
Tax Compliance Guide

Maintenance Agreements Topic 348

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The tax character of maintenance agreements is generally dependent upon three factors: whether or not purchase of the agreement is required in conjunction with the purchase of the maintained property; whether or not the price of the agreement includes both service labor and replacement property; and whether or not the price of the agreement is stated separately from the price of the maintained property.

Maintenance agreements differ from extended warranties in that they generally provide for routine, periodic repairs to property (including software) in order to keep such property in a continuous state of good working order. When maintenance agreements provide for repair parts, supplies, or software updates, the purchaser intends to acquire such property as an object of the agreement. Warranties are indemnities against defect. Property is used only if a defect is discovered.

Equipment Maintenance Agreements

Agreements to provide ongoing repairs and maintenance to computer hardware, office equipment such as copiers and fax machines, vehicles, or other tangible personal property are not taxable provided that all of the following conditions are met:

1. The agreement is not mandatory for the purchase, lease, or rental of the equipment maintained;
2. The charge for the agreement is separately stated from the purchase price, lease price, or rental price of the equipment maintained (if any); and
3. The periodic charge for the agreement does not include parts and supplies, or the periodic charges for parts and supplies are stated separately from the charges for labor.

Sellers must collect Westminster sales tax on charges for separately stated parts and supplies sold subsequent to the maintenance agreement. The seller may not avoid collecting sales tax on parts by paying sales or use tax on such parts upon purchase, or by taxing all or part of the maintenance agreement or warranty charge.

Because parts used in fulfilling the agreement will be resold and taxed – either as part of the price of the agreement, or individually as they are used – they may be purchased tax free at wholesale.

Charges for surplus consumption, such as copy machine click charges, constitute part of the price paid for the lease or rental of tangible personal property, and are, therefore, subject to City sales tax.

Software Maintenance Agreements

While many software maintenance agreements include provisions for technical support and troubleshooting, these maintenance agreements frequently include the right to future releases, upgrades, updates, security patches, or other modifications or improvements. As such, most software maintenance agreements are subject to City sales/use tax. Software agreements are not taxable provided that all of the following conditions are met:

1. They are not mandatory for the purchase, lease, or rental of the underlying software (or software license);
2. They are separately stated from the purchase price, lease, or rental payment amount (including the amounts for software licenses); and
3. They are strictly for technical support services and do not include the right to any future releases, upgrades, updates, security patches, or other modifications or improvements.

Examples

1. Company A purchases a copy machine from Seller B. Company A also purchases a 12-month, optional maintenance agreement. Company A pays a flat, monthly charge plus charges for parts, if any, needed to repair the machine. The monthly charge for the

agreement is not subject to tax. Seller B must collect sales tax on charges for parts used to repair the copy machine. Seller B should not pay sales tax when purchasing parts for repair inventory, because the parts will be taxed upon their resale.

2. Company C leases a copy machine from Seller B. The monthly charge for the lease is \$500 plus \$0.10 per page over 3,000 pages. Seller B must collect sales tax on both the \$500 base charge and the \$0.10 per page overage charge.
3. Company D leases kitchen equipment from Seller E. Company D is required, per the lease, to pay \$2,400 per month for the equipment and also must purchase a service plan from Seller E for an additional \$200 per month. The service plan covers labor, but replacement parts are additional. Because the service plan is mandatory for the lease of the kitchen equipment, Seller E must collect sales tax on the \$200 price in addition to the monthly lease charges. Seller E must also collect sales tax on repair parts, if any, sold to Company D.
4. Company F purchases accounting software from Seller G for \$10,000. Company F is required to pay an annual maintenance fee of \$1,500 per user, for which it receives 24 hour technical support and monthly updates from Seller G. Seller G is not a licensed Westminster retailer and does not collect tax on the charge for the software or the annual maintenance fees. Company F must, therefore, report and pay use tax on the \$10,000 software charge and the \$1,500 annual maintenance fee on their periodic City sales/use tax return.
5. Company H purchases an optional support plan from Seller I for software it purchased from Seller I. The support plan entitles Company H to call Seller I Monday through Friday from 8:00AM to 5:00PM and receive technical support for up to three hours per month. Company H does not receive any upgrades, updates, patches, or other additional software from Seller I unless it purchases them separately. The optional support plan is not subject to Westminster sales/use tax.

Related Topics

Software
Warranties

Citations

Westminster Municipal Code
§ 4-2-2. Definitions
§ 4-2-3. Rate; Imposition & Collection; Distribution

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