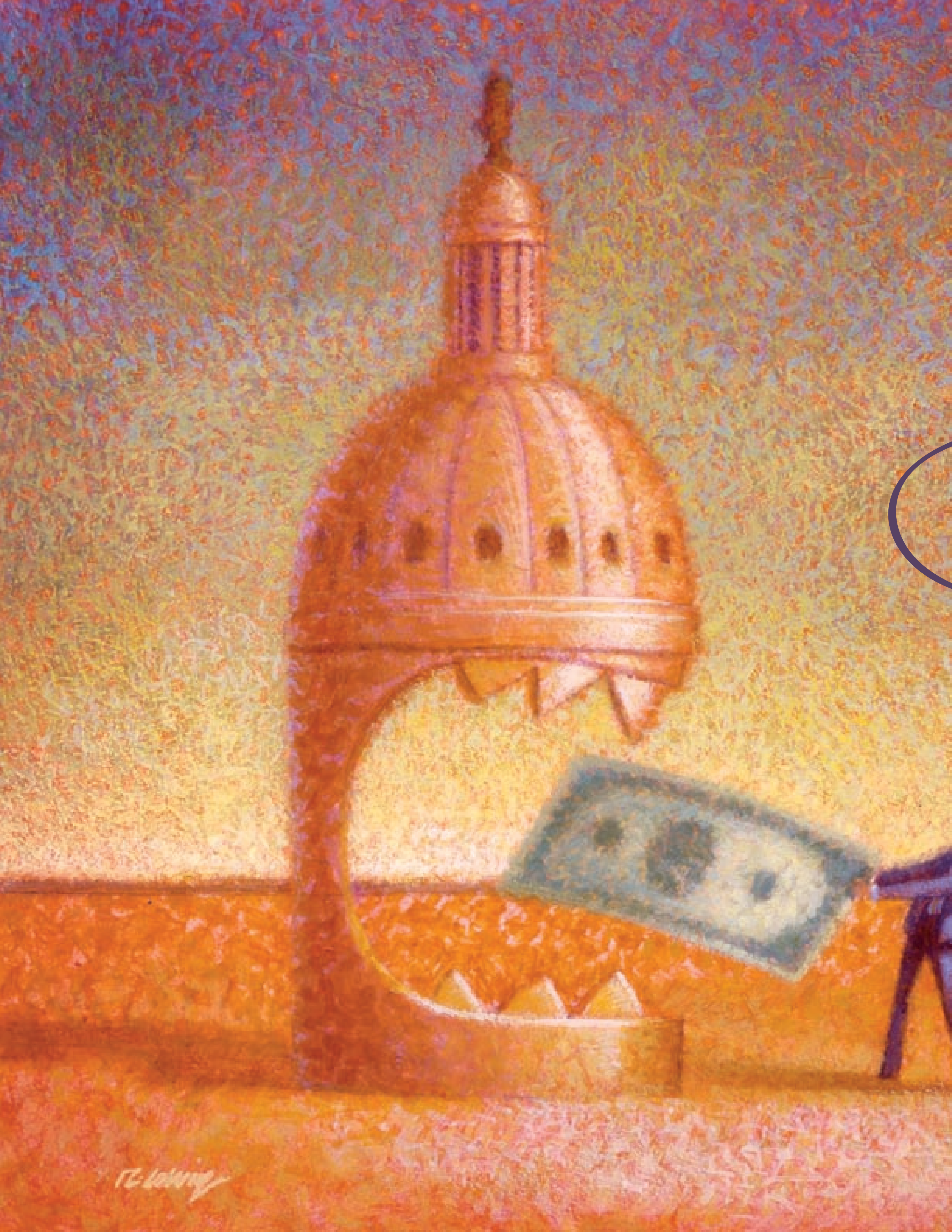

# DEATH and (PERSONAL PROPERTY) TAXES

THIS ARTICLE IS REALLY ABOUT RENT-TO-OWN MERCHANDISE, PARTICULARLY UNITS IN THE FIELD AND PERSONAL PROPERTY TAXES, SOMETIMES CALLED AD VALOREM TAXES, BECAUSE THE TAX IS BASED ON THE VALUE OF THE PROPERTY. IT SHOULD NOT HAVE ANYTHING TO DO WITH DEATH. NO RENTAL DEALER HAS EVER ACTUALLY DIED FROM HAVING HAD TO PAY THE PERSONAL PROPERTY TAX DUE ON UNITS IN THE FIELD, ALTHOUGH A FEW HAVE SUFFERED SEVERE EMOTIONAL DISTRESS WHEN PRESENTED WITH A BILL FOR BACK TAXES, INTEREST AND PENALTIES THAT CAN BE 100 PERCENT OF THE TAX.

By Ed Winn III

Not every state imposes a tax on personal property, although these days, most do. Most often personal property tax is levied on a person's or a business' tangible personal property. There is a separate tax on real property. Taxpayers must fill out a schedule and, as of a certain date each year (often January 1), list the value of all personal property that the taxpayer owns on that date that is not subject to one of the exemptions in the state tax code. Taxpayers must then remit the tax due to the county according to the taxing schedule—a percentage of the declared value of the property.

States have enacted many exemptions to the personal property tax: motor vehicles, personal effects, household furnishings, business inventories, intangibles, etc. Some rental dealers have paid the tax on their idle units only and have left the value of their units out on rent off the return. Not all county tax assessors are familiar with the rent-to-own business and so even under audit, these dealers have avoided paying tax on the value of their units in the field, because the valuation offered by the dealer corresponded roughly with the units on display and in the back room and the auditor left, satisfied.

Other dealers have challenged the premise of having to pay personal property tax on their units held for rental altogether. They have made different kinds of arguments over the years, depending upon the specific wording of the applicable tax provisions. Most often, rental dealers have argued that their rental units qualify for the business inventory exemption—that they are goods held for resale in the ordinary course of business. These arguments have been made in Virginia, Florida, Missouri, Utah, Texas and, most recently, in Indiana. All of these attempts at qualifying for the exemption have failed.

The one state where the argument succeeded was Kansas. The Kansas challenge began in 1991 and was based upon amendments to the tax code that were enacted in 1989. As a result of those amendments, the definitions of "merchant" and "inventory" in the Kansas law are unique. Inventory is defined as "any tangible personal property…which shall have been purchased primarily for resale without modification or change…*and without any intervening use, except that, an incidental use, including but not limited to the rental or lease of any such property, shall not be deemed to be an intervening use*." (The amendment added the language in italics.)

The issue of whether RTO property qualified as inventory under Kansas law bounced around the courts in several different counties, through multiple administrative hearings with multiple rental companies joining the fray and made two trips to the Kansas Supreme Court before finally being resolved in favor of the rental companies in 1999 with the ruling in *Board of Sedgwick County Commissioners v. Action Rent To Own Inc.*, 969 P2d 844 (1999).

The court specifically held that the rental company's rent-to-own merchandise qualifies as inventory and is statutorily exempt from taxation. Even so, in 2000, the Kansas Department of Revenue issued a directive to all county appraisers (No. 99-037), that concluded: "If a county appraiser is in doubt as to whether rent-to-own property is held primarily for sale or for rent in the ordinary of business, he or she should construe in favor of taxation… All relevant facts should be presented to the Board to allow them to make a proper determination." It is apparent that the Department of Revenue did not care for the Supreme Court's reading of the tax code.

To read the briefs in the Kansas litigation is to fall down the rabbit hole and find rental dealers arguing that down is up and that leases are sales for the purposes of interpreting the Kansas property tax code. Some of these arguments were being made at the very same time that Representative Henry B. Gonzalez was holding his infamous hearing in the U.S. House Banking Committee in 1993, "Rent-To-Own: Providing Opportunities or Gouging Customers?" Gonzalez did not allow the industry's doublespeak to pass unnoticed:

"A rent-to-own company is now arguing in a Kansas appellate court that it is in the 'sales' business in order to avoid paying state taxes on rental property… One thing is clear. The industry cannot have it both ways. Rent-to-own operators cannot be lessors in order to evade state usury ceilings and federal disclosure laws, and yet be sellers in order to escape state property taxes."

The industry held its collective breath during those hearings and their aftermath. Having fought long and hard and successfully to prove that rent-to-own trans-

actions were really leases and not disguised sales, the industry could only watch, awestruck, as a handful of Kansas rental dealers threatened the legal status of RTO for the whole country to save a few thousand dollars in local taxes.

Gonzalez was not successful in putting RTO dealers out of business, despite his best efforts. The world did not split in half on account of the Kansas rental dealers. The rent-to-own industry continued to flourish and rental dealers have, from time to time, continued to argue for an exemption to paying personal property taxes on their units in the field, although to date, only the Kansas dealers have been successful. The latest unsuccessful attempt brought by a music merchant came in Indiana—see *W.H. Paige & Co. v. State Board of Tax Commissioners*, 711 N.E. 2d 552 (Ind. 1999) or view the case online at http://www.ai.org/judiciary/opinions/previous/wpd/07190001.tgf.doc

The issue has most recently come to life in Colorado, where a two-store dealer intends to challenge a personal property tax audit by making the inventory/sale argument.

The rent-to-own world is safer in the 21st century than it was during the 1990s. It is unlikely that the Colorado dealer's arguments will seriously affect the legal status of RTO transactions in the country or even in Colorado. If every dealer in the country started making this argument, there might be legislative repercussions, but an isolated tax challenge here and there should not undermine the RTO legal edifice that has been so laboriously constructed over the years.

**RTO dealers may be able to lower their personal property taxes if they are willing to challenge the system and spend some time and money on the process. But they are unlikely to beat the tax altogether.**

There is, however, something to be said for consistency. Rental dealers who understand the business that they are in and who feel that they are paying too much in personal property taxes every year can challenge those taxes without having to twist their logic and words and pretend that they are retailers.

They can challenge how their property is being valued and in most places, it is probably being overvalued, which means that the dealer is paying too much in personal property taxes. The reason for this is that many county assessors apply generic depreciation tables to the kinds of products that rental dealers rent. Those tables reflect how long televisions or refrigerators typically last in a business environment when used by the business and they might be on seven or even 10-year depreciation schedules. This means that a dealer who paid $1,000 for a TV in 2007 might be assessed tax on a value of $900 in 2008 when, in fact, the TV will only be the property of the dealer for 18 months or so and the real value should be $667 or even $334, depending upon when the unit was acquired.

Dealers have been successful arguing for more realistic depreciation schedules for rent-to-own property in a number of jurisdictions, including Florida and California, although not all such efforts have been successful—see *Rent-Way Inc. v. Wilkins, Tax Commissioner*, Ohio Board of Tax Appeals, No. 2004-A-331 (April 13, 2007). The board acknowledged that the code allows a taxpayer to show that the administrative code guidelines can be rebutted if the taxpayer can prove a more accurate valuation. Then the board rejected the rental company's proof as inadequate.

In Texas, rental dealers have taken another approach to the too-high personal property tax issue. Fresh on the heels of their successes in getting the Legislature to increase late charges in rent-to-own transactions and to decrease grace periods, Texas rental dealers sought a constitutional amendment that would exempt RTO property from personal property taxation altogether. A few years previously, car dealers had gotten an amendment for their industry that allowed them to lease vehicles in Texas. Prior to this change, Texas car dealers had to offer vehicle leases by selling cars to consumers with an agreement to buy them back at the end of the "lease." Television and appliance rental dealers were able to go to the Legislature and argue equal protection. The car dealers got their inventory exempted and it is only fair for TV and appliance dealers to be treated the same way. The argument was persuasive and Texas dealers got bills passed out of both houses of the Texas Legislature, but ran out of time on the legislative calendar to get the issue on a statewide referendum for voters, which is a requirement for a constitutional amendment in the state. Most states would not require a constitutional amendment to make changes to the personal property tax code. It is a quirk in Texas law that requires this extra step for Texas rental dealers.

*Ad valorem* taxes remain a lively issue in the industry and, for most rental dealers, a painful, but not unmanageable cost of doing business. Dealers may be able to lower their personal property taxes if they are willing to challenge the system and spend some time and money on the process. They are unlikely to beat the tax altogether unless they die—or live in Kansas. ■

*Ed Winn is APRO's general counsel. His e-mail address is edwinn@mwvmlaw.com.*