

Excise Tax Advisory

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ETA 3XXX.20XX

Issue Date: , 2015

Taxability of Home Service Contracts and Mixed Service Contracts

Purpose

This Excise Tax Advisory addresses how to distinguish real property from tangible personal property, the taxation of income from sales of home service contracts and mixed service contracts, and the use of parts and repair services covered under such contracts.

Distinguishing between a fixture (real property) and tangible personal property (TPP)

The taxability of sales from home service contracts and mixed service contracts depends on whether the underlying property is a fixture (real property) or tangible personal property (TPP).

In accordance with common law, an item is deemed to be a fixture if it satisfies **all** three of the following general tests:

1. Actual annexation to the realty, or something appurtenant thereto;
2. Application to the use or purpose to which that part of the realty with which it is connected is appropriated; and
3. The intention of the party making the annexation to make a permanent accession to the freehold.

If any one of these elements is absent, proof of a fixture is lacking and the item is considered TPP.

Home service contracts

What is a home service contract?

For the purpose of this ETA, a home service contract (also sometimes referred to as a home service agreement) is

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- a contract for any duration
- to perform the service, repair, replacement, or maintenance of property or indemnification for service, repair, replacement, or maintenance,
- for the operational or structural failure of any residential property due to a defect in materials, workmanship, inherent defect or normal wear and tear,
- with or without additional provisions for incidental payment or indemnity under limited circumstances.

Home service contracts cover real property including, but not limited to, heating and air conditioning systems, electrical systems, structural building components, and built-in appliances. They are comparable to a warranty, as that term is defined in RCW 82.04.050, except that home service contracts cover real property while warranties cover tangible personal property.

Sales of home service contracts

The sale of a home service contract is not a retail sale of a warranty because the home service contract does not cover tangible personal property as is required in the definition of a warranty in RCW 82.04.050(7). See also WAC 458-20-257, *Tangible personal property warranties and service contracts*. Income from sales of home service contracts is subject to tax under the service and other activities B&O tax classification. RCW 82.04.290.

Sales of repair services or parts to obligor

When a person obligated under a home service contract (the “obligor”) performs repairs for no additional charge, the obligor is the consumer of parts and materials used for the repair and must pay retail sales tax to the supplier. If retail sales tax is not paid at the time of purchase, the obligor must pay deferred sales tax or use tax on the parts and materials.

If an obligor hires another party to perform the repair work, the person making the repairs is making a retail sale to the obligor and must collect retail sales tax on the invoiced amount, and remit it along with the retailing B&O tax on its excise tax return. Again, if retail sales tax is not paid at the time of purchase, the obligor must pay deferred sales tax or use tax on the parts and materials.

Additional coverage for tangible personal property

Sales of additional coverage for tangible personal property

Additional coverage for TPP is often available for a purchaser of a home services contract. Income from retail sales of this additional coverage, sometimes called an addendum, is subject to the retailing B&O tax and retail sales tax. See RCW 82.04.050(7) and WAC 458-20-257.

Sales of repair services or parts to obligor

Persons obligated under an addendum for additional coverage of TPP may purchase the following from a supplier or service provider at wholesale without incurring retail sales tax, provided the obligor provides the supplier or service provider with a copy of their reseller permit:

- Parts purchased to replace or become an ingredient or component of TPP covered by the addendum, as long as there is no intervening use of the parts by obligor or any other person as a consumer; and
- Repair services purchased to satisfy the obligor's obligations under an addendum.

The supplier or service provider is subject to tax under the wholesaling B&O tax

classification on sales to the obligor of the parts and services provided.

Mixed service contracts

What is a mixed service contract?

For the purpose of this ETA, a mixed service contract is a contract that includes coverage for real property and TPP for one lump sum charge.

Sales of mixed service contracts

The sales of a mixed service contract is a retail sale subject to retailing B&O and retail sales taxes, unless the seller can establish that the coverage for the TPP meets the 10% de minimis threshold provided by RCW 82.08.190. "De minimis" means the seller's purchase price or sales price for the TPP coverage is ten percent or less of the seller's total purchase price or sales price of the mixed service contract. Either the seller's purchase price or sales price, not a combination, must be used to determine if the coverage for TPP is de minimis. If the coverage for the TPP meets the de minimis threshold, the income from the sale of the mixed service contract is subject to tax under the service and other activities B&O tax classification.

Sales of repair services or parts to obligor

When a person obligated under a retail mixed service contract performs repairs for no additional charge, the obligor may purchase the parts and materials used for the repair at wholesale with the use of a reseller permit. If a mixed service contract meets the de minimis threshold, the obligor's purchases of these parts and materials for repairs are retail purchases subject to retail sales or use tax.

Likewise, if a person obligated under a retail mixed service contract hires another party to perform the repair work, the obligor may purchase the repair service at wholesale with the use of a reseller permit. If a mixed service contract meets the de minimis threshold, the obligor's purchase of the repair service is a retail purchase subject to retail sales tax.

Additional charges that are paid by the policyholder

In some cases, a customer or policyholder is required to pay an amount for services or parts not fully covered under a home service contract or mixed service contract. This additional amount charged by the provider of the services or parts is subject to the retailing B&O tax and retail sales tax.

Commissions earned by third parties

If the obligor hires a third party as the obligor's agent to sell home service contracts or mixed service contracts, the consideration received by the agent as a commission is generally subject to tax under the service and other activities B&O tax classification. However, if the third-party seller of the home service contract or mixed service contract is licensed under chapter 48.17 RCW with respect to this specific selling activity, the commission is subject to tax under the insurance producers B&O tax classification.
