



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

WARRANTIES, SERVICE CONTRACTS, AND MAINTENANCE AGREEMENTS

This bulletin is intended solely as advice to assist persons in determining and complying with their obligations under Maine tax law. It is written in a relatively informal style and is intended to address the tax treatment and responsibilities of retailers and customers regarding product warranty sales and repairs of items of tangible personal property. Taxpayers are responsible for complying with all applicable tax statutes and rules. Although bulletins issued by Maine Revenue Services (“MRS”) do not have the same legal force and effect as rules, justifiable reliance upon this bulletin will be considered in mitigation of any penalties for any underpayment of tax due. This bulletin is current as of the last revision date shown at the end of the document.

The Sales and Use Tax Law is found in Part 3 of MRSA (“Maine Revised Statutes Annotated”) Title 36. Both Title 36 and all MRS rules may be seen by clicking on “laws and rules” on the MRS website.

1. MANUFACTURERS’ WARRANTIES

A. 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.

B. 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 under a 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 or use tax.

2. SERVICE CONTRACTS AND MAINTENANCE AGREEMENTS

A. 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).

B. Computer software service contracts. Software updates are not considered to be “repairs.” The sale of canned computer software is treated as the sale of tangible personal property and thus taxable, and the sale of 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 help to avoid questions upon audit.

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

3. EXTENDED WARRANTIES – ITEMS OTHER THAN AUTOMOBILES AND TRUCKS

A. 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.

B. 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.

4. EXTENDED WARRANTIES – AUTOMOBILES AND TRUCKS

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. For transactions entered into on or after October 9, 2013, the same is true for the sale of extended service contracts for trucks. 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.

"Automobile" includes not only an all-terrain vehicle but also a pickup truck or van with a gross vehicle weight rating of 10,000 pounds or less. (See 36 MRSA § 1752(1-B)) "Automobile" does not include a vehicle with more than 4 wheels, motorcycle, camper or motor home, or a pickup truck or van with a gross vehicle weight rating of more than 10,000 pounds. "Truck" means a self-propelled motor vehicle with at least 4 wheels designed and used primarily to carry property, not designed to run on tracks and having a gross vehicle weight rating greater than 10,000 pounds; it includes a vehicle used to tow trailers or semitrailers. For more information on automobiles, see Instructional Bulletin No. 24 ("Vehicle Dealers").

5. 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 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.

6. 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 that a warranty typically will not include. Sales of these parts outside of a warranty are subject to tax.

- A. Photocopier drums
- B. Toner cartridges
- C. Car batteries, vacuum hoses, windshield wipers, etc.
- D. Items that have been misused, abnormally serviced, handled improperly, or modified
- E. Watch batteries
- F. Items where warranty registrations were not completed prior to expiration

7. 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.

8. MERCHANDISE RETURNS UNDER WARRANTY

A. Generally. 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:

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

B. 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.

C. 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 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.

9. 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:

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TEL: 207-624-9693
TTY: 7-1-1**

Or visit our website at www.maine.gov/revenue

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