

Warranty Matters

General Motors Edition

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Tax on Goodwill?

Quite honestly, we expect most of you will find this to be an unpleasant article to read. In fact, we stumbled on some of the initial information some months ago while researching an entirely different matter. The information here is not focused towards GM, but rather all manufactures and all dealerships.

We, by no means, are a tax accounting firm, however, the opinions we have received from state revenue offices seem to put the dealership and/or manufacturer at some risk of tax liability in regard to goodwill repairs, or other gratuitous offerings.

These matters are highly complex and can vary widely from state-to-state. We urge readers to review this information with your accounting office and tax advisor and seek a "Letter Ruling" from your state's tax revenue office. (Most states do not charge for a Letter Ruling, yet, some states, like Tennessee, do charge for this.)

First, most every manufacturer allows some sort of leeway for a dealer to make goodwill (or in Ford terminology, After-Warranty Adjustment) decisions. Goodwill basically falls into two categories:

- 1) Repairs that would have been warranty anyway, but the coverage has expired by time and/or mileage.
- 2) Non-warranty repairs that the manufacturer and/or dealer agree to repair at no charge to the customer. This has been a common practice of Import manufacturers for several years. Recently, the domestic manufacturers have begun to follow suit.

Most (but not all) states agree that repairs covered under the vehicle's normal warranty period are *not* taxable. There is, however, a wide range of opinion as to whether or not goodwill repairs can be classified as taxable events.

Manufacturers and dealers have argued two basic points to oppose assessment of sales or use tax with varying degrees of success:

- The potential cost of goodwill repairs is calculated into the price of the vehicle and therefore taxed upon the sale of the vehicle. In GM's case, they have maintained their warranty program consists of four parts: 1) The limited warranty program, 2) Special Policy, 3) Campaigns/Recalls and 4) Goodwill repairs, all of which are considered to determine the dealer's price of vehicles.
- Goodwill repairs are only considered if the failure can reasonably be concluded to have begun during the limited warranty period. While this could logically include Special Policy and Campaign repairs, Mitsubishi successfully used this argument regarding goodwill tax liability against the Ohio Tax Appeal Board.

Although Warranty Matters did not query each of the 50 states for an opinion on this matter, we did research those with direct ties to our readers and clients. Unfortunately, not every state we contacted responded with an opinion.

IN THIS ISSUE

<i>Tax on Goodwill?</i>	1-3
<i>Other Considerations</i>	3
<i>What's Your Potential Liability?</i>	3
<i>The Money Game</i>	4
<i>The Back Page</i>	4

- *Many, if not most, are unaware of their state's policy regarding taxation of goodwill repairs*
- *Goodwill tax policies mostly mirror those rates for extended service contract repairs*
- *Most states hold the dealership responsible for paying goodwill taxes and have little regard for how they are collected*
- *Dependant on the state, tax liability could rival a good-sized warranty audit*

(Continued on page 2)

(Continued from page 1)

Thus far, only three of those states responding have made rulings exempting goodwill repairs from any tax liability.

In **Michigan**, this issue went all the way to their Supreme Court, which ruled: *“Treasury’s position is that they were not under warranty so they are taxable. Supreme Court ruled that they were a warranty replacement, even though discretionary, and not subject to sales tax.”*

Louisiana says, *“R.S.47:301(16)(c) provides an exclusion from sales tax on the repair of a vehicle which is preformed after the lapse of the applicable warranty on that vehicle and at no charge to the owner of the vehicle. The goodwill repair is not subject to sales tax.”*

Maine replied simply, *“That issue has arisen here. Goodwill or implied warranty repairs have no Maine sales/use tax implication.”*

Some states, we learned, have a “Gross Receipts” tax, rather than a standard sales or use tax. In essence, these states tax all repair work, including basic warranty and/or goodwill, by charging taxes on the gross sales. These taxes are not normally passed along to the consumer.

Delaware responded, *“Delaware does not have a specific ruling in regards to after warranty repairs. Delaware does not have a sales tax, but has a gross receipts tax on services performed. The rate is .38%. So, any time money changes hands and the service provider is paid for service performed in Delaware, the service provider must include the money in the computation of gross receipts tax.”*

New Mexico said, *“If there are receipts for this transaction between the manufacturer and the dealership, then those receipts would be subject to gross receipts tax.”*

To the contrary, the majority of state revenue offices we contacted had a differing view. These responses are considered “informational opinions” to provide guidance on possible tax consequences and are not binding Letter Rulings, nor have they been ruled on by the states’ court system in most cases.

Alabama—*“The State of Alabama’s position is that After Warranty Repairs and/or Goodwill repairs should be taxed as this is not part of the original warranty coverage obligation when the vehicle was sold.”*

Arkansas—*“If the repairs are not covered by warranty and the manufacturer is charged for the repairs, the invoice should include tax.”*

Georgia—*“We have taken the position that any repair occurring after the original factory warranty period would be taxable. In the event any party elects to goodwill the repair as a customer satisfaction, the dealer would be responsible for the sales and use tax on the parts.”*

Illinois—*“These repairs are taxable. When goodwill repairs are made, the dealer has, in essence, made a gift of these repairs. A donor of tangible personal property is deemed to be the user of that property. Therefore, there is a use tax obligation on the part of the donor, in this instance on the cost price of the parts transferred incident to the repair.”*

Missouri—*“Repairs covered during the basic warranty that comes with the vehicle are not subject to tax since the warranty came with the vehicle. However, repairs covered after the warranty has expired are taxable.”*

New Jersey—*“If you are not collecting sales tax from the customer then you must self assess use tax on your purchase price of the parts only, not labor.”*

Ohio—*“Ohio revised Code 5739.01 (B)(7) states all transactions in which a warranty, maintenance, or service contract, or similar agreement, by which the vendor of the warranty, contract, or agreement agrees to repair or maintain the tangible personal property of the consumer is or is to be provided. Warranties are considered sales and taxable to the end consumer.”*

Tennessee—*“Under Tennessee law, the parts and labor provided under the original manufacturers’ warranty are exempt from sales tax under the provisions of Tenn. Code Ann. Section 67-6-324. However, it seems obvious when the original manufacturers’ warranty has expired there is no basis in law for the dealer to exempt the transaction. Rather, it is our opinion that the dealer will be liable for the tax on repair under these circumstances. Our law holds the dealer liable, regardless of whether such dealer is paid the tax by the entity that the dealer bills.”*

Texas—*“A motor vehicle dealer that uses parts to perform free repairs not covered by a manufacturer’s written warranty performs [a] ‘goodwill repair’ and the parts used are taxable to the dealer under Tax Code Section 151.154.”*

(Continued on page 3)

(Continued from page 2)

Dependent upon the state, taxes could apply to just the parts, or both parts and labor. By and large, laws seemed to mirror taxation in the same manner and rates (parts and/or labor) that an Extended Service Contract repair would be taxed in that state.

One theme seemed consistent among states that view goodwill as a taxable event—The dealer would most likely be the entity held liable for payment. Still though, of those states that rendered opinions stating goodwill is taxable, none (with the exception of Ohio) acknowledged aggressively pursuing those funds at time of publication. Some states wrongly assumed taxes were being collected and paid on every goodwill claim.

We have learned that Ford Motor Company does allow dealers to submit for taxes on After Warranty Adjustments in those states that require this tax. From our own experience, however, few dealers are aware of this provision or if their state even views goodwill as a taxable event, and rarely, if ever, collect taxes on AWA. Nonetheless, this would seem to relieve Ford of any liability on their part.

However, this could change, as several states commented that they had been assessing the wording of their tax codes to see if it would hold up in court. Maybe not so surprisingly, some revenue offices had never heard of goodwill, nonetheless, after research of statutes, their opinion was this would be taxable.

Other Considerations

It's not hard to conceive why states would expect to receive tax revenue on goodwill, particularly if you are of the opinion that goodwill decisions can be based on a "whim" and are more a matter of choice, rather than an obligation under warranty provisions.

As mentioned above, some revenue offices weren't completely aware of manufacturers' goodwill policies, much less how they might be applied. As also mentioned on the first page, goodwill can sometimes include repairs that otherwise would not be warrantable in the first place.

When they can include non-warranty (i.e., customer damaged) repairs, the states would certainly be entitled to tax dollars. After all, if it weren't being handled through the manufacturers' processing system, it would normally be a customer pay (insurance included) transaction and taxes would be collected.

Some manufacturers, on a case-by-case basis, pro-

vide (or allow their dealers to offer) factory-backed extended service contracts at no charge to customers who've experienced costly failures.

In those cases, the parts and/or labor would be taxed once a repair was performed, but in at least 19 states the "sale" of an extended service contract is taxable as well.

According to Ford's Extended Service Contract Guide, AR, CT, FL, HI, IA, KS, LA, NE, NJ, NY, OH, PA, SD, TN, UT, VA, WA, WV and WI tax the sale of an extended service contract.

More recently, GM has provided "Customer Loyalty" coupons good for "free" maintenance. Although we didn't pursue this matter with our questions to the revenue offices, it would be a safe bet they would view these as taxable events too.

What's Your Potential Liability?

Of course, this isn't an easy question to answer. Back in 2003, we reported that most GM Regions averaged about 7–10% goodwill to regular warranty dollars, with individual dealers running as high as 24%.

These numbers have been fairly consistent for several years, but as we all know, manufacturers are pushing for increased market share and increased goodwill offerings are often part of that effort.

Splitting the difference and using 15% as a goodwill base and considering a tax rate on parts *and* labor of 8%, a dealer doing \$880,000 annually in total warranty claims would be looking at taxes due in the neighborhood of \$10,560 for that year.

While \$10,000 might not break the bank of the average dealership, states often conduct audits of back taxes that encompass more than the current year.

These audit timeframes vary from state to state, but 3 - 5 years is fairly common, with some states, like Ohio, claiming "*no limitation on the look-back period.*" With this consideration, a sales/use tax audit could easily rival a good-sized warranty audit.

Some dealers we've already spoken with about this liability have decided to charge the tax to the customer, but this would seem to defeat the intention of goodwill policy in the first place.

Warranty Matters has forwarded this predicament to the General Motors warranty office to obtain an opinion, but did not receive a response by time of publication. As soon as that information comes available, we promise to pass it along to our readers.

Warranty Matters

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The Money Game

In what may be the single biggest change to the Lifetime Service Guarantee (LSG) program since its inception, GM issued message VSU20050951 that added wheel bearing hub assemblies to the LSG program. More importantly, however, a complete series of common retail sale parts have been removed from the LSG coverage program.

Effective with sales on or after January 1, 2006, ignition modules/coils, ignition wire(s), fuel injectors, EGR valves, oxygen sensors, CV joints and boot kits (installed by the dealership) will only be covered under the standard 12-month or 12,000-mile (whichever comes first) part/labor warranty.

Although the message states this decision was reached after review with the GM Dealer Fixed Operations Advisory Board, every dealer we've spoken with about the program was shocked that 44% of former LSG parts were removed from lifetime coverage eligibility and aren't too pleased with the Advisory Board or General Motors over this change.

In fact, most say they were happy with the previous coverage and hardly see it as a fair trade off—to add one part line and remove seven more. Let's face it, the parts removed from LSG coverage are more common sellers than wheel bearing hubs.

The message contends the Advisory Board wanted the LSG program to move in the direction that “higher dollar value repairs being eligible and those with a lower dollar value not being as important.” This statement and product removal seems strange, as to our recollection some of the now ineligible parts aren't exactly on the cheap side.

Dealers have expressed concern over possible lost sales opportunities directly related to these changes, particularly since various aftermarket parts warehouses offer comparable coverage for some of the same parts removed from the LSG listing.

Any of the now ineligible parts that were installed at a GM dealership prior to 1/1/2006 will continue to be covered under the LSG program. Likewise, any wheel bearing hubs installed prior to 1/1/2006 will only carry the 12/12 standard part warranty coverage.

The Back Page

In September of 2005 we published an article titled “Bulletin Contradiction” where we pointed out a discrepancy in bulletin #05-00-89-055 (GM Dealer Empowerment Program). The bulletin revision incorrectly stated authorization code ‘G’ was not required for Claim Type ‘B’ or ‘N.’

We alerted GM of the contradiction between this bulletin and DCS message #1387, which was issued last April to require authorization code ‘G’ on both claim types.

Although we didn't receive a formal response from GM, bulletin #05-00-89-055A was revised on 11/21/2005 to “...clarify the information under Authorization Code G.”

More recently, we received a reply in regard to the “Tire Claim Fiasco” and “More on Tires” articles in the October and November issues of *Warranty Matters*. (While we're still in the process of clarifying the procedure and eventually expect an updated tire replacement bulletin, we are not prepared to publish a complete explanation at this time.)

In other cases, some of our articles have resulted in “behind-the-scene” reprimands and other actions to improve dealer relations.

The point here is that GM (and GMPP) really does listen and *will* respond to valid dealer concerns in most situations. Sometimes the response isn't quite as fast as we'd like, or maybe not what we necessarily want to hear, but they usually will respond.

Some of the questions and issues we address like the “Tax on Goodwill” article in this month's issue are complex and have to go through the slow corporate chain of command, often including review by attorneys before a response is released.

A service director from a Kia dealership called last week because he'd sent an email to his rep over what he felt was an improper debit of a part return. Based on the explanation of the situation, it seemed he was correct in objecting to the debit. Eventually, this email worked its way to upper management in Korea and he now fears being marked as a “trouble maker.”

If you have a legitimate concern, don't be afraid to express your thoughts. If you have a fear of reprisal, forward your concerns to us and give us an opportunity to look into them. After all, if you do nothing, you can expect the same in return.