



COLORADO

Department of Revenue

Taxation Division

Office of Tax Policy
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Denver, CO 80217-0087

DOR_TaxPolicy@state.co.us

PLR-15-008

November 16, 2015

XXXXXXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX

Re: Lessee Maintenance Agreements

Dear XXXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXXXXXXX (“Company”) a request for a private letter ruling to the Colorado Department of Revenue (“Department”) pursuant to Department Rule 24-35-103.5. This private letter ruling cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

Issue

Is the lessee liable for sales or use tax on lessor’s monthly fee for a maintenance agreement?

Conclusion

No, lessee is not liable for sales or use tax on lessor’s monthly fee for the maintenance agreement. Lessor is liable for sales or use tax on tangible personal property used to perform the maintenance agreement.

Background

Company is in the business of leasing motor vehicles to lessees. Company also offers lessees an optional and separately stated maintenance agreement that covers certain maintenance and repair work. Lessees pay a monthly fee for the maintenance agreement. Company engages a third party to perform the maintenance work. Lessees do not pay the third party for maintenance that is covered under the maintenance agreement. The third party bills Company for the maintenance work, including sales tax on parts and materials used to perform the maintenance.

Discussion

Colorado imposes sales tax on each payment a lessee makes on a long-term lease of tangible personal property, including long-term leases of motor vehicles. Long-term leases are leases whose initial lease term is longer than three years. A lessor who also offers a maintenance or service agreement as part of a lease arrangement must collect tax on both the lease payment and the maintenance charge. In particular, § 39-26-105(4), C.R.S. states, in part:

(4) Every retailer conducting a business in which the transaction between the retailer and the consumer consists of the supplying of tangible personal property and services in connection with the maintenance or servicing of the same shall be required to pay the taxes levied under this article upon the full contract price, [...]

However, a lessor's charge for maintenance is not included in the calculation of the lessee's sales tax if the charge is separately stated or, if not separately stated, the Department gives lessor permission to separately account for the maintenance charge. Specifically, § 39-26-105(4), C.R.S. states:

[Tax is collected on the charge for maintenance] unless application is made to the executive director of the department of revenue for permission to use a percentage basis of reporting the tangible personal property sold and the services supplied under such contract. The executive director is authorized to determine the percentage based upon the ratio of the tangible personal property included in the consideration as it bears to the total of the consideration paid under said combination contract or sale that is subject to the sales tax levied under the provisions of this part 1. This section shall not be construed to include items upon which the sales tax is imposed on the full purchase price as designated in section 39-26-102 (12).

The Department has issued guidance on the taxation of warranty and maintenance agreements. In FYI Sales 70 "Warranty and Maintenance Agreements, the Department distinguishes between, on the one hand, mandatory maintenance contracts that a lessee is required to purchase as part of a lease (or sale) of tangible personal property, and, on the other hand, optional maintenance agreements that the lessee can choose not purchase as part of a lease (or sale) of tangible personal property. This mandatory / optional rule is premised on the more general rule that a charge for a service is included in the sales tax of the tangible personal property if the service is inseparably intertwined with the taxable tangible personal property.

MANDATORY CONTRACTS For warranties and maintenance agreements which are mandatory and part of the purchase price of the item the warranty covers, in most cases the seller must collect sales tax on the total purchase price. When the warranty is taxed in this manner, no additional sales or use tax is due from the seller or buyer on the materials used in performing the maintenance. For information on when use tax versus sales tax is due, see FYI Sales 6 Contractors and Retailer-Contractors and FYI General 10 Consumer Use Tax. Colorado sales tax regulations allow an exception to the above rule in taxing mandatory service contracts on tangible personal property only for companies that receive permission to enter into a written agreement with the Department of Revenue. In such agreements, the department is authorized to determine what percentage of the company's sales contracts is for the sale of tangible personal property and what percentage is for services supplied. The company must then charge sales tax on that percentage of the contract for goods sold and exempt the service portion of the contract. To qualify for this agreement with the department call the Customer Support Section at (303) 238-SERV (7378). An example of a

company that might find such an arrangement useful would be a computer company that sells hardware packages bundled with a standard service contract for equipment maintenance.

OPTIONAL CONTRACTS If the maintenance agreement is optional, and is sold to the customer as a separate item, tax is not normally charged on the contract at the time of sale. The seller responsible for the warranty work must then pay sales or use tax on the cost of the materials used in performing the maintenance. However, a warranty or maintenance agreement seller may elect to charge sales tax on the warranty contract or maintenance to avoid having taxable and nontaxable warranty parts or maintenance components. If the warranty seller contracts with a third party to perform the maintenance work, it is the subcontractor who is responsible for charging and remitting any tax on the materials used. The third party maintenance contractor would normally bill the warranty seller for actual maintenance costs, including sales tax on parts, supplies and materials. Regarding which local jurisdictions are owed sales tax for the parts used in performance of a warranty agreement: sales tax is due to the local jurisdictions where the warranty work is being performed, regardless of where the original warranty contract was purchased. Warranty contracts taxed at point of sale with the tangible personal property are subject to the same rate as the personal property, including all applicable local taxes.

In the present case, Company leases motor vehicles and offers lessees the option to purchase maintenance service that is set forth in a separate contract. Because the maintenance agreement is separately stated and is optional, a lessee's payment for this maintenance contract is not included in the amount on which the lessee's sales tax obligation for the lease of the motor vehicle is calculated.

In general, a lessor that does not collect sales tax on the maintenance contract pays sales tax to the third party for the parts and materials used in connection with the maintenance work. Company represents that it pays sales tax to the third parties for parts and materials used for maintenance.

Finally, subsection 105(4) is premised on the assumption that lease payments are subject to tax. Although this is always the case for long-term leases, sales tax does not apply to lease payments on short-term lease (three years or less), except as noted below. Instead, a lessor of a short-term lease pays sales or use tax when the tangible personal property is acquired. However, the lessor of a short-term lease can acquire the property without paying sales or use tax if the Department gives the lessor permission to collect sales tax on lease payments. In the context of this ruling, if the lessor paid sales or use tax when it acquired the motor vehicles, the lessee is not liable for sales tax on the lessor's charge for maintenance even if the maintenance charge is not separately accounted for or separately stated. The lessor is still liable in such a case for sales tax for the parts supplied pursuant to the maintenance agreement.

Miscellaneous

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Company's representations. This ruling is null and void if any

such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

This ruling is binding on the Department to the extent set forth in Department Regulation 24-35-103.5. It cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

This ruling applies only to sales and use taxes administered by the Department. Please note that the Department administers state and state-collected city and county sales taxes and special district sales and use taxes, but does not administer sales and use taxes for self-collected home rule cities and 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 ruling. Pursuant to statute and regulation, this redacted version of the ruling 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 version of the ruling.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue

This ruling cannot be relied upon by any other taxpayer other than the taxpayer to whom the ruling is made.