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REQUEST LETTER

06-018

June 19, 2006

Utah State Tax Commission
Attn: Request for a Private Letter Ruling
210 North1950 West
Salt Lake City UT 84134

Request for a Private Letter Ruling
Sales Tax Procedures for Replacement Vehicles
Acct No. ######

To Whom It May Concern:

Purpose:

The purpose of this letter is to request a written Private Letter Ruling from the State Tax Commission (Utah Code Ann. §59-1-210). The written ruling shall be the Commission's position regarding Utah sales taxes after reviewing the presented facts. The issue involves whether sales tax applies to replacement vehicles under Utah's Lemon Law (Utah Code Ann. §13-20-1).

Statement of Facts:

COMPANY is a distributor of passenger motor vehicles in the United States. It sells vehicles to authorized CAR NAME dealers who sell the vehicles to retail customers. The vehicles sold at retail are covered by a manufacturer's warranty for specific time periods or mileage, whichever comes first. The vehicles are also subject to certain state and federal requirements regarding implied warranties. Utah's lemon law provides for certain remedies if the manufacturer, its agents or authorized dealers do not conform the vehicle to an express warranty by repairing or correcting any defect or condition that substantially impairs the use and value of the motor vehicle to the consumer. Those remedies include replacement of the vehicle with a new vehicle, or accept the return of the vehicle from the consumer and refund the full purchase price.

The issue presented for this ruling request is the application of the sales tax on a replacement vehicle provided to a retail customer pursuant to Utah's lemon law or the manufacturer's express warranty. The typical process is as follows:

1. The retail customer makes a claim pursuant to the Utah lemon law with COMPANY.

2. If COMPANY and the customer cannot reach an agreement, the customer may then take the issue to the informal dispute settlement procedure process.
3. If the customer then agrees to accept a replacement vehicle, COMPANY locates a similar vehicle and arranges with an authorized dealer to process the transaction. The replacement vehicle can be from either the dealer's inventory or shipped to the dealer from COMPANY's inventory.
    a. If the vehicle is from the dealer's inventory, COMPANY pays the dealer the invoice price amount originally paid to COMPANY for the vehicle.
    b. If the vehicle is from COMPANY's inventory, the dealer is invoiced for the vehicle then COMPANY pays the dealer the invoice price.
4. In most situations, the customer is not required to pay any additional amount for the vehicle. However, if the customer chooses to upgrade the vehicle (i.e. additional accessories or options), the customer pays the upgrade cost on the new vehicle.
5. COMPANY reimburses the dealer for any registration and fees payable to transfer the replacement vehicle to the customer.

The following exhibits are attached:

A) Copy of sales invoice between dealer and retail customer – original vehicle
B) Copy of letter offering replacement vehicle and acceptance by customer
C) Copy of "sales" invoice between dealer and retail customer – replacement vehicle

Issues:

COMPANY requests that the State Tax commission address the following issues:

1. Is the amount COMPANY pays to the dealer for the replacement vehicle (taken directly from dealer inventory or allocated to dealer inventory) subject to sales or use tax? If it is exempt from tax, what documentation must the dealer and/or COMPANY maintain to support the exemption?
2. If the vehicle was delivered through a dealership directly from COMPANY's inventory (the dealer is not paid for the vehicle), would the transaction between the customer and COMPANY be subject to sales or use tax? The customer would not pay COMPANY for the replacement. Would a fee paid to the dealer for processing and delivering the vehicle be subject to sales or use tax?

Taxpayer's Conclusion:

Under either situation, the vehicle is being provided to the customer in satisfaction of the vehicle warranty, and or, the expressed warranty. The applicable law that addresses the taxable sales or motor vehicles falls under Utah Code Ann. §59-12-103.

Issue 1: The original retail sale of the vehicle between the dealer and the retail customer was subject to the state and local sales tax imposed in the applicable taxing jurisdiction. The manufacturer's expressed warranty was sold with the vehicle and was included in the taxable amount at the time of the original sale. A manufacturer's expressed warranty, by its nature, is included in the sales price of the property sold and is therefore subject to the initial sales tax. The subsequent replacement of tangible personal property (in this case a replacement vehicle) in satisfaction of an expressed warranty would not be subject to state and local sales or use tax since it is covered under the contractual terms of the original contract (original sale).

The lemon law under Utah Code ann. §13-20-1 must be followed to ensure the consumer is left with a vehicle that conforms to the expressed warranty. Utah lemon law dictates that if a vehicle cannot be repaired within a stated amount of repair attempts or is out of service for a stated amount of days, then the manufacturer must replace the motor vehicle. When replacing a vehicle under the Utah lemon law, the manufacturer must replace the motor vehicle with a comparable new motor vehicle at no cost (or provide a refund). Since there is "no cost" to the customer, there is no taxable basis to compute a sales or use tax. Utah Information Publication No. 5, 01/01/2006, mentions that tax does not apply to the cost of parts to repair a vehicle recently sold under an implied warranty and/or to keep the customer's goodwill. Whether the manufacture is replacing "a part" of the vehicle or the "entire" vehicle should not make a difference, as there is no ultimate cost to the consumer. As such, the amount paid by a manufacturer to a dealer for a replacement vehicle should not be subject to sales or use tax.

If the customer decides to take a replacement vehicle, which is an upgrade (higher cost) from the original vehicle, the customer pays the difference to the dealer. The additional amount paid to the dealer (difference between value of original vehicle and upgrade vehicle) would be subject to sales tax. The dealer would collect the sales tax and remit it to the proper taxing jurisdiction.

Taxpayer proposes that the sales contract between the dealer and customer identify the transaction as being a replacement vehicle provided under the terms of the expressed warranty. This should be adequate documentation to support the exemption from Utah sales and use tax.

Utah Code Ann. §59-12-104 allows for a trade-in credit against the purchase of a new vehicle. Under this Code provision, a new sales transaction is being entered into and not a fulfillment of a warranty obligation. As such, the trade-in rules under this Code provision should not apply to our situation where a customer is receiving a replacement vehicle that is under a manufacturer's warranty.

Issue 2: Currently, the replacement vehicle is taken directly from the dealer's inventory or allocated to dealer inventory (in both cases the dealer is paid for the vehicle). An alternative would be to take the vehicle directly from COMPANY's inventory, ship to the appropriate dealer, and have the customer pick up the vehicle at the dealership. There would be no exchange of funds between the customer and COMPANY since it is a replacement vehicle of same/similar kind.

As with issue 1, the original retail sale of the vehicle between the dealer and the retail customer was subject to sales tax on the gross taxable amount. The expressed warranty under the Utah lemon law provisions was sold with the vehicle and included in the taxable amount at the time of the original sale. The subsequent use of tangible personal property (in this case a replacement vehicle) in satisfaction of an expressed warranty would not be subject to tax under sales or use tax since it is covered under the contractual terms of the original contract.

Therefore, when a vehicle is taken from COMPANY's inventory and sent to a dealer so the customer can pick up the vehicle at no charge (if same or similar), the replacement vehicle is not subject to sales or use tax using the same rationale as in issue 1.

If COMPANY would pay the dealer a nominal "courtesy " fee for handling and processing the replacement vehicle, would this service be subject to sales or use tax? It would appear that under Utah Code Ann. §59-12-102 that this service transaction would not be subject to sales or use tax, as it is not tangible personal property or any other taxable transaction under the Code.

Taxpayer Statements Provided to Utah State Tax Commission:

1. The issues or related issues are not subject to an existing audit, protest or appeal, or litigation concerning the taxpayer.
2. The taxpayer knows of no Commission statute, regulation or court decision that is contrary to the position taken by the taxpayer.
3. To the best of taxpayer's knowledge, the identical issue has not been previously submitted to the Utah State Tax Commission or any other Utah taxing revenue authority.
4. The taxpayer advocates the conclusion presented above.
5. The taxpayer requests a Private Letter Ruling to provide guidance based on the facts and circumstances as submitted.

If you need additional information, please contact NAME at (###) ###-####.

"Under penalties of perjury, I declare that I have examined this request, including the accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the requested ruling are true, correct, and complete."

Dated: 6/21/06 COMPANY

By: 2ND NAME
Executive Director, Tax & Customs

RESPONSE LETTER

December 6, 2006

2ND NAME
TITLE

NAME
National Manager, State and Local Tax

COMPANY
ADDRESS

Re: Sales tax on replacement vehicle provided pursuant to the Utah's "Lemon Law" and Private Letter Ruling 06-018

Dear Mr. 2ND NAME and NAME,

Thank you for your patience as we sought to address the questions outlined in your letter to us dated June 19, 2006. This private letter ruling (PLR) is in response to your request for tax guidance and is an interpretation and application of the tax law as it relates to the facts presented in your letter of June 19, 2006.

Facts

Utah's Lemon Law:

Utah Code section 13-20-4 provides, in pertinent part:

> (1) If the manufacturer, its agent, or its authorized dealer is unable to conform the motor vehicle to any applicable express warranty by repairing or correcting any defect or condition that substantially impairs the use, market value, or safety of the motor vehicle after a reasonable number of attempts, the manufacturer shall replace the motor vehicle with a comparable new motor vehicle or accept return of the vehicle from the consumer and refund to the consumer the full purchase price including all collateral charges, less a reasonable allowance for the consumer's use of the vehicle. Refunds shall be made to the consumer, and any lien holders or lessors as their interests may appear.
>
> (2) A reasonable allowance for use is that amount directly attributable to use by the consumer prior to his first report of the nonconformity to the manufacturer, its agent, or its authorized dealer, and during any

subsequent period when the vehicle is not out of service because of repair.

(3) Upon receipt of any refund or replacement under Subsection (1), the consumer, lien holder, or lessor shall furnish to the manufacturer clear title to and possession of the motor vehicle.

Utah Administrative Rule R152-20-2 defines "collateral charges" to include sales tax, document preparation fees and the cost of additional or extended warranties that were included in the sales price. "Purchase price" means the actual amount paid for the vehicle, including taxes, licensing fees, and additional warranty fees, but not collateral charges.

With regard to leased vehicles, Utah Administrative Rule R152-20-3 requires the manufacturer to refund to the lessor all payments made under the lease. The rule also specifies that the refund or repurchase price include trade-in value, inception payment, and security deposit. Additionally, the manufacturer must make all payments on behalf of the lessee in order to obtain clear title and to relieve the consumer of any further obligations. Any excess from the payments must be paid over to the lessee. In arranging for a replacement vehicle, the customer will not incur additional expense with respect to the replacement vehicle, except as a reasonable allowance for use of the buy-back vehicle.

COMPANY transactions under Utah's Lemon Law

COMPANY sells vehicles to authorized dealers for sale to retail customers. New vehicles sold at retail are covered by a manufacturer's warranty for a specified period determined by time or miles. The cost of the warranty is included in the sales price of the vehicle. A vehicle that does not conform to the manufacturer's warranty is subject to replacement or other remedies under Utah's Lemon Law. When a retail customer agrees to accept a replacement vehicle under Utah's Lemon Law, COMPANY locates a comparable vehicle and arranges for an authorized CAR dealer to process the transaction. The vehicle may come from the dealer's inventory or it may be shipped to the dealer from the manufacturer.

In terms of Utah's Lemon Law, you have asked for sales tax guidance in the following two scenarios:

Scenario One: The manufacturer arranges for a dealer to supply the replacement vehicle from the dealer's own inventory. COMPANY reimburses the dealer for the vehicle at the invoice price plus the cost of any fees due to get the vehicle into the hands of the retail customer. There is no charge to the customer unless the customer orders upgrades on the replacement vehicle. In that case, the customer is charged for the upgrades. Specifically, you have asked if the transaction between the dealer and COMPANY is subject to sales or use tax. If not, you ask what documentation is required to support an exemption.

Scenario Two: The replacement vehicle is shipped from COMPANY's inventory and processed through a dealer, but there is no sales transaction between COMPANY and the

dealer. Specifically you have asked if (1) the transaction between COMPANY and the retail customer is taxable; and (2) if the processing fee paid to the dealer is taxable. In terms of Scenario two you have asked for a ruling on an alternative method, which is different than your current practice. Therefore, we will limit our ruling on Scenario two to the facts set forth in the alternative method.

Analysis and Ruling

Analysis of Scenario One: Where a replacement vehicle is delivered to the retail customer from the dealer's inventory, there is no taxable sale to the customer unless the customer orders upgrades on the replacement vehicle. In which case, the customer must pay tax on any amount charged in excess of the replacement or repurchase price.

Ruling under Scenario One: The transaction between COMPANY and the dealer is exempt from sales tax under Utah's resale provisions (this would be the case regardless of whether the vehicle is taken directly from the dealer's inventory or allocated by COMPANY to the dealer's inventory). It is recommended sales documents indicate the transaction is for a replacement vehicle pursuant to Utah Code section 13-20-4 and the exemption supported by a Utah Exemption Certificate (see Form TC-721 at HREF="http://www.tax.utah.gov/" MACROBUTTON HtmlResAnchor www.tax.utah.gov).

Analysis of Scenario Two: If COMPANY ships the vehicle to a dealer, who processes the transaction and delivers the vehicle to the customer; there is no sales transaction between and the dealer. Any processing fee charged to COMPANY by the dealer is not taxable.

Ruling under Scenario Two: In Utah, replacements of tangible personal property under warranties are considered non-taxable transactions (See Utah Admin. Rule R865-19S-78.) Furthermore, the customer already paid tax on the original sale and no additional tax is due on the replacement vehicle unless the customer is charged for upgrades on the replacement vehicle. In that case, the customer must pay sales tax only on the cost of the upgrades. It is recommend sales documents indicate the transaction is for a replacement vehicle pursuant to Utah Code section 13-20-4.

In conclusion, every effort has been made to assure the Commission and its tax divisions understood your questions. Upon receipt and review of this PLR, if you determine the facts and assumptions upon which the ruling is based were incorrectly interpreted and applied, please contact the Office of the Commission at 801-297-3900. Finally, this private letter ruling (PLR) is an interpretation of the tax law as it relates to the specific facts presented in your letter of June 19, 2006 and not intended as a statement of broad tax policy.

Sincerely,

D'Arcy Dixon Pignanelli
Tax Commissioner