
WARRANTIES and MAINTENANCE AGREEMENTS

WARRANTIES

Manufacturer's Warranty

A manufacturer's initial warranty generally provides for the repair or replacement of defective property or parts while the product is under warranty at no charge to the purchaser. This warranty is usually included in the purchase price paid for the property. Authorized dealers or repair agents subsequently remove property from inventory in order to replace the defective parts. This inventory, presumably purchased tax free for resale, is not subject to additional sales/use tax because it was included in the taxable purchase price paid for the original product.

Extended Warranty

Extended warranties are normally offered by the manufacturer and/or seller in conjunction with the sales of the warranted property. Such warranties expand the initial warranty by indemnifying the purchaser for an extended period of time. Such warranties may also cover additional losses not warranted by the manufacturer.

Extended warranties are not subject to sales/use tax provided they are optional and provided further that the price of the warranty is stated separately from the price of the property. Parts or materials used in performing **optional** extended warranties or maintenance agreements are subject to Arvada sales/use tax because they are not considered to have been included in the original purchase price of the product. The vendor performing the repair may collect sales tax on the purchase price of the parts if billed individually to the customer. If parts are included in the agreement, the vendor must report and pay a use tax on the cost of the parts used.

Vendors must collect Arvada sales tax on charges for separately stated parts and supplies sold subsequent to the warranty. The seller may not avoid collecting sales tax on parts by paying sales tax or use tax on such parts upon purchase, or by taxing all or part of the warranty charge.

MAINTENANCE AGREEMENTS

The tax character of maintenance agreements is generally dependent upon three factors:

1. Whether or not purchase of the agreement is required (**mandatory**) in conjunction with the purchase of the maintained property;
2. Whether or not the price of the agreement includes both service and replacement property, and;
3. Whether or not the price of the agreement is stated separately from the price of the maintained property.

Maintenance agreements differ from an extended warranty in that they generally provide for routine, periodic repairs to property (including software) in order to keep such property in a continuous state of good working order. When maintenance agreements provide for repair parts, supplies, or software updates, the purchaser intends to acquire property as an object of the agreement. Warranties are indemnities against defects. Property is used only if a defect is discovered.

TAXABILITY

Hardware & Equipment Maintenance Agreements

Agreements to provide ongoing repairs and maintenance to computer hardware, office equipment such as copiers and fax machines, vehicles, or other tangible personal property are **not** taxable provided that **all** of the following conditions are met:

1. The agreement is **optional** for the purchase, lease, or rental of the equipment maintained;
2. The charge for the agreement is separately stated from the purchase price, lease price, or rental price of the property being maintained (if any); and
3. The periodic charge for the agreement does not include parts and supplies or the periodic charges for parts and supplies are separately stated and taxed.

If the maintenance agreement is determined to be non-taxable (**optional**), and is sold to the customer as a separate item, tax is not normally charged on the contract at the time of sale. The seller responsible for the repair work must then pay sales or use tax on the cost of the materials used in the performing the maintenance.

Software Maintenance Agreements

While many software maintenance agreements include provisions for technical support and troubleshooting, these maintenance agreements generally represent the right to future releases, upgrades, updates, security patches, or other modifications or improvements. As such, most software maintenance agreements are subject to sales tax. Software agreements are **not** taxable provided that **all** of the following conditions are met:

1. The agreement is **optional** for the purchase, lease, or rental of the underlying software (including software license);
2. They are separately stated from the purchase price, lease or rental payment amount (including the amounts for software licenses); and
3. They are strictly for technical support and do not include the right to any future releases, upgrades, security patches, or other modifications or improvements.

Optional Maintenance Agreements

If the vendor sells an optional extended warranty or maintenance agreement, the price charged to the customer for that agreement is not taxable. However, replacement parts, materials, and supplies used or consumed in Arvada in the fulfillment of the agreement are taxable, either to the party performing the work, or to the purchaser of the maintenance contract as follows:

1. If the tangible personal property consumed or used in order to fulfill the agreement is not separately stated on an invoice for work performed, itemized, or segregated at a fixed or retail price, the party performing the service is subject to Arvada use tax on the purchase price of the material used.
2. If the tangible personal property is separately stated, sales tax must be charged on the tangible personal property and collected from the customer.

Click Charge

A "Click Charge" is a method of costing the maintenance of equipment by usage (Example: The cost of the maintenance agreement is charge by the number of copies produced on a machine). This is referred to as a "click charge." The click charges cover the labor to repair the device as well as any parts. Some contracts will include the cost of ALL consumables (toner /ink) in the maintenance contracts as Services and Supply. Additional, materials such as paper, staples can also be incorporated into a contract. For surplus consumption, such as copy machine "click charges" constitute part of the price paid for the lease or rental of tangible personal property and are therefore, subject the sales tax. Because a "click charge" can be inclusive of different components (taxable/nontaxable) it is important to understand the maintenance contract to know if it is subject to tax.

EXAMPLES

1. At the time of the sale, the retailer offers an extended warranty contract beyond the manufacturer's warranty. The agreement covers parts and labor. An annual charge is made to keep the agreement in force. At the time of performing repairs, there is no charge to the customer. The retailer is responsible to report and pay use tax based on the cost of the parts and materials used to perform the service.
2. A vendor/repair facility which represents several manufacturers of copier equipment offers a preventive maintenance program for the copiers. This program includes periodic inspection, cleaning, and adjusting of the copiers. If any parts are needed, a separate charge is made. The vendor/repair facility must collect and remit sales tax on the sale of the parts. There is no tax on the charge for the maintenance program.
3. A manufacturer of computer systems enters into a leasing agreement with its customer. A maintenance contract is required as part of the lease agreement. This mandatory charge is considered part of the lease payment and is subject to sales/use tax.
4. ABC Company leases a copy machine from All About Copy Company. The monthly charge for the lease is \$500.00 plus \$0.10 per page over 3,000 pages. All About Copy Company must collect sales tax on both the \$500.00 base charge and the \$0.10 per page overage charge.

5. XYZ Company purchased accounting software from Software To-Go for \$10,000. XYZ Company is required to pay an annual maintenance fee of \$1,500 per user, for which it receives 24 hour technical support and monthly updates from Software To-Go. Software To-Go is not a licensed retailer with the City of Arvada and does not collect tax on the charge for the software or the annual maintenance fees. XYZ Company must, therefore, report the \$10,000 software charge and the \$1,500 annual maintenance fee on their periodic sales/use tax return.

RELATED TOPICS

SOFTWARE PROGRAMS AND HARDWARE DEVICES

THE ABOVE INFORMATION IS A SUMMARY IN LAYMAN'S TERMS OF THE RELEVANT ARVADA TAX LAW FOR THIS SUBJECT, INDUSTRY OR BUSINESS SEGMENT. IT IS NOT INTENDED FOR LEGAL PURPOSES TO BE SUBSTITUTED FOR THE FULL TEXT OF THE ARVADA MUNICIPAL CODE. HOWEVER, THE TAX GUIDE SHALL BE USED IN CONJUNCTION WITH THE ARVADA MUNICIPAL CODE (CHAPTER 98) IN DETERMINING TAX LIABILITY.