



DIRECTIVE

Subject: Service Contracts
Tax: Sales and Use Tax
Law: N.C. Gen. Stat. § 105-164.4(a)(11)
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Effective January 1, 2014, N.C. Gen. Stat. § 105-164.4(a)(11) imposes the 4.75% general State and applicable local and transit rates of sales and use tax “to the sales price of a service contract” sold at retail by a retailer on or after January 1, 2014 and sourced to this State. Effective January 1, 2014, N.C. Gen. Stat. § 105-164.3(38b) defines “[s]ervice contract” as “[a] warranty agreement, a maintenance agreement, a repair contract, or a similar agreement or contract by which the seller agrees to maintain or repair tangible personal property.” N.C. Gen. Stat. § 105-164.3(46) defines “[t]angible personal property” as “[p]ersonal property that may be seen, weighed, measured, felt, or touched or is in any other manner perceptible to the senses. The term includes electricity, water, gas, steam, and prewritten computer software.”

A single repair transaction between a retailer and a purchaser for tangible personal property that is not completed pursuant to a “service contract” sold to a purchaser is not a service contract for purposes of N.C. Gen. Stat. § 105-164.4(a)(11). For example, a retailer that sells and installs an alternator for a motor vehicle, where such transaction is not completed under a service contract, continues to be subject to the 4.75% general State and applicable local and transit rates of sales and use tax on the retail sales price of the alternator. The amount charged by the retailer to the purchaser for installation of the alternator is exempt from sales and use tax per N.C. Gen. Stat. § 105-164.13(49) provided the installation labor is separately stated on the invoice or similar billing document given to the purchaser at the time of sale.

The sales and use tax does not apply to a contract where a person agrees to maintain, service, or repair real property or an item of tangible personal property permanently attached to real property, provided such contract is sold to a

purchaser after an item of tangible personal property is permanently attached to real property. For example, where a purchaser buys a house that has garage doors on the garage and such person subsequently purchases a contract for an annual garage door service agreement that covers all repairs without an additional charge within the contract period, such contract is not the sale of a service contract subject to tax per N.C. Gen. Stat. § 105-164.4(a)(11). Such contract is for the service of an item of real property. The garage door company continues to be subject to sales and use tax on the sales or purchase price of an item of tangible personal property or a taxable service used to fulfill the contract. If the garage door service company makes a separate retail sale of a part to such purchaser that is not covered by the garage door service agreement, the 4.75% general State and applicable local and transit rates of sales and use tax is due on the sales price of the part.

Retailer of “Service Contract” Engaged in Business in the State is Liable

A retailer engaged in business in the State that sells a “service contract” at retail sourced to this State is liable for the sales and use tax due on such transaction. A retailer that enters into an agreement or contract or otherwise authorizes, another person to sell or enter into a “service contract” sourced to this State on the retailer’s behalf, is engaged in business as a retailer in this State. Such retailer is liable for the 4.75% general State and applicable local and transit rates of sales and use tax on the sales price of a “service contract;” notwithstanding that the salesperson, agent, or other person may receive payment, in full or in part, on behalf of the retailer from a purchaser.

A retailer that authorizes another person to sell or enter into a “service contract” sourced to this State with a purchaser on behalf of the retailer is encouraged to ensure that any agreement between the parties provides that any sales and use tax collected on the sales price of a “service contract” must be submitted to the retailer to be remitted to the Department. A retailer engaged in business in this State is not relieved of its liability for sales and use tax on the retail sale of a “service contract” sourced to this State due to failure by another person to collect or remit the applicable sales and use tax due on the sale of the contract. Where the retailer bills for the sale of a “service contract” sourced to this State, such retailer should separately state the 4.75% general State and applicable local and transit sales and use tax due on the invoice or other similar billing document given to the purchaser at the time of the sale.

N.C. Gen. Stat. § 105-164.3(35) defines the term “[r]etailer,” in part, as “[a] person engaged in the business of . . . [m]aking sales at retail, offering to make sales at retail, or soliciting sales at retail of . . . services for storage, use, or consumption in this State. When the Secretary finds it necessary for the efficient administration of [Sales and Use Tax] to regard any sales representatives, solicitors, representatives, consignees, peddlers, or truckers as agents of the

dealers, distributors, consignors, supervisors, employers, or persons under whom they operate or from whom they obtain the items sold by them regardless of whether they are making sales on their own behalf or on behalf of these dealers, distributors, consignors, supervisors, employers, or persons, the Secretary may so regard them and may regard the dealers, distributors, consignors, supervisors, employers, or persons as ‘retailers’ for the purpose of [Sales and Use Tax]. . . .”

N.C. Gen. Stat. § 105-164.3(9) defines “[e]ngaged in business,” in part, as “[m]aintaining, occupying, or using permanently or temporarily, directly or indirectly, or through a subsidiary or agent, by whatever name called, any office, place of distribution, sales or sample room, warehouse or storage place, or other place of business for selling or delivering . . . a service for storage, use, or consumption in this State, or permanently or temporarily, directly or through a subsidiary, having any representative, agent, sales representative, or solicitor operating in this State in the selling or delivering. The fact that any corporate retailer, agent, or subsidiary engaged in business in this State may not be legally domesticated or qualified to do business in this State is immaterial.”

N.C. Gen. Stat. § 105-164.3(11) defines “[b]usiness” as “[a]n activity a person engages in or causes another to engage in with the object of gain, profit, benefit, or advantage, either direct or indirect. The term does not include an occasional and isolated sale or transaction by a person who does not claim to be engaged in business.”

N.C. Gen. Stat. § 105-228.90(b)(5) defines, “[p]erson,” in part, as “[a]n individual, a fiduciary, a firm, an association, a partnership, a limited liability company, a corporation, a unit of government, or another group acting as a unit. The term includes an officer or employee of a corporation, a member, a manager, or an employee of a limited liability company, and a member or employee of a partnership who, as officer, employee, member, or manager, is under a duty to perform an act in meeting the requirements of Subchapter I, V, or VIII of [Chapter 105]. . . .”

Sales and Use Tax Applicable to Receipts for Certain “Service Contracts” Entered Into Prior to January 1, 2014

N.C. Gen. Stat. § 105-164.15A, as amended effective January 1, 2014 and applicable to sales made on or after that date, provides that “[t]he effective date of a tax change for tangible personal property, digital property, or services taxable under [the Sales and Use Tax Article] is administered as follows:

- (1) For a taxable item that is provided and billed on a monthly or other periodic basis:
 . . . A new tax . . . applies to the first billing period that is at least 30 days after enactment and that starts on or after the effective date. . . .

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- (2) For a taxable item that is not billed on a monthly or other periodic basis, a tax change applies to amounts received for items provided on or after the effective date”

A billing period for a “service contract” billed on a monthly or other periodic basis that begins on or after January 1, 2014, is subject to sales and use tax provided the contract is not for an item statutorily exempt from sales and use tax in N.C. Gen. Stat. § 105-164.13 and no matter that the contract was executed prior to January 1, 2014. For example, a “service contract” for a motor vehicle that provides for oil changes for a three-year period, is billed on a monthly basis. The 4.75% general State and applicable transit and local rates of sales and use tax apply to the gross receipts for the “service contract” for billing periods that begin on or after January 1, 2014.

A “service contract” entered into on or after January 1, 2014 for an annual basis is subject to sales and use tax provided the contract is not for an item exempt from sales and use tax per N.C. Gen. Stat. § 105-164.13.

The sales price of a three-year extended warranty contract entered into and billed in full on December 24, 2013 to maintain or repair a motor vehicle is not subject to sales and use tax no matter that the contract is in effect for periods beginning on or after January 1, 2014.

Exemptions

N.C. Gen. Stat. § 105-164.13(61)

Effective for sales made on or after January 1, 2014, N.C. Gen. Stat. § 105-164.13(61) provides an exemption from sales and use tax for the sale at retail and the use, storage, or consumption in this State of “[a] service contract for tangible personal property that is provided for any of the following:

- a. An item exempt from sales and use tax under [Article 5 of Chapter 105 of the N.C. General Statutes], other than [a motor vehicle and] an item exempt from tax under [N.C. Gen. Stat. §] 105-164.13(32).
- b. A transmission, distribution, or other network asset contained on utility-owned land, right-of-way, or easement.
- c. An item purchased by a professional motorsports racing team for which the team may receive a sales tax refund under [N.C. Gen. Stat. §] 105.164.14A(5).”

The sales price of a “service contract” entered into on or after January 1, 2014, or billed on a monthly or other periodic basis on or after January 1, 2014, for a billing period that begins on or after January 1, 2014 for a contract that meets the definition of “service contract” but entered into prior to January 1, 2014, for one of the following items is not subject to sales and use tax pursuant to N.C. Gen. Stat. § 105-164.13(61)a. Items include, but are not limited to the following:

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- (1) Products that are subject to tax under Article 5F which include mill machinery, mill machinery parts or accessories purchased for storage, use, or consumption in this State by a manufacturing industry or person.
- (2) Logging machinery used by a person engaged in commercial logging to harvest raw forest products for transport to first market.
- (3) Telephone company central office, switchboard equipment, private branch exchange equipment, and certain terminal equipment to a telephone company regularly engaged in providing telecommunications service to subscribers on a commercial basis.
- (4) Broadcasting equipment used by a radio or television company licensed by the Federal Communications Commission.
- (5) Broadcasting equipment used by a cable service provider.
- (6) Tangible personal property purchased by a State agency that meet the statutory requirements of N.C. Gen. Stat. § 105-164.13(52).
- (7) Tangible personal property purchased by the United States Government.
- (8) Qualifying farm machinery used by a “farmer” in the planting, cultivating, harvesting, or curing of farm crops or in the production of dairy products, eggs, or animals.
- (9) Laundry and dry-cleaning machinery used by a commercial laundry.
- (10) Boats sold to a commercial fishing operator that meet the statutory requirements of N.C. Gen. Stat. § 105-164.13(9).
- (11) Durable medical equipment and mobility enhancing equipment sold on prescription.
- (12) Prosthetic devices for human use.
- (13) Custom computer software and certain other software coming within the exemption in N.C. Gen. Stat. §§ 105-164.13(43a) or (43b).

N.C. Gen. Stat. § 105-164.13(62)

Effective for sales made on or after January 1, 2014, N.C. Gen. Stat. § 105-164.13(62) provides an exemption from sales and use tax for the sale at retail and the use, storage, or consumption in this State of “[a]n item used to maintain or repair tangible personal property pursuant to a service contract if the purchaser of the contract is not charged for the item.”

The sale, purchase, or withdrawal from inventory, of an item on or after January 1, 2014, and used in a “service contract” entered into before, on, or after January 1, 2014 is exempt from sales and use tax provided the purchaser of the “service contract” is not charged for such item.

Sourcing

N.C. Gen. Stat. § 105-164.4B provides the sourcing principles to be used in determining where to source the sale of a “service contract.” The following sourcing principles apply to the sales price of a “service contract:”

- (1) When a purchaser receives a product at a business location of the seller, the sale is sourced to that business location.
- (2) When a purchaser or purchaser’s donee receives a product at a location specified by the purchaser and the location is not a business location of the seller, the sale is sourced to the location where the purchaser or purchaser’s donee receives the product.
- (3) When (1) and (2) of this section do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller’s business when use of this address does not constitute bad faith.
- (4) When (1), (2) or (3) of this section do not apply, the sale is sourced to the location indicated by an address for the purchaser obtained during the consummation of the sale, including the address of a purchaser’s payment instrument, if no other address is available, when use of this address does not constitute bad faith.
- (5) When (1), (2), (3), and (4) of this section do not apply, including the circumstance in which the seller is without sufficient information to apply the rules, the location will be determined based on the following:
 - a. Address from which tangible personal property was shipped,
 - b. Address from which the digital good or the computer software delivered electronically was first available for transmission by the seller, or
 - c. Address from which the service was provided.

For purposes of N.C. Gen. Stat. § 105-164.4B(a)(1) and (2) and in accordance with Rule 311.1 of the Streamlined Sales Tax Governing Board, the term “receives” means “making first use of services.” The Rule provides that the location (or locations) where the purchaser (or the purchaser’s donee) can potentially first make use of the result of the service is the location (or locations) where the service is received by a purchaser.

The sale of a “service contract” at retail by the retailer or on behalf of a retailer by another person to a purchaser at a location in this State is the location where the sale of the “service contract” is sourced provided the purchaser can potentially first make use of the service at the location. If the purchaser of the “service contract” cannot potentially make first use at the location where the “service

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contract” is sold, the sale is sourced in accordance with N.C. Gen. Stat. § 105-164.4B (3), (4) or (5) based on the hierarchy and available address.

For example, for a sale of a “service contract” for a motor vehicle to a purchaser where a credit union enters into and processes the sale on behalf of the retailer, the sale of the “service contract” is sourced in accordance with N.C. Gen. Stat § 105-164.4B(3), (4) or (5). Where an automotive dealer sells a “service contract” on behalf of a retailer to a purchaser at the dealership location in this State, the sale of the “service contract” is sourced to the location of the dealership, as the location where the purchaser can potentially first make use of the service, unless the retailer has information or knowledge to the contrary.

Examples

Used Car Retailer Extended Automobile Warranty:

A used car retailer sells a used motor vehicle for \$10,000 and also sells an extended warranty agreement for \$1,500 to a purchaser on January 1, 2014. The extended warranty agreement provides that the used car retailer will maintain or repair the motor vehicle and will not charge the purchaser of the agreement for products used by the used car retailer to maintain or repair the motor vehicle. The used car retailer is liable for collecting and remitting the 4.75% general State and applicable local and transit rates of sales and use tax on the \$1,500 sales price of the extended warranty agreement.

New Car Manufacturer Extended Automobile Warranty:

On January 15, 2014, a new car retailer sells a new motor vehicle for \$45,000 to a purchaser. The new car retailer also sells, on behalf of a new car manufacturer, an extended warranty agreement for \$2,000 to the purchaser. The new car retailer receives a commission on the sale of the extended warranty agreement from the new car manufacturer. The extended warranty agreement provides that the new car manufacturer will maintain or repair the motor vehicle for a three-year period and the purchaser of the contract will not be charged for an item used to maintain or repair the motor vehicle. The sales price of \$2,000 paid for the extended warranty agreement executed by the new car retailer with the purchaser on January 15, 2014, on behalf of new car manufacturer, is subject to the 4.75% general State and applicable local and transit rates of sales and use tax. The new car manufacturer is the person liable for remittance of the sales and use tax to the Department.

The sale, purchase, or withdrawal from inventory of parts by the new car retailer or other person to maintain or repair the motor vehicle on or after January 1, 2014, pursuant to the extended warranty agreement are exempt from tax. Any invoice, bill of sale, or other similar document issued by the new car retailer to the new car manufacturer is not subject to sales and use tax provided the new car retailer obtains a certificate of exemption or the required data elements per

N.C. Gen. Stat. § 105-164.28 from the new car manufacturer or the new car retailer retains other documentation such as an authorization for repair received from the new car manufacturer to support that the parts and other tangible personal property used by the new car retailer are to repair a motor vehicle pursuant to a “service contract.”

All Terrain Vehicle Manufacturer Maintenance Agreement:

An all terrain vehicle (ATV) retailer sells a new ATV for \$8,000 and a maintenance agreement for \$2,000 to an individual in North Carolina on January 1, 2014. The maintenance agreement is entered into between the individual and the ATV manufacturer and provides that the ATV manufacturer, and not the ATV retailer, must maintain the ATV without any charges to the consumer for a period of one year. The ATV retailer is not obligated as a result of the maintenance agreement to maintain or repair the ATV. The ATV manufacturer, as the retailer of the maintenance agreement sold on its behalf by ATV retailer in the State, is liable for the 4.75% general State and applicable local and transit rates of sales and use tax on the sales price of \$2,000 for the maintenance agreement sold to the individual.

Laptop Repair Contract:

An individual purchases a \$500 repair contract for a laptop from a computer repair shop on January 1, 2014. The computer repair shop agrees to provide all parts and labor for the period of the repair contract. The laptop repair shop must collect and remit the 4.75% general State and applicable local and transit rates of sales tax on the \$500 sales price of the repair contract.

Airplane Extended Warranty Agreement:

An airplane retailer sells an airplane for \$500,000 and an extended warranty agreement for \$15,000 to a purchaser on February 1, 2014. The extended warranty requires the airplane retailer to maintain or repair the purchaser’s airplane without additional charge for a period of one year. The sale of the airplane is subject to the 3% State rate of tax with a maximum tax of \$1,500. The sales price of the extended warranty agreement in the amount of \$15,000 is subject to the 4.75% general State and applicable local and transit rates of sales tax.

In-Ground Pool Warranty Contract:

A pool retailer sells a dealer’s warranty for \$1,000 for the liner of an in-ground swimming pool on January 1, 2014. The dealer’s warranty provides that the pool retailer will repair or replace the pool liner for a period up to two years from date of purchase of the warranty agreement. The liner was purchased from the pool retailer and installed prior to January 1, 2014. The sale of the warranty agreement on January 1, 2014 is the sale of a contract for a pool liner that is attached to real property at the time of the sale and is not subject to sales and

use tax. Tangible personal property purchased to repair or replace the liner by the pool retailer to fulfill a dealer's warranty continues to be exempt from sales and use tax in accordance with SD-99-3.

HVAC Service Contract:

An HVAC contractor sells a service contract, the sales price of which is \$200, to a customer on January 1, 2014. The service contract provides that the HVAC contractor will service, maintain and repair the customer's HVAC for a period of one year. The HVAC service contract is not subject to sales and use tax as the HVAC system is attached to real property at the time of the sale of the contract and is not a contract by which the seller agrees to maintain or repair tangible personal property. The HVAC contractor continues to be subject to the 4.75% general State and applicable local and transit rates of sales and use tax for repair parts and supplies for use in providing the service contract to customer.

Cancellation or Refund of a "Service Contract"

Where a "service contract" subject to tax is canceled at any time after the date of sale, except as discussed below, no amount of the applicable State, local, and transit rates of sales and use taxes originally charged on the sales price of the "service contract" is an overcollection of tax subject to refund by the Department pursuant to N.C. Gen. Stat. § 105-164.11. Additionally, the retailer should not take a deduction from taxable sales or deduct a credit from tax due on Form E-500, Sales and Use Tax Return, filed with the Department as a result of a refund of any portion of a "service contract" to a customer, as a result of cancellation of a "service contract."

Where a representative or other person enters into a "service contract" with a purchaser on behalf of the retailer, if such contract is not accepted or executed by the retailer upon receipt of information from the representative or other person, any sales and use tax collected on the retail sales price of the "service contract" and refunded to the purchaser is subject to the refund provisions in N.C. Gen. Stat. § 105-164.11 provided the tax collected has previously been remitted by the retailer to the Department.

Computer Software Maintenance Contracts

The sales price of a "service contract" on or after January 1, 2014, by which the seller agrees to maintain or repair taxable prewritten computer software pursuant to the contract is subject to the 4.75% general State and applicable local and transit rates of sales and use tax. Prior to January 1, 2014, the taxability of the sale of a maintenance agreement for taxable prewritten computer software is determined primarily on whether such software maintenance agreement is mandatory and therefore a part of the sales price of the sale of the computer software or whether such sale is for an optional maintenance agreement. A computer software service contract that only provides for support labor to

operate taxable computer software will continue to be exempt from sales tax. Guidance regarding the taxability of computer software maintenance agreements is available in the Streamlined Sales Tax Governing Board Section 328 Taxability Matrix, dated November 12, 2013, and available on the Department's website.

Use Tax Issues

An agreement for services provided without charge or as a part of the sales price of tangible personal property subject to either sales and use tax, highway use tax, or the alternate highway use tax, where a separate charge for the agreement is not listed on the invoice, bill of sale, similar document, or in the books or records of the retailer, such agreement is not a sale of a "service contract" subject to sales or use tax. Where an item of inventory purchased without payment of tax is used by a person under such an agreement, use tax per N.C. Gen. Stat. § 105-164.6 is due on the purchase price of the tangible personal property used to fulfill the agreement or perform the service. N. C. Gen. Stat. § 105-164.3(33) defines "[p]urchase price" as having "the same meaning as the term 'sales price' when applied to an item subject to use tax." For example, a motor vehicle dealer provides a three year agreement for oil changes as part of the sales price of a motor vehicle subject to highway use tax per Article 5A of Chapter 105. Provided there is no charge for the three-year agreement by the dealer and such amount is included in the sales price of the motor vehicle on which the highway use tax is paid, the dealer owes sales and use tax on the purchase price of any products used to perform the services covered by such agreement.

Registration

A retailer of "service contracts" that is not registered to collect and remit sales and use tax should complete NC-BR, Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Machinery and Equipment Tax. Both an online business registration portal and a web-fill version of Form NC-BR are available at the Department's website, www.dornrc.com. There is no fee required to register and obtain a certificate of registration.

Assistance

Questions regarding this directive should be directed to the Taxpayer Assistance and Collection Center at telephone number 1-877-252-3052 (toll-free).