
State of South Carolina
Department of Revenue
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Website Address: <http://www.sctax.org>

SC PRIVATE LETTER RULING #08-2

SUBJECT: Automobile Leases and Vehicle Maintenance Contracts
(Sales and Use Tax)

REFERENCES: S. C. Code Ann. Section 12-36-910(A) (2000)
S. C. Code Ann. Section 12-36-1110 (Supp. 2007)
S. C. Code Ann. Section 12-36-2110(A) (Supp. 2007)
S. C. Code Ann. Section 12-36-2120(53) (2000)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (2000)
S. C. Code Ann. Section 1-23-10(4) (2005)
SC Revenue Procedure #05-2

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set forth, and is binding on agency personnel only with respect to the person to whom it was issued and only until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion, providing the representations made in the request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.

Question:

Is the sale of the optional vehicle service contract, as described in the "Facts" exempt from the sales and use tax under Code Section 12-36-2120(53)?

Conclusion:

The sale of the optional vehicle service contract, as described in the "Facts," is exempt from the sales and use tax under Code Section 12-36-2120(53), whether the sales price of the optional vehicle service contract is either separately stated in the lease agreement (provided it reasonably represents the retail fair market value of the vehicle service contract) or is accounted for based on its reasonable retail fair market value if the sales price is not separately stated in the lease agreement.

Note: The imposition of the tax on the sale or renewal of a warranty, maintenance or similar service contract under Code Section 12-36-910(B)(6) or Code Section 12-36-1310(B)(6) (use tax) does not apply to a mandatory warranty, maintenance or similar service contract, such as a manufacturer's warranty, since such a contract is not sold, but is a part of the sale of the tangible personal property. It only applies to an optional warranty, maintenance or similar service contract, whether or not sold in conjunction with the tangible personal property (e.g., optional contracts sold by third parties, optional contracts sold by manufacturers to extend the manufacturer's warranty, optional contract sold by the retailer of the tangible personal property).

Facts:

ABC is engaged in the business of leasing motor vehicle at retail in South Carolina and many other states. ABC ("ABC") contracts with XYZ ("XYZ") to administer each of these leases on behalf of ABC, including the collection of payments under the leases. ABC and XYZ have jointly requested this private letter ruling concerning the application of the sales and use tax to the portion of the lease contract that represents an optional vehicle service contract ("service contract" or "vehicle service contract") for the leased vehicle.

The motor vehicle lease agreements compute the monthly lease payments for a lease beginning with the "gross capitalized cost" of the vehicle, which is generally equal to (i) the agreed-upon value of the vehicle, as equipped at the lease signing, plus (ii) the agreed-upon value of any accessories or optional equipment to be added after the lease signing, plus (iii) the cost of any service contract purchased by the customer for the leased vehicle, plus (iv) the acquisition fee. The gross capitalized cost is then reduced by the "capital cost reduction," which is generally equal to any cash (or trade) down payment made by the customer. Finally, the monthly lease payments are computed based on the difference (amortized over the term of the lease) between the gross capitalized cost of the vehicle, as adjusted above, and the residual value of the vehicle at the end of the lease term, (such difference being referred to hereinafter as the "lease base amount").

Each service contract generally provides that XYZ, rather than the customer, will be responsible for any repairs that need to be made to the vehicle during the contract period. The purchase of the service contract is optional. Under the service contract, the customer may have the vehicle serviced at any authorized dealership, and not simply the dealership that leased the vehicle to the customer. The dealership that performs the repairs will issue an invoice for the repair charge to XYZ and XYZ will pay such charges, including any applicable sales taxes, to the dealership.

A vehicle service contract will be handled in one of the following three scenarios:

Scenario #1: The lease agreement and each of the monthly lease payment invoices sent to the customer separately state the portion of each lease payment that is attributable to any vehicle service contract purchased at the time of the lease and the portion that is attributable to anything other than the vehicle service contract (e.g., the value of the lease vehicle and any add-on accessories or equipment and the acquisition fee).

Scenario #2: The monthly lease payment invoices do not separately state the portion of each lease payment that is attributable to the purchase of the vehicle service contract; however, the lease agreement does separately state the vehicle service contract amount.

Scenario #3: Neither the lease agreement nor any of the monthly lease payment invoices separately states the portion of each lease payment that is attributable to the purchase of the vehicle service contract. However, the lease agreement does separately state the cost of the vehicle service contract and the cost of the vehicle (as well as the cost of any add-on accessories or equipment, acquisition fee, etc) used in computing the gross capitalized cost, which is in turn used to calculate the monthly lease payment.

The customer may also elect to purchase a vehicle service contract after the lease signing. In this event, the price paid for the vehicle service contract is not amortized as part of the monthly lease payment; instead, the customer pays the entire cost of the vehicle service contract at the time of purchase.

Discussion:

Code Section 12-36-910(A) imposes “a sales tax, equal to [six] percent of gross proceeds of sales, upon every person engaged ... within this State in the business of selling tangible personal property at retail.”

Code Section 12-36-90 defines the term “gross proceeds of sales” and reads, in part:

Gross proceeds of sales, or any similar term, means the value proceeding or accruing from the sale, lease, or rental of tangible personal property.

(1) The term includes:

* * * *

(b) the proceeds from the sale of tangible personal property without any deduction for:

- (i) the cost of goods sold;
- (ii) the cost of materials, labor, or service;
- (iii) interest paid;
- (iv) losses;
- (v) transportation costs;
- (vi) manufacturers or importers excise taxes imposed by the United States; or

(vii) any other expenses.

(2) The term does not include:

(a) a cash discount allowed and taken on sales;

* * * *

Code Section 12-36-1310(A) imposes the use tax at the rate of six percent of the sales price of the property “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.”

Code Section 12-36-130 defines the term “sales price” and reads:

"Sales price" means the total amount for which tangible personal property is sold, without any deduction for the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, losses, or any other expenses.

(1) The term includes:

(a) any services or transportation costs that are a part of the sale, whether paid in money or otherwise; and

(b) any manufacturers or importers excise tax imposed by the United States.

(2) The term does not include:

(a) a cash discount allowed and taken on the sale;

(b) an amount charged for property, which is returned by the purchaser, and the full amount is refunded in cash or by credit;

(c) the value allowed for secondhand property transferred to the vendor in partial payment; and

(d) the amount of any tax imposed by the United States with respect to retail sales, whether imposed upon the retailer or consumer, except for manufacturers or importers excise taxes.

Code Section 12-36-100 defines the terms “sale” and “purchase” to include a rental or lease of tangible personal property.

Code Section 12-36-2110(A) establishes a maximum tax for motor vehicle (and certain other items) and states in part

(A) The maximum tax imposed by this chapter is three hundred dollars for each sale made after June 30, 1984, or lease executed after August 31, 1985, of each:

* * * *

(2) motor vehicle;

* * * *

In the case of a lease, the total tax rate required by law applies on each payment until the total tax paid equals three hundred dollars. Nothing in this section prohibits a taxpayer from paying the total tax due at the time of execution of the lease, or with any payment under the lease. To qualify for the tax limitation provided by this section, a lease must be in writing and specifically state the term of, and remain in force for, a period in excess of ninety continuous days.

Based on the above, the sale or lease of a motor vehicle is subject to the sales and use tax; however, the maximum tax due on the sale of a motor vehicle is \$300.00 and the maximum tax due on the lease of a motor vehicle is \$300.00 provided the lease is in writing and specifically states a term of, and remain in force for, a period in excess of ninety continuous days.

Effective for sales or renewals on or after October 1, 2005, Code Sections 12-36-910(B)(6) and 12-36-1310(B)(6) impose the sales and use tax on the:

gross proceeds accruing or proceeding from the sale or renewal of warranty, maintenance, or similar service contracts for tangible personal property, whether or not such contracts are purchased in conjunction with the sale of tangible personal property.

Code Section 12-36-60 defines the term “tangible personal property” to mean:

personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses. It also includes services and intangibles, including communications, laundry and related services, furnishing of accommodations and sales of electricity, the sale or use of which is subject to tax under this chapter and does not include stocks, notes, bonds, mortgages, or other evidences of debt. Tangible personal property does not include the transmission of computer database information by a cooperative service when the database information has been assembled by and for the exclusive use of the members of the cooperative service. (Emphasis added.)

As such, a charge for the sale or renewal of a warranty, maintenance, or similar service contract for tangible personal property is subject to the sales and use tax, whether or not such contract was purchased in conjunction with the sale of the tangible personal property. In addition, since warranty, maintenance and similar service contracts are subject to the sales and use tax, sales or renewals of warranty, maintenance and similar service contracts are considered sales of tangible personal property for purposes of the sales and use tax.

Code Section 12-36-2120 exempts from the tax:

* * * *

(53) motor vehicle extended service contracts and motor vehicle extended warranty contracts.

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Based on the above, the sale or renewal of a warranty, maintenance or similar service contract is subject to the sales and use tax. However, the sale or renewal of a motor vehicle extended service contract or a motor vehicle extended warranty contract is exempt from the sales and use tax.

In SC Revenue Ruling #06-9, the Department provided the following example with respect to the application of the sales and use tax to the sale of a motor vehicle and an automobile service contract:

The sale of a motor vehicle for \$20,000.00 is subject to the tax; however, the tax due is limited to \$300.00 under the maximum tax provisions under Code Section 12-36-2110. If the retailer sold the purchaser an extended warranty contract for the motor vehicle for an additional \$1,000.00, the sales price (\$1,000.00) of the extended service contract is exempt from the tax under Code Section 12-36-2120(53). The total tax due on the motor vehicle and the extended service contract would therefore be \$300.00 (\$300.00 tax on the motor vehicle and \$0.00 on the extended service contract since it is exempt under Code Section 12-36-2120(53)).

Finally, the issue arises as to the application of the sales and use tax to the sale of a motor vehicle and an automobile service contract if the charge for the automobile service contract is not separately stated in the invoice or agreement provided to the customer.

The terms “gross proceeds of sales” and “sales price,” as cited above, are the basis for calculating the sales tax and the use tax. These terms include all charges associated with the sale at retail; however, the General Assembly has enacted two distinct impositions with respect to the issue at hand. One imposition applies to sales of “typical” tangible personal property and the other imposition applies to sales of warranty, maintenance and similar service contracts.

Based on the above, when a retailer sells an optional warranty, maintenance or similar service contract in conjunction with the sale or lease at retail of tangible personal property, then the tax imposed under Code Section 12-36-910(A) (sales tax) or Code Section 12-36-1310(A) (use tax) applies to the sale of the tangible personal property and the tax imposed under Code Section 12-36-910(B)(6) or Code Section 12-36-1310(B)(6) (use tax) applies to the sale of the warranty, maintenance or similar service contract.

The imposition of the tax under Code Section 12-36-910(B)(6) or Code Section 12-36-1310(B)(6) (use tax) does not apply to mandatory warranties, maintenance or similar service contracts, such as a manufacturer's warranty, since such contracts are not sold, but are a part of the sale of the tangible personal property. It only applies to optional warranty, maintenance or similar service contracts, whether or not sold in conjunction with the tangible personal property (e.g., optional contracts sold by third parties, optional contracts sold by manufacturers to extend the manufacturer's warranty, optional contract sold by the retailer of the tangible personal property).

The amount upon which the tax is calculated on an optional warranty, maintenance or similar service contract sold in conjunction with the tangible personal property is the amount listed in the sales contract for the warranty, maintenance or similar service contract or the retail fair market value of the warranty, maintenance or similar service contract if the amount for the warranty, maintenance or similar service contract is not listed in the sales contract or if the amount listed in the sales contract does not reasonably represent the retail fair market value of the warranty, maintenance or similar service contract.

Based on the above, whether the sale price of the vehicle service contract is either separately stated in the lease agreement (provided it reasonably represents the retail fair market value of the vehicle service contract) or is accounted for based on its reasonable retail fair market value, the sales price (including the service contract's reasonable retail fair market value if the sales price is not separately stated in the lease) of the optional motor vehicle service contracts is exempt from the sales and use tax under Code Section 12-36-2120(53).

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Ray N. Stevens
Ray N. Stevens

July 18 _____, 2008
Columbia, South Carolina