

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 24-04

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

Applicability of Tennessee sales and use tax to streetlights and related equipment and materials on behalf of public power authorities.

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

[REDACTED] (the "Taxpayer") [REDACTED] develops, designs, and implements projects to improve energy efficiency and reduce costs for electric power generation and distribution systems. [REDACTED- IDENTIFYING INFORMATION]

The Taxpayer entered contracts with local power authorities in Tennessee to upgrade those authorities' streetlight infrastructure. Streetlight upgrades frequently fulfill many policy goals at once—improving safety for motorists and pedestrians, enhancing quality of life for residents, and significantly improving energy efficiency and reliability of the electric distribution system.

Streetlights

Modern power grids comprise four stages: generation, transmission, distribution, and service drops where private parties may connect to the grid. High-voltage transmission lines carry electricity over long distances, while medium-voltage distribution systems more safely deliver power from power generators and transmission lines to most residential, commercial, and industrial users. The final stage begins at service drops that deliver electricity into homes and businesses at the lowest and safest voltages.

Streetlights have been a feature of electric distribution systems since the earliest days of electric power. Integrating streetlights directly into power lines and poles has reduced costs, raised funds, and secured public support for both the lighting of streets and distribution of electricity. Additionally, power companies are well positioned to efficiently build and operate streetlights by safely connecting them to more dangerous, yet more efficient power, while spreading the cost among the users who are most directly served by both the lines and the lights. At the same time, streetlights provide direct benefits of safety and security to distribution lines and offset the inconvenience that distribution systems may cause to nearby residents and businesses. A trained utility worker can quickly and safely see things in the way lights are working or not working that might otherwise require the difficult and dangerous task of accessing overhead or underground lines. Each light—on or off, flickering or stable—provides data that the utility worker can use when diagnosing and locating the problem.

Taxpayer's Installation

The Taxpayer installs streetlights, photocells, and smart nodes into distribution systems owned and operated by political subdivisions of Tennessee. In rare cases, the Taxpayer will replace and/or add poles, which can be standalone poles, shared infrastructure poles, and decorative poles. These public power authorities expect the streetlights, photocells, and smart nodes to reduce energy use by [PERCENTAGE] and to significantly reduce operational and maintenance expenses for their distribution systems. The reduced energy use is achieved by updating to modern LED and solid-state lighting solutions. Photocells automatically turn a streetlight on or off based on the available light level. Additionally, the installation of "smart nodes," an integrated technology, improves the performance of the electric distribution system by [SPECIFIC FUNCTIONALITY]. The Taxpayer installs smart nodes on many of its projects, including all of the Taxpayer's large projects. The authorities hire the Taxpayer – rather than purchase and install these technologies directly – because of the Taxpayer's greater experience and expertise in the highly technical and specialized field of electrical distribution systems and technologies.

All of the streetlights, photocells, smart nodes, and poles discussed in this ruling will be directly attached in a permanent manner to the power authorities' electric distribution lines and are intended to remain in place for their useful life. The Taxpayer will install these assets at points in the system before the service drops that allow private customers to connect to the electric grid. The point where they connect is within what the industry calls the "safety zone," where only electric companies and those qualified to work with their electric distribution systems may service, alter, or remove them. The streetlights, photocells, smart nodes, and poles are included in the calculation of the payment in lieu of taxes (the "PILOTs") paid by a utility to a taxing jurisdiction pursuant to the Municipal Electric System Tax Equivalent Law of 1987.

RULINGS

Is the Taxpayer's purchase and installation of streetlights, photocells, smart nodes, and poles on behalf of public power authorities subject to sales and use tax?

Ruling: No. The streetlights, photocells, smart nodes, and poles are exempt from sales and use tax pursuant to TENN. CODE ANN. § 67-6-209(e).

ANALYSIS

Under the Retailer's Sales Tax Act, retail sales in Tennessee of tangible personal property and specifically enumerated services are subject to the sales tax, unless an exemption applies.¹ Use tax, which is generally regarded as a complement to the sales tax, similarly applies, absent an exemption. In this case, the application of use tax to a contractor is at issue.

TENN. CODE ANN. § 67-6-209(b) states that where a contractor or subcontractor defined as a "dealer"² uses tangible personal property in the performance of a contract, or to fulfill contract or subcontract obligations "such contractor shall pay at the rate prescribed by § 67-6-203 measured by the purchase price of such property." Consequently, under Tennessee law, a contractor is liable for the "contractor's use tax" when the contractor uses tangible personal property in the performance of a contract, unless an exemption applies.³

TENN. CODE ANN. § 67-6-209(e) (2022) exempts "the sale or use of materials and equipment purchased or used for construction or installation, by a contractor, subcontractor or otherwise, of, in or as part of any electric generating plant or distribution system" that is "owned or operated by the United States or any agency thereof created by an act of congress, or by the state of Tennessee or any agency or political subdivision thereof, or any authority organized pursuant to the Rural Electric and Community Services Cooperative Act, compiled in title 65, chapter 25".

TENN. COMP. RULE & REGS. 1320-05-01-.102 (1974) ("Rule 102") states that tangible personal property which actually becomes a component part of an electric generating plant or distribution system owned or operated by a political subdivision of the State of Tennessee is exempt from sales or use tax. Rule 102 clarifies that the exemption does not apply to any tangible personal property as a part of such a system, nor does it apply to tangible personal property or to a taxable service that is used in the process of installing the exempt property, when such property does not become a component part of the electric generating plant or distribution system.

Here, the electric distribution systems are owned or operated by political subdivisions of Tennessee, or authority organized pursuant to the Rural Electric and Community Services Cooperative Act, compiled in title 65, chapter 25. Accordingly, this analysis turns on whether the streetlights, photocells, and smart nodes installed by the Taxpayer are "component parts" of an electric generating plant or distribution system.

The relevant terms in Rule 102, "electric generating plant," "distribution system," and "component parts," are not defined in the sales tax law, but other sections of the Tennessee Code provide the guidance that the distribution system is a part of the electric plant system which includes the generation, transmission, and distribution systems. Under the Municipal Electric Plant Law of 1935,

¹ Tennessee Retailer's 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 (2022 & Supp. 2023).

² TENN. CODE ANN. § 67-6-102(23)(K) (Supp. 2023).

³ TENN. CODE ANN. § 67-6-209(c) (2022).

“electric plant” is defined as “generating, transmission, or distribution systems, together with all other facilities, equipment and appurtenances necessary or appropriate to any such systems for the furnishing of electric power and energy for lighting, heating, power or any other purpose for which electric power and energy can be used.”⁴

Relatedly, the Municipal Electric System Tax Equivalent Law of 1987 sets forth the complete law of Tennessee with respect to PILOTs on the property and operations of all electric systems owned and operated by incorporated cities or towns, by counties, and by metropolitan governments.⁵ PILOT amounts are determined based partly on a calculation that includes the property tax multiplied by the net plant value of the electric plant and the book value of materials and supplies within the taxing jurisdiction.⁶ The PILOT statutory scheme defines “electric system” as all tangible and intangible property and resources of every kind and description used or held for use in the purchase, generation, transmission, distribution, and sale of electric energy.⁷

In addition, terms appearing in the Municipal Electric System Tax Equivalent Law of 1987 that are not specifically defined have the same meanings defined or ascribed to them in the Federal Energy Regulation Commission’s (the “FERC’s”) uniform system of accounts applicable to electric system operations.⁸ The FERC, which prescribes uniform accounting rules and definitions for public power companies, categorizes “street lighting and signal systems” as one group of assets that make up a distribution system.⁹

The common understanding of an electric distribution system is a system that supplies and distributes electricity to users in a particular area. “Distribute” is defined in part as: to divide among several; to spread out as to cover something; to give out or deliver especially to members of a group; to place or position so as to be properly apportioned throughout an area.¹⁰ “Component part” is not defined for sales tax purposes, but its general definition is “something (as a building or part of a building) that cannot be removed without substantial damage to itself or to the immovable property to which it is attached.”¹¹ In a case involving whether materials became component parts for purposes of the industrial materials exemption, the Supreme Court of Tennessee has held that the materials must have “actually gone into the finished product as an ingredient or component, that such an exemption applies only to such personal property as has been chemically or mechanically incorporated into the finished product.”¹²

Looking at the issue from a common perspective, poles that provide support for power lines are incorporated into the distribution system, while streetlights, photocells, and smart nodes are more oriented to the consumption of electricity. In other words, the contributions that streetlights, photocells, and smart nodes make to the electric distribution system are tangential, providing a more

⁴ TENN. CODE ANN. § 7-52-102(3) (2024).

⁵ TENN CODE ANN. § 7-52-302.

⁶ TENN. CODE ANN. § 7-52-304(1)(A).

⁷ TENN. CODE ANN. § 7-52-303(a)(4) (2024).

⁸ TENN. CODE ANN. § 7-52-303(b).

⁹ See Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act, 18 C.F.R. Pt. 101 (2024).

¹⁰ *Merriam Webster's Collegiate Dictionary*, Eleventh Edition, Merriam Webster Inc. (2007).

¹¹ *Id.*

¹² *Kingsport Pub. Corp. v. Olsen*, 667 S.W. 2d, 745, 746 (Tenn. 1984).

holistic contribution to the distribution of electricity; they do not play a functional role in distributing electrons through the system, nor do they generate any electricity. Nevertheless, the Department has previously recognized that it has applied the exemption to a distribution system that is not on private property and will include in the system all components from the source of the electricity through and including the transformers that lead to each building.¹³ The items at issue here are incorporated into the power authorities' distribution system because they attach to the distribution system before the service drops that distribute the power to private parties, and are only accessible by those authorized from the electric companies. Finally, the streetlights, photocells, smart nodes, and poles are integrated in functionality and by physical means to the distribution system.

In the absence of clear definitions for electric distribution systems and component parts, a number of factors weigh in favor of finding that the streetlights, photocells, smart nodes, and poles are a component part of the electric distribution system under Rule 102. Those items are directly attached in a permanent manner to the power authorities' electric distribution lines, attached before consumer drop points in a location where only electric companies would have access, and are included in the calculation of the PILOTs paid by a utility to a taxing jurisdiction pursuant to the Municipal Electric System Tax Equivalent Law of 1987. Accordingly, the streetlights, photocells, smart nodes, and poles are exempt from sales and use tax.

APPROVED: David Gerregano
Commissioner of Revenue

DATE: June 4, 2024

¹³ See Tenn. Dept. of Rev. Ltr. Rul. 99-03, <https://www.tn.gov/content/dam/tn/revenue/documents/rulings/sales/99-03.pdf> (last accessed on April 1, 2024).