OKLAHOMA TAX COMMISSION

TAX POLICY AND RESEARCH DIVISION
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October 6, 2006

Re: Our File No. LR-05-158

Dear

I am writing in response to your request for a letter ruling regarding the application of OAC 710:65-19-11(c) to a shop charge Taxpayer bills its repair customers and the application of OAC 710:65-19-371(d) to original manufacturer's warranty repair work performed after the original warranty has expired. A restatement of the facts outlined in your inquiry, the questions posed therein along with the responses thereto are set forth as follows:

1. **Shop Expense and Shop Supplies.** ("Taxpayer') is an authorized dealer for manufacturers of new and used cranes, heavy equipment and industrial equipment. As a part of its business, Taxpayer maintains, services, and repairs customers' equipment. Taxpayer purchases miscellaneous parts (e.g., nuts, bolts, oil engine fluids, and washers) and miscellaneous supplies (e.g., shop rags, safety glasses, drill bits, and welding supplies) from in-state and out-of-state vendors exempt from sales and/or use tax. Taxpayer, in addition to selling the miscellaneous parts, uses the parts and miscellaneous supplies in repairs to its customers' equipment, but with the exception for the welding supplies and some other incidental items does not incorporate the miscellaneous supplies into its customers' equipment when it performs repair work. Taxpayer does not itemize and separately charge its repair customers for the miscellaneous parts incorporated in repair of their customer's equipment or for the miscellaneous supplies used or consumed in connection with the repair work. Further, for customer equipment repair Taxpayer does not accrue and pay sales/use tax at the time the miscellaneous parts are withdrawn from Taxpayer's inventory or at the time Taxpayer uses or consumes the miscellaneous supplies. Instead, Taxpayer charges its customers a 5% shop charge not to exceed $50.00 as a method of billing its customers for the costs of the miscellaneous parts and supplies it purchases exempt from tax. Taxpayer collects and remits sales tax on the 5% shop charge to the Tax Commission.

Question #1

Whether Taxpayer may include a "shop charge" under OAC 710:65-19-11(c) on its bills or invoices to its customers as a method of billing its customers for the costs of miscellaneous parts and the miscellaneous supplies purchased by Taxpayer exempt from tax, and collect and remit

sales tax on the "shop charge" to the Commission, in lieu of paying sales tax to the Commission at the time Taxpayer withdraws the miscellaneous parts from its inventory or at the time Taxpayer consumes or uses the miscellaneous supplies in connection with repair work to its customers' equipment?

Response #1

Oklahoma Administrative Code 710:65-19-11(c) addresses the sales tax treatment of a shop charge utilized by taxpayers as a method of billing its repair customers for the parts, incidental to the repair service. OAC 710:65-19-11(c) provides:

> Parts utilized by the repairer, including body shops, incidental to the repair service and not itemized and charged separately are considered to be used, not sold, by the repairman and are subject to sales or use tax at the time purchased by the repairman. If the repairman does purchase these items exempt and later uses the items, they are subject to sales tax on their **"sales value"**, as defined in *OAC* 710:65-1-2, at the time the items are withdrawn from inventory by the repairman for consumption or use. If instead, the repairman includes a **"shop charge"** on the bill or invoice to the customer, as a method of billing the customer for the incidental items that were purchased exempt from tax, the **"shop charge"** is subject to sales tax. [**See:** 68 O.S. §§1352, 1357]

Based on OAC 710:65-19-11(c), Taxpayer may include a shop charge on its repair customer's invoices as a method of billing the customer for incidental miscellaneous parts, purchased tax exempt, which are incorporated in the customer's equipment when the repair service is performed. Sales tax is properly collected on the shop charge by Taxpayer from its repair customers. However, with the exception of the welding supplies and other unidentified items, the miscellaneous supplies e.g., shop rags, safety glasses and drill bits are not incorporated by Taxpayer into its customer's equipment when the repair service is performed and therefore these supplies should not be purchased by Taxpayer tax exempt for resale. 68 O.S. § 1357(3). If the miscellaneous supplies are purchased tax exempt, sales tax is due on the sales value of these items at the time they are withdrawn by Taxpayer for its own use or consumption. 68 O.S. 1362(D).

2. **Product Warranty.** Taxpayer's new equipment for sale includes an original manufacturer's warranty which in accordance with an original manufacturer's warranty agreement between the customer and the manufacturer lasts for a specified time period beginning after the Taxpayer notifies the manufacturer of the sale and the identity of the customer. Some manufacturers in the described industry allow the customer to submit a warranty claim after the expiration of the original manufacturers warranty period. Such a policy is evidenced in Section 11.10, Claims on Machines Beyond the Standard Warranty Period, of the Equipment Warranty with provides as follows:

> Claims submitted for failure on machines outside the warranty period must include a complete and detailed explanation in writing with all relevant background information. This is necessary to provide justification and support allowing complete evaluation and final disposition to be made against each request. The claim will be reviewed and any warranty consideration will be based upon the individual merits and support provided.

When the manufacturer honors repair work performed after the expiration of the original manufacturer's warranty, the taxpayer is reimbursed by the manufacturer for the cost of parts used to perform the repair work as if the repair work was done by Taxpayer prior to the expiration of the original manufacturer's warranty. In connection with these repairs, Taxpayer does not sell and/or bill the parts to its customers. But for the passage of time, these repairs would have been covered under the original manufacturer's warranty and are not made by Taxpayer under any extended warranty. When the manufacturer does not honor the repair work, Taxpayer charges the customer for the parts used to perform the repair work and charges the customer sales tax on those parts and collects and remits the sales tax to the Tax Commission.

Question #2

Whether the parts Taxpayer uses to perform original manufacturer's warranty repair work to its customers' equipment under an original manufacturer's warranty agreement between the customer and the manufacturer after the expiration of the original manufacturer's warranty period, are considered to be sold to the manufacturer for resale under OAC 710:65-19-371(d)? Therefore, the sale of parts is exempt from sales tax under Title 68 O.S. § 1357(3), which provides for the "sale-for-resale" exemption from sales tax, where Taxpayer does not sell and/or bill the parts to the customer, and where the manufacturer honors the repairs under the original manufacturer's warranty and the manufacturer reimburses Taxpayer for the cost of the parts Taxpayer uses to perform the repair work.

Response #2

The manufacturer's original product warranty is defined at OAC 710:65-19-317(a) as follows:

> "Manufacturer's original product warranty" means those warranties which are provided as a condition of all sales of a product and which constitute an indistinguishable part of the product sold. For purposes of this section, a **"manufacturer's original product warranty,"** is included within the basis for determining sales tax, without regard for whether the charges for the warranty and for the product are separately stated.

Parts utilized by a dealer to perform original manufacturer's warranty repair or replacement pursuant to the warranty contract, when not billed to the customer are not subject to sales tax as provided in OAC 710:65-19-371(d) which states:

> If the manufacturer has agreements with dealers or the representatives to perform original manufacturers' warranty repairs, the parts used to perform the repairs, if not sold/billed to the customer, are considered to be sold to the manufacturer for re-sale or manufacturing.

When this discretionary policy—to perform certain warranty repairs after the expiration of the warranty term—is provided for by the terms of the original manufacturer's warranty, then the parts utilized to provide the honored warranty repairs which are not billed to the customer are not subject to sales tax. Therefore, the parts Taxpayer uses to perform original manufacturer's warranty repair work to its customers' equipment under specific discretionary provisions of the original manufacturer's warranty between the customer and the manufacturer, allowing for warranty repairs after expiration

of the original warranty period, which are not billed to the customer are considered to be sold to the manufacturer for resale under OAC 710:65-19-371(d) and therefore are exempt from sales tax.

This response applies only to the circumstances discussed in your request of September 15, 2005. Pursuant to Commission Rule 710:1-3-73(e), this Letter ruling may be generally relied upon only by the entity to whom it is issued, assuming that all pertinent facts have been accurately and completely stated, and there has been no change in applicable law.

Sincerely,

OKLAHOMA TAX COMMISSION

Christy J. Caesar

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Tax Policy Analyst