

IN THE SUPREME COURT OF OHIO

EPISCOPAL SCHOOL OF CINCINNATI, :
Appellee, :
v. :
WILLIAM W. WILKINS [RICHARD A. :
LEVIN], TAX COMMISSIONER OF :
OHIO, :
Appellant. :

CASE NO. 07-0126

On Appeal from the Ohio Board
Of Tax Appeals

BTA Case No. 2004-R-230

MERIT BRIEF OF APPELLEE EPISCOPAL SCHOOL OF CINCINNATI

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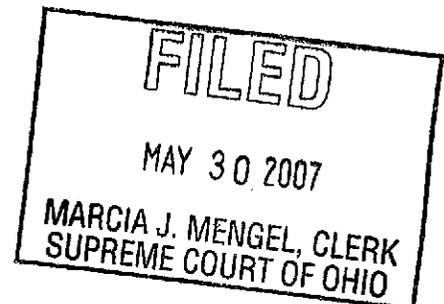


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Pursuant to R.C. 323.11, 5713.08 and 5715.27, the taxability of real property, and the entitlement of property to exemption from taxation, is determined as of the tax lien date of each year, without regard to when an exemption application is filed.

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I. INTRODUCTION

The Episcopal School of Cincinnati (ESC) spent over \$7 million in 2001 to create a religiously based, non-profit school in Cincinnati. As of January 1, 2001, the tax lien date for the year in question, it is undisputed that ESC was actively working towards use of the property it purchased in November 2000 to create a school.

The Tax Commissioner nonetheless denied exemption from real estate tax for the year 2001 by using hindsight. The Commissioner delayed acting on ESC's exemption application for more than two years - until February 10, 2004. By then, ESC had decided not to create a school on the property, and instead sold it in November 2002. The Commissioner wrongly declared that, because the property never operated as a school, the property was not entitled to exemption for 2001, when enormous effort was made to turn the property into a school.

This Court said in *Holy Trinity Protestant Episcopal Church of Kenwood v. Bowers* (1961), 172 Ohio St. 103:

A religious institution which purchases vacant land for the purpose of erecting a house of worship thereon is entitled to have such land exempted from taxation, where such institution is actively working toward the use of such land for the public benefit; and the intent to make such a use of the land may be evidenced by a showing that plans have been prepared and funds were available, or were to be available, to effectuate actual construction of such house of worship within a reasonable time from the filing of the exemption.

This syllabus language means that exemption applies before the ultimate intended use occurs, so long as the church is "actively working toward the use of such land for the public benefit." The language that follows this point offers one way to present evidence of the prospective exempt use. The essence of the holding is that land is entitled to tax exemption from the time a charity or religious body acquires it if there is active work towards completion of the structure that will house the exempt use. Any contrary rule would tax charitable and religious bodies that hold

property purely for exempt uses and are in the midst of development or construction activities. Such a rule would conflict with statutes and overturn settled authority.

The Commissioner's Final Determination recognized that tremendous work towards creating a school on ESC's property occurred throughout 2001 and that it was not until November 2002 that this work ceased and the property was sold to a for-profit buyer. The Commissioner said, "Evidence of those preparation efforts must exist as of tax lien date for the year the taxpayer is requesting exemption." Appx. 23, p. 2. This was a correct statement of what this Court and the exemption statutes say. Despite the fact that preparation efforts were well under way on the tax lien date for 2001 -- January 1, 2001 -- the Commissioner erroneously ruled:

"In reviewing this application, the passing of time has proven to be a benefit because the facts available to us now are more complete and accurate than those available at the time this application was filed. Since it has been established that the applicant's intention did not result in an exempt use of the property, then neither the actual nor prospective use test have been satisfied, and the requirements of R.C. 5709.07 have not been satisfied."

Id. at 3. This amounts to a blatant rejection of this Court's clear direction that one must judge whether preparation efforts existed as of the tax lien date (January 1, 2001), not at a point in time over three years later when the Commissioner ruled.

The Board of Tax Appeals followed this Court's direction by deciding whether as of January 1, 2001 there was work going on to turn the property into a school. The overwhelming, unchallenged evidence was that there was. The BTA thus reversed the Commissioner's ruling. Only in its post-hearing brief did counsel for the Commissioner take the novel position that one should judge activity as of the date that ESC applied for tax exemption (December 2001) instead of the January 1 tax lien date. Although this position contradicts the Commissioner's own holding, it was apparently the only way to try to escape the Commissioner's flawed use of

hindsight. Nowhere in the statute or prior case law is there any support for the idea that the application date has any relevance to an exemption request. This is because an applicant for exemption may request it any time up to three tax years after the year for which exemption is sought, and taxability for each intervening year is determined as of the tax lien date for that year, not the application date.

Although the Commissioner claims to seek reinstatement of his Final Determination, that is not the case. His Final Determination was grounded on the theory that the prospective use test for exemption does not apply if, retrospectively at the time of his *decision* (not the application date), one can conclude that the ultimate exempt purpose was never realized. The BTA correctly overruled that novel approach. Now, the Commissioner has abandoned his previous position and has come up with an entirely new theory of the case – one that was not raised in his Final Determination -- that the prospective use test does not apply if the ultimate exempt purpose has not been achieved *at the date of application*.

The position now taken by the Commissioner would rewrite the statute and reverse longstanding, controlling case law, including the Commissioner's own stated position. It would mean that even though a charity or school was hard at work developing a property on the tax lien date, it would be taxed and lose its exemption if it hesitated or did not ultimately complete the project. This would effectively abolish the prospective use test that this Court affirmed in *Holy Trinity*. The taxability of real property is determined for each parcel as of January 1 of the tax year. The Commissioner's position would unlawfully shift that determination to the date of application for exemption. Appellant's position has no basis in the evidence or in law.

Moreover, the evidence in the record is inconsistent with the Commissioner's claim that efforts to build a school on the property had been abandoned by the date of application.

II. STATEMENT OF FACTS

The record supports, and the Commissioner does not contest, that ESC is a charitable, educational institution formed by the Episcopal Diocese of Southern Ohio that purchased the subject property in 2000 and by tax lien date 2001 had taken extensive steps to open a school later that year. It is also undisputed that ESC never operated the property with any view to profit.

After a three-year period of preparation and planning, ESC purchased the subject property in 2000 with the intent to convert the former Cincinnati Natural History Museum building into an independent, Episcopal elementary and middle school, with a planned, publicly announced and advertised opening to occur in September 2001. The steps taken by ESC on or before the tax lien date (January 1, 2001) included the following:

- Formed ESC as a religious, charitable, non-profit corporation, which is included within the Episcopal Church's group federal tax exemption under IRC 501(c)(3) (2d Supp. 1-6);
- Recruited a volunteer Board of Trustees composed of outstanding community leaders (Supp. 7., Tr. 23; Supp. 56-58);
- Hired a retired Episcopal priest as Coordinator in charge of completing all steps necessary to open the school (Supp. 7., Tr. 23; Supp. 54-55);
- Contributed \$4,500,000 to the Cincinnati Museum Center to acquire the subject property, subject to a covenant running with the land that legally restricted its use to educational or museum purposes (Supp. 7-8, Tr. 24-25; 2d Supp. 177, Ex. 4);
- Bought an additional parcel of property for \$1,800,000 and transferred it to the Cincinnati Museum Center (Supp. 7-8, Tr. 24-26; 2d Supp. 177, Ex. 4);

- Engaged McGill Smith Punshon, an architectural firm, which prepared a feasibility study, floor plans and furniture plans, and was ultimately paid more than \$460,000 for its services by ESC and the Episcopal Diocese (2d Supp. 180-234; Supp. 24-25, Tr. 87-90);
- Engaged a construction company, which prepared a detailed construction budget (2d Supp. 66-103, 176);
- Prepared and filed school certification documents with the Ohio Department of Education (2d Supp. 7-65);
- Hired and paid a Head of School, a Chief Financial Officer and a Development Director (Supp. 9, 25, Tr. 31, 91);
- Obtained a \$500,000 grant from the William Cooper Procter Fund of the Episcopal Diocese of Southern Ohio (Supp. 25, Tr. 92); and
- Obtained a \$6,500,000 Committed Line of Credit loan facility, and a \$10,500,000 Letter of Credit facility, from PNC Bank to finance the property acquisition (2d Supp. 106-175).

ESC hired Frank Messer & Sons Construction Co. to complete the renovations for conversion of the building to a school facility. Although the formal contract was not executed until January 2001 with an effective date of January 2, 2001 (2d Supp. 176), Messer had previously prepared an extensive "Project Conceptual Budget" dated September 13, 2000, detailing approximately \$4,000,000 in renovations to complete Phase I of the project. (2d Supp. 66-103.)

By August 2000, ESC hired Dr. Carolyn Blackburn as Head of School, who became its spokesperson. (Supp. 9, Tr. 31; 2d Supp. 104-105.) Dr. Blackburn had been head of Cincinnati

Country Day School's lower school. (Supp. 49.) ESC also hired a controller and a development director. (Supp. 9, 25, Tr. 31, 91.) The school's planned opening for September 2001 attracted media attention as early as July 2000. (Supp. 160-161.)

In April 2001, when financial difficulties with ESC began to surface, Archdeacon James Hanisian met with architecture firm McGill Smith to see if a scaled-down version of the school could be created. McGill Smith came back with an alternate plan requiring about \$2,000,000 - \$3,000,000 in expenditures. (Supp. 12, Tr. 43.) Although expenditures became more limited later in 2001, and the property was sold in November 2002, there was never a time when the property was owned by ESC that ESC's Board or the Bishop of the Episcopal Diocese contemplated any other use for the property than as a school. (Supp. 22, Tr. 81-82.) In August 2001, ESC hoped to open the school in the fall of 2002. (Supp. 18, Tr. 65-66.) Neither the Bishop nor Archdeacon Hanisian abandoned their plan to find a way to put a school on the property, until it was sold in November 2002. (Supp. 12-13, Tr. 44-45.) The record does not support the Commissioner's claim that ESC had abandoned its plans to build a school on the property at the time the exemption application was filed in December 2001.

The total amount of money invested by the Episcopal Diocese in ESC and in attempting to open a school on the subject property was about \$6,400,000, after deducting the net proceeds from the sale of the property in 2002 (\$1,077,000). (Supp. 25, Tr. 90-91.)

III. ARGUMENT

A. Proposition of Law No. 1:

Where an institution acquires real property with the ultimate purpose of devoting it to a use which is exempt from taxation, and is actively working toward this use on the tax lien date of the year for which exemption is sought, the property is entitled to be exempted from taxation for that year, even though actual use of the property for the prospective exempt purpose has not begun, and even if further efforts to realize that purpose have ceased by the time the exemption application is filed.

The prospective use test, adopted by the Court in *City of Cleveland v. Carney* (1959), 169 Ohio St. 259, as confirmed in *Holy Trinity Protestant Episcopal Church of Kerwood v. Bowers* (1961), 172 Ohio St. 103, and *Bd. of Cty. Cmmrs. of Lake Cty. v. Supanick* (1972), 32 Ohio St.2d 45, mandates tax exemption for property absent actual physical use for the intended exempt purpose so long as active efforts to achieve that purpose have been undertaken, even if those efforts are ultimately unsuccessful.

The Commissioner's theory in this case is based on the faulty premise that a different prospective use test is applied to non-government property from that applicable to government property. The Commissioner contends that while government property is entitled to tax exemption under *Carney* during the period that significant steps toward an exempt purpose are being taken, even if the exempt purpose is abandoned or ceases to exist, the test for exemption is more rigorous for non-government property. In the Commissioner's view, an additional test must be imposed; namely: ". . . the applicant must demonstrate that the property 'will be devoted to an actual physical use.'" (Brief of Appellant at 26.) The Commissioner then argues that this additional standard can only be met "[i]f the applicant is still taking concrete steps toward completing the goal at the time the applicant files the application . . ." *Id.*

There is nothing in the statutes or case law to support such a distinction. The Commissioner's interpretation misapplies this Court's findings in *Holy Trinity*. In *Holy Trinity*, the

Court overruled the Board of Tax Appeals' refusal to apply the prospective use test to a non-governmental entity seeking exemption. In so doing, the Court stated:

“The basis for tax exemption is the public benefit, and the ultimate purpose of tax exemption, whether in relation to public property or nongovernmental property, is to insure that property or funds devoted to one public benefit shall not be diminished by diverting such funds by means of taxation to another public benefit.

It is of course axiomatic that services which are for the public benefit are not confined purely to public or governmental operations. Many nongovernmental entities such as hospitals and churches are considered to be operated for the benefit of the public.”

~~172 Ohio St. at 105. There is no basis for a legal distinction between governmental and non-~~
governmental property in the application of the prospective use test for property tax exemption.

This Court's decision in *Bd. of Cty. Cmmrs. of Lake Cty. v. Supanick* (1972), 32 Ohio St.2d 45 sets the applicable standard for both governmental and non-governmental uses. In *Supanick*, the Court held that “. . . property is entitled to be exempted from taxation until such time as the ultimate purpose has been abandoned, or efforts to realize the ultimate purpose have ceased, or the property has been put to a non-public use, even though actual physical use of the property for the intended exempt purpose has not yet begun.” 32 Ohio St.2d 45, syllabus. Importantly, exemption is effective *until* the ultimate purpose has been abandoned or efforts have ceased, not *unless* such events later occur.

The Commissioner's argument now (contrary to his actual Determination) is that non-governmental property is exempt only if efforts to achieve the ultimate purpose have not ceased by the application date. In other words, he contends that a second test of continued efforts must be applied as of the application date – a hindsight-view test neither contemplated nor authorized by *Supanick* or its predecessors. Contrary to the Commissioner's position, the appropriate analysis is that used by the Board of Tax Appeals below and by the Eighth District Court of Appeals in *Community Temple v. Voinovich* (April 8, 1976), Cuyahoga App. No. 35395, 1976 Ohio App.

LEXIS 8333, unreported. Both the BTA and the Eighth District interpreted *Holy Trinity* and *Supanick* to recognize exempt status for property where active steps had been taken to achieve the ultimate exempt purpose, even though such purpose was not ultimately achieved. The timing of the filing of the exemption application is obviously irrelevant to this determination.

The Commissioner attempts to cut a very thin slice – while not expressly advocating overturning *Supanick*. His argument seems to be that exemption is permissible even if the ultimate exempt purpose has been abandoned or efforts to achieve it have ceased, *unless* that happens before the application is filed. Then, the Commissioner would deny exemption, apparently without regard to how many tax lien dates have passed between the commencement of exempt purpose activities and the date of application for exemption.

Notably, R.C. 5713.081 permits the filing of an exemption application up to three years after the tax year for which exemption may ultimately be available. For example, if property was acquired (as in this case) in 2000 and actions were immediately taken to devote it to the exempt purpose, the exemption application could be filed in 2004 for that tax year and for the three preceding tax years; namely, 2001, 2002 and 2003. If the commissioner determines that the property was entitled to exemption for 2001 but not for subsequent years, he must exempt it for 2001. In that situation, the fact that the property no longer qualified for exemption prior to the date of filing the application in 2004 is irrelevant to determining its taxable status for 2001.¹ The only difference in this case is that, according to the Commissioner, efforts to achieve the exempt purpose ceased by December 2001. But in both situations, *Holy Trinity* and *Supanick* dictate that the

¹ There is no authority to deny in its entirety an exemption application filed requesting remission for multiple tax years, merely because the property qualifies for one but not all of the years for which exemption is sought.

prospective use test is applied as of the tax lien date for the year in question, not retroactively as of a later date of application.

B. Proposition of Law No. 2:

Pursuant to R.C. 323.11, 5713.08 and 5715.27, the taxability of real property, and the entitlement of property to exemption from taxation, is determined as of the tax lien date of each year, without regard to when an exemption application is filed.

1. ~~Even assuming that ESC abandoned efforts to convert the property to~~ exempt use by the time it filed the exemption application, the appropriate date to determine the right to exemption is the tax lien date, not the application date.

Because the taxability of real property is determined as of January 1 (the tax lien date) of each year, the determination of whether property is entitled to exemption from taxes logically must be made as of that date. The state's lien for taxes attaches to real property on the first day of January annually. R.C. 323.11. The county auditor has a duty to make a determination of the true value of each tax parcel of property. That determination involves viewing and appraising each parcel at its true value at least once in each six-year period. R.C. 5713.01(B). True value must be determined as of the tax lien date for the tax year in question. R.C. 5715.01(C). January 1 is the "crucial valuation date for tax assessment purposes." *Freshwater v. Belmont Cty. Bd. of Revision* (1997), 80 Ohio St. 3d 26, 30.

The county auditor also is tasked with creating a list of all property that is exempt from taxation, and correcting the list annually by adding the parcels that have been exempted during the year. R.C. 5713.08(A). Any taxes that have become a lien on property (which happens each January 1st) after it was first used for an exempt purpose (but not prior to the date of acquisition), may be remitted by the tax commissioner, for up to three tax years. R.C. 5713.08(B), R.C.

5713.081(A). In order to exempt a parcel from taxes, an application must be filed by December 31 of the year for which exemption is requested. R.C. 5715.27(F). The tax commissioner may make the determination of entitlement to exemption separately for each tax year in question if the commissioner determines that the use of the property changed while the application is pending. R.C. 5715.27(H).

These statutes share a necessary common element that requires the determination of liability for taxation as of the tax lien date, January 1, of each tax year. Nowhere in this statutory scheme is there any authority for the claim that liability may be determined as of any other date. The Commissioner's assertion is without support.

The county auditor's duty to assess liability for taxes requires making two determinations for each tax parcel: whether the property is taxable or exempt, and fixing its true value. Those determinations must be made on a consistent, uniform basis as to their effective date for the system of property taxation to function correctly. As unfair as it may seem, property that is first devoted to an exempt use on January 2 is not eligible for exemption from taxes until the following tax year, even where there have been 364 continuous days of use for an exempt purpose during the prior year. Similarly, property that is devoted to an exempt use on January 1, but for which the use changes or which is transferred to a non-qualifying entity during the tax year, is still entitled to exemption for that full tax year.² There is no authority to curtail or prorate an exemption mid-year. Yet that is precisely the result that the Commissioner advocates in this case: while acknowledging that the ESC property qualified for exemption on the tax lien date 2001, he contends that exemption status should be retroactively revoked on the basis of developments that may have taken place later in the year. Such a radical conclusion finds no support in the statutes and is inconsistent with this Court's

² In like manner, assessed valuations apply for the full tax year, even if the value of a property changes significantly during the course of the year. R.C. 5715.01(C)

decisions in *City of Cleveland v. Carney* (1959), 169 Ohio St. 259; *Holy Trinity Protestant Episcopal Church of Kenwood v. Bowers* (1961), 172 Ohio St. 103; *Bd. of Cty. Cmmrs. of Lake Cty. v. Supanick* (1972), 32 Ohio St.2d 45; and *Christian Benevolent Assn. of Greater Cincinnati, Inc. v. Limbach* (1994), 69 Ohio St.3d 296.

Adopting the Commissioner's proposed application date test would lead to inconsistent results. For example, if efforts to achieve an exempt purpose were underway on the tax lien date (January 1), and the application was filed in March of that year, but the efforts were then abandoned and the property was sold in April and converted to a non-exempt use, the Commissioner's test would result in granting the exemption. Alternatively, if the efforts on the same property continued for the entire tax year but were abandoned the following March, and the application was filed in April, the Commissioner would deny the exemption, since by his reasoning the critical factor is whether the exempt purpose efforts continued through the date of application. Such a result completely ignores the fact that taxability of real estate is determined as of the tax lien date of each year. Instead, the Commissioner suggests that a hindsight test be substituted and that it be applied as of an arbitrary date of application. Such a rule would render the prospective use test meaningless.

2. The record does not support the Commissioner's claim that ESC had abandoned its efforts to build a school on the property by the time the exemption application was filed.

The Commissioner's appeal and theory of this case are premised not only on a misinterpretation of the law, but also on an improper examination of the facts. The record is clear that the two principal individuals responsible for ESC, the late Bishop Herbert Thompson, Jr. and

Archdeacon James Hanisian, were consistent in expressing their desire to build a school on the property, through the time the exemption application was filed in December 2001 and up to the time the property was sold to Scripps Howard in November 2002.

The unrebutted testimony in this case is that there was never a time until the property was sold in November 2002 that the Bishop or Archdeacon Hanisian had abandoned the plan to put a school on the property. (Supp. 12-13, Tr. 44-45.) In Archdeacon Hanisian's words, "we still had hopes that we would open in the fall of 2002" when interviewed by the press in August 2001. (Supp. 18, Tr. 65-66.) In response to repeated questioning from the hearing examiner, Mr. Hanisian succinctly agreed that, during the time ESC owned the property (until it was sold in November 2002), as far as the board, the Bishop, or anyone else was concerned, there was never any contemplated use of the property other than for a school. (Supp. 22, Tr. 81-82.)

The testimony of Ms. Patricia Hassel, the Diocesan Financial Officer of the Episcopal Diocese of Southern Ohio, was consistent with that of Mr. Hanisian. She responded "no" when asked whether by December 2001 the school was no longer possible in the building on the property. She affirmed that the Bishop still wanted it, and that "it still would have been a possibility if the Bishop wanted it to happen." (Supp. 27, Tr. 98-99.)

Curiously, the BTA stated below that ". . . as of the filing date in December 2001, plans for using the subject property as a school had effectively been abandoned . . ." (BTA Decision and Order at 10.) The only factual reference in the decision for this statement is at page 9, which references pages 99-100 of the transcript of the BTA hearing. But those pages reflect the testimony of Ms. Hassel who, in addition to testifying that the Bishop still wanted a school on the property, merely agreed that in December, January and February of 2002 there were no financial steps taken to renovate the property, no further payments to teachers and no students in the building. (Supp. 27,

Tr. 99-100). This testimony does not support a conclusion that plans for using the property as a school had been effectively abandoned by the application date, particularly in the context of testimony that the Bishop and Archdeacon still desired to open the school and had not abandoned their plan to do so.

Thus, despite the disappointments experienced by ESC in raising funds during 2001, it cannot accurately be claimed that ESC had “ceased its efforts” or “abandoned its plans” to convert the property to a school by the time the exemption application was filed in December 2001. The record simply does not support that claim. Without factual support for his claim, the Commissioner’s argument is reduced to one in opposition to the holding in *Supanick*. He is limited to arguing that the prospective use test under R.C. 5709.07 is really a retrospective test. The crux of his remaining argument is this: if by the time the Commissioner eventually rules on an exemption application he can determine that the property has not been physically used for the exempt purpose, then no exemption is available, regardless of the passage of time, the use on the tax lien date, or the number of tax years during which efforts have been made to devote the property to the exempt use. That is precisely the rule the Commissioner relied on in his Final Determination in this case, which the Board of Tax Appeals correctly reversed. Such a rule is contrary to the law of Ohio.

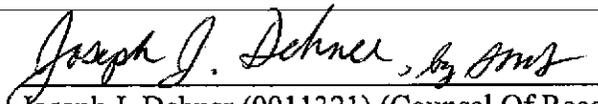
IV. CONCLUSION

This appeal by the Commissioner seeks a result wholly inconsistent with Ohio property tax law. ESC undertook substantial efforts to convert its property to a school, both before and well into 2001. As of the 2001 tax lien date, it is undisputed that efforts were significant and ongoing. The Commissioner’s novel theory, that eligibility for exemption should be tested as of

the application date, not the tax lien date, is unsupported by the statutes and this Court's established rulings. The record does not support the claim that ESC had abandoned efforts to open a school on the property by the time the exemption application was filed.

For the foregoing reasons, the Court should uphold the Board's decision that ESC's property qualified for property tax exemption for tax year 2001.

Respectfully submitted,

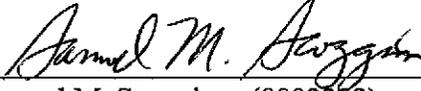


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CERTIFICATE OF SERVICE

I hereby certify that a copy of this Merit Brief was sent by ordinary U.S. mail to counsel of record for the Appellant, Janyce C. Katz, Assistant Attorney General, State Office Tower, 30 East Broad Street, 16th Floor, Columbus, Ohio 43215, this 29th day of May, 2007.



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