

Cite as Det. No. 94-125, 15 WTD 33 (1995).

BEFORE THE INTERPRETATIONS AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
for Refund of)	
)	No. 94-125
)	
. . .)	Registration No. . . .
)	FY. . ./Audit No. . . .
)	

RULE 257: USE TAX -- EXTENDED WARRANTIES -- EXCHANGES AND REPLACEMENTS -- REPAIR PARTS. When a company under an extended warranty provides for the replacement of defective equipment with refurbished equipment, it must pay use tax on the parts it uses to refurbish the equipment because it is the consumer of those parts.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

Manufacturer of high speed printers protests the assessment of use tax on parts used to repair printers which are exchanged for defective printers under an express warranty program.¹

FACTS:

Mahan, A.L.J. -- The taxpayer manufacturers high speed printers. In addition to any other warranty, the taxpayer offers its customers the opportunity to enroll in a program. Under this program the taxpayer's customers are allowed to exchange defective printers for a refurbished printer. The replacement printers are sent out within 24 hours after an order is placed.

¹Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

In this manner customers can shorten any loss of use caused by a defective printer. Most of its customers reside out-of-state. In order to take part in the program, customers must pay a non-refundable up-front fee, a per incident fee, and freight charges. The taxpayer pays service B&O tax on income from the program. Customers receive no consideration, credit, or other adjustment based on the age, usage, or condition of the returned printers.

Upon receipt of a defective printer, the company either refurbishes the printer or salvages usable parts from the printer. If it is refurbished, defective parts are replaced, it is cleaned and tested, and placed into inventory, to be used as a replacement printer for some other customer.

Under the terms of the program, once the replacement printer is sent to the customer, "the replacement printer is now your property and the transaction is complete." Implicit in this arrangement is that the defective printer then becomes the property of the taxpayer.

The Department of Revenue (Department) audited the taxpayer's books and records for the January 1, 1989 through March 31, 1993 period. As a result the taxpayer received a substantial refund. It believes its refund would have been greater had the auditor not assessed use tax on the parts the taxpayer used to refurbish printers under the program. The auditor reasoned that use tax was applicable because the activity involved a repair made under a separately stated warranty. See WAC 458-20-257 (Rule 257). The taxpayer argues that its activity under the warranty is the replacement, not repair, of printers and, accordingly, use tax should not be imposed.

After the audit was completed, the taxpayer also discovered what it believes was an error in its records. According to the taxpayer, it maintains a subaccount for the cost of parts which are found to be defective and which have been purchased for use in manufacturing printers. Under its accounting system it had assigned such costs to its internal accounts. It pays sales tax on parts used internally, such as for engineering purposes, and incorrectly paid sales tax on the defective parts which had been purchased for manufacturing. This issue will be remanded to Audit Division and will not be further addressed in this determination. To the extent the taxpayer is able to demonstrate that it paid sales or use tax on such defective parts, for which no credit was received, it will be entitled to a credit.

ISSUE:

Whether the taxpayer must pay use tax on parts used to refurbish property which is used to meet its contractual obligations under an extended warranty.

DISCUSSION:

The Audit Division assessed use tax based on WAC 458-20-257 (Rule 257). With respect to the application of the use tax to the repair or replacement of equipment under an extended warranty, Rule 257 provides:

(1) DEFINITIONS. For the purposes of this section, the following terms will apply:

(a) Warranties. Warranties, sometimes referred to as guarantees, are agreements which call for the replacement or repair of tangible personal property with no additional charge for parts or labor, or both, based upon the happening of some unforeseen occurrence, e.g., the property needs repair within the warranty period.

. . .

(4) USE TAX.

. . .

(b) Nonmanufacturer's warranties and manufacturer's warranties not included in the retail selling price of the article being sold.

(i) When a repair is made by the warrantor under a separately stated warranty, the warrantor is the consumer of the parts and the parts are subject to use tax measured by the warrantor's cost.

(ii) When a person other than the warrantor makes a repair for the warrantor, the person making the repair is making a retail sale to the warrantor. Retail sales tax, not use tax, is collected.

(Emphasis added.)

The taxpayer contends that Rule 257 does not apply, because it does not repair the printers "under a separately stated warranty." Rather, it replaces printers with ones it has in its inventory.

[1] Even if we accept the taxpayer's argument, the result is the same. The rationale behind subsection 4(b)(i) is that the warrantor is the consumer of the parts it uses to fulfill its obligations under an extended warranty. As the consumer of the parts, the warrantor owes retail sales tax on the parts it purchases.

In this regard, RCW 82.04.050 defines a retail sale to include the "repairing, cleaning, altering, imprinting, or improving tangible personal property of or for consumers." A consumer is defined under RCW 82.04.190 to include persons who "repair, clean, alter, improve, construct, or decorate real or personal property of or for consumers" In this case, the taxpayer consumes the parts it uses to repair the printers it places into its inventory. By doing so, it is able to meet its obligations under the express warranty program. As the consumer of the parts, the taxpayer owes use tax on the parts.

DECISION AND DISPOSITION:

The taxpayer's petition with respect to use tax on parts is denied. The case is remanded to the Audit Division for verification that an internal accounting error was made whereby the taxpayer paid use tax on defective parts which had been purchased for use in manufacturing printers.

DATED this 30th day of June, 1994.