

STATE OF COLORADO

DEPARTMENT OF REVENUE
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PLR-11-009

John Hickenlooper
Governor

December 21, 2011

Barbara J. Brohl
Executive Director

XXXXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX

Re: Private Letter Ruling

Dear XXXXXXXXXXXX,

Your firm submitted on behalf of XXXXXXXXXXXXXXXXXXXX ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Regulation 24-35-103.5. This letter is the Department's private letter ruling.

Issues

1. Is the Company's purchase of XXXXXXXXXXXXXXXXXXXX ("System") exempt from state and state-administered local sales taxes because the System qualifies either for the Resale exemption (defined below) or for the Renewable exemption (defined below)?
2. Does the Customer's purchase of the System qualify for the Renewable exemption?

Conclusion

1. Company's purchase of the System from Contractor is exempt from state and state-administered local taxes.
2. Customer's lease and purchase of the System is exempt from state and state-administered sales and use taxes under the Renewable Components exemption, except the on-site monitoring system which is subject to sales and use taxes.

Background

Company is in the business of leasing turnkey photovoltaic energy systems ("System") to residential customers ("Customers"). A System consists of photovoltaic modules, mounting racks, an inverter, an on-site monitoring system, and wiring. Photovoltaic modules are mounted to a home – typically a roof – with mounting racks and related hardware. Company's mounting racks are designed to be removable. The modules

convert sunlight into direct current electricity. Because direct current electricity is unsuitable for most household applications, an inverter converts direct current electricity to alternating current electricity. An on-site monitoring device monitors the amount of power produced by the System and the performance of the panels and inverter. After passing through the inverter and monitoring device, electricity enters the home and is available for consumption by customer. Unused power is sent to the local utility's distribution grid and, in some regions, can offset the customer's use of power from the grid.

Company engages independent contractors ("Contractor") to market the System to potential residential customers, and, when they locate willing customers, to procure and install Systems on customers' homes. Company's contracts require its contractors purchase components for each System they install and provide all labor, supplies, tools, insurance, and certifications necessary to install and test the System. During installation, Contractors retain title to, and possession of, the System. Company pays Contractor an agreed-upon fixed price for the System in two installments (i.e., a portion after substantial completion and the remainder after testing). The contracts are lump sum - neither contract nor invoices separately state charges for materials and installation.

After purchasing a System, Company leases it to its customer – the residential homeowner. Its lease agreements provide that a System does not become a fixture (i.e., it remains tangible personal property) and that Company may remove it after the lease terminates. All customer leases have terms that are greater than three years. After a lease term (including renewals) expires, a customer may purchase the System for its fair market value or have Company remove it.

Discussion

1. Company's purchase of the System is not subject to sales or use taxes administered by the Department.

We find that the contract between Contractor and Company is not subject to sales or use tax. Company's purchase of the System is exempt under the Renewable Component exemption set forth in §39-26-724, C.R.S.,¹ which applies not only to purchases by the ultimate consumer (Customer) but to "all" sales and uses of qualifying renewable energy components.

We also note that, if the System is a real property fixture when possession passes to Customer, then the transaction is not subject to sales and use taxes because these taxes apply only to the sale and use of personal property. However, we do not determine here whether the System is a fixture when purchased by Company because the transaction is exempt regardless of such a determination.

¹ Subsection 724 exempts the sale of components used to produce energy from renewable energy sources, including photovoltaic energy systems.

For purposes of completeness, we also note that Contractor is entitled to a sale-for-resale exemption for its purchase and use of component parts used to construct the System if the System is not a real property fixture, regardless of whether the components are exempt under the Renewable Component exemption. Conversely, Contractor is not entitled to the resale exemption if the contract is for the building of a real property fixture, but Contractor is entitled to the Renewable Component exemption if Contractor's purchases from suppliers are of qualifying components. For example, Company represents that Contractor purchases solar modules that meet the statutory definition of "solar modules." As such, Contractor's purchases of these modules are exempt because the Renewable Component exemption applies to all purchases, not just purchases by the ultimate consumer. However, Contractor cannot claim the Renewable Component exemption if Contractor is purchasing from suppliers only the parts of qualifying components and not the components themselves. This is true even if the parts, when assembled, become qualifying components.

We next turn to the issue of whether the various components of the System qualify as "components" under subsection 724. Company represents that the System is solely comprised of those items specifically identified in subsection 724, except for an on-site monitoring system, which we discuss below. Based on this representation, we rule that Company's purchases of components that are specifically listed in subsection 724 are exempt.

With respect to the on-site monitoring component, we find that it does not qualify as a "component." We first consider the statutory terms. Subsection 724(2)(b)(I) identifies the following components as exempt: wind turbines, rotors and blades, solar modules, trackers, generating equipment, supporting structures or racks, inverters, towers, and foundations, balance of system components such as wiring, control systems, switchgears, and generator step-up transformers, and concentrating solar power components that include, but are not limited to, mirrors, plumbing, and heat exchangers. Subsection 724(2)(b)(II) then lists components that are not exempt: any component beyond the point of a generator step-up transformer located at the production site,² labor, energy storage devices, and "remote monitoring" systems. The term "on-site monitoring system" is not found in either category, but would appear at first blush to be similar to the remote monitoring system listed in the non-qualifying equipment list.

Company argues that its on-site monitoring system is not a "remote monitoring" system as this term is used in subsection 724(b)(II). Company represents that "remote monitoring" systems are those used by large commercial wind and solar energy generation facilities to monitor and operate generation equipment from facilities separate from the generation site. Company represents that most large solar and wind generation facilities use sophisticated "supervisory control and data acquisition" (SCADA) systems enabling employees to monitor system performance and to make

² Company represents that a generator step-up transformer is typically used in commercial settings and is not used in its System for residential homes. Thus, there is no reference point to determine whether the on-site monitoring component is located beyond such a generator.

necessary adjustments, all from remote locations. In distinction to remote monitoring systems, the on-site monitoring system at issue here is part of the on-site meter and provides lessees with information regarding the amount of electricity that their system generates. In some cases, these on-site monitors can also send this information to Company through lessee's Internet connection, but the Company cannot control the System.

We agree that the "remote" monitoring component listed in subsection 724(b)(II) suggests a component that is not located on the System's premises. In this case, Customer is the principal user of the on-site monitoring component. This monitoring system allows the Customer to determine the amount of electrical energy being used by the System and make decisions related to when and what household appliance should be used. Customers also use this component to track sales of electrical energy to electricity utilities. Although Company may make use of the data, it is not the component's predominant function. Thus, we find that this on-site monitoring system is not a remote monitoring system as used in subsection 724(2)(b)(II).

However, the lists of qualifying and non-qualifying equipment are not exclusive.³ We must still determine if the on-site monitoring component more accurately falls within the qualified components category or within the non-qualifying components category. And in this inquiry, we are guided by at least two well-established rules for interpreting statutes. First, exemptions are narrowly interpreted. *Regional Transp. Dist. v. Charnes*, 660 P.2d 24, 25 (Colo. App. 1982). Second, taxpayer has the burden of establishing that the transaction clearly falls within an exemption. *General Motors v. City and County of Denver*, 990 P.2d 59 (Colo. 1999).

The common thread between these lists is that qualifying components are those that are directly used for the production of electricity. This is a common criterion used to evaluate whether the sale or use of tangible property is exempt in a host of other settings. For example, machines and machine tools used in manufacturing are exempt; however, manufacturing involves a variety of machines and equipment and not all are exempt. Equipment that is not directly used in the manufacturing process (e.g., computers used by administrative staff of a manufacturing company) is not exempt even though the equipment may have some connection to the manufacturing process.⁴

We are impressed by the fact that the System is largely, if not completely, automated and does not require a monitoring device in order to operate. Indeed, the monitoring component does not control or operate the System. Rather, the monitor performs an administrative function of recording energy sales to the utility and providing information

³ "Components used in the production of alternating current electricity from renewable energy source' shall include, but are not limited to, ..."

⁴ §39-26-709, C.R.S. See, also, §39-26-719(1)(d), 2(c) and 3(c) (items directly used in farm operations); Special Regulation 2, Agricultural Producers (land directly used in agricultural operation); §39-26-401(4) (equipment directly used in biotechnology research); §39-26-601(1) (property directly used in research and development) (repealed); §39-26-713(2)(e)(l)(B) (property directly used in processing of food).

to the Customer regarding when best to use household appliances. This administrative function is too attenuated from the operational needs of the System to qualify as an exempt Renewable Component. Therefore, we conclude that the on-site monitoring system is not a qualified component.

Although the on-site monitoring system is not exempt under the Renewable Energy exemption, Company is not liable for sales or use tax when it acquires this on-site monitoring component from Contractor, again for two alternative reasons. If the contract between Contractor and Company is a sale of tangible personal property, then Company and Contractor are entitled to a sale for resale exemption because Company resells the component when it leases it to the Customer. On the other hand, if the contract between the Contractor and Company is for the installation of a real property fixture, then the Company has not purchased tangible personal property from the Contractor. In this latter case, however, the Contractor is liable for use tax when it acquires and installs the on-site monitoring system on Customer's home.

2. Company's lease of the System to Customers is exempt from sales and use taxes under the Renewable exemption, except for the lease of the on-site monitoring component.

Leases⁵ of tangible personal property for more than three years are treated as sales and are subject to sales and use taxes, unless the lease is otherwise exempt. If the System remains tangible personal property after it is installed on the Customer's premise, then the lease of the System is exempt, except with respect to the on-site monitoring component, because the System qualifies under the Renewable Energy exemption. Similarly, Company's sale to, and Customer's use of, the System at the end of the lease is also exempt under the Renewable Component exemption, except for the on-site monitoring component.

Customer must pay, and the Company must collect, sales tax on the lease price of the on-site monitoring system and purchase price of the on-site monitoring system if lessee exercises its option to purchase the component at the expiration of the lease. Company must calculate this price, which must include a reasonable markup from the cost of this component, and separately state the price for this item on the Customer's invoice or contract. Alternatively, Company can pay use tax on the fair market value of the on-site monitoring component. The on-site monitoring component is inconsequential in value in relation to the overall price of the System. For this reason, the Department will allow the seller to pay use tax on this taxable item. Under this alternative approach, the Department does not have an objection if this use tax is passed on to Customer as a matter of contract.

⁵ We do not determine whether the lease at issue is a true lease or a finance lease (i.e., credit sale) in which the lease and retention of title are merely security interests held by Company. The distinction is largely irrelevant except when the seller factors the finance lease. See, generally, §39-26-111, C.R.S.; GIL-08-023 and GIL-11-013.

If the System is a real property fixture, including the on-site monitoring system, then the lease is not subject to sales or use taxes because these taxes apply only to personal property. However, and as discussed above, Contractor's purchase of the on-site monitoring system is subject to sales or use tax if the System is a real property fixture.

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes.

This ruling is premised on the assumption that the Church has completely and accurately disclosed all material facts. The department reserves the right, among others, to independently evaluate Church's representations. This ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

Enclosed is a redacted version of this ruling. You have previously reviewed and stated you have no comment or objection to the redaction.

Sincerely,

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