

## Sales of Warranty or Service Contracts

### **New Law Clarifies the Taxation of Warranty or Service Contracts**

The General Assembly recently passed Public Chapter 273 (2015), which clarifies when the sale of a warranty or service contract covering tangible personal property is taxable. These provisions take effect **October 1, 2015**.

The new law clarifies when the sale of, use of, or subscription to warranty or service contracts covering the repair or maintenance of tangible personal property in Tennessee are subject to the sales or use tax. It provides that sales or use tax is due under each of the following circumstances:

#### **1) A Warranty or Service Contract is Taxable if Sold in Conjunction with Tangible Personal Property That Is Subject to Tax**

The new law says that the warranty or service contract is taxable if it is sold as part of or in connection with a sale of tangible personal property that is subject to Tennessee sales tax.

Example: Tennessee Furniture Dealer (“TFD”) sells office furniture in Tennessee to a purchaser and collects Tennessee sales tax on the sale. In conjunction with this sale, TFD also sells a warranty or service contract to the purchaser that covers the repair of the furniture. TFD must also collect Tennessee sales tax on the sale of the contract.

#### **2) A Warranty or Service Contract is Taxable if it Covers Tangible Personal Property Located in Tennessee**

The new law says that the warranty or service contract is also taxable if the tangible personal property covered by the warranty or service contract is located in Tennessee.

Example 1: Warranty Dealer (“WD”) sells warranty or service contracts that cover the repair of furniture sold by National Furniture Seller (“NFS”). WD sells a warranty or service contract to Purchaser that covers the repair of office furniture located in Purchaser’s Tennessee office. The sale of the contract is subject to Tennessee sales tax, and WD should collect and remit the tax. However, if the sales tax was not collected on the purchase, Purchaser would owe Tennessee use tax on the purchase price of the contract.

Example 2: Tennessee Farm Equipment Dealer (“TFED”) sells a tractor to a qualified farmer. There is a specific exemption for farm equipment sold to qualified farmers. Therefore, TFED does not collect sales tax on the sale of the tractor. However, TFED also sells a warranty or service contract to the farmer that covers repair and maintenance of the tractor located in Tennessee. Even though the equipment is exempt, the sale of the contract is still subject to Tennessee sales tax. TFED must collect and remit the tax because it covers tangible personal property located in the state.

#### **3) If the Location of the Property Is Unknown, the Warranty or Service Contract Is Taxable if the Purchaser Has a Tennessee Address**

The new law says that if the location of the tangible personal property covered by the warranty or service contract is unknown, the warranty or service contract is taxable if the purchaser's residential or primary business address is located in Tennessee.

Example: Warranty Dealer ("WD") sells warranty or service contracts that cover the repair of all furniture sold by National Furniture Seller ("NFS"). WD sells a warranty or service contract to Tennessee Purchaser ("TP") that covers the repair of office furniture purchased from NFS. WD does not know where the office furniture is located, but it does know that TP's primary business address is in Tennessee. The sale of the contract is subject to Tennessee sales tax.

### **Warranty or Service Contracts Are Subject to Both Sales and Use Tax**

The new law also subjects warranty or service contracts covering the repair or maintenance of tangible personal property to the Tennessee use tax. Therefore, if a purchaser buys a warranty or service contract from an out-of-state seller, and the seller does not collect tax on that purchase, the purchaser will owe use tax on the purchase price of the contract covering tangible personal property located in Tennessee. Furthermore, if a seller collects another state's sales tax and the rate of the tax was lower than the Tennessee sales and use tax rate, the purchaser will owe use tax on the difference between the out-of-state tax paid and the amount that would be owed based on the Tennessee tax rate.

### **Warranty or Service Contracts Covering Vehicles, Boats, and Aircraft Purchased by Nonresidents under a Three-Day or 15-Day Removal Affidavit Are Not Taxable**

Under the new law, warranty or service contracts sold in Tennessee to nonresidents in conjunction with the sale of vehicles and boats that are removed from Tennessee within three days and aircraft that

are removed within 15 days to the purchaser's home state are not subject to Tennessee sales and use tax. The purchaser must complete and the seller must maintain an affidavit stating that the vehicle or boat will be removed within three days or the aircraft will be removed within 15 days to the purchaser's home state. Note that, beginning January 1, 2016, aircraft must be removed from the state within 30 days, rather than 15.

Example: Tennessee Car Dealer ("TCD") sells a vehicle and warranty or service contract covering the vehicle to nonresident purchaser in Tennessee. Purchaser buys the vehicle using a three-day removal affidavit (i.e., Purchaser attests that he is permanently removing the vehicle from Tennessee within three days). Neither the sale of the vehicle nor the sale of the contract are subject to sales tax in Tennessee.

### **Warranty or Service Contracts Covering Vehicles, Boats, and Aircraft Purchased by a Tennessee Resident in Another State and Brought into Tennessee Are Taxable**

Conversely, if a Tennessee resident purchases a warranty or service contract in conjunction with the purchase of a vehicle, boat or aircraft in another state, with the intent of moving that vehicle, boat or aircraft back to Tennessee, then use tax will be owed on the warranty, as well as the vehicle, boat or aircraft, when a person brings those items into Tennessee.

Example: Tennessee Purchaser ("TP") buys a vehicle and a warranty or service contract covering that vehicle in Georgia, and TP brings the vehicle back to register it in Tennessee. The Tennessee county clerk must collect use tax on the warranty or service contract as well as the vehicle when TP registers the vehicle.

### **The Single Article Tax Limitation Does Not Apply to Warranty or Service Contracts**

The total sales price for a warranty or service contract covering the repair or maintenance of

tangible personal property is subject to the state tax rate plus the applicable local tax rate. The local option single article tax limitation on the first \$1,600 of the sales price of tangible personal property does not apply to the sale or use of a warranty or service contract.

### **Warranty or Service Contracts Covering Property Located Both Inside and Outside Tennessee Are Taxable Only on the Tennessee Portion**

When a warranty or service contract covers tangible personal property that is located both inside and outside the state, then Tennessee sales or use tax is only due on the percentage of the sales price that correlates to the percentage of the tangible personal property located in Tennessee.

Example: A purchaser buys a warranty or service contract from Warranty Dealer (“WD”). The contract covers repairs to office furniture that is located, in equal amounts, in the purchaser’s Tennessee office and three of the purchaser’s Florida offices. The purchaser pays \$500 for the contract. Only \$125, or 25%, of the purchase price would be subject to the Tennessee sales or use tax.

### **No Additional Tax Is Due on Repairs Performed Under a Warranty or Service Contract**

If sales or use tax is paid on a warranty or service contract covering the repair and maintenance of tangible personal property, then the purchaser of the contract will not owe sales or use tax on any

repairs, including parts and services, covered under the contract. However, if the repair is not covered by the contract, the purchaser will owe sales tax on the repair. Additionally, the purchaser will owe sales tax on any minimum fee or deductible that is not covered by the contract.

Example 1: A purchaser purchases a warranty contract from Tennessee Furniture Dealer (“TFD”) that covers the purchaser’s office furniture. One of the furniture items breaks because of faulty construction, and it must be repaired. The repair is covered by the warranty contract, and so TFD repairs the furniture at no charge. No sales tax is owed on the repair.

Example 2: A purchaser purchases a warranty contract from Tennessee Furniture Dealer (“TFD”) that covers the purchaser’s office furniture. One of the furniture items breaks because of misuse and must be repaired. This type of repair is not covered by the warranty contract, so TFD charges \$100 for the repair. Sales tax will be owed on the \$100 charge.

### **For More Information**

Visit [www.tn.gov/revenue](http://www.tn.gov/revenue). Click on [Revenue Help](#) to search for answers or to submit an information request to one of our agents.

### **References**

Tenn. Code Ann. §§ 67-6-313(h); 67-6-343; 67-6-345; Public Chapter 273 (2015); Public Chapter 48 (2015)