




---

**STATE BOARD OF EQUALIZATION**

450 N STREET, SACRAMENTO, CALIFORNIA MIC: 85  
 (P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)  
 (916) 324-2608

MEMBER  
 First District

BRAD SHERMAN  
 Second District, Los Angeles

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

MATTHEW K. ONG  
 Fourth District, Los Angeles

GRAY DAVIS  
 Controller, Sacramento

BURTON W. OLIVER  
 Executive Director

April 27, 1994

Mr. B--- S---  
 T--- S--- Corporation  
 XXXX --- Drive  
 ---, CA XXXXX-XXXX

Dear Mr. S---:

Re: SR --- XX-XXXXXX

This is in response to your letter dated February 23, 1994, in which you ask how tax applies to parts used to fulfill warranties. You state:

"When parts are purchased for resale, without tax, should California use tax be accrued when parts are withdrawn from inventory, whether the parts are used in California or shipped within a reasonable time to out of State? (Parts withdrawn from inventory are used for optional or mandatory warranties)"

You are a retailer engaged in the business of selling tangible personal property in this state. Sales tax is imposed on all retailers measured by their gross receipts from retail sales of tangible personal property in this state. (Rev. & Tax. Code § 6051.) When the sales tax does not apply, use tax is imposed on the sales price of property purchased from a retailer for use, storage, or other consumption in California. (Rev. & Tax. Code §§ 6201, 6401.)

We assume you are not charging your customer for the parts you ship to them when fulfilling the warranties but that the parts are provided without charge pursuant to the warranty agreement. We further assume that the parts in question are properly purchased for resale, that is, that each type of part you purchase is actually resold. (If you purchase a particular type of part that you always consume you would not be entitled to purchase that type of part for resale. On the other hand, you may properly purchase a particular type of part for resale if you sometimes resell the part and sometimes consume the part but do not know at the time of your purchase which specific part you will consume and which you will resell.)

If a purchaser who purchases property extax for resale thereafter makes any use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, the purchaser owes use tax measured by the purchase price at the time the property is first used or stored. (Rev. & Tax. Code § 6244.)

"Mandatory" and "optional" warranties are defined in Regulation 1655(c)(1) as follows:

"Mandatory Warranty.' A warranty is mandatory within the meaning of this regulation when the buyer, as a condition of the sale, is required to purchase the warranty or guaranty contract from the seller. `Optional Warranty.' A warranty is optional within the meaning of this regulation when the buyer is not required to purchase the warranty or guaranty contract from the seller, i.e., he is free to contract with anyone he chooses."

The tax treatment with regard to mandatory warranties is discussed in subdivision (c)(2) of Regulation 1655 which states:

"The sale of tangible personal property includes furnishing, pursuant to the guaranty provision of the contract of sale, or mandatory warranty, of replacement parts or materials, and if the property subject to the warranty is sold at retail, the measure of the tax includes any amount charged for the guaranty or warranty, whether or not separately stated. The sale of the replacement parts and materials to the seller furnishing them thereunder is a sale for resale and not taxable."

In other words, parts and materials furnished in connection with the performance of "mandatory warranties" are regarded as sold to the customer as part of the original sale. The sale of the replacement parts and materials to the seller furnishing them thereunder is a sale for resale and not taxable. (See also Sales and Use Tax Reg. 1546, subd.(b)(3).) Thus, if your warranty is mandatory you are regarded as purchasing the parts for resale and, in effect, selling them as part of the original taxable sale. No use tax applies when you furnish parts for such mandatory warranties.

On the other hand, subdivision (c)(3) of Regulation 1655, which discusses optional warranties, states that the person obligated to furnish parts and materials for optional warranties is the consumer of those parts and materials and tax applies to the sale of those items to that person. If the items are purchased extax that person must report and pay tax on the cost of that property when that person uses them to fulfill the optional warranty. Thus, for the optional warranties you are fulfilling, as the consumer, you owe use tax on that use unless there is an exemption or exception pertinent to that use.

A relevant exception is found in Revenue and Taxation Code section 6009.1 which states that "use" for purposes of the Sales and Use Tax Law does not include the keeping or retaining of property for the purpose of transporting it outside the state for use thereafter solely outside the state. When the property's presence in California comes within this provision, there is no taxable use. A person may not issue a resale certificate solely for the purpose of coming within this provision.

However, if a person properly issues a resale certificate as discussed above, and the property is shipped to that person's location out-of-state and is then transferred by that person from its out-of-state location to the out-of-state customer to fulfill an optional warranty, that person is regarded as using the property outside California. California use tax would not apply. On the other hand, if title passes in this state, that person is regarded as using the property in this state and such use of property withdrawn from resale inventory is subject to use tax. For instance, if the property is shipped from a point in this state by the warrantor directly to the customer's out-of-state location, title transfers to the out-of-state customer (recipient) the moment the property is placed in the hands of the shipper. At that moment the warrantor has made a taxable use of the property and use tax applies. (Rev. & Tax. Code § 6009.1; BTLG Ann. 280.0360 and 280.0640.)

In summary, parts used in fulfilling mandatory warranties are not subject to tax because those parts are regarded as part of the original taxable sale. On the other hand, parts used in fulfilling optional warranties are taxable if those parts are used in California as explained herein. If the parts are properly purchased under a resale certificate but thereafter used outside California, that use is not subject to tax.

I note that you indicate that property that is shipped within a "reasonable time" is not taxable. The amount of time property is held before being shipped is not generally relevant to the application of tax. If you have any further questions please feel free to write again.

Very truly yours,

Rachel M. Aragon  
Staff Counsel

RMA:md

cc: --- - District Administrator