TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #95-38

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Applicability of Tennessee gross receipts tax provisions to a corporation's supply of steam, electricity and river water to a joint venture with which it is associated.

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

[THE TAXPAYER] is a corporation, with headquarters in [COUNTY], Tennessee**,** and is principally engaged in the [BUSINESS]. [THE TAXPAYER] has entered

into a 50/50 joint venture with [THE COMPANY] to build a modern [BUSINESS] facility at [THE TAXPAYER]'s [NAME] plant site in [COUNTY], Tennessee**.**

That site was chosen over other available worldwide sites by the [TAXPAYER AND THE COMPANY] ("Venture") due to cost advantages realized from locating close to raw material supplies and the availability of support services and facilities from [THE TAXPAYER]'s Division. Venture's participants chose the business form (joint venture partnership) for business reasons.

The [BUSINESS] facility built by Venture is part of the larger plant site owned by [THE TAXPAYER] and utilized by the corporation in connection with its business of [MANUFACTURING]. The cellulose acetate facility is operated under contract by [THE TAXPAYER]'s employees pursuant to the contract between Venture and [THE TAXPAYER]. The facility's output is split between [THE TAXPAYER AND THE COMPANY] pursuant to their contract.

The [BUSINESS] facility, like other manufacturing operations at the [COUNTY] plant site, obtains steam, electricity and river water from [THE TAXPAYER]'s Division. These services are produced at the [THE TAXPAYER]'s plant primarily for consumption in connection with [THE TAXPAYER]'s own internal manufacturing operations and secondarily for use by Venture in the manufacturing operations conducted by the latter pursuant to the contract between the partners of Venture.

For accounting purposes, [THE TAXPAYER] charges the cost of production to the manufacturing operation which uses the service. Thus, since Venture uses certain steam, electricity and river water services supplied by [THE TAXPAYER] in connection with Venture's [MANUFACTURING] facility operations, [THE TAXPAYER] "charges" the allocable cost to Venture**.**

Other facts provided by [THE TAXPAYER] in connection with this letter ruling request include the following:

1) Venture is a general partnership which is managed and run by employees of both partners and has no employees of its own. Venture is governed by the Uniform Partnership Act of the State of [NOT TENNESSEE] and each partner has a 50% (fifty percent) interest. Its partners contributed consideration of approximately equal value. [THE TAXPAYER] is responsible for operating the facility.

2) [THE TAXPAYER] owns the land on which the plant was built and leases the land to the Industrial Development Board of [TENNESSEE COUNTY], who in turn sub-leases the land to Venture. The term of the lease is [NUMBER]ten years subject to termination under certain conditions and with proper written notice.

3) Venture has reported its activities to the Internal Revenue Service by utilization of the federal partnership return form (Form 1065).

4) Costs for utilities are required by the agreements to be billed on the same basis as are used to bill internal [THE TAXPAYER] manufacturing operations. The agreements recognize that certain of the utilities might not be provided directly by [THE TAXPAYER], but are arranged by [THE TAXPAYER] from third parties. The charge for such utilities provided by third parties is the actual cost charged to [THE TAXPAYER] by the supplier of such utilities.

5) Meters to determine quantities of utilities are used whenever reasonably possible. In the absence of such meters, the quantity is estimated by [THE TAXPAYER] on the basis of good-faith engineering estimates.

6) The buildings and personal property are owned by the Industrial Development Board of [TENNESSEE COUNTY] and leased to Venture.

7) Venture is registered for Tennessee sales and use tax.

8) One of the items on which [THE TAXPAYER] is currently paying gross receipts tax is steam. ([THE TAXPAYER] included this item as a taxable receipt only after telephone contact was made with the Department of Revenue to help clarify [THE TAXPAYER]'s status relative to the gross receipts tax.)

ISSUES

1. Does T.C.A. § 67-4-406 subject [THE TAXPAYER] to Tennessee gross receipts tax?

2. Is [THE TAXPAYER] subject to Tennessee gross receipts tax upon its supply of steam, electricity and/or river water to Venture?

RULINGS

1. No.

2. [THE TAXPAYER] is subject to Tennessee gross receipts tax upon its supply of electricity and river water to Venture pursuant to T.C.A. § 67-4-405(a)(1). [THE TAXPAYER] is not subject to Tennessee gross receipts tax upon its supply of steam (water vapor) to Venture under either T.C.A. § 67-4-405(a)(1) or (a)(2).

ANALYSIS

1. T.C.A. § 67-4-406 is a statute which provides generally for a gross receipts tax on each public utility, other than those specifically enumerated and taxed under another section of the privilege tax part of the Tennessee taxing statutes (Title 67, Part 4). Thus, the only taxpayers affected by the statute are public utilities, and more specifically, only those public utilities which are not taxed elsewhere in the Tennessee privilege tax statutes.

The privilege tax statutes fail to define "public utility." However, T.C.A. § 65-4-101 provides a detailed definition of that term in the context of establishing the state regulatory system of public utilities by the Tennessee Public Service Commission. The definition provided there generally relates to public functions such as businesses, operations, properties or facilities which are ". . . affected by and dedicated to the public use . . ."

"Public utility" has been defined as "a business or service which is engaged in regularly supplying the public with some commodity or service of public consequence, such as electricity, gas, water, transportation, or telephone or telegraph service." 64 Am Jur. 2d Public Utilities, § 1.

Black's Law Dictionary defines "public utility," in part, as follows:

> A privately owned and operated business whose services are so essential to the general public as to justify the grant of special franchises for the use of public property or the right of eminent domain, in consideration of which the owners must serve all persons who apply, without discrimination. It is always a virtual monopoly.

Black's Law Dictionary, 6th Edition, p.1232.

In view of the definitions cited above, it is reasonable to conclude that the legislature intended that the taxing statute be applied only to businesses which provide some essential commodity or service to the general public rather than on a specific contract basis. Such construction would also be consistent with the principle that statutes imposing taxes should be strictly construed. See 23 Tenn. Jur. Taxation, § 3.

Therefore, [THE TAXPAYER] is not a public utility under T.C.A. § 67-4-406 which would be subject to the gross receipts tax thereunder.

2. **T.C.A. § 67-4-405**

The Tennessee statute deserving closest analysis in connection with the question concerning [THE TAXPAYER]'s supply of steam, electricity and river

water to Venture is clearly T.C.A. § 67-4-405. To facilitate analysis, the applicable portions of the statute are quoted below:

> 67-4-405. Gas, water and electric companies**.**
> (a) (1) Each person engaged in the business of furnishing or distributing gas, water, or electric current, whether to a dealer, consumer, municipality or other customer, shall, for the privilege of doing such business, pay to the state for state purposes an amount equal to three percent (3%) of the gross receipts derived from intrastate business in the state.
> *(*a) (2) Persons engaged in the business of manufacturing gas or of distributing manufactured gas or natural gas shall, in lieu of the foregoing, pay an amount equal to one and one-half percent (1.5%) of the gross receipts derived from intrastate business in this state, which payment shall be subject to the same provisions, restrictions and credits hereinafter provided in this section.
> (b) This tax does not apply to cities or other political subdivisions of the state owning and operating gas companies, water companies or power plants, nor does it apply to any governmental agency of the United States.
> (c) It is the intention of this section to levy a tax for the privilege of engaging in intrastate commerce carried on wholly within this state and not a part of interstate commerce.

It must first be noted that section headings or "catchlines" must not be considered to be law nor are they to be interpreted as a component of the law. T.C.A. § 1-3-109 states that "[h]eadings to sections in this code . . . shall not be construed as part of the law."

According to the Tennessee Code Annotated User's Guide, found in the front of each volume of Tennessee Code Annotated, T.C.A. headings or "catchlines" are developed by the Tennessee Code Commission and the publisher - not the Tennessee legislature - and generally give no more information than is necessary to distinguish one section from others which might be consulted. See Tennessee Code Annotated User's Guide, Section Headings at page xiii.

Thus, the heading "Gas, water and electric companies" found in T.C.A. § 67-4-405 cannot be considered as part of the law which would either supersede the specific language of the statute or even affect the interpretation of the statute.

The language of T.C.A. § 67-4-405(a)(1) itself fails to reflect any indication that only companies typically considered or thought of as "gas, water or electric companies" would be subject to the tax. Instead, the statutory language simply defines, in general, the types of business activities which would trigger a privilege tax liability - specifically, the furnishing or distribution of gas, water or electric current.[1]

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[1] The Department finds no support in the statute for the notion, suggested by [THE TAXPAYER] in its September 14, 1994 letter to Thomas R. Bain, that the gross receipts tax - at least the tax provided in

The approach used by the legislature to establish the gross receipts tax in T.C.A. § 67-4-405(a)(1) seems to negate any intent to impose the tax only upon companies traditionally considered to be gas, water or electric companies. The statute, rather than describing the companies which would be subject to the tax, delineates the nature of the business operations which are subject to the privilege tax. This formula for taxation is in direct contrast to that used by the legislature in T.C.A. § 67-4-406, where the tax is imposed on "each public utility."

Considering the above analysis, it appears that [THE TAXPAYER] furnishes the services listed in T.C.A. § 67-4-405(a)(1) to others as a part of its current business operations since the cellulose acetate facility operated by Venture obtains electricity and river water from [THE TAXPAYER]'s Division (See **ANALYSIS, Section 2, Steam, Electricity and River Water,** below).

Analysis of T.C.A. § 67-4-405 indicates that neither the exclusions of subsection (b) nor the exemption of subsection (c) would be applicable to the facts presented here.

Subsection (b) states that the tax does not apply to cities or other political subdivisions of the state owning and operating gas companies, water companies or power plants, nor does it apply to any governmental agency of the United States. [THE TAXPAYER]'s supply of services to Venture clearly does not fit into the category of any of these governmental operations and is not thereby excluded.

Subsection (c) indicates that the tax is levied for the privilege of engaging in intrastate commerce carried on wholly within this state and not a part of interstate commerce. Since [THE TAXPAYER]'s provision of services to Venture both originates and is completed in [COUNTY], Tennessee, this "exemption" would not apply.

[THE TAXPAYER] asserts that it is not "in the business" of selling services (steam, electricity and river water) to external customers and therefore is not subject to the tax of T.C.A. § 67-4-405. However, the facts indicate plainly that, pursuant to contract with Venture, [THE TAXPAYER] provides steam, electricity and river water to Venture, and Venture is charged an amount equal to the cost allocated by [THE TAXPAYER] to those services. Nowhere does the statute indicate that the provision of the listed services must be the primary business - or even a significant business in absolute or relative terms - of the person providing the services.

It may be asserted that Venture has a special relationship with [THE TAXPAYER], which results from the partnership agreement between [THE

T.C.A. § 67-4-405(a)(1) - is a privilege tax levied on "gas, water and electric companies" for the exclusive right to sell utilities within defined service districts (emphasis provided).

TAXPAYER AND THE COMPANY]. Additionally, [THE TAXPAYER] merely charges for its allocable cost of the services provided rather than including a margin for profit**.** However, T.C.A. § 67-4-405(a)(1) simply states that the furnishing or distributing of certain specified services to a "dealer, consumer, municipality or other customer" subjects the provider to the tax on gross receipts. Neither the special partnership relationship nor the lack of profit margin attached to the provision of services makes Venture any less a "customer" of [THE TAXPAYER] under the statute with respect to the services provided.

Both the partnership (Venture) and each of its partners [THE TAXPAYER AND THE COMPANY] consider themselves to be separately identifiable entities in virtually all respects.

For example, [THE TAXPAYER] contracts with Venture for the operation of the [BUSINESS] facility. [THE TAXPAYER] charges Venture for the use of steam, electricity and river water services and that charge is equal to the cost allocation performed internally by [THE TAXPAYER]. [THE TAXPAYER] owns the land on which the facility was built and leases it to the Industrial Development Board of [TENNESSEE COUNTY], who in turn sub-leases it to Venture. The buildings and personal property connected with Venture's operations are owned by the Industrial Development Board of [TENNESSEE COUNTY] and leased to Venture. Finally, Venture is separately registered for Tennessee sales and use tax.

Since [THE TAXPAYER] and Venture consider themselves separately identifiable entities, Venture is therefore [THE TAXPAYER]'s "customer" of services provided and taxation of [THE TAXPAYER] gross receipts generated on the services listed in T.C.A. § 67-4-405(a)(1) is authorized**.**

This tax treatment is consistent with the current trend of the law to treat a partnership as an entity in and of itself. See 20 Tenn. Jur. Partnership, § 2.

Additionally, the Tennessee courts have acknowledged that, where the parties dealt with and treated the partnership as if it were an entity separate and distinct from the individuals composing it, the intention of the parties can only be given effect in the enforcement of the contract by judicial recognition of the partnership entity as contemplated by the parties. United States Fid. & Guar. Co. v. Booth, 45 S.W.2d 1075 (Tenn. 1932).

Finally, to subject a partner to taxation in connection with its transactions with the partnership is supported by an opinion of the Tennessee Attorney General concerning the taxation of partnerships. (See Op. Atty. Gen. 83-443, October 3, 1983, in which the Attorney General opined that a partnership should be treated as a separate legal entity in Tennessee for purposes of taxation.)

Steam, Electricity and River Water

[THE TAXPAYER] provision of electricity to Venture clearly constitutes the furnishing of electric current to a customer pursuant to T.C.A. § 67-4-405(a)(1). Therefore, it is subject to the privilege tax on gross receipts provided in that statute.

"River water" is not specifically listed as a service the distribution of which subjects the provider to the privilege tax under T.C.A. § 67-4-405(a)(1). However, the statute makes no reference to the source of water (e.g., river water, lake water, ocean water, water distilled from another substance, or even water obtained by the distributor from another source, such as a third party contractor) when it refers to businesses subject to the gross receipts tax.

Therefore, it must be presumed that the legislature considered the source of the water immaterial to the determination of whether the business of furnishing or distributing water is subject to taxation. Thus, the furnishing or distribution of all water, from whatever source, is business subject to the tax under T.C.A. § 67-4-405 (a)(1).

Steam is generally thought of as the vapor or gas form of water. However, it may also be the vapor or gas arising from some heated substance or liquid.

Steam which is simply water in its vapor or gaseous form is still water. Thus, an argument could be made that [THE TAXPAYER]'s business of furnishing "water vapor" steam to Venture for the latter's use in the cellulose acetate facility is a business subject to the privilege tax provided in T.C.A. § 67-4-405(a)(1).

However, general rules of statutory construction prevent strained interpretations of statutes which extend the law beyond their plain language, and taxing statutes, in particular, are not to be overextended. The court, in National Gas Distributors, Inc. v. State, stated the following:

> In interpreting statutes, the legislative intent must be determined from the plain language it contains, read in the context of the entire statute, without any forced or subtle construction which would extend or limit its meaning. See Metro. Government of Nashville, etc., v. Motel Systems, Inc., 525 S.W.2d 840, 841 (Tenn. 1975). Statutes levying taxes or duties on citizens will not be extended by implication beyond a clear import of the language used, nor will their operation be enlarged so as to embrace matters not specifically named or pointed out. Doubts as to the application of tax statutes will be resolved in favor of the citizen and tax statutes will be construed most strongly against the State. (Citations omitted). Union Carbide Corp. v. Alexander, 679 S.W.2d 938, 942 (Tenn. 1984).

National Gas Distributors, Inc. v. State, 804 S.W.2d 66, 67 (Tenn. 1991).

Had the legislature intended to subject the business of furnishing or distributing "steam" to taxation under T.C.A. § 67-4-405(a)(1), it could have done so by including it in the statutory list of services the distribution business of which was clearly subject to tax. Since it did not do so, [THE TAXPAYER]'s furnishing of steam to Venture would not be business which is subject to the tax under the statute.

It should be noted, however, that T.C.A. § 67-4-405(a)(2) provides for a tax upon persons engaged in the business of manufacturing gas or of distributing manufactured gas or natural gas equal to 1.5% of the gross receipts derived therefrom and that this tax is to be in lieu of the 3% tax provided in T.C.A. § 67-4-405(a)(1).

In the National Gas Distributors case cited above, the Tennessee Supreme Court concluded that the legislative reference to "natural gas" in T.C.A. § 67-4-405(a)(2) was intended to mean "natural gas transmitted and distributed through pipelines to the ultimate consumer." Id., at 67. "Manufactured gas" is defined as "a gaseous fuel made from various petroleum products or from soft coal." The American Heritage Dictionary, 764 (1985). The business of "manufacturing gas," although not specifically defined in the Tennessee taxing statute itself, simply appears to be the activity of producing "manufactured gas."

It is the Department's understanding that the steam furnished by [THE TAXPAYER] to Venture is merely the vapor or gaseous form of water. Therefore, the steam supplied could clearly not be categorized as either "natural gas" or "manufactured gas" as defined above and the tax provided by T.C.A. § 67-4-405(a)(2) would not be applicable.

CONCLUSION

Therefore, [THE TAXPAYER] provision of electricity and river water to Venture is subject to the gross receipts tax provided in T.C.A. § 67-4-405(a)(1) and [THE TAXPAYER]'s gross receipts are equal to its charges to Venture for the provision of these services.

However, since there is no gross receipts tax due under T.C.A. § 67-4-405(a)(1) or (a)(2) upon [THE TAXPAYER]'s supply of steam (water vapor) to Venture, any tax previously paid by [THE TAXPAYER] upon that activity would be refundable to [THE TAXPAYER].

Thomas R. Bain
Tax Counsel

APPROVED: Ruth E. Johnson
Commissioner

DATE: 10/16/95