



SC REVENUE RULING #93-6

SUBJECT: Extended Warranties
(Sales and Use Tax)

TAX MANAGER: John P. McCormack

EFFECTIVE DATE: July 1, 1993

REFERENCE: S.C. Code Ann. Section 12-36-90 (Supp. 1992)
S.C. Code Ann. Section 12-36-130 (Supp. 1992)
S.C. Code Ann. Section 12-36-910(A) (Supp. 1992)
S.C. Code Ann. Section 12-36-1310(A) (Supp. 1992)
Regulation 117-174.48

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Supp. 1992)
SC Revenue Procedure #87-3

SCOPE: A Revenue Ruling is the Commission's official interpretation of how tax law is to be applied to a specific set of facts. A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.

Question:

Are charges for extended warranties subject to the sales or use taxes?

Facts:

Frequently, when a product is purchased, the manufacturer warrants that the product will be free of defects for a specified period of time. The cost of this warranty is not separately stated, but is a part of the sales price of the product.

The retailer, usually in conjunction with the manufacturer, will offer the customer the opportunity to purchase an extended warranty at the time the product is purchased. For example, a copier manufacturer may warrant that the copy machine it manufactures will be free from defects for twelve months. For an additional fee, that will be separately stated on the invoice to the customer, the customer can buy an extended warranty. The extended warranty will guarantee that the copier will be free from defects for an additional twelve months, for a total warranty period of twenty-four months. If the copier does breakdown, the manufacturer (or an authorized service center) will repair the copier, usually, free of charge.

If the customer decides not to purchase the extended warranty at the time the product is purchased, some retailers will allow the customer to purchase the extended warranty after the sale. In the above example, if the customer had not purchased the extended warranty at the time of the sale, the retailer may contact the customer at any time within a specified period of time after the sale and offer the customer a second opportunity to buy the extended warranty.

Discussion:

Before we can discuss whether extended warranties are subject to tax, we need to review the sections of the law that impose the State sales and use taxes.

Code Section 12-36-910(A) states:

A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail. (Emphasis added.)

Code Section 12-36-1310(A) reads:

A use tax is imposed 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, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State. (Emphasis added.)

Having established that the sale or purchase of tangible personal property is subject to the sales or use tax, we must next examine whether charges associated with the acquisition of tangible personal property are taxable (i.e. extended warranty agreements).

Extended Warranties Sold in Conjunction
with Tangible Personal Property

The sales tax is imposed upon a retailer's "gross proceeds of sales" which is defined at Code Section 12-36-90, in part, as:

...the value proceeding or accruing from the sale, lease, or rental of tangible personal property... without any deduction for... the cost of materials, labor, or service... [or] any other expenses....

The use tax is based upon the "sales price" of tangible personal property. The term "sales price" is defined at Code Section 12-36-130, in part, as:

...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;...

Regulation 117-174.48, entitled "Warranties", reads, in part:

On all sales of tangible personal property which include a charge for warranty which is a part of the sales price of the property, such warranty charges are to be included in the measure of the tax, even though said warranty charges may be billed separately from the price of the merchandise.

Furthermore, in Meyers Arnold, Inc. v. South Carolina Tax Commission, 285 S.C. 303, 328 S.E.2d 920, 923 (1985), the Court of Appeals of South Carolina held the element of service involved in a lay away sale was subject to tax as being part of the sale of tangible personal property. The test used by the court was as follows:

...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.

Accordingly, the total amount charged in conjunction with the sale or purchase of tangible personal property is subject to the tax.

Based on the court's finding in Meyers Arnold v. South Carolina Tax Commission, supra, but for the sale of the tangible personal property, the retailer would not receive the fees for the warranty agreement.

In an analogous situation concerning computer software maintenance contracts, the Commission, based on a similar review of the statute in SC Revenue Ruling #93-4, found that:

Maintenance contracts (whether optional or mandatory) sold in conjunction with the sale of computer software are includable in the measure of the sales or use tax. It is irrelevant whether the maintenance contract is for tangible personal property, services, or both.

In Commission Decision #90-38, the Commission held that charges for engraving services, even though optional, were a part of the sale of plaques and trophies by the retailer and includable in gross proceeds of sales. The decision states, in part:

...We find and conclude that here the "engraving charges" are part of the sale of tangible personal property since the customer is not seeking a professional service but is seeking an engraved trophy or plaque....

* * * *

...The Courts have held that although the amount of materials used may be inconsequential with respect to the labor involved where the customer seeks to purchase custom made or designed tangible personal property, the artistic skill of the craftsman is a part of the sales price of the product and is inextricably linked....

In summary, charges for extended warranties (whether optional or mandatory) that are made in conjunction with, or as part of the sale of, tangible personal property are includable in "gross proceeds of sales" or "sales price", and, therefore, subject to the tax.

Extended Warranties Not Sold in Conjunction
with Tangible Personal Property

The above discussion concerns extended warranties that are sold in conjunction with the sale of tangible personal property. However, we must also consider sales of extended warranties that are not made in conjunction with the sale of tangible personal property (e.g. contracts sold at a later date).

Regulation 117-174.48, entitled "Warranties", addresses this issue and reads, in part:

Warranty contracts entered into subsequent to the sale of tangible personal property and which are separate and distinct from the sale, and for which a separate and distinct charge is made are not to be included in the measure of the tax....

Therefore, sales of extended warranties that are not made in conjunction with the sale of tangible personal property are not subject to the sales and use taxes.

Tangible Personal Property Withdrawn, Used
or Consumed in Servicing a Warranty

While it is not directly relevant to the question at hand, it is important to be aware of additional statutory provisions as they relate to warranties.

Regulation 117-174.48 states, with respect to extended warranties sold in conjunction with the sale of tangible personal property and those not sold in conjunction with the sale of tangible personal property:

In either event, the person servicing warranties incurs a tax based on the fair market value of tangible personal property withdrawn, used or consumed in servicing all warranties.

Note however, Act 302 of 1957 amended paragraph 2 of subsection (3) of [Section] 12-35-30 [Now Code Section 12-36-90(1)(c)] so as to exclude from the measure of the tax, " ... property withdrawn from such business or stock for use or consumption by such business in replacing parts under written warranty contracts given without charge to the purchaser at the time of original purchase, provided the tax was paid on the sale of the part found to be defective or on the sale of the property of which the defective part was a component; and provided further no charge for labor or materials is made to the warrantee.

Conclusions:

Extended Warranties Sold In Conjunction With The
Sale Of Tangible Personal Property

Charges for extended warranties (whether optional or mandatory) sold in conjunction with the sale of tangible personal property are includable in the measure of the sales or use tax and therefore subject to the tax

Extended Warranties That Are Not Sold In Conjunction
With The Sale Of Tangible Personal Property

Charges for extended warranties that are not sold in conjunction with the sale of tangible personal property (e.g. contracts sold at a later date) are not subject to the sales or use tax.

SOUTH CAROLINA TAX COMMISSION

s/A. Crawford Clarkson Jr.

A. Crawford Clarkson, Jr., Chairman

s/T. R. McConnell

T. R. McConnell, Commissioner

s/James M. Waddell

James M. Waddell, Commissioner

Columbia, South Carolina
April 13, 1993

Note: This advisory opinion is a corrected version. The quote from the Meyers Arnold case was corrected.