



**Sales and Use Tax Division
North Carolina Department of Revenue
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www.dornnc.com**

IMPORTANT NOTICE: SERVICE CONTRACTS

Effective October 1, 2014, N.C. Gen. Stat. § 105-164.4(a)(11), as amended, imposes a privilege tax at the 4.75% general State and applicable local and transit rates of sales and use tax on a retailer to the sales price of or the gross receipts derived from a service contract sold at retail. Additionally, a service contract sold at retail on or after October 1, 2014 is taxed in accordance with N.C. Gen. Stat. § 105-164.4I. See [Directive SD-13-5, Service Contracts](#), for additional information regarding the application of sales and use tax to the retail sale of a service contract sold on or after January 1, 2014 and prior to October 1, 2014.

Definitions

N.C. Gen. Stat. § 105-164.3(38b) as amended for service contracts sold on or after October 1, 2014, defines “**service contract**” as “[a] contract where the obligor under the contract agrees to maintain or repair tangible personal property or a motor vehicle. Examples of a service contract include a warranty agreement other than a manufacturer's warranty or dealer's warranty provided at no charge to the purchaser, an extended warranty agreement, a maintenance agreement, a repair contract, or a similar agreement or contract.”

An “**obligor**” is a person who is legally, or contractually, obliged to provide the services for the service contract to the purchaser.

For the purposes of N.C. Gen. Stat. § 105-164.4I, a “**facilitator**” is a person who contracts with the obligor of the service contract to market the service contract and accepts payment from the purchaser for the service contract.

Retailer of a Service Contract

The sales and use tax on the retail sale of or the gross receipts derived from a service contract is due and payable by the retailer in accordance with N.C. Gen. Stat. § 105-164.16. N.C. Gen. Stat. § 105-164.4I, effective for the gross receipts derived from service contracts sold at retail on or after October 1, 2014, provides that the retailer is the applicable person listed below:

- (1) When a service contract is sold at retail to a purchaser by the obligor under the contract, the obligor is the retailer.
- (2) When a service contract is sold at retail to a purchaser by a facilitator on behalf of the obligor under the contract, the facilitator is the retailer unless the provisions of (3) below apply.
- (3) When a service contract is sold at retail to a purchaser by a facilitator on behalf of the obligor under the contract and there is an agreement between the facilitator and the obligor that states the obligor will be liable for the payment of the sales and use tax, the obligor is the retailer. The facilitator must send the retailer the sales and use tax due on the sales price of or gross receipts derived from the service contract no later than 10 days after the end of each calendar month. A facilitator that does

not send the retailer the sales and use tax due on the sales price of or gross receipts derived from a service contract is liable for the amount of sales and use tax the facilitator fails to send. A facilitator is not liable for sales and use tax sent to a retailer but not remitted by the retailer to the Secretary. Sales and use tax payments received by a retailer from a facilitator are held in trust by the retailer for remittance to the Secretary. A retailer that receives a sales and use tax payment from a facilitator must remit the amount received to the Secretary. A retailer is not liable for sales and use tax due but not received from a facilitator. The requirements imposed by this subdivision on a retailer and a facilitator are considered terms of the agreement between the retailer and the facilitator.

Exemptions

N.C. Gen. Stat. § 105-164.41(b) provides the sales price of or the gross receipts derived from a service contract applicable to any of the following are specifically exempt from sales and use tax:

- (1) An item exempt from tax under Article 5 of Chapter 105 (Sales and Use Tax) of the General Statutes, other than a motor vehicle exempt from tax under N.C. Gen. Stat. § 105-164.13(32).
- (2) A transmission, distribution, or other network asset contained on utility-owned land, right-of-way, or easement.
- (3) An item purchased by a professional motorsports racing team for which the team may receive a sales tax refund under N.C. Gen. Stat. § 105-164.14A(5).
- (4) An item subject to tax under Article 5F of Chapter 105 (Certain Machinery and Equipment) of the General Statutes.

For an additional list of service contracts for items where the sales price of or the gross receipts derived from the retail sale of a service contract are exempt, see page five of [Directive SD-13-5, Service Contracts](#), on the Department's website, www.dornnc.com.

Effective for the sale of or the gross receipts derived from the sale of a service contract sold at retail on or after October 1, 2014, N.C. Gen. Stat. § 105-164.13(62) is amended to provide the sale at retail and the use, storage, or consumption in this State of the following is specifically exempt from the sales and use tax:

"An item used to maintain or repair tangible personal property or a motor vehicle pursuant to a service contract if the purchaser of the contract is not charged for the item. This exemption does not apply to an item used to maintain or repair tangible personal property pursuant to a service contract exempt from tax under G.S. 105-164.41(b). For purposes of this exemption, the term "item" does not include a tool, equipment, supply, or similar tangible personal property used to complete the maintenance or repair and that is not deemed to be a component or repair part of the tangible personal property or motor vehicle for which a service contract is sold to a purchaser."

Exceptions

Effective for the sale of or the gross receipts derived from a service contract sold at retail on or after October 1, 2014, N.C. Gen. Stat. § 105-164.41(c) provides that sales and use tax does not apply to the sales price of or the gross receipts derived from a service contract for tangible personal property that is or will become a part of real property unless the service contract is sold by the obligor or by a third party or facilitator on behalf of the obligor at the same time as the item of tangible personal property covered in the service contract. Additionally, the sales and use tax imposed on the sales price of or the gross receipts derived from a service contract sold at retail does not apply to a security

or similar monitoring contract for real property or to a renewal of a service contract where the tangible personal property becomes a part of or affixed to real property prior to the effective date of the renewal.

For example:

- If a water heater is sold at retail and a service contract is sold for the water heater at the time of the sale, the sales price of or gross receipts derived from the service contract is subject to sales and use tax.
- The sales price of or the gross receipts derived from the renewal of a service contract for the water heater subsequent to the date of sale of the water heater, is not subject to sales and use tax.
- The sales price of or the gross receipts derived from a service contract sold at retail to a customer for an annual garage door inspection/maintenance plan is not subject to sales and use tax provided the garage door is installed in the home prior to the date the service contract is sold by the retailer to the customer.
- The sales price of or gross receipts derived from a contract for a home monitoring system is not a service contract subject to sales and use tax.

Basis of Reporting

Effective for the sales price of or the gross receipts derived from a service contract sold at retail on or after October 1, 2014, N.C. Gen. Stat. § 105-164.41(d) provides that a retailer who sells or derives gross receipts from a service contract must report those sales on an accrual basis of accounting for sales and use tax purposes, notwithstanding that the retailer may report sales and use tax on the cash basis for other sales at retail. The sales and use tax on the sales price of or the gross receipts derived from a service contract is due at the time of the retail sale, notwithstanding any portion of the sales price of or gross receipts derived from a service contract that may be financed. If the sales price of or the gross receipts derived from the service contract is financed in whole or in part, the financed amount of the sales price of or the gross receipts derived from the service contract included in each payment is exempt from sales and use tax if the amount is separately stated in the contract and on the billing statement or other documentation provided to the purchaser at the time of the sale.

Refund of Tax Paid on Rescinded Sale or Cancellation of Service

N.C. Gen. Stat. § 105-164.11A provides the following provisions for sales and use tax paid on the sales price of or the gross receipts derived from a service contract on or after October 1, 2014 and where the service contract is cancelled or the sale is rescinded on or after October 1, 2014:

- (a) *Refund.* – A retailer is allowed a refund of sales and use tax remitted on a rescinded sale or cancelled service. A service is cancelled when the service is terminated and the purchaser receives a refund, in whole or in part, of the sales price paid, including a refund of the pro rata amount of the sales and use tax paid based on the taxable amount of the sales price refunded. A retailer entitled to a refund under this section may reduce taxable receipts by the taxable amount of the refund for the period in which the refund occurs or may request a refund of an overpayment as provided in N.C. Gen. Stat. § 105-241.7 provided the sales and use tax has been refunded to the purchaser. The records of the retailer must clearly reflect and support the claim for refund for an overpayment of tax or adjustment to taxable receipts for a sales and use tax return filed with the Department for the period in which the refund occurs.
- (b) *Service Contract.* – When a service contract is cancelled and a purchaser receives a refund, in whole or in part, of the sales price paid for the service contract, the purchaser may receive a refund of the pro rata amount of the sales and use tax

paid based on the taxable amount of the sales price refunded as provided in this subsection:

- (1) *Refund from retailer.* – If the purchaser receives a refund on any portion of the sales price for a service contract purchased from the retailer required to remit the sales and use tax on the retail sale of the service contract, then the provisions of subsection (a) apply.
- (2) *Refund application.* – If the purchaser receives a refund on any portion of the sales price for a service contract from a person other than the retailer required to remit the sales and use tax on the retail sale of the service contract, then the amount refunded to the purchaser by the person does not have to include the sales and use tax on the taxable amount of the refund. If the amount refunded to the purchaser by the person does not include the sales and use tax paid on the portion of the sales price of the service contract refunded, then the purchaser may apply to the Department for a refund of the pro rata amount of the sales and use tax paid based on the taxable amount of the service contract refunded to the purchaser.

The application for a refund by a purchaser must be made on Form E-588SC, supported by documentation on the taxable amount of the service contract refunded to the purchaser from the person who refunded that amount, and filed within 30 days after the purchaser receives a refund. The date the purchaser receives a refund is considered the date of the postmark on the envelope in which the refund is received, the date of an electronic transfer, or the date of the check, whichever is later. An application for a refund filed by the purchaser after the due date is barred. Sales and use taxes for which a refund is allowed directly to the purchaser for sales and use tax paid on a service contract are not an overpayment of tax and do not accrue interest as provided in N.C. Gen. Stat. § 105-241.21.

Service Contracts and Lease Receipts from Motor Vehicles Subject to the Alternate Highway Use Tax

N.C. Gen. Stat. § 105-187.5(a) is amended effective October 1, 2014 and applies to the sales price of or the gross receipts derived from a service contract sold at retail on or after that date. The statute as amended provides that the portion of a lease or rental billing or payment that represents any amount applicable to the sales price of or sales tax on a service contract sold at retail that is subject to the sales and use tax and sourced to this State should not be included in the gross receipts subject to the alternate highway use tax.

The amount of the lease or rental billing or payment applicable to the sales price of or sales tax on a service contract sold at retail subject to the sales and use tax and sourced to the State should be separately stated on documentation given to the purchaser at the time the lease or rental agreement goes into effect, or on the monthly billing statement or other documentation given to the purchaser.

Assistance

General questions regarding this notice should be directed to the Taxpayer Assistance and Collection Center at telephone number 1-877-252-3052 (toll-free). To the extent that any provision in [Directive SD-13-5](#) or any other published guidance regarding sales and use tax or highway use tax issued prior to the date of this notice conflicts with this Important Notice, the provisions contained in this Important Notice supersede.