

STATE OF ALABAMA,  
DEPARTMENT OF REVENUE,

vs.

EQUIPMENT SALES CORPORATION  
703 Western Drive  
Mobile, AL 36607,

Taxpayer.

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STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

DOCKET NO. S.92-286

FINAL ORDER

The Revenue Department assessed sales tax against Equipment Sales Corporation ("Taxpayer") for the period October, 1988 through September, 1991. The Taxpayer appealed to the Administrative Law Division and the matter was submitted on a joint stipulation of facts. Ronald P. Davis represented the Taxpayer. Assistant counsel Duncan Crow represented the Department.

The issue in dispute is whether sales tax is due on repair parts withdrawn from inventory and used by the Taxpayer to replace defective parts free-of-charge for customers covered by an extended manufacturer's warranty.

The Taxpayer operated during the period in issue as a Carrier Corporation distributor in the business of selling air conditioning and heating equipment in Mobile, Alabama. As a Carrier distributor, the Taxpayer sold Carrier equipment which included a standard manufacturer's warranty. There was no extra charge for the standard warranty. The Taxpayer remitted sales tax to the Department on the sales price of the equipment only.

The Taxpayer also sold extended manufacturer's warranties which gave additional warranty protection to the customer over and above the standard manufacturer's warranty. The Taxpayer charged the customer an additional amount for the extended manufacturer's warranty. The Department agrees that the amount paid by the customer for the extended warranty is not subject to sales tax.

When a customer covered by an extended warranty returns a defective part for exchange, the Taxpayer withdraws the part from inventory and delivers it to the customer. Any replacement part covered by an extended warranty is provided to the customer at no cost.

The Department audited the Taxpayer and assessed additional tax based on the Taxpayer's cost of those replacement parts withdrawn from inventory by the Taxpayer and provided to customers free-of-charge under an extended manufacturer's warranty.

The Taxpayer concedes that the withdrawal from inventory of the replacement parts in issue constituted a retail sales under the sales tax withdrawal provision found at Code of Ala. 1975, §40-23-1(a)(10). However, the Taxpayer argues that no tax is due because the sales were specifically exempted from sales tax pursuant to Code of Ala. 1975, §40-23-4(a)(18). That provision exempts from sales tax the following:

(18) When dealers or distributors use parts taken from stocks owned by them in making repairs without charge for such parts to the owner of the property repaired pursuant to warranty agreements entered into by manufacturers,

such use shall not constitute taxable sales to the manufacturers, distributors, or to the dealers, under this division or under any county sales tax law.

The Department argues that the exemption does not apply in this case because the term "warranty agreements" as used in the statute applies only to standard warranty agreements, not extended warranty agreements. The Department cites Department Reg. 810-6-1-.186.05 in support of its position.

I disagree with the Department's position. A warranty agreement includes both a standard warranty agreement provided free-of-charge when the property is purchased, and also an extended manufacturer's warranty subsequently purchased by the customer. There is no substantive difference between the two. In both cases, the manufacturer warrants or guarantees the replacement of defective parts at no cost to the customer.

The Department argues that the exemption cannot apply because the warranty contracts in issue were between the customers and the Taxpayer, not the manufacturer. However, the stipulation of facts states that "[A]ll of the extended warranty contracts were manufacturer's warranties, i.e., warranties granted to the customer by Carrier Corporation, the manufacturer of the equipment sold".

Stipulation at page 4. The Taxpayer initially provided the replacement parts to the customers at no cost, then later received a full credit for the parts from the manufacturer, Carrier

Corporation. Clearly the manufacturer, Carrier Corporation, entered into and was a party to the warranty agreements in issue.

The Department argues on page 3 of its brief that if the parts in issue are not taxed, then "no tax would ever be paid if parts are purchased or removed from inventory to fulfill the extended warranty". That statement is correct, but that is the purpose for the exemption in the first place.

In summary, parts and materials withdrawn from inventory by a dealer and provided to a customer at no cost pursuant to a standard or extended manufacturer's warranty agreement are not subject to sales tax. There is no substantive difference between a standard manufacturer's warranty agreement and an extended manufacturer's warranty agreement. Both are "warranty agreements entered into by manufacturers" pursuant to §40-23-4(a)(18). Department Reg. 810-6-1-.186.05 is rejected to the extent it conflicts with the above holding.

The assessment in issue is vacated and no additional sales tax is owed by the Taxpayer for the period in question. This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on February 24, 1994.

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BILL THOMPSON

Chief Administrative Law Judge