COLORADO
Department of Revenue
Taxation Division

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GIL-18-002

January 30, 2018

XXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXX
Sent via email: XXXXXX

Re: Sales Tax on Monthly Charges for Energy Savings Technology

Dear XXXXXXXXXXXX,

You submitted on behalf of XXXXXXX ("Company") a request for a general information letter regarding the applicability of sales tax to Company's charges for energy saving technology. In prior communications on this issue, the Department recommended Company request a private letter ruling because of the specificity requested in the request for guidance. Company indicated that it may pursue such a ruling but would make that determination after it reviews guidance pursuant to a general information letter. This is a general information letter in response to Company's request.

Background

Company purchases energy efficiency technology from a vendor, to whom Company pays applicable state and local sales taxes. The technology is installed at the customer's location by third-party contractors who are licensed by Company. Customers pay Company a charge, which is described by Company as a "subscription." The contract is effective for a predetermined period of time during which the technology is guaranteed to operate within specified parameters. Customers may have the option to purchase the technology at the end of that period. Company states that it does not guarantee customers will have energy savings but only that the technology will "function or perform" within specified parameters. For example, in the case of lighting technology, Company does not guarantee that the customer will have reduced energy costs but only that the lighting will have a specified "lumen output and wattage delivery for each area of the building."

Company represents that it "retains title, ownership and control of the technology at all times." Company represents that customers do not gain possession or control of the technology because the contract provides strict guidelines about how the equipment can and cannot be used and, more specifically, that customers cannot alter or maintain the technology. The technology is not permanently attached to the customer's premises and can be removed.

Issue

Is Company's subscription charge subject to sales and use tax?

Discussion

Colorado levies sales and use taxes on either the purchase or rental of tangible personal property, but generally not on services.[1] A lessor pays tax on purchases of property if the lessor subsequently rents the property to lessees for three years or less (short term lease), unless the lessor obtains permission from the Department to collect sales tax on lease payments rather than on its purchase of the property.[2] Sales tax is always imposed on lease payments, rather than on lessor's purchase of the property, if the lease term is more than three years (long term lease).[3] If a company is providing a service, it must pay sales or use tax when it acquires property used to provide the service.

The question raised in this request for guidance is whether Company is providing a nontaxable service to customers or engaging in the taxable rental of tangible personal property.[4] Differentiating between these types of transactions can be difficult in some circumstances. The Department will typically examine a number of factors in making its determination. The Department notes at the outset that Company represents that it retains title and ownership of the technology. Although retention of title and ownership may distinguish a sale of goods from a sale of services, retention of title and ownership is not relevant when, as here, the issue is whether the Company is providing a service or renting property.

One of the most common factors the Department considers is whether the customer has control over the property.[5] For example, a charge for the use of a truck is subject to tax because the customer controls the truck.[6] On the other hand, the transaction is more likely viewed as a nontaxable service of shipping if the company also provides a driver because the company is in control of the truck.

Although control of the property is a factor considered by the Department, it is not determinative. For instance, a rental company may rent property only on the condition that the customer not alter, repair, or perform maintenance on the rented property, or permit such work only by persons trained to perform such work. These limitations on the right to control the equipment do not necessarily mean that the contract is one for a non-taxable service.

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[1] Charges for service can be included in the calculation of tax on a taxable transaction if the service is inseparable from the sale or rental of taxable property and the true object of the transaction is the sale of taxable goods or, if the service is separable from the sale of goods, the charge for the service is not separately stated.

[2] §39-26-713(a), C.R.S.

[3] §39-26-102(23), C.R.S.

[4] The Department assumes for purposes of discussion that the contract period for the subscription is greater than three years because, if the contract period is three years or less, then tax is imposed on the Company when it acquires the property, regardless of whether the subscription is treated as the sale of a service or as a short term rental of property.

[5] See, e.g., GIL 14-018, GIL 09-029

[6] This assumes that the lessor has, as is typically the case, permission to collect tax on lease payments.

Moreover, control becomes significantly less relevant when the property operates autonomously. For example, a rental company may rent an electrical generator, which runs autonomously and requires only fuel and periodic maintenance. The lease of the generator may be a taxable rental of property and not a service.[7] Similarly, energy saving technologies may operate autonomously and require little or no maintenance.

Related to the issue of autonomy and control is whether the operation of the property requires special expertise. In such cases, control of the property may rest with the party who has such expertise. It should be noted that the expertise to install or maintain the property is not the same as the expertise to control or modify the property, which may be relevant. For example, a business may rent a large printer and agree that only a certified technician with proper training and expertise can install, service, and repair the printer, but this expertise does not make the entire transaction one for services.

The location of the property can also be relevant in determining who has control of the property. Property located at the lessor's premises is more likely viewed as controlled by the lessor and, conversely, property located at the customer's location is more likely viewed as controlled by the customer. In addition, the degree of integration may be indicative of who has control of the property.

The question of whether there is a service or rental of property is often framed in terms of the customer's true object: is the customer's true object of the transaction to acquire a service or to acquire property?[8] This test, however, is applied only in those cases where the sale of the service is so intertwined with the property that the two are inseparable. Inseparable in this context means that the property and services are so intertwined that they are essentially unusable in the absence of the other. The fact that a customer can purchase the property at the end of a contract may suggest the property and services are separable.

If the service and property are inseparable, then the true object test is used to determine if the transaction is primarily for a service or for the rental of property. This true object test considers whether the service component of the transaction predominates and the property merely is incidental to that service.[9] Ultimately, the true object test is based on what is commonly understood to be a service or a rental of property.

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

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[7] See, e.g., GIL 07-013 (electrical generator as taxable rental property).

[8] See, e.g., Special Regulation 1 C.C.R. 201-5: SR 40 (Service Enterprises). However, the true object test applies only after it is first determined that the sale of the goods is inseparable from the sale of services. If they are not inseparable, then tax applies to the entire purchase price if the price for the service is not separately stated. See, also, *AD Stores v. Colorado Department of Revenue*, 19 P.3rd 680 (Colo. 2001)

[9] See, footnote 6.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/tax for more information about state and local sales taxes.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted letter.

Sincerely,

Neil Tillquist
Colorado Department of Revenue
Office of Tax Policy & Analysis