



COMMONWEALTH of VIRGINIA
Department of Taxation

MEMORANDUM

TO: Lawrence Durbin, Assistant Tax Commissioner
Office of Customer Services

Robert Schultze, Assistant Tax Commissioner
Office of Compliance

FROM: Howard T. Macrae, Jr., Assistant Tax Commissioner
Office of Tax Policy

DATE: April 21, 1999

SUBJECT: § 58.1-609.3(3): Retail Sales and Use Tax
Virginia Electric and Power Company v. State Corporation Commission,
219 Va. 894 (1979)

This memorandum is to advise you of information concerning the application of the retail sales and use tax exemption for public utilities. Specifically, the court case Virginia Power and Electric Company v. State Corporation Commission, 219 Va. 894 (1979), which has been cited by auditors and Tax Policy for the purpose of applying the sales tax exemption for public utilities, should no longer be cited for the proposition that tangible personal property used to provide residential outdoor lighting does not qualify for the sales tax exemption. This memo will outline the background of the case and the reasons for the change.

Background of the Case

The court case between Virginia Electric and Power Company (VEPCO) and the State Corporation Commission (SCC) focused on the issue of whether the outdoor lighting service provided to residential customers under Schedule 26 was offered pursuant to the public utility function of VEPCO. The SCC determined that outdoor lighting provided by VEPCO to residential customers was not a part of its public service and should not be included in their rate base. The court affirmed the Commission's power to determine that outdoor residential lighting was not a public utility function.

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Prior Application of Case for Sales Tax Purposes

Title 23 of The Virginia Administrative Code 10-210-3020 provides that the availability of the sales and use exemption under Code of Virginia § 58.1-609.3(3) is determined according to the utility's use of an item in the rendition of a public service. If an item is used directly in an activity the cost of which is recoverable by a utility through the rate making process, the exemption applies.

The decision in the VEPCO case has been cited by auditors and Tax Policy for the proposition that tangible personal property used to provide outdoor lighting is not used directly in the rendition of a public utility's public service because the costs are not recoverable through the rate base of a public utility. Consequently, tangible personal property used to provide outdoor lighting does not qualify for the sales tax exemption provided in Code of Virginia § 58.1-609.3(3).

SCC Overturns Prior Decision

In March 1988, the General Assembly passed House Joint Resolution No.129 requesting that the SCC study the desirability of authorizing VEPCO to provide outdoor lighting facilities for safety and security to residential customers pursuant to a regulated tariff. The SCC authorized VEPCO (now Virginia Power), under Schedule 27, to offer outdoor lighting service for safety and security purposes to residential customers for one year. The study revealed that residential customers desired outdoor lighting for safety and security purposes. As a result, in October 1990, the SCC ordered that Schedule 27 (residential outdoor lighting) be approved on a permanent basis. In essence, the SCC overturned its prior decision to remove residential street lighting from VEPCO's public service obligations.

Accordingly, tangible personal property used by Virginia Power in providing residential outdoor lighting, the cost of which is recoverable through the rate making process, is used directly in the rendition of its public service. Thus, the property is exempt from sales tax under Code of Virginia § 58.1-609.3(3).

Auditing Electric Utilities

In a recent appeal addressed by Tax Policy, the auditor cited the VEPCO court case as a basis for holding taxable street lights provided to residential customers by an

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electric cooperative. In researching this case, our discussions with the SCC revealed that each utility has a separate schedule approved by SCC for determining the base rate upon which a utility is entitled to a rate of return. The VEPCO case addressed a specific schedule for rate making purposes applicable to VEPCO only and had no bearing on other public utilities. Therefore, the VEPCO case had no bearing on the application of the tax to residential outdoor lighting provided by the electric cooperative.

In future audits, the department should obtain a copy of the schedule for rate making purposes from the SCC for each electric utility being audited. The SCC makes the determination regarding which items may be included in a utility's rate making process based on the utility's use of the item. The rate making schedule must be reviewed to determine if a specific activity (including residential outdoor lighting) is included in that particular utility's rate base. If an activity is included in the utility's rate base, the tangible personal property used directly in such activity will be deemed to be used in the rendition of the utility's public service and will qualify for the sales tax exemption under § 58.1-609.3(3).

If you have any questions about this issue, please contact Brenda Breeland in Office of Tax Policy at 367-2737.

c: Danny M. Payne
Tax Policy Staff

Enclosures (3)

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