



STATE BOARD OF EQUALIZATION

LEGAL DIVISION (MIC:82)
450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
Ph: (916) 324-2637
FAX: (916) 323-3387

MEMBER
First District

BRAD SHERMAN
Second District, Los Angeles

ERNEST J. DRONENBURG, JR.
Third District, San Diego

MATTHEW K. FONG
Fourth District, Los Angeles

GRAY DAVIS
Controller, Sacramento

November 10, 1994

BURTON W. OLIVER
Executive Director

Mr. W--- -, S---
Associate
F--- B--- & A---, Inc.
XXX Route XX South
--- --- ---, NJ XXXXX

Re: SR --- XX-XXXXXX (AS--)
SS --- XX-XXXXXX (A--)

Dear Mr. S---:

This is a response to your August 12, 1994 letter to Assistant Chief Counsel Gary J. Jugum regarding the application of tax to warranty repairs performed on behalf of your client, the A--- S--- C--- ("ASCO").

You state that ASCO designs, manufacturers and sells electrical control equipment. My understanding is that ASCO provides a warranty to its customers as part of its sale of electrical equipment and that the warranty covers defective materials or workmanship on ASCO products for one year after shipment from its factory. Warranty work on ASCO products is performed either by ASCO's wholly owned subsidiary, A--- S---, Inc. ("ASI"), or by other independent service centers ("ISC"). Both ASCO and ASI are located outside the state, are engaged in business in this state within the meaning of Revenue and Taxation Code section 6203, and hold California seller's permits. You ask a series of questions regarding the application of tax to charges for parts and labor provided by ASI or others to fulfil ASCO's obligations under the warranty. For purposes of clarity, we have responded to each question separately.

“1. ASCO contracts its subsidiary, ASI, to perform warranty work on ASCO's behalf. These activities include the following:

- A. ASCO receives orders from its customers who are independent distributors and who have provided ASCO with resale exemption certificates. ASCO includes in its contract price start-up or commissioning of power control systems equipment sold to its customers, as well as warranty work. The start-up work is performed at the job-site by ASCO employees.

“Question: Is any part of this transaction taxable?”

As you know, a retailer owes sales tax on its gross receipts from the retail sale of tangible personal property in California unless the sale is otherwise exempted from taxation by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax applies to the storage, use or consumption of property purchased from a retailer for use in California. (Rev. & Tax. Code §§ 6201, 6401.) Gross receipts include all amounts received with respect to the sale, with no deduction for the cost of materials, service or expenses of the retailer passed on to the purchaser. (Rev. & Tax. Code § 6012; see also Rev. & Tax. Code § 6011 relating to “sales price.”) Thus, fees for the start-up or commissioning of power control systems equipment and warranty (provided the warranty is “mandatory” and not “optional” within the meaning of Sales and Use Tax Regulation 1655(c)(1) as discussed below) are included in either ASCO's gross receipts or sales price. (Id.)

You state that ASCO sells its electrical equipment to independent distributors who provide ASCO with resale certificates. We assume that ASCO's purchasers are engaged in the business of selling tangible personal property and that each holds a California seller's permit. Thus, if ASCO accepts a timely resale certificate from its independent distributors in good faith, it will be relieved from liability for sales or use tax with respect to such sales. (Rev. & Tax. Code §§ 6091, 6241; Reg. 1668.) A resale certificate is timely if taken before the seller bills the purchaser for the property, or any time within the seller's normal billing and payment cycle, or any time at or prior to the delivery of the property to the purchaser. (Reg. 1668(a)(1).)

“[1.]B. ASI uses the parts inventory of ASCO to perform warranty work. ASCO does not invoice ASI for the value of the parts used. The parts are for replacement of defective materials included in the selling price of original ASCO products shipped to the customer. ASI performs the warranty work at the customer's job site. The customer here may be the end-use customer who bought the equipment from an independent distributor or an engine

generator dealer (ASCO customer).

“[First] Question: Is the warranty service performed by ASI for ASCO's customer taxable to ASCO?”

Charges for labor or services used in installing or applying property sold are not subject to tax. (Rev. & Tax. Code § 6012(c)(3); Reg. 1546.) This rule applies whether ASCO or ASI supplies the replacement parts and whether the labor is performed at the independent distributor's or end customer's site.

“[Second] Question: [Assuming the same facts from 1.B. above,] are the parts removed from ASCO's parts inventory by ASI exempt as part of the original sales price of product which included the warranty?”

The application of tax on parts removed from ASCO's inventory depends on whether ASCO's warranty with its purchasers is optional or mandatory. A warranty is mandatory when the buyer, as a condition of the sale, is required to purchase the warranty from the seller. (Reg. 1655(c)(1), copy enclosed.) You have not provided enough facts for us to determine whether ASCO's warranties are optional or mandatory.

If ASCO is obligated to provide warranty work on its electrical goods pursuant to an optional warranty, it is the consumer of the parts and materials furnished under its agreement. (Regs. 1546(b)(3)(C), 1655(c)(3).) This means that ASCO is using parts from its inventory when ASI installs ASCO's parts on the equipment purchased by ASCO's customers or dealers. If ASCO purchased the parts furnished to ASI for resale, or otherwise acquired the property without paying California sales tax reimbursement or use tax, it must report and pay use tax on the cost of such parts installed by ASI in California. (Conversely, there is no taxable use of ASCO's parts where ASI installs such parts outside California.) The use of ASCO's parts occurs when ASI installs ASCO's parts in the electrical control equipment.

On the other hand, if ASCO is obligated to perform or provide warranty work pursuant to a mandatory warranty, it is regarded as the retailer of the parts and materials it furnishes to its customers under warranty and may purchase these parts for resale. (Regs. 1546(b)(3)(B), 1655(c)(2).) ASCO's charges for a mandatory warranty are included in its gross receipts and are subject to sales tax or, if ASCO sells for resale, are subject to tax when included in the dealer's gross receipts. (Reg. 1655(c)(2).) The parts subsequently furnished by ASCO to perform warranty repairs are thereby part of its original sales transaction. This means that ASCO is regarded as having sold the parts used in performing the warranty repair as part of its original sales transaction. Thus, tax does not apply with respect to the parts provided by ASCO to ASI

Mr. W--- , S---

-4-

November 10, 1994
315.0297

when they are furnished to fulfill ASCO's obligations under a mandatory warranty.

“2. ASCO contracts with independent service centers to perform warranty work on ASCO's behalf. In both (A) and (B) below, the parts are for replacement of defective materials included in the selling price of original ASCO products shipped to the customer. The independent service center performs the warranty work at the customer's job site. The customer here may be the end-use customer who bought the equipment from an independent distributor or engine generator dealer (ASCO's customer). These activities include the following.

“A. The independent service center uses the parts inventory of ASCO to perform warranty work if it is known in advance that the job is warranty work, and the independent service center did not have the parts in stock. ASCO does not invoice the independent service center for the value of the parts used.

“[First] Question: Are the parts exempt in this transaction?”

Please see our response to the second question from factual scenario 1.B. above. If the independent service center uses parts from its inventory, however, the application of tax to this transaction is the same as our response to question 2.B. below.

“[Second] Question: [Assuming the same facts from 2.A. above,] is the service performed by the independent service center taxable to ASCO?”

Please see our response to the first question from factual scenario of 1.B. above.

“[2.]B. The independent certified service center invoices ASCO for parts, if the independent certified service center had the parts in stock and charges ASCO the service center's usual markup on the parts. The independent certified service center would have previously bought these parts from ASCO.

“Question: Are the parts taxable to ASCO if used in warranty work which was included by ASCO in its original selling price to the customer?”

You state that ASCO is charged a markup on the parts used by ISC. Thus, we assume that the ISC is paid on a per-job basis for the work it performs on ASCO's behalf. If this assumption is incorrect, our opinion would be different.

The rules applicable to the ISC's repairs are set forth in Sales and Use Tax Regulation 1546(b)(1) and (b)(2):

“(b)(1) If the retail value of the parts and materials furnished in connection with repair work is more than 10 percent of the total charge, or if the repairman makes a separate charge for such property, the repairman is the retailer and tax applies to the fair retail selling price of the property. (Fn. omitted.)

“If the retail value of the property is more than 10 percent of the total charge, the repairman must segregate on the invoices to his customers and in his records the fair retail selling price of the parts and materials from the charges for labor of repair, installation, or other services performed. (Fn. omitted.) ‘Total charge’ means the aggregate of the retail value of the parts and materials furnished or consumed in making the repairs, charges for installation, and charges for labor of repair or other services performed in making the repairs, including charges for in-plant or on-location handling, disassembly and reassembly. It does not include pick-up or delivery charges.

“If the retailer does not make a segregation, the retail selling price of the parts and materials will be determined by the board based on information available to it.

“(2) If the retail value of the parts and materials furnished in connection with the repair work is 10 percent or less of the total charge, as defined in (b)(1) above, and if no separate charge is made for such property, the repairman is the consumer of the property, and tax applies to the sale of the property to him.” (Fn. omitted.)

This means that when the ISC separately states its charges for parts, or the retail value of the parts furnished in connection with its repairs is greater than 10 percent of its total charge, the ISC is regarded as selling the replacement parts to ASCO. The remaining issue is whether tax applies to the sales of these parts from the ISC to ASCO.

The application of tax on parts sold by the ISC to ASCO again depends on whether the repairs are provided by ASCO pursuant to an optional or a mandatory warranty. As explained above, ASCO is the consumer of parts and materials it furnishes to its customers pursuant to an optional warranty. (Regs. 1546(b)(3)(C), 1655(c)(3).) Sales tax applies to the ISC's sale of parts to ASCO if ASCO's warranty is optional and the sale of parts to ASCO is a retail sale inside this state. (Rev. & Tax. Code § 6051.) Conversely, the ISC's sale of parts to ASCO outside the state is not subject to California sales or use tax because neither the sale nor ASCO's use of the parts is inside California. If ASCO's warranty with its customer is mandatory, ASCO is the retailer of parts it furnishes to its customers and may purchase these parts from the ISC for resale. (Regs. 1546(b)(3)(B), 1655(c)(2).) Again, these parts are deemed sold as part of the original sales transaction such that sales or use tax is not applicable to the sale of parts furnished by ASCO pursuant to its mandatory warranty.

We hope this answers your questions. If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Staff Counsel

WLA:plh

Enclosures - Reg. 1655

cc: --- --- --- District Office - - -