



STATE OF SOUTH CAROLINA  
**DEPARTMENT OF REVENUE**

300A Outlet Pointe Blvd., Columbia, South Carolina 29210  
P.O. Box 125, Columbia, South Carolina 29214-0575

SC PRIVATE LETTER RULING #21-1

**SUBJECT:** Warranty Agreements and Withdrawals of Repair Parts from Inventory by a Manufacturer under a Warranty (Sales and Use Tax)

**REFERENCES:** S.C. Code Ann. Section 12-36-90 (2014; Supp. 2020)  
S.C. Code Ann. Section 12-36-130 (2014; Supp. 2020)  
S.C. Code Ann. Section 12-36-910 (2014)  
S.C. Code Ann. Section 12-36-1310 (2014)

**AUTHORITY:** S.C. Code Ann. Section 12-4-320 (2014)  
S.C. Code Ann. Section 1-23-10(4) (2005)  
SC Revenue Procedure #09-3

**SCOPE:** A Private Letter Ruling is an advisory opinion issued to a specific taxpayer by the Department to apply principles of law to a specific set of facts or a particular tax situation. It is the Department's opinion limited to the specific facts set forth, and is binding on agency personnel only with respect to the person to whom it was issued and only until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion, providing the representations made in the request reflect an accurate statement of the material facts and the transaction was carried out as proposed.

**QUESTIONS**

1. What is the application of the sales and use tax to the sale of an optional extended warranty by ABC, Inc., as described in the facts?
2. What is the application of the sales and use tax to ABC, Inc.'s withdrawal from inventory of a part to repair a customer's equipment under one of its warranty contracts, as described in the facts?

**FACTS**

ABC, Inc. ("ABC") is a manufacturer of certain medical equipment, which it primarily sells to medical product distributors, hospitals (e.g., for profit, nonprofit, or federal government

hospitals), and privately owned medical practices. All sales of new equipment manufactured by ABC are covered by a “new product limited warranty,” which ABC provides without charge. During the effective period of the new product limited warranty, ABC will repair or replace the equipment or refund or credit the purchase price if the equipment is found to be defective.

When purchasing equipment, customers may also purchase a service agreement (referred to in this advisory opinion as an “optional extended warranty”). An optional extended warranty extends the effective period of the new product limited warranty through the duration of the optional extended warranty. Some customers enter a contract to purchase an optional extended warranty in conjunction with their purchase of equipment; however, customers who do not enter a contract to purchase an optional extended warranty in conjunction with the purchase of equipment may purchase an optional extended warranty at any time.

Customers who enter a contract to purchase an optional extended warranty in conjunction with the purchase of equipment are not invoiced for the optional extended warranty until the new product limited warranty expires. The new product limited warranty expires the earlier of 15 months from the date of shipment or one year from the date of installation. A customer who has contracted to purchase an optional extended warranty in conjunction with the purchase of equipment has the right to cancel the optional extended warranty 60 days before the optional extended warranty is to take effect. Optional extended warranty agreements are billed on an annual basis, and each renewal of the agreement is optional.

Customers may provide ABC a copy of a direct pay certificate or an exemption certificate from the Department to purchase the equipment.<sup>1</sup>

## **LAW AND DISCUSSION**

### Application of the Sales and Use Tax to the Sale of an Optional Extended Warranty

Code Section 12-36-910(A) imposes a sales tax upon every person engaged or continuing within this State in the business of selling tangible personal property at retail. Code Section 12-36-1310(A) imposes a use tax on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, regardless of whether the retailer is or is not engaged in business in this State.

The sales tax is imposed on the “gross proceeds of sales” as defined in Code Section 12-36-90. The use tax is imposed on the “sales price” as defined in Code Section 12-36-130. They are essentially both defined as the total proceeds or “value proceeding or accruing from the sale, lease, or rental of tangible personal property,” without deductions for expenses. Expenses that

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<sup>1</sup> Code Section 12-36-2510(A)(2)(a) provides for a “direct pay certificate,” which allows its holder to make all purchases tax free and to report and pay directly to the Department any taxes due. The holder of a direct pay certificate is liable for any taxes due. Code Section 12-36-2510(A)(2)(b) provides for an “exemption certificate,” which allows its holder to make only certain purchases tax free, such as machinery. The holder of an exemption certificate is liable for any taxes due.

are not deducted include: the cost of goods sold; the cost of materials, labor, or service; interest; losses; and transportation.

In *Meyers Arnold, Inc. v. South Carolina Tax Commission*, 285 S.C. 303, 328 S.E.2d 920 (Ct. App. 1985), the Court of Appeals, in interpreting the definition of “gross proceeds of sales” with respect to lay away fees paid in conjunction with lay away sales, held:

But for the lay away sales, Meyers Arnold would not receive the lay away fees. The fees are obviously charged for the service rendered in making lay away sales. For these reasons, this court holds the lay away fees are part of the gross proceeds and subject to the sales tax.

Based on the above, when the optional extended warranty is sold in conjunction with the sale of medical equipment, as described in the facts, it is part of the gross proceeds of sales or sales price of the sale of equipment, regardless of when the payment for the optional extended warranty is made.

#### Taxability of Withdrawals of Repair Parts from Inventory for Warranty Contracts

ABC withdraws from inventory parts to repair medical equipment under its new product limited warranty and its optional extended warranty. A retailer’s withdrawing of parts from inventory that were originally purchased at wholesale is treated as a retail sale by the retailer under the law and is subject to sales tax.<sup>2</sup> Code Section 12-36-90(1)(c) defines “gross proceeds of sales,” the basis or measure of the tax, to impose the tax on the fair market value of the tangible personal property. Code Section 12-36-90(1)(c) reads, in part:

the fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed in connection with the business or used or consumed by any person withdrawing it.

Code Sections 12-36-910(B)(4) and 12-36-1310(B)(4) similarly impose the sales and use tax on the “use” by a manufacturer of an item withdrawn from its inventory for use by the manufacturer based on the fair market value of the item.<sup>3</sup>

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<sup>2</sup> See Code Section 12-36-110(c).

<sup>3</sup> Although “fair market value” as used in Code Sections 12-36-910(B)(4) and 12-36-1310(B)(4) with respect to manufacturers is not defined in the sales tax law or regulations, it is defined in SC Regulation 117-309.17 for purposes of a similar application of the tax for retailers under Code Section 12-36-90(1)(c). With respect to Code Section 12-36-90(1)(c), the sales tax is imposed on the fair market value of tangible personal property withdrawn from inventory for the retailer’s use instead of for sale. Similarly, with respect to Code Sections 12-36-910(B)(4) and 12-36-1310(B)(4), the sales tax and the use tax are imposed on the fair market value of tangible personal property used by the manufacturer instead of sold by such manufacturer. As such, it is the opinion of the Department that the definition of fair market value as defined in SC Regulation 117-309.17 (“the price at which these goods are offered for sale by the person withdrawing them. All cash or other customary discounts which he would allow to his customers may be deducted; however, in no event can the amount used as gross proceeds of sales be less than the amount paid for the goods by the person making the withdrawal”) applies to Code Sections 12-36-910(B)(4) and 12-36-1310(B)(4), as well as Code Section 12-36-90(1)(c).

Code Section 12-36-90(1)(c)(iii) however, provides an exclusion from sales tax for certain withdrawals from inventory of tangible personal property for use in replacing a defective part under a warranty contract and reads:

tangible personal property replacing defective parts underwritten warranty contracts if:

(A) the warranty contract is given without charge at the time of original purchase of the defective property;

(B) the tax was paid on the sale of the defective part or on the sale of the property of which the defective part was a component; and

(C) the warrantee is not charged for any labor or materials.

All three of the above conditions must be met in order for the withdrawal from inventory to be nontaxable. If a withdrawal fails one or more of the conditions, then sales tax is due on the withdrawal based on the fair market value of the property withdrawn from inventory.<sup>4</sup>

Note: A withdrawal from inventory to repair or replace defective equipment under a warranty is also exempt from the sales and use tax where the defective part or equipment, if it had been sold by the retailer to the customer, would have been exempt from sales and use tax.

## CONCLUSIONS

### Application of the Sales and Use Tax to the Sale of an Optional Extended Warranty

The application of the sales and use tax to the sale of an optional extended warranty, as described in the facts, is as follows:

1. The sale of an optional extended warranty in conjunction with, or a part of, the retail sale of medical equipment is includable in the “gross proceeds of sales” or “sales price” of the medical equipment and, therefore, is subject to the sales and use tax, unless the transaction is otherwise exempt.<sup>5</sup>
2. The sale of an optional extended warranty that is not in conjunction with, or a part of, the retail sale of medical equipment (including a renewal of an optional extended warranty) is not includable in the “gross proceeds of sales” or “sales price” of the medical equipment and, therefore, not subject to the sales and use tax.

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<sup>4</sup> See SC Regulation 117-309.17.

<sup>5</sup> A sale to the federal government is one example of a transaction that would be otherwise exempt from sales and use tax. See Code Section 12-36-2120(2).

Note: When a customer provides a direct pay certificate, ABC is not responsible for collecting the tax, but the customer is responsible for remitting the tax on the retail purchase, unless the purchase is otherwise exempt.

### Taxability of Withdrawals from Inventory for Warranty Contracts

The application of the sales and use tax to withdrawals from inventory by ABC under a new product limited warranty or an optional extended warranty is as follows:

1. For a new product limited warranty, the withdrawal from inventory by ABC of the part to repair a customer's equipment is not subject to sales and use tax, provided:
  - a. The warranty contract is given without charge at the time of original purchase; the tax was paid on the sale of the defective part or on the sale of the property of which the defective part was a component; and the customer (warranty) is not charged for any labor or materials; or
  - b. The part withdrawn from inventory is for the repair of medical equipment the sale of which was exempt from sales and use tax when originally sold by ABC to its customer.

If the conditions listed above are not met with respect to a new product limited warranty, then the withdrawal from inventory, or the use, by ABC of the part to repair a customer's equipment is subject to sales and use tax, based on the fair market value of the part.

Note: If ABC refunds or credits the purchase price of the defective equipment instead of repairing or replacing the equipment, then the sale of the equipment is not subject to sales and use tax provided the full price ("gross proceeds" or "sales price") is refunded to the purchaser in cash or by credit and the equipment is returned to ABC. See SC Regulation 117-318.8.

2. For an optional extended warranty, because the customer is charged or will be charged an annual fee, the withdrawal from inventory by ABC of a part to repair or replace a customer's medical equipment is subject to sales and use tax, based on the fair market value of the part. The withdrawal or use of the part from inventory, however, is not subject to the tax provided the part, if it had been sold by the retailer to the customer, would have been exempt from the sales and use tax.

When a customer uses a direct pay certificate in making the original purchase of the medical equipment from ABC, the application of the sales and use tax upon the withdrawal or use of a part by ABC to make the repair under warranty is as follows:

1. If the original sale of the medical equipment is subject to tax, then ABC is responsible for the sales and use tax on the withdrawal or use of the part from inventory, unless Code Section 12-36-90(1)(c)(iii) applies.

2. If the original sale of the medical equipment is exempt from tax, then the withdrawal or use of the part from inventory is not subject to the tax provided the part, if it had been sold by the retailer to the customer, would have been exempt from the sales and use tax.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/W. Hartley Powell  
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W. Hartley Powell, Director

June 8 \_\_\_\_\_, 2021  
Columbia, South Carolina

**CAVEAT: This advisory opinion is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting the advisory opinion may not rely on it. If the taxpayer relies on this advisory opinion, and the Department discovers, upon examination, that the facts and circumstances are different in any material respect from the facts and circumstances given in this advisory opinion, then the advisory opinion will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this advisory opinion, changes in a statute, a regulation, or case law could void the advisory opinion.**