

REQUEST LETTER

04-007

NAME

ADDRESS

PHONE

Re: Private Letter Ruling Request – Sales/Use Taxes

FIRM represents a client (“Company”) that recently conducted a review of its business activities in several states including Utah. The review specifically addressed: (a) whether the Company should be collecting and remitting sales/use tax on certain sales; and if so, (b) when the tax should be assessed. We respectfully request a private letter ruling, which confirms that some of the transactions described below are not subject to the Utah Sales and Use Tax.

There is no particular tax period at issue for this ruling request. The Company is not under audit and is not involved in any litigation with the State Tax Commission. To the best of our knowledge, and to the best of the Company’s knowledge, the Commission has never ruled on the issue discussed in this request (or on any similar issue) for the Company or its predecessors. In this connection, neither the Company nor any of its representatives has ever submitted this or any similar issue for a ruling by the Commission. The Company is unaware of any authority contrary to the views expressed in this request.

FACTS

The Company is a provider of home warranty contracts to homeowners of existing homes. The contracts are for a specific amount of time (e.g., twelve months) and are renewable. Pursuant to the contracts, the Company agrees to repair or, when necessary, replace major built-in appliances and covered mechanical systems (such as a water heater, central heat, and air-conditioning), which malfunction due to normal wear and tear.

Depending on the type of coverage provided to a homeowner, the contract may cover only tangible personal property, only real property such as items permanently affixed to the home, or both real property and tangible personal property. If the contract covers both real property and tangible personal property, the contract may separately state what part of the purchase price applies to each type of property.

When a homeowner requests services under the contract, the Company engages local independent service contractors to provide those services. When an independent contractor makes a service call, there is a low trade service call fee due from the homeowner (approximately \$\$\$\$ to \$\$\$\$). This trade service call fee is in addition to the price paid for the

warranty and any additional charge to the customer for labor or parts. Also, at times, the Company will supply the repair parts. The Company pays Utah sales/use tax on parts purchased in-state.

LAW

In general, the sales tax is imposed on the amounts paid or charged for services for repairs and renovations of tangible personal property. Utah Code Ann. Section 59-12-103 (1)(g)(i). It is clear that taxable services include sales of extended warranty agreements or service plans for tangible personal property and that such tax is due at the time of the sale of the agreement. Utah Regulation Rule R865-19S-78(D)(1).

If the tax is properly collected and remitted upon the sale of the warranty of tangible personal property, when a repair is performed under a warranty, neither sales or use tax applies to repair parts provided and services rendered free of charge to the homeowner. Utah Regulation Rule R865-19S-78(D)(1)(a). However, any deductible charge or any charge for labor or parts that is actually made to the homeowner is subject to the sales tax. Utah Regulation Rule R865-19S-78(D)(1)(b).

It is also clear that services performed on real property are not subject to the sales tax. Utah Regulation Rule R865-19S-58(B). As a result, sales of warranties for the repair of real property or for items of tangible personal property that are converted to real property are not subject to tax. Utah Regulation Rule R865-19S-78(D)(2). When a repair is performed under a warranty of real property, there is also no tax assessed based on the associated labor. However, the taxpayer must pay use tax on any replacement parts used by the taxpayer in providing warranty service on tangible personal property converted to real property. Utah Regulation Rule R865-19S-58(A).

It is respectfully requested that the State Tax Commission issue a private letter ruling which confirms that:

(A) Sale of Warranties for the Repair of Tangible Personal Property.

(A)(1). Pursuant to Utah Regulation Rule R865-19S-78(D)(1), the Company is required to collect sales tax on the sale of warranties for the repair of tangible personal property at the time of the initial sale; and

(A)(2). Pursuant to Utah Regulation Rule R865-19S-78(D)(1)(b), with respect to warranties for the repair of tangible personal property, the Company is required to collect sales tax on any trade service call fee charged to a customer at the time the warranty service is provided.

(B) Sale of Warranties for the Repair of Real Property

(A) Pursuant to Utah Regulation Rule R865-19S-58(B) and Utah Regulation

Rule R865-19S-78(D)(2), the company is not required to collect sales tax on the sale of warranties for the repair of real property; and

- (B) Pursuant to Utah Regulation Rule R8685-19S-58(B), for warranties for the repair of real property, the Company is not required to collect sales ax on any trade service call fee charged to a customer at the time the warranty service is provided.
- (C) Sale of Warranties for the Repair of Tangible Personal Property and Real Property “That Are Separately Stated”.
 - (C)(1). Pursuant to Utah Regulation Rule R865-19S-78(D)(1), Utah Regulation Rule R865-19S-58(B) and Utah Regulation Rule R865-19S-78(D)(2), with respect to the sale of warranties for the repair of both real property and tangible personal property, if the contract separately states what portion of the purchase price applies to each type of property, the Company is only required to collect sales tax on the portion of the purchase price which applies to tangible personal property; and
 - (C)(2). Pursuant to Utah Regulation Rule R865-19S-78(D)(1)(b) and Utah Regulation Rule R865-19S-58(B), with respect to the sale of warranties for the repair of both real property and tangible personal property, if the contract separately states what portion of the purchase price applies to each type of property, the Company is only required to collect sales tax on any trade service call fee charged to a customer at the time the warranty service is provided for tangible personal property.
- (A) Sale of Warranties for Repair of Tangible Personal Property and Real Property “That Are not separately stated.”
 - (A)(1). Pursuant to Utah Regulation Rule R865-19S-78(D)(1), Utah Regulation Rule R865-19S-58(B) and Utah Regulation Rule R865-19S-78(D)(2), with respect to the sale of warranties for the repair of both real property and tangible property, if the contract does not separately state what portion of the purchase price applies to each type of property, the Company is not required to collect sales tax on any portion of the purchase price; and
 - (A)(2). Pursuant to Utah Regulation Rule R865-19S-78(D)(1)(b) and Utah Regulation rule R865-19S-58(B), with respect to the sale of warranties for the repair of both real property and tangible personal property, if the contract does not separately state what portion of the purchase price applies to each type of property, the company is not required to collect sales tax on any trade service call fee charged to a customer at the time the warranty service is provided for either type of property

(A) Purchase of Parts Used in Servicing the Warranties.

(A)(1). Pursuant to Utah Regulation Rule R865-19S-78(D)(1)(a), if the Company properly collects and remits sales tax on the sale of a warranty of only tangible personal property, the Company is not required to pay use tax on tangible personal property that is purchased and used in servicing the warranty;

(A)(2). Pursuant to Utah Regulation Rule R865-19S-58(A), if the Company is not required to collect and remit sales tax on the sale of a warranty of real property and the Company does not in fact collect and remit the tax, the Company is required to pay use tax on tangible personal property that is purchased and used in servicing the warranty of real property;

(A)(3). Pursuant to Utah Regulation Rule R865-19S-78(D)(1)(a) and Utah Regulation Rule R865-19S-58(A), notwithstanding the type of property for which the warranty service is provided, the Company is only required to collect use tax on tangible personal property that is purchased and used in servicing the warranty for which no sales tax was every previously paid;

(A)(4). If the Company is required to remit use tax on tangible personal property that is purchased and used in servicing the warranty, the use tax is due when such property is withdrawn from the Company's inventory to service the warranty.

DISCUSSION

(A) Sale of Warranties for the Repair of Tangible Personal Property.

In general, Utah Regulation Rule R865-19S-78(D)(1) is clear that a warranty of tangible personal property is to be taxed at the time of the initial sale. The regulation is also clear that if the tax is properly collected and remitted on the warranty sale, repair parts provided and services rendered free of charge to the customer under the warranty are not taxable. The regulation further provides that is the customer is required to pay for a trade service call fee at the time the warranty service on tangible personal property is provided, sales tax must be collected from the customer on any amount charged.

(A) Sale of Warranties for the Repair of Real Property.

It is clear that pursuant to Utah Regulation Rule R865-19S-58(B) and Utah Regulation Rule R865-19S-78(D)(2) that a warranty for real property is not subject to sale tax. Further, if the initial sale of a warranty of real property is not subject to sales tax, repair parts provided and services rendered free o charge to the customer as well as any trade service call fee charged to the customer under the warranty of real property would not be taxable.

(A) Sale of Warranties for the Repair of Tangible Personal Property and Real Property That are Separately Stated.

Utah Regulation Rule R865-19S-78(D)(1) is clear that a warranty of tangible personal

property is to be taxed at the time of the initial sale. Also, Utah Regulation rule R865-19S58(B) and Utah Regulation Rule R865-19S-78(D)(2) are clear that a warranty of real property is not subject to sales tax. However, there is neither a statute nor a Department of Revenue Regulation that addresses the taxation of warranties of both tangible personal property and real property.

Applying the rules regarding warranties for each type of property, if the contract separately states what portion of the purchase price applies to each type of property, the Company would only be required to collect sales tax on the portion of the purchase price which applies to tangible personal property. Also, if the tax is properly collected and remitted on the portion of the purchase price which applies to tangible personal property, repair parts provided and services rendered free of charge to the customer under a warranty of both tangible personal property and real property are not taxable.

Although the current rules provide that when a repair is performed under the warranty of tangible personal property, any charge that is actually made to the customer for labor or parts is subject to the sales or use tax, they do not address whether such charge would be subject to tax for a warranty of real property or of both tangible personal property and real property. Applying the rules regarding trade service call fees, if the contract separately states what portion of the purchase price applies to each type of property, a trade service call fee that is charged to the customer for service on tangible personal property would be subject to tax. However, a trade service call fee that is charged to the customer for service on real property would not be subject to tax.

(A) Sale of Warranties for the Repair of Tangible Personal Property and Real Property That are Not Separately Stated.

Utah Regulation rule R865-19S-78(D)(1) is clear that a warranty of tangible personal property is to be taxed at the time of the initial sale. Also, Utah Regulation Rule R865-19S58 (B) and Utah Regulation Rule R865-19S-78(D)(2) are clear that a warranty of real property is not subject to sales tax. However, there is neither a statute nor Department of Revenue Regulation that addresses the taxation of warranties of both tangible personal property and real property.

Applying the rules regarding warranties for each type of property, if the contract does not separately state what portion of the purchase price applies to each type of property, then the Company should not be required to collect sales tax on any portion of the purchase price at the time of the initial sale. Also, the Company should not be required to collect sales tax on repair parts provided and services rendered free of charge to the customer under the warranty.

Although the rules provide that when a repair is performed under the warranty of tangible personal property, any charge that is actually made to the customer for labor or parts is

subject to the sale or use tax, they do not address whether such charge would be subject to tax for a warranty of real property or of both tangible personal property and real property. Applying the rules regarding trade service call fees, if the contract does not separately state what portion of the purchase price applies to each type of property, a trade service call fee that is charged to the customer for service on either type of property should not be subject to tax.

(A) Purchase of Parts Used in Servicing the Warranties.

Utah Regulation Rule R865-19S-78(D)(1)(a) is clear that with respect to warranties of tangible personal property when the tax is properly collected and remitted at the time of the initial sale, taxpayers buying and using tangible personal property to fulfill the warranty obligations to a customer free of charge may purchase and use the tangible personal property without the paying of any sales and use tax. Also, Utah Regulation Rule R865-19S-58-(A) is clear that with respect to warranties of real property, taxpayers are required to pay use tax on tangible personal property that is purchased and used in servicing the warranty. The rules do not address the taxation of tangible personal property purchased and used by the taxpayer to fulfill warranty obligations for warranties of both tangible personal property and real property.

Regardless of the type of property covered by the warranty, the rules infer that if tax is collected and remitted on a portion or all of the warranty at the time of the sale, the Company should not be subject to use tax for those parts that are purchased and used in servicing such portions of the warranty for which tax has been previously collected and remitted. Likewise, the Company should only be required to pay and remit tax on those parts purchased and used to service such portions of the warranty for which no tax has been previously collected and remitted.

Finally, as it is difficult to determine the use of a part when it is initially purchased, any use tax that is required to be collected and remitted should be due only when the part is withdrawn from the Company inventory and used to service a portion of a warranty for which no previous sales tax has been paid.

If you concur, please issue your favorable ruling to the undersigned. If you do not concur, please advise so that we may discuss your reasoning before an adverse ruling is used.

SUMMARY OF CONCLUSIONS

Also, in connection with this private letter ruling request, we would respectfully request a “Summary of Conclusions” as to the primary issues presented above – namely issues (A)1, (C)1, and (D)1. In this regard, we are providing you an initial draft of the Summary of Conclusions that highlights the pertinent facts as well as conclusions of law. Of course, such

draft "Summary of Conclusions" is subject to the approval of as well as any modifications by your office. Thank you, in advance, for your consideration of this portion of the ruling request.

RESPONSE LETTER

May 3, 2006

NAME
ADDRESS

RE: Private Letter Ruling Request

Dear NAME,

We have received your request for a ruling on certain purchases of warranties, as well as associated service charges for service calls, labor, and parts. This response covers the law and rules that you discussed in your request. Because our response has taken longer than anticipated, for which we apologize, and because changes in the law took effect on July 1, 2005, we have addressed the changes in the law.

You state that you represent a client ("Company") that provides home warranty contracts to the owners of existing homes. The contracts are usually for twelve months and are renewable. They cover major built-in appliances and mechanical systems. The contract provides for repair or replacement when these items malfunction due to normal wear and tear.

You have relied largely on §59-12-103 (1)(g)(i), and Utah State Tax Commission Administrative Rules R865-19S-58 and R865-19S-78 ("Rules 58 and 78). A review of your analysis follows.

Sales of Warranties for the Repair of Personal Property

You stated your understanding that according to Rule 78 (D)(1) a warranty of tangible personal property is to be taxed at the time of the initial sale. If the tax is properly collected and remitted on the sale of the warranty, repair parts provided and services rendered free of charge to the customer under the warranty are not taxable. You also said that if a customer is required to pay a service fee, the service fee is subject to sales tax with subparagraph (b). We agree with your analysis.

Sales of Warranties for the Repair of Real Property

On the issue of warranties associated with the sale of real property, you stated your opinion that according to Rule 78 (D)(2), in conjunction with Rule 58, warranties for the repair of real property, or tangible personal property converted to real property, are not subject to sales tax. You said that repairs to real property made pursuant to such warranties are not subject to sales tax, nor is the labor associated with the repairs. You stated that sales tax is due on replacement parts used in providing warranty service on tangible personal property that have been converted to real property. We also agree with this analysis.

We note that labor to repair tangible personal property, permanently attached to real property, is not subject to sales tax. However, the cost of replacement parts is subject to sales tax, assuming the service contract does not cover such costs. In order for any labor costs not covered by the service contract to receive the exemption, they must be separately stated on the invoice.

Sales of Warranties for the Repair of both Real and Personal Property That Are Separately Stated

With regard to the repair of both real and personal property, the Commission agrees with your analysis. You indicated in your letter that according to Rules 58 and 78 “. . . if the contract separately states what portion of the purchase price applies to each type of property, the Company is only required to collect sales tax on the portion of the purchase price which applies to tangible personal property; and . . . on any trade service call fee charged to a customer at the time the warranty service is provided for tangible personal property.” As you conclude, tax is only collected and remitted on taxable transactions as long as they are itemized or invoiced separately from non-taxable transactions. Absent itemization, the entire transaction may be subject to taxation.

Sale of Warranties for Repair of Tangible Personal Property and Real Property That Are not Separately Stated

Your interpretation of this section appears to be that the company is not required to collect sales tax on any portion of the purchase price when the contract does not separately state which portion of the purchase price applies to real property and which portion applies to tangible personal property.

We disagree with your analysis (paragraphs (D) (1) and (2) in the Request for Ruling portion of your letter) regarding invoices where the types of property being serviced are not

separately stated. In your analysis of R865-19S- 78(D)(1)(b), 58(B), and 78(D)(2) you take the position that if the different types of property are not separately identified on the invoice that “. . . the Company is not required to collect sales tax on any portion of the purchase price . . . [or] . . . any trade service call fee charged to a customer at the time the warranty service is provided for either type of property.”

Pursuant to Rule 78(D)(1), warranties for the repair of tangible personal property are taxable, as we stated previously. This is because the actual repair is taxable under state law and would be collected if no warranty were in place. The warranty is actually considered to be a prepayment. However, the Commission has long held that if a combined or “bundled” transaction occurs that consists of both taxable and non-taxable transactions, the entire transaction is taxable unless the different transactions are separately invoiced or itemized. This concept is specified for exempt transactions under Rule 78(D)(1), which states “. . . [i]f the extended warranty agreement covers parts as well as labor, any parts that are exempt from sales tax pursuant to Section 59-12-104 must be separately stated on the invoice or the entire charge under the extended warranty agreement is taxable.” It follows, then, that if the contract does not separately state what portion of the purchase price for the warranty applies to each type of property, the Company is required to collect sales tax on the entire purchase price. The same holds for service fees; if the contract does not separately state what portion of the purchase price applies to each type of property, the company is required to collect sales tax on the entire trade service call fee charged to a customer at the time the warranty service is provided.

In summary, we understand your interpretation of the foregoing to be that the company is not required to collect sales tax on any portion of the purchase price when the contract does not separately state which portion of the purchase price applies to real property and which portion applies to tangible personal property. The Commission’s interpretation is the opposite of what appears to be your understanding. When the contract separately states what portion of the purchase price pertains to real property, that portion of the total purchase price is exempt from sales tax. Failure to itemize the charges results in the entire amount being subject to sales tax.

Purchase of Parts Used in Servicing the Warranties

The final part of your request addresses the purchase of parts. Rather than address each of your specific scenarios, we will state the broad applications. To begin, with respect to R865-19S-78 (D)(1), “if the extended warranty agreement covers replacement parts as well as labor, any parts that are exempt from sales tax pursuant to Section 59-12-104 must be separately stated on the invoice or the entire charge under the extended warranty is taxable.” The Rule further states:

“a) Repair parts provided and services rendered under the warranty agreements or service plans are not taxable because the tax is considered prepaid as a result of taxing the sale of the warranty or service plan when it was sold.

b) . . . Sales tax must also be collected on any deductibles charged to customers for their

share of the repair work done under the warranty agreement. Parts or materials that are exempt from sales tax pursuant to Section 59-12-104 must be separately stated on the invoice or the entire charge for labor and parts is taxable.”

To summarize, the Company must collect and remit sales tax for amounts paid by its customers in excess of the warranty for any taxable transactions. If these transactions include amounts for exempt or non-taxable transactions the entire amount is subject to tax unless stated separately.

There is another point we would like to address that you identified. In your paragraph three under FACTS, you said;

“[w]hen a homeowner requests services under the contract, the Company engages local independent service contractors to provide those services. . . . Also, at times, the Company will supply the repair parts. The Company pays Utah sales/use tax on parts purchased in-state.”

You also stated any “use tax is due when such property is withdrawn from inventory.”

We offer the following general observation. For parts the Company consumes in providing repairs to tangible property, the Company may either pay the tax when it purchases the parts or accrue the tax on its sales tax return as goods consumed if it purchases the parts exempt or from an out-of-state seller.

Conclusion

In conclusion we reiterate that it is important when dealing with sales exempt from sales or use tax to state them separately and identify them as exempt. If they are not properly distinguished from items subject to sales or use tax, the entire charge is taxable.

Our review of changes in 59-12-103, effective July 1, 2005, does not suggest our response would be different after July 1, 2005. Subsection (g) has been amended as follows:

“(g) amounts paid or charged for services[~~(+)~~] for repairs or renovations of tangible personal property, unless Section 59-12-104 provides for an exemption from sales and use tax for:

[~~(A)~~] (i) the tangible personal property; and

[~~(B)~~] (ii) parts used in the repairs or renovations of the tangible personal property described in Subsection (1)(g)(i)[~~(A)~~], whether or not any parts are actually used in the repairs or renovations

of that tangible personal property; [ø]

~~[(ii) to install tangible personal property in connection with other tangible personal property, unless the tangible personal property being installed is exempt from sales and use tax under Section 59-12-104;]~~”

The service provided by your client remains the repair or renovation of tangible personal property, including the use of parts. Unless the tangible personal property is exempt under 59-12-104, the amount paid or charged for services for repairs or renovations of tangible personal property would be subject to sales and use tax.

The conclusions stated in this letter ruling are based on facts and circumstances as you have described to us. Should actual facts and circumstances be different from those you have indicated, or should they change, the outcome of our ruling may change as well. If you have additional questions or concerns, please contact us.

For the Commission,

Marc B. Johnson
Commissioner

MBJ/SR
04-007