as agent, broker, or principal.

~~(c) Maintenance agreements. Maintenance agreements (service contracts) require the periodic specific performance of inspecting, cleaning, physical servicing, altering, and/or improving of tangible personal property. Charges for maintenance~~

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~~agreements are retail sales, subject to retailing business license tax. Maintenance agreements or service contracts concerning non-tangible personal property, such as custom software, or items not included in the definition of a retail sale, should be reported under the service classification. Additional guidance on maintenance agreements for software is included in Rule 5-500 Computer Software.~~

- (e) Service contract. A “service contract”, sometimes referred to as a maintenance agreement or even an extended warranty, provides for the repairing, cleaning, altering, or improving of tangible personal property, generally for the purpose of continued satisfactory operation. These services may be performed on a regular or irregular basis. Even though a service contract may be referred to by some other name, it is the coverage that determines whether the contract is a service contract or extended warranty.
- (f) Warranties. ~~Warranties~~ A “warranty”, sometimes referred to as ~~guarantees a guarantee, and~~ is an agreement which provides ~~call~~ for the replacement or repair of ~~a purchased product with~~ tangible personal property at no additional charge ~~for parts and/or labor if the product is found to be defective or ceases to operate as designed during a specified warranty period or at a reduced charge for tangible personal property, labor, or both, or to compensate for the replacement or repair of tangible personal property, based upon the happening of some unforeseen occurrence, e.g., a component part fails and the property needs repair. Unless otherwise stated, the term warranty includes both a warranty and an extended warranty.~~
- ~~(b) Warrantor. The warrantor is the person obligated, as specified in the warranty agreement, to perform labor and/or provide materials to the owner of the purchased product to which the warranty agreement relates. In most cases the warrantor is the manufacturer.~~
- ~~(c) Maintenance agreements. Maintenance agreements sometimes referred to as service contracts, are agreements which require the specific performance of repairing, cleaning, altering, or improving of tangible personal property on a regular or irregular basis to ensure its continued satisfactory operation.~~

~~(2) Business License Tax.~~

~~(a) Manufacturers warranties included in the retail selling price of the product being sold.~~

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~~(i) When a manufacturers warranty is included in the retail selling price of the property sold and no additional charge is made, the value of the warranty is a part of the selling price. The value of the warranty is included in the "gross proceeds of sale" of the article sold and reported under the appropriate classification (e.g. retail sales and retail services or wholesaling).~~

~~(ii) When a repair is made by the warrantor under a manufacturers warranty, the value of the labor and/or parts provided are not subject to the business license tax.~~

~~(iii) When a person other than the warrantor makes a repair for the warrantor, the person making the repair is making a wholesale sale of the repair service to the warrantor. The person doing the repair is liable for business license tax under the wholesaling classification on the value of the parts and labor provided.~~

~~(b) Non-manufacturers warranties and manufacturers warranties not included in the retail selling price of the article being sold.~~

~~(i) When a warranty is sold for a charge separately stated on the invoice from the charge of the product, e.g., a warranty extending the manufacturers warranty, the charge is reported under the retail sales and retail services classification of the business license tax.~~

~~(ii) When a repair is made by the warrantor under a warranty that was separately stated on the invoice from the charge for the product, the value of the labor and or parts provided are not subject to business license tax.~~

~~(iii) When a person other than the warrantor makes a repair for the warrantor, the person making the repair is making a wholesale sale of the repair service to the warrantor. The person making the repair is liable for business license tax under the wholesaling tax classification provided the warrantor provides the person making the repair with a reseller permit.~~

(3) Sales of agreements for tangible personal property.

(a) Retail sales. Income from agreements sold with or without tangible personal property to consumers is subject to tax under the retail sales and retail services classification.

Income from the sales of insurance riders to consumers that is not subject to Washington State insurance premiums tax (RCW 48.14) is also taxable under the retail sales and retail services classification. Unless a specific exemption exists, sellers of agreements and insurance riders to consumers are subject to tax under the retail sales and retail services classification.

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~~(d) Amounts received as a commission or other consideration for selling a warranty or maintenance agreement of a third-party warrantor or provider are generally subject to business license tax under the service and other activities classification.~~

~~(e) In the event a warrantor purchases an insurance policy to cover their obligations under the warranty, amounts received by the warrantor under the insurance policy are insurance claim reimbursements that are not subject to business license tax.~~

A seller who is acting as an agent or broker for another party, such as the actual warrantor, normally receives a commission. Commission income is taxable under the service and other business activities classification. See subsection (4) of this rule for "sales by third parties." The warrantor's gross income on the sale is subject to tax under the retail sales and retail services classification. There is no deduction allowed for the commission paid to the agent or broker.

(b) Wholesale sales. Sales of agreements can be made at wholesale when the buyer will be reselling the agreement without intervening use or including the agreement in the sale of tangible personal property.

Example 1. An automobile dealer sells a vehicle to a customer for a selling price of \$20,000 that includes a manufacturer's limited five years or 50,000 miles warranty. The automobile dealer extends coverage for an additional two years, as a bonus to the customer. When the automobile dealer purchases the two-year agreement from a warranty provider, with the intent to sell the agreement along with the sale of the vehicle to the customer, the purchase of the extended warranty by the automobile dealer is for resale.

Example 2. A home improvement store (store) sells a lawnmower to a customer. The store also makes available for purchase a manufacturer's agreement for extended coverage. The customer decides to purchase an agreement from the store for the lawnmower. Both the sales of the lawnmower and agreement to the customer by the store are subject to tax under the retail sales and retail services classification. Sales of the manufacturer's agreement from the manufacturer to the store is considered a sale at wholesale. If the manufacturer has nexus with Seattle, the manufacturer would be subject to tax under the wholesaling classification for the sale of the manufacturer's agreement to the store.

Example 3. For a special holiday sale, the home improvement store in Example 2 purchases the manufacturer's extended warranties to provide with the sales of lawnmowers. The store makes no intervening use of the extended warranties and

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does not charge customers for the warranties. The warranty purchases by the store are wholesale purchases. The store is not the consumer of the warranties as the warranties are provided to customers as a condition of purchase of the lawnmowers. The store is subject to tax under the retail sales and retail services classification. If the manufacturer has nexus with Seattle, the manufacturer would be subject to tax under the wholesaling classification for the sale of the extended warranties to the store.

Example 4. If a vehicle wholesaler sells a vehicle to a retailer and includes an agreement with the sale, the sale of the vehicle with agreement is a wholesale sale. If the vehicle wholesaler has nexus with Seattle, the vehicle wholesaler would be subject to tax under the wholesaling classification.

~~(3) Additional service – deductible. If services are provided in addition to any warranty or maintenance agreement, such services are subject to retailing business license tax. This includes so-called "deductible" amounts not covered by a warranty or maintenance agreement.~~

(c) Additional charges for parts or repair services covered under an agreement. In some cases, a customer is required to pay an amount for services or parts not fully covered under an agreement. This additional amount is subject to tax under the retail sales and retail services classification.

Example 5. The automobile dealer in Example 1 sells a vehicle to a customer for a selling price of \$20,000 that includes a manufacturer's limited five-year or 50,000 miles warranty. The dealer also sells its own extended warranty to the customer for \$200. The dealer insures itself with an insurance carrier, and under the policy claims are paid on the retail value of the repairs. The customer has the dealer complete \$500 of repairs under the warranty. The customer pays the dealer a reduced charge of \$100 for the warranty services and the dealer receives \$400 from its insurance carrier. In completing the repair, the dealer installed parts from its inventory which had a cost to the dealer of \$150 and subcontracted part of the repair to an electrical shop which charged the dealer \$200. The tax liability to the dealer and subcontractor is as follows:

The \$20,200 selling price for both the automobile and warranty is subject to tax under the retail sales and retail services classification.

The \$400 received by the dealer from the insurance company is a nontaxable insurance claim reimbursement.

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The subcontractor is making a \$200 wholesale sale to the dealer if the dealer provides the subcontractor with a copy of its reseller permit.

~~(5)~~(d) Additional Examples.

~~(a)~~ Example 6. An automobile dealer sells a vehicle to a customer for selling price of \$15,000 cash and the selling price includes a manufacturer's limited warranty for 5 years or 50,000 miles. The owner of the vehicle has \$600 (\$200 parts and \$400 labor) warranty work, paying no deductible, performed by the dealer who is not the manufacturer-warrantor. The \$15,000 selling price is reported under the ~~retailing~~ retail sales and retail services ~~business license tax~~ classification. The \$600 repair is reported under the wholesaling ~~business license tax~~ classification.

~~(b)~~ Example 7. The automobile dealer in ~~Example (a)~~ Example 6 also sells its own extended warranty to the customer for \$200. The dealer insures itself with an insurance carrier and under the terms of the policy, claims are paid on the retail value of the repairs. In addition to the repairs in example (a), the customer has the dealer complete \$500 of repairs under the dealer's extended warranty. The customer paid the \$100 deductible and the dealer received \$400 from his insurance carrier. In completing the repair, the dealer installed parts from its inventory which had a cost to the dealer of \$150 and subcontracted part of the repair to an electrical shop which charged the dealer \$200. The tax liability to the dealer and the subcontractor are as follows:

(i) The dealer reports the \$200 sale of the warranty under the business license tax retail sales and retail services classification.

(ii) The \$100 deductible received by the dealer is a retail sale subject to tax under the retail sales and retail services classification ~~retailing business license tax~~.

(iii) The \$400 received by the dealer from the insurance company is a nontaxable insurance claim reimbursement.

(iv) The subcontractor is making a wholesale sale to the dealer, if the dealer provides the subcontractor with a copy of its reseller permit.

(4) Sales by third parties. Consideration received by a third party as a commission for selling an agreement for the actual warrantor is generally subject to tax under the service and other business activities tax classification. In this situation, the third-party seller never takes

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possession of the agreement, and the warrantor maintains liability for the provisions of the agreement.

Tax reporting responsibility of the warrantor. The warrantor is subject to tax under the retail sales and retail services classification on the gross sales price received from the sales of agreements by third parties. No deduction is allowed for commissions paid to third parties. The third party is responsible for service and other business activities tax on its commission income. If the seller of the agreement is subject to an insurance premiums tax on the sales of the warranty agreements, under chapter 48.17 RCW, such sales by the seller are exempt from tax (See SMC 5.45.090(N)).

(5) Sales of repair services or parts to obligor. A person obligated under an agreement, including any third-party obligor under an agreement sold to a retailer and provided at no additional charge to the end consumer, may purchase the following from a supplier or service provider at wholesale:

- (a) Parts purchased to replace or become an ingredient or component of tangible personal property covered by the agreement, if there is no intervening use of the parts as a consumer; and
- (b) Repair services purchased to satisfy the obligor's obligations under an agreement.

Gross income received by the supplier or service provider is subject to tax under the wholesaling classification on the value of the parts and labor provided.

(6) Warranties with insurance elements. There are tangible personal property agreements that include elements of insurance (i.e., theft, loss) and elements of warranty (operational failure, damage). Income from sales to consumers of agreements defined as a warranty service contract or maintenance agreement, that are not otherwise insurance contracts where tax has been paid under Title 48 RCW insurance premiums tax, is subject to tax under the retail sales and retail services classification.

DIRECTOR'S CERTIFICATION

~~I, Glen M. Lee, Finance Director of the City of Seattle, do hereby certify under penalty of perjury of law, that the within and foregoing is a true and correct copy as adopted by the City of Seattle, Department of Finance and Administrative Services.~~

Effective July, 2016