



# MAINE REVENUE SERVICES SALES, FUEL & SPECIAL TAX DIVISION INSTRUCTIONAL BULLETIN NO. 53

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## WARRANTIES, SERVICE CONTRACTS, AND MAINTENANCE AGREEMENTS

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This bulletin is intended solely as advice to assist persons in determining, exercising or complying with their legal rights, duties or privileges. It contains general and specific information of interest as well as interpretations and determinations by Maine Revenue Services regarding issues commonly faced by your business. Applicable portions of the Maine Sales and Use tax law (Title 36, Part 3) referred to in this Bulletin can be found in Attachment #1.

This bulletin explains the tax treatment and responsibilities of retailers and customers regarding product warranty sales and repairs of items of tangible personal property.

### A. MANUFACTURERS' WARRANTIES

**Sale:** Many sellers of tangible personal property offer a manufacturer's warranty that is included in the sale price of an item. Examples are automobiles, computers, photocopiers, watches, major appliances, and power tools. Manufacturers' warranties are considered part of the sale price of the item when originally purchased. Sales tax is calculated on the entire sale price.

**Repair:** Since the warranty has been taxed as part of an item's original purchase price, covered repair and replacement parts that a retailer uses to complete repairs covered under manufacturers' warranty are not subject to sales or use tax to the warrantor. Repair and replacement parts that are not covered by the warranty are subject to sales tax.

### B. SERVICE CONTRACTS AND MAINTENANCE AGREEMENTS

**Generally:** In most circumstances the stand-alone sale of a service contract or maintenance agreement for tangible personal property already owned by the purchaser/customer is not subject to sales or use tax. Covered repair and replacement parts used by the seller in the performance of the agreement are subject to use tax based on its acquisition cost for the parts, even if the customer is exempt from sales tax. If the seller provides to the purchaser/customer repair or replacement parts that are not covered by the agreement, it must charge sales tax to the customer (unless the customer is exempt).

**Computer software service contracts:** Software updates are not considered to be "repairs." Canned computer software is taxable as tangible personal property, and updates to such software are similarly taxable. Therefore, while the sale of a software maintenance agreement itself is not normally taxable, a seller of a maintenance agreement for "canned" computer software that provides for updates must nevertheless collect sales tax from its customer on the full price of the agreement if the updates are not separately stated; if they are separately stated, tax applies only to the price of the updates (rather than to any other services provided pursuant to the contract). A breakout

in the books and records of the seller will satisfy this requirement, but separately stating the price of the updates in an invoice provided to the customer is preferable and will serve to avoid questions upon audit.

In the case of telecommunications equipment, charges for installation, maintenance or repair are subject to Maine's Service Provider Tax; see Instructional Bulletin No. 55 for more information.

### **C. EXTENDED WARRANTIES – ITEMS OTHER THAN AUTOMOBILES**

**Sale:** The sale of an extended warranty is not taxable provided the purchase is optional and is separately stated from the sale of the item. An extended warranty is considered an “insurance policy” against the possible future loss of or damage to an item. In this sense, it is not tangible personal property and is not subject to sales tax.

**Repair:** In cases where the customer is not responsible for any additional payment for repairs under warranty, the warrantor is liable for sales or use tax on the repair parts based on the warrantor's cost. Parts associated with repairs made pursuant to an extended warranty are subject to sales or use tax to the warrantor, even if the warranty repair is being performed for a customer that is an exempt entity. If the customer is liable for all or a portion of the repair; the retailer performing the repair work must charge sales tax to the customer on the portion attributable to repair parts.

### **D. EXTENDED WARRANTIES – AUTOMOBILES**

For transactions entered into on after September 20, 2007, the sale of an extended service contract on an automobile that entitles the purchaser to specific benefits in the service of the automobile for a specific duration is a taxable service. Parts associated with repairs made pursuant to such a warranty are therefore not taxable either to the dealer or to the customer, since the parts are considered to be included in the original price of the extended warranty. If a warranty provides for a “deductible” to be paid by the customer at the time of repair or maintenance, the amount paid by the customer is first applied to non-taxable labor. If the deductible exceeds the amount charged for labor, the remaining amount will be applied to parts, on which the customer would have to pay sales tax.

For transactions entered into prior to September 20, 2007, the sale of an optional extended warranty on an automobile, if separately stated from the sales price, was not taxable, but parts associated with repairs made pursuant to such a warranty were taxable. Where the customer was not responsible for any additional payment for repairs under warranty, the dealer was liable for use tax on the repair parts based on the dealer's cost. If the customer was liable for all or a portion of the repair, the dealer would charge sales tax to the customer on the portion attributable to repair parts.

### **E. GOODWILL REPAIRS**

A repair made at no charge to the customer within the 30-day period immediately following the initial purchase is considered to be made pursuant to an implied warranty and is considered part of the original purchase price of the item. If repair or replacement parts used in such a repair were purchased by the retailer with a resale certificate and the sales tax was not paid at the time of purchase, the retailer does not need to report use tax or collect sales tax from the customer on those

parts. If the retailer did pay sales tax on the parts, an adjustment for the sales tax paid may be made on the next sales tax return filed.

#### **F. REPAIRS AND MAINTENANCE OUTSIDE OF WARRANTY**

When repair parts or accessories are installed in an item owned by the customer, and the charge for installation or repair labor is separately stated from the charge for the parts or accessories, only the materials portion of the sale is subject to tax. If labor and materials are not separately stated, but invoiced as one bundled price, the entire amount charged to the customer is taxable. The following are examples of parts or situations that a warranty typically will not include. Sales of these parts outside of a warranty are subject to tax.

- Photocopier drums
- Toner cartridges
- Car batteries, vacuum hoses, windshield wipers, etc.
- Misuse, abnormal service, improper handling, or modification to the item
- Watch batteries
- Warranty Registrations not completed prior to expiration

#### **G. WARRANTIES SUBJECT TO DEDUCTIBLE.**

Normally there is no sales tax on repair parts provided to a customer in connection with a manufacturer's warranty. Certain warranties require an "out of pocket" deductible to be paid prior to warranty coverage for repair or maintenance taking effect. The deductible is paid by the customer at the time of repair or maintenance. Deductibles paid by the customer are first applied to non-taxable labor. If the deductible exceeds the amount charged for labor, the remaining amount will be applied to taxable parts. Sales tax applies to the sale of these parts to the customer.

#### **H. MERCHANDISE RETURNS UNDER WARRANTY.**

The definition of "sale price" excludes allowances made on defective merchandise that is returned pursuant to warranty, and also excludes returned property when a full refund is given. Therefore, partial or full credit may be taken by a retailer for transactions previously reported as taxable if:

- A refund or credit is allowed the purchaser pursuant to warranty; or
- The full purchase price is refunded to the purchaser upon return of the merchandise.

**1. Returns Pursuant to Warranty.** When a price adjustment is made by a retailer on warranted defective merchandise returns, the adjustment, or allowance, is deductible on the retailer's subsequent sales tax return if the original sale was taxable and was so reported by the retailer and if

documentation supports that the sales tax was credited or refunded to the customer. The deduction may be taken on the next return or within three years from the date of adjustment.

*Example: A tire is sold with a 30-month warranty with a refund provision based upon period of use. The tire was sold for \$30.00. The warranty has a use allowance of \$1.00 per month if the tire fails before the warranty expires. If the tire is returned for failure after 24 months, the allowance would be \$6.00. The purchaser would be entitled to a refund of \$6.00 plus sales tax. The retailer would deduct \$6.00 on his next sales tax return.*

The warranty may be written or “implied”. A typical implied warranty would be a general guarantee that goods are not defective for the purpose for which they are designed. While an adjustment of sales tax liability may be made for allowance by warranty, whether written or implied, an adjustment cannot be made if the merchandise is returned because the purchaser finds it is not suited to his or her particular purpose. In the following example, unless the **full** purchase price is refunded, a sales tax adjustment cannot be made.

*Example: A customer purchases a snow blower with a manufacturer’s warranty. After using it for a short time, the customer finds that it is not powerful enough to meet his or her needs. The customer attempts to return the snow blower for a refund. The machine is not defective and thus there is no failure to meet a written or unwritten warranty. The retailer allows the return, but refunds only 85% of the original purchase price. A sales tax adjustment is not permitted.*

**2. Return of Merchandise and Refund of Full Purchase Price.** Where merchandise is returned by the customer and the full purchase price is refunded, either in cash or by merchandise credit, the retailer may deduct the original purchase price of the item on a subsequent sales tax return, if the original transaction was taxable and was so reported and if documentation supports that the sales tax was credited or refunded to the customer. The deduction may be taken on the next return or within three years from the date of adjustment.

In the following example the retailer applies a standard service charge stated as either a flat fee, or a percentage of the sale price (sometimes called a “restocking fee”) to the warranted return. The transaction will still be considered a refund of the full purchase price if the service charge is separately shown and identified on the invoice to the customer or in the retailer’s records. The customer would be entitled to a refund of the entire sales tax paid on the original transaction.

*Example: A retailer applies a standard service charge of \$1.00 to all merchandise returned for a refund. The invoice or credit memo to the customer indicates "purchase price refunded \$30.00, less service charge \$1.00 - net \$29.00". The retailer should treat this as a refund of the full purchase price and also refund the \$1.50 sales tax originally paid on the \$30.00 sale.*

If an item has been used by the customer and the retailer refunds less than the full purchase price (the transaction not involving an express or implied warranty); a sales tax adjustment cannot be made.

**I. ADDITIONAL INFORMATION.**

The information in this bulletin addresses some of the more common questions regarding warranty and extended warranty issues faced by your business. It is not intended to be all-inclusive. Requests for additional information on specific situations should be in writing, should contain full information as to the transaction in question and should be directed to:

**MAINE REVENUE SERVICES  
SALES, FUEL & SPECIAL TAX DIVISION  
P.O. BOX 1065  
AUGUSTA, ME 04332-1065  
TEL: 207-624-9693  
TTY: NexTalk 1-888-577-6690**

Or visit our website at [www.maine.gov/revenue](http://www.maine.gov/revenue)

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## **Attachment #1**

### **36 MRSA §1752 (Definitions)**

**10. Retailer.** "Retailer" means a person who makes retail sales or who is required to register by section 1754-A or 1754-B or who is registered under section 1756.

**11. Retail Sale.** "Retail sale" means any sale of tangible personal property or a taxable service in the ordinary course of business.

A. "Retail sale" includes:

(1) Conditional sales, installment lease sales and any other transfer of tangible personal property when the title is retained as security for the payment of the purchase price and is intended to be transferred later;

(2) Sale of products for internal human consumption to a person for resale through vending machines when sold to a person more than 50% of whose gross receipts from the retail sale of tangible personal property are derived from sales through vending machines. The tax must be paid by the retailer to the State;

(3) A sale in the ordinary course of business by a retailer to a purchaser who is not engaged in selling that kind of tangible personal property or taxable service in the ordinary course of repeated and successive transactions of like character; and

(4) The sale or liquidation of a business or the sale of substantially all of the assets of a business, to the extent that the seller purchased the assets of the business for resale, lease or rental in the ordinary course of business, except when:

(a) The sale is to an affiliated entity and the transferee, or ultimate transferee in a series of transactions among affiliated entities, purchases the assets for resale, lease or rental in the ordinary course of business; or

(b) The sale is to a person that purchases the assets for resale, lease or rental in the ordinary course of business or that purchases the assets for transfer to an affiliate, directly or through a series of transactions among affiliated entities, for resale, lease or rental by the affiliate in the ordinary course of business.

For purposes of this subparagraph, "affiliate" or "affiliated" includes both direct and indirect affiliates.

B. "Retail sale" does not include:

(1) Any casual sale;

(2) Any sale by a personal representative in the settlement of an estate, unless the sale is made through a retailer, or unless the sale is made in the continuation or operation of a business;

(3) The sale, to a person engaged in the business of renting automobiles, of automobiles, integral parts of automobiles or accessories to automobiles, for rental or for use in an automobile rented on a short-term basis;

(4) The sale, to a person engaged in the business of renting video media and video equipment, of video media or video equipment for rental;

- (5) The sale, to a person engaged in the business of renting or leasing automobiles, of automobiles for rental or lease for one year or more;
- (6) The sale, to a person engaged in the business of providing cable or satellite television services, of associated equipment for rental or lease to subscribers in conjunction with a sale of extended cable or extended satellite television services;
- (7) The sale, to a person engaged in the business of renting furniture, or audio media and audio equipment, of furniture, audio media or audio equipment for rental pursuant to a rental-purchase agreement as defined in Title 9-A, section 11-105; or
- (8) The sale of loaner vehicles to a new vehicle dealer licensed as such pursuant to Title 29-A, section 953;
- (9) The sale of automobile repair parts used in the performance of repair services on an automobile pursuant to an extended service contract sold on or after September 20, 2007 that entitles the purchaser to specific benefits in the service of the automobile for a specific duration;
- (10) The sale, to a retailer that has been issued a resale certificate pursuant to section 1754-B, subsection 2-B or 2-C, of tangible personal property for resale in the form of tangible personal property, except resale as a casual sale;
- (11) The sale, to a retailer that has been issued a resale certificate pursuant to section 1754-B, subsection 2-B or 2-C, of a taxable service for resale, except resale as a casual sale;
- (12) The sale, to a retailer that is not required to register under section 1754-B, of tangible personal property for resale outside the State in the form of tangible personal property, except resale as a casual sale; or
- (13) The sale, to a retailer that is not required to register under section 1754-B, of a taxable service for resale outside the State, except resale as a casual sale.

**13. Sale.** "Sale" means any transfer, exchange or barter, in any manner or by any means whatsoever, for a consideration and includes leases and contracts payable by rental or license fees for the right of possession and use, but only when such leases and contracts are deemed by the State Tax Assessor to be in lieu of purchase.

**13-A. Sale at retail.** "Sale at retail" means retail sale.

**14. Sale price.** "Sale price" means the total amount of a retail sale valued in money, whether received in money or otherwise.

A. "Sale price" includes:

- (1) Any consideration for services that are a part of a retail sale; and
- (2) All receipts, cash, credits and property of any kind or nature and any amount for which credit is allowed by the seller to the purchaser, without any deduction on account of the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, losses or any other expenses.

B. "Sale price" does not include:

- (1) Discounts allowed and taken on sales;
- (2) Allowances in cash or by credit made upon the return of merchandise pursuant to warranty;
- (3) The price of property returned by customers, when the full price is refunded either in cash or by credit;
- (4) The price received for labor or services used in installing or applying or repairing the property sold, if separately charged or stated;
- (5) Any amount charged or collected, in lieu of a gratuity or tip, as a specifically stated service charge, when that amount is to be disbursed by a hotel, restaurant or other eating establishment to its employees as wages;
- (6) The amount of any tax imposed by the United States on or with respect to retail sales, whether imposed upon the retailer or the consumer, except any manufacturers', importers', alcohol or tobacco excise tax;
- (7) The cost of transportation from the retailer's place of business or other point from which shipment is made directly to the purchaser, provided that those charges are separately stated and the transportation occurs by means of common carrier, contract carrier or the United States mail;
- (8) The fee imposed by Title 10, section 1169, subsection 11;
- (9) The fee imposed by section 4832, subsection 1;
- (10) The lead-acid battery deposit imposed by Title 38, section 1604, subsection 2-B;
- (11) Any amount charged or collected by a person engaged in the rental of living quarters as a forfeited room deposit or cancellation fee if the prospective occupant of the living quarters cancels the reservation on or before the scheduled date of arrival; and
- (12) The premium on motor vehicle oil changes imposed by Title 10, section 1020, subsection 6.

**17. Tangible personal property.** "Tangible personal property" means personal property that may be seen, weighed, measured, felt, touched or in any other manner perceived by the senses, but does not include rights and credits, insurance policies, bills of exchange, stocks and bonds and similar evidences of indebtedness or ownership. "Tangible personal property" includes electricity. "Tangible personal property" includes any computer software that is not a custom computer software program.

### **36 MRSA §1861. Imposition (Use Tax)**

A tax is imposed, at the respective rate provided in section 1811, on the storage, use or other consumption in this State of tangible personal property or a service, the sale of which would be subject to tax under section 1764 or 1811. Every person so storing, using or otherwise consuming is liable for the tax until the person has paid the tax or has taken a receipt from the seller, as duly authorized by the assessor, showing that the seller has collected the sales or use tax, in which case the seller is liable for it. Retailers registered under section 1754-B or 1756 shall collect the tax and

make remittance to the assessor. The amount of the tax payable by the purchaser is that provided in the case of sales taxes by section 1812. When tangible personal property purchased for resale is withdrawn from inventory by the retailer for the retailer's own use, use tax liability accrues at the date of withdrawal.

### **36 MRSA §2011. Overpayment; refunds**

If the State Tax Assessor determines, upon written application by a taxpayer or during the course of an audit, that any tax under this Part has been paid more than once or has been erroneously or illegally collected or computed, the assessor shall certify to the State Controller the amount paid in excess of that legally due. That amount must be credited by the assessor on any taxes then due from the taxpayer and the balance refunded to the taxpayer or the taxpayer's successor in interest, but no such credit or refund may be allowed unless within 3 years from the date of overpayment either a written petition stating the grounds upon which the refund or credit is claimed is filed with the assessor or the overpayment is discovered on audit. Interest at the rate determined pursuant to section 186 must be paid on any balance refunded pursuant to this chapter from the date the return listing the overpayment was filed or the date the payment was made, whichever is later, except that no interest may be paid with respect to the refunds provided by section 2013 and, in cases of excessive or erroneous collections, interest must be paid in accordance with section 1814, subsection 3. At the election of the assessor, unless the taxpayer specifically requests a cash refund, the refund may be credited to the taxpayer's sales and use tax account, but, in the case of a credit no further interest may accrue from the date of that election. The taxpayer may not apply for a refund of any amount assessed when administrative and judicial review under section 151 has been completed.

A taxpayer dissatisfied with the decision of the assessor, upon a written request for refund filed under this section may request reconsideration and appeal from the reconsideration to the Superior Court in the same manner and under the same conditions as in the case of assessments made under chapter 7. The decision of the assessor upon a written request for refund becomes final as to law and fact in the same manner and under the same conditions as in the case of assessments made under chapter 7.