

Commonwealth of Kentucky
Court of Appeals

NO. 2017-CA-001653-MR

DEPARTMENT OF REVENUE,
FINANCE AND ADMINISTRATION CABINET,
COMMONWEALTH OF KENTUCKY

APPELLANT

v. APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE THOMAS D. WINGATE, JUDGE
ACTION NO. 16-CI-01075

RENT-A-CENTER EAST, INC.;
AND RENT-WAY, INC.

APPELLEES

OPINION
AFFIRMING

** ** * * * * *

BEFORE: JONES, LAMBERT, AND K. THOMPSON, JUDGES.

THOMPSON, K., JUDGE: Customers of Rent-A-Center, East and Rent-Way,

Inc.¹ may purchase optional liability waiver agreements (the waiver) to avoid

¹ Rent-A-Center, East, Inc. and Rent-Way, Inc. merged in 2009. Thus, unless otherwise specified, we will refer to them as Rent-A-Center.

having to pay for lost or damaged rental items under certain circumstances. The question before us is whether the cost of those waivers is subject to Kentucky's six-percent sales tax. Like the Kentucky Board of Tax Appeals² and the Franklin Circuit Court, we conclude the answer is no.

The essential facts are uncontested. Rent-A-Center offers household items, such as furniture and electronics, to the public on a "rent to own" basis whereby a customer obtains possession of the items for a set, periodic rental fee set forth in a written contract. Under the standard terms of the rental agreement, the customer owes Rent-A-Center the fair market value of damaged or lost rented items. Rent-A-Center collects sales tax on the rental fee.

Rent-A-Center also offers written waivers, which relieve the customer from having to pay the fair market value to Rent-A-Center for damaged or lost rental items under specified conditions (such as theft, fire and flood). A customer may decline the waiver without increasing the weekly rental fee or otherwise impacting the customer's rights to the rented property; conversely, a customer does not gain additional rights to the rented property by electing waiver coverage. Rent-A-Center does not collect sales tax on the waiver fee.

² The Kentucky Board of Tax Appeals was subsequently abolished.

The Department of Revenue audited Rent-A-Center and Rent-Way for the tax periods between July 2007 and June 2011. Those audits resulted in issuance of a tax assessment of over \$500,000 for Rent-A-Center (plus interest) and over \$50,000 (plus interest and fees) for Rent-Way due to their failure to collect sales tax on the waiver fees. Both rental entities appealed to the Kentucky Board of Tax Appeals, which eventually concluded the waiver fees were not taxable. The Department filed an action in the Franklin Circuit Court challenging that determination. In September 2017, the circuit court granted summary judgment to Rent-A-Center. The Department then filed this appeal.

Because only questions of law are presented, we review the matter *de novo*. *Estate of McVey v. Department of Revenue*, 480 S.W.3d 233, 240 (Ky. 2015). We begin our analysis by listing the relevant portions of KRS 139.200, our sales tax statute:³

A tax is hereby imposed upon all retailers at the rate of six percent (6%) of the gross receipts derived from:
(1) Retail sales of:
(a) Tangible personal property, regardless of the method of deliver, made within this Commonwealth[.]

³ KRS 139.200 was amended in 2018 and 2019, but those amendments did not change the language quoted herein.

There is no dispute that the rentals qualify as “retail sales” under KRS 139.010(36).⁴ Instead, the primary question is whether the waivers are retail sales of “tangible personal property,” which is defined in KRS 139.010(41) as “personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses and includes natural, artificial, and mixed gas, electricity, water, steam, and prewritten computer software[.]”⁵

Though the parties present voluminous arguments, we cannot materially improve upon the Franklin Circuit Court’s concise, cogent analysis, and so we adopt the following portions of its opinion and order:

The Department concedes that the Waiver is not tangible personal property. A customer who executes the Waiver creates an intangible right, Rent-A-Center’s promise to not pursue legal action in certain situations. . . . The Rental Fee is unaffected at all times by the customer’s choice whether to execute or decline a Waiver. . . . Even if, as the Department states, approximately eighty-five percent of customers opt into the Waiver with their purchase of rental property, approximately fifteen percent are able to obtain their rental property without the Waiver.

This Court is unconvinced by the Department’s “plain language” reading of the Waiver Agreement as a provision of the Rental Agreement. The Waiver may be signed when a customer enters into a Rental Agreement

⁴ Under KRS 139.010(36), “retail sale” is defined as “any sale, lease, or rental for any purpose other than resale, sublease, or subrent[.]” That definition has not changed since 2009, though its location within KRS 139.010 has changed during this litigation.

⁵ The definition of “tangible personal property” has not changed since 2009, though its location within KRS 139.010 has changed during this litigation.

and fees for each agreement may be paid on the same schedule, but the two agreements are not inextricably linked. The Waiver does not interfere with a customer's right to possession or use of his rental property and at no time contributes to the payment of rental property. If the customer damages or loses the rental property, he does not receive a replacement. Executing a waiver entitles the customer to a single consideration from Rent-A-Center, that, if rental property is damaged or lost in certain scenarios, Rent-A-Center will waive claims it might otherwise have available against the customer.

In its Final Order, the Board noted that tax imposition statutes must be narrowly construed. This Court agrees. [See, e.g., *Department of Revenue v. Greyhound Corp.*, 321 S.W.2d 60, 61 (Ky. 1959) (holding that “as a general proposition, taxing statutes must be strictly construed, and doubts be resolved in favor of the taxpayer.”).] The Waiver, an intangible right paid separately from the Rental Agreement, is not subject to sales and use taxation.

Our conclusion is reinforced by the fact that even the Department once agreed with Rent-A-Center. Specifically, the Department did not seek to collect sales tax on Rent-A-Center's waiver fees after conducting a previous audit. Though the Department's arguments in favor of its new stance are not wholly frivolous, we need not delve into them at length because, at their core, they are inevitably based upon an expansive reading of the relevant taxing authorities.⁶

⁶ For example, both sides cite to dueling extraterritorial authorities which support their respective positions. We decline to address those sundry authorities because they are not binding, and the matter can be addressed adequately under Kentucky law.

But, as previously explained, taxing authorities must be narrowly construed and all doubts about taxability should be resolved in favor of the taxpayer. *Id.*

For the foregoing reasons, the Franklin Circuit Court is affirmed.

ALL CONCUR.

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