IN THE SUPREME COURT OF OHIO

UBS Financial Services, Inc. f/k/a Paine Webber, Inc., Appellant, v. Thomas M. Zaino, [Richard A. Levin] Tax Commissioner of Ohio, Appellee.	: : : : : : : : : : : : :	Supreme Court Case No. 2007-1129 Appeal from the Ohio Board of Tax Appeals BTA Case No. 2003-T-1139

REPLY BRIEF OF APPELLANT

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REPLY BRIEF OF APPELLANT

Proposition of Law No. 1

One Percent of the Gross Receipts of Outright Sales Was Added to Gross Commissions in the Numerator and Denominator of the Apportionment Formula for Broker/Dealers Under Former R.C. 5725.14.

A. The Plain Meaning Doctrine for Construing Statutes Applies.

The central question is the meaning of the term "gross receipts" in the formula to apportion the value of UBS Financial Services Inc. ("UBS"). The formula measures the ratio of Ohio gross receipts to gross receipts everywhere. The Tax Commissioner agrees that no deductions are used to measure gross receipts for commissions and for all components of the apportionment statute with one glaring exception: the Tax Commissioner substitutes a "net gains and losses" (net trading profits) standard for the "gross receipts" standard for purposes of outright sales. The statute, however, uses "gross receipts" for outright sales just as the "gross receipts" standard is used for other components of the ratio.

The plain meaning of the statute is readily discernible. The word "receipts" is one of general understanding and means all that is taken in - before deductions to reach a net value. "Gross receipts" by its very nature means no netting is done. The statute did not employ any concept of **net** trading profits and losses for any aspect of the apportionment calculation, and did not create a unique calculation for outright sales.

The Tax Commissioner commits only a single paragraph to the discussion of the common meaning of the word "receipts." See the first paragraph of page 30 of the Brief of Appellee. His sole argument is that "receipts" include the word "income" in its definition. That observation does not address the central issue in this case – whether one takes deductions from receipts to reach a net value (net gain or loss). Nothing in the applicable statute or dictionary definitions provide any support for substituting **net** gains for receipts. The Tax Commissioner ignores the modifier "gross" before "receipts". Moreover, his argument compels the Tax Commissioner to advocate deducting losses (thus canceling out other receipts altogether) although the transactions did actually create receipts.

In addition, the Tax Commissioner attempts to divert the Court's attention away from the language of the statute to the supposed long-standing administrative practice and to a discussion of current financial accounting for income. This Court, however, in a long line of its cases, including tax cases, consistently has expressed as the primary rule of construction that the words of the statute remain the best indicator of the General Assembly's intent. *Storer Communications, Inc. v. Limbach* (1988), 37 Ohio St. 3d 193, 194 ("Where the language of a statute is plain and unambiguous and conveys a clear and definite meaning, there is no occasion for resorting to rules of statutory interpretation. An unambiguous statute is to be applied, not interpreted." *Sears v. Weimer* (1944), 143 Ohio St. 312.) In *Storer,* this Court found that the

BTA should be reversed on an allocation issue because the BTA had "interpreted a clear, unambiguous statute that needed only application." 37 Ohio St. 3d at 194.

The Tax Commissioner also violates cardinal rules of statutory construction as he seeks to use aids in statutory construction absent a demonstration of ambiguity in the statutory language. *Sears v. Weimer, supra,* paragraph five of the syllabus. The statute that directs "Court considerations as a legislative intent," permits the use of aids in construction, "[i]f a statute is ambiguous." R.C. 1.49. Absent ambiguity, the reasoning of the Tax Commissioner serves no purpose. The Tax Commissioner has demonstrated no ambiguity because the use of "gross receipts" is an example of plain speech.

Instead, the Tax Commissioner presents the position asserted by a tax agent and an accountant in a desperate effort to divert the Court's attention from the plain statutory language, and create ambiguity in the statute. Aids in construction, however, are not used to create ambiguity, as opposed to addressing an ambiguity existing in the language. See *Railroad Comm'n. of Wisconsin v. Chicago, B. & Q.R.* (1921), 257 U.S. 563, 589. Consequently, this Court should look first and exclusively to the plain language of the statute in determining the meaning of "gross receipts."

B. An Official Announcement by a Former Tax Commissioner as to the Application of the Statute Strongly Supports UBS.

If the Court were to go beyond the words of the statute, an early interpretation of the statute provided under the authority of a prior Tax Commissioner is the best evidence of the intended meaning of the statute. The Comment stated simply that "one per cent of the **gross receipts of the outright sales** should have approximately the same weight of the gross commissions charged." Emphasis added. See Brief of Appellant at 12-13. An early published, official statement of the Tax Commissioner, nearer in time to the enactment of the statute, has far

more probative value than anything conjured up by the Tax Commissioner, including the unannounced position of a tax agent supervisor, a paragraph from instructions added sixty-four years after enactment of the statute, or financial accounting standards for measuring net income for current Securities and Exchange Commission requirements – each distant in time from the enactment of the statute in question.

C. The Tax Department's Interpretation Cannot Displace The Language of the Statute and Deference to an Administrative Interpretation of a Tax Statute is Never Triggered by an *Unannounced* Position of One or More Employees of the Tax Commissioner.

The Tax Commissioner persists in his focus on the long-standing administrative policy argument despite being confronted with the conclusion that the BTA had been misinformed about the prior years' instructions. The Tax Commissioner induced the BTA to believe that the forms, including instructions for numerous prior years, were consistent with the post 1994 instructions presented to the BTA. That impression, however, was false.

The Tax Commissioner is unapologetic about the serious misperception of the facts created, even though the Tax Commissioner should have known of the date of the change of his own form instructions. The Tax Commissioner now proceeds as if the BTA would have found the existence of a long-standing administrative practice absent the perception that the 1995 instructions also had been in place for prior years. The BTA relied on wrong information. The Tax Commissioner cannot act as if the BTA would have accepted the "long-standing" nature of the policy when confronted with the absence of the "policy" language on which the Tax Commissioner relied in the return immediately previous to the forms submitted into evidence at the BTA. The Tax Commissioner is left with reliance on an unannounced, undocumented position of an audit level employee, who could only testify as to what he had been told by his

predecessor and what he would have told a taxpayer had they called him.[1] Supplement of Appellant ("Supp.") Volume IV at 1009-1010 (TR. Vol. II at 211-212).

One rationale for deferring to a long-standing administrative interpretation is that absent a statute overruling that interpretation, the General Assembly is deemed to be satisfied with that interpretation. An unannounced interpretation, however, cannot be deemed to have been known by the General Assembly and cannot trigger deference. Allowing internal, unannounced interpretations to influence statutory interpretation is dangerous and against basic principles of the Rule of Law.

Even more fundamentally, the Tax Commissioner seeks to ignore the requirement that tax policies of general application must be promulgated as rules. The Tax Commissioner has no response to *McLean Trucking Co. v. Lindley* (1982), 70 Ohio St. 2d 106, addressed in the Brief of Appellant at 17, requiring the Tax Commissioner to promulgate rules when enforcing tax polices of general application. The rule-making process remains a very important protection for taxpayers and should be enforced in this case.

No cases have been found that support, nor do the cases cited by the Tax Commissioner compel, judicial deference to an administrative policy of a state agency on such a whimsical basis as an audit position by a mid-level employee of an agency. When the unreliability of the source is coupled with the plain contradiction of the statute, the reliance on a "long-standing administrative policy" is a meaningless exercise by the Tax Commissioner.

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[1] Three times in the Brief of Appellee reference is made to Mr. Sachs as the "Administrator" of the Dealer in Intangibles Tax (see the first of the two pages 4's and page 5). An Administrator, however, is an executive position in a division of the Tax Department – a position that Mr. Sachs never held. Moreover, Mr. Sachs admitted that he was not even consulted on all relevant matters, Supp. Volume IV at 995 (TR. Vol. II at 197), and despite his willingness to speak of alleged agency policy for the period of his employment and that of his predecessor, he did not even know that the instructions had been changed between 1994 and 1995.

D. The Commissioner's Argument That "The Industry" Followed His Interpretation Lacks Support And Significance.

The Tax Commissioner then takes the argument of "long standing practice" even further by insisting that there was "universal industry acceptance" of the Tax Commissioner's current position. He reaches this conclusion by arguing that Mr. Sachs "knew" how other taxpayers prepared the apportionment factors. Mr. Sachs, however, could not know how taxpayers were reporting without auditing those taxpayers, and he admitted that not all taxpayers were audited in the following exchange with counsel, Mr. Hubbard:

> Q. Okay... In your experience, Mike throughout your entire tenure did the dealer in intangible tax industry uniformly follow that methodology [the methodology of using net gains and losses rather than receipts]?
>
> A. I would assume so. But without performing an actual field audit on every dealer in intangibles, I cannot say one way or another. That is how we requested the return to be filed.
>
> Q. So you testimony is that you did not ...[audit] every return?
>
> A. No.

Bracketed material added. Supp. Volume IV at 1010-1011 (TR. Vol. II at 212-213). No evidence was presented as to the actual method of reporting by other taxpayers for any years, much less years before 1995. UBS does not know how its competitors filed their returns, but neither does the Tax Department in the absence of audits.[2]

[2] Any suggestion that the use of an apportionment method other than that desired by the audit staff would be plain on the face of the return is untenable. Only an audit would reveal the method of calculation.

Even if some other taxpayers filed as suggested by Mr. Sachs, those taxpayers likely did so in reliance on the erroneous instructions first included in 1995. Those erroneous instructions could not change the statute and cannot prevent those taxpayers following the instructions in good faith from receiving the benefit of the statute.

The Tax Commissioner's attempt to argue "universal acceptance" of his method of calculation of receipts has no support in the record below. In any event, the Tax Commissioner's argument that UBS's position swims counter to the position of the audit staff of the Tax Department or other taxpayers is without substance and is not useful in determining the meaning of the term "gross receipts."

E. The Accounting Testimony Added No Value to the Discussion.

The Tax Commissioner simply ignores the statement by Professor Stephens himself that "receipts," the actual word in the statute, is **not** used in statements for financial accounting. The difference between the Tax Commissioner's argument and the statement of his witness is very striking. In the Brief of Appellee at 24, the Tax Commissioner states his position as follows:

> Thus, Dr. Stephens' testimony as to the meaning of "receipts" derives from his expert understanding of the meaning of "receipts" for purposes of GAAP, as defined in the securities brokerage industry.

The actual testimony of Professor Stephens contradicts the Tax Commissioner when Professor Stephens states:

> Q. So for financial accounting purposes, the term "receipts" isn't used at all?
>
> [Ray Stephens]
>
> A. It's not presented on the financial statement.

Supp. Vol. IV at 952 (TR. Vol. II at 154); Cf. Brief of Appellant at 18.

Moreover, the Commissioner makes no effort to show that any part of the accounting testimony that was directed to the measurement of net income by the brokerage industry had any relevance to a 1931 statute that described the apportionment method in place during the relevant period—a statute that was not ambiguous in 1931 and was not ambiguous during the years in question. In *State v. Vanderbilt* (1882), 37 Ohio St. 590 at 640, the Court spoke to the method of interpreting a statute in the following terms:

> And it is also a well settled rule that it being of the very essence of a law that it be uniform and unchangeable, whatever was the meaning of a statute when first enacted, should be its meaning through all future time.

That rule yields to subsequent changes in the statute or other statutes that would be read in pari material with the primary statute, but in the present case, neither former R.C. 5725.14 nor other applicable statutes were changed to alter the application of former R.C. 5725.14 until after the period in question. The statute then was amended after the period in question in a manner that was markedly different than that espoused by the Tax Commissioner in this case.

Likewise the Tax Commissioner failed even to address this Court's decisions in which tax accounting determinations have been rejected as a basis for construing the application of apportionment statutes. See Brief of Appellant at 19.

Otherwise, the Tax Commissioner's verbal tsunami at pages 20-28 of the Brief of Appellee presents assertions that are wholly off topic for this appeal. The task of construing the language of the statute is wholly unaltered by Professor's Stephen's exposition.

F. The Tax Commissioner's Distortion Argument is Wholly Misplaced.

The Tax Commissioner repeatedly insists that he can disregard the terms of the statute because of the supposed distortion caused by the statute in apportioning value within and outside Ohio. This argument should be rejected by the Court for several reasons.

1. The Dealer In Intangibles Tax Contains No Provision for the Use of Alternative Apportionment Formulas.

The Tax Commissioner's argument is a proposal to substitute his "gains and losses" standard for the statutory gross receipts standard to change the ratio. Nothing in R.C. Chapters 5707 and 5725, however, countenances such a deviation. In vivid contrast, the Ohio franchise tax contains provisions authorizing alternative apportionment formulas. See R.C. 5733.05. The alternative apportionment provision of R.C. 5733.05(B)(2)(d) provides:

> (d) If the allocation and apportionment provisions of division (B) of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may request, which request must be in writing and must accompany the report, a timely filed petition for reassessment, or a timely filed amended report, or the tax commissioner may require, in respect to all or any part of the taxpayer's allocated or apportioned base, if reasonable, any one or more of the following:
>
> (i) Separate accounting;
>
> (ii) The exclusion of any one or more of the factors;
>
> (iii) The inclusion of one or more additional factors that will fairly represent the taxpayer's allocated or apportioned base in this state.
>
> An alternative method will be effective only with approval by the tax commissioner.

The absence of an authorization by the General Assembly for an alternative method at the request of either the Tax Commissioner or a taxpayer for the Dealer-In-Intangibles tax is a significant omission. No principled reason exists to permit deviation in the present case in the context of the Dealer-In-Intangibles tax.

2. The Proper Relationship Between Commissions and Other Receipts Was Set by Statute.

The Tax Commissioner argues that only one type of receipt – outright sales – cannot be measured by gross receipts. The General Assembly, however, specifically addressed the issue by requiring the application of the one hundred to one ratio in former R.C. 5725.14—each dollar of commission is equal to one hundred dollars of outright sales. This ratio is the express statutory mechanism for dealing with the very issue raised by the Tax Commissioner. The early explanation of the statute by Tax Commissioner Evatt made clear that the responsible parties were addressing the specific relationship between commissions and outright sales. The Tax Commissioner's further reduction of the relative weight of outright sales is unauthorized and contrary to law.

3. The Distortion Issue Is Not Properly Before the Court.

Although the Tax Commissioner made the distortion argument before the BTA, the BTA did not find distortion and the Tax Commissioner did not appeal the BTA's decision. Accordingly, the issue of distortion is not properly before the Court.

4. The Issue is Tax Policy Not Distortion.

The application of the statute as written did not create distortion. The issue is one of tax policy, i.e., the extent to which the home office activities of a brokerage firm will be recognized in seeking a proper apportionment between in-state and out-of-state activities. Outright sales

typically are conducted in the home office, and not at the individual brokerage offices. The previous formula was fair in apportioning some value based, in part, on activities, such as managing a portfolio of assets sold on the Dealer's own account, which would have been done in the home office. The statute already provided a one hundred to one ratio to assign greater weight to the commissions compared to the outright sales. The Tax Commissioner is wholly unjustified in further reducing the effect of outright sales contrary to the express language of the statute.

The present statute, as enacted by the General Assembly after the period in question, changed the approach and the tax policy by using only the commissions in the formula and ignoring all other activities. The General Assembly likely changed the statute to better align the state's tax policy to other states' business taxes that currently emphasize the use of market-oriented factors and de-emphasize the activities in the state of domicile. The key to the new statute is that it provides Dealers an incentive to establish the home office in Ohio. The new statute creates a tax incentive because the in-state apportionment will not be increased by home office activities. Instead, the value will be assigned according to the commissions, most of which are assigned to the satellite brokerage offices. The policy debate belongs in the General Assembly. No distortion existed in the application of the former statute to UBS.

Proposition of Law No. 2

The Tax Commissioner Has Jurisdiction to Reduce a Taxpayers' Total Taxable Value Below That Reflected on the Preliminary Assessment Certificates.

A. Introduction

Tax Commissioner concedes as he must that the BTA made a blatant error by not acknowledging that a taxpayer always can **offset** any assessment with overpayments that are proven. See Brief of Appellee at 9. The necessary concession of the Tax Commissioner,

however, does not cure other errors made by the BTA. Specifically, the BTA has jurisdiction to order a tax refund in this matter. The Tax Commissioner continues, however, to resist correcting the error brought to his attention on administrative review and issuing a refund of the total amount overpaid.

The Tax Commissioner had no answer to several important points of Appellant's presentation, which can be summarized as follows:

- The request for a petition for reassessment is a request for a final assessment—Brief of Appellant at 24;

- The taxpayer is permitted to raise additional arguments as part of the petition for reassessment—Brief of Appellant at 22-23;

- The taxpayer did preserve the additional issue (the erroneous use of net gains and losses rather than receipts for the apportionment factor) during the review of the petition for reassessment—Brief of Appellant at 30;

- It is not customary to file an amended return to preserve issues in a matter pending before the Tax Appeals Division of the Ohio Department of Taxation—Brief of Appellant at 30;

- The claimed jurisdictional defect being raised for the first time on appeal to the BTA shows that the Tax Department attorneys perceived no jurisdictional defect—Brief of Appellant at 26;

- The final determination in response to a petition for reassessment determines all elements of the assessment –Brief of Appellant at 23;

- Unlike the Ohio franchise tax, the reference in the Dealer-in-Intangible statutes to the review of the *assessment* refers to one assessment (the preliminary assessment and the amendment to that assessment) and not to a deficiency assessment as in the franchise tax situation. Thus, the petition for reassessment reviews the entire assessment including items on the assessment not adjusted by the Tax Commissioner—Brief of Appellant at 22;

- The relevant statutes contemplate that refunds can flow from a petition for reassessment as well as from an application for final assessment—Brief of Appellant at 24-25; and

- No claim for refund is recognized in the property tax arena thus making *International Business Machines Corp. v. Zaino* (2002), 94 Ohio St. 3d 152 wholly inapplicable—Brief of Appellant at 30-31.

B. This Court's Case Law Contradicts the Position of the Tax Commissioner

Wright Aeronautical Corp. v. Glander (1949), 151 Ohio St. 29 does not stand for the position asserted by the Tax Commissioner. In *Wright,* the taxpayer did not raise the issue before the Tax Commissioner but first raised the issue in the notice of appeal to the BTA. 151 Ohio St. at 32. In *Lincoln Elec. Co. v. Limbach* (1993), 66 Ohio St. 3d 176, 179, this Court distinguished *Wright* by saying:

> In *Wright*, the taxpayer did not file an amended personal property tax return; it sought review of the error when it appealed to the BTA. We held that the taxpayer had not properly applied for correction of the mistake, either by applying for a review and reassessment or filing a claim for deduction from book value. We also decided that the claim had no merit, which we characterized as the "* * * decisive factor in the solution of this problem." 151 Ohio St. at 41, ... Thus, we did not deny the taxpayer's ability to amend its return. Moreover, *Procter & Gamble*[3] and *First Banc Group,*[4] which bracket *Wright*, do allow amended returns.

Here UBS did request review of the error on the returns in the manner provided by the statute—raising the issue on the petition for reassessment. To assert that UBS followed the same path as *Wright* as the Tax Commissioner states in the Brief of Appellee at 37 is misleading and wrong. To argue that *Wright* speaks to this issue, much less that *Wright* is controlling, is wholly without merit.

C. The Tax Commissioner Cannot Crystallize Errors in the Return.

The Tax Commissioner argues that the taxpayer must file an application for final assessment even when a petition for reassessment is pending. That conclusion is contrary to the statute in several important ways. The determination of the "petition for reassessment" is the final determination with respect to **all** items on the return. The Tax Commissioner could effectively reject the application for final assessment by dealing only with the items on the petition for reassessment and issuing a final determination before taking up the application for final assessment, thus effectively refusing to consider the errors made on the return. The fact that both petitions for reassessment and applications for final assessment result in final determinations (final assessments) means that the Tax Commissioner's demand for two distinct

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[3] *Procter & Gamble Company v. Evatt* (1943), 142 Ohio St. 373; Brief of Appellant at 26.
[4] *First Banc Group, Inc. v. Lindley* (1981), 68 Ohio St. 2d 81; Brief of Appellant at 28.

filings to accomplish a single end is an effort solely to deny refunds and provides no benefit in administrative efficiency. His position violates the rule that refunds of erroneously paid tax are construed liberally in favor of the taxpayer. *Phoenix Amusement Co. v. Glander* (1947), 148 Ohio St. 592, Syl. 1; *Key Serv. Corp. v. Zaino* (2002), 95 Ohio St. 3d 11, 15.

On the question of filing an amended return, in the Brief of Appellee at 39, the Tax Commissioner argues that the amended return must be filed **before** he issues amended preliminary assessment certificates. Thus, he assumes that once he amends his assessment, the taxpayer cannot amend even though such a conclusion is directly contrary to R.C. 5711.31, which states specifically that additional arguments can be raised.

Ultimately, the Tax Commissioner's argument is reduced to the proposition that he can induce taxpayers into overpaying tax by erroneous instructions and then use that very payment of the tax on the preliminary assessment to deny taxpayers their statutory rights. As this Court said, the Tax Commissioner cannot crystallize the errors in the returns.

Conclusion

The receipts standard and not the net gains or losses standard was required by statute as the approved method for the apportionment factor for dealers in intangibles. Procedurally, the Tax Commissioner had full authority to correct all the errors raised by UBS in the petition for reassessment. The BTA should be reversed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing Brief was served upon Barton A. Hubbard, Taxation Section, Ohio Attorney General's Office, 30 East Broad Street, 25th Floor, Columbus, Ohio 43215 by hand delivery this 28th day of January, 2008.

Edward J. Bernert

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§ 1.49 Court considerations as a legislative intent.

If a statute is ambiguous, the court, in determining the intention of the legislature, may consider among other matters:

(A) The object sought to be attained;

(B) The circumstances under which the statute was enacted;

(C) The legislative history;

(D) The common law or former statutory provisions, including laws upon the same or similar subjects;

(E) The consequences of a particular construction;

(F) The administrative construction of the statute.

HISTORY: 134 v H 607. Eff 1-3-72.

Former R.C. 5725.14

§ 5725.14 Annual return of resources by dealer in intangibles; gross receipts; consolidated returns.

Each dealer in intangibles shall return to the tax commissioner between the first and second Mondays of March, annually, a report exhibiting in detail, and under appropriate heads, his resources and liabilities at the close of business on the thirty-first day of December next preceding.

If a dealer in intangibles maintains separate business offices, whether within this state only or within and without this state, said report shall also show the gross receipts from business done at each such office during the year ending on the thirty-first day of December next preceding.

"Gross receipts" as used in this section and section 5725.15 of the Revised Code, means, in the case of a dealer in intangibles principally engaged in the business of lending money or discounting loans, the aggregate amount of loans effected or discounted; in the case of a dealer in intangibles principally engaged in the business of selling or buying stocks, bonds, and other similar securities either on his own account or as agent for another, gross receipts means the aggregate amount of all commissions charged plus one per cent of the aggregate amount of all other receipts.

As used in this section and section 5725.15 of the Revised Code business is considered done at an office when it originates at such office, but the receipts from business originating at one office and consummated at another office shall be divided equitably between such offices.

An incorporated dealer in intangibles which owns or controls fifty-one per cent or more of the common stock of another incorporated dealer in intangibles may, under uniform regulations prescribed by the tax commissioner, make a consolidated return for the purpose of sections 5725.01 to 5725.26, inclusive, of the Revised Code. In such case the parent corporation making such return is not required to include in its resources any of the stocks, securities, or other obligations of its subsidiary dealers, nor permitted to include in its liabilities any of its own securities or other obligations belonging to its subsidiaries.

HISTORY: GC § 5414-4; 114 v 714 (751); 115 v 574; 119 v 34; 122 v 375; 124 v 449, § 3; Bureau of Code Revision. Eff 10-1-53.

§ 5733.05 Determination of value of issued and outstanding stock and intangible property; determination of net income of corporation.

As used in this section, "qualified research" means laboratory research, experimental research, and other similar types of research; research in developing or improving a product; or research in developing or improving the means of producing a product. It does not include market research, consumer surveys, efficiency surveys, management studies, ordinary testing or inspection of materials or products for quality control, historical research, or literary research. "Product" as used in this paragraph does not include services or intangible property.

The annual report determines the value of the issued and outstanding shares of stock of the taxpayer, which under division (A) or divisions (B) and (C) of this section is the base or measure of the franchise tax liability. Such determination shall be made as of the date shown by the report to have been the beginning of the corporation's annual accounting period that includes the first day of January of the tax year. For the purposes of this chapter, the value of the issued and outstanding shares of stock of any corporation that is a financial institution shall be deemed to be the value as calculated in accordance with division (A) of this section. For the purposes of this chapter, the value of the issued and outstanding shares of stock of any corporation that is not a financial institution shall be deemed to be the values as calculated in accordance with divisions (B) and (C) of this section. Except as otherwise required by this section or section 5733.056 [5733.05.6] of the Revised Code, the value of a taxpay-

er's issued and outstanding shares of stock under division (A) or (C) of this section does not include any amount that is treated as a liability under generally accepted accounting principles.

(A) The total value, as shown by the books of the financial institution, of its capital, surplus, whether earned or unearned, undivided profits, and reserves shall be determined as prescribed by section 5733.056 [5733.05.6] of the Revised Code for tax years 1998 and thereafter.

(B) The sum of the corporation's net income during the corporation's taxable year, allocated or apportioned to this state as prescribed in divisions (B)(1) and (2) of this section, and subject to sections 5733.052 [5733.05.2], 5733.053 [5733.05.3], 5733.057 [5733.05.7], 5733.058 [5733.05.8], 5733.059 [5733.05.9], and 5733.0510 [5733.05.10] of the Revised Code:

(1) The net nonbusiness income allocated or apportioned to this state as provided by section 5733.051 [5733.05.1] of the Revised Code.

(2) The amount of Ohio apportioned net business income, which shall be calculated by multiplying the corporation's net business income by a fraction. The numerator of the fraction is the sum of the following products: the property factor multiplied by twenty, the payroll factor multiplied by twenty, and the sales factor multiplied by sixty. The denominator of the fraction is one hundred, provided that the denominator shall be reduced by twenty if the property factor has a denominator of zero, by twenty if the payroll factor has a denominator of zero, and by sixty if the sales factor has a denominator of zero.

The property, payroll, and sales factors shall be determined as follows, but the numerator and the denominator of the factors shall not include the portion of any property, payroll, and sales otherwise includible in the factors to the extent that the portion relates to, or is used in connection with, the production of nonbusiness income allocated under section 5733.051 [5733.05.1] of the Revised Code:

(a) The property factor is a fraction computed as follows:

The numerator of the fraction is the average value of the corporation's real and tangible personal property owned or rented, and used in the trade or business in this state during the taxable year, and the denominator of the fraction is the average value of all the corporation's real and tangible personal property owned or rented, and used in the trade or business everywhere during such year. Real and tangible personal property used in the trade or business includes, but is not limited to, real and tangible personal property that the corporation rents, subrents, leases, or subleases to others if the income or loss from such rentals, subrentals, leases, or subleases is business income. There shall be excluded from the numerator and denominator of the fraction the original cost of all of the following property within Ohio: property with respect to which a "pollution control facility" certificate has been issued pursuant to section 5709.21 of the Revised Code; property with respect to which an "industrial water pollution control certificate" has been issued pursuant to that section or former section 6111.31 of the Revised Code; and property used exclusively during the taxable year for qualified research.

(i) Property owned by the corporation is valued at its original cost. Property rented by the corporation is valued at eight times the net annual rental rate. "Net annual rental rate" means the annual rental rate paid by the corporation less any annual rental rate received by the corporation from subrentals.

(ii) The average value of property shall be determined by averaging the values at the beginning and the end of the taxable year, but the tax commissioner may require the averaging of monthly values during the taxable year, if reasonably required to reflect properly the average value of the corporation's property.

(b) The payroll factor is a fraction computed as follows:

The numerator of the fraction is the total amount paid in this state during the taxable year by the corporation for compensation, and the denominator of the fraction is the total compensation paid everywhere by the corporation during such year. There shall be excluded from the numerator and the denominator of the payroll factor the total compensation paid in this state to employees who are primarily engaged in qualified research.

(i) Compensation means any form of remuneration paid to an employee for personal services.

(ii) Compensation is paid in this state if: (I) the recipient's service is performed entirely within this state, (II) the recipient's service is performed both within and without this state, but the service performed without this state is incidental to the recipient's service within this state, (III) some of the service is performed within this state and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this state, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the recipient's residence is in this state.

(iii) Compensation is paid in this state to any employee of a common or contract motor carrier corporation, who performs the employee's regularly assigned duties on a motor vehicle in more than one state, in the same ratio by which the mileage traveled by such employee within the state bears to the total mileage traveled by such employee everywhere during the taxable year.

(c) The sales factor is a fraction computed as follows:

Except as provided in this section, the numerator of the fraction is the total sales in this state by the corporation during the taxable year or part thereof, and the denominator of the fraction is the total sales by the corporation everywhere during such year or part thereof. In computing the numerator and denominator of the fraction, the following shall be eliminated from the fraction: receipts and any related gains or losses from the sale or other disposal of excluded assets;

dividends or distributions; and interest or other similar amounts received for the use of, or for the forbearance of the use of, money. Also, in computing the numerator and denominator of the sales factor, in the case of a corporation owning at least eighty per cent of the issued and outstanding common stock of one or more insurance companies or public utilities, except an electric company and a combined company, and, for tax years 2005 and thereafter, a telephone company, or owning at least twenty-five per cent of the issued and outstanding common stock of one or more financial institutions, receipts received by the corporation from such utilities, insurance companies, and financial institutions shall be eliminated. As used in this division, "excluded assets" means property that is either: intangible property, other than trademarks, trade names, patents, copyrights, and similar intellectual property; or tangible personal property or real property where that property is a capital asset or an asset described in section 1231 of the Internal Revenue Code, without regard to the holding period specified therein.

(i) For the purpose of this section and section 5733.03 of the Revised Code, receipts not eliminated or excluded from the fraction shall be sitused as follows:

Receipts from rents and royalties from real property located in this state shall be sitused to this state.

Receipts from rents and royalties of tangible personal property, to the extent the tangible personal property is used in this state, shall be sitused to this state.

Receipts from the sale of electricity and of electric transmission and distribution services shall be sitused to this state in the manner provided under section 5733.059 [5733.05.9] of the Revised Code.

Receipts from the sale of real property located in this state shall be sitused to this state.

Receipts from the sale of tangible personal property shall be sitused to this state if such property is received in this state by the purchaser. In the case of delivery of tangible personal property by common carrier or by other means of transportation, the place at which such property is ultimately received after all transportation has been completed shall be considered as the place at which such property is received by the purchaser. Direct delivery in this state, other than for purposes of transportation, to a person or firm designated by a purchaser constitutes delivery to the purchaser in this state, and direct delivery outside this state to a person or firm designated by a purchaser does not constitute delivery to the purchaser in this state, regardless of where title passes or other conditions of sale.

(ii) Receipts from all other sales not eliminated or excluded from the fraction shall be sitused to this state as follows:

Receipts from the sale, exchange, disposition, or other grant of the right to use trademarks, trade names, patents, copyrights, and similar intellectual property shall be sitused to this state to the extent that the receipts are based on the amount of use of that property in this state. If the receipts are not based on the amount of use of that property, but rather on the right to use the property and the payor has the right to use the property in this state, then the receipts from the sale, exchange, disposition, or other grant of the right to use such property shall be sitused to this state to the extent the receipts are based on the right to use the property in this state.

Receipts from the sale of services, and receipts from any other sales not eliminated or excluded from the sales factor and not otherwise sitused under division (B)(2)(c) of this section, shall be sitused to this state in the proportion to the purchaser's benefit, with respect to the sale, in this state to the purchaser's benefit, with respect to the sale, everywhere. The physical location where the purchaser ultimately uses or receives the benefit of what was purchased shall be paramount in determining the proportion of the benefit in this state to the benefit everywhere.

(iii) Income from receipts eliminated or excluded from the sales factor under division (B)(2)(c) of this section shall not be presumed to be nonbusiness income.

(d) If the allocation and apportionment provisions of division (B) of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may request, which request must be in writing and must accompany the report, a timely filed petition for reassessment, or a timely filed amended report, or the tax commissioner may require, in respect to all or any part of the taxpayer's allocated or apportioned base, if reasonable, any one or more of the following:

(i) Separate accounting;

(ii) The exclusion of any one or more of the factors;

(iii) The inclusion of one or more additional factors that will fairly represent the taxpayer's allocated or apportioned base in this state.

An alternative method will be effective only with approval by the tax commissioner.

Nothing in this section shall be construed to extend any statute of limitations set forth in this chapter.

(e) The tax commissioner may adopt rules providing for alternative allocation and apportionment methods, and alternative calculations of a corporation's base, that apply to corporations engaged in telecommunications.

(C)(1) The total value, as shown on the books of each corporation that is not a qualified holding company, of the net book value of the corporation's assets less the net carrying value of its liabilities, and excluding from the corporation's assets land devoted exclusively to agricultural use as of the first Monday of June in the corporation's taxable year as determined by the county auditor of the county in which the land is located pursuant to section 5713.31 of the Revised Code, and making any adjustment required by division (D) of this section. For the purposes of determining that total value, any reserves shown on the corporation's books shall be considered liabilities or contra assets, as the case may be, except for any reserves that are deemed appropriations of retained earnings under generally accepted accounting principles.

(2) The base upon which the tax is levied under division (C) of section 5733.06 of the Revised Code

shall be computed by multiplying the amount determined under division (C)(1) of this section by the fraction determined under divisions (B)(2)(a) to (c) of this section and, if applicable, divisions (B)(2)(d)(ii) and (iii) of this section, and without regard to section 5733.052 [5733.05.2] of the Revised Code, but substituting "net worth" for "net income" wherever "net income" appears in division (B)(2)(c) in this section. For purposes of division (C)(2) of this section, the numerator and denominator of each of the fractions shall include the portion of any real and tangible personal property, payroll, and sales, respectively, relating to, or used in connection with the production of, net nonbusiness income allocated under section 5733.051 [5733.05.1] of the Revised Code. Nothing in this division shall allow any amount to be included in the numerator or denominator more than once.

(D)(1) If, on the last day of the taxpayer's taxable year preceding the tax year, the taxpayer is a related member to a corporation that elects to be a qualifying holding company for the tax year beginning after the last day of the taxpayer's taxable year, or if, on the last day of the taxpayer's taxable year preceding the tax year, a corporation that elects to be a qualifying holding company for the tax year beginning after the last day of the taxpayer's taxable year is a related member to the taxpayer, then the taxpayer's total value for the purposes of division (C) of this section shall be adjusted by the qualifying amount. Except as otherwise provided under division (D)(2) of this section, "qualifying amount" means the amount that, when added to the taxpayer's total value, and when subtracted from the net carrying value of the taxpayer's liabilities computed without regard to division (C)(2) of this section, or when subtracted from the taxpayer's total value and when added to the net carrying value of the taxpayer's liabilities computed without regard to division (D) of this section, results in the taxpayer's debt-to-equity ratio equaling the debt-to-equity ratio of the qualifying controlled group on the last day of the taxable year ending prior to the first day of the tax year computed on a consolidated basis in accordance with general accepted accounting principles. For the purposes of division (D)(1) of this section, the corporation's total value, after the adjustment required by that division, shall not exceed the net book value of the corporation's assets.

(2)(a) The amount added to the taxpayer's total value and subtracted from the net carrying value of the taxpayer's liabilities shall not exceed the amount of the net carrying value of the taxpayer's liabilities owed to the taxpayer's related members.

(b) A liability owed to the taxpayer's related members includes, but is not limited to, any amount that the corporation owes to a person that is not a related member if the corporation's related member or related members in whole or in part guarantee any portion or all of that amount, or pledge, hypothecate, mortgage, or carry out any similar transactions to secure any portion or all of that amount.

(3) The base upon which the tax is levied under division (C) of section 5733.06 of the Revised Code shall be computed by multiplying the amount determined under divisions (C) and (D) of this section but without regard to section 5733.052 [5733.05.2] of the Revised Code.

(4) For purposes of division (D) of this section, "related member" has the same meaning as in section 5733.042 [5733.04.2] of the Revised Code.

HISTORY: GC § 5498; 111 v 471, § 4; 112 v 410, § 6; 113 v 637; 114 v 714(762); 115 v 589; Bureau of Code Revision, 10-1-53; 125 v 903(1053) (Eff 10-1-53); 126 v 747 (Eff 10-5-55); 132 v S 350 (Eff 12-1-67); 133 v S 55 (Eff 10-2-69); 134 v H 475 (Eff 12-20-71); 134 v H 1046 (Eff 4-14-72); 134 v H 1134 (Eff 6-14-72); 135 v H 95 (Eff 7-20-73); 139 v H 694 (Eff 11-15-81); 139 v S 550 (Eff 11-26-82); 140 v H 291 (Eff 7-1-83); 140 v H 250 (Eff 7-30-84); 140 v H 794 (Eff 7-6-84); 141 v S 123 (Eff 9-23-85); 141 v H 238 (Eff 1-1-86); 141 v H 428 (Eff 12-23-86); 145 v H 152 (Eff 7-1-93); 147 v H 215 (Eff 9-29-97); 147 v H 770 (Eff 9-16-98); 148 v H 283 (Eff 9-29-99); 148 v S 3 (Eff 7-6-99); 149 v S 200. Eff 9-6-2002; 150 v H 95, § 1, eff. 6-26-03; 150 v H 127, § 1, eff. 12-11-03.