THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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APPEAL FROM THE ADMINISTRATIVE LAW COURT COUNTY

H. W. Funderburk, Jr., Administrative Law Judge



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Case No. 13-ALJ-17-0601-CC

Appellate Case No. 2016-001210

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Rent-A-Center East, Inc. and Rent Way, Inc., Appellants,

v.

South Carolina Department of Revenue, Respondent.

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# INITIAL BRIEF OF APPELLANTS

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## STATEMENT OF THE CASE

This case involves a protest by Rent-A-Center East, Inc. ("RAC East") and Rent Way, Inc. ("Rent Way") (collectively "Rent-A-Center" or "Appellants") of an assessment of sales tax by the South Carolina Department of Revenue ("SCDOR" or "Respondent") for the income tax years of April 1, 2007- October 31, 2010 for RAC East and April 1, 2007- December 31, 2009 for Rent Way. SCDOR issued audit reports to Rent-A-Center on or about April 30, 2012. See Audit Report for RAC East, R. pp. ____; Audit Report for Rent Way, R. pp. ____. SCDOR claimed that Rent-A-Center owed the following in sales tax and interest as of 5/30/12:[1]

[1] The audit reports also assessed penalties. However, SCDOR later dropped the penalties so they are not at issue, and the total assessments have been revised to so reflect.

RENT-A-CENTER EAST

| Audit Period | Tax | Interest | Total |
|---|---|---|---|
| 4/1/07-10/31/10 | $767,004.50 | $106,154.80 | $873,159.30 |

RENT WAY

| Audit Period | Tax | Interest | Total |
|---|---|---|---|
| 4/1/07-12/31/09 | $309,654.51 | $52,458.18 | $362,112.69 |

Appellants timely protested this assessment. See RAC East Notice of Protest, R. pp. ____; Rent Way Notice of Protest, R. pp. ____. Following a conference, SCDOR issued Department Determinations on November 18, 2013 upholding the portion of the assessments related to the sale of Optional Liability Waiver Provisions.[2] See SCDOR Department Determination for RAC East, R. pp. ____; SCDOR Department Determination for Rent Way, R. pp. ____. SCDOR assessed tax and interest totaling $618,347.44 as to RAC East and $233,274.87 as to Rent Way. Id. at p. 1 (in both Determinations), R. pp. ____. Appellants then timely requested a contested case hearing before the Administrative Law Court (the "ALC") pursuant to S.C. Code Ann. § 12-60-460 (2014).

The ALC held a hearing on September 24 and 25, 2015, and issued a Final Order (the "Order") finding for SCDOR on all issues on March 30, 2016. See Order, R. pp. ____. Appellants received written notice of the Order that same day and subsequently filed a Motion for Reconsideration on April 12, 2016. See Rent-A-Center East and Rent Way's Motion for Reconsideration, R. pp. _____. The ALC denied this motion on May 5, 2016, and Appellants received that order that same day. On or about May 31, 2016, Appellants

[2] The figures in the Determinations differ from those in the audit reports because the audit reports included several additional findings and assessed taxes, interest and penalties associated with those findings. However, the parties resolved all issues except for the issue of whether the Optional Liability Waiver Provisions were subject to sales tax prior to the issuance of the Determinations. See Department Determinations at p. 12, n. 2, R. pp. ____.

submitted payment to SCDOR for all taxes and interest owed in the total amount of $919,585.55. See Letter from Appellants' Counsel to SCDOR dated May 31, 2016 with enclosed check, R. p. ____.[3] Appellants then timely filed a Notice of Appeal on June 6, 2016 such that the Initial Brief and Designation of Matter to be Included on Appeal were due on or before July 6, 2016. Thereafter, Appellants obtained a thirty day extension such that these items were due on or before August 5, 2016 and then requested a second thirty day extension such that they would be due on or before September 6, 2015.

## STATEMENT OF FACTS

### A. The Rental Agreement

Rent-A-Center operates retail stores in South Carolina (as well as other states) from which customers can "rent to own" certain household items such as electronics, appliances, furniture, and computers. Trial Transcript ("Tr.") at 69:1-7, R. p. ____. A customer who chooses to rent an item enters into an agreement with Rent-A-Center entitled a "Consumer Rental-Purchase Agreement" (the "Rental Agreement") under which he makes payments over a stated period of time, and, if all payments are made, he will eventually own the item rented. Id. at 70:12-71:25, R. p. ____; see also Rental Agreement, R. p. ____.[4] The customer can choose a weekly, semi-monthly or monthly renewal term. Rental Agreement, R. p. ____. The customer automatically renews the Rental Agreement by making an advance payment prior

[3] Appellants are thus in compliance with S.C. Code Ann. § 12-60-3370 (2014), which requires payment of contested amounts prior to filing a notice of appeal.

[4] RAC East and Rent Way submitted trial exhibits that were virtually identical, so unless otherwise indicated, references herein will be to those of RAC East, and the Court may assume the Rent Way version does not differ in any substantive way. However, the Rent Way version will immediately follow the RAC East version in the Record in case the Court would like to review it.

to the expiration of the term chosen. Id. Rent-A-Center cannot unilaterally terminate the Rental Agreement; only the customer can do so by violating its terms or returning the item. Id. If renewed by the customer, the Rental Agreement does not terminate until the customer takes title to the item or if the item is destroyed or stolen. Id. Rent-A-Center provides certain services in connection with the rental of merchandise, including warranty and maintenance services. Tr. at 74:16- 75:11, R. p. ____; Rental Agreement, R. p. ____ (stating that Rent-A-Center is "responsible for maintaining or servicing the goods while they are being rented.").

**B. The Waiver**

If a rented item is "lost, stolen, damaged or destroyed" while the customer is renting it, then the Rental Agreement provides that the customer is "responsible for the fair market value of the property. . . ." Tr. at 72:1-11, R. p. ____; Rental Agreement, R. p. ____. However, Rent-A-Center offers its customers the opportunity to avoid some of this risk by entering an additional and separate, optional agreement entitled an "Optional Liability Waiver Provision" (the "Waiver"), which negates that risk as to certain covered events, including lightening, fire, smoke, windstorm, theft and flood. Tr. at 72:12- 74:11 and 78:6-10, R. pp. ____; Waiver, R. p. ____. The Waiver does not provide for repairs or replacement of the items, (Waiver, R. p. ____; Tr. at 74:12-15, R.p. ___), and no warranty, maintenance or other services are provided under the Waiver.[5] Waiver, R. p. ___; Tr. at 75:12-15 and 76:14-77:9, R. pp. ____. Rent-A-Center does not insure the rental merchandise, and there is no other cost or cost of service associated with the Waiver that is passed on to the customer. Tr. at 77:10-16, R. p. ____. The Waiver simply secures Rent-A-Center's promise to waive any claim it would otherwise have

[5] As previously stated, warranty and maintenance services are provided under the Rental Agreement, and the fee for those services is included in the taxable Rental Agreement fee.

against the customer in the future if damage to or loss of the rented item due to the covered events occurs. Waiver, R. p. ____.

If a customer purchases an optional Waiver, the fee is separate and distinct from the charge for the rental of the property. The Waiver fee is recorded separately in Rent-A-Center's books and records used for financial accounting purposes. Tr. at 86:21-25, R. p. ___. The Waiver fee is also noted separately on the customer's receipt. Id. at 83:17-84:8, R. p.____; Waiver, R. p. ____; Sample Receipt, R. p. ____. The payment due under the Rental Agreement remains the same whether or not a customer purchases an optional Waiver, and payment of the Waiver fee does not count towards the rental charge or eventual purchase of the property. Tr. at 78:11-79:12, R. p. ____; Rental Agreement, R. p. ____; Waiver, R. p. ____.

Customers can purchase a Waiver when they enter into a Rental Agreement, or they can choose to do so later. Tr. at 79:13-17, R. p. ____; Waiver Policy Statement, R. p. ____. The customer can cancel the Waiver at any time, and, if canceled, the Rental Agreement is not impacted in any way and remains in effect. Tr. at 81:14-82:3, R. p. ____; Waiver, R. p. ____. Unlike the Rental Agreement, Rent-A-Center can also cancel the Waiver at any time.

In sum, the Rental Agreement and the Waiver are separate, distinct and singular transactions, which for separate charges and separate terms provide two different benefits to the customer: the Rental Agreement provides the benefit of renting to own an item, while the Waiver provides the benefit of avoiding the risk of loss (*i.e.* avoiding responsibility for paying the fair value of the property) in case of certain enumerated damages to or theft of the property. Tr. at 84:12-85:3 and 85:20-86:10, R. p. ____; see also Rental Agreement, R. p. ____; Waiver, R. p. ____. The Waiver does not increase the value of the rented property. Id.

In other words, if a customer rents a television that is valued at $500 and then purchases a Waiver, the television's value remains $500. Tr. 147:11- 149:20, R. p.____. Likewise, the Waiver does not alter, enhance or improve the rented property in any way. Tr. at 84:9-14, R. p. ____. The Waiver can be contrasted with the example of an engraved and assembled trophy discussed at several points during the trial. See e.g. Tr. 170:23- 171:25, R. p. ____. Unlike the intangible Waiver, the services of assembly and engraving alter, enhance, improve and are embodied in the trophy, and its value is thereby increased.

**C. Treatment of the Proceeds from the Rental Agreements and the Waivers**

The proceeds from the Rental Agreements for the rental of tangible personal property are subject to sales tax in South Carolina, and Rent-A-Center paid all taxes on the rental proceeds. Tr. at 92:17-93:1, R. p. ____. However, during the audit periods at issue, Rent-A-Center did not pay sales tax on the separately itemized sales of optional Waivers because it believed that those proceeds were not taxable as they were not attributable to the rental of tangible personal property nor were they a service cost associated with the rental of tangible personal property.

**D. Expert Testimony regarding Tax Policy Matters**

Professor Richard D. Pomp[6] testified at the hearing regarding certain tax policy matters, including, but not limited to: (1) why questions of imposition of tax statutes (or coverage questions) are construed against the State while exemption statutes are construed against the taxpayer (Tr. at 133:11-134:19, R. p. ____); (2) that an item must be subject to tax under an

[6] Professor Pomp was qualified as an expert in tax policy Tr. 119:8-15, R. p. ___. He is the Alva P. Loiselle Professor of Law at the University of Connecticut School of Law and is an adjunct professor at the NYU School of Law, and has taught tax law, with an emphasis or specialty in state and local tax law, for approximately 40 years. Id. at 119:22-120:25. See also CV of Richard D. Pomp, R. p. ____.

imposition statute in order to be taxable and that a court should not reach a "measure of tax" statute unless an imposition statute is first triggered (Tr. at 138:3-139:7 and 144:4-146:15, R. p. ____); (3) that the tax policy rationale behind the sales tax not allowing a deduction for costs is to avoid bifurcation of receipts, and by avoiding this bifurcation, prevent taxpayers from trying to carve out service costs that are embedded in the sale of an item that is subject to sales tax (Tr. at 140:7-144:3, R. p. ____); and (4) that SCDOR's "but for" argument (i.e. "but for" the sale of the rented item, there would be no Waiver) in support of taxing the Waiver proceeds is not sound from a tax policy perspective (Tr. at 155:10-156:18, R. p. ____). His testimony will be discussed in more detail below where relevant.

## STANDARD OF REVIEW

The Administrative Procedures Act provides the appropriate standard of review in an appeal related to the decision of an administrative agency. S.C. Code Ann. § 1-23-610 (Supp. 2009); see also The Original Blue Ribbon Taxi Corporation v. SCDMV, 380 S.C. 600, 604, 670 S.E.2d 674, 676 (2008). Under S.C. Code Ann. § 1-23-610(B), the Court of Appeals may reverse or modify a decision of the ALC "if the substantive rights of the petitioner have been prejudiced because the finding, conclusion, or decision is: (a) in violation of constitutional or statutory provisions; . . . (d) affected by other error of law; [or] (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record. . . ." S.C. Code Ann. § 1-23-610 (Supp. 2009); Brownlee v. South Carolina Dep't of Health and Environmental Control, 382 S.C. 129, 676 S.E.2d 116 (holding ALJ may be reversed based on error of law or if his findings were not supported by substantial evidence).

## ARGUMENT

The primary issue in this appeal is whether the ALC properly interpreted the South Carolina tax statutes at issue to levy a sales tax upon the sales by Rent-A-Center of intangible Waivers. As will be discussed below, the relevant imposition statute contained in S.C. Code Ann. §12-36-910 imposes sales tax on tangible personal property and certain enumerated services, but there is no imposition statute that imposes a tax on intangibles similar to the Waivers. The clearest proof that the Waivers are not subject to sales tax under the imposition statute is SCDOR's admission that the Waivers are not taxable on their own. See Tr. at 209:19-210:2, R. p. ____. In other words, if a third party, or even an affiliate of Rent-A-Center, sold only Waivers, the Waivers would not be taxable. Id. This is not surprising as it is well known and accepted (and even SCDOR would likely agree), that the sale of services (such as legal, medical, architectural, barber shop and other similar services) as well as intangibles (such as intellectual property) are generally not subject to sales tax in South Carolina. S.C. Code Ann. §12-36-910; see also Boggero v. S.C. Dept. of Rev., 414 S.C. 277, 777 S.E.2d 842 at n. 1 (Ct. App. 2015) (noting that "[g]enerally, the gross proceeds from services are not subject to sales and use tax.") citing S.C. Code Ann. Regs. § 117-308 (2012).

SCDOR attempts to avoid this result here by focusing on the fact that the Waivers are often sold in conjunction with the rentals of tangible personal property (which is true), and thereby attempts to combine these two revenue streams into a single taxable event. However, the law is clear that unless the service is bundled or inextricably linked to the sale of tangible personal property, then the court must examine each transaction on its own to determine if it is subject to sales tax. Here, the optional Waivers, which for a separate price provide a separate benefit to the customer of protection from liability, are not inseparable from the rentals of

appliances and other items, which can be purchased with or without a Waiver. In sum and as will be discussed below, because no statute imposes a tax on the intangible Waivers and because no bundled transaction is at issue, the Waivers are not subject to sales tax.

## I. The ALC Erred in Failing to Apply the Appropriate Rules of Statutory Construction to the Tax Statutes at Issue.

The ALC erred in failing to apply the appropriate rules of statutory construction to the tax statutes at issue. More specifically, the Order fails (a) to apply the plain meaning rule to the tax statutes; and (b) to construe these statutes in favor of the taxpayers and against the taxing authority and imposition of the tax. While the ALC cited both of these rules in the Order under the heading "Applicable Tax Provisions" (see Order at p. 5, R. p. ___), there is no discussion of either rule in the "Analysis" section wherein the ALC analyzes the relevant tax statutes and determines whether they impose a tax on the Waivers. In its subsequent Order Denying Motion for Reconsideration, the ALC states that it "must follow the plain meaning rule" (see Order Denying Pet. Mot. for Reconsideration at p. 2, R. p. ____) thus implying that it did apply that rule. The ALC also states that the statutes at issue are not ambiguous thus perhaps adopting SCDOR's argument that the ALC need not construe the tax statutes in favor of the taxpayers because they were not ambiguous. Id.; see also SCDOR's Resp. to Pet. Mot. for Reconsideration at pp. 5-7, R. p. ____. However, a review of the decision reveals that neither rule was properly applied, and due to these errors of law and violations of statutory provisions, Appellants' substantive rights have been prejudiced, and the decision should be reversed. S.C. Code Ann. § 1-23-610 (Supp. 2009).

### A. The ALC Erred in Failing to Apply the Plain Meaning Rule.

The ALC erred in failing to apply the plain meaning rule. The sole function of a court in construing statutes is to determine and give effect to the intent of the legislature, and the starting

point in doing so should always be the text of the statute itself. Hodges v. Rainey, 341 S.C 79, 85, 533 S.E.2d 578, 581 (2000). In interpreting the text, the plain meaning rule requires that "words must be given their plain and ordinary meaning without resort to subtle or forced construction to limit or expand that statute's operation," and when the language of the statute is clear, "a court cannot rewrite the statute and inject matters into it which are not in the legislature's language. . . ." State v. Leopard, 349 S.C. 467, 471, 563 S.E.2d 342, 344 (Ct. App. 2002); see also Rosmer v. Pfizer, 263 F.3d 263 (4th Cir. 2001) (holding that when a statute is plain on its face, the court's inquiry is at an end).[7] See also Alltel v. S.C. Dept. of Rev., 2015 WL 7681302, slip op. at pp. 17-20 (S.C. Admin. Law Ct. Nov. 13, 2015) (applying plain meaning rule to imposition statute to determine whether a taxpayer's proceeds are subject to sales tax) and infra, §II (for additional discussion of Alltel court's application of plain meaning rule applied to imposition statute).

As will be discussed in more detail below, both the Order and the Order Denying Petitioners' Motion for Reconsideration fail to identify an imposition statute that imposes a tax on Waivers and refer instead to the "gross proceeds" or "measure of tax" statute contained in S.C. Code §12-36-60 as the basis for imposing sales tax on the Waivers. See Order at pp. 4-8, R. p. ___; Order Denying Mot. for Reconsideration at p. 2, R. p. ___; see also infra §II (for discussion of ALC's failure to identify an imposition statute) and §III (for discussion of ALC's error in relying on the measure of tax statute in §12-36-60 when no imposition statute was invoked). The ALC's failure to properly apply the plain meaning rule caused it to improperly

[7] See also House Bill 3700, Part IB, Section 90, Proviso 90.21 (Act No. 73), R. p. ____ (proviso adopted by Legislature for the year of this audit that emphasizes this rule and states that "the Department's interpretation of South Carolina's revenue statutes must be based solely on the plain meaning of the statute's text and the legislative intent giving rise to the enactment of the statute. Terms in tax statutes may not be given broader meaning beyond the meaning of the statute.").

construe the taxing statutes at issue and to err in finding the Waivers subject to sales tax. Thus, Appellants respectfully request that this Court reverse the ALC's Order.

### B. The ALC Erred in Failing to Construe the Tax Statutes at Issue in Favor of the Taxpayers and Against SCDOR and Imposition of the Tax.

The Order also does not apply the cardinal rule of statutory construction that requires a court to construe a tax imposition statute in favor of the taxpayer and against the taxing authority and imposition of the tax. The law is clear that where there is a question of imposition of tax (or coverage) and not one of exemption, the taxing statutes should be construed in favor of the taxpayer and against the imposition of the tax (as opposed to an exemption statute, which is construed against the taxpayer claiming the exemption and in favor of the government). United States v. Merriam, 263 U.S. 179, 188 (1923) (citations omitted) (stating that if the words in a tax statute are in doubt then "the doubt must be resolved against the Government and in favor of the taxpayer"); Clark v. S.C. Tax Comm'n, 259 S.C. 161, 191 S.E.2d 23 (1972) (holding that "[r]evenue laws are generally construed in favor of the taxpayer and against the taxing authority"); Taylor v. Aiken County Assessor, 402 S.C. 559, 741 S.E.2d 31 (Ct. App. 2013) (same); Pot-O-Gold Rentals, LLC v. City of Baton Rouge, 155 So.3d 511, 512 (La. 2015) (holding that "tax statutes are to be interpreted liberally in favor of the taxpayer and against the taxing authority. If the statute can reasonably be interpreted more than one way, the interpretation less onerous to the taxpayer is to be adopted.").

As Appellants' tax policy expert testified, there are policy reasons underlying this longstanding cannon of construction. First, the Fifth Amendment of the U.S. Constitution, which prohibits deprivation of property without due process of law, requires that taxpayers be given clear notice and warning of the circumstances that will lead to their payment of taxes. Tr. at 133:11- 134:8, R.p. ___. Ambiguities in a tax statute interfere with these rights, and,

thus, they are construed against the government. Id. Additionally, the State drafted the tax laws, and, thus, just as contracts are construed against the drafter, so too are tax laws construed against the State. Id. at 134:8-19, R.p. ___.

SCDOR has asserted, and the ALC found, that the taxing statutes are not ambiguous, and, thus, SCDOR contends (and the ALC appears to have at least implicitly agreed) that the ALC should not have applied this rule of statutory construction. See SCDOR's Resp. to Mot. for Reconsideration at pp. 5-7, R. p. ___; Order Denying Petitioners' Mot. for Reconsideration at p. 2, R. p.___. Appellants agree that the taxing statutes at issue are unambiguous. See infra §II (for full discussion of same). However, several of SCDOR's arguments as well as the ALC's subsequent ruling regarding how the imposition statute should be interpreted would create an ambiguity in the statute and thereby invoke this rule of statutory construction. For example, SCDOR argues that the imposition statute imposes a tax on a class of taxpayers (i.e. those in the business of selling tangible personal property) as opposed to Appellants' interpretation that it imposes a tax on the sale of tangible personal property and certain enumerated services. The Order, while not articulating SCDOR's exact argument, appears to be based on similar reasoning. However, the heading of the imposition statute supports Appellants' interpretation as it states that the sale tax is "on tangible personal property" and certain enumerated items (see S.C. Code Ann. § 12-36-910), and the statutory definition of tangible personal property confirms that only items enumerated under the sales tax chapter are subject to sales tax as "tangible personal property." See S.C. Code Ann. §12-36-60. Case law also confirms that services are generally not taxable. See Boggero v. S.C. Dept. of Rev., 414 S.C. 277, 777 S.E.2d 842 at n. 1 (Ct. App. 2015) (noting that "[g]enerally, the gross proceeds from services are not subject to sales and use tax.")(citations omitted). To the

extent SCDOR's (and possibly the ALC's) interpretation that the sales tax applies to everything that a retailer of tangible personal property sells is considered by this Court, the imposition statute is, at best, ambiguous and must be construed in favor of Rent-A-Center.

SCDOR has also argued in the past that a "but for" test[8] is controlling. It relies on Meyers Arnold v. S.C. Tax Comm'n, 285 S.C. 303, 328 S.E.2d 920 (Ct. App. 1985) and argues that a "but for" test should be applied here (see SCDOR's Proposed Order at pp. 11-12, R.p. ___) even though SCDOR has conceded that the Waivers are not taxable on their own. See Tr. at 209:19-210:2, R. p. ____. The application of such a test would also render the statute ambiguous by requiring the Court to construe a statute when the plain meaning of its literal wording requires no construction. See Alltel Communications, Inc. v. S.C. Dept. of Rev., 2015 WL 7681302, slip op. at pp. 19-20 (S.C. Admin. Law Ct. Nov. 13, 2015) (stating that "even if this Court were to agree with the Department on this point [i.e. that the "but for" test applies], however, the Department would not prevail because the statute would be rendered ambiguous and therefore inapplicable to Alltel"). Although the ALC did not rely on or apply such a test, to the extent this Court considers such a test, the statute would be rendered ambiguous.

In sum, if the imposition statute is interpreted to impose a sales tax on items beyond tangible personal property and the services enumerated therein, then the imposition statute is rendered ambiguous, and the imposition statute must be construed in favor of the taxpayer and against SCDOR and the imposition of the tax. As discussed more fully in §II below, when this rule is applied to the imposition statute at hand, there is only one conclusion that can be

[8] The gist of SCDOR's "but for" test is that "but for" a taxable transaction (here the rental of an appliance or other item), there would be no additional nontaxable transaction (here the Waiver), and therefore, the additional nontaxable transaction is subject to tax.

reached - the imposition statute contains no language that imposes a tax on intangible Waivers, and, thus, they are not subject to sales tax. Accordingly, Appellants respectfully request that the Court reverse the ALC's decision.

## II. The ALC Erred in Finding the Waivers Subject to Sales Tax When it Failed to Identify any Imposition Statute that Imposes a Tax on Waivers.

### A. S.C. Code Ann. §12-36-910 Does Not Impose a Sales Tax on Waivers.

The ALC does not apply any imposition statute that imposes a tax on Waivers and thus erred in finding that the Waivers were subject to sales tax. An imposition statute imposes a tax and places taxpayers on notice of what activities will be subject to taxation. See Tr. at 138:3-17, R. p. ___. Although properly citing the relevant imposition statute (i.e., S.C. Code Ann. §12-36-910), the Order appears to incorrectly conclude that it imposes a tax on the Waivers. Order at p. 4-8, R. p. ___. This error of law and erroneous interpretation of a statute affected the ALC's decision and prejudiced the rights of Appellants, and, therefore, should be reversed.

The relevant part of the imposition statute reads as follows:

> **SECTION 12-36-910.** Five percent tax on tangible personal property; laundry services, electricity, communication services, and manufacturer-consumed goods.
>
> (A) A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail.

The imposition statute then describes certain enumerated services that are subject to sales tax, including operating a laundry (S.C. Code Ann. §12-36-910(b)(1)), providing accommodations (S.C. Code Ann. §12-36-920), providing communications services (S.C. Code Ann. §§12-36-910(b)(3)& (5) and 12-36-1310), and selling electricity (S.C. Code Ann. §12-36-910(b)(2)).

The tax code defines "tangible personal property" (which is subject to the sales tax) as:

> personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the

> senses. It also *includes services and intangibles*, including communications, laundry and related services, furnishing of accommodations and sales of electricity, *the sale or use of which is subject to tax under this chapter* . . . .

S.C. Code Ann. §12-36-60 (emphasis added). In other words, only the sales of tangible personal property and those services or intangibles that are specifically identified in the sales tax chapter are subject to sales tax. S.C. Code Ann. §§12-36-910 and 12-36-60.[9]

The parties agreed that the sale of a Waiver is not the sale of tangible personal property. See Tr. at 205:17-206:6. R. p. ____. SCDOR characterized it as a service, while Appellants contended that it is an intangible. The ALC appears to have agreed with Appellants and found that a Waiver is an intangible (see Order at p. 5, n. 5, R. p. ___ wherein the ALC discussed several dictionary definitions of "intangible," which defined it as something abstract like a responsibility or obligation and then described the Waivers as an obligation) and bolded the word "intangible" when quoting the statute defining tangible personal property.). Order at p. 5, R. p. ___.

Applying the plain meaning rule to the taxing statutes at issue, it is clear that no South Carolina statute identifies the sale of anything similar to a Waiver (whether a service or an intangible) as taxable. See S.C. Code Ann. §12-36-910; Tr. at 207:17-24, R. p. ___. The ALC does not specify any imposition statute that subjects Waivers to sales tax and fails to address the law providing that sales tax only applies to services or intangibles "the sale or use of which is subject to tax under this chapter . . . ." See S.C. Code Ann. § 12-36-60. Instead, the ALC appears to rely primarily on the "gross proceeds" or "measure of tax" statute in reaching its conclusion that the Waivers are subject to tax. See Order at p. 9, R. p. ___, and

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[9] The only exception to this rule is that where a bundled transaction is at issue, certain services that are inextricably linked to the sale of tangible personal property can be subject to sales tax if the "true object" of the sale is the purchase of property and not the purchase of a service. See Boggero v. S.C. Dept. of Rev., 414 S.C. 277, 777 S.E.2d 842 (Ct. App. 2015). No such transaction is at issue here. See infra §III(B)(2).

Order Denying Pet. Mot. for Reconsideration at p. 2, R. p. ___. However, if no imposition statute is invoked, a measure of tax statute cannot be relied upon by the court. See infra §III.

A strikingly similar case was recently addressed by the ALC in Alltel Communications, Inc. v. S.C. Dept. of Rev., 2015 WL 7681302 (S.C. Admin. Law Ct. Nov. 13, 2015).[10] The issue in Alltel was whether sales proceeds from optional contracts sold by Alltel for indemnification coverage in the form of repair or replacement for lost, stolen or damaged wireless communication devices were subject to sales tax when the contracts were sold in conjunction with the sales of wireless communication devices. Alltel argued that under the plain meaning of S.C. Code Ann. §12-36-910, the indemnification coverage proceeds were not subject to tax because an insurance type product is not tangible personal property under §12-36-60 and therefore cannot be part of its gross proceeds of sales under §12-36-90. Id. at 17. The ALC noted SCDOR's concessions that no statute states that insurance policies (which term it used to refer to the indemnification coverage at issue) are subject to sales tax and that the policies are not tangible personal property. Id. Applying the plain meaning rule, the ALC then concluded that no imposition statute imposed a tax on indemnification coverage proceeds, and, thus, they are not subject to sales tax. Id. at 18.

The Alltel decision is right on point with this case. As previously stated, no imposition statute imposes a tax on the intangible Waivers at issue. In fact, SCDOR's manager of policy recognized this when he correctly agreed that if the Waivers were sold by a third party or even by an affiliate of Rent-A-Center, they would not be taxable. Tr. at 209:19-210:2, R. p. ____. If an imposition statute did impose a tax on Waivers, then the sales by affiliates or third parties

[10] SCDOR initially appealed the Alltel decision; however, the parties subsequently settled the matter and dismissed the appeal, and, thus, this opinion is a final decision of the ALC.

would be subject to tax. See Pot-O-Gold, 155 So.3d at 512 (noting absurdity of lower court's finding that the sale of optional cleaning services sold in conjunction with the rental of portable toilets would be taxable if the toilets were owned by the lessor but not taxable if the toilets were owned by a third party). Thus, the ALC erred in finding the Waivers subject to tax when no imposition statute imposes such a tax.

While Appellants agree that the taxing statutes are clear and unambiguous and thus no statutory construction rules need be applied, if the Court is persuaded by SCDOR or the ALC's interpretations of the taxing statutes, then they are at best rendered ambiguous such that the statutes must be construed in favor of the taxpayers and against SCDOR and imposition of the tax. See supra §I. When the imposition statute is construed in favor of the taxpayers and against imposition of the tax, there can be no doubt that the statute does not impose a tax on an intangible Waiver, and, thus, the ALC's Order should be reversed.

### B. Travelscape, Meyers Arnold and Boggero Do Not Support the ALC's Order.

The ALC's decision that the Waivers are subject to sales tax appears to be primarily based not on the imposition statute but on the following three cases (in addition to the measure of tax statute at S.C. Code Ann. §12-36-90 discussed in §III below): Travelscape, LLC v. S.C. Dept. of Rev., 391 S.C. 89, 705 S.E.2d 28 (2011), Meyers Arnold v. S.C. Tax Comm'n, 285 S.C. 303, 328 S.E.2d 920 (Ct. App. 1985) and Boggero v. S.C. Dept. of Rev., 414 S.C. 277, 777 S.E.2d 842 (Ct. App. 2015). Order at pp. 5-7, R. p. ___. Appellants respectfully submit that none of these cases supports the ALC's conclusion that the Waivers are subject to sales tax.

1. Meyers Arnold and Travelscape Involve Mandatory Fees and Improper Attempts to Deduct Costs of Service and Thus Do Not Support SCDOR's Attempt to Tax the Waivers.

Meyers Arnold and Travelscape both involve mandatory (versus optional) fees as well as improper attempts to deduct service costs and therefore do not support SCDOR's attempt to tax the Waivers. In Meyers Arnold, a layaway fee was required in order to make a layaway purchase and in Travelscape, a "service and facilitation" fee was added to the price of booking a hotel room. In other words, the fees were required in order for the layaway sale or the hotel room sale to take place and those fees were added to the purchase price of the tangible personal property. See Alltel, 2015 WL 7681302, slip op. at p. 24 (noting that Meyers Arnold and Travelscape both involve fees where the customer could not make the purchase of tangible personal property without paying the fee).

The ALC agreed that the fees in both Meyers Arnold and Travelscape were mandatory but still found that the optional Waivers here were inextricably linked to the rentals apparently based on the gift wrapping issue also addressed in Meyers Arnold. Order at p. 6; R. p. ____. However, this reliance is misplaced and does not support the ALC's conclusion. In Meyers Arnold, this Court addressed whether charges for the service of gift wrapping were taxable where the service was free unless more expensive paper was chosen were taxable. It found that the charge was really for the wrapping paper and not the separate service of wrapping and found that the transaction would have been taxable except for a statutory exemption from sales tax for wrapping paper. The ALC's Order in this case then concludes: "Without this fact-specific exemption, the exercise of this option would have subjected the fees to tax. Thus merely being optional does not prevent part of a sales transaction from being subject to sales tax." Order at p. 6, R. p. ___.

The statement that merely being optional does not automatically prevent a transaction from being taxable is correct, but clarification of the reason it is correct is warranted. The wrapping paper charges would be taxable absent an exemption because the paper is tangible personal property and the wrapping service was a part of that sale. In this case, the Waiver is not tangible personal property and its acquisition is separate from the rental of appliances and other items because customers can and do rent items without the Waiver. In addition, the ALC made no determination, nor is one supported by the facts, that the fee for Waivers is not actually a charge for the service or intangible of providing the Waivers, but is instead really a charge for purchasing tangible personal property (such as a television) as was the case with the wrapping paper. Being optional cannot save an otherwise taxable transaction from being taxable, but if a transaction is not taxable under the imposition statute (like the intangible Waivers here), then whether an item is optional is a critical factor to be considered in resolving whether an otherwise non-taxable transaction (the Waiver) that is purchased at the same time as a taxable transaction (the rented property) can become taxable. See Alltel, 2015 WL 7681302, slip op. at p. 20 (finding that the wrapping paper holding in Meyers Arnold does not require conclusion that the indemnification coverage at issue was taxable because wrapping paper itself is tangible personal property). Appellants submit that in this case, the fact that the Waivers are optional is one of many factors that establish that the two transactions at issue here are not bundled such that the "true object" test discussed hereinbelow should not be applied. See infra §III(B)(2).

Additionally, both Meyers Arnold and Travelscape can be viewed as attempts by the taxpayers to deduct service costs from revenues, which is prohibited under South Carolina sales tax law. More specifically, S.C. Code Ann. §12-36-90(b) provides that the term "gross

proceeds" (which is the measure of the sales tax) includes the proceeds from the sale of tangible personal property *without any deduction for*: . . . (ii) the cost of materials, labor, *or service*. . . ." Id. (emphasis added). As Appellants' tax policy expert testified, if deduction of service costs was not prohibited, taxpayers might be tempted to bifurcate service costs (which are generally not subject to sales tax) in their receipts so that the labor that went into producing a product would not be taxable. Tr. 142:14 -143:17, R. p. ___. Thus, this rule prevents the deduction of certain expenses incurred prior to or concurrent with the sale of the tangible personal property.

In contrast, the ALC in the case at hand acknowledges that the Waivers here are optional (versus the mandatory fees in Travelscape and Meyers Arnold) and did not find the Waiver proceeds to be an improperly deducted service cost (as the proceeds were in Travelscape and Meyers Arnold). The overwhelming evidence in the record supports the facts that the Waiver is not a cost of producing the item rented (i.e. an appliance), is not added to the purchase price of the item rented, and is not a cost necessary to accomplish the sales transaction involving the rented item. See supra pp. 6-7. R. p. ___. Stated differently, the Waiver fees are revenue from the intangible Waivers sold and not a cost of the appliances and other items being rented. Instead, as in Alltel, the Waiver is a separate item of value that is in the nature of an intangible, and in the case of the Waiver, any cost associated with the Waiver would only arise in the future, if and when, a covered event occurred. Id. Thus, the ALC should have found that Meyers Arnold and Travelscape do not support the Waivers being subject to sales tax.

2. The "True Object" Test Applied in Boggero is Not Applicable Here because the Waiver is Not Part of a Bundled Transaction.

The "true object" test applied in Boggero v. S.C. Dept. of Rev., 414 S.C. 277, 777 S.E.2d 842 (Ct. App. 2015) is not applicable here because the Waiver is not part of a bundled transaction. The "true object" test is used where a bundled transaction exists (stated another way, where two transactions are inextricably linked), and the court must examine the "true object" of the bundled transactions (i.e. whether the true object is the sale of tangible personal property or the sale of a service) to determine if the transaction is subject to sales tax. See e.g. Boggero v. S.C. Dept. of Rev., 414 S.C. 277, 777 S.E.2d 842 (Ct. App. 2015); see also Tr. 149:24-150:9, R. p. ___ (testimony of Appellants' tax policy expert explaining that where you have one combined or integrated transaction with two elements such that a bundled transaction exists, the true object test seeks to determine "which elements are going to dominate and control how we characterize the [integrated] transaction").

In Boggero, the taxpayer rented and serviced portable toilets via a single agreement, and it appears that servicing the toilets was included with the rental and was not optional. See Boggero, 414 S.C. at 286-87, 777 S.E.2d at 846-47. The invoices also do not appear to have separately itemized the charges for the rental of portable toilets versus the charges for the service of waste removal. Id. Hence, although not specifically discussed in the opinion, the rental and service transactions were bundled and could not be easily separated. The Court then affirmed the lower court's application of the "true object" test whereby the ALC found that the customer's true object was to obtain the use of the toilet (versus the service of waste removal), and thus, the true object was the rental of tangible personal property, which is subject to sales tax. Id.

Another example can be found in Southeastern Cinema where the ALC examined whether proceeds from the sale of a trademark sold in conjunction with the sale of an IMAX theater were part of "gross proceeds" and thus subject to sales tax. Southeastern Cinema Entertainment v. S.C. Dept. of Rev., 2014 WL 2417715, slip op. at p. 2 (S.C. Admin. Law Ct. 2014). The ALC in that case concluded that the trademark proceeds were part of "gross proceeds" because the purchase agreement, which covered both the theater and the trademark, did not itemize the cost of the two items (id. at 5) and because the IMAX theater could not be used without the trademark license such that the trademark was inextricably linked to or embodied in the purchase of the system. Id. at 6.

At trial, Rent-A-Center's tax policy expert discussed an engraved trophy as another example of a bundled transaction. See e.g. Tr. 164:9- 165:24 and 170:23- 171:25, R. pp. ____. He states that whether the sale takes place via one agreement or separate agreements, the transaction is bundled because the customer's object is to purchase an engraved trophy. Id. In other words, once a trophy is assembled and engraved, the trophy has been altered or improved such that assembly and engraving are no longer optional if one is going to purchase that trophy. The services that caused the improvements have been physically incorporated into the trophy and thus are inextricably linked to it such that the sale of the trophy and the sale of the assembly and engraving services are bundled transactions. Once a trophy has been assembled and engraved, it cannot be unassembled and unengraved.

Unlike Boggero, Southeastern Cinemas and the engraved trophy example, the transactions here are not bundled such that they cannot be separated. The Waiver is optional at all times prior to purchase and its charge is separately delineated on a customer's receipt. See Waiver, R. p. ____; Sample Receipt, R. p. ___; Tr. 78:6-10 and 83:17-84:8, R. pp. ____ and

___; see also Tr. at 153:4-154:2, R. p. ___ (testimony of Appellants' tax policy expert stating that because the Waiver here is optional, the transaction is not bundled). Additionally, the Waiver does not alter or improve the rented property and is not physically incorporated into the property (as in the assembled and engraved trophy example)[11] nor does it permit the rented property to be used (as was the case in Southeastern Cinemas with the sale of the intellectual property rights to operate the IMAX theater) such that its value cannot be separated from the value of the rented item or such that it is inextricably linked to the rented item. See Tr. 84:9-14, R. p. ___ and Waiver, R. p. ____. The two values of (1) renting an item, and (2) avoiding the risk of certain losses are clearly separate and distinct, and the rented item can obviously be used without the Waiver. The simple undisputed fact that customers can and do rent items without purchasing Waivers proves that the rental item and the Waiver can be separated. Thus, the two separate transactions of the sale of a Waiver and the rental of an item are not inextricably linked or bundled.

The ALC reached the contrary conclusion that the Rental Agreement and the Waivers were inextricably linked (and thus presumably a bundled transaction) based on two purported facts: (1) that a single agreement existed, and (2) that once the Waiver is purchased, "it is merged into and becomes inextricable from the transaction and has no value apart from the

[11] The trophy example may have been misunderstood by the ALC. The Order points to the statement that "once you bought all three together" [i.e. the trophy assembled and engraved], "it wasn't optional anymore" and was bundled, and the ALC construes or analogizes this to mean that once a Rent-A-Center customer purchases a Waiver, it is no longer optional and thus is a bundled transaction. Order at pp. 3-4, R. p. _____. This errant conclusion does not follow. Of course, one could say that any item, once purchased, is no longer optional. The key question is whether it is optional at the time of the sale of the tangible personal property in the form that the customer desires it. In the trophy example, although the customer may have the option of assembly and engraving, if he desires to purchase the tangible personal property of an assembled and engraved trophy, those services are not optional. In contrast, if a Rent-A-Center customer desires the tangible personal property of a TV, the intangible Waiver remains optional until the time of purchase.

underlying transaction." Order at p. 7, R. p. ___. As explained in §V below, even if a single agreement or transaction is at issue, that is not determinative. The Court must still evaluate whether the otherwise non-taxable intangible of a Waiver is subject to tax. See infra §V.

Additionally, the ALC's apparent finding that the Waiver once purchased "merges into and becomes inextricable from it" does not appear to be based on any additional facts beyond that it found a single agreement was involved (which is not determinative as discussed below) and its erroneous belief that the Waiver "has no value apart from the underlying transaction." Order at p. 7, R. p. ___. This latter finding regarding value is not supported by any evidence in the record and instead is contradicted by all evidence pertaining to the Waivers' continuing separate existence and value, and thus, is clearly erroneous. The Waiver has the same value before and after its purchase as does the Rental Agreement. The record clearly shows that these agreements provide two separate and distinct values- the value of renting an item such as a television and the value of avoiding the risk of certain losses. Tr. 84:12-85:3 and 85:20-86:10, R. pp. ____ and ___. There was no evidence to the contrary. The Waiver does not suddenly lose its value or have its value merged into the property rented upon purchase. Its value remains the same. Additionally, the price of the rental property is not impacted at all by the Waiver; the rental price is not increased if the Waiver is purchased (versus the price of the items in Meyers Arnold, which increased if the item was purchased on layaway), and the Waiver can also be terminated at any time without affecting the rental price. Tr. 81:14-82:3 and 78:11-79:12, R. p ___ and ____. Additionally, the Waiver does not enhance or increase the value of the property rented. Tr. 84:9-85:3 and 85:20-86:10, R. pp. ___ and ___. The value of the property rented is the same whether or not a Waiver is purchased. A television that is worth $500 at the time of purchase remains that value even if the Waiver is purchased.

Tr. 147:11-149:20, R. p. ___. There is also no merger of value between the two as there is with the engraved trophy example (where the tangible personal property was altered or improved by the otherwise non-taxable services) or as in Southeastern Cinemas (where the tangible personal property could not be used without the otherwise non-taxable intangible property).

To the extent the ALC was implying that there is no value to the Waiver apart from the underlying transaction because a customer does not purchase a Waiver without also renting an item (an argument made by SCDOR at trial), this is likewise not a valid basis for finding the transactions to be bundled. As Appellants' tax policy expert responded when asked this very question at trial:

> It doesn't make it a bundled transaction. It can still be a separate transaction. It has a factual predicate but that doesn't mean it's not a separate transaction. I mean, if I buy a car from you . . . for $10.00, you could get car washes for the next year. Those car washes aren't going to become taxable if they won't otherwise be taxable because of the factual predicate I had to buy the car. I'll sell you my casebook, and you know that's tangible personal property, even though most of the value of the book is an intellectual property, but we do it as tangible. And then I say, anyone who buys the book today for a discounted price can get an hour's worth of consultation with me. Normally legal services aren't taxable. They don't become taxable because you couldn't get those services without purchasing the book. So you can have a factual predicate, but that doesn't make the second transaction somehow part of the bundled transaction.

Tr. 167:24- 168:20, R. p. ___. In sum, the fundamental question is not whether the Waiver can be purchased without renting an item but whether the Waiver must be purchased in order to rent the item desired by the customer. Accordingly, the ALC's conclusion that the Rental Agreement and the Waiver are inextricably linked or are a bundled transaction is not supported by any evidence in the record and thus is clearly erroneous and should be reversed. S.C. Code

Ann. § 1-23-610(B). Additionally, because a bundled transaction is not at issue, the "true object" test set forth in Boggero need not be applied.

## III. The ALC Erred in Relying on the Measure of Tax Statute When No Imposition Statute Imposes a Sales Tax on Waivers.

The ALC erred in relying on the measure of tax statute contained in S.C. Code Ann. §12-36-90 (i.e. the definition of "gross proceeds") when no imposition statute imposes a sales tax on the Waivers. This error of law and erroneous interpretation of a statute affected the ALC's decision and prejudiced the rights of Appellants, and, therefore, should be reversed. S.C. Code Ann. § 1-23-610(B).

From a tax policy perspective, an imposition statute places a taxpayer on notice that a tax will be owed if he conducts certain activities, while a measure of tax statute tells the taxpayer the amount of tax he will owe. Tr. at 138:13-22, R. p. ___. As stated by Appellants' tax policy expert and as reflected in the tax cases cited by Appellants, one must "pass through the first statute [i.e. the imposition statute] before you get to the second [i.e. the measure of tax statute], because the second is irrelevant if you are not subject to the imposition in the first place. So assuming that you pass through the first statute, you get to the second one, and now we go ahead and calculate the gross proceeds of sales, and that's what you will pay your tax on the basis of." Tr. at 138:22-139:5, R. p. ___. If you do not have an imposition statute, then that is "the end of the game. You don't ever get to § 12-36-90, because there is no sales tax in play." Tr. at 144:12-15, R. p. ___.

Because no imposition statute applies in this case (see supra §II), the measure of tax statute (*i.e.* §12-36-90) is never reached and cannot be used to justify imposing a sales tax on the Waiver proceeds. Id. See also Alltel, 2015 WL 7681302, slip op. at pp. 18-20 (rejecting SCDOR's arguments that sales proceeds from optional indemnification contracts sold in

conjunction with wireless communications devices were subject to sales tax as "value proceeding or accruing from the sale of tangible personal property" under the gross proceeds of sales statute where no imposition statute imposed such a tax); Brock Serv., LLC v. Ala. Dept. of Rev., No. S. 14-1236, slip op. at pp. 3-10 (Ala. Tax Tribunal Sept. 28, 2015) (finding that labor services provided in conjunction with renting of scaffolding were not subject to sales tax under the imposition statute (which mirrors the South Carolina imposition statute) and rejecting argument that the gross proceeds of sales statute (which mirrors the South Carolina gross proceeds of sales statute) justified imposing a tax noting that "the broad definition of 'gross proceeds' at §40-12-220(4) prevents a lessor from deducting its overhead, labor, and other operating expenses from its otherwise taxable gross proceeds. Like the gross proceeds in Thyssenkrupp, the labor receipts in issue in this case were never gross proceeds subject to the rental tax to begin with."); Rent-A-Center West, Inc. v. Utah State Tax Comm'n, No. 20140129, slip op. at pp. 3-6 and n. 1 (Utah January 5, 2016) (addressing the Waivers that are also at issue here and determining that they were not subject to sales tax because they were not "an amount paid or charged for leases or rentals of tangible personal property" as the Utah imposition statute required; that whether the fees could be encompassed within the definition of "purchase price" or "sales price" in the definitions statute was irrelevant because they were not encompassed by the imposition statute; and that a long-standing Tax Commission regulation was invalid because it "impermissibly broaden[ed] the language of the statute");[12] Letter Ruling No. CL 2290, 2000 Mo. Tax Ltr. Rul. LEXIS 37

[12] The ALC in this case cited this Rent-A-Center case in Utah (finding the same Waivers as are at issue here not taxable) as well as a Louisiana case (Rent-A-Center East v. Lincoln Par. Sales & Use Tax Comm'n, 60 So.3d 95 (La. App. 2 Cir. 2011), writ denied, 63 So.3d 985 (2011)) (finding the Waivers taxable) in support of its decision. It found that the South Carolina statute, which imposes sales tax on the "value proceeding or accruing from the

(Miss. Dep't Rev. May 18, 2000) (ruling that the sale of optional damage waiver protection for a separately stated price was not taxable as it was not the sale of tangible personal property nor was it specifically listed as a taxable service under the relevant statutes.).

The ALC appears to have distinguished the Alltel decision on the basis that Alltel paid the premiums received from its customers for the indemnification coverage directly to a third party insurer. Order at pp. 7-8, R. p. ___. While the ALC in Alltel did make that factual finding, a review of the full opinion makes it clear that this should not alter the outcome. The law and analysis discussed therein[13] would apply regardless of whether Alltel retained the proceeds and paid them out of its own accounts to satisfy a bill from a third party insurer or remitted payments directly to the third party insurer. That factual distinction is simply irrelevant and does not change the law that requires that an imposition statute first be invoked before the measure of tax statute can be reached.

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sale of tangible personal property" was broader and more inclusive than the Utah statute (which imposes sales tax on the "amounts paid or charged for leases or rentals of tangible personal property") and was instead more similar to the Louisiana statute (which imposes sales tax on "gross proceeds derived from the lease or rental of tangible personal property. . ."). See Order at pp. 8-9, R. pp. ___.

Appellants disagree with the ALC's interpretation of these cases. None of the imposition statutes therein encompass the Waivers, which are not values, amounts or proceeds (a) paid for the sale or rental of tangible personal property, (b) derived from the sale or rental of tangible personal property, or (c) proceeding or accruing from the sale or rental of tangible personal property. Curiously, the ALC failed to mention the Brock case cited above, which found labor services provided in conjunction with the renting of scaffolding were not subject to sales tax because they were not a "value proceeding or accruing from the sale of tangible personal property." Brock Serv., LLC v. Ala. Dept. of Rev., No. S. 14-1236, slip op. at pp. 4-10 (Ala. Tax Tribunal Sept. 28, 2015). Alabama's imposition and gross proceeds statutes are *identical* to those of South Carolina and therefore would appear to be more instructive.

[13] See also supra § II (as to Alltel court's analysis on whether imposition statute imposed a tax on indemnification coverage proceeds) and infra §IV (as to Alltel court's discussion of whether those proceeds constituted gross proceeds of sale).

Appellants respectfully request that the Court reverse the ALC because it failed to invoke an imposition statute prior to relying on the measure of tax statute and thus should have found that the Waivers are not taxable.

## IV. Even if the ALC Properly Reached the Measure of Tax Statute, the ALC Erred in Finding the Waiver Proceeds Part of Appellants' "Gross Proceeds of Sale."

Even if the ALC properly reached the measure of tax statute, the ALC erred in finding the Waiver proceeds to be a part of Appellants' "gross proceeds of sale." See Order at pp. 8 and 10, R. pp. ____. This error of law and erroneous interpretation of a statute affected the ALC's decision and prejudiced the rights of Appellants, and, therefore, should be reversed. S.C. Code Ann. § 1-23-610(B).

The Order states that the Waiver fees are part of "the value proceeding or accruing from the sale, lease, or rental of tangible personal property." Order at p. 8, R. p. ___. This conclusion appears to be based on a number of assumptions including the Court's finding that the Waiver might enhance the value of the rented item and its application of the "true object" test. These issues have been previously addressed. However, Appellants will now address whether, even if the measure of tax statute can be used when no imposition statue has been invoked, the facts of this case fit within the statutory language of "gross proceeds of sale," as the ALC held.

This issue was recently addressed in the Alltel case previously discussed with regard to indemnification coverage proceeds collected in conjunction with the sale of communication devices. Alltel, 2015 WL 7681302, slip op. at pp. 18-20. After concluding that no imposition statute covered those proceeds, the ALC went on to examine SCDOR's argument that, notwithstanding the lack of an imposition statute, they were taxable because they were sold in conjunction with the sale of tangible personal property (i.e. the communication devices). Id.

The ALC described SCDOR's argument as characterizing "'gross proceeds of sale almost as a bucket with regard to the sale of tangible personal property' and that 'anything associated with that sale of tangible personal property goes into the bucket of gross proceeds.'" Id. at p. 19 (citing to trial transcript). SCDOR cited to Meyers Arnold, as they have done in this case, in support of this argument. Id. At trial and in its proposed order, SCDOR contended that "but for" the sale of the tangible personal property (such as a television), there would be no sale of a Waiver, therefore the Waiver is part of gross proceeds and thus taxable. See SCDOR's Proposed Order at pp. 11-12, R. p. ___. Although the ALC's order does not expressly adopt or apply the so-called "but for" test, the result under the "bucket" analogy appears to be the same.

The ALC in Alltel correctly rejected these arguments. It noted that insurance like the indemnification coverage at issue is not tangible personal property, and thus proceeds from the sales of such coverage do not proceed or accrue from the sale of tangible personal property. Alltel, 2015 WL 7681302, slip op. at pp. 17-18. The ALC also explained that "to accept the Department's argument that the statute requires that any amounts of revenue collected at the same time it receives revenue from the sale of tangible personal property be subjected to sales tax, the court would be required to read language into the statute that is absent. This violates the plain meaning rule." Id. at p. 19. The ALC further held that SCDOR's position would also "require the court to read out of the statute language that limits the application of sale tax to 'services and intangibles . . . the sale . . . of which is subject to tax under Chapter 36 of Title 12 . . . [which ] . . . also violates the plain meaning rule." Id. Moreover, accepting SCDOR's interpretation of the statute would render the statute ambiguous, and thus the statute would have to be construed in favor of the taxpayer and against imposition of the tax. Id. at

pp. 19-20 (stating that "even if this Court were to agree with the Department on this point, however, the Department would not prevail because the statute would be rendered ambiguous and therefore inapplicable to Alltel"). See also supra § I.

Applying the plain meaning of the relevant statutes to the facts of this case and construing the statute against imposition of the tax as South Carolina law requires[14] necessarily results in the conclusion that the Waiver fees do not qualify as "gross proceeds of sales." As previously stated, South Carolina law defines "gross proceeds of sales" as "the value proceeding or accruing from sales and leases or rental of tangible personal property." S.C. Code Ann. §12-36-90 (2014). Here, the proceeds from the rental of property under the **Rental Agreements** are clearly "a value proceeding or accruing from" the sale or rental of tangible personal property (such as, for example, the rental of a television). On the other hand, the Waiver proceeds are "a value proceeding or accruing from" the sale of the intangible **Waiver**, which provides the customer, via a separate, optional agreement and for a separate charge, with the option to avoid certain risks of loss of the property rented. Tr. at 86:4-10 and 93:2-12, R. pp. ___ and ____. See also Alltel, 2015 WL 7681302, slip op. at p. 17-19 (finding that proceeds from the sale of indemnification coverage did not proceed or accrue from sale of tangible personal property as such coverage was not tangible personal property). As SCDOR agreed, the Waiver is not tangible personal property, and, therefore, the value proceeding or accruing from its sale is not from the sale of tangible personal property. See S.C. Code Ann. §12-36-90 (2014).[15]

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[14] See supra § I.

[15] SCDOR's manager of policy correctly agreed that if the Waiver was sold by a third party or even by an affiliate of Appellants, it would not be taxable (Tr. at 209:19-210:2, R. p.

The Order mistakenly asserts that the value of the rented property in the customer's hands is enhanced by the Waiver and appears to have viewed that as another basis for concluding that the Waiver proceeds were part of Rent-A-Center's gross proceeds. Order at p. 8, R. p. ___ (stating that customers who purchase items from Rent-A-Center "could reasonably consider that the value of their doing so would be enhanced by avoiding the obligation to pay for lost or damaged items by shifting the risk to [Rent-A-Center]"); Order Denying Pet. Mot. for Reconsideration at p. 2, n. 4, R. p. ___ (stating that the "value" in the context of the gross proceeds statute "is not the price of the durable good, which as Petitioners correctly observe, is not changed by the Waiver. It is the value of the transaction to the consumer.").

This is an incorrect interpretation of the gross proceeds statute. The ALC has erroneously shifted the focus from the value that proceeds or accrues to the seller (which is the focus of the imposition statute) to the value received by the customer. As SCDOR's manager of tax policy agreed, the relevant value under the statute is the value received by the seller, i.e. the "gross proceeds" it receives from the customer. Tr. 216:21-25 and 217:17-22, R. pp.____ and ____ .

A simple example will illustrate this point. If a customer buys a diamond ring for $5,000 but receives an accurate appraisal at the time of sale valuing the ring at $7,000, only the $5,000 received by the seller is subject to tax. The value to the customer because he benefitted from a bargain purchase is irrelevant because the value to the customer is not being taxed; the sales tax statute only reaches the value received by the seller. See S.C. Code Ann. §12-36-90.

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___), which, as the Pot-O-Gold court noted, would produce an absurd result. Pot-O-Gold Rentals, 155 So.3d at 512.

In sum, applying the plain meaning of the gross proceeds statute and construing it in favor of the taxpayer results in the conclusion that the Waiver proceeds cannot be part of Appellants' gross proceeds of sale, and Appellants respectfully request that this Court reverse the ALC's finding to the contrary.

## V. Even if the Waiver and the Rental Agreement Constitute a Single Agreement or Transaction, the Court Must Still Determine whether the Intangible Waivers are Subject to Sales Tax.

The ALC erroneously found that the Rental Agreement and the Waiver constituted one agreement or transaction. See Order at p. 3-4, R. p. ___ (finding that "the Agreement and Waiver are not separate agreements" and "that there is one transaction, one document consisting of two forms. . . ."). See also supra §VI (discussing these erroneous findings). The ALC then concluded from this that both components of the agreement or transaction are subject to sales tax. This is not true. The Court must still examine whether each part of the agreement or transaction is subject to sales tax. Where a taxpayer sells both tangible personal property and a service or intangible, the service or intangible does not become taxable merely because it is sold in conjunction with tangible property. See e.g. Alltel, 2015 WL 7681302, slip op. at pp. 18-20 (finding that sales proceeds from Alltel's optional contracts for indemnification coverage for wireless communication devices sold in conjunction with the devices were not subject to sales tax because no statute imposed such a tax); Southeastern Cinema Entertainment v. S.C. Dept. of Rev., 2014 WL 2417715 (S.C. Admin. Law Ct. 2014)(analyzing whether the proceeds from both the sale of an IMAX theater cinema and the sale of intangible trademarks pursuant to a single agreement were subject to sales tax); Rent-A-Center West, Inc. v. Utah State Tax Comm'n, No. 20140129, slip op. at p. 5 (Utah January 5, 2016) (holding that "[a]lthough the findings show a connection between the rental payments

and the liability waiver fee – the liability waiver provision is signed at the same time as the rental agreement, payments are made on the same schedule, etc. – none of these findings illustrate why this fee is paid *for* the rental property" and stating that "the waiver fee does not have any effect on the customer's possession, use or operation of the property"); Brock Serv., LLC v. Ala. Dept. of Rev., No. S. 14-1236, slip op. at p. 2 and 10 (Ala. Tax Tribunal Sept. 28, 2015)(finding that labor services provided in conjunction with renting of scaffolding pursuant to a single agreement were not subject to sales tax and noting that this result would follow "whether the separate labor services are included in the rental agreement or in a separate contract"); Pot-O-Gold Rentals, L.L.C. v. City of Baton Rouge, 155 So.3d 511, 512 (La. 2015) (holding that Pot-O-Gold's proceeds from the sale of optional cleaning services to a customer in conjunction with the rental of a portable toilet were not part of its gross proceeds and noting the absurdity of a conclusion that would find cleaning services for portable toilets not taxable if the toilet is owned by a third party but would find it a taxable service if the toilet is owned by the lessor.); Snite v. Ill. Dept. of Rev., 74 N.E.2d 877, 880 (Ill. 1947) (holding that "[i]f the service rendered in connection with an article does not enhance its value and there is a fixed or ascertainable relation between the value of the article and the value of the service rendered in connection therewith, then the vendor is engaged in the business of selling at retail, and also engaged in the business of furnishing service, and is subject to tax as to the one business and tax exempt as to the other."); B&B Inflatable Fun World, LLC v. State of Ala. Dept. of Rev., Docket no. S. 15-1595 (Ala. Tax Tribunal July 20, 2016)(explaining that whether the sale of labor services and the sale of tangible personal property are set forth in one versus two agreements does not control as "otherwise, evasion of the taxing statutes would be permitted by merely affixing a nontaxable label to an otherwise taxable transaction"). See also

infra § II(B)(2) (for discussion of bundled transactions, which can result in a service or intangible sold in conjunction with tangible personal property being subject to tax, but which are not at issue here).

In sum, whether one agreement or transaction or multiple agreements or transactions are at issue, a court must still examine whether each part of the agreement(s) or transaction(s) is subject to sales tax. The ALC failed to do this, and therefore, the Order must be reversed.

## VI. The ALC Erred in Making the Factual Finding that the Rental Agreement and the Waiver Constitute a Single Agreement or Transaction.

The ALC erroneously found that the Rental Agreement and the Waiver constituted a single agreement or transaction. See Order at p. 3-4, R. p. ___. The ALC based this conclusion primarily on the following: that the Waiver is entitled "Optional Liability Waiver Provision" and states that it is "an additional part of the Rental Agreement;" that the Waiver fee is calculated as a percentage of the rental fee and may only be enforced while the Rental Agreement is in effect; that the Waiver fee is listed on the Rental Agreement; that the Waivers are only available on items acquired from Rent-A-Center; that Professor Pomp stated in his testimony once an engraved trophy was purchased, engraving and assembly were no longer optional. Id.

While a finding that a single agreement or transaction existed is not determinative in this matter (see supra §V), it is clearly erroneous in light of the substantial evidence in the record establishing that the Rental Agreement and the Waiver are, in fact, two separate agreements and transactions, and this finding appears to have led the ALC to improperly conclude that the agreements were "fundamentally interconnected" and to incorrectly apply the "true object" test. Order at p. 3, R. p. ___ (as to ALC's finding that the agreements were

"fundamentally interconnected") and p. 8, R. p. ___ (as to ALC's application of "true object" test); see also supra at §II(B)(2) (for discussion of improper application of "true object" test).

Substantial evidence in the record established that two separate agreements or transactions are at issue here. The Waivers are entirely optional, and if purchased, the fee is noted separately on the customer's receipt. Waiver, R. p. ___; Sample Receipt, R. p. ___; Tr. 78:6-10 and 83:17- 84:8; R. pp. ___. Payment of that fee does not count toward the rental charge or the purchase of the rental property. Rental Agreement, R. p. ___; Waiver, R. p. ___; Tr. 78:11-79:12, R. p. ___. The Waivers can be purchased at any time and canceled at any time without impacting the Rental Agreement in any way. Waiver, R. p. ___; Waiver Policy Statement, R. p. ___, Waiver, R. p. ___; Tr. 79:13-17 and 81:14- 82:3, R. pp. ___ and ___, Waiver, R. p. ___.

Additionally, the two agreements provide two different benefits to the customer: the Rental Agreement provides the benefit of renting to own an item, while the Waiver provides the benefit of avoiding the risk of loss (*i.e.* avoiding responsibility for paying the fair value of the property) in case of certain enumerated damages to or theft of the property. Tr. at 84:15-85:3 and 85:20-87:5, R. pp. ___ and ___; see also Rental Agreement, R. p. _____; Waiver, R. p.____. Each agreement has its own separate offer, acceptance and consideration, and the parties execute each agreement independently. Id. Each is therefore a separate and independently enforceable contract.

The reference to the cost of the Waiver in the Rental Agreement and the incorporation by reference of some terms of the Rental Agreement into the Waiver were both required by

law.[16] These requirements should not be used to convert the Waiver into something that it is not (i.e. a single agreement or transaction) when the facts establish that the Waiver is an optional, additional, separate and independent agreement and transaction. Additionally, the labeling of the Waiver as a "provision" and as an "additional part of the rental agreement" in order to incorporate the provisions from one agreement into the other is not determinative. The Waiver remains an optional, separate and independent contract with its own offer, acceptance and consideration. Calling it a provision does not change those facts, and viewing it as a single agreement or transaction would be elevating form over substance.

In light of the above discussed evidence, the ALC's finding that the Rental Agreement and the Waiver were a single agreement or transaction is contrary to the substantial evidence in the case and is clearly erroneous. Thus, Appellants respectfully request that the Court reverse the ALC's finding as the evidence clearly shows that two separate agreements or transactions are at issue.

## CONCLUSION

Based on the foregoing, Appellants respectfully requests that this Court reverse the ALC's decision because their rights have been prejudiced because the administrative findings, inferences, conclusions or decisions are in violation of constitutional or statutory provisions, affected by errors of law, or are clearly erroneous in light of the reliable, probative and substantial evidence in the record, and the assessment against them should be dismissed.

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[16] More specifically and as stated in the testimony, certain consumer protection laws related to notice and transparency require that the cost of the Waiver be reflected in the Rental Agreement versus being only set forth in the Waiver. Tr. 82:13-23, R. p. ____. Various consumer protection laws also require that the Waiver include some of the disclosures made in the Rental Agreement. Tr. 85:4-19, R. p. ____.

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Charleston, South Carolina
September 6, 2016

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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APPEAL FROM THE ADMINISTRATIVE LAW COURT COUNTY

H. W. Funderburk, Jr., Administrative Law Judge



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Case No. 13-ALJ-17-0601-CC

Appellant Case No. 2016-001210

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Rent-A-Center East, Inc. and Rent Way, Inc., Appellants,

v.

South Carolina Department of Revenue, Respondent.

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PROOF OF SERVICE

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I, the undersigned Administrative Assistant of the law offices of Nelson Mullins Riley & Scarborough LLP, attorneys for Rent-A-Center East, Inc. and Rent Way, Inc., hereby certify that I have served all counsel in this action with a copy of the pleading(s) hereinbelow specified via U.S. Mail to the following address(es):

Pleadings:

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September 6, 2016



**Via Hand Delivery**
The Honorable Jenny Abbott Kitchings
Clerk of Court
SC Court of Appeals
1220 Senate Street
Columbia, SC 29211

RE: Rent-A-Center East, Inc., and Rent Way, Inc., Appellants v. South Carolina Department of Revenue, Respondent.
SC Appellate No.: 2016-001210
Our File No. 17856/09003

Dear Ms. Kitchings:

Enclosed are the originals and one copy of the following documents in the above matter:

1. Initial Brief of Appellant;
2. Appellant's Designation of Matter to be Included in the Record on Appeal; and
3. Proof of Service.

Please file the original pleadings and return the clocked-in copies to us via our courier. By copy of this letter, we are serving these pleadings on counsel for Respondent.

Thank you for your assistance with this matter.

With kind regards,

Bryson M. Geer

BMG:dh
Enclosures
cc: Sean G. Ryan, Esq.
Lauren Acquaviva, Esq.