



COLORADO
Department of Revenue

Taxation Division

Physical Address:
1375 Sherman Street
Denver, CO 80203

Mailing Address:
P.O. Box 17087
Denver, CO 80217-0087

GIL-15-008

April 16, 2015

XXXXXXXXXXXXXXXXXX
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Re: Discharged Maintenance Contract

Dear XXXXXXXXXXXX,

You (“Buyer”) submitted documents indicating that you are requesting a refund of sales tax related to the purchase of certain automotive parts. A claim for refund is submitted on Department Form 0137. Nevertheless, we will treat your documents as both a request for tax guidance in the form of a general information letter and as a request for refund submitted pursuant to Form 0137.

We reviewed your refund request and conclude that a refund is not allowed. Given the unusual factual circumstances giving rise to your request, we have set forth below in this general information letter a detailed explanation for our conclusion. The Department will mail to you in the near future a Notice of Denial of Refund Claim. You have the right to appeal the denial of a refund claim. An appeal must be filed with the Department within thirty (30) days of date on the Notice of Denial of Refund Claim. This letter sets forth the reasons for the denial but it is not the Notice of Denial of Refund Claim.

Issue

Is Buyer entitled to a refund of sales tax paid for tangible personal property that otherwise would have been covered by a maintenance contract that was discharged in bankruptcy?

Background

Buyer purchased an electric vehicle (“Vehicle”) from an automotive dealer (“Dealer”) in 2012. The sales price of the Vehicle included a mandatory six-year manufacturer’s warranty (“Warranty”). Pursuant to § 39-26-105(4) C.R.S., Dealer assessed state sales tax and Regional Transportation District (“RTD”) tax on the combined purchase price of Vehicle and Warranty. The Vehicle’s manufacturer (“Manufacturer”) subsequently filed for bankruptcy in 2013. Manufacturer’s bankruptcy reorganization plan reclassified the Buyer’s Warranty claim as a general unsecured claim, which was discharged as a consequence of the bankruptcy.

In 2014, the Vehicle’s electrical battery pack became defective. Dealer replaced the battery pack and charged Buyer for parts, labor, shipping, and state and local sales taxes. We assume for purposes of this discussion that these parts and services would have been provided without charge to Buyer under the Warranty had it not been discharged in bankruptcy.

Discussion

Sales tax is assessed on the sale of tangible personal property.¹ Motor vehicles and parts used in automotive repairs are tangible personal property and are subject to sales tax.²

Buyer requests a refund of the sales taxes paid for the battery and related parts based on Department FYI Sales 70 "Warranties and Maintenance Agreements" ("FYI 70"). This FYI states if a buyer purchases a warranty agreement as part of the purchase of taxable tangible personal property (e.g., a car), then sales tax is paid on the entire charge, including the charge for the warranty or maintenance contract, but sales tax is not assessed for materials that may be subsequently used in performing the warranty or maintenance service.³ Buyer's purchase of the Warranty as part of the purchase of the Vehicle was properly subject to sales tax. Buyer states that the battery and parts purchased from the Dealer are parts that would have been supplied under the Warranty and, therefore, should be exempt from tax.

Sales tax is a transactional tax. This means that tax is assessed based on the facts that existed at the time of the transaction is entered into. Events that occur after the transaction generally do not affect the taxability of the initial transaction.⁴

There are two transactions at issue here: (1) the initial purchase of the Warranty in 2012 and (2) the purchase of the battery and related parts in 2014. The two transactions are separated not only in time but also by the nature of the transactions. The first transaction was the purchase of a warranty in which the seller promises to replace parts that become defective during the warranty period.⁵ A warranty is similar to an insurance contract and its value lies in the contingent right to have parts and labor replaced should a defect arise. When the Warranty was later discharged in bankruptcy, the Warranty was rendered worthless. However, the transaction was taxable at the time the Warranty was entered into and the subsequent discharge of the Warranty does not affect the taxability of the initial transaction.

An example helps explain this concept. Had the Vehicle not been defective during the warranty period, Buyer would not have been entitled to a refund for the sales taxes paid on the Warranty, even though Buyer would not have received parts pursuant to Warranty. This is because the initial transaction was taxable at the time it was entered into and subsequent events (or non-events) do not give rise to a refund. We also note that a refund of the tax on the Warranty would not be appropriate because the Warranty was, in fact, effective for a period before it was ultimately discharged.

Two years after the purchase of the Warranty, Buyer entered into a second taxable transaction to purchase automotive parts from the Dealer. This latter transaction, as we noted above, is a purchase of tangible personal property and, therefore, subject to tax. We also note that this purchase was not entered into, or in any way governed by, the Warranty - the Warranty had been

¹ § 39-26-105(4), C.R.S.

² 1 CCR 201-5, SR-4; § 39-26-104(a)(1), C.R.S.

³ See General Information Letter GIL 08-020 for a general discussion of this statute, which you can view on the Department's website at <https://www.colorado.gov/pacific/tax> > Education and Legal Research > Legal Research > Letter Rulings by Number.

⁴ See *S. Cal Edison v. State Bd. of Equalization*, 7 Cal. 3d 652, 102 Cal. Rptr. 766, 498 P.2d 1014 (1972) (retailer not entitled to sales tax relief for price adjustment subsequently made after sale and based on damages paid by retailer to purchaser).

⁵ See generally 15 U.S.C. §§ 2301, 2304 (2014)

previously discharged in bankruptcy.

The fact that the first transaction proved worthless does not mean that the second transaction two years later is, therefore, exempt from tax. As a way of illustrating this point, suppose a car buyer purchases a car that is completely destroyed in an accident six months later. The purchase of the car is subject to sales tax and the subsequent destruction of the car does not mean that the buyer is entitled to a sales tax refund. The tax was properly imposed at the time of the sale and subsequent events do not undo the tax. If the car buyer then buys a second car to replace the first car, the buyer is not entitled to purchase the second car exempt from tax.

The same principles apply here. The Warranty was appropriately taxed when it was entered into. The parts were not purchased pursuant to the Warranty and, therefore, the rule set forth in FYI 70 does not apply here. The Warranty subsequently lost its value when it was discharged in bankruptcy. Two years after the purchase of the Warranty, Buyer entered into a second transaction to buy the battery and other parts. These parts were properly taxed and their purchase was not exempt because the first transaction (Warranty) proved worthless.

We understand that this conclusion may seem inequitable. Buyer paid sales tax on both the warranty and the replacement parts that Buyer would have otherwise received free of charge and without additional tax. However, the source of this economic hardship lies in the federal bankruptcy code. The federal bankruptcy code allows Manufacturer to reduce or eliminate the economic value of contractual obligations consumers purchased from the Manufacturer. Moreover, the Department does not have the authority to issue a refund of tax that is legally due and that the Department must collect.

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/tax for more information about state and local sales taxes.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted letter.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue