

Revenue Ruling 19-2013-01

April 5, 2013

Sales Tax Treatment of Home Service Contracts

At the request of the National Home Service Contract Association (“NHSCA”), this revenue ruling is issued to state the proper sales tax treatment of the purchase of a “home service contract” (HSC), which is a specific type of service contract entered into between a HSC provider and a buyer or seller of existing residential property. NHSCA has represented the following information concerning HSCs:

“Home service contract” or “home warranty” means a contract or agreement for a separately stated consideration for any duration to perform the service, repair, replacement or maintenance of property or indemnification for service, repair, replacement or maintenance, for the operational or structural failure of any residential property due to a defect in materials, workmanship, inherent defect or normal wear and tear, with or without additional provisions for incidental payment or indemnity under limited circumstances. Home service contracts may provide for the service, repair, replacement, or maintenance of property for damage resulting from power surges or interruption and accidental damage from handling and may provide for leak or repair coverage to house roofing systems. Home service contracts are not insurance in this state or otherwise regulated under the insurance code.

A home service contract (HSC) provides service, repair or replacement for a range of specifically identified home systems and appliances for a periodic fee. Property covered may include the home’s electrical, heating and air-conditioning systems, interior plumbing and, dishwashers, range, cook-top, garbage disposer, water heater, garage-door opener and related property such as ductwork, built-in microwaves, trash compactors, ceiling fans, instant hot/cold water dispensers, central vacuums and smoke detectors. Most HSC providers offer a menu of additional property that may be added such as swimming pools, hot tub and spa equipment, freestanding appliances, or as needed, septic systems and well pumps.

Typically, coverage does not include construction or structural defects. Foundation, walls and basic structure is commonly covered by state law and/or another industry under certain types of “2-10” style programs offered by builders. HSCs are purchased by home sellers to increase the marketability of their home. HSC may provide protection during the listing period prior to sale. Homebuyers can also purchase a contract to secure peace of mind against unexpected appliance or systems failure in the home. HSCs typically are written for a term of one year and are renewable. Nearly two-thirds of all first year home

service contracts are sold *in connection with the transfer or sale* of residential real estate. Real estate agents assist in consummating the sale in these cases. The rest are direct sales to existing homeowners, often through direct solicitation or the Internet. There are other limited variations of home service contracts that cover only water, sewer or other utility lines.

A HSC *is not* a manufacturer warranty nor an *extended retail* warranty. A HSC is not a maintenance agreement that only provides for periodic inspection and servicing, but *does not cover the full cost of repairs or replacement*. HSC providers normally establish a network of local, independent service technicians, plumbers, and electricians to provide the services to homeowners. Providers ensure that their local contractors are properly licensed, insured, bonded or meet other local requirements.

HSC providers do not sell tangible personal property. Nearly all systems and appliances covered are normally conveyed in a home sale transaction. They cover existing or “used” property in, on and around a home. Virtually all is considered real estate, even optional and special “line items” such as septic tanks, well pumps or pool pumps. Some contracts may add a line item for a freestanding refrigerator or clothes dryer that might be considered personal property. Providers do not view or inspect a home in advance, so final determinations on property and conditions covered are in the hands of skilled, local contractors. Consumers may ask for a second opinion and providers may override the judgment of their local contractor in favor of a consumer.

NHSCA indicates the current practice of its members in the HSC industry is that sales tax is not charged on the price for the purchase of the HSC. When a customer contacts the HSC provider to make a claim for repair service, the HSC provider dispatches a local contractor to perform the repairs. The local contractor makes the repairs, determines the sales tax due on taxable services and includes that in the full invoice to the HSC provider. The contractor collects from the consumer the first \$60-75 off the top of the full invoice as a service fee, and the invoice to the HSC provider reflects receipt of that payment. However, sales tax is billed to the HSC provider on the full invoice amount for taxable services, including the fee received from the consumer. Upon receiving payment from the provider, the local contractor then remits the applicable sales tax to the state.

Charges for service and maintenance agreements are taxable in Kansas. K.S.A. 79-3603(r) imposes sales tax on:

(r) the gross receipts from fees or charges made under service or maintenance agreement contracts for services, charges for the providing of which are taxable under the provisions of subsection (p) or (q). . . .

The sum of the taxable charges referenced in subsection (r) invoiced in a reporting period total:

(p) the gross receipts received for the service of installing or applying tangible personal property which when installed or applied is not being held for sale in the regular course of business, and whether or not such tangible personal property

when installed or applied remains tangible personal property or becomes a part of real estate

and

(q) the gross receipts received for the service of repairing, servicing, altering or maintaining tangible personal property . . . whether or not any tangible personal property is transferred in connection therewith. The tax imposed by this subsection shall be applicable to the services of repairing, servicing, altering or maintaining an item of tangible personal property which has been and is fastened to, connected with or built into real property. . . .

Subsection (p) requires Kansas service providers to collect sales tax on their labor service charges for applying or installing parts or other material to tangible personal property (TPP) or to what was once TPP that has become part of real property, such as the construction materials that make up the walls and floors of a building. Subsection (p) requires service providers to collect tax on their labor service charges for repairing, servicing, altering, or maintaining a customer's TTP or what was once TPP that has become part of the customer's real property. Customer line-item charges for the repair parts or other TPP being installed or applied are also taxable *K.S.A. 79-3603(a)*.

Sales tax applies to sales of materials to real-property contractors for use in their construction or repair projects on real property. A contractor is treated as the final user or consumer of those materials.

K.S.A. 79-3603(r) states that charges for service contracts are taxable if the future services contracted for are taxable under K.S.A. 79-3603(p) and (q). Under K.S.A. 79-3603(p), certain labor charges for the "original construction, restoration, remodeling, renovation, repair or replacement of a residence" are exempt. Charges for services to some built-in appliances are taxable, just as services to stand-alone appliances are taxable. Charges for services to residential fixtures, other than the built in appliances, qualify for the residential exemption and are not subject to sales tax. *See EDU-28, Sales Tax Guidelines for Businesses that Sell and Service Appliances and Electronic Products (5/31/05)*. Requiring sales tax to be paid on the entire charge for the HSC upfront may overcharge for taxes imposed under (p), (q), and (r) when labor services provided pursuant to the HSC are exempt under (p).

The tax-compliance requirements for HSCs

The following tax compliance procedures are determined for the sale of an HSC:

(a) Sales tax is not required to be paid on the purchase charge for the HSC, because some of the covered services may not be taxable under (p) or (q).

(b) Sales tax is due on the charges the service provider bills to the HSC provider for the taxable services performed for the HSC customer repair claim. HSC coverage may include repairs for residential systems or real-property fixtures (the labor charges for which would be exempt and the contractor would pay sales tax on the materials used), such as the roof,

furnace and central air conditioner, as well as repairs to appliances (the parts and labor charges for which would both be taxable), such as ovens, refrigerators, or garbage disposals.

(c) HSC providers are required to notify their contractors or service providers in writing that no sales tax has been paid on the charges for purchase of the HSC, and the contractor or service provider must bill the HSC provider for any sales tax due on the charges for the work performed pursuant to the HSC. Because the customer will make a repair claim under the HSC to the HSC provider, the HSC provider will contact and notify the contractor or service provider of the specific repair needed and that the contractor or service provider must bill the HSC provider for sales tax due on the services provided.

This ruling is based solely on the facts provided and replaces and supersedes all prior advice or rulings issued concerning the proper sales tax treatment of HSCs. This ruling will be revoked in the future by the operation of law without further department action if there is a change in the statutes, administrative regulations, or case law, or published revenue ruling, that materially effects this ruling.

Secretary of Revenue

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