



Sales and Use Tax Division
North Carolina Department of Revenue
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IMPORTANT NOTICE: SERVICE CONTRACTS

Note: The sales price of or the gross receipts derived from the sale or renewal of a "motor vehicle service contract," as defined in N.C. Gen. Stat. § 105-164.3(23a), on or after January 1, 2017, is exempt from sales or use tax. The application of the sales and use tax laws to the sale or renewal of a "motor vehicle service contract" on or after January 1, 2017 is addressed in the Important Notice: Motor Vehicle Service Contracts issued November 15, 2016 by the Department.

Imposition

The sales price of or the gross receipts derived from a "service contract" sold at retail is subject to the general 4.75% State, applicable local (2.00% or 2.25%), and applicable transit (0.50%) rates of sales and use tax. "Service contracts" are taxed in accordance with N.C. Gen. Stat. § 105-164.41. The application of the sales and use tax laws to the sale or renewal of a service contract sold at retail prior to January 1, 2017, was addressed in the [Important Notice: Sale or Renewal of a Service Contract for Tangible Personal Property Changes](#) published by the Department on February 2, 2016 and is available on the Department's website.

Definitions

Effective January 1, 2017, for sales made on or after such date, N.C. Gen. Stat. § 105-164.3(38b), as amended, expands and clarifies the definition of the term "**service contract**." The underlined words and phrases are the changes and additions to the definition of "service contract." The definition as amended is:

A contract where the obligor under the contract agrees to maintain, monitor, inspect, or repair digital property or tangible personal property for a period of time or some other defined measure, regardless of whether the property becomes a part of or is applied to real property. The term does not include a single repair, maintenance, or installation service. The term includes a service contract for a pool, fish tank, or similar aquatic feature and a home warranty. Examples 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.

The term "**maintain**" is defined in the Merriam-Webster Dictionary, in part, as "to keep in an existing state."

The term "**monitor**" is defined in the Merriam-Webster Dictionary, in part, as "to watch, keep track of, or check usually for a special purpose."

The term "**inspect**" is defined in the Merriam-Webster Dictionary, in part, as "to view closely in critical appraisal."

The phrase, “**a period of time or some other defined measure**” includes, but is not limited to:

- Hour(s), day(s), month(s), year(s), etc.).
- Predetermined units of which the number declines with use in a known amount.
- Predetermined dollar amount of which the value declines with use in a known amount.
- Quantity (i.e. copies).
- Distance (meter(s), feet, mile(s), etc.).
- Weight.
- Volume (cup(s), quart(s), gallon(s), cubic capacity, etc.).

Effective January 1, 2017, for sales made on or after such date, N.C. Gen. Stat. § 105-164.3(33d) defines the term “**real property**” as any one or more of the following: land; building or structure on land; permanent fixture on land; a manufactured home or a modular home that is placed on a permanent foundation.

It is important to note that the retail sale of many home warranties on or after March 1, 2016 and prior to January 1, 2017 meet the definition of service contract and the sales price of or the gross receipts derived from such are subject to sales and use tax. Often a home warranty is to maintain or repair tangible personal property, such as appliances (refrigerators, washing machines, microwaves, etc.).

Service Contract Exemptions Clarified and Added

Effective January 1, 2017, for sales made on or after such date, N.C. Gen. Stat. § 105-164.4I(b), as amended, provides clarification of and additional exemptions from sales and use tax for the sales price of or the gross receipts derived from a service contract applicable to any of the following items:

- An item exempt from tax under Article 5 of Chapter 105 of the North Carolina General Statutes. **This exemption does not apply to water maintained under a service contract for a pool, fish tank, or similar aquatic feature.**

For purposes of this exemption and the repair, maintenance, and installation services exemption discussed below, if a service contract is to only inspect (test) the appropriate chemical levels of water in a swimming pool, as required by law, the sales price of or the gross receipts derived from such service contract is exempt from sales and use tax, provided the fee or charge for the inspection (test) is separately stated on the invoice or other documentation provided to the purchaser at the time of the sale.

- A motor vehicle service contract. The term “motor vehicle service contract” is defined, in part, by N.C. Gen. Stat. § 105-164.3(23a) as “[a] service contract sold by a motor vehicle dealer or by or on behalf of a motor vehicle service agreement company for a motor vehicle or one or more components, systems, or accessories for a motor vehicle.”
- Per N.C. Gen. Stat. § 105-164.13(61a), sales of or the gross receipts derived from the following repair, maintenance, and installation services are exempt from tax:
 - A fee or charge for an inspection required by law, regardless of whether the amount is paid to a public or private entity, provided the charge is separately stated on the invoice or other documentation provided to the purchaser at the time of the sale.
 - Services performed for a person by a related member, as the term related member is defined in N.C. Gen. Stat. § 105-130.7A.
 - Services performed to resolve an issue that was part of a real property contract if the services are performed within six months of completion of the real

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- property contract or, for new construction, within 12 months of the new structure being occupied for the first time.
- Cleaning of real property, except where the service constitutes a part of the gross receipts derived from the rental of an accommodation subject to tax under N.C. Gen. Stat. § 105-164.4 **or for a pool, fish tank, or other similar aquatic feature.**
 - Services on roads, driveways, parking lots, and sidewalks.
 - Removal of waste, trash, debris, grease, snow, and other similar items from tangible personal property, including a motor vehicle, and real property, but does not include removal of waste from portable toilets. (Example: The removal of septage from an airplane, a boat, and a train.)
 - Home inspections related to the preparation for or the sale of real property.
 - Landscaping service. **Effective January 1, 2017, for sales made on or after such date**, N.C. Gen. Stat. § 105-164.3(16e) defines the term “landscaping service” as “[a] service to maintain or improve lawns, yards, or ornamental plants and trees. Examples include the installation of trees, shrubs, or flowers; tree trimming; lawn mowing; and the application of seed, mulch, pesticide, or fertilizer to a lawn or yard.”
 - Alteration and repair of clothing, except where the service constitutes a part of the gross receipts derived from the rental of clothing subject to tax under N.C. Gen. Stat. § 105-164.4 or for alteration and repair of belts and shoes.
 - Pest control service.
 - Moving services.
 - Self-service car washes.

The sales price of or gross receipts derived from the retail sale of a service contract for specific items, as provided in the “Other Service Contract Exemptions” section of the [Important Notice: Sale or Renewal of a Service Contract for Tangible Person Property Changes](#) issued February 2, 2016 by the Department, continue to be exempt from sales and use tax. For additional information regarding the exemptions, see the important notice.

Other Service Contract Examples

Example: On February 2, 2017, a homeowner enters into a service contract with a pest control service company for a 12-month period. The homeowner is billed twelve hundred dollars (\$1,200.00) in advance by the pest control service company and is required to pay the amount due upon receipt of the invoice. A service contract for pest control services is not subject to sales and use tax; therefore, the twelve hundred dollars (\$1,200.00) derived from the service contract is exempt from sales and use tax.

Example: On April 4, 2017, a retailer sells a service contract to a North Carolina resident that provides for the inspection or repair of audiovisual works and audio works (digital property) for up to eighty hours, and the retailer will provide the labor and any necessary supplies. The retailer of the service contract is liable for and should collect the general 4.75% State, applicable local (2.00% or 2.25%), and applicable transit (0.50%) rates of sales and use tax on the sales price of or the gross receipts derived from the service contract sold at retail on the digital property.

Example: On May 1, 2017, a retailer sells a service contract to a North Carolina homeowners association that requires the obligor to maintain the water chemical levels daily for a community swimming pool located in North Carolina for a period of six months. The retailer is liable for and should collect the general 4.75% State, applicable local (2.00% or 2.25%), and applicable transit (0.50%) rates

of sales and use tax on the sales price of or the gross receipts derived from the service contract sold at retail to maintain the water chemical levels.

Example: On August 11, 2017, an HVAC company engaged in business in North Carolina sells a service contract with a sales price of \$300.00 for an existing heat pump to a homeowner for a home in North Carolina. Under the contract, the obligor agrees to inspect and maintain the heat pump. The HVAC company should collect and remit the general 4.75% State, applicable local (2.00% or 2.25%), and applicable transit (0.50%) rates of sales and use tax on the sales price of \$300.00 for the service contract.

Example: A retailer engaged in business in North Carolina provides and installs a water heater on April 1, 2017 in a customer's North Carolina home. At the time of the installation, the customer elects to purchase a two year extended warranty. The sale of the extended warranty by the retailer to the customer is a taxable service contract. The retailer should collect the general 4.75% State, applicable local (2.00% or 2.25%), and applicable transit (0.50%) rates of sales and use tax on the sales price of the extended warranty. Additionally, the gross receipts derived from the retail sale of the repair, maintenance, and installation services to provide and install the water heater are subject to sales tax at the same rate of tax as the extended warranty.

Example: On March 18, 2017, a retailer sells a 5-year home warranty to a North Carolina homeowner for a sales price of \$3,250.00 that requires the obligor to repair or replace the following items:

- *paint, stain, and varnish*
- *interior finish*
- *interior doors*
- *interior trim and molding*
- *interior stairs*
- *cabinets*
- *countertops*
- *carpeting*
- *vinyl flooring*
- *hardwood flooring*
- *tile, brick, marble and stone flooring*
- *exterior doors*
- *exterior finish*
- *exterior trim*
- *vinyl siding*
- *cement board siding*
- *masonry and veneer*
- *garbage disposal*
- *garage door opener*
- *light fixtures*
- *plumbing fixtures*
- *shower door*
- *smoke detectors*
- *irrigation system*
- *tubs/showers*
- *water heater*
- *windows*
- *oven/range/cooktop/
built in microwave oven*
- *dishwasher*
- *trash compactor*
- *kitchen exhaust fan*
- *receptacles/GFI*
- *refrigerator*
- *washer/dryer*
- *interior and exterior walls*
- *structural beams, columns, posts*
- *floor system*
- *subfloor and joists*
- *wall framing*
- *moisture barriers and flashing*
- *wall insulation*
- *windows and glass*
- *roof structure*
- *roof sheathing*
- *wood and composite decks*
- *roof vents*
- *roof coverings*
- *gutters and downspouts*
- *interior floor construction*
- *heating and cooling systems*
- *ventilation*

By definition the term service contract includes a home warranty. Therefore, the retailer is liable for the general 4.75% State, applicable local (2.00% or 2.25%), and applicable transit (0.50%) rates of sales and use tax on the \$3,250.00 sales price of the service contract.

Example: On March 2, 2017 a business enters into a service contract with a lawn care company for a 6-month period to maintain the lawn, ornamental plants, and trees on the business's property located in North Carolina. The business is billed three thousand dollars (\$3,000.00) by the lawn care company for the service contract. A service contract for landscaping service is not subject to sales and use tax; therefore, the three thousand dollars (\$3,000.00) gross receipts derived from the retail sale of the service contract are exempt from sales and use tax.

Example: On August 1, 2017, a retailer sells a service contract to a North Carolina homeowners association that requires the obligor to maintain, monitor, and inspect the concrete swimming pool shell, pool plumbing, plumbing accessories, and electrical components of a pool for a one-year period for a community swimming pool in North Carolina. The retailer is liable for and should collect the general 4.75% State, applicable local (2.00% or 2.25%), and applicable transit (0.50%) rates of sales and use tax on the sales price of or the gross receipts derived from the service contract.

Bundled Service Contract Transaction

Effective January 1, 2017, for sales made on or after such date, N.C. Gen. Stat. § 105-164.4D(a)(6) provides sales and use tax applies to the sales price of a bundled transaction unless "[t]he bundle includes a contract for two or more services, one of which is subject to tax under [Article 5 of Chapter 105 of the North Carolina General Statutes] and one of which is not subject to tax under [Article 5 of Chapter 105 of the North Carolina General Statutes]. The [retailer] must determine an allocated price for the taxable service portion of the contract in the bundle based on a reasonable allocation of revenue that is supported by the [retailer's] business records kept in the ordinary course of business."

If a retailer is unable to determine an allocated price for the taxable service portion of the contract in the bundled transaction, the entire charge for the service contract bundle is subject to sales and use tax. Additionally, if a retailer does not keep business records in the ordinary course of business to support an allocation, the entire charge for the bundled service contract transaction is subject to sales and use tax.

Example: On March 1, 2017, a retailer engaged in business in North Carolina sells prewritten software to a customer located in North Carolina. The customer enters into a separate contract with the retailer for an additional charge to install the prewritten software and deploy any updates for the prewritten software onto a personal computer located in North Carolina for a period of three months. In addition, the retailer is to provide training for existing computer software applications on the customer's personal computer for a period of three months. The retailer charges fifteen hundred dollars (\$1,500.00) for the bundled contract for all of the services. The retailer determines, based on a reasonable allocation of its revenue that is supported by its business records, that five hundred dollars (\$500.00) of the sales price for the contract is allocated for the repair, maintenance, and installation services of the prewritten software and one thousand dollars (\$1,000.00) is allocated for the training services for the customer's existing software. The retailer is liable for sales and use tax on the five hundred dollar (\$500.00) portion of the sales price allocated to the taxable portion of the service contract for repair, maintenance, and installation service of the prewritten software.

Example: On April 15, 2017, a management company that manages a homeowners association located in North Carolina obtains a contract on behalf of the homeowners association from a service company to provide janitorial services for the pool area and restrooms and to maintain, repair, and inspect the pool heater and pool pump for a period of six months. The total amount of the contract is ten thousand dollars (\$10,000.00). The service company does not maintain any books and records in its ordinary course of business to establish an allocated amount applicable to the maintenance, repair, or inspection of the pool heater and pool pump and janitorial services; therefore, the entire sales price of ten thousand dollars (\$10,000.00) is subject to sales and use tax.

Exemption for Certain Purchases – Service Contract

Effective January 1, 2017, for sales made on or after such date, N.C. Gen. Stat. § 105-164.13(62), as amended, provides an exemption from sales and use tax for the sale at retail and the use, storage, or consumption in this State of the following:

An item or repair, maintenance, and installation services used to maintain, monitor, inspect, or repair tangible personal property or digital property pursuant to a service contract taxable under [Article 5 of Chapter 105 of the North Carolina General Statutes] if the purchaser of the contract is not charged for the item or services. For purposes of this exemption, the term "item" does not include a tool, equipment, supply, or similar tangible personal property that is not deemed to be a component or repair part of the tangible personal property or digital property for which a service contract is sold to a purchaser.

Purchases of an item or repair, maintenance, and installation services to maintain or repair tangible personal property pursuant to a service contract subject to tax under N.C. Gen. Stat. § 105-164.4(a)(11) should be purchased by the obligor, retailer or wholesale merchant exempt from sales and use tax by issuing a properly completed [Form E-595E, Streamlined Sales and Use Tax Agreement Certificate of Exemption](#), to a seller. Alternatively, the data elements as required by N.C. Gen. Stat. § 105-164.28(a) to substantiate an exemption can be provided to a seller by the obligor, retailer or wholesale merchant.

Exception

N.C. Gen. Stat. § 105-164.4I(c) continues to provide that sales and use tax does not apply to the sales price of or the gross receipts derived from a service contract or renewal of a service contract sold at retail for a security or similar monitoring contract for real property before or after March 1, 2016.

Registration

Any person, who is not registered with the Department and is required to collect and/or remit sales and use tax on the sales price of or the gross receipts derived from a service contract, must complete Form NC-BR, Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Machinery and Equipment Tax. Both an [online business registration portal](#) and [a web-fill version](#) of Form NC-BR are available on the Department's website. There is no fee required to register and obtain a certificate of registration.

Reporting and Remittance

The sales price of or the gross receipts derived from a service contract and the amount of sales and use tax due must be reported using Form E-500, Sales and Use Tax Return, or through the Department's [online filing and payment system](#). Gross receipts for resale and exempt gross receipts must be reported on lines 2 and 3, respectively, when filing Form E-500. In addition, if local and/or transit tax is due for a county other than the county in which the business is located or for more than one county, Form E-536, Schedule of County Sales and Use Taxes, must be completed in conjunction with Form E-500 and submitted to the Department.

N.C. Gen. Stat. § 105-164.20(b) provides that "[a] retailer who sells or derives gross receipts from a service contract" must report the gross receipts from such and pay the applicable sales and use tax due on the accrual basis of accounting. A retailer that sells or derives gross receipts from a service contract and that allows the consumer to pay for the contract over time, may wish to require payment of the sales tax initially to the retailer. However, a retailer, that fails to collect the sales tax at the time of the sale of a service contract from a consumer, is liable for payment of the tax for the period in which the sale occurs.

For information regarding the refund of tax paid on a cancelled service contract, see the provisions of N.C. Gen. Stat. § 105-164.11A.

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 there is any change in the rate or amount of tax, change to a statute or regulation, or new case law subsequent to the date of this notice, the provisions in this important notice may be superseded or voided. To the extent that any provisions in any other notice, directive, technical bulletin, or published guidance issued prior to the date of this notice conflicts with this important notice, the provisions contained in this important notice supersede.