Warranties

A warranty is a guarantee that an article of property will be free of defects for a specific period of time. Usually, the warrantor indemnifies the purchaser of the property by agreeing to replace or repair specified defects that arise without cost. The primary distinction between a warranty and a maintenance agreement is that, typically, work is performed under a warranty only if a defect is discovered.

Manufacturer's Warranty

Many articles of property will be sold by the manufacturer with a warranty against defects. This warranty may be included in the purchase price paid for the property.

Property that is removed from inventory to replace defective parts under a warranty is not subject to additional sales/use tax because the warranty was included in the taxable purchase price paid for the original product – even though the removed inventory was presumably purchased tax-free for resale.

Extended Warranties

Extended warranties are normally offered by the manufacturer or the seller in conjunction with the sale of the warranted property. Such warranties may extend the initial warranty for a period of time or cover additional losses not warranted by the manufacturer.

Extended warranties are subject to sales/use tax whether included in the cost of the tangible personal property or sold separately, regardless of whether the tangible personal property is rented, leased or purchased. Extended warranties are taxable based on the location of the tangible personal property at the point of purchase. Parts or materials used in fulfilling extended warranties are <u>not</u> subject to sales/use tax.

Examples

1. Dealer A sells all new cars with a 3,000 mile manufacturer's warranty. After only 1,500 miles, Customer B finds that the air conditioner does not work. He takes the car to the dealer who has to replace a condenser. The dealer removes this part, which costs $200, from resale inventory and installs it in Customer B's car at no charge. There is no use tax due on this transaction because the warranty was included in the taxable purchase price paid for the new car.

2. Company C, located in Lakewood, leases a copy machine from Seller D. In addition, Company C purchases an optional 12-month extended warranty. Seller D must collect sales tax on the extended warranty at the time of sale based on where the equipment is located. The monthly charge for the lease of the equipment is also subject to tax. Because the warranty was taxed at the time of purchase, any parts used in the repair of the copy machine for Company C, as covered under the extended warranty, will not be subject to tax.

3. Customer E purchases a new computer from Retailer F. The computer comes with a standard, 90-day warranty for defective parts. Customer E also purchases an optional, 1-year extended warranty that covers all parts and labor. The new computer and optional warranty are subject to tax at the point of purchase.

Related Topics

Automotive Service & Repair
Maintenance Contracts
Sales Tax

Citations

Lakewood Municipal Code
§ 3.01.120(I) Property and Services Taxed
§ 3.01.120(L) Property and Services Taxed
§ 3.01.130 Collection of Sales Tax

Regulations
§ 3.01.120(12) Warranty & Maintenance Contracts

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