

STATE OF NORTH CAROLINA  
COUNTY OF WAKE

BEFORE THE PROPERTY TAX COMMISSION  
SITTING AS THE  
STATE BOARD OF EQUALIZATION AND  
REVIEW

IN THE MATTER OF THE APPEAL  
OF:

**AARON'S INC.,**  
**Appellant**

**16 PTC 0124**

From the decision of the Sampson  
County Board of Equalization and  
Review concerning the valuation of  
certain personal property for tax year  
2016

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**FINAL DECISION**

This matter came on for hearing before the North Carolina Property Tax Commission (“Commission”) sitting as the State Board of Equalization and Review in the City of Raleigh, Wake County, North Carolina on Wednesday, December 20, 2017, pursuant to the Appellant’s appeal from the decision of the Sampson County Board of Equalization and Review (“Board”).

Chairman Robert C. Hunter presided over the hearing, with Vice Chairman Terry L. Wheeler and Commission Members William W. Peaslee, Alexander A. Guess, and Charles W. Penny participating.

Sampson County Attorney W. Joel Starling, Jr., appeared on behalf of Sampson County (“County”). Alexander P. Sands, III, Esq., appeared on behalf of the Appellant.

**STATEMENT OF THE CASE**

The Appellant operates a business in Sampson County that offers items of personal property such as furniture, appliances, personal computers and other household electronics to its customers either for direct sale or under the terms of a monthly renewable lease with option to purchase. This appeal does not involve personal property such as store display or point of sale equipment that is owned by the appellant; the appeal is solely related to the items of personal property that the Appellant offers to its customers. At any given time, some portion of the personal property owned by the Appellant is located on the business premises, such as that on display, and

a substantial portion of the property is situated on the property of the Appellant's customers and subject to the terms of one of the aforesaid lease agreements. With regard to the subject personal property, the Appellant sought the exclusion offered by N.C. Gen. Stat. §105-275(34), "Inventories owned by retail and wholesale merchants."

The Appellant made application to the County for the aforesaid exclusion, which application was denied. The Appellant then appealed said denial to the Sampson County Board of Equalization and Review ("Board"). On April 21, 2016, the Board determined that the personal property was not entitled to the exclusion sought by the Appellant, and mailed notice of its decision to the Appellant on May 4, 2016. The Appellant appealed the decision of the Board by filing its Notice of Appeal and Application for Hearing with the Commission on June 1, 2016. In said Notice and Application, the Appellant contended that it was entitled to the exclusion offered by N.C. Gen. Stat. §105-275(34), further contending that it is a "retail merchant," and that all of the personal property is "inventory," as these terms are defined in N.C. Gen. Stat. §105-273.

#### ANALYSIS AND ISSUES

N.C. Gen. Stat. §105-274 provides that all property located within North Carolina, both real and personal, is subject to taxation unless expressly excluded or exempt from taxation by a statutory or constitutional provision. N.C. Gen. Stat. §105-275(34) expressly excludes from taxation "[i]nventories owned by retail and wholesale merchants." "Inventories" is defined by N.C. Gen. Stat. §105-273(8a)(a.) as "[g]oods held for sale in the regular course of business by manufacturers, retail and wholesale merchants, and construction contractors."<sup>1</sup>

In seeking an exemption or exclusion from taxation, "it is the taxpayer's burden to **prove** that the property in question is entitled to an exemption,"<sup>2</sup> and "a party claiming a statutory exemption bears the burden of bringing itself within the exemption or exception."<sup>3</sup>

Under this analysis, the Commission must consider whether the Appellant carried its burden of producing competent, material and substantial evidence<sup>4</sup> proving that the personal

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<sup>1</sup> See In re Appeal of R.W. Moore Equipment Company, Inc., 115 N.C. App. 129, 131, 443 S.E.2d 734, 735 (1994)

<sup>2</sup> In re Appeal of Southeastern Baptist Theological Seminary Inc., 135 N.C. App. 247, 249, 520 S.E.2d 302, 304 (1999) [emphasis added to distinguish this burden from one of production]

<sup>3</sup> Parkdale America, LLC v. Hinton, 200 N.C. App. 275, 278, 684 S.E.2d 458, 461 (2009)

<sup>4</sup> N.C. Gen. Stat. §105-345.2(b)(5)

property made the subject of this appeal is excluded from property taxation as inventory of the Appellant.

**FROM THE EVIDENCE PRESENTED AND ALL DOCUMENTS OF RECORD,  
THE COMMISSION MAKES THE FOLLOWING FINDINGS OF FACT:**

1. All of the Appellant's personal property is initially available for direct sale from the showroom floor at the business premises. Testimony and other evidence indicated that, ultimately, approximately 5% of the property is purchased directly from the showroom, with the remaining 95% being made subject to the terms of monthly renewable lease agreements between the Appellant and multiple lessees.
2. The Appellant's standard lease agreement for North Carolina includes a "Purchase Option" by which the lessee may acquire ownership of the leased property by making the "Total No. of Payments to Own" provided in the lease. The lessee may also exercise an "Early Purchase Option," through which the lessee may purchase the leased property at the original cash price, receiving credit toward the purchase in the amount of 50% of lease payments made up to the date of purchase.
3. The lease agreement further states that ownership of the property remains with the Appellant until the lessee has exercised one of the purchase options; that the lessee will not obtain any equity interest in the property prior to purchase; and that the lessee may voluntarily return the property and terminate the lease at any time.
4. The lease agreement further provides for the collection from and payment by the lessee of sales and use tax on the gross proceeds paid under each renewable lease payment.
5. Ben Turner, the tax director for the Appellant and former Certified Public Accountant (Georgia), testified that all of the Appellant's property which is subject to lease is listed as a depreciable asset for income tax or other financial reporting purposes while being leased.
6. Mr. Turner further testified as to the information contained in a trial balance submitted to the County and marked as "Sampson County TY15," stating that the "sales new" account description reflected direct purchases, and that the "lease revenue" account description was used for "internal tracking," and that it represented "purchases on time."

**BASED UPON THE FOREGOING FINDINGS OF FACT, THE PROPERTY TAX COMMISSION CONCLUDES AS A MATTER OF LAW:**

1. The Commission has jurisdiction over the parties and the subject matter of this appeal.
2. The Appellant has advanced multiple theories by which it urges that the Commission could view the subject property as inventory, which we will attempt to address comprehensively and in turn.
3. The various theories generally involve characterizing the lease agreements as long-term sales, since the lessee is entitled to ownership of the property upon making the “Total No. of Payments to Own” provided in the lease. We distinguish these transactions from installment or other long-term sales for two reasons: First, the leases are not dependent on the Appellant’s extension of credit of the lessees; in fact, the Appellant widely advertises “No Credit Needed” to enter into a personal property lease. Second, and more importantly, we recognize that both a sale and a lease involve the transfer of possession from the original owner to another; however, a sale also mutually commits the parties to the transfer of ownership in exchange for the purchase price. In contrast, the Appellant’s lease agreement is freely terminable by the lessee—there is never an obligation to purchase the property—and transfer of ownership is only enforceable as to the Appellant, and then only under certain conditions. Testimony of the Appellant’s manager for the Clinton, North Carolina business location indicated that only 70% to 75% of first-time property leases remained in effect until the “Total No. of Payments to Own” were paid, so a significant number of leases appear never to meet the requirements necessary for ownership to transfer from the Appellant.
4. The Appellant further suggests that the lease agreements are the equivalent of specific sale arrangements, and that the leased property is therefore inventory. For example, when asked the difference in a lease to purchase and a conditional sale, the Appellant’s witness Mr. Turner responded that they were merely “different ways to get to the same answer.” Separately, the Appellant argues that the lease agreements are “basically [a] bill of sale or sale contract.” We disagree with each of these characterizations. As noted earlier, a sale is a transfer or a mutually enforceable agreement to transfer the ownership and possession of property for a price. A sale

contract is such an agreement to transfer, creating obligations both to buy and to sell; a bill of sale is simply documentation of the right to own specific property; and we find the Oxford English Dictionary definition of “conditional sale” to be particularly fitting:

The sale of goods according to a contract containing conditions, typically that ownership does not pass to the buyer until after a set time, usually after payment of the last installment of the purchase price, although **the buyer has possession and is committed to acquiring ownership.**<sup>5</sup>

The plain and ordinary meaning of “sale,” whether by installment, contract, or condition, requires a mutually enforceable obligation to effect the transfer of ownership for a price, which obligation is determined at the outset of the arrangement, rather than by default at its conclusion. No matter the label, any sale arrangement is distinguishable from the Appellant’s lease agreements because the transfer of ownership is merely an option under the lease, as demonstrated historically by the fact that the option appears not to be exercised in a significant portion of leases.

5. The Appellant offers various interpretations of provisions of the Uniform Commercial Code (“UCC”) as adopted by the North Carolina General Assembly in N.C. Gen. Stat. Chapter 25 in support of its argument that its transactions are sales, but we see no need to further analyze the distinction. Even if the UCC provisions were further enlightening, the ultimate issue before the Commission is whether the property is inventory as defined in N.C. Gen. Stat. §105-273(8a)(a.) of the Machinery Act, and not directly whether the transactions are sales or leases.
6. Finally, the Appellant offers a case heard by the Texas Court of Appeals, Rent-A-Center, Inc. v. Hegar, 468 S.W.3d 220 (2015), in which that court considered whether Rent-A-Center’s, “rental-purchase” agreements justified treating the transactions as sales, and therefore whether Rent-A-Center could be characterized as a “retail merchant” for purposes of Texas state franchise tax. The Texas court described the Rent-A-Center agreements as “hybrids of rentals and sales” and noted, “The salient question is: Are they *more* like sales or leases?” [emphasis in original]. Without

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<sup>5</sup> [https://en.oxforddictionaries.com/definition/us/conditional\\_sale](https://en.oxforddictionaries.com/definition/us/conditional_sale) [emphasis added], accessed February 19, 2018

further discussion, the Texas court concluded that the transactions are more like sales, and that Rent-A-Center is therefore “primarily engaged in retail trade.” We see at least three issues with extending the Texas court’s holding to this case. First, the Texas holding carries no legal precedent in North Carolina. Secondly, although the description provided of Rent-A-Center’s business activities sound similar to those of the Appellant, we do not have the benefit of reviewing Rent-A-Center’s rental-purchase agreements to compare them with the Appellant’s, and the Texas court’s description of the rental-purchase agreements suggests that there could well be significant differences in the agreements employed by different companies in different states. And, finally, just as described earlier, the “sale or lease” question is an indirect approach to the actual underlying question. In North Carolina, the real question is, “is the subject property inventory?” The Texas question was, “is Rent-A-Center a retail merchant?” The fact that the Texas court reached its conclusion on the way to interpreting Texas franchise tax law hardly seems relevant to answering the North Carolina question.

7. The Court of Appeals of North Carolina considered whether property rented to third properties was inventory for the lessor in In re Appeal of R.W. Moore Equipment Co., 115 N.C. App. 129, 443 S.E.2d 734 (1994). In that case, the taxpayer sold and rented heavy equipment, and retained the right to withdraw the equipment from rental at any time and sell it to a party other than the renter. The Court’s holding in the Moore case contained several observations that are relevant to the case at hand:
  - a. In reviewing the language of N.C. Gen. Stat. §105-273(8a)(a.), which requires that “goods be held for sale” in order to be considered inventory, the Court found that the property in question “was not ‘held’ by taxpayer, but rather the lessee....” Similarly, all property under lease by the Appellant in this case is not held by the Appellant, but rather by the lessees.
  - b. Even though the taxpayer in the Moore case had the authority to pull equipment off lease and sell it to a third party, the Court found that the option to purchase given to the renter limited the taxpayer’s power to sell the property that was under lease. Here, the Appellant is even more limited in its power to sell the leased property because it cannot sell the leased property to a

third party, and although the lessee has the option to purchase the property, the Appellant cannot require a purchase.

- c. “It is the use to which the property is dedicated, rather than the nature or characteristics of the owning entity which ultimately determines the property's exemption status. In re Wake Forest University, 51 N.C. App. 516, 277 S.E.2d 91, disc. review denied, 303 N.C. 544, 281 S.E.2d 391 (1981).(Citations omitted.) While Taxpayer contends that it holds all its equipment for the purpose of sale, the evidence shows that the equipment of Taxpayer in question is primarily used for rental purposes. We, therefore, agree with the Commission that **Taxpayer, by renting the equipment to third parties, is not entitled to the inventory tax exclusion for the rented equipment.**”<sup>6</sup>

In this case, the Appellant’s income received from actual sales is dwarfed by income received from rental payments, suggesting that the primary use to which the property is dedicated is to generate lease income. Regardless, the Moore court’s holding indicates that any rental of the Appellant’s property eliminates the property’s eligibility for the inventory tax exclusion.

- d. The Moore Court’s point is emphasized when consideration is given to the fact that the Appellant depreciates the leased property for income tax and financial reporting purposes:

“The record reflects that defendant [taxpayer] treats the equipment as income producing property rather than inventory for financial reporting purposes, depreciating only that part of its inventory of new and used equipment that it uses for rental purposes. We, therefore, agree with the Commission's finding that **this treatment renders the equipment used for rental purposes ineligible for tax exclusion because its use and consumption as income producing property is incompatible with its character as inventory.**”<sup>7</sup>

- e. Finally, the Appellant in this case leases property without requiring the lessees to purchase the property, much like the taxpayer in the Moore case, which was

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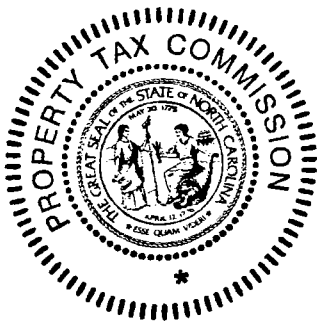
<sup>6</sup> In re Appeal of R.W. Moore Equipment Co., 115 N.C. App. 129, 132, 443 S.E.2d 734, 736 (1994) [emphasis added]

<sup>7</sup> Id at 133 [emphasis added]

determined by the Court to be “in direct competition with the rental companies,”<sup>8</sup> further indicating that the Appellant’s business model is more like a rental company than like a company that relies on the direct sale of its property for its business.

8. Property that remains in the actual possession of the Appellant and is available for sale is inventory within the meaning of N.C. Gen. Stat. §105-273(8a)(a.) until it becomes subject to a lease.

**WHEREFORE**, the Commission orders and decrees that all property of the Appellant that is subject to a lease is not eligible for the property tax exclusion offered by N.C. Gen. Stat. §105-275(34), but that said property tax exclusion does apply as to such personal property that is in the actual possession of the Appellant and available for sale.



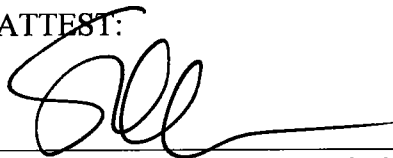
NORTH CAROLINA PROPERTY TAX COMMISSION

  
Robert C. Hunter, Chairman

Commission Members Peaslee, Guess, and Penny  
concur.

Date Entered: 3/1/18

ATTEST:

  
Stephen W. Pelfrey, Commission Secretary

**DISSENT**

I respectfully disagree with the majority for the following reasons:

1. The facts in the Moore case are distinguishable from the case at hand because the taxpayer in the Moore case was not engaged in a rental business that had as its

<sup>8</sup> Id at 133



ultimate objective ownership by the lessee; the taxpayer was merely renting the property in that case. Conversely, the Appellant in this case offered testimony that ownership by the lessee was the ultimate goal of the lease agreements.

2. I agree with the reasoning in the case heard by the Texas Court of Appeals, and would use the same logic to find that the Appellant's transactions in this case are actually more like sales than leases, and that the property subject to the leases is therefore appropriately considered inventory.



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Terry L. Wheeler, Vice Chairman