

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 18-04

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

The application of the Tennessee sales and use tax to the installation and monitoring of energy-saving equipment.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[TAXPAYER] (the "Taxpayer"), a [STATE]-based company, designs, installs, and monitors energy-saving power systems for customers looking to reduce their energy expenses. The Taxpayer

describes its product offering as [REDACTED]. The Taxpayer's customers include [REDACTED] companies with numerous facilities across the country, some of which are in Tennessee.

The Taxpayer installs energy consumption meters in a customer's facilities to evaluate its existing power system, [REDACTED]. The Taxpayer then designs a retrofit system that will reduce the customer's energy consumption and installs the necessary equipment, such as [REDACTED]. The Taxpayer remotely monitors the customer's energy use through its consumption meters and a web-based dashboard and calculates the customer's energy savings as a result of the Taxpayer's installation. The Taxpayer continues to monitor a customer's energy usage for the time period set forth in the customer's [AGREEMENT] (the "Agreement").

The Taxpayer bills customers for their monthly energy savings. Customers pay the Taxpayer a fixed rate per unit of energy saved, such as [REDACTED], pursuant to the Agreement. This is the only fee customers pay the Taxpayer. If a customer does not experience any energy savings, the customer does not remit any payment to the Taxpayer.

The Taxpayer owns and maintains the equipment installed in a customer's facility for the life of the Agreement. The Agreement provides that the equipment does not attach to or become a fixture to the customer's real property. If the equipment malfunctions, the Taxpayer will service or replace the equipment at no additional cost to the customer. Customers have no ability to access or operate the Taxpayer's equipment, though they can access the data collected from the equipment using the Taxpayer's web-based dashboard. At the end of a customer's Agreement, the Taxpayer either removes its equipment from the customer's facility or leaves it in place. The Taxpayer makes this decision on a case-by-case basis toward the end of the contract period. Customers do not have the option to purchase the equipment.

RULING

Are the Taxpayer's Agreements to furnish and monitor energy-saving power equipment subject to Tennessee sales and use tax?

Ruling: Yes, the Taxpayer's Agreements to furnish and monitor energy-saving power equipment are subject to Tennessee sales and use tax under TENN. CODE ANN. § 67-6-204 (Supp. 2017).

ANALYSIS

Under the Retailers' Sales Tax Act, the retail sale in Tennessee of tangible personal property and specifically enumerated services are subject to the sales and use tax, unless an exemption applies.¹ "Retail sale" is defined as "any sale, lease, or rental for any purpose other than for resale, sublease, or subrent."²

TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2017) defines "sale," in pertinent part, to mean "any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any

¹ Tennessee Retailers' Sales Tax Act, Ch. 3, §§ 1-18, 1947 Tenn. Pub. Acts Ch. 22, §§ 2254 (codified as amended at TENN. CODE ANN. §§ 67-6-101 to -907 (2013 & Supp. 2017)).

² TENN. CODE ANN. § 67-6-102(76) (Supp. 2017).

manner or by any means whatsoever of tangible personal property for a consideration.” Furthermore, TENN. CODE ANN. § 67-6-102(49) (Supp. 2017) defines “lease or rental” as “any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration.” However, “lease or rental” does not include providing tangible personal property along with an operator, provided that “the operator is necessary for the equipment to perform as designed” and “must do more than maintain, inspect, or set-up tangible personal property.”³ “Tangible personal property” includes “property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses.”⁴

TENN. CODE ANN. § 67-6-204(a)(1) (Supp. 2017) imposes a tax on the sales price of all leases and rentals of tangible personal property where the lease or rental is part of or germane to the established business. “Sales price” is defined as “the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented.”⁵ The sales tax is computed based on the billing cycle set forth in the applicable lease or rental contract.⁶

The Tennessee sales tax also applies to retail sales of services specifically enumerated in the Retailers’ Sales Tax Act.⁷ One such service is “the installing of tangible personal property that remains tangible personal property after installation...where a charge is made for the installation, whether or not the installation is made as an incident to the sale of tangible personal property.”⁸

Additionally, when a transaction involves taxable and nontaxable components and the transaction’s true object or a “crucial,”⁹ “essential,”¹⁰ “necessary,”¹¹ “consequential,”¹² or “integral”¹³ element of the

³ TENN. CODE ANN. § 67-6-102(49)(A)(iii).

⁴ TENN. CODE ANN. § 67-6-102(89)(A).

⁵ TENN. CODE ANN. § 67-6-102(79)(A).

⁶ TENN. COMP. R. & REGS. 1320-05-01-.32(2) (1987).

⁷ See TENN. CODE ANN. § 67-6-205(c) (Supp. 2017).

⁸ TENN. CODE ANN. § 67-6-205(c)(6).

⁹ See, e.g., *Thomas Nelson, Inc. v. Olsen*, 723 S.W.2d 621, 624 (Tenn. 1987) (holding that a transaction involving the sale of non-taxable intangible advertising concepts was nevertheless subject to sales tax on the entire amount of the transaction because advertising models, which were tangible personal property, were an “essential,” “crucial,” and “necessary” element of the transaction).

¹⁰ *Id.*; see also *AT&T Corp. v. Johnson*, No. M2000-01407-COA-R3-CV, 2002 WL 31247083, at *8 (Tenn. Ct. App. Oct. 8, 2002) (holding that a transaction involving the sale of engineering services along with separately itemized tangible telecommunications systems was subject to sales tax on the entire amount of the contract because “equipment, engineering, and installation combine in this instance to product BellSouth’s desired result: a functioning item of tangible personal property assembled on the customer’s premises,” and further describing the engineering services as “essential” and “integral” to the sale of tangible personal property).

¹¹ See *supra* note 11.

¹² See *Rivergate Toyota, Inc. v. Huddleston*, No. 01A01-9602-CH-00053, 1998 WL 83720, at *4 (Tenn. Ct. App. Feb. 27, 1998) (holding that a transaction involving the commission and distribution of advertising brochures was subject to sales tax on the “entire cost of the transaction” because, although the transaction involved a number of services, the brochures themselves “were not inconsequential elements of the transaction but, in fact, were the sole purpose of the contract”).

¹³ See *AT&T Corp. v. Johnson*, 2002 WL 31247083, at *8.

transaction is subject to tax, the entire transaction is subject to sales tax.¹⁴ If the true object of the transaction is independently taxable, then the true object and any essential elements of the transaction will be subject to sales tax.¹⁵ Only if the true object of the transaction is not independently subject to sales tax and the items that would be subject to sales tax are “merely incidental” to the true object of the transaction will the transaction not be subject to sales tax.¹⁶

The Taxpayer’s equipment [REDACTED] is tangible personal property, as it can easily be seen and touched. When the Taxpayer installs this equipment in a customer’s facility, it is transferring possession of the property to the customer for consideration, without transferring title. The customer’s inability to operate the equipment does not negate the fact that the Taxpayer has transferred possession. Additionally, although the Taxpayer monitors the equipment remotely, it does not provide an operator that is necessary for proper system function. This transaction therefore is a lease.

Tennessee sales tax is imposed on the sales price of a lease or rental when that lease is an essential part of an established business.¹⁷ The lease of the Taxpayer’s equipment is an essential part of the Taxpayer’s business and is therefore subject to sales tax. The Taxpayer does not itemize a specific sales price upfront but instead bills customers monthly for their energy savings according to a predetermined formula set forth in the customer’s Agreement. This monthly charge is the only consideration a customer pays to the Taxpayer. The amount charged to a customer in the monthly bill is therefore the Taxpayer’s sales price. Accordingly, the Taxpayer owes sales and use tax on the price billed each month to Tennessee customers.

Furthermore, the Taxpayer’s business model is similar to that addressed in *Essary v. Huddleston*, as both involve a lease of tangible personal property coupled with a servicing component. In *Essary*, the Tennessee Court of Appeals held that providing portable toilets to customers and maintaining them for the duration of use constituted a taxable lease of tangible personal property.¹⁸

Although the Taxpayer’s installation service is not independently taxable because no separate charge is made for the installation, the true object of the Taxpayer’s business transactions is the lease of the energy-saving equipment. The Taxpayer’s entire business model is based on providing customers with equipment that will reduce their energy expenses and allow the Taxpayer to collect a portion of those savings. As set forth above, the equipment lease is independently taxable. Sales tax is thus imposed on the Taxpayer’s total sales price, which includes both the monthly charge billed to customers for the lease of the energy-saving equipment and the included installation service.¹⁹

¹⁴ See generally Tenn. Dept. of Rev. Ltr. Rul. 14-10 (Oct. 14, 2014) [hereinafter “Ltr. Rul. 14-10”] (discussing Tennessee law regarding bundling and the “true object” test).

¹⁵ See *AT&T Corp. v. Johnson*, 2002 WL 31247083, at *9.

¹⁶ See generally Ltr. Rul. No. 14-10, *supra* note 15.

¹⁷ See TENN. CODE ANN. § 67-6-204(a).

¹⁸ *Essary v. Huddleston*, No. 02A01-9408-CH-00179, 1995 WL 384985, at *2 (Tenn. Ct. App. June 29, 1995).

¹⁹ See TENN. COMP. R & REGS. 1320-5-1-.27(2) (2016). (clarifying that installation services performed in connection with the sale of tangible personal property are included in the sales price of that tangible personal property).

Accordingly, the Taxpayer's Agreements are subject to the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-204 as a lease of tangible personal property.

Courtney Swim
Assistant General Counsel

APPROVED:

David Gerregano
Commissioner of Revenue

DATE:

9/12/18