

IN THE SUPREME COURT OF OHIO

Appeal From the Ohio Board of Tax Appeals

HEALTHSOUTH CORPORATION, :  
: :  
Appellee, :  
: Case No. 07-2281  
v. :  
: Appeal from BTA  
WILLIAM W. WILKINS [RICHARD A. :  
LEVIN], TAX COMMISSIONER OF OHIO, : Case No. 2005-A-1386  
: :  
Appellant. :

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BRIEF OF APPELLANT

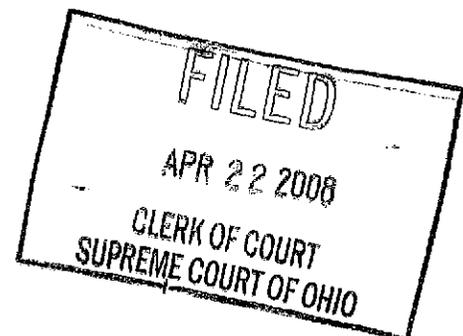
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LAW AND ARGUMENT

Proposition of Law No. 1:

A personal property taxpayer’s intentional over-reporting of its asset values and resultant tax due in its annual Ohio personal property tax return in order to hide its own accounting fraud overcapitalization of its fixed asset values as reported on its publicly filed SEC financial statements for that period properly bars the claimant from subsequently receiving a refund of the overpaid taxes, which the taxpayer sought only after an SEC investigation revealed the fraud..... 12

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At the BTA, a personal property taxpayer refund claimant fails to meet its affirmative burden of demonstrating the Commissioner’s findings to be “clearly unreasonable or unlawful” when it:

- (1) fails to produce any accounting journal entries, balance sheets or other financial statement records for its Ohio facility locations showing the removal of any alleged “fictitious” assets or asset values, as would be required under generally accepted accounting principles (GAAP) had such overstatements actually occurred, whether in the dollar amounts claimed in its refund claim or otherwise;
- (2) relies solely on multiple-level hearsay as the basis for its identification of alleged “fictitious” Ohio taxable assets; and
- (3) concedes, through its sole BTA witness, that, at best, its submitted refund claim is “fairly accurate.” ..... 20

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	:	<b>BRIEF OF APPELLEE</b>
Appellant.	:	

**STATEMENT OF CASE AND FACTS**

**A. Procedural posture**

This appeal is taken as of right pursuant to R.C. 5717.04. It involves a refund claim (application for final assessment) brought by the appellee, HealthSouth Corporation (“HealthSouth”), concerning its Ohio business personal property taxes for the 2002 tax year. The Tax Commissioner has filed his Notice of Appeal with this Court on independent grounds.

Most fundamentally, HealthSouth should be barred from receiving the requested refund because of its accounting fraud. Specifically, HealthSouth’s refund claim seeks Ohio’s public school districts and other taxing districts to pay refunds of taxes that HealthSouth claims it intentionally had overpaid in order to hide a fraudulent accounting scheme in which it overstated its earnings and assets on its financial statements filed with the Securities and Exchange Commission. See numbered paragraph 7 of the Commissioner’s Notice of Appeal.

Additionally, even assuming that HealthSouth’s accounting fraud would not bar the refund claim, HealthSouth failed to adduce probative, competent evidence in support of its claim.

HealthSouth failed to present to the Commissioner or to the BTA the accounting journal entries, fixed asset ledger and balance sheet adjustments that would necessarily have been required under generally accepted accounting principles (GAAP) if HealthSouth's reported taxable assets truly had included fictitious asset values, whether in the amounts claimed by HealthSouth or otherwise.

Instead, HealthSouth presented unauthenticated, multiple-level hearsay documents, testified to by a sole witness who admitted he did not prepare any of the documentary evidence, nor review any of the underlying documentation from which the documentary evidence allegedly was derived. See numbered paragraphs 4-6 of the Commissioner's Notice of Appeal. We now proceed with a factual presentation regarding the accounting fraud estoppel issue.

**B. HealthSouth's personal property tax refund claim for the 2002 tax year seeks to recover previously paid taxes that HealthSouth asserts it intentionally over-reported in its Ohio personal property tax return for that year by overcapitalizing its Ohio taxable asset values in order to hide the accounting fraud scheme it was perpetrating at that time on its publicly filed SEC financial statements.**

The pertinent chronological information concerning this case begins with HealthSouth's filing of its Ohio personal property tax return in June of 2002. S.T. 661, Supp. 479. Significant to the accounting fraud estoppel issue, the 2002 tax year return is signed under penalty of perjury by a vice president of taxation / officer of HealthSouth, Richard E. Botts, who later was indicted and convicted for his role in HealthSouth's accounting fraud. Several other HealthSouth officers were likewise indicted and convicted for their respective roles in the fraud. See the testimony of HealthSouth's sole witness at the BTA hearing, Michael David Martin. Tr. 95, Supp. 37; and, e.g., *United States v. Richard E. Botts* (2005, 11th Cir.), 139 Fed. Appx. 416, U.S. App. LEXIS 12078; and *United States v. Michael D. Martin* (2006, 11th Cir.), 455 F.3d 1227.

The declaratory language of the 2002 tax year return providing that it is signed under penalty of perjury is as follows:

“I declare **under penalty of perjury** that this return (and any accompanying schedules and attachments) has been examined by me and to the best of my knowledge and belief is a true, correct and complete return and report.”

(Emphasis added.), S.T. 684, Supp.501. Mr. Botts signed his name on the signature line immediately below that declaration. Id.

Thereafter, on March 18, 2003, the Federal Bureau of Investigation, as part of an ongoing Securities and Exchange Commission (SEC) investigation of HealthSouth, conducted a search of HealthSouth’s Birmingham, Alabama headquarters pursuant to warrant. See HealthSouth’s Form 10-K filed with the Securities and Exchange Commission (SEC) for the fiscal years ending December 31, 2003 and December 31, 2002 (BTA Ex. 5) at 5-6, Supp.161-162; and HealthSouth’s Form 8-K as of May 28, 2004 at 6, BTA Ex. 1, Supp.80.

HealthSouth’s SEC Form 8-K for that period succinctly details the investigation and its immediate aftermath, as follows:

On March 18, 2003, a federal law enforcement task force executed a search warrant at the Birmingham, Alabama offices of HealthSouth Corporation, seizing thousands of documents maintained in the Company’s executive offices and financial, accounting, information technology, and other departments. The following day, the Securities and Exchange Commission, which six months earlier had begun an investigation triggered by insider stock sales in advance of the Company’s August 2002 announcement of an anticipated \$175 million earnings shortfall, filed suit against HealthSouth and its Chairman, Chief Executive Officer and principal founder, Richard M. Scrushy, claiming that the Company had deliberately overstated its earnings by at least \$1.4 billion since 1999.

Within five weeks, nearly a dozen current and former HealthSouth executives, including all five who had served as Chief Financial Officers, had pleaded guilty to criminal violations of the federal securities laws and related statutes. Federal authorities also revised their estimates of HealthSouth’s earnings overstatement to more than \$2.5 billion.

**As details of the Company's accounting practices emerged, it became apparent that HealthSouth had suffered the largest public company accounting fraud in Alabama history and one of the largest in the history of American business \*\*\***

(Emphasis added.) BTA Ex. 1 at 6, Supp. 80. See also, *Martin*, supra, 455 F.3d at 1230-1231, fn.1 (finding the extent of the accounting fraud, as reflected in HealthSouth's annual Forms 10-K from 1994 through 2002, included "cumulative inflations [of earnings and asset values] summed in the billions of dollars."); *Decision and Order of the BTA* at 6, citing HealthSouth's Form 8-K as of May 28, 2004 at 13, Supp. 87.

Well after the fraud became a matter of general public knowledge, by letter dated June 1, 2004, HealthSouth's then-tax representative, Brian T. Skully of the accounting firm of KPMG, LLP, sought a personal property tax refund for the 2002 tax year in the stated amount of \$236,928. S.T. 78, Supp.1394. In that June 1, 2004 letter, Mr. Skully, on behalf of HealthSouth, requested the refund on the basis of a "mistake of fact" which Mr. Skully admitted was relied on by the "taxing officials." Id. Mr. Skully further asserted that the basis for the "mistake" was the listing of "fictitious assets on depreciation schedules using the asset description 'AP SUMMARY,'" which Mr. Skully asserted related to assets that "did not exist." Id.

Subsequently, by letter dated August 4, 2004, Mr. Skully filed an application for final assessment formally seeking a tax refund on behalf of HealthSouth for the 2002 tax year. S.T. 49, Supp.1397. As part of his supporting documentation, he attached a summary document captioned "HealthSouth Corporation Tax Year 2002 Amended Fixed Assets." S.T. 246-364, Supp.1399-1517. Upon the Commissioner's receipt of the application and supporting materials, by letter dated March 11, 2005, Tax Commissioner's Agent Christopher Clemens requested "full and detailed journal entries that are reflective of the write-off or write-down of these assets on

Ohio showing the originally reported costs have been written off the books of HealthSouth Corporation.” S.T. 45, Supp.1518.

When, however, Mr. Skully failed to respond to this request, Agent Clemens sent a follow-up letter dated July 15, 2005 advising that no changes would be made to HealthSouth’s previously reported valuation amounts of its taxable personal property. S.T. 37-38, Supp.1520-1521. Specifically, HealthSouth had failed to provide “probative evidence” that it was entitled to any reduction in its reported valuations, including failing to provide any evidence that it had written off asset values as required under generally accepted accounting principles [GAAP]. Id.

Accordingly, on July 22, 2005, the Commissioner issued final assessment certificates in the same total assessed value as self-reported by HealthSouth in its Ohio personal property tax return for the 2002 tax year. S.T. 1-20, Supp.1522-1541. HealthSouth then filed its notice of appeal with the BTA seeking a tax refund in the amount of \$236, 928. Supp.1.

**C. HealthSouth fell far short of meeting its affirmative evidentiary burden of demonstrating that the Commissioner’s valuation findings were “clearly unreasonable or unlawful.”**

1. *At the BTA hearing, HealthSouth failed to produce any accounting journal entries, balance sheets or other financial statement records for its Ohio facility locations showing the removal of any alleged “fictitious” assets or asset values, as would be required under GAAP had such overstatements actually occurred, whether in the dollar amounts claimed by HealthSouth in its refund claim or otherwise.*

As outlined in Section B, supra, in the administrative proceedings before the Tax Commissioner, the Commissioner’s auditing agent assigned to HealthSouth’s refund claim for the 2002 tax year, Christopher Clemens, emphasized in his correspondence with HealthSouth’s CPA firm tax representative, Brian T. Skully, the need for HealthSouth to provide the Commissioner with the appropriate accounting records under generally accepted accounting principles (GAAP). He requested the journal entries and other accounting records that are

required under GAAP whenever acquisition costs are truly overstated. In other words, as applied here, the accounting journal entries would reverse the journal entries whereby the alleged “fictitious assets” were created.

Yet, despite Agent Clemens’ demand, Mr. Skully failed to provide any such records, and failed to explain the absence of such records. In other words, Mr. Skully was inexplicably totally silent on the matter. This shortcoming was hardly rectified at the BTA.

At the BTA, HealthSouth followed this same course by presenting no explanation for its failure to have provided any “journal entry” accounting records or balance sheets evidencing the removal or reversal of any journal entries overstating the acquisition costs for any fixed assets located at any of its Ohio-located facilities. Nor did HealthSouth provide any testimony at the BTA to challenge the Commissioner’s auditing findings that such records are required under GAAP.

Instead of presenting Mr. Skully or some other accounting witness, HealthSouth relied exclusively upon the testimony of a non-accountant, Michael D. Martin. Mr. Martin expressly disavowed expertise in accounting matters. See, e.g. Tr.106, Supp.40 (“I’m not [an accountant]”). In other words, the Commissioner’s audit findings concerning the necessity under GAAP to make such journal entries (which then would be reflected in HealthSouth’s facility-specific balance sheets) to remove the overstated acquisition costs stands entirely un rebutted.

Moreover, HealthSouth’s failure at the BTA to have provided any revised facility-specific balance sheets for its Ohio locations is particularly suspicious because such facility-specific balance sheets were enclosed with its 2002 tax year return. See, e.g., S.T. 867, Supp.683; S.T. 884, Supp.700. Thus, HealthSouth’s failure to provide revised facility-specific balance sheets for the tax valuation date at issue here (December 31, 2001) cannot be explained on the

basis that, in the ordinary course of its accounting practices, HealthSouth did not create and maintain such financial statements.

Similarly, at the very least, if HealthSouth truly had overstated the acquisition costs of its taxable Ohio fixed assets in the amounts it has alleged in its Ohio refund claim, it would have provided the BTA with such facility-specific balance sheets for subsequent fiscal year-ends. That is, even if HealthSouth did not undertake to retroactively correct its December 31, 2001 facility-specific balance sheets, it necessarily would have been required to have corrected them for subsequent fiscal years. In other words, “the absence of such evidence is evidence of absence.”

But this is not all. As we discuss in the following sub-sections, the evidence that HealthSouth did present to the BTA – particularly in light of the foregoing failures of proof – falls far short of probative or competent evidence.

*2. HealthSouth relied solely on multiple-level hearsay as the basis for its identification of alleged “fictitious” Ohio taxable assets.*

**a. The BTA testimony of Michael D. Martin clearly revealed that he had no personal knowledge or involvement in the preparation or filing of HealthSouth’s 2002 Ohio personal property tax return and attachments thereto. Instead, these materials were submitted and approved by a HealthSouth official subsequently convicted of accounting fraud.**

As detailed in Section B, *supra*, HealthSouth’s Ohio personal property tax return for the 2002 tax year, with attachments thereto, S.T. 661-1581, Supp.479-1387, was signed under penalty of perjury by Richard E. Botts, HealthSouth’s then-Vice President of the tax department, on June 14, 2002. Following his conviction for his role in HealthSouth’s accounting fraud, Mr. Botts understandably did not testify at the BTA evidentiary hearing. Nor did anyone else involved in HealthSouth’s preparation or filing of that return. Instead, Michael D. Martin was the sole BTA witness testifying on behalf of HealthSouth at that hearing.

Mr. Martin testified that he started his employment with HealthSouth in 1998 as a sales and use tax supervisor and then “around April of 2003” (i.e., well after HealthSouth filed its 2002 tax year return) he became in charge of property tax. Tr. 10, Supp. 16. Mr. Martin further testified that, during Mr. Botts’ tenure, Mr. Martin never had any communications with him concerning personal property taxes. Tr. 95, Supp. 37 .

As Mr. Martin candidly admitted, he was not “real familiar with Ohio’s return.” Tr. 23, Supp. 19. This is to say the least. In fact, in his testimony concerning the Ohio personal property tax return for the 2002 tax year and the attachments thereto, Mr. Martin clearly testified to his complete unfamiliarity with the return and all of the supporting documentation.

Specifically, concerning the documentation attached to the 2002 return captioned “Assessed Value Detail –Personal Property –Tax Year 2002,” beginning at S.T. 855, Supp. 671, Mr. Martin testified only that “**it looks like** it comes from our compliance software that was used at that time.” (Emphasis added.) Tr. 14, Supp. 17. Similarly, regarding the various facility-specific balance sheets included in the attachments to the 2002 return, e.g., S.T. 881 [relating to Facility no. 04-0209] and the pages following the balance sheets, Mr. Martin testified that “**it looks like** it is information right out of our asset management [system].” (Emphasis added.) Tr. 16, Supp. 17. Simply put, Mr. Martin’s testimony was plainly that of a person who was looking at the 2002 return and the attachments thereto for the very first time.

**b. Mr. Martin likewise had no personal knowledge of or involvement in the compilation or preparation of the documentation captioned “HealthSouth Corporation Tax Year 2002 Amended Fixed Assets” submitted to the Commissioner by HealthSouth’s then-tax representative, Brian T. Skully, for purposes of litigation in support of the refund claim.**

As explained in Section B, supra, as part of HealthSouth’s application for final assessment for the 2002 tax year, KPMG employee/property tax consultant Brian T. Skully

furnished the Commissioner with a documentation captioned "HealthSouth Corporation Tax Year 2002 Amended Fixed Assets" S.T. 246-364, Supp. 1399-1517. On the bottom left-hand side of each page of that documentation appears the wording "KPMG confidential," strongly indicating that the documentation was prepared and created for purposes of supporting HealthSouth's refund claim, rather than constituting a regular-course-of-business record created and maintained by HealthSouth. Id.

Unfortunately for HealthSouth, Mr. Skully did not testify at the BTA and Mr. Martin's testimony concerning the documentation manifested his lack of personal knowledge about its creation, preparation and accuracy. When asked to identify the documentation in direct examination he explained that "**it looks like** all the asset detail for every single location." (Emphasis added.) Tr. 24, Supp. 19. Moreover, he admitted that he did not prepare the documentation, but that he believed the documentation "came from HealthSouth's asset management system." Tr. 27-28, Supp. 20. In this regard, he testified he was "somewhat" familiar with the asset management department of HealthSouth. Similarly, earlier in his testimony he disavowed any direct connection with the asset management department within HealthSouth, stating that he had only a "high-level" or "general knowledge" of the numbers generated by that department, out of which, according to Mr. Martin, the accounting fraud was perpetrated. Tr. 12, Supp. 16.

Given the clear hearsay nature of Mr. Martin's testimony, the Commissioner's counsel timely raised objections to it on the grounds that it was litigation-prepared, summary documentation for which Mr. Martin had no personal involvement either in its creation or in reviewing or verifying its accuracy. Tr. 26-31, Supp. 20-21.

**c. HealthSouth's BTA Exhibits 3 and 4 constituted unauthenticated, multiple-level hearsay that therefore lacked any probative value and plainly constituted incompetent evidence.**

The character of HealthSouth's BTA Exhibits 3 and 4 as unauthenticated hearsay was even clearer because of the greater levels of hearsay involved. At the BTA hearing, the primary discussion of these exhibits centered on BTA Ex. 4, Supp. 127-156, regarding which Mr. Martin admitted that he had no involvement in preparing, creating or verifying – activities that he ascribed to Mr. Skully. On the bottom left-hand side each page of Ex. 4, the words "Paradigm Tax Group Confidential" appear. *Id.* Consistent with this designation, Mr. Martin testified that he believed Mr. Skully joined Paradigm Tax Group, which had spun off from KPMG's property tax group, and that Mr. Skully was the preparer of BTA Ex. 4. Tr. 48, Supp. 25, Tr. 77, Supp. 33. Mr. Martin further testified that the documentation used to compile BTA Ex. 4 consisted of various materials from various sources, the specifics of which he simply did not know. Namely, Mr. Martin stated his understanding to be that Mr. Skully utilized unspecified records maintained by HealthSouth's asset management group, which, in turn, utilized physical inventory ("bag and tag") records created by third-party entities identified by Mr. Martin as Grant Thornton (and accounting firm) and "American Appraisal." Tr. 79, 83-84, Supp. 33-34.

Mr. Martin testified similarly regarding BTA Ex. 3, a one-page summary of financial figures captioned "Presentation for Balance Sheet, and having separate columns for "2003" and "2002". Supp. 125. Mr. Martin testified that he thought that a HealthSouth employee in the asset management group by the name of Brent Woodall prepared that document, and that he "might have" relied upon workpapers and other underlying documentation for his summary. Tr. 90-92, Supp. 36. When asked a series of questions concerning the contents of the document, Mr. Martin admitted that he could only speculate as to the answers. Tr. 93, Supp. 37.

Finally, as to HealthSouth's remaining BTA exhibits, i.e., BTA exhibits 1, 2 and 5, Supp. 75-124 and 157-478, Mr. Martin merely identified them as SEC financial statement excerpts or filings, for which he had no direct involvement in their preparation, creation or review. Accordingly, his testimony was purely in the nature of identification of the documents. (As noted above, he admitted to having no accounting expertise.) In sum, as to the BTA Exhibits, Mr. Martin's testimony was pure multi-level hearsay, and BTA Exhibits 3 and 4 were themselves multiple-level hearsay. Consequently, the Commissioner and the BTA could not possibly conduct any meaningful examination for the sole witness could only speculate about their contents.

3. *HealthSouth issued hundreds of written disclaimers concerning the accuracy of its refund claims and amended returns for the taxable period at issue in the present case and thereafter.*

Finally, we note evidence that was also adduced in the Alabama trial court proceedings that ultimately led to the Alabama Supreme Court's decision that the Commissioner cites as persuasive authority under Proposition of Law No. 1, *infra*. See, *Ex Parte HealthSouth Corp. (In re: HealthSouth Corporation v. Jefferson County Tax Assessor, Dan Wietrib, and Jefferson County Tax Collector, J.T. Smallwood)* (2007), \_\_ So. 2d \_\_\_, 2007 Ala. LEXIS 174, T.C. Appx. 18-28; and BTA Ex. A (the trial transcript in the Alabama case)<sup>1</sup>.

In the Alabama trial court proceedings and at the BTA, Mr. Martin identified a written disclaimer. That written disclaimer was marked and admitted into evidence at the BTA as Ex. B, Supp. 74, having previously been admitted into the Alabama trial court proceedings as Defendant's Exhibit 1. See Mr. Martin's Alabama trial court testimony at Supp. 70, and his BTA testimony at Tr. 74-75, 84-85, Supp. 32, 34-35.

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<sup>1</sup> Mr. Martin's testimony in that case is reproduced at Supp. 63-73.

As Mr. Martin admitted in his testimony at the BTA, as well as in parallel court proceedings in Jefferson County, Alabama, on the advice of its legal counsel, HealthSouth advised through written disclaimers “concerning virtually every property tax return, no matter what state, \*\*\* that our returns were still being audited.” Tr. 75, 85 Supp. 32, 35. Furthermore, Mr. Martin stated that such disclaimers were issued for tax returns through the 2005 tax year, i.e., long after HealthSouth submitted its application for final assessment in the present case. Tr. 85, Supp. 35. Mr. Martin stated that he believed that the substance of the disclaimer was that the “amended returns may not be accurate,” but that he would say that they would be “fairly accurate.” Tr. 84, 85, Supp. 35. This is hardly a ringing endorsement of HealthSouth’s 2002 tax year refund claim by HealthSouth’s sole witness!

Any further facts will be referenced to Law and Argument section, which follows.

## LAW AND ARGUMENT

### Proposition of Law No. 1:

**A personal property taxpayer’s intentional over-reporting of its asset values and resultant tax due in its annual Ohio personal property tax return in order to hide its own accounting fraud overcapitalization of its fixed asset values as reported on its publicly filed SEC financial statements for that period properly bars the claimant from subsequently receiving a refund of the overpaid taxes, which the taxpayer sought only after an SEC investigation revealed the fraud.**

This appeal involves a refund claim for Ohio personal property taxes -- a tax that depends for its effective administration on the integrity and honesty of Ohio’s business taxpayers who must annually self-report the “true value” of their taxable personal property and voluntarily pay the taxes due per that self-reporting. In turn, Ohio’s school districts, county and municipal governments, park districts, libraries, and other local government recipients of personal property tax revenues must rely on the honesty and integrity of this self-reporting for purposes of their

own budgeting and financial planning. Indeed, because they are heavily reliant on the revenues from this tax, our Ohio public schools and other local taxing districts would be thrown into fiscal chaos if Ohio's business taxpayers were not to perform their statutory self-reporting obligations in a responsible and honest way.

Recognizing the significant compliance burdens imposed on Ohio businesses to annually file true and accurate returns, the Ohio personal property tax law provides a remedy when businesses make honest, unintentional errors in filing their returns, thereby resulting in overpayments of the tax. Namely, the overpaid taxes are refundable by timely filing an application for final assessment pursuant to R.C. 5711.26. In fact, by simply reviewing its own cases and a vast body of lower appellate court and BTA decisions, the Court may determine for itself that over the long history of the tax, vast numbers of taxpayers have received refunds of honestly, but erroneously, overpaid personal property taxes.

The Commissioner is compelled to take the instant appeal, however, because the BTA's decision in the present case departed from all existing precedent by granting a refund claim to a personal property taxpayer that had **intentionally and fraudulently**, not mistakenly, over-reported its tax liability. As HealthSouth is now forced to admit, to the extent that its Ohio personal property 2002 tax return overstates the true values of its taxable personal property, the overstatement was intentional. It was done in order to hide HealthSouth's own fraudulent accounting scheme whereby it inflated its earnings and assets on its financial statements filed with the Securities and Exchange Commission (SEC). See *Decision and Order of the BTA* at 6, citing HealthSouth's SEC Form 8-K as of May 28, 2004, BTA Ex. 1 at 13, Supp. 87 and the extensive discussion in Section B of the Statement of Case and Facts, *supra*.

Rather than basing its refund claim on honest, unintentional errors in its Ohio personal property tax reporting, HealthSouth Corporation (HealthSouth) has sought a tax refund of over \$236,000 for the 2002 tax year on the basis that it had previously intentionally overstated its taxable asset values in its Ohio return for that year. Only after SEC investigators uncovered the accounting fraud in March of 2003 did HealthSouth assert that its 2002 Ohio personal property tax return (which HealthSouth had filed with the Commissioner in June of 2002) included fictitious assets or fictitious asset values.

In the history of Ohio taxation and, apparently, in the history of all other taxing jurisdictions as well, the BTA's decision below stands alone as the only known, published decision granting a tax refund on the basis of a tax refund claimant's openly admitted, fraudulent overstatement of the tax. Despite an extensive search of the case law, the Commissioner has not unearthed any decisions in which a tax refund claim based upon an openly admitted, fraudulent overstatement of tax has been granted.

In stark contrast to the complete absence of any decisional law supporting HealthSouth's refund claim, the Court may look to Ohio's sister jurisdictions for direct precedent denying HealthSouth's claim here. Most notably, in HealthSouth's home state, the Alabama Supreme Court emphatically rejected HealthSouth's property tax refund claims for the same tax year at issue here, affirming the trial court's and lower appellate court's holdings that HealthSouth's intentional overstatement of the value of its taxable personal property barred its refund claim. *Ex Parte HealthSouth Corp. (In re: HealthSouth Corporation v. Jefferson County Tax Assessor,*

*Dan Wietrib, and Jefferson County Tax Collector, J.T. Smallwood*)<sup>2</sup> (2007), \_\_\_ So. 2d \_\_\_, 2007 Ala. LEXIS 174, T.C. Appx. 18-28.

Apparently independently arriving at the same conclusion, in a decision recently issued, the Connecticut Superior Court likewise rejected HealthSouth's personal property tax refund claims for the same tax year at issue here, holding that such claims were barred by reason of HealthSouth's accounting fraud. *Healthsouth Corp. v. City of Waterbury et al.* (March 13, 2008), Conn. Sup. Ct. Case Nos. CV0540111048, CV054010916, CV05401807, CV054002794, and CV054006234, T.C. Appx. 29-33.

Ohio tax decisions are in full accord with these Alabama and Connecticut *HealthSouth* decisions rejecting HealthSouth's personal property tax refund claims. As we noted at the BTA hearing below, a Twelfth District Court of Appeals decision is directly on point. *The William Bayley Co. v. Lindley* (March 28, 1979), Clark Cty. App. No. 1308, unreported. The Court ruled that a publicly-held personal property taxpayer is properly estopped from obtaining a valuation below the stated book value of its intangible assets as reported for SEC purposes because, if such reduced value were accepted for tax purposes, it "**would recognize a corporate fraud on the public.**" *Id.* at 8. T.C. Appx. 34-36.

The reasonableness and lawfulness of the *William Bayley* Court's rejection of a personal property taxpayer's refund claim on the basis of accounting fraud estoppel finds powerful confirmation in this Court's own tax decisions. Perhaps because of the very brazenness entailed in advancing such claims, this Court has not had occasion itself to apply an estoppel bar against a

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<sup>2</sup> At the BTA, the transcript of the Alabama trial proceedings in *Ex Parte HealthSouth Corp.* was admitted into evidence as Appellee's Exhibit A. As part of the Supplement, we have reproduced the testimony of Michael D. Martin in that case, who provided the sole witness testimony on behalf of HealthSouth in the BTA proceedings in the present case, Supp. 63-73, and who testified that his testimony in the Alabama case was true and accurate. Tr. 71-74, Supp. 31-32.

taxpayer refund claimant on the basis of the taxpayer's own fraudulent overstatement of tax. Nonetheless, the Court has had numerous occasions to apply estoppel principles in tax cases. For example, we note that in the following four sales and use tax decisions (which historically have comprised the vast majority of this Court's tax decisions) the Court did just that:

- (1) *Ormet Corp. v. Lindley* (1982), 69 Ohio St.2d 263 (holding that the Commissioner was estopped from imposing sales and use tax liability where the Commissioner, for prior audit periods, had entered into a "direct pay permit" agreement with the taxpayer for sales and use tax purposes, and the taxpayer detrimentally relied upon that agreement for a subsequent audit period when no such agreement was in effect);
- (2) *NLO, Inc. v. Limbach* (1993), 66 Ohio St.3d 389 (holding that the Commissioner's counsel's long-standing letters to the taxpayer stating that the taxpayer's purchases were constitutionally immune from sales and use taxation estopped the Commissioner from assessing sales and use taxes for audit periods prior to *U.S. v. New Mexico* (1982), 455 U.S. 720, in which the Supreme Court of the United States ruled that such purchases were not immune from state sales and use taxation);
- (3) *Youngstown Sheet & Tube Co. v. Lindley* (1988), 38 Ohio St.3d 232 (holding that, despite the General Assembly's repeal of a sales and use tax exemption, the Commissioner was required to recognize the exemption because he had failed to rescind his formally promulgated rule amplifying that exemption); and
- (4) *Lyden Co. v. Tracy* (1996), 76 Ohio St.3d 66 (same as in *Youngstown Sheet & Tube*).

For three fundamental reasons, the instant case presents at least as compelling a case for application of estoppel principles than did the previous four decisions in which this Court has applied them to resolve state taxation disputes. First, the Commissioner's and the school districts' and other taxing districts' reliance on HealthSouth's representations is at least as reasonable as the taxpayers' reliance on the Commissioner's representations in those cases. After all, the Commissioner and the taxing district recipients of the HealthSouth's personal property tax payments for the 2002 tax year relied upon the representations made by HealthSouth in its

2002 return concerning the purely **factual** issue of the acquisition costs of HealthSouth's taxable assets. Notably, these representations were made by its vice president of taxation, Richard E. Botts, **under penalty of perjury**. See S.T. 684, Supp. 501 [declaration page of the 2002 tax year returns signed under penalty of perjury] and Tr. 95, Supp. 37 (BTA testimony of Michael D. Martin identifying Mr. Botts' signature). In other words, as representations of fact made to the Commissioner under oath, HealthSouth's return information constituted special factual knowledge possessed by HealthSouth alone to which the Commissioner had no independent means of verification.

Second, by HealthSouth's own admission, its misrepresentations to the Commissioner constituted accounting "fraud." See the extensive discussion of the fraud in HealthSouth's SEC Form 8-K as of May 28, 2004, BTA Ex. 1, Supp. 75-123. In favorable contrast, the representations of the Commissioner upon which the estoppel bars were based in the foregoing four cases simply constituted non-fraudulent errors on the Commissioner's part, i.e., a mistaken interpretation of the applicable federal constitutional law (*NLO*); a failure to clarify language in a tax agreement (*Ormet*); and neglect in failing to timely repeal promulgated rules (*Youngstown Sheet & Tube* and *Lyden*).

Third, the detriment to the Commissioner, as the assessor of the tax, and the detriment to public schools, parks, libraries, counties, cities and other taxing district recipients of the personal property tax revenues, are just as great or are greater than the detriments incurred by the taxpayers in the foregoing cases. As to the Commissioner's administrative role as tax assessor, HealthSouth's fraudulent overstatement of the tax and subsequent refund claim have occasioned considerable expenditures of administrative and litigation resources in reviewing and evaluating

the claim<sup>3</sup>. Moreover, there are significant “opportunity costs” occasioned by HealthSouth’s fraudulent misrepresentations as well. Having devoted resources to this case means the Commissioner’s and Attorney General’s personnel involved have foregone the opportunity to devote those resources to other matters.

But even more basically, if HealthSouth’s refund claim were granted, the school districts and other taxing district recipients of the personal property taxes previously paid by HealthSouth would be substantially harmed. The monies to pay the refund claim would have to come from their current or future operating budgets. Thus, payment of the refund claim would diminish the amounts that otherwise would be available to meet the taxing districts’ operational needs. To be sure, had the Commissioner not been estopped from following through with his tax assessments in *NLO*, *Ormet*, *Youngstown Sheet & Tube*, and *Lyden*, the taxpayers in those cases would have had to pay taxes that they may not have anticipated an obligation to pay. Thus, a similar financial detriment was present in those cases.

Yet, the taxing districts would be placed in a more untenable position in attempting to meet such unexpected tax refund obligations than the taxpayers in the foregoing cases would have confronted had they been required to pay the assessed taxes. The private business taxpayers in those cases, at least, would not have had to confront the additional problem that Ohio’s taxing districts inevitably face in trying to meet their obligations to pay back previously collected

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<sup>3</sup> As detailed in the Statement of Case and Facts and further discussed under Proposition of Law No. 2, the resources devoted to a review and evaluation of the refund claim have been considerable. In its evidentiary presentation in the Tax Commissioner’s administrative proceedings and the BTA evidentiary hearing, HealthSouth failed to provide competent or probative evidence to meet its affirmative burden of factually demonstrating the extent to which it overstated the true value of its taxable Ohio fixed assets. Rather than having expended the necessary effort to restate its balance sheets for its Ohio locations for the December 31, 2001 tax listing date at issue, HealthSouth instead has chosen to rely on multiple-level hearsay summary documentation, occasioning substantial additional expenditures of audit and litigation resources regarding that issue.

personal property taxes. As political subdivisions of the State, Ohio's taxing districts are severely limited in how they can increase revenues because to do so they often must present to the voters bond issuances or tax levies, which may or may not be approved. In other words, the taxing districts simply lack the flexibility of private businesses to meet such obligations.

For all these reasons, the BTA's unprecedented grant of a tax refund based on HealthSouth's openly-admitted fraudulent overstatement of its assets values should be reversed. Instead, the Court should follow the lead of its own tax law precedent applying estoppel principles in *NLO, Ormet, Youngstown Sheet & Tube* and *Lyden*, as well as the Court of Appeals decision directly on point in *William Bayley* and the Alabama Supreme Court and Connecticut Superior Court *HealthSouth* decisions. As the Alabama Supreme Court cogently concluded in its *HealthSouth* decision:

HealthSouth's intentional misrepresentation of its assets did not abrogate the right of the taxing authorities to assess and collect personal-property taxes from HealthSouth based upon the information HealthSouth provided on its personal-property tax return."

*Ex parte HealthSouth*, supra at 22, T.C. Appx. 24.

So, too, should this Court hold here<sup>4</sup>.

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<sup>4</sup> The amicus brief filed with the Court in support of the Commissioner by the Ohio School Boards Association provides further compelling case law analysis and reasoning in support of the Commissioner. We welcome the support of the Commissioner's position reflected in the OSBA's amicus brief. The Commissioner would like to take this opportunity to formally extend his appreciation to the author of the OSBA amicus brief, Case Western Reserve University School of Law Professor Craig M. Boise. Prof. Boise brings a special expertise to the matter expressly recognized by the Alabama Supreme Court's *Health South* decision. *Ex Parte HealthSouth Corp.*, supra, at 19-20 (quoting extensively with approval from Professor Boise's law review article, "Playing with Monopoly Money: Phony Profits, Fraud Penalties, and Equity," 90 Minn. L. Rev. 144(2005)).

**Proposition of Law No. 2:**

**At the BTA, a personal property taxpayer refund claimant fails to meet its affirmative burden of demonstrating the Commissioner's findings to be "clearly unreasonable or unlawful" when it:**

- (1) fails to produce any journal entries, balance sheets or other financial statement records for its Ohio facility locations showing the removal of any alleged "fictitious" assets or asset values, as would be required under generally accepted accounting principles (GAAP) had such overstatements actually occurred, whether in the dollar amounts claimed in its refund claim or otherwise;**
- (2) relies solely on multiple-level hearsay as the basis for its identification of alleged "fictitious" Ohio taxable assets; and**
- (3) concedes, that, at best, its submitted refund claim is "fairly accurate."**

As an independent basis for upholding the Commissioner's denial of HealthSouth's refund claim, and reversing the BTA's grant of that claim, HealthSouth failed to meet its affirmative burden of proof of showing the Commissioner's findings to be "clearly unreasonable and unlawful." Notably, the BTA's decision itself is silent as to that burden of proof, which this Court has long and uniformly applied, as recently reiterated in *Shiloh Automotive, Inc. v. Levin*, 117 Ohio St. 3d 4, 2008 Ohio 68, ¶ 16, as follows:

The commissioner's findings "are presumptively valid, absent a demonstration that those findings are clearly unreasonable or unlawful." *Nusseibeh v. Zaino*, 98 Ohio St.3d 292, 2003 Ohio 855, 784 N.E.2d 93, at ¶ 10.

As we detailed in Section C.1. of the Statement of Case and Facts, *supra*, the evidentiary record reflects that, despite the Commissioner's express request for such documentation, HealthSouth failed to furnish to either the Commissioner or to the BTA the primary and secondary accounting records necessary to establish the manner and extent of its asserted over-reporting of its taxable fixed asset values. Namely, HealthSouth failed to produce any accounting journal entries, balance sheets or other financial statement records for its Ohio facility locations

showing the removal of any alleged “fictitious” assets or asset values, as would be required under generally accepted accounting principles (GAAP) had such overstatements actually occurred, whether in the dollar amounts claimed in its refund claim or otherwise. Thus, in this fundamental way, HealthSouth failed to meet its affirmative burden of proof.

As we detailed in Section C.2. of the Statement of Case and Facts, *supra*, rather than having provided such probative evidence, HealthSouth instead relied solely upon hearsay testimony of a sole BTA witness regarding summary documentation which itself constituted multiple-level hearsay. In relying on such incompetent and non-probative testimony and documentation, the BTA plainly failed to apply the correct burden of proof. Moreover, the BTA violated a long line of this Court’s and the BTA’s own case law rejecting such evidence.

Specifically, in order for a personal property taxpayer to factually meet its affirmative burden of proof of showing the Commissioner’s determination of true value to be “clearly unreasonable or unlawful,” the taxpayer’s use of summary figures to support the reductions in true value must be accompanied by reliable and probative documentary evidence and testimony concerning the records upon which the summaries are based. *United Tel. Co. of Ohio v. Tracy* (1999), 84 Ohio St.3d 506, 512; *Rent-Way Inc. v. Wilkins* (April 13, 2007), BTA No. 2004-A-331, unreported. T.C. Appx. 37-43; *Anheuser-Busch Companies, Inc. v. Zaino* (September 24, 2004), BTA No. 2003-K-699, unreported, T.C. Appx. 44-50; *MCI Metro Access Transmission Services, LLC , and MCI WorldCom Network Services, Inc. v. Wilkins* (Apr. 13, 2007), BTA Nos. 2004-K-749, 750, unreported, appeal pending, Franklin County Ct. of Appeals Nos. 07APH05-0398, -0399, T.C. Appx. 51-58; *Hancor v. Limbach* (Jan. 11, 1991), Case No. 89-H-443, unreported, T.C. Appx. 59-62.

In *Rent-Way*, the BTA rejected a PWC disposal study prepared by PWC employee Edward Gifford in part because PWC had been engaged by Rent-Way on a contingency fee basis. But this was not the only reason that the BTA found the PWC-prepared evidence not to be probative or credible. The BTA rejected the disposal study as reliable and probative evidence because it was predicated on summary information unsupported by the underlying record detail concerning the specific disposals, as follows:

Further, upon our review of the disposal study, we are not persuaded by its conclusions. The study lists disposals by category, and no information on individual items was included. No distinction is made between the different types of Rent-Way's merchandise. **No underlying records or details regarding the disposals were provided. Especially since PWC [the PriceWaterhouseCoopers accounting firm] created the disposal study using the summary figures supplied by Rent-Way, without reviewing any information regarding specific disposals, supporting documentation should have been provided for the conclusions made by Rent-Way in its summary.** See *United Tel. Co. v. Tracy* (1999), 84 Ohio St.3d 506; *Anheuser-Busch Companies, Inc. v. Zaino* (Sept. 24, 2004), BTA No. 2003-K-699, unreported.

*Rent-Way*, at 18-19 (Emphasis and underlining added.)

Similarly, in *MCI*, supra, the BTA rejected the taxpayers' use of unsupported summary figures as the basis for true value reductions to their taxable telecommunications plant property, as follows:

Even if we were to accept appellants' claim that historical costs overstate the value of their assets, we still consider it necessary to critically review the basis upon which adjustments are sought to be made. In the present appeals, we cannot undertake such a review. **Instead, appellants ask that we accept at face value an impairment analysis performed on a system-wide level which, in some undisclosed manner, purportedly took into account issues of accounting fraud and the overall decline experienced by WorldCom/MCI within the telecommunications industry. We have little before us regarding either the entity which performed this analysis n10 or, more significantly, the data relied upon and the methodology utilized in generating the impairment estimates.** Indeed, such estimates may suffer from the same deficiencies of which this board has previously been critical. **We therefore cannot conclude that appellants have demonstrated, by**

**competent and probative evidence, that the 2003 assessed values do not accurately reflect the true value of their Ohio assets.**

*MCI* at 23-24. (Emphasis added.)

The BTA's and courts' rejection of unsupported summary information has a long history; the two foregoing cases are merely very recent examples of the application of well-established law. We, therefore, provide two further, earlier decisions applying this same principle. In *Hancor*, supra, the BTA rejected the appellant intangible personal property taxpayer's assessment challenge on the basis that its summary information concerning expenses were not supported by probative or competent evidence, as follows:

The Tax Commissioner's brief argument on this subject states that Appellant has failed to submit proof that the expenses for which credit is here sought were incurred at all, and, moreover, has failed to prove that they were incurred -- the goods or services provided -- in the fiscal years at issue. We must agree with the Tax Commissioner on this point. **The only evidence we have that the expenses were incurred in the appropriate fiscal years is the testimony of Mr. Haugawout and certain summaries, written after the fact by Mr. Haugawout and co-workers, found in Appellant's Exhibit D.** At the hearing Mr. Haugawout explained that the checks and invoices had been discarded due to the substantial passage of time. **We understand that, but we find that the evidence presented is not sufficiently reliable when the crucial factor is when expenses were incurred and all evidence consists of summaries --- constructed from what records we do not know - -- written after the fact.**

*Hancor*, at 10-11. (Emphasis and underlining added.)

Thus, in addition to erroneously disregarding HealthSouth's failure to adduce the accounting records required under GAAP evidencing that any "fictitious" asset values had been corrected on its accounting records, the BTA grossly departed from its own and this Court's established precedent in a further way. The BTA wrongly relying exclusively on summary, multiple-level hearsay documentation testified to by a sole witness with no personal knowledge

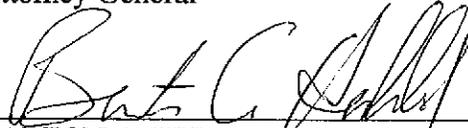
in the preparation, creation or verification of the summary documentation, or of the underlying documentation on which the summary documentation was allegedly based.

### CONCLUSION

For all the foregoing reasons, the Court should reverse the BTA's grant of HealthSouth's personal property tax refund claim on the grounds that HealthSouth is barred by its own accounting fraud from receiving personal property tax refunds of taxes that it intentionally and fraudulently overpaid. Alternatively, the BTA's decision should be reversed because HealthSouth plainly failed to meet its affirmative burden of proof of demonstrating the Commissioner's valuation findings to be clearly unreasonable or unlawful.

Respectfully submitted,

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IN THE SUPREME COURT OF OHIO

2007 DEC 10 PM 3:24

Appeal from the Ohio Board of Tax Appeals,

HEALTHSOUTH CORPORATION

Appellee,

v.

WILLIAM W. WILKINS [RICHARD A.  
LEVIN], TAX COMMISSIONER OF OHIO,

Appellant.

Case No. **07-2281**

Appeal from BTA Case  
No. 2005-A-1386

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NOTICE OF APPEAL

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SUPREME COURT OF OHIO

IN THE SUPREME COURT OF OHIO

Appeal from the Ohio Board of Tax Appeals,

HEALTHSOUTH CORPORATION

Appellee,

v.

WILLIAM W. WILKINS [RICHARD A. LEVIN], TAX COMMISSIONER OF OHIO,

Appellant.

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: Case No. \_\_\_\_\_  
:  
: Appeal from BTA Case  
: No. 2005-A-1386  
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NOTICE OF APPEAL

Richard A. Levin, Tax Commissioner of Ohio, successor to William W. Wilkins, hereby gives notice of his appeal as of right, pursuant to R.C. 5717.04, to the Supreme Court of Ohio from a decision and order of the Ohio Board of Tax Appeals ("BTA"), journalized on November 9, 2007, in Case No. 2005-A-1386 before the BTA. A true copy of the decision and order of the BTA being appealed from is attached hereto and incorporated herein by reference.

The errors in the decision and order of the BTA of which the Tax Commissioner ("Commissioner") complains are as follows:

1. The BTA erred, as a matter of fact and law, in ordering the Commissioner to reduce the assessed valuations of the taxable personal property of HealthSouth Corporation ("HealthSouth") for the 2002 tax year below the valuations that had been assessed by the Commissioner under his acquisition-cost-less-prescribed-allowances-for-depreciation method for determining "true value."
2. The BTA erred, as a matter of fact and law, in granting, in whole or in part, HealthSouth's request for refund of personal property taxes regarding the true values

of personal property listed for taxation by HealthSouth on its 2002 tax year Ohio personal property tax return and assessed by the Commissioner against HealthSouth for that tax year.

3. The BTA erred, as a matter of fact and law, in determining that HealthSouth had met its affirmative burden of demonstrating both the manner and the extent of any error in the Commissioner's determination of the taxable true value of HealthSouth's personal property for the 2002 tax year.
4. The BTA erred, as a matter of fact and law, in determining that HealthSouth had established by probative, competent evidence the extent, if any, to which for Ohio personal property taxation for the 2002 tax year HealthSouth had listed "phantom" or "fictitious" assets or "phantom" or "fictitious" asset values that never existed or existed in acquisition amounts less than the actual amounts HealthSouth incurred for acquiring or producing its Ohio-located taxable assets.
5. The BTA erred, as a matter of fact and law, in admitting into evidence multiple-level hearsay witness testimony and in solely relying, as the basis for the BTA's granting of HealthSouth's refund claim, upon that incompetent, non-probative witness testimony and unauthenticated, multiple-level hearsay summary documentation that had been presented and rejected as such by the Commissioner.
6. The BTA erred, as a matter of fact and law, by failing: (1) to have required HealthSouth to have admitted into evidence, as necessary foundation documentation, the underlying documentation supporting the unauthenticated, multiple-level hearsay summaries relied upon by the BTA to reduce the Tax Commissioner's determination of true value and grant HealthSouth's refund claim, and (2) to have required

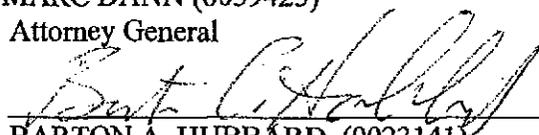
HealthSouth to have presented the accounting books and records and journal entries reflecting any corrections to HealthSouth's alleged fraudulent over-reporting of its Ohio-located taxable personal property.

7. Even had HealthSouth established by probative, competent evidence the manner and extent to which any of the assessed true value of HealthSouth's taxable personal property included "phantom" assets or "phantom" asset values, the BTA erred, as a matter of fact and law, in failing to hold that HealthSouth is properly barred or estopped from obtaining a reduction in taxable value of personal property and a refund of personal property taxes for the 2002 tax year.

HealthSouth is properly barred from such relief because any such over-reporting by HealthSouth of assets or asset values on its Ohio personal property tax return constituted an intentional, fraudulent misrepresentation under penalty of perjury that was relied upon by the Commissioner, the Ohio school districts and other recipients of the tax revenues to their detriment. HealthSouth perpetrated any such fraudulent misrepresentations in order to hide its intentional and fraudulent financial statements filed with the Securities and Exchange Commission in order to perpetrate a fraud on its stockholders, the general public, and all other users of its financial statements.

Respectfully submitted,

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certificates, issued under date of July 22, 2005, relate to an application for final assessment, i.e., request for refund, filed by appellant for the 2002 personal property tax year.

The matter was submitted to the Board of Tax Appeals upon the notice of appeal, the statutory transcript certified to this board by the Tax Commissioner, the record of the hearing before this board, and the brief filed by counsel to the appellant.

In reviewing appellant's appeal, we recognize the presumption that the findings of the Tax Commissioner are valid. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121. It is therefore incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the presumption and establish a right to the relief requested. *Hatchadorian v. Lindley* (1986), 21 Ohio St.3d 66; *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138. Moreover, the taxpayer is assigned the burden of showing in what manner and to what extent the Tax Commissioner's determination is in error. *Kern v. Tracy* (1995), 72 Ohio St.3d 347; *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213. Where no competent and probative evidence is developed before this board by the appellant to show that the Tax Commissioner's findings are incorrect, then the Board of Tax Appeals must affirm the Tax Commissioner's findings. *Kern, supra*; *Kroger Co. v. Limbach* (1990), 53 Ohio St.3d 245; *Alcan, supra*.

As we consider this case, we note that every taxpayer engaged in business in Ohio must annually file a personal property tax return with the county

auditor of each county in which property used in the taxpayer's business is located.

R.C. 5711.02. On that return, the taxpayer must list "all his taxable property \*\*\* as to value, ownership and taxing districts as of the tax lien date he engages in business."

R.C. 5711.03. In this instance, appellant has filed an inter-county return. R.C. 5711.13.

Initially, we note appellant's contentions, as set forth in the notice of appeal, as follows:

"2. Appellant requests that the decision be reversed because the Tax Commissioner erred in the following respects:

"A. The Tax Commissioner erred in upholding a tax assessment against property which did not exist on the tax lien date. Such property which was initially reported was the result of accounting irregularities at the Appellant which resulted in the listing of fictitious assets on the originally filed return. Taxpayers has [sic] timely requested a refund of tax paid on these fictitious assets and such refund should be granted.

"B. The Tax Commissioner also erred by denying Appellant the right to due process of law and equal protection under the Fifth and Fourteenth Amendments of the Constitution of the United States of America, and Article I, Section 2 of the Ohio Constitution, and denying Appellant the right to due course of law under Article I, §16 of the Constitution of the State of Ohio, including but not limited to the improper disqualification of the property, if the Tax Commissioner believes that it did exist, from its proper classification as not used in business."

More specifically, attached to its request for final assessment for tax year 2002, appellant HealthSouth Corporation provided the following information regarding its claim:

"In March 2003, HealthSouth became aware of accounting irregularities. Part of the accounting irregularities, consisted of overstating property, plant and equipment by listing fictitious assets on depreciation schedules using the asset description "AP SUMMARY". These assets do not exist. As a result of this, HealthSouth has been reporting, has been assessed and has paid personal property taxes on these erroneous assets. Consequently, these erroneous assets have been included in the taxing jurisdictions certified tax roll in error." S.T. at 73.

The basis of the tax department's denial of HealthSouth's refund request was set forth in a letter from the Ohio Department of Taxation regarding the final audit results and indicated that:

"You requested final assessment of the 2002 return on the basis that the assets have been over reported [sic] on the 2002 return. The asset listing you submitted in regards [sic] to this request show [sic] acquisition cost amounts compared to the AP summary amounts for various items of property in the State of Ohio. Under section 5711.18 of the Ohio Revised Code and Section 5703-3-10[c] of the Ohio Administrative rules, probative evidence is needed to establish true value of tangible personal property. In the request letter of March 11, 2005, the auditor requested journal entries to establish probative evidence the items being requested to be removed from the 2002 return have in fact been written off the books as well. As this information was not provided, there is a sufficient lack of evidence to establish these items have fully been removed from the assets as required by GAAP." S.T. at 37.

It is appellant's contention that specific line items designated on its 2002 personal property tax return as "AP SUMMARY" were erroneously included as tangible personal property, when, in fact, the items did not exist. H.R. at 7. This overstatement of assets was uncovered when HealthSouth "hired PricewaterhouseCoopers' forensic auditors to come in and start reviewing \*\*\* returns

and identifying all the irregularities and fixed asset – fictitious fixed assets, and just completely restate \*\*\* financial statements.” H.R. at 32-33. In addition, “a bag and tag inventory” count for virtually all of HealthSouth’s facilities was used to assist in completing a restatement of HealthSouth’s assets for purposes of filing restated and/or original financial statements for a four-year period, 2001-2004, a “super 10-K” that was filed with the SEC. H.R. at 40-42, 57. In the course of identifying the fraudulent listings on the earlier-filed tax returns and filing refund claims in various jurisdictions throughout the country, asset information was assembled by HealthSouth’s asset management group, which, in turn provided it to an outside consultant in order to help him “to determine the property, plant and equipment totals for each facility, which ties back to this schedule [Exhibit 4], and to the 10-K.” H.R. at 45.

Testimony before this board indicates that for purposes of preparing the refund request in question, HealthSouth’s asset management group assembled the asset listing, which was established through “bag and tag” inventory counts at each of HealthSouth’s facilities in Ohio. H.R. at 79, 85. In completing the inventory counts, consultants were given an asset listing of everything that should be at a particular facility. “\*\*\* [T]hen any assets that they had at the facility that weren’t on the list, that was added, and then anything that was on the list that wasn’t physically there was removed.” H.R. at 86-87.

As we review the foregoing evidence and testimony offered by appellant, we first note that there appears to be no dispute that a significant accounting fraud occurred at HealthSouth in which its earnings were dramatically

overstated. "Stated most simply, the fraud was accomplished by making over \$2.7 billion in false or unsupported entries in the Company's accounting systems. These improper accounting entries, made for the purpose of inflating HealthSouth's earnings, took two principal forms: (1) exaggeration of reported revenue, primarily through reductions to contractual adjustment accounts, and (2) failure to properly characterize and record operating expenses." Ex. 1 at 13. It is HealthSouth's claim that as a result of this fraudulent activity, its assets were overstated, and correspondingly, the personal property taxes on such assets were overpaid.

It appears from the record that the state's basis for denying HealthSouth's refund stems from HealthSouth's failure to provide the state with evidence, e.g., journal entries, that it had properly written off the "AP SUMMARY" assets from its books. When asked by counsel why those entries had not been provided, HealthSouth's witness, Michael D. Martin, vice-president of tax in charge of the sales and use tax, property tax, and unclaimed property tax departments, stated "I'm not aware of any journal entries to write this stuff off." H.R. at 65. He then went on to testify how the restated financials were determined, indicating "for property, plant and equipment, I know we hired American Appraisal Associates and quite a few other consulting firms to actually go out to our facilities and do a physical inventory of equipment at each facility. And I believe that was one of the primary tools or documents used to restate the property, plant and equipment accounts." H.R. at 66.

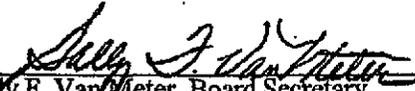
As we review the efforts undertaken by HealthSouth to accurately establish and report its personal property asset listings, we find nothing in the record

to indicate any impropriety in the methodology utilized. While HealthSouth did not provide the documentation requested by the Department of Taxation to establish that the assets listed as AP SUMMARY did not exist, it arguably utilized a viable, alternative means of establishing the assets that did exist. There is nothing in the provisions cited by the Department of Taxation, i.e., R.C. 5711.18 and Ohio Adm. Code 5703-3-10(c), to demonstrate that the means by which this taxpayer chose to establish its assets, and accordingly, the associated value of those assets for personal property taxation purposes, was improper. Further, there is nothing in the record to indicate that the amounts sought through the refund request were erroneous; it simply appears that the refund request was denied solely on the basis that the taxpayer did not provide evidence of its personal property value in the form in which the Department of Taxation requested. We find HealthSouth's evidence of value sufficient and probative in that regard.

Therefore, based upon the foregoing, we find that HealthSouth has sufficiently established that the assets designated as AP SUMMARY never existed. Further, we find that HealthSouth has met its burden of proof with regard to establishing that the denial of its refund request was improper. Accordingly, we find that HealthSouth has rebutted the presumption of correctness of the Tax Commissioner's findings herein. Therefore, it is the decision and order of the Board of Tax Appeals that the determination of the Tax Commissioner must be, and

hereby is, reversed and that the taxpayer's refund request shall be granted.

I hereby certify the foregoing to be a true and complete copy of the action taken by the Board of Tax Appeals of the State of Ohio and entered upon its journal this day, with respect to the captioned matter.

  
Sally F. VanMeter, Board Secretary

**In The Supreme Court of Ohio**  
**Case Information Statement**

<b>Case Name:</b> <u>HealthSouth Corporation v Wilkins</u>	<b>Case No.:</b> _____
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**I. Has this case previously been decided or remanded by this Court? Yes  No**   
If so, please provide the Case Name: \_\_\_\_\_  
Case No.: \_\_\_\_\_  
Any Citation: \_\_\_\_\_

**II. Will the determination of this case involve the interpretation or application of any particular case decided by the Supreme Court of Ohio or the Supreme Court of the United States? Yes  No**   
If so, please provide the Case Name and Citation: \_\_\_\_\_  
**Will the determination of this case involve the interpretation or application of any particular constitutional provision, statute, or rule of court? Yes  No**   
If so, please provide the appropriate citation to the constitutional provision, statute, or court rule, as follows:  
U.S. Constitution: Article \_\_\_\_\_, Section \_\_\_\_\_ Ohio Revised Code: R.C. Chapter 5711  
Ohio Constitution: Article \_\_\_\_\_, Section \_\_\_\_\_ Court Rule: \_\_\_\_\_  
United States Code: Title \_\_\_\_\_, Section \_\_\_\_\_ Ohio Admin. Code: O.A.C. \_\_\_\_\_

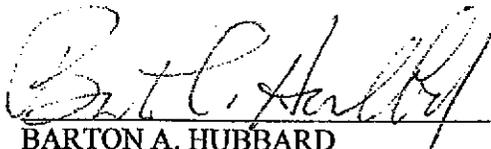
**III. Indicate up to three primary areas or topics of law involved in this proceeding (e.g., jury instructions, UM/UIM, search and seizure, etc.):**  
1) personal property taxation  
2) fraud/estoppel  
3) refund claims

**IV. Are you aware of any case now pending or about to be brought before this Court that involves an issue substantially the same as, similar to, or related to an issue in this case? Yes  No**   
If so, please identify the Case Name: \_\_\_\_\_  
Case No.: \_\_\_\_\_  
Court where Currently Pending: \_\_\_\_\_  
Issue: \_\_\_\_\_

**Contact information for appellant or counsel:**  
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30 East Broad Street, 25<sup>th</sup> Floor \_\_\_\_\_  
Address Signature of appellant or counsel  
Columbus OH 43215-3428 \_\_\_\_\_  
City State Zip Code Counsel for: Tax Commissioner

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a true copy of the Notice of Appeal was sent by certified U.S. mail to Nicholas Ray, Siegal Siegal Johnson & Jennings Co., LPA. 3001 Bethel Road, Suite 208 Columbus, Ohio 43220 on the 13<sup>th</sup> day of December, 2007.



**BARTON A. HUBBARD**  
Assistant Attorney General

### § 5711.26. Making certain final assessments

Except for taxable property concerning the assessment of which an appeal has been filed under *section 5717.02 of the Revised Code*, the tax commissioner may, within the time limitation in *section 5711.25 of the Revised Code*, and shall, upon application filed within such time limitation in accordance with the requirements of this section, finally assess the taxable property required to be returned by any taxpayer, financial institution, dealer in intangibles, or domestic insurance company as to which a preliminary or amended assessment has been made by or certified to a county treasurer or certified to the auditor of state or as to which the preliminary assessment is evidenced by a return filed with a county auditor for any prior year; and the commissioner may finally assess the taxable property of a taxpayer, financial institution, dealer in intangibles, or domestic insurance company who has failed to make a return to a county auditor or to the department of taxation in any such year. Application for final assessment shall be filed with the tax commissioner in person or by certified mail. If the application is filed by certified mail, the date of the United States postmark placed on the sender's receipt by the postal employee to whom the application is presented shall be treated as the date of filing. The application shall have attached thereto and incorporated therein by reference a true copy of the most recent preliminary or amended assessment, whether evidenced by certificate or return, to which correction is sought through the issuance of a final assessment certificate. The application shall also have attached thereto and incorporated therein by reference evidence establishing that the taxes, and any penalties and interest thereon, due on such preliminary or amended assessment have been paid. By filing such application within the time prescribed by *section 5711.25 of the Revised Code*, the taxpayer has waived such time limitation and consented to the issuance of his assessment certificate after the expiration of such time limitation.

For the purpose of issuing a final assessment the commissioner may utilize all facts or information he possesses, and shall certify in the manner prescribed by law a final assessment certificate in such form as the case may require, giving notice thereof by mail to the taxpayer, financial institution, dealer in intangibles, or domestic insurance company. Such final assessment certificate shall set forth, as to each year covered, the amount of the final assessment as to each class of property and the amount of the corresponding preliminary or last amended assessment. If no preliminary or amended assessment was made, the amount listed in the taxpayer's return for each such class of property shall be shown. If the amount of any final assessment of any such class for any year exceeds the amount of the preliminary or amended assessment of such class for such year, the difference shall be designated a "deficiency," and if no preliminary or amended assessment has been made, each item in the final assessment certificate shall be so designated. If the final assessment of any such class for any such year is less in amount than the preliminary or amended assessment thereof for such year, the difference shall be designated an "excess." The commissioner shall add to each such deficiency assessment the penalty provided by law, computed on the amount of such deficiency.

A copy of the final assessment certificate shall be transmitted to the treasurer of state or the proper county auditor, who shall make any corrections to his records and tax lists and duplicates required in accordance therewith and proceed as prescribed by *section 5711.32 or 5725.22 of the Revised Code*.

An appeal may be taken from any assessment authorized by this section to the board of tax appeals as provided by *section 5717.02 of the Revised Code*. When such an appeal is filed and the notice of appeal filed with the commissioner has attached thereto and incorporated therein by reference a true copy of any assessment authorized by this section as required by *section 5717.02 of the Revised Code*, the commissioner shall notify the treasurer of state or the auditor and treasurer of each county having any part of such assessment entered on the tax list or duplicate.

Upon the final determination of an appeal which may be taken from an assessment authorized by this section, the commissioner shall notify the treasurer of state or the proper county auditor of such final determination. The notification may be in the form of a corrected assessment certificate. Upon receipt of the notification, the treasurer of state or the county auditor shall make any corrections to his records and tax lists and duplicates required in accordance therewith and proceed as prescribed by *section 5711.32 or 5725.22 of the Revised Code*.

The assessment certificates mentioned in this section, and the copies thereof, shall not be open to public inspection.

§ 5717.04. Appeal from decision of board of tax appeals to supreme court; parties who may appeal; certification

The proceeding to obtain a reversal, vacation, or modification of a decision of the board of tax appeals shall be by appeal to the supreme court or the court of appeals for the county in which the property taxed is situated or in which the taxpayer resides. If the taxpayer is a corporation, then the proceeding to obtain such reversal, vacation, or modification shall be by appeal to the supreme court or to the court of appeals for the county in which the property taxed is situated, or the county of residence of the agent for service of process, tax notices, or demands, or the county in which the corporation has its principal place of business. In all other instances, the proceeding to obtain such reversal, vacation, or modification shall be by appeal to the court of appeals for Franklin county.

Appeals from decisions of the board determining appeals from decisions of county boards of revision may be instituted by any of the persons who were parties to the appeal before the board of tax appeals, by the person in whose name the property involved in the appeal is listed or sought to be listed, if such person was not a party to the appeal before the board of tax appeals, or by the county auditor of the county in which the property involved in the appeal is located.

Appeals from decisions of the board of tax appeals determining appeals from final determinations by the tax commissioner of any preliminary, amended, or final tax assessments, reassessments, valuations, determinations, findings, computations, or orders made by the commissioner may be instituted by any of the persons who were parties to the appeal or application before the board, by the person in whose name the property is listed or sought to be listed, if the decision appealed from determines the valuation or liability of property for taxation and if any such person was not a party to the appeal or application before the board, by the taxpayer or any other person to whom the decision of the board appealed from was by law required to be certified, by the director of budget and management, if the revenue affected by the decision of the board appealed from would accrue primarily to the state treasury, by the county auditor of the county to the undivided general tax funds of which the revenues affected by the decision of the board appealed from would primarily accrue, or by the tax commissioner.

Appeals from decisions of the board upon all other appeals or applications filed with and determined by the board may be instituted by any of the persons who were parties to such appeal or application before the board, by any persons to whom the decision of the board appealed from was by law required to be certified, or by any other person to whom the board certified the decision appealed from, as authorized by *section 5717.03 of the Revised Code*.

Such appeals shall be taken within thirty days after the date of the entry of the decision of the board on the journal of its proceedings, as provided by such section, by the filing by appellant of a notice of appeal with the court to which the appeal is taken and the board. If a timely notice of appeal is filed by a party, any other party may file a notice of appeal within ten days of the date on which the first notice of appeal was filed or within the time otherwise prescribed in this section, whichever is later. A notice of appeal shall set forth the decision of the board appealed from and the errors therein complained of. Proof of the filing of such notice with the board shall be filed with the court to which the appeal is being taken. The court in which notice of appeal is first filed shall have exclusive jurisdiction of the appeal.

In all such appeals the tax commissioner or all persons to whom the decision of the board appealed from is required by such section to be certified, other than the appellant, shall be made appellees. Unless waived, notice of the appeal shall be served upon all appellees by certified mail. The prosecuting attorney shall represent the county auditor in any such appeal in which the auditor is a party.

The board, upon written demand filed by an appellant, shall within thirty days after the filing of such demand file with the court to which the appeal is being taken a certified transcript of the record of the proceedings of the board pertaining to the decision complained of and the evidence considered by the board in making such decision.

If upon hearing and consideration of such record and evidence the court decides that the decision of the board appealed from is reasonable and lawful it shall affirm the same, but if the court decides that such decision of the board is unreasonable or unlawful, the court shall reverse and vacate the decision or modify it and enter final judgment in accordance with such modification.

The clerk of the court shall certify the judgment of the court to the board, which shall certify such judgment to such public officials or take such other action in connection therewith as is required to give effect to the decision. The "taxpayer" includes any person required to return any property for taxation.

Any party to the appeal shall have the right to appeal from the judgment of the court of appeals on questions of law, as in other cases.

LEXSEE 2007 ALA. LEXIS 174

**Ex parte HealthSouth Corporation (In re: HealthSouth Corporation v. Jefferson County Tax Assessor, Dan Weinrib, and Jefferson County Tax Collector, J.T. Smallwood)**

1060296

## SUPREME COURT OF ALABAMA

2007 Ala. LEXIS 174

August 24, 2007, Released

**NOTICE:**

THIS OPINION IS SUBJECT TO FORMAL REVISION BEFORE PUBLICATION IN THE ADVANCE SHEETS OF SOUTHERN REPORTER.

**SUBSEQUENT HISTORY:** As Corrected August 27, 2007.

**PRIOR HISTORY:** [\*1]

Jefferson Probate Court, 187686; Court of Civil Appeals, 2050538.  
*Ex parte Healthsouth Corp.*, 2007 Ala. LEXIS 76 (Ala., May 4, 2007)

**DISPOSITION:** APPLICATION OVERRULED; OPINION OF MAY 4, 2007, WITHDRAWN; OPINION SUBSTITUTED; AFFIRMED.

**CASE SUMMARY:**

**PROCEDURAL POSTURE:** Pursuant to *Ala. Code* § 40-10-160, a taxpayer petitioned for a refund of ad valorem personal-property taxes. County taxing authorities denied the petitions, and the trial court affirmed. The taxpayer appealed; the Alabama Court of Civil Appeals affirmed the judgment of the trial court. The taxpayer sought further review.

**OVERVIEW:** In its personal-property tax returns, the taxpayer intentionally listed numerous fictitious items of personal property and assigned fabricated values to those items. It later amended the tax returns to remove the fictitious assets and petitioned for a refund of the portion of ad valorem personal-property taxes it claimed it overpaid as a result of listing the fictitious assets. The taxing authorities denied its petitions for a refund; this litigation followed. The intermediate appellate court held that §

40-10-160, providing for tax refunds based upon a "mistake" or an "error," did not permit a refund when the taxpayer's overpayment resulted from its intentionally false statements as to the value of nonexistent assets. The high court agreed. An intentional misrepresentation was not included in the plain meaning of either "error" or "mistake." Further, due to the clean hands doctrine, the trial court could not invoke its equity jurisdiction to grant the refund petitions, because there was no equity in allowing the taxpayer to obtain relief from its own fraudulent scheme.

**OUTCOME:** The high court affirmed the judgment of the intermediate appellate court.

**JUDGES:** Cobb, C.J., and Woodall, Stuart, and Smith, JJ., concur. See, J., concurs in the rationale in part and concurs in the result. Parker, J., concurs in part and dissents in part. Bolin and Murdock, JJ., recuse themselves.

**OPINION BY: LYONS****OPINION****PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CIVIL APPEALS***On Application for Rehearing*

LYONS, Justice.

The opinion of May 4, 2007, is withdrawn, and the following is substituted therefor.

HealthSouth Corporation appealed to the Court of Civil Appeals from a judgment of the Jefferson Probate Court in favor of Dan Weinrib, the Jefferson County tax assessor, and J.T. Smallwood, the Jefferson County tax collector ("the taxing authorities"). The Court of Civil

Appeals affirmed the judgment of the probate court. *HealthSouth Corp. v. Jefferson County Tax Assessor*, [Ms. 2050538, October 27, 2006] \_\_\_ So. 2d \_\_\_, 2006 Ala. Civ. App. LEXIS 659 (Ala. Civ. App. 2006). HealthSouth then petitioned this Court for a writ of certiorari, and we granted HealthSouth's petition to review two issues presented by this case. We affirm the judgment of the Court of Civil Appeals.

### I. [\*2] Factual Background and Procedural History

For the tax years 2001, 2002, and 2003, HealthSouth submitted personal-property tax returns to the Jefferson County tax assessor on which it intentionally listed numerous fictitious items of personal property and assigned fabricated values to those items.<sup>1</sup> HealthSouth paid taxes for the years 2001 and 2002 based on the submitted returns. Before paying the amount due for 2003, however, HealthSouth amended its tax return for that year to remove the fictitious assets. The Jefferson County tax assessor allowed the adjustment as to 2003. HealthSouth then amended its 2001 and 2002 returns and filed petitions for a refund of the portion of ad valorem personal-property taxes it claims it overpaid as a result of listing the fictitious items of personal property on its tax returns for 2001 and 2002. The Jefferson County tax collector requested an opinion from the attorney general, who determined that no refund was due. The tax collector then denied the petitions for a refund of the taxes HealthSouth had paid for 2001 and 2002 on the fictitious property.

1 As the Court of Civil Appeals noted, before 2002 several officials of HealthSouth were involved in [\*3] a scheme to artificially inflate the company's reported earnings and, in furtherance of that scheme, overstated the corporation's fixed assets. The inflated personal-property tax returns reflected the overstated assets.

HealthSouth filed an action in the Jefferson Probate Court challenging the tax collector's refusal to grant its petitions for the refund of ad valorem taxes paid on personal property for the years 2001 and 2002. When the probate court denied the petitions for refund, HealthSouth appealed to the Court of Civil Appeals. That court affirmed the judgment of the probate court. The Court of Civil Appeals held that § 40-10-160, Ala. Code 1975, providing for tax refunds based upon a mistake or an error, did not permit a refund when the taxpayer's overpayment resulted from the taxpayer's intentionally false statements as to the value of nonexistent assets. The Court of Civil Appeals further held that "HealthSouth's violation of its duty to provide correct and truthful information on its tax returns did not abrogate the tax assessor's authority to affix values for assessment purposes to the property listed on HealthSouth's tax returns."

So. 2d at . This Court granted certiorari [\*4] to consider two questions of first impression: whether the term "error" has a meaning different from the term "mistake," specifically whether the former term is broad enough to encompass intentional dishonest conduct; and whether an intentional misrepresentation by a taxpayer in reporting property on a tax return can create a right in the taxing authorities to collect and retain taxes on nonexistent property so that no refund of taxes collected because of such an error can be had under § 40-10-160, Ala. Code 1975.

### II. Standard of Review

"In reviewing a decision of the Court of Civil Appeals on a petition for a writ of certiorari, this Court 'accords no presumption of correctness to the legal conclusions of the intermediate appellate court. Therefore, we must apply de novo the standard of review that was applicable in the Court of Civil Appeals.' *Ex parte Toyota Motor Corp.*, 684 So. 2d 132, 135 (Ala. 1996). Because the material facts before the Court of Civil Appeals were undisputed, that court's review of the trial court's ruling would be *de novo* as well. *State Dep't of Revenue v. Robertson*, 733 So. 2d 397, 399 (Ala. Civ. App. 1998). This is particularly true where the intermediate [\*5] appellate court is construing statutory provisions. *Robertson, supra*; *Pilgrim v. Gregory*, 594 So. 2d 114, 120 (Ala. Civ. App. 1991)."

*Ex parte Exxon Mobil Corp.*, 926 So. 2d 303, 308 (Ala. 2005).

### III. Analysis

#### A. Whether "Error" Has a Meaning Different from "Mistake"

Section 40-10-160 provides:

"Any taxpayer who through *any mistake*, or by reason of any double assessment, or by *any error* in the assessment or collection of taxes, or *other error*, has paid taxes that were not due upon the property of such taxpayer shall be entitled, upon making proof of such payment to the satisfaction of the Comptroller, to have such taxes refunded to him if application shall be made therefor, as hereinaf-

ter provided, within two years from the date of such payment."

(Emphasis added.)

This Court's decision to grant HealthSouth's petition for the writ of certiorari was triggered by the pivotal issue of the significance, if any, of the legislature's choice of two words -- "error" and "mistake" -- in its refund statute and its linking those words with the disjunctive conjunction "or." The parties have wrestled mightily with parsed definitions from various sources that might afford a separate field of operation for [\*6] each term. Of course, HealthSouth contends that "error" can embrace an intentional act and therefore that its fraudulent inclusion on its personal-property tax returns of assets that did not exist constitutes the type of activity for which it is entitled to relief pursuant to § 40-10-160 in the form of a refund of taxes paid. HealthSouth does not contend that "mistake" embraces its activities. The taxing authorities,<sup>2</sup> on the other hand, argue that neither "error" nor "mistake" includes deliberate, intentional acts of the character committed by HealthSouth.

2 The State of Alabama has intervened as an amicus curiae in support of the taxing authorities.

The Court of Civil Appeals, after citing definitions for each word, concluded:

"Although HealthSouth may be correct that the plain meaning of the word 'mistake' is slightly different from the plain meaning of the word 'error,' we are clear to the conclusion that an intentional misrepresentation is not included in the plain meaning of either word."

\_\_\_ So. 2d at \_\_\_, 2006 Ala. Civ. App. LEXIS 659 at \*8.

We conclude that the Court of Civil Appeals was correct. While nuanced definitions of the two words could considerably lengthen this opinion, there is ample authority for the [\*7] proposition that neither "error" nor "mistake" contemplates dishonest activity. This Court considered the significance of a legislative choice of "clerical error" and "other mistake of the clerk" in *Ford v. Tinchant & Brother*, 49 Ala. 567, 571 (1873). Although the *Ford* Court concluded that each of the terms had a separate field of operation, a limitation in its holding is significant to the issue in this case. This Court in *Ford* stated:

"The legislature cannot be held to have been so careless of language, as to have used the expressions 'clerical error,' and 'other mistake of the clerk,' in exactly synonymous sense, in view of the liability to mistake in the entries and record of causes; or to have excluded from amendment the manifest oversights and inaccuracies of the counsel, *not calculated to mislead*, in permitting the correction of 'any error in fact in the process.'"

(Emphasis added.) Thus, in *Ford* this Court qualified the field of operation of "clerical error" and "other mistake of the clerk" by embracing only conduct that was "not calculated to mislead."

In *Alabama & Georgia Lumber Co. v. Tisdale*, 139 Ala. 250, 36 So. 618 (1903), the amount of the judgment enforcing a mechanic's [\*8] lien was less than the amount that had previously been claimed in the statement of lien filed in the office of judge of probate. The validity of the lien was challenged on the basis of the discrepancy. The applicable statute provided: "[N]o error in the amount of the demand or in the name of the owner or proprietor shall affect the lien ...." 139 Ala. at 255, 36 So. at 619. The Court observed:

"Fraud is never presumed. On the facts found, the discrepancy can and should be accounted for on the ground of a mistake or error ....

"... Whether the present statute was intended to prevent a destruction of the lien when the amount in the statement was intentionally made excessive in order to secure to the lienor a fraudulent advantage, we will not decide. But where, as here, no fraudulent purpose or intent is found to exist, we are clearly of [the] opinion that the lien is not impaired or destroyed by the error as to the amount."

139 Ala. at 256-57, 36 So. at 620. Later, in *Fleming v. McDade*, 207 Ala. 650, 651, 93 So. 618, 619 (1922), this Court was required to resolve the question left unanswered in *Alabama & Georgia Lumber Co.* This Court stated:

"In *Ala. & Ga. Lbr. Co. v. Tisdale*, 139 Ala. 250, 257, 36 South. 618 [(1903)], [\*9] there is to be found a query whether the present statute [providing for protection from destruction of the lien for error

in the amount of the demand] was intended to prevent the destruction of the lien, as held in *Lane & Bodley Co. v. Jones*, [79 Ala. 156 (1885), holding that a fraudulent statement vitiated the lien] under the statute then in force, as to which no opinion was expressed. We are clearly of the opinion, however, that the principle announced in the older case has been in no wise affected by the provision of the present statute that 'no error in the amount of the demand, ... shall affect the lien'; for this means merely an inadvertent or honest mistake, and not a willfully false claim."

In *Scheuer v. Berringer*, 102 Ala. 216, 14 So. 640 (1894), dealing with error or mistake, on the one hand, or fraud, on the other, in settlements of accounts between partners, this Court recognized differing relief available attending each circumstance. This Court quoted with approval the trial court's order, which in turn quoted *Cowan v. Jones*, 27 Ala. 317, 325 (1855), in which this Court stated, ""The rule is settled that, where errors or mistakes only are shown, the account will not be opened, [\*10] as where fraud is shown; but the party alleging error or mistake in the account, will be permitted to surcharge and falsify it."" 102 Ala. at 220, 14 So. at 642. The trial court's order continued:

"In *Moses [Bros.] v. Noble[is Adm'r]*, 86 Ala. 407, [410, 5 So. 181, 182 (1888),] Justice Clopton remarks: "In the absence of allegation and proof of fraud or undue influence, which taints the entire account, the court will not open and unravel as if no account had been made. ... When only errors or mistakes are made, alleged, and proved, wrong charges which should be deducted, or omission of credit which should be allowed, the court will give the party complaining permission to surcharge and falsify the account, and limits its authority to a correction of the errors or mistakes.""

102 Ala. at 220, 14 So. at 642. *Scheuer* was followed in *Burks v. Parker*, 192 Ala. 250, 68 So. 271 (1915).

In the context of acts of a municipality, this Court has limited error or mistake to honest activity:

"Bad faith is synonymous with fraud. 6 C.J. pp. 880, 881; *Morton & Bliss v. [New Orleans & Selma] Railway Co.*, 79 Ala. 590, 617 [(1885)]. Error or mistake of judgment, in the exercise of a discretionary power, [\*11] is not the equivalent of bad faith or fraud. In such circumstances, *error or mistake of judgment consists with honest intention, or freedom from unworthy or unlawful motive or design.*"

*Pilcher v. City of Dothan*, 207 Ala. 421, 424, 93 So. 16, 19 (1922) (emphasis added).

HealthSouth accuses the Court of Civil Appeals of rewriting § 40-10-160 by refusing to permit the modifier "any," used in the statute to modify both error and mistake, to have a field of operation. But adopting HealthSouth's view requires us to expand the commonly understood and long-settled scope of the terms "error" or "mistake," contrary to this Court's treatment of those terms over the years. Indeed, in *Fleming v. McDade*, the statute in question used an equally broad adjective in providing that "no error in the amount of the demand, ... shall affect the lien." 207 Ala. at 651, 93 So. at 619 (emphasis added). As previously noted, this Court did not permit such language, contrary to common usage, to sweep so broadly as to protect a party from the destruction of its lien by reason of its fraudulent statement of amount.

We are not led to a different conclusion by reason of a recent opinion of a Georgia trial court recognizing [\*12] HealthSouth's right to a refund pursuant to a Georgia statute. <sup>3</sup> *Section 48-5-380(a), Ga. Code Ann.*, provides:

"Each county and municipality may refund to taxpayers *any and all taxes* and license fees which are determined to have been *erroneously or illegally assessed* and collected from the taxpayers under the laws of this state or under the resolutions or ordinances of any county or municipality or which are determined to have been *voluntarily or involuntarily overpaid* by the taxpayers."

(Emphasis added.) In *Marconi Avionics, Inc. v. DeKalb County*, 165 Ga. App. 628, 630, 302 S.E.2d 384, 385-86 (1983), relied upon by the Georgia trial court, the Georgia Court of Appeals stated: "We interpret the refund statute according to its literal and logical meaning: it applies to all property 'erroneously or illegally assessed' and taxes 'voluntarily or involuntarily overpaid,' for

whatever reason." *Section 40-10-160* is materially different from the Georgia statute.

3 HealthSouth relies upon an unpublished opinion rendered by the Superior Court of Clayton County, Georgia, a copy of which HealthSouth provided to this Court. *HealthSouth Holdings, Inc. v. Clayton County, Georgia*, No. 2005-CV-2056-7 [\*13] (Clayton Superior Court, October 19, 2006).

Finally, we note that HealthSouth contends that the Court of Civil Appeals has disregarded the rule of construction of statutes that presumes every word has some purpose and that no superfluous provisions are used. See *Ex parte Panell*, 756 So. 2d 862, 867 (Ala. 1999). Our determination that the words "error" and "mistake" are not consistent with dishonest acts, regardless of whatever else they might mean, obviates the necessity for determining the applicability of this presumption. Nevertheless, we note that this Court, as well as other jurisdictions, has recognized that presumption can be overcome by a determination that the legislature has used synonyms. See *Anderson v. Hooks*, 9 Ala. 704, 709-10 (1846), discussing the significance of a phrase in the Statute of Frauds referring to "the intent or purpose" and concluding:

"The introduction of the term 'purpose' into the act, does not impart to it any additional potency. It is only the synonym for design, intention, aim -- is but a mere expletive, intended to convey the idea which the legislature had in view more strikingly, and might be stricken from the act without affecting its interpretation [\*14] in any manner."

Likewise, in *Caldwell v. State*, 32 Ala. App. 228, 230, 23 So. 2d 876, 878 (1945), the Court of Appeals held that "[t]he words 'oppose' and 'resist' as they appear in the [Code] section are synonymous."

"It seems clear that the terms 'oppose' and 'resist', as they are used in the statute under consideration, convey a legislative intent to protect the officer against obstruction and interference and therefore contemplate the use of either actual or constructive force against the officer who is making an effort to serve or execute the legal writ or process. In other words, it is not made a criminal offense to hinder or interrupt or circumvent the service of the process with which the officer is armed,

unless in doing so actual or constructive force is used against the officer himself."

32 Ala. App. at 230-31, 23 So. 2d at 878.

Such observations about a legislature's capacity to employ synonyms were summarized in *Hawaiian Airlines, Inc. v. Norris*, 512 U.S. 246, 253, 114 S. Ct. 2239, 129 L. Ed. 2d 203 (1994), in which the United States Supreme Court noted the existence of cases recognizing the use of synonyms in statutes, by referring to *United States v. Olano*, 507 U.S. 725, 732, 113 S. Ct. 1770, 123 L. Ed. 2d 508 (1993), which it described as "reading [\*15] 'error or defect' to create one category of 'error.'" The Court then noted that *Olano* cited *McNally v. United States*, 483 U.S. 350, 358-59, 107 S. Ct. 2875, 97 L. Ed. 2d 292 (1987), which the Court described as holding that the "second phrase in [the] disjunctive [was] added simply to make the meaning of the first phrase 'unmistakable.'" In *McNally*, the Court stated: "As we see it, adding the second phrase simply made it unmistakable that the statute reached false promises and misrepresentations as to the future as well as other frauds involving money or property." 483 U.S. at 359. See also *Southwick v. State*, 126 Ark. 188, 190, 189 S.W. 843, 844 (1916) ("The use of the disjunctive 'or' between the words 'intimidation' and 'threats' in the statute was not in the sense of indicating that they are two different things, but was only used as an alias to designate the same thing by different words."); and *Smith v. R.F. Brodegaard & Co.*, 77 Ga. App. 661, 663-64, 49 S.E.2d 500, 502 (1948):

"We do not think the words 'possession, custody, or control,' as used in the statute providing for bail in actions for personalty, mean three different things; or that they state three different situations or grounds on which a plaintiff [\*16] in trover can require a bond of the defendant. They express an alternative of terms, definitions or explanations of the same thing in different words. They mean substantially the same thing, i.e. that the property is within the power and dominion of the defendant. ... 'The word "or," when used not to connect two distinct facts of different natures, but to characterize and include two or more phases of the same fact, attended with the same result, states but a single ground, and not the alternative.' 46 C.J., 1125(4). This rule of construction has been recognized and applied by our courts in criminal cases and in civil cases."

See also *Lewis v. Superior Court*, 217 Cal. App. 3d 379, 397, 265 Cal. Rptr. 855, 865 (1990) ("Although we endeavor to give effect to every word in a statute, sometimes terms used together are simply synonymous."). Finally, see *United States v. Patterson*, 55 F. 605, 639 (C.C.D. Mass. 1893):

"The court is well aware of the general rule which has been several times (twice certainly) laid down by the supreme court of the United States, that in construing a statute every word must have its effect, and the consequent presumption that the statute does not use two different [\*17] words for the same purpose; but this rule has its limitations, and it is a constant practice for the legislature to use synonyms. A word is used which it is thought does not perhaps quite convey the idea which the legislature intends, and it takes another word, which perhaps has to some a little different meaning, without intending to more than make strong the purpose of the expression in the statute."

Even if the terms "error" or "mistake" are synonymous, resort to synonyms for clarity or emphasis is clearly within the prerogative of the legislature.

*B. Whether a Taxing Authority Has the Right to Assess and Collect Taxes on the Basis of an Intentional Misrepresentation by the Taxpayer*

HealthSouth also argues that even though it intentionally misrepresented assets on its personal-property tax returns, because those assets did not actually exist, the taxing authorities did not have the right to assess and collect personal-property taxes on the assets listed on the tax returns. As to this issue, we affirm the judgment of the Court of Civil Appeals for the reasons set forth in Part II of its opinion of October 27, 2006. The Court of Civil Appeals stated:

"In essence, HealthSouth requested [\*18] the probate court to invoke its equity jurisdiction to grant the refund petitions. A party seeking equitable relief, however, must have acted with equity and must come into court with clean hands. *Levine v. Levine*, 262 Ala. 491, 494, 80 So. 2d 235, 237 (1955). In *J&M Bail Bonding Co. v. Hayes*, 748 So. 2d 198 (Ala. 1999), the Alabama Supreme Court stated:

"The purpose of the clean hands doctrine is to prevent a party from asserting his, her, or its rights under the law when that party's own wrongful conduct renders the assertion of such legal rights "contrary to equity and good conscience." *Draughon v. General Fin. Credit Corp.*, 362 So. 2d 880, 884 (Ala. 1978). The application of the clean hands doctrine is a matter within the sound discretion of the trial court. *Lowe v. Lowe*, 466 So. 2d 969 (Ala. Civ. App. 1985)."

"748 So. 2d at 199. HealthSouth cannot be permitted to take advantage of its own wrong by receiving a refund based on its own inequitable conduct. There is no equity in allowing HealthSouth to obtain relief from its own fraudulent scheme."

\_\_\_\_ So. 2d at \_\_\_\_, 2006 Ala. Civ. App. LEXIS 659 at \*21.

Justice Parker's dissent states: "Such refunds [for overpayment of taxes] are appropriate regardless of the malfeasance [\*19] of the person seeking the refund. This was noted by Craig M. Boise in *Playing with 'Monopoly Money': Phony Profits, Fraud Penalties and Equity*, 90 Minn. L. Rev. 144, 147-48 (2005), which examines recent incidents of falsely inflated income of major U.S. corporations." So. 2d at .

The law review article cited by Justice Parker in fact supports the completely opposite view that equitable defenses should be available in actions seeking a tax refund after the taxpayer's fraud in overstating its tax liability has been exposed. The article states:

"Recognizing that companies that inflate their taxable income make the IRS 'an unwitting accomplice to ... fraud,' the Senate, in May 2003, approved a measure that would have increased the penalty for tax fraud to an amount equal to the overpayment of tax attributable to the fraud. The effect of this provision would have been to disallow any refunds of taxes paid

on fraudulently inflated income. Unfortunately, *the measure was dropped in the conference committee and did not become part of the American Jobs Creation Act of 2004* ultimately signed by President George W. Bush in October 2004. However, *this Article suggests that the IRS may be able* [\*20] *to achieve the results intended by the omitted Senate provision through the rules of equity.* Moreover, equity may well furnish a more sound approach to penalizing offenders in such cases than would a legislative enactment.

"Central to the thesis of this Article is the fact that tax-refund suits are in essence claims in equity, a proposition that has two important implications. First, the taxpayer filing a tax-refund suit is asking the court to impose a fair, just, and equitable 'remedy' -- namely, the refund of taxes paid in excess of what was due. As an equity claimant, the taxpayer is not in a position to demand that the refund be granted. Second, the fact that refund suits are actions in equity means that claimants are subject to well-established equitable defenses like the doctrine of unclean hands. *Based on these twin propositions, this Article asserts that the IRS not only may, but should, assert equitable defenses to deny refunds of taxes paid on fraudulently inflated earnings.*"

90 *Minn. L. Rev.* at 150-51 (emphasis added) (footnotes omitted).

The dissenting opinion also relies on the views of three staff reporters of *The Wall Street Journal*. The dissent states:

"A *Wall Street Journal* [\*21] article noted the same principle: '[f]raud or not, the current tax code makes no distinctions. It is a basic tenet of tax law -- both for individuals and corporations -- that those who overpay are entitled to a refund.' Rebecca Blumenstein, Dennis K. Berman, and Evan Perez, *After Inflating Their Income, Companies Want IRS Refunds*, *The Wall Street Journal*, May 3, 2003, at A1."

So. 2d at .

We are more impressed with the holding in *Stone v. White*, 301 U.S. 532, 535, 57 S. Ct. 851, 81 L. Ed. 1265, 1937-1 C.B. 224 (1937):

"The statutes authorizing tax refunds and suits for their recovery are predicated upon the same equitable principles that underlie an action in assumpsit for money had and received. *United States v. Jefferson Electric [Mfg.] Co.*, 291 U.S. 386, 402, 54 S. Ct. 443, 78 L. Ed. 859, 78 Ct. Cl. 846, 1934-1 C.B. 393 [(1934)]. Since, in this type of action, the plaintiff must recover by virtue of a right measured by equitable standards, it follows that it is open to the defendant to show any state of facts which, according to those standards, would deny the right, *Moses v. Macferlan*, supra, [2 Burr. 1005] at 1010 [(K.B. 1750)]; *Myers v. Hurley Motor Co.*, 273 U.S. 18, 24, 47 S. Ct. 277, 71 L. Ed. 515, 50 A.L.R. 1181 [(1927)]; cf. *Winchester v. Hackley*, 6 U.S. 342274, 2 Cranch 342, 2 L. Ed. 299 [(1805)], even without resort to the modern statutory [\*22] authority for pleading equitable defenses in actions which are more strictly legal, Jud. Code, § 274b, 28 U.S.C. § 398."

#### IV. Conclusion

The settled meaning of the terms "error" and "mistake" is not consistent with intentional dishonest acts. Furthermore, HealthSouth's intentional misrepresentation of its assets did not abrogate the right of the taxing authorities to assess and collect personal-property taxes from HealthSouth based upon the information HealthSouth provided on its personal-property tax return. We therefore affirm the judgment of the Court of Civil Appeals.

APPLICATION OVERRULED; OPINION OF MAY 4, 2007, WITHDRAWN; OPINION SUBSTITUTED; AFFIRMED.

Cobb, C.J., and Woodall, Stuart, and Smith, JJ., concur.

See, J., concurs in the rationale in part and concurs in the result.

Parker, J., concurs in part and dissents in part.

Bolin and Murdock, JJ., recuse themselves.

CONCUR BY: SEE (In Part); PARKER (In Part)

**CONCUR**

SEE, Justice (concurring in the rationale in part and concurring in the result).

I fully join in the holding of the main opinion. I agree that neither "mistake" nor "error" in this statute encompasses HealthSouth's deliberate misrepresentations on its tax returns. I write specially only to note that I do [\*23] not consider it necessary to determine whether the legislature could have intended to use the terms "error" and "mistake" as synonyms. Therefore, I do not join in that discussion.

**DISSENT BY: PARKER (In Part)****DISSENT**

PARKER, Justice (concurring in part and dissenting in part).

I concur with the conclusion of the main opinion on the first issue -- whether the term "error" differs from the term "mistake," specifically, whether "error" is broad enough to encompass intentional conduct. However, I dissent from the adoption by the majority of the rationale of the Court of Civil Appeals' opinion on the second issue -- whether an intentional misrepresentation by a taxpayer in reporting property can create a right to collect and retain taxes on nonexistent property so that no refund of taxes collected due to such an error can be had under § 40-10-160, Ala. Code 1975.

The majority opinion, by affirming the judgment of the Court of Civil Appeals on this issue, effectually holds that the State has the authority to tax nonexistent property. The Court of Civil Appeals distinguished the present case from *City of Birmingham v. Piggly Wiggly Alabama Distributing Co.*, 638 So. 2d 759, 765 (Ala. 1994), in order to contradict [\*24] HealthSouth's contention that the tax assessor had no authority to assess nonexistent personal property to HealthSouth. The Court of Civil Appeals' opinion notes that *Piggly Wiggly* involved a mistake, whereas the present case involves an intentional misrepresentation. That opinion holds that in an instance of mistake, such as in *Piggly Wiggly*, the assessor is without authority to assess the property. But in this case, the Court of Civil Appeals held:

"The tax assessor was *authorized* to assess the taxes based on the lists provided by HealthSouth. HealthSouth's violation of its duty to provide correct and truthful information on its tax returns did not abrogate the tax assessor's authority to affix values for assessment purposes to the property listed on HealthSouth's tax returns."

So. 2d at (citation omitted). Although this mistake/intentional-misrepresentation distinction does distinguish *Piggly Wiggly* from this case, it is irrelevant. The forms an entity fills out may give the assessor authority to assess the value of the property listed; however, this presupposes there is property listed that has value to be assessed. Nonexistent property has no value, and without property [\*25] to assess, the assessor is without authority.

The Court of Civil Appeals also suggested that equity has a place in tax matters. \_\_\_ So. 2d at \_\_\_, 2006 Ala. Civ. App. LEXIS 659 at \*18 (citing *Sims v. White*, 522 So. 2d 239, 240 (Ala. 1988)). However, equity may not prevent HealthSouth from receiving a refund, because it is illegal for the tax assessor to assess nonexistent property. <sup>4</sup> "Illegal" is defined generally as "[a]gainst or not authorized by law." *Piggly Wiggly*, 638 So. 2d at 765 (quoting *Black's Law Dictionary* 747 (6th ed. 1990)). Because the assessor has no authority to assess nonexistent property, it is illegal for the assessor to do so. There is no constitutional or statutory support for the proposition that the assessor is authorized to assess nonexistent property.

4 The majority opinion quotes *Stone v. White*, 301 U.S. 532, 535, 57 S. Ct. 851, 81 L. Ed. 1265, 1937-1 C.B. 224 (1937), as recognizing that federal tax "statutes authorizing tax refunds and suits for their recovery are predicated upon the same equitable principles that underlie an action in assumpsit for money had and received." So. 2d at . In *Stone*, where a trust had mistakenly paid the tax on money disbursed to a beneficiary when the beneficiary should have paid the tax, the trust sued [\*26] to recoup the tax payment after the point in time when the Internal Revenue Service could have required the beneficiary to pay the tax. The Supreme Court recognized that equitable principles would apply to the government, as well as to the taxpayer: "Equitable conceptions of justice compel the conclusion that the retention of the tax money would not result in any unjust enrichment of the government." 301 U.S. at 537. The Court found that although the tax-payment procedure had been erroneous, it had "resulted in no unjust enrichment to the government, and in no injury to petitioners or their beneficiary." 301 U.S. at 539.

Here, in contrast, the retention of the tax payment would result in unjust enrichment to the government and injury to the petitioner and its shareholders.

Equity, however, has no place in our constitutional scheme limiting the authority of the tax assessor, explained *infra*. Moreover, court adoption of equity principles would empower the judiciary to exact penalties against taxpayers that the legislature has not enacted.

#### *Constitutional and Statutory Construction*

The *Alabama Constitution of 1901*, § 211, explicitly limits the State's taxing authority:

"All taxes levied on [\*27] property in this state shall be assessed in exact proportion to the value of such property ...."

Nonexistent property has no value; therefore, nonexistent property may not be taxed. The "value of [n]onexistent property" is zero. Any "exact proportion" of zero is zero.

This Court has recognized the following three principles regarding the government's power of taxation:

"(1) The power of taxation is an incident of sovereignty and is possessed by the government without being expressly conferred by the people.

"(2) The power is purely legislative.

"(3) So long as no constitutional limitations are exceeded, the Legislature is of supreme authority, and the courts, as well as all others, must obey."

*State v. Birmingham So. Ry.*, 182 Ala. 475, 479, 62 So. 77, 79 (1913). This Court noted that "[t]he purpose and scope of this constitutional limitation ... is that it was designed to secure uniformity and equality by the enforcement of an ad valorem system of taxation and to prohibit arbitrary or capricious modes of taxation without regard to value." 182 Ala. at 480-81, 62 So. at 79 (emphasis added). This Court further stated that "[i]f the legislative provision in question is unconstitutional, it [\*28] must be because it is repugnant to one or more of the following sections of the state constitution: Section 211 ...." 182 Ala. at 479, 62 So. at 79.

The authority of the tax assessor is derived from the legislature through § 40-7-1, *Ala. Code* 1975, as shown below, and if that authority is to extend to nonexistent property, the statute would be unconstitutional because it would be repugnant to § 211, *Ala. Const. 1901*. It is a well-settled principle of statutory construction that a statute should be construed to avoid conflict with the constitution. The Constitution of Alabama establishes the

extent of the authority to tax property when it states: "All taxes levied on property in this state shall be assessed in exact proportion to the value of such property." *Ala. Const. 1901*, § 211. This section "prohibit[s] the Legislature from prescribing or declaring an arbitrary or artificial value of the property of individuals or corporations, and assessing taxes on such valuation." *Birmingham So. Ry.*, 182 Ala. at 481, 62 So. at 79 (citing *Assessment Board v. A.C.R.R.*, 59 Ala. 551 (1877)). Section 211 prevents placing an "artificial value" on nonexistent property. Such a valuation would disregard [\*29] the constitutional mandate that the tax is to be "in exact proportion to the value of" the property. Nonexistent property has no value. Therefore, if the authority of the assessor, derived from § 40-7-1, is to be read to include nonexistent property, the statute conferring that authority would be repugnant to § 211 and, therefore, unconstitutional.

Taxation statutes are to be strictly construed against the taxing authority: "[W]e are here concerned with a taxing act, with regard to which the general rule requiring adherence to the letter applies with peculiar strictness." *Crooks v. Harrelson*, 282 U.S. 55, 61, 51 S. Ct. 49, 75 L. Ed. 156, 1931-1 C.B. 469 (1930). In *United States v. Merriam*, 263 U.S. 179, 187-88, 44 S. Ct. 69, 68 L. Ed. 240, T.D. 3535, 21 Ohio L. Rep. 379 (1923), the Supreme Court stated: "[I]n statutes levying taxes the literal meaning of the words employed is most important for such statutes are not to be extended by implication beyond the clear import of the language used." "[I]f there is a serious doubt as to taxability, the doubt should be resolved in favor of the taxpayer." *Western Elec. Co. v. United States*, 564 F.2d 53, 66, 215 Ct. Cl. 100, 124 (1977)(citing *Allstate Ins. Co. v. United States*, 530 F.2d 378, 209 Ct. Cl. 1 (1976); *Ellis v. United States*, 416 F.2d 894, 897 (6th Cir. 1969); [\*30] and *McFeely v. Commissioner*, 296 U.S. 102, 111, 56 S. Ct. 54, 80 L. Ed. 83 (1935)). "A basic rule of statutory construction is that ambiguous tax statutes are construed against the taxing authority and in favor of the taxpayer." *Birmingham v. AmSouth Bank, N.A.*, 591 So. 2d 473, 477 (1991) (citing *Alabama Farm Bureau Mut. Cas. Ins. Co. v. City of Hartselle*, 460 So. 2d 1219 (Ala. 1984); *Owen v. West Alabama Butane Co.*, 278 Ala. 406, 178 So. 2d 636 (1965); and *Müller v. Standard Nut Margarine Co.*, 284 U.S. 498, 52 S. Ct. 260, 76 L. Ed. 422, 1932 C.B. 370, 1932-1 C.B. 370 (1932)).

The Court of Civil Appeals concluded that the tax assessor was authorized to assess taxes on the assets HealthSouth listed on its tax returns. \_\_\_ So. 2d at \_\_\_, 2006 Ala. Civ. App. LEXIS 659 at \*15 (relying on § 40-7-1(a), § 40-7-27, and § 40-7-34). "HealthSouth's violation of its duty to provide correct and truthful information on its tax returns did not abrogate the tax assessor's authority to affix values for assessment purposes to the

property listed on HealthSouth's tax returns." \_\_\_ So. 2d at \_\_\_, 2006 Ala. Civ. App. LEXIS 659 at \*17. Therefore, the Court of Civil Appeals concluded, it was not illegal to assess value on the nonexistent property, because the tax assessor had the authority to do so and that authority was not abrogated.

The Court of Civil Appeals misinterprets [\*31] the statutes that give the tax assessor his authority. The only statute relevant to the issue of authority, because it is the only statute that addresses the issue of authority, is § 40-7-1, which provides: "The tax assessor ... shall have the right and authority to assess all ... personal property to the party last assessing the same, or to the owner of record ...." That court concluded that because the statute gives authority to the assessor to "assess all personal property ... to the owner of record" and because HealthSouth included the nonexistent property on its returns, the statute gives the assessor authority over the nonexistent property. However, § 40-7-1 nowhere grants authority to the tax assessor to assess nonexistent property. The phrase "owner of record" allows the assessor to assess the property listed on the return, but this necessarily presumes that the property listed actually exists and has value. Even though it may be listed, nonexistent property has no owner -- of record or otherwise -- and no value capable of being assessed. Even if somehow we were to conclude that the assessor could assess fictitious property, no verifiable valuation criteria would exist by which to [\*32] do so.

If doubt exists as to whether the State has constitutional or statutory authority to tax nonexistent property, we must return to the basic axiom of statutory interpretation set forth above: Taxation statutes are to be construed strictly in favor of the taxpayer and against the State.

#### Analogous Cases

Taxes are to be assessed in exact proportion to the value of the property taxed. Although it has been stated that this valuation may be a percentage of the actual value, see *State v. Birmingham So. Ry.*, *supra*, and the valuation process is not always accurate, see *Hamilton v. Adkins*, 250 Ala. 557, 35 So. 2d 183 (1948), if that proportionate value is overstated, in the case of nonexistent or exempt property, and the taxes collected are beyond those owed, then refunds have been allowed. "In *Pacific Coast Co. v. Wells*, 134 Cal. 471, [66 P. 657 (1901)], the taxpayer inadvertently overstated the amount of his solvent credits, and the assessor adopted the erroneous figure as the basis of the assessment. The Supreme Court treated the tax there as based pro tanto on nonexistent property and held the taxpayer entitled to a refund." *Lockheed Aircraft Corp. v. County of Los Angeles*, 207 Cal. App. 2d 119, 126-27, 24 Cal. Rptr. 316, 321 (1962). [\*33] In *Lockheed*, the court stated that the various re-

fund decisions "reflect the view of the courts that where it can be established that an assessment is based upon property which is exempt, outside the jurisdiction, or nonexistent, the taxpayer is entitled to judicial relief." 207 Cal. App. 2d at 127, 24 Cal. Rptr. at 321. Therefore, an overpayment of tax should result in a tax refund.

Such refunds are appropriate regardless of the malfeasance of the person seeking the refund. This was noted by Craig M. Boise in *Playing with "Monopoly Money": Phony Profits, Fraud Penalties and Equity*, 90 Minn. L. Rev. 144, 147-48 (2005), which examines recent incidents of falsely inflated income of major U.S. corporations. <sup>5</sup> A Wall Street Journal article noted the same principle: "[f]raud or not, the current tax code makes no distinctions. It is a basic tenet of tax law -- both for individuals and corporations -- that those who overpay are entitled to a refund." Rebecca Blumenstein, Dennis K. Berman, and Evan Perez, *After Inflating Their Income, Companies Want IRS Refunds*, The Wall Street Journal, May 3, 2003, at A1. Additionally, many articles have reported that HealthSouth, Enron Corporation, and WorldCom [\*34] are seeking tax refunds from the Internal Revenue Service ("the IRS"). See, e.g., Associated Press, *Judge orders Scrushy to pay back millions in HealthSouth bonuses*, Bradenton Herald, Jan. 5, 2006, which stated: "Combined with as much as \$ 265 million in refunds the company is seeking from the federal government for taxes it paid on overstated income during the fraud, the court-ordered repayment could help shore up the finances of HealthSouth."

5 As noted in the majority opinion, the author of this article argues "that equitable defenses *should* be available in actions seeking a tax refund after the taxpayer's fraud in overstating its tax liability has been exposed." So. 2d at (emphasis added). The author states that the position he argues "would establish a new precedent." 90 Minn. L. Rev. at 201 ("The use of equitable defenses in denying a fraud-related refund claim in a case like WorldCom's, for example, would establish a new precedent."). In that portion of the article quoted in the majority opinion, the author argues that the Internal Revenue Service should use principles of equity to accomplish what Congress refused to do in 2004 -- to authorize the Internal Revenue Service [\*35] to retain the full amount of the overpayment in cases of fraudulent overpayments.

As noted in note 4, *supra*, equity cannot be employed to expand the constitutionally limited authority of our tax assessors.

Although taxpayers who fraudulently increase their income are entitled to a refund, we may have difficulty

determining whether these taxpayers actually get a refund. The IRS requires confidentiality of federal income-tax returns. 26 U.S.C. § 6103. Nonetheless, some reports may come from the corporations themselves, as was the case for MCI, formerly WorldCom. "MCI, formerly known as WorldCom Inc., has already collected nearly \$ 300 million in overpayments from the I.R.S., a company spokeswoman said. The telecommunications giant's accounting irregularities total \$ 11 billion." Anitha Reddy and Christopher Stern, *Firms Want Refunds of Tax on Fake Profit; MCI Collects Almost \$ 300 Million*, The Washington Post, final ed. May 3, 2003, at E1. The State of Alabama should not deny refunds on nonexistent property when the IRS provides refunds of taxes paid on nonexistent income.

#### *Punitive Aspect Is Misdirected*

The Court of Civil Appeals' opinion concludes: "HealthSouth cannot be permitted to take [\*36] advantage of its own wrong by receiving a refund based on its own inequitable conduct." \_\_\_ So. 2d at \_\_\_, 2006 Ala. Civ. App. LEXIS 659 at \*21. HealthSouth is not seeking to "take advantage of its own wrong"; rather, HealthSouth is asking to be placed in the position it would be in if the property had been reported and assessed properly. In so doing, HealthSouth is attempting to right the wrong done to its shareholders by its former officers or agents.

Any effort to hold HealthSouth accountable for the fraud of its former officers should not overlook the fact that those who have suffered most as a result of HealthSouth's wrongdoing are its innocent stockholders. HealthSouth's former officers who were involved in the

fraud have already, for the most part, borne the consequences of their actions. Penalizing HealthSouth further by retaining this tax would not be an act of reprimand, but a misplaced chastisement of the innocent shareholders, because withholding the tax refund would prevent the shareholders and creditors from using the tax refund to mitigate damages. As Boise says, "After all, the direct cost of any penalty generally will be borne by shareholders in addition to the potential indirect costs associated with the [\*37] penalty." *Playing with "Monopoly Money,"* 90 Minn. L. Rev. at 201. Retaining the excess tax does not deter future tax fraud, because those who perpetrated the fraud are not the persons who will suffer from the denial of the refund.

It is true that shareholders assume the risks of their investments. However, the State should not magnify the shareholders' losses by refusing to refund illegal taxes on nonexistent property, especially when, as in this case, the fraud and misrepresentations were concealed from the shareholders.

#### *Conclusion*

I therefore dissent -- not because I tolerate corporate fraud, but because I see the need to carefully limit the power of the State in the area of taxation. In *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 391, 4 L. Ed. 579 (1819), Chief Justice John Marshall declared: "A right to tax, without limit or control, is essentially a power to destroy." The power to tax nonexistent property adds to the power to destroy the power to redefine reality. This is a power that must not be ceded, even in the most egregious of circumstances.

1 of 1 DOCUMENT

**Healthsouth Corporation v. City of Waterbury; Healthsouth Corporation v. Town of Madison, Healthsouth Corporation v. Town of Fairfield, Healthsouth Corporation v. Town of Willimantic, Healthsouth Corporation v. City of Norwalk**

**CV054011048, CV054010916, CV054010807, CV054002794, CV054006234**

**SUPERIOR COURT OF CONNECTICUT, JUDICIAL DISTRICT OF NEW BRITAIN AT NEW BRITAIN**

*2008 Conn. Super. LEXIS 625*

**March 13, 2008, Decided**

**March 13, 2008, Filed**

**NOTICE:** THIS DECISION IS UNREPORTED AND MAY BE SUBJECT TO FURTHER APPELLATE REVIEW. COUNSEL IS CAUTIONED TO MAKE AN INDEPENDENT DETERMINATION OF THE STATUS OF THIS CASE.

**CASE SUMMARY:**

**PROCEDURAL POSTURE:** Plaintiff taxpayer filed tax appeals seeking a writ of mandamus under *Conn. Gen. Stat. § 52-485* against defendants, five municipalities and their assessors, due to a refusal to issue certificates of correction removing personal property from the respective Grand Lists of October 1, 2001, pursuant to *Conn. Gen. Stat. § 12-57* when such property did not exist. The parties filed cross-motions for summary judgment.

**OVERVIEW:** The taxpayer sought to remove non-existent personal property from the assessors' lists after they were investigated for a massive accounting fraud involving the overstatement of assets. The trial court held that the municipalities' special defenses implicated causes of action under *Conn. Gen. Stat. §§ 12-117a* and *12-119* that were not pled. The taxpayer argued that the municipalities had to show that the taxpayer engaged in willful misconduct. The taxpayer knowingly included non-existent personal property in its declaration of taxable assets to the assessors, which was not an erroneous act under *Conn. Gen. Stat. § 12-57*. Since a mandamus action was based upon the enforcement of a ministerial act on the part of the assessor, the mandamus action could not lie as the taxpayer had a right to appeal the action of the assessors under *Conn. Gen. Stat. § 12-119*. A mandamus could not be issued to compel the perform-

ance of an act that would work a public and private mischief, or to compel a compliance with the strict letter of the law in disregard of its spirit or in aid of a palpable fraud. The taxpayer did not come into court with clean hands.

**OUTCOME:** The taxpayer's motions for summary judgment were denied. The municipalities' cross-motions for summary judgment were granted with judgment to enter in favor of each municipality, without costs to any parties.

**JUDGES:** [\*1] Arnold W. Aronson, Judge Trial Referee.

**OPINION BY:** Arnold W. Aronson

**OPINION**

*MEMORANDUM OF DECISION*

The plaintiff, HealthSouth Corporation (HealthSouth), brought the above captioned municipal tax appeals, challenging the actions of the assessors in five municipalities, Waterbury, Madison, Fairfield, Windham and Norwalk, that listed personal property on the assessment rolls in the name of HealthSouth on the Grand Lists of October 1, 2001, when HealthSouth claims it did not own such property.

The plaintiff seeks a writ of mandamus pursuant to *General Statutes §52-485*<sup>1</sup> claiming that the assessors from all five defendant municipalities refused to issue certificates of correction removing personal property from the respective Grand Lists of October 1, 2001, pursuant to *General Statutes §12-57*<sup>2</sup> when such property

did not exist, and could not be subject to tax on said Grand Lists.

1 *General Statutes §52-485* provides, in relevant part, as follows: "Writ of mandamus. (a) The Superior Court may issue a writ of mandamus in any case in which a writ of mandamus may by law be granted, and may proceed therein and render judgment according to rules made by the judges of the Superior Court or, in default thereof, according [\*2] to the course of the common law."

2 *General Statutes §12-57* provides, in relevant part, as follows: "Certificates of correction. (a) When it has been determined by the assessors of a municipality that tangible personal property has been assessed when it should not have been, the assessors shall, not later than three years following the tax due date relative to the property, issue a certificate of correction removing such tangible personal property from the list of the person who was assessed in error, whether such error resulted from information furnished by such person or otherwise."

Although each of the plaintiff's one-count complaints seeking mandamus are based upon the alleged failure of the assessors in all five defendant municipalities to correct the assessment rolls on the 2001 Grand List, the defendants raise the following special defenses to the plaintiff's mandamus claim:

1. Under the doctrine of clean hands, the plaintiff is not entitled to relief.
2. The appeal is untimely filed pursuant to *General Statutes §12-119*.
3. The appeal is untimely filed pursuant to *General Statutes §12-117a*.

In addressing the untimeliness defense under *§12-119*, the plaintiff acknowledges in its memorandum [\*3] of law in support of its motion for summary judgment (hereinafter plaintiff's 12/14/07 MOL), p. 12, that these actions were not filed within the one-year time limitation period contained in *§12-119*. Instead, the plaintiff contends that these actions involve claims pursuant to *§12-57* which has a three-year period within which to seek correction of the assessors' actions. The plaintiff does not address the defendants' special defense dealing with relief pursuant to *§12-117a*.

*Practice Book §10-51* requires the defendant to plead special defenses that "must refer to the cause of action which it is intended to answer . . ." The court notes that the defendants' special defenses implicates causes of action under *§12-117a* and *§12-119* that the

plaintiff did not plead, yet the defendants seek to dismiss these specific nonpleaded causes of action for the plaintiff's failure to comply with these statutory provisions. Although the plaintiff has not filed a motion to strike claiming that the special defenses are improper, pursuant to *Practice Book §10-39(a)(5)*, the court is still faced with a complaint pleading a mandamus action as provided for in *§52-485*, not a complaint based upon *§12-117a* or *§12-119*. [\*4] For this reason, the defendants' motions to dismiss are denied.

Apart from the defendants' motions to dismiss, the parties filed cross motions for summary judgment in each of the five appeals. In their motions for summary judgment, all of the parties argue there are no material facts in issue and that based upon the parties' stipulation of facts, each is entitled to judgment as a matter of law.

In its appeal, HealthSouth recites the following uncontested facts in its 12/14/07 MOL, pp. 2-4:

The parties have submitted a Stipulation of Facts for the purposes of filing cross motions for summary judgment . . . HealthSouth is a foreign corporation and the owner of certain personal property located in various towns and cities in the State of Connecticut including the defendant [municipalities]. HealthSouth made a timely filing of a declaration of tangible personal property for the 2001 Grand List. It was discovered that a portion of the personal property listed on the foregoing declaration[s] did not exist, but had been included in the declaration[s] as a result of the overstatement of assets owned by HealthSouth nationwide made in an effort to meet or exceed earnings expectations established [\*5] by Wall Street analysts.

HealthSouth is one of the nation's largest healthcare providers, providing such services as outpatient surgery, diagnostic and rehabilitative services. When HealthSouth determined that its declaration of tangible personal property for the 2001 Grand List included entries representing property that did not exist, it authorized a representative to seek a correction of that erroneous overstatement of personal property. Correspondence dated May 4, 2004 was sent from Brian T. Scully to the municipal assessor[s], with attachments, explaining the circumstances leading to the error in including these fictitious assets in the declaration for the 2001 Grand Lists. That correspondence is

referenced in the Stipulation of Facts, and a copy of the correspondence and attachments is provided as Exhibit 1 attached to this memorandum.

As explained in the SEC Complaint, the Scully Correspondence, and illustrated by the attachment to that correspondence entitled 'Assessed Value Detail--Personal Property' for each of the respective grand lists, each of the fictitious assets at each HealthSouth facility, and the facility in Waterbury in particular, were described in the facility asset [\*6] books as 'AP Summary.' This contrasts sharply with the description of the actual assets such as 'MEDIX SYSTEM,' 'AEROBIC ERGOMETER' or 'DUMBELL WAGON,'<sup>3</sup> using examples for the 2001 Grand List shown on the Assessed Value Detail.

Mr. Scully made a second request seeking corrections in the assessments on the 2001 and 2002 Grand Lists [by the Scully 2005 Correspondence, Exhibit 2]. In this correspondence [it was] again requested that the assessments be corrected to remove the items listed as 'AP Summary' from HealthSouth's list for the 2001 Grand List, as that property were not tangible assets and should not have been included. Mr. Scully also invited the [municipalities] to perform an audit of HealthSouth pursuant to *C.G.S. §12-53(e)(1)* in this correspondence.

The Assessor for the [municipality] has not issued a certificate of correction in response to the plaintiff's request to do so, nor has the Assessor otherwise amended the 2001 Grand List in response to the plaintiff's request.

<sup>3</sup> The court notes that various assets are listed for each municipality in the plaintiff's 12/14/07 MOL.

Central to the plaintiff's claim for mandamus is the language in §12-57 that provides, in relevant part, [\*7] as follows:

When it has been determined by the assessors of a municipality that tangible personal property has been assessed when

it should not have been, the assessors shall, not later than three years following the tax due date relative to the property, *issue a certificate of correction* removing such tangible personal property from the list of the person who was *assessed in error, whether such error* resulted from information furnished by such person or otherwise.

(Emphasis added.)

The plaintiff's argument, that the assessors were required to issue certificates of correction once informed that the lists of tangible personal property for assessment purposes were made in error, presupposes that the subsequent information given to the assessors was correct and would compel the assessors to issue certificates of correction once this information was received.

The requirements for the issuance of a writ of mandamus are well settled. "A writ of mandamus is an extraordinary remedy, available in limited circumstances for limited purposes . . . It is fundamental that the issuance of the writ rests in the discretion of the court, not an arbitrary discretion exercised as a result of caprice but a [\*8] sound discretion exercised in accordance with recognized principles of law . . . That discretion will be exercised in favor of issuing the writ only where the plaintiff has a clear legal right to have done that which he seeks . . . The writ is proper only when (1) the law imposes on the party against whom the writ would run a duty the performance of which is mandatory and not discretionary; (2) the party applying for the writ has a clear legal right to have the duty performed; and (3) there is no other specific adequate remedy." (Internal quotation marks omitted.) *Morris v. Congdon*, 277 Conn. 565, 569, 893 A.2d 413 (2006). "Even satisfaction of this demanding [three-pronged] test does not, however, automatically compel issuance of the requested writ of mandamus . . . In deciding the propriety of a writ of mandamus, the trial court exercises discretion rooted in the principles of equity." (Internal quotation marks omitted.) *AvalonBay Communities, Inc. v. Sewer Commission*, 270 Conn. 409, 417, 853 A.2d 497 (2004).

The *AvalonBay* court further noted that "[i]t is axiomatic that [t]he duty [that a writ of mandamus] compels must be a ministerial one; the writ will not lie to compel the performance [\*9] of a duty which is discretionary. Consequently, a writ of mandamus will lie only to direct performance of a ministerial act which requires no exercise of a public officer's judgment or discretion . . . Furthermore, where a public officer acts within the scope of delegated authority and honestly exercises her judgment in performing her function, mandamus is not available to

review the action or to compel a different course of action. Discretion is determined from the nature of the act or thing to be done rather than from the character of the office of the one against whom the writ is directed." (Citations omitted; internal quotation marks omitted.) *Id.*, 422.

The plaintiff's position is that even if, for purposes of assessment, it intentionally listed property it did not own at the time of the valuation, the non-existent personal property can have no situs, and therefore, cannot be taxed. See plaintiff's 12/14/07 MOL, p. 6, citing *Levin-Townsend Computer Corporation v. Hartford*, 166 Conn. 405, 407, 349 A.2d 853 (1974).

Although the plaintiff recognizes that the doctrine of clean hands is applicable in an equitable action and that the defendant municipalities can argue that the doctrine [\*10] of unclean hands bars the plaintiff from recovery, the plaintiff nonetheless argues that the defendants must show that the plaintiff engaged in willful misconduct. See plaintiff's 12/14/07 MOL, pp. 6-7, citing *Ridgefield v. Eppoliti Realty Co.*, 71 Conn.App. 321, 801 A.2d 902, cert. denied, 261 Conn. 933, 806 A.2d 1070 (2002). The plaintiff's main point is that the municipalities will have a windfall they are not entitled to if the assessors consider property it did not own for purposes of taxation.

The plaintiff also relies on the holding in *Chatterjee v. Commissioner of Revenue Services*, 277 Conn. 681, 894 A.2d 919 (2006), for the proposition that when the legislature enacts language that the commissioner of revenue services "shall" do something required by statute, as in *General Statutes* §12-425(1) or in §12-549, the "shall" language in §12-57 "clearly mandates that [each] assessor of the [various municipalities] issue a certificate of correction removing the entries for personal property that did not exist and therefore was assessed when it should not have been." (Plaintiff's 12/14/07 MOL, pp. 9-10.)

Fundamental to the plaintiff's argument is that the plaintiff's action in submitting [\*11] lists of fictitious assets to the various assessors for taxation purposes was an error which could be rectified by §12-57.

"Error" is defined as "b: an act involving an unintentional deviation from truth or accuracy[;] c: an act that through ignorance, deficiency, or accident departs from or fails to achieve what should be done[.]" Merriam Webster's Collegiate Dictionary (10th Ed.). According to this definition, an error cannot arise from an intentional act, but that is exactly what the plaintiff did when it knowingly and deliberately included non-existent personal property in its declaration of taxable assets to the assessors.

The parties' stipulation of facts includes a letter dated May 4, 2004 from Brian T. Scully (Scully), Manager, National State and Local Tax Practice of KPMG, LLP. Scully issued the letter on behalf of his client, HealthSouth and its subsidiaries, stating in part, that "HealthSouth is being investigated by the Securities and Exchange Commission ('SEC') for a massive accounting fraud . . . Part of the accounting fraud, as detailed in the SEC complaint, consisted of overstating property, plant and equipment by listing fictitious assets on depreciation schedules using [\*12] the asset description of 'AP SUMMARY.' *These assets do not exist.* As a result of this, HealthSouth has been reporting, has been assessed and has paid personal property taxes on these erroneous assets. Consequently, these erroneous assets have been included in the taxing jurisdictions certified tax roll in error." (Emphasis added.) (Exhibit C to 10/22/07 stipulation of parties.)

The SEC complaint (see Exhibit B to 10/22/07 stipulation of parties), recites as follows in the introduction section:

1. Since 1999, HealthSouth Corp. ('HRC'), one of the nation's largest health-care providers, has overstated its earnings by at least \$ 1.4 billion. This massive overstatement occurred because HRC's founder, Chief Executive Officer and Chairman of the Board, Richard M. Scrusby ('Scrusby'), insisted that HRC meet or exceed earnings expectations established by Wall Street analysts. 'When HRC's earnings fell short of such estimates, Scrusby directed HRC's accounting personnel to 'fix it' by artificially inflating the company's earnings to match Wall Street expectations. To balance HRC's books, the false increases in earnings were matched by false increases in HRC's assets. By the third quarter of 2002, [\*13] HRC's assets were overstated by at least \$ 800 million, or approximately 10 percent of total assets. HRC's most recent reports filed with the Commission continue to reflect the fraudulent numbers.

2. Despite the fact that HRC's financial statements were materially misstated, on August 14, 2002, Scrusby certified under oath that HRC's 2001 Form 10-K contained 'no untrue statement of a material fact.' In truth, the financial statements filed with this report overstated HRC's earnings, identified on HRC's income statement as 'Income Before Income

Taxes and Minority Interests,' by at least 4,700%."

Clearly, an intentional act to misstate the plaintiff's taxable personal assets, in the declarations submitted to each of the defendant municipalities, is not the commission of an erroneous act. Of particular interest is the "Declaration of Personal Property Affidavit," signed by the plaintiff's agent and notarized, reciting: "I DO HEREBY declare under penalty of perjury that all [sections] of this declaration have been completed according to the best of my knowledge, remembrance and belief, is a true assessment of ail my personal property liable to taxation; and that I have not conveyed or temporarily [\*14] disposed of any estate for the purpose of evading the laws relating to the assessment and collection of taxes." (Exhibit A, p. 7.) The plaintiff would be hard pressed to claim that the intentional inclusion of non-existing assets in its declarations of personal property for tax purposes was an error under §12-57. Such a claim would be a perfect example of an "oxymoron."<sup>4</sup>

4 The word "oxymoron" is defined as "a combination of contradictory or incongruous words[.]" Merriam Webster's Collegiate Dictionary, 10th Ed.

The granting of a mandamus order here would deprive the assessors of the opportunity to exercise their judgment to make a factual finding as to whether the plaintiff's action amounted to an error or not. Since a mandamus action is based upon the enforcement of a ministerial act on the part of the assessor and not upon an act of the assessor requiring judgment or discretion, the mandamus action cannot lie. As noted above, "[t]he writ is proper only when (1) the law imposes on the party against whom the writ would run a duty the performance of which is mandatory and not discretionary; (2) the party applying for the writ has a clear legal right to have the duty performed; and (3) [\*15] there is no other specific adequate remedy." (Internal quotation marks omitted.) *Morris v. Congdon*, 277 Conn. 565, 569, 893 A.2d 413.

Since this action was brought as a mandamus action as the sole remedy, it is necessary to consider whether mandamus is the proper vehicle to use when challenging the action of an assessor. As discussed above, a three-

pronged test is applicable. See *id.* Furthermore, the "legislature has established two primary methods by which taxpayers may challenge a town's assessment or revaluation of their property. First, any taxpayer claiming to be aggrieved by an action of an assessor may appeal, pursuant to *General Statutes* §12-111, to the town's board of tax review. The taxpayer may then appeal, pursuant to *General Statutes* [§12-117a], an adverse decision of the town's board of tax review to the Superior Court. The second method of challenging an assessment or revaluation is by way of §12-119 . . . [Section] 12-119 allows a taxpayer one year to bring a claim that the tax was imposed by a town that had no authority to tax the subject property . . ." *Waterbury Hotel Equity, LLC v. Waterbury*, 85 Conn.App. 480, 501, 858 A.2d 259, cert. denied, 272 Conn. 901, 863 A.2d 696 (2004).

In the [\*16] present action, the plaintiff's basis for seeking a writ of mandamus against the defendant assessors must fail for three reasons. First, each assessor's refusal to revisit the plaintiff's assessment of personal property on the 2001 Grand Lists was a discretionary act. It was not the performance of a mandatory act because the plaintiff's filing of the 2001 declarations were not made in error, they were intentional acts. Second, a writ of mandamus does not lie where the plaintiff has a right to appeal the action of the assessors pursuant to §12-119. Third, a mandamus "is a remedial process and may be issued to remedy a wrong, not to promote one, to compel the discharge of a duty which ought to be performed, but not to compel the performance of an act which will work a public and private mischief, or to compel a compliance with the strict letter of the law in disregard of its spirit or in aid of a palpable fraud. The [plaintiff] must come into court with clean hands." (Internal quotation marks omitted.) *Jalowiec Realty Associates, L.P. v. Planning & Zoning Commission*, 278 Conn. 408, 419, 898 A.2d 157 (2006).

For the above stated reasons, the plaintiff is not entitled to a writ of mandamus [\*17] against the various assessors of the defendant towns. Accordingly, the plaintiff's motions for summary judgment are denied, the defendants' cross motions for summary judgment are granted with judgment to enter in favor of each of the defendant towns, without costs to any parties.

Arnold W. Aronson

Judge Trial Referee

THE WILLIAM BAYLEY COMPANY 1200 WARDER STREET SPRINGFIELD,  
OHIO, Appellant v. EDGAR L. LINDLEY TAX COMMISSIONER OF OHIO  
STATE OF OHIO 30 EAST BROAD STREET COLUMBUS, OHIO 43215, Appel-  
lee

Case No. 1308

Court of Appeals of Ohio, Second Appellate District, Clark County

1979 Ohio App. LEXIS 9958

March 28, 1979

**NOTICE:**

PURSUANT TO RULE 2(G) OF THE OHIO SUPREME COURT RULES FOR THE REPORTING OF OPINIONS, UNPUBLISHED OPINIONS MAY BE CITED SUBJECT TO CERTAIN RESTRAINTS, LIMITATIONS AND EXCEPTIONS.

**DISPOSITION:** [\*1] The order of the Board of Tax Appeals is hereby affirmed

**CASE SUMMARY:**

**PROCEDURAL POSTURE:** Appellant taxpayer sought review of an order from the Board of Tax Appeals (Ohio), which affirmed an assessment for personal property taxes on a demand note issued to the taxpayer.

**OVERVIEW:** The note, representing a loan to the taxpayer's parent corporation, was not an account receivable from ordinary trade but was carried on the books as other assets. The taxpayer did not list the note in its personal property tax returns for two years, although it regularly reported the note as an asset in its public statements. In the year following the two disputed tax years, the note was declared a bad debt and was written off as worthless. The court held that the taxpayer, having elected to treat the note as an asset, had the burden of establishing the worthlessness of the note and in what year it decided that the note was of no value. The assessment, which accepted the value reported and reflected by the taxpayer on its books, was not arbitrary. The assignment of book value was prima facie evidence of true value, and the taxpayer's receipt of interest on the note was inconsistent with its assertion that the note was worthless from the start. The valuation of such commercial paper was particularly within the knowledge and control of the taxpayer. The court found no error in excluding information

relative to the future value or future stated value of the note.

**OUTCOME:** The court affirmed the trial court's judgment that upheld the personal property tax assessment.

**COUNSEL:** Martin, Browne, Hull & Harper, Oscar T. Martin, of Counsel, Attorney for Appellant

William J. Brown, Attorney General, by: J. Elaine Bialczak, Assistant Attorney General, Attorney for Appellee

**JUDGES:** McBRIDE, P.J., KERNS AND PHILLIPS, JJ., concur.

**OPINION BY:** McBRIDE

**OPINION**

*OPINION AND FINAL ENTRY*

McBRIDE, P.J.

This appeal is from an order of the Board of Tax Appeals affirming an assessment of the Tax Commissioner for personal property taxes for the years 1974 and 1975 on a demand note issued to the taxpayer for an amount of \$ 1,606,356.00. The note was not an account receivable from ordinary trade but was carried on the books as other assets. In 1976 the note was declared a bad debt and written off as worthless.

We will not report the lengthy history of this note which, while it represented a substantial amount of cash by others, was a paper transaction by the taxpayer, The William Bayley Company of Springfield, Ohio, a totally owned subsidiary of Aetna Industrial Corporation of New York. Briefly Aetna was in financial trouble, its only real asset being its ownership of the stock in

Bayley. To protect its interests [\*2] a Chicago bank advanced \$ 1,500,000.00 to save Aetna and protect the bank's interests. It could not make a direct loan to Aetna. The Bayley Company was the only solvent and profitable holding by Aetna. The loan was channeled through Bayley to Aetna, which in turn issued the note to Bayley, which advanced some additional cash to Aetna. Since Aetna held the Bayley stock, the taxpayer's interest was to avoid any implication caused by the collapse of Aetna. The note to Bayley was pledged to the Chicago bank as security for the bank loan.

As one of the officers testified for the taxpayer the purpose of the note was (1) to consolidate Aetna's debts, (2) to leave Bayley's assets unincumbered so that it could continue to operate in the public contracting field with governmental units in which public performance bonds are required to continue in business and (3) to give the Chicago bank full control over Bayley and to enable the bank to take judgment and assume control of the taxpayer-corporation. The circuitous route taken by the loan and the note was provoked by the inability of the bank to make a loan to Aetna because of its financial collapse. Bayley carried the note on its books [\*3] as a non-current asset until 1976. The note represented the substantial outlay by the bank including some hundred thousand dollars in cash advanced to Aetna by Bayley. The benefit to Bayley was that by following the instructions of the bank and Aetna it avoided the takeover of its stock ownership by Aetna's creditors and it permitted Bayley to continue as a going business venture without interruption.

We are not concerned here with the intricacies of high finance or corporate management. What is involved is a note in which a corporation invested some cash, its credit and to some extent its reputation, and the time when it determined that the asset it carried on its books and regularly reported in its public statements was in fact worthless, or an advance or distribution to its stockholder. Having elected to treat the note as an asset the taxpayer has a burden of establishing the worthlessness of the note and in what year it decided that it was of no value. For this purpose resort must be made to the personal property tax laws of this state. *R.C. 5711.01 to R.C. 5711.36.*

As with any paper transaction the showing of the substantial loan by Bayley and the offsetting note from [\*4] Aetna on the balance sheet led to other complications. The receivable was shown under notes due after one year even though it was a demand obligation. R. p. 41. To maintain this false front the Bayley Company paid dividends and advanced cash to Aetna for the purpose of (1) servicing interest on the loan by Bayley to Aetna and (2) meeting other legal, accounting and administrative costs of Aetna. The bulk of Bayley's divi-

dends were reimbursed by Aetna back to Bayley. R. p. 42. As a result of the transactions the Bayley corporation continued to operate at a profit without interruption, Aetna was able to report an income, and Bayley could show that interest payments were made above the prime rate on its note -- a note which it now insists was worthless despite deliberate efforts to make it appear otherwise on its books. R. p. 43; App. Ex. No. 4.

Appellant lists seven assignments of error; however appellant and appellee submitted and argued three propositions of law under categories A,B and C. The response of this court is according to the method of submission.

#### A.

Appellant's first proposition is that the decision of the Board of Tax Appeals is unreasonable and unlawful in holding [\*5] that the \$ 1,606,356.00 note should be listed for taxation of personal property for 1974 and 1975 at its face value without consideration of its actual value, if any.

Appellant concedes that it did not list this note in its 1974 and 1975 personal property tax returns and that it did not file a Form 902 or its equivalent with its returns for the purpose of challenging its actual value. The Tax Commissioner added the omitted note and assessed a tax for each year. Appellant argues that the Commissioner had a duty to value the note at its true value and that it was arbitrary to accept the value reported and reflected by the taxpayer on its books.

Where a taxpayer fails to report an asset for the tax and the commissioner makes an assessment thereon the determination may be reviewed and corrected or he may affirm the assessment. *R.C. 5711.31.*

It appears to be true that the taxpayer could have filed a consolidated report with its parent, Aetna, however this was not done and that factor is not involved in this case.

The Commission heard the evidence which brought forth the omission to report the note, its inclusion as an asset on the books of the corporation, the receipt of substantial [\*6] interest payments on the note, the efforts of the taxpayer to convince others that the cash it advanced and the pyramid of paper reflected a real value and finally the failure to list the note on its return and promptly seek a reduction in its stated value, all of which constitute overwhelming evidence of the taxpayers plan and election to convince everyone of the stated value of the note. Under these circumstances we do not find that the conclusion of the Tax Commissioner or the Board of Tax Appeals was either unlawful or arbitrary. Had he done otherwise the practices of the taxpayer would have continued and it would not have acted, as it did, to declare

the note worthless in 1976 and the assessor would have become a party to the corporate misstatements.

The demand note was not an obligation within the ordinary trade of the taxpayer. It was not an asset subject to depreciation in the usual sense of the word. It was an extraordinary obligation, representing corporate cash and credit, to which the taxpayer assigned the book value and from which it received a substantial amount of interest. The assignment of book value is prima facie evidence of true value. *Tube Co. vs. Kosydar*, [\*7] 44 *Ohio St. 2d* 96. The receipt of interest on the note is inconsistent with a conclusion that it was worthless from the start.

The issue in this case is not one of generally accepted accounting principles and practices. Whether the demand note was carried as a current or non-current account, or as a trade or non-trade item is not significant. What is significant is that in the judgment of the corporation it was a valuable item and reported as an asset at its stated value for the years in question for purposes of its own. This conclusion is supported by the cash advanced on the note and the interest received. The corporation did not elect to change its determination of the value of the note until 1976. The valuation of this type of commercial paper is particularly within the knowledge and control of the taxpayer. Where a taxpayer lists such an asset at its stated value in its financial statements and makes no effort to reflect otherwise or to take timely steps to remove it from its books, its judgment may be accepted, especially where the record supports the receipt of a substantial amount of interest on the obligation.

The case of *Alcoa vs. Kosydar*, 54 *Ohio St. 2d* 477, involves [\*8] percentages for depreciation for equipment used in the manufacturing process and has no application to the valuation of a note, the value of which does not depreciate according to any normal method. The value of a note may disappear overnight. It may have value to the holder that others do not appreciate. The anomaly in this case is that the taxpayer denies its own judgment of true value as reported in its statements and seeks a retroactive conclusion by the tax assessor that, if accepted, would recognize a corporate fraud upon the public.

Attention is devoted in the briefs to procedural and jurisdictional questions; however, it appears that the final

order is based upon a decision on the merits finding that the true value of the note was not other than that stated by the taxpayer.

The first proposition is denied.

B.

The second proposition argued is that the Board erred in excluding evidence offered by appellant in the taxpayer's subsequent 1976 personal property tax return that the note had no value in 1976.

In 1976 the corporation charged off the note, reflecting a major change in its financial statements. The 1976 election by the corporation represented a complete change [\*9] in the circumstances as to the note. The year of the write-off was 1976. That this was not done earlier was the taxpayer's judgment. Not being an item of physical property subject to ordinary depreciation, the write-off and the time when it was taken was indicative of prior true value and of the value of the note to the corporation on the tax listing day.

We find no error in excluding the information relative to the future value or future stated value of the note. The record presented by the 1976 return was a totally different ball game based upon different facts in a different tax period. In addition the record otherwise reflects appellant's position and if the denial of the evidence was erroneous, the ruling was not prejudicial.

This proposition is denied.

C.

The third proposition is error in holding that the taxpayer did not give timely written notice of the claim of deduction from book value of receivables in connection with the 1974 and 1975 returns.

Appellant concedes it did not file a Form 902 to claim such a deduction in either 1974 or 1975. However, as we have indicated this matter was brought to the taxpayer's attention and the issue fully heard on the merits. [\*10] The assessor did make a determination after a full hearing and it is our opinion that the determination was not unlawful nor unreasonable.

The third proposition is denied.

Rent-Way Inc., Appellant, vs. William W. Wilkins, Tax Commissioner of Ohio, Appellee.

CASE NO. 2004-A-331 (PERSONAL PROPERTY TAX)

STATE OF OHIO -- BOARD OF TAX APPEALS

2007 Ohio Tax LEXIS 523

April 13, 2007

[\*1]

APPEARANCES

For the Appellant - Bailey Cavaleri LLC, Harlan S. Louis, One Columbus, 10 West Broad Street, Suite 2100, Columbus, Ohio 43215-3422

For the Appellee - Marc Dann, Attorney General of Ohio, John K. McManus, Assistant Attorney General, 30 East Broad Street, 16<sup>th</sup> Floor, Columbus, Ohio 43215

OPINION:

DECISION AND ORDER

Ms. Margulies, Mr. Eberhart, and Mr. Dunlap concur.

This cause and matter came on to be considered by the Board of Tax Appeals upon a notice of appeal filed herein by the above-named appellant from final assessment certificates of valuation issued by the Tax Commissioner. The assessment certificates relate to applications for final assessment filed by appellant for the 2000, 2001, and 2002 personal property tax years. By such applications, Rent-Way sought the designation of a shorter class life for its schedule 4 short-term rental property than the class life III it used in reporting the true value on its 2000 and 2001 returns and the class life V used on its 2002 return. Rent-Way primarily contends that the application of the standard 302 computation by the Tax Commissioner to its inventory does not provide an accurate reflection of its inventory life, which it [\*2] claims has a useful life of thirty months, as supported by a disposal analysis it offered. H.R., Vol. I at 6-7.

The matter was submitted to the Board of Tax Appeals upon the notice of appeal, the statutory transcript n1 certified to this board by the Tax Commissioner, the record of the hearing before this board, and the briefs filed by counsel.

n1 We note that appellant contends, both by motion and in post-hearing briefs, that the statutory transcript, filed with this board by the tax commissioner pursuant to R.C. 5717.02, is incomplete. By order dated November 10, 2004, the board acknowledged the filing of the statutory transcript on September 1, 2004, and indicated that "appellant has alleged that the transcript which has been filed is incomplete. However, since this is an issue that requires evidentiary proof, the board will reserve ruling on this portion of the motion until the parties have had an opportunity to submit evidence addressing this issue." *Rent-Way Inc. v. Wilkins* (Interim Order, Nov. 10, 2004), BTA No. 2004-A-331, unreported, at 2. Appellant neither renewed its previous motion nor provided evidence or testimony at the hearing to substantiate its claim; all of the exhibits offered by appellant at the hearing, which arguably supplement information provided in the statutory transcript, were received into evidence and considered by this board in making its determination herein. Therefore, without a specific reference from appellant to indicate the nature of the omission from the transcript and/or the related prejudice caused by such omission, we deem the record before the board in this matter, including the statutory transcript, complete.

[\*3]

In reviewing appellant's appeal, we recognize the presumption that the findings of the Tax Commissioner are valid. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121. It is therefore incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the presumption and establish a right to the relief requested. *Hatchadorian v. Lindley* (1986), 21 Ohio St.3d 66; *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135; *Midwest Transfer Co. v.*

*Porterfield (1968)*, 13 Ohio St.2d 138. Moreover, the taxpayer is assigned the burden of showing in what manner and to what extent the Tax Commissioner's determination is in error. *Kern v. Tracy (1995)*, 72 Ohio St.3d 347; *Federated Dept. Stores, Inc. v. Lindley (1983)*, 5 Ohio St.3d 213. Where no competent and probative evidence is developed before this board by the appellant to show that the Tax Commissioner's findings are incorrect, then the Board of Tax Appeals must affirm the Tax Commissioner's findings. *Kern, supra*; [\*4] *Kroger Co. v. Limbach (1990)*, 53 Ohio St.3d 245; *Alcan, supra*.

Initially, we note appellant's contentions, which are set forth in the notice of appeal, in pertinent part, as follows:

"2. For the assessment amounts for the return years of 2000, 2001 and 2002, the Tax Commissioner erred in assessing tangible personal property tax by failing to properly account for and value Appellant's rental merchandise as follows:

"a. By assigning the wrong useful life time periods and by erroneously valuing such property different from its true value in money under Ohio Revised Code Section 5711.21, Ohio Administrative Code Section 5703-3-10, and other relevant provisions. \*\*\*

"b. Or in the alternative, by not classifying such property as merchandising inventory, under Ohio Revised Code Section 5711.15 and other relevant provisions, and by not valuing such inventory at its proper value, including lower of cost or market adjustments.

"3. For the assessment amounts for the return years of 2000, 2001 and 2002, the Tax Commissioner erred in assessing tangible personal property tax on idle assets that are being held for disposal and [\*5] no longer used in business.

"4. For the assessment amounts for the return years of 2000, 2001 and 2002, the Tax Commissioner erred in assessing tangible personal property tax on certain assets that were disposed of and no longer at the Appellant's facilities and assets that were stolen, lost, and otherwise removed from an Ohio taxing district and no longer used in business.

"5. For the assessment amounts for the return years of 2000, 2001 and 2002, the Tax Commissioner erred in assessing tangible personal property tax on inventory that is being held for storage only.

"6. For the assessment amounts for the return years of 2000, 2001 and 2002, the Tax Commissioner erred in assessing tangible personal property tax by including items not properly taxable as personal property, by not correctly reflecting the year of acquisition, and by not correctly reflecting the class and class life of certain assets, including real properties and other tangible personal property not owned by the Appellant and/or represented on the Appellant's books and records as intangible assets.

"7. For the assessment amounts for the return years 2000, 2001 and 2002, the Tax Commissioner erred in assessing [\*6] tangible personal property by not following its own directives, procedures, methods and other obligations prescribed by law."

Appellant Rent-Way operates a rent-to-own business. Rent-Way's customers may rent, on a week-to-week basis, a variety of household goods, including, but not limited to, televisions, computers, furniture, appliances, and other electronic items. H.R., Vol. I at 19-20. If all of the rental payments under the rental agreement are made, the customer would then own the item(s) in question; if all payments are not made, the item(s) are returned to Rent-Way, to be rented again. H.R., Vol. I at 16-17. Customers may also purchase the rented item(s) prior to the end of the rental term, for an amount specified at the inception of the rental agreement. H.R., Vol. I at 17. Certain previously rented merchandise can also be purchased outright, in a cash transaction, by customers, when it no longer meets Rent-Way's standards for further rental. H.R., Vol. I at 38. Rent-Way's employees can also purchase merchandise outright. H.R., Vol. I at 60.

Any merchandise that is not purchased by a customer is returned to Rent-Way and rented again to a different customer, until it can [\*7] no longer be offered for rent due to its condition. H.R., Vol. I at 30. Merchandise rental terms are based on the condition of the merchandise at the time of rental; rental rates remain constant for each category of merchandise. H.R., Vol. I at 32-24. Ultimately, Rent-Way's inventory of merchandise is either purchased by customers

or disposed of by other means, i.e., it may be stolen, lost, discarded, damaged or destroyed while in a customer's possession, or donated to charity. H.R., Vol. I at 58-59, 61. It is noted that even when an item is never ultimately purchased by a customer, Rent-Way may have previously received rental payments and/or insurance reimbursements prior to an item's disposal. H.R., Vol. I at 75.

Appellant Rent-Way summarized its position regarding its appeal in its brief, stating, "Rent-Way, Inc., rents and sells consumer goods. These items are taxed by the Tax Commissioner as tangible personal property. These items, however, do not fit neatly into the Commissioner's '302 computation.' Rent-Way's disposal study dramatically points this out. The Commissioner erred by not adjusting the 302 computation." Appellant's Brief at 1. Rent-Way requested that the true value [\*8] of its short-term rental merchandise be calculated by applying the following percentages of acquisition cost: acquisition year 1 -- 60%; year 2 -- 30%; year 3 and older -- 10%, and offered a disposal study for the years in question to support its position. S.T. at 48.

As we begin our consideration of this case, we note that every taxpayer engaged in business in Ohio must annually file a personal property tax return with the county auditor of each county in which property used in the taxpayer's business is located. R.C. 5711.02. On that return, the taxpayer must list "all his taxable property \*\*\* as to value, ownership and taxing districts as of the date he engages in business." R.C. 5711.03. R.C. 5711.18 describes the manner in which taxable property is to be listed, providing in pertinent part that:

"In the case of personal property used in business, the book value thereof less book depreciation at such time shall be listed, and such depreciated book value shall be taken as the true value of such property, unless the assessor finds that such depreciated book value is greater or less than the then true value of such property in money. Claim for any deduction from \*\*\* depreciated [\*9] book value of personal property must be made in writing by the taxpayer at the time of making the taxpayer's return \*\*\*."

Recognizing that it would be impractical to personally value all personal property in Ohio, the Tax Commissioner developed a formula, referred to as the "302 computation," in order to determine the true value of such property. *W.L. Harper v. Peck (1954), 161 Ohio St. 300; Snider v. Limbach (1989), 44 Ohio St.3d 200.*

Ohio Adm. Code 5703-3-10 speaks directly to the valuation of personal property for tax purposes and provides in pertinent part that:

"(A) Tangible personal property used in business in this state must be returned, for purposes of the personal property tax, at its true value in money. The true value of depreciable personal property is its book cost less book depreciation, unless the tax commissioner finds that the depreciated book value is greater or less than the true value of such property.

"(B) Application of the composite annual allowance procedure provided for in rule 5703-3-11 of the Administrative Code shall determine the prima facie true value of depreciable tangible personal [\*10] property used in business. The prima facie valuations can be rebutted by probative evidence of higher or lower valuation.

\*\*\*\*

"(3) If a taxpayer believes that the composite annual allowance procedure as determined by the commissioner does not accurately reflect the true value in money of the taxpayer's depreciable tangible personal property on hand, the taxpayer may establish more accurate annual allowances by probative evidence.

"(a) Such evidence must show that the published composite annual allowance procedures are inappropriate because they cause an unjust or unreasonable result, or must be modified because of special or unusual circumstances.

"(b) Such evidence may include, but is not limited to, an aging of disposals study and any other studies, data, or documentation the taxpayer wishes to submit for consideration by the commissioner.

"(c) Such evidence must cover a sufficient number of years to demonstrate a pattern in the history of the useful life of the subject property."

The "composite annual allowance" or "302 computation" is more fully discussed in Ohio Adm. Code 5703-3-11, which provides, in pertinent part:

"(A) To assist taxpayers in returning the [\*11] true value of depreciable tangible personal property used in business in this state, as required by Chapter 5711 of the Revised Code and rule 5703-3-10 of the Administrative Code, and to assist in the efficient administration of the personal property tax, the tax commissioner shall determine a composite annual allowance procedure for use in computing the true value of such property. The application of the composite annual allowance procedure to the original cost of tangible personal property may be referred to as the 'true value computation' or the '302 computation.'

"(B) The valuation determined by the true value computation shall be the prima facie true value in money of the taxable tangible personal property."

The Supreme Court has repeatedly accepted the 302 computation as an appropriate method to value personal property. As the court held in *PPG Industries v. Kosydar* (1981), 65 Ohio St.2d 80, 83, "this directive has been approved by this court as a practical, reasonable and lawful method and device to achieve uniform valuation of plant equipment in Ohio by prescribing annual depreciation rates in lieu of book depreciation for Ohio personal property [\*12] tax purposes. *Wheeling Steel Corp. v. Evatt* [(1944), 143 Ohio St. 71] \* \* \*; *W.L. Harper Co. v. Peck* (1954), 161 Ohio St. 300." See, also, *Campbell Soup Co. v. Tracy* (2000), 88 Ohio St.3d 473, 476. While application of the 302 computation results in a prima facie true value figure, the value reflected through its use is not absolute. A taxpayer that objects to the use of the 302 computation can demonstrate, through competent and probative evidence, that a different result is warranted. *PPG Industries, supra*; *Gahanna Heights, Inc. v. Porterfield* (1968), 15 Ohio St.2d 189.

In *Towmotor Corp. v. Lindley* (1981), 66 Ohio St.2d 53, the court set forth a two-prong test to be applied by this board when considering a taxpayer's claim that the 302 computation does not reflect the true value of the personal property:

"First, the board must determine if there exist special and unusual circumstances which require that the '302 Computation' not be used. If the board determines that such circumstances do exist, [\*13] the '302 Computation' is inappropriate. If such circumstances do not exist the board must, second, determine if the rigid application of the '302 Computation' directive creates an unjust or unreasonable result in that case. If so, the directive is inappropriate. \*\*\*" *Id. at 54.*

Thus, Rent-Way's burden in this case, i.e., proving that its property is overvalued when reported in accordance with the commissioner's classification directives, may be met by any of three accepted methods. Rent Way may prove that special or unusual circumstances exist, that the use of the 302 computation produces an unjust or unreasonable result, or Rent-Way may offer direct evidence of the personalty's true value. *RPS, Inc. (fka Roadway Package System, Inc.) v. Tracy* (Oct. 30, 1998), BTA. No. 1996-M-1209, unreported. Rent-Way has attempted to meet its burden by offering evidence that the commissioner's rigid application of the 302 computation to its inventory produced an unreasonable result.

In support of its position, Rent-Way presented the testimony of Mr. Cerezo, Rent-Way's internal audit supervisor, concerning Rent-Way's business operations and tax liability, and Mr. [\*14] Gifford, director of property tax services for PricewaterhouseCoopers (PWC), concerning the disposal analysis prepared by PWC. First, Mr. Cerezo testified that he compiled the information for the disposal study by creating a database from Rent-Way's inventory management system which listed 152,962 disposed items over a 46-month period. The list indicated some information about each item, like the purchase date and disposal date, but did not, for example, contain information regarding the reason for the disposal. H.R., Vol. I at 52-53; 85-89. A summary of the list, which grouped disposals together by category, as well as the database, was forwarded to PWC, which relied on the summary to make its study and recommendations to Rent-Way. Specifically, PWC performed an age of disposals study which "examined the ages of the assets disposed of based on their dollar year age, expired cost, and disposal proceeds," a turnover study which "examined the investment turnover by comparing the disposal costs to the cost of investment," and an age of assets study which "examined the age of the rental property assets which remained on hand." Appellant's Brief at 4. The study and summary were then presented

[\*15] to the Tax Commissioner as the basis for Rent-Way's position that a different class life should have been utilized in determining Rent-Way's personal property tax liability. H.R., Vol II at 54.

As always, in reviewing the disposal study and associated testimony, we are mindful of the fact that this board is vested with wide discretion in determining the weight to be given to the evidence before it. See, e.g., *Parma Hts. v. Wilkins*, 105 Ohio St.3d 463, 467, 2005-Ohio-2818 (" [W]e always give wide discretion to the BTA in evaluating the credibility of witnesses and the weight that should be given to any evidence presented to it."); *Campbell Soup, supra*, (quoting from *Strongsville Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision (1997)*, 77 Ohio St.3d 402, 405, "[w]e also affirm the BTA's rulings on credibility of witnesses and weight attributed to evidence if the BTA has exercised sound discretion in rendering these rulings."). Having considered the study in its entirety, we find that it fails to provide probative, credible evidence of the value of the subject property.

Most notably, at the outset, [\*16] we must remark that the credibility of the disposal study is clouded by the direct financial interest PWC has in the subject appeal. PWC entered into a contingent fee agreement with Rent-Way under which PWC would receive 25 or 30% of any tax savings realized by Rent-Way as a result of the use of PWC's disposal study in the instant proceedings. H.R., Vol. I at 204-205. Specifically, Mr. Gifford testified that PWC's fee would be "based upon a percentage of tax savings. I believe it is 25, 30 percent." H.R., Vol. I at 205. We question the reliability of PWC's study considering that it has such a vested interest in the outcome of this matter. In fact, we previously considered a similar fact pattern involving PWC where the taxpayer's counsel made the same arguments suggesting that the credibility of PWC's conclusions was not affected by such a contingent arrangement, "i.e., the issue has generally only arisen in real property valuation appeals, [the employee of PWC] will not personally benefit from the contingency fee arrangement which his employer has, PWC will lose money on its engagement even if it receives the maximum contingency fee, \*\*\* and it is unreasonable to assume that 'one [\*17] of the four largest international accounting firms, PricewaterhouseCoopers, would present false evidence for a fee that represents but a fraction of its total revenue.'" *Choice One Communications of Ohio, Inc. v. Wilkins* (June 9, 2006), BTA No. 2003-K-1461, 2004-K-409, unreported, at 27. n2

n2 Although issued by this board after the merit hearing and briefing took place herein, we find the reasoning in *Choice One* to be equally applicable to the instant facts.

Here, as in *Choice One*, we are unpersuaded by the taxpayer's protestations that PWC's conclusions were not affected by its contingent fee arrangement. "This board has consistently discounted the credibility/reliability of an expert who personally acquires, or whose employer acquires, a pecuniary interest in litigation through a contingent fee arrangement. By acquiring such a direct interest in the litigation, the expert's ability to render an independent and unbiased opinion or evaluation is called into question. \*\*\* It simply cannot be overemphasized that the essential effectiveness of an expert depends not only upon his or her ability to persuade the trier of fact as to elements of basic competence, but also [\*18] his or her ability to demonstrate unyielding impartiality." *Choice One* at 27, 32. We concluded that "given appellant's admission that PWC is entitled to receive thirty percent of the tax savings which may be achieved through these appeals, even in the absence of the other flaws discussed herein, we find no basis for deviating from our previously stated position on this subject and will therefore accord the PWC tax study no more than minimal weight." *Id.* at 32. See, also, *Witt Co. v. Hamilton Cty. Bd. of Revision (1991)*, 61 Ohio St.3d 155; *Keystone Powdered Metal Company v. Zaino* (Mar. 22, 2002), BTA No. 2000-A-749, unreported; *La Spina v. Summit Cty. Bd. of Revision* (Jan. 12, 1996), BTA No. 1994-T-1149, unreported. Based upon the foregoing, PWC's disposal study will not be accorded more than minimal weight.

Further, upon our review of the disposal study, we are not persuaded by its conclusions. The study lists disposals by category, and no information on individual items was included. No distinction is made between the different types of Rent-Way's merchandise. No underlying records or details regarding the disposals were provided. Especially [\*19] since PWC created the disposal study using the summary figures supplied by Rent-Way, without reviewing any information regarding specific disposals, supporting documentation should have been provided for the conclusions made by Rent-Way in its summary. See *United Tel. Co. v. Tracy (1999)*, 84 Ohio St.3d 506; *Anheuser-Busch Companies, Inc. v. Zaino* (Sept. 24, 2004), BTA No. 2003-K-699, unreported. Other examples of perceived flaws within the study include: 1) the study includes items that were stolen, lost, or damaged, which would not accurately depict the useful life of the items; any insurance reimbursements or other recovered costs should have been reflected in the study; 2) the study includes items that were sold to Rent-Way employees, brand new, never having been rented, and, in addition, the proceeds from such sales were not reflected, H.R., Vol. I at 103-104, 106-107; 3) the disposal study covered a period of time when Rent-Way's policies dictated that certain merchandise within its inventory be disposed of, even if it still had

remaining life/value, so that it could be replaced by merchandise Rent-Way deemed better suited for the market; such [\*20] items, when disposed, were treated in the study in the same way as merchandise that was disposed of because it had no remaining life/value. Arguably, such treatment does not reflect an accurate picture of the useful lives of some of Rent-Way's inventory, Exs. 5 and 6; H.R., Vol. I at 118-120; 4) the inconsistency in the disposal proceeds figures within the study raises concerns over the accuracy of the information provided, S.T. at 54, 66; and 5) the purchase dates and delete dates used in the study were averages, not the actual dates. H.R., Vol. I at 90.

Thus, the foregoing concerns about the disposal study offered by Rent-Way further render it unreliable. Rent-Way has failed to establish that application of the 302 computation created an unjust or unreasonable result in determining the value of its personal property. We also note that with the rent-to-own business, it is difficult to apply a disposal study to its practices as many of its "disposals" are due to sales and are not necessarily an indication of the items' useful lives. We agree with the Tax Commissioner that generally, the disposal study prepared by PWC is more reflective of how long it takes Rent-Way to sell the items [\*21] in its inventory, not the average life of such property. H.R., Vol. II at 84.

This board has previously considered similar facts in *Keystone Powdered Metal Company v. Zaino* (Mar. 22, 2002), BTA No. 2000-A-749, unreported. Therein, the taxpayer attempted to justify deviating from the 302 computation in valuing its personal property by establishing the existence of special circumstances in its manufacturing process and, in the alternative, that the application of the 302 computation created an unjust or unreasonable result. After unsuccessfully arguing the former, the taxpayer presented a disposal study in support of the latter contention. In review of the disposal study, this board held that "[a]t the outset, we must remark that the credibility of Mr. Russell's study is clouded by his direct financial interest in the subject appeal. Specifically, Mr. Russell 'would get 50 percent of what they [Keystone] save including accumulated interest.' \*\*\* We question the reliability of Mr. Russell's conclusions considering that he has such a personal stake in the outcome of this matter." Id. at 12. Further, in discussing the specifics of the subject study, we stated "[n]o underlying records [\*22] or details regarding the 'disposals' in Mr. Russell's summary were provided." Id. at 13. We then proceeded to detail a laundry list of perceived flaws in the study. Rent-Way attempts to distinguish the foregoing by contrasting the specific flaws in each case, which of course, are based on the very different taxpayers involved in the studies. However, the general concerns in both cases remain the same; first, the author of each study had a direct interest in the outcome of the appeal, which significantly detracts from the credibility of the conclusions reached therein, and, second, even if the studies were able to be given substantive consideration, they are flawed and lack the documentation necessary to support the conclusions reached. In response, Rent-Way attempts to argue that the commissioner failed to audit the source documentation, and, as such, cannot now claim that the supporting documentation was lacking, citing this board's decision in *Oasis Corporation, f/k/a Ebco Manufacturing Co. v. Tracy* (Sept. 21, 2001), BTA No. 1998-P-940, unreported, as support for its position. However, in *Oasis*, the taxpayer had filed its personal property tax return "based upon unaudited [\*23] preliminary financial statements intended only for internal use. \*\*\* When it discovered how the return had been prepared it notified the tax commissioner's representative that the return as originally filed was based upon inaccurate financial statements. It also pointed out that the return mistakenly included non-Ohio inventory. The tax commissioner requested certain documents \*\*\*. Oasis Corporation forwarded the documents requested. Nonetheless, the tax commissioner issued a final assessment certificate of valuation based upon the originally filed return." Id. at 2. We went on to hold that:

"The tax commissioner asserts in his brief that Oasis Corporation failed to meet its evidentiary burden. He complains that insufficient source documentation has been provided. But the record before us contains audited financial statements, worksheets, demonstrative exhibits and other explanatory documents that support Oasis Corporation's position. Financial statements and accounting worksheets prepared in the ordinary course of business as part of the audit process are included in the record. A foundation has been laid through the testimony of Mr. Wilson. These records have the force of probative [\*24] evidence. The tax commissioner was free to probe other specific documents or accounts if he so desired. He might have conducted a field audit or utilized the discovery process if doubts or suspicions existed as to the veracity of the evidence contained in the statutory transcript." (Footnotes omitted.) Id. at 8.

Unlike in *Oasis*, in the instant matter, there is no underlying documentation that has been provided by Rent-Way to support the position advocated through the use of its study. As such, we cannot rely upon the conclusions rendered therein.

Rent-Way also contends that the commissioner erred by taxing property that Rent-Way does not own, i.e., leasehold improvements. However, while such concept was raised at the hearing before this board and addressed in post-hearing briefs, Rent-Way did not specifically identify the items that were improperly assessed nor did it offer any testimony from an individual(s) with personal knowledge about the use of and/or corresponding classification of such items. The taxpayer bears the burden of establishing any error on the Tax Commissioner's part. Having presented no specific evidence with regard to leasehold improvements that it argues [\*25] were classified improperly, and consequently, improperly taxed, we find that Rent-Way has failed to meet its established burden. See *Hatchadorian, supra*; *Kern, supra*; *Kroger, supra*; *Alcan, supra*.

Based upon the record before us, we find that appellant Rent-Way has failed to rebut the presumption of correctness of the Tax Commissioner's findings herein. Therefore, it is the decision and order of the Board of Tax Appeals that the decision of the Tax Commissioner must be and hereby is affirmed.

**Legal Topics:**

For related research and practice materials, see the following legal topics:

Tax Law Federal Income Tax Computation Deductions for Amortization, Depletion & Depreciation Amortization, Cost Recovery & Depreciation (IRC secs. 167-169, 171, 178, 194-195, 197, 216, 248, 280F) General Overview Tax Law Federal Income Tax Computation Valuation Personal Property Tax Law State & Local Taxes Personal Property Tax Tangible Property Imposition of Tax

Anheuser-Busch Companies, Inc., Appellant, vs. Thomas M. Zaino, Tax Commissioner of Ohio, Appellee.

CASE NO. 2003-K-699 (PERSONAL PROPERTY TAX)

STATE OF OHIO -- BOARD OF TAX APPEALS

*2004 Ohio Tax LEXIS 1483*

September 28, 2004; September 24, 2004, Entered

[\*1]

APPEARANCES:

For the Appellant -- Squire, Sanders & Dempsey, LLP, Stacy D. Ballin, William H. Conner, Suzanne K. Ketler, 4900 Key Tower, 127 Public Square, Cleveland, Ohio 44114-1304

For the Appellee -- Jim Petro, Attorney General of Ohio, Richard C. Farrin, Assistant Attorney General, State Office Tower -- 16<sup>th</sup> Floor, 30 East Broad Street, Columbus, Ohio 43215

OPINION:

DECISION AND ORDER

Ms. Jackson, Ms. Margulies, and Mr. Eberhart concur.

On June 6, 2003, appellant, Anheuser-Busch Companies, Inc., filed the present appeal with this board seeking reversal of a final determination issued by the Tax Commissioner. Through his determination, the commissioner denied appellant's petition for reassessment in which appellant had challenged previously issued personal property tax assessments for tax years 1995 and 1996.

This matter is now considered upon appellant's notice of appeal, the statutory transcript ("ST.") certified by the Tax Commissioner, the evidence presented at a hearing convened before this board and the post-hearing briefs of counsel. At this board's hearing, appellant presented the testimony of two witnesses: Thomas C. Ford, its senior engineering manager, and Carl Blough, its [\*2] manager of fixed assets and property taxes.

Following the filing of appellant's inter-county personal property tax returns for tax years 1995 and 1996, the Tax Commissioner issued amended preliminary assessment certificates which resulted in an increase in the valuation of appellant's taxable Schedule 2 property located in Franklin County, Ohio. n1 Appellant then filed with the Tax Commissioner a petition for reassessment n2 in which it asserted that costs attributable to engineering drawings had been improperly included within the valuation of its Schedule 2 machinery and equipment.

n1 The notices issued to appellant did not include the addition of any costs attributable to engineering drawings now at issue in this appeal. Rather, appellant raised for the first time in its petition for reassessment its claim that costs it initially reported in its personal property tax returns for engineering drawings be removed.

n2 As noted by the Tax Commissioner in his final determination, although appellant initially challenged several aspects of the preliminary assessments, it later withdrew such claims and instead elected to restrict its argument to the one pursued through the present appeal:

"The petitioner contends that the assessments include the cost of exempt pollution control equipment; the improper reclassification of land and building improvements as personal property; an improper increase in the true value of Schedule 2 machinery and equipment to account for moving and relocation costs; and the cost of exempt engineering drawings. However, prior to hearing, the petitioner indicated that the only issue it wished to pursue was the issue of exempt drawings.

Therefore, the only issue for consideration is whether the petitioner's machinery and equipment costs contain costs that should be removed as exempt drawings. Although the petitioner raised the issue of exempt drawings in its petition for reassessment, it was not an issue on audit and is being considered here for the first time." S.T. at 1.

[\*3]

During the period in question, appellant undertook four separate construction projects at its Columbus, Ohio brewery whereby it either built new or expanded upon existing manufacturing operations. These projects were identified as follows: (1) Project 598-O'Douls Expansion; (2) Project 6506-Chip Upgrade; (3) Project 6241-Process Piping for Ice Beer and (4) Project 418/410-Aseptic Filling for Bud Dry. n3

n3 Appellant's witness briefly described the nature of these projects: Project 598-O'Douls Expansion: "Anheuser-Busch was -- was wanting to increase the capacity of its O'Douls production [a non-alcoholic beer], so they put forth a capital production for the Columbus brewery to increase that capacity." H.R. at 18-19. Project 6506-Chip Upgrade: "We wanted to modify our -- our process and we added some -- some chip separators to take yeast out of the -- out of the chips." H.R. at 31. "We at the time were trying to get -- to figure out a way to remove the yeast from our chips, you know, the beechwood chips that we put in Budweiser. And so we put in chip separators kind of like a centrifuge and they would centrifuge the chips and the yeast would come off and then we could reuse the chips easier and dispose of the yeast." H.R. at 126. Project 6241-Process Piping for Ice Beer -- "Ice beer is another product that we wanted to make it -- at Columbus. And these would -- this was a modification to the process systems to make ice beer." H.R. at 36. Project 418/410-Aseptic Filling for Bud Dry: "We wanted to make an aseptic product sort of like a draft beer in a bottle; so we had to modify a substantial amount of the plant to allow that to occur." H.R. at 39.

[\*4]

In order to complete these projects, appellant engaged two outside engineering firms, i.e., MK Ferguson Corporation and Holloman and Associates. As part of their efforts, these firms either newly created or modified a number of engineering drawings, many of which appellant maintains in the ordinary course of its business. However, neither of these firms, on any invoices which could be located by appellant, separately stated the specific costs attributable to the creation of engineering drawings. Instead, invoices simply made reference to "engineering services." In the absence of specifically invoiced costs for engineering drawings, yet in an effort to demonstrate that such costs had been improperly included as taxable personal property, appellant provided an estimate of drawings costs to the commissioner predicated upon an internal analysis performed by its employee, Thomas Ford.

In his final determination, the Tax Commissioner rejected appellant's claims and affirmed the assessments as issued. In reaching this conclusion, the commissioner found that the methodology employed by appellant in calculating the costs of engineering drawings could neither be verified nor audited, and therefore [\*5] could not be relied upon as a basis for the claimed reduction:

"In the instant case, the petitioner has provided no detailed project review that would allow verification of the accuracy of its estimates. Furthermore, drawings costs and the results of the estimates were not subject to Department or objective external review. Without detailed and verifiable information, no modifications can be made to these assessments." S.T. at 3.

From the proceeding determination, appellant appealed to this board, specifying the following as error:

"The Final Determination erroneously allowed the 1995 and 1996 tax assessments to stand as issued, even though such assessments improperly included the cost of engineering drawings in the valuation of Appellant's Schedule 2 taxable property; drawings are excluded from the definition of personal property under R.C. 5701.03(A)."

Appellant asserts that costs attributable to engineering drawings were improperly included within the 1995 and 1996 personal property tax assessments issued by the commissioner. See fn. 1, supra. Although R.C. 5709.01 subjects to personal property tax all personalty located and used in business in this state, engineering [\*6] drawings are expressly

excluded from this definition by virtue of R.C. 5701.03(A): " Personal property' does not include \* \* \* drawings that are held for use and not for sale in the ordinary course of business \* \* \*."

It is uncontroverted that engineering drawings were created for purposes of completing the projects undertaken by appellant. However, as previously indicated, the costs specifically attributable to these drawings were not delineated on invoices appellant received from its outside engineering firms. In the absence of such information, n4 appellant's senior engineering manager developed a methodology, substantially similar for three of the four projects, i.e., Projects 598, 6506 and 6241, by which he estimated the costs attributable to engineering drawings.

n4 Thomas Ford testified that he had been employed as an engineer with appellant for thirty years, the last fifteen of which have been as a senior manager of engineering services. In his current position, Ford not only manages an internal group of professionals who create drawings, but he also generally oversees those engineering projects which are outsourced to private engineering firms.

For these three projects, [\*7] Ford indicated that his efforts began with a review of the master drawing lists retained by appellant which identified the drawings used in each project. He then reviewed the drawings themselves, not only to ensure all drawings were accounted for on the master lists, but to also ascertain whether the drawings were newly created or modified versions of pre-existing drawings. n5

n5 In order to ascertain whether drawings were modified or newly created for a particular project, Ford reviewed the drawings themselves and the corresponding revision numbers reflected thereon. Using what he considered to be a "conservative approach," Ford categorized drawings which had undergone three or fewer revisions as new drawings, while those with four or more revisions were treated as modified drawings. As indicated above, under Ford's approach, "modified" drawings took less time to create and were therefore less costly.

Ford categorized the projects' drawings into one of six "disciplines," i.e., process, mechanical, structural, piping, electrical, or instrumentation. Based upon his personal experience in dealing with design and engineering drawings, he attributed an average number of hours to [\*8] the creation of both new and modified drawings for each discipline. n6 Ford next estimated the hourly costs attributable to the creation of engineering drawings by first noting that appellant currently pays its outside engineering firm, MK Ferguson, \$ 90 per hour for engineering work. Relying upon his personal experience, he determined that the average market rate for engineering services had increased at approximately three percent annually since the time the projects had been undertaken. Using this percentage, he concluded that average market engineering rates for 1993 and 1992 would have been \$ 67 and \$ 65 per hour, respectively. However, in calculating costs, Ford elected to use \$ 60 per hour in order to ensure his estimate would again be conservative.

n6 Ford stated that the use of an "average" number of hours would again result in a conservative estimate, suggesting that more complicated drawings would take significantly longer to prepare than simpler ones. To illustrate his conclusions, in order to develop modified drawings, Ford indicated an average of 40 hours would be required for process and mechanical drawings, 30 hours for structural and piping, 10 hours for electrical and 1 hour for instrumentation drawings. In order to create new drawings for each of the preceding categories, Ford estimated the following average number of hours for each discipline: process and mechanical -- 120 hours; structural and piping -- 100 hours; electrical -- 40 hours; and instrumentation -- 4 hours.

[\*9]

Ford then multiplied the various disciplines of engineering drawings by the average number of hours he considered attributable to their creation. These figures were then multiplied by the average hourly costs he attributed to the years in which they would have been created, resulting in the following total engineering drawings costs: Project 598 -- \$ 917,940; Project 6506 -- \$ 239,520; and Project 6241 -- \$ 85,680. Ford testified, that, based upon his experience, engineering drawings costs typically accounted for between eight and twelve percent of total project costs. However, when he compared his estimated costs to each of the total project costs, Ford found the amounts he attributed to engineering drawings to have been extremely conservative, i.e., Project 598 -- 5.8%, Project 6506 -- 3.9%, and Project 6241 -- 3.5%.

With respect to Project 418/410, Ford indicated he was required to develop a different approach for estimating drawings costs. He explained that this project actually involved multi-plant construction undertaken at several of appellant's brewery locations, including the one located in Columbus, Ohio. He testified that, like the other three projects, invoices detailing [\*10] costs for engineering drawings were lacking. However, unlike the other three projects, appellant did not have a master drawings list or even the actual drawings used in the project because it had been abandoned several years earlier.

Therefore, Ford first reviewed appellant's business records and determined the total costs for the multi-site project to be \$ 40 million. Of that amount, approximately \$ 17 million of total project costs, or 43%, was allocated to work performed at the Columbus brewery. Similarly, Ford's review of available records indicated that of the total capital costs for the project, 43% was again attributable to the Columbus brewery, i.e., approximately \$ 12.3 million of \$ 28.5 million. From a review of appellant's records, he determined that approximately \$ 3.9 million had been paid in total engineering fees to MK Ferguson for the entire project. n7 Using the above-referenced 43% as his benchmark, Ford applied that percentage to the MK Ferguson costs and concluded that \$ 1,687,480 of the Columbus brewery project costs were actually attributable to engineering drawings.

n7 In arriving at the above-referenced engineering costs, i.e., \$ 3,910,375, Ford relied upon appellant's disbursements rather than the actual invoices themselves since he was able to locate only a portion of the invoices related to the project, totaling only \$ 1,108,129.

[\*11]

Appellant next called as a witness Carl Blough, who testified that he prepares and files appellant's property tax returns and that engineering drawings costs for all four projects would have been included as part of appellant's taxable property reported for the years in question. Blough explained that as costs for a project are incurred, they are recorded in appellant's "construction-in-progress" ("CIP") system. n8 As a project nears completion, appellant's engineering department informs the property accounting group, and when assets are actually placed in service they are cleared from the CIP system and transferred to a fixed assets general ledger system. When assets are placed in service, all soft costs, such as design and engineering drawings costs, which cannot be specifically identified with a particular asset, are "spread," or allocated, among hard assets ultimately reported by appellant on its returns. Since no specific breakout existed for engineering drawings costs, such costs would have been allocated among the hard assets placed in service as part of the construction projects.

n8 The record erroneously referred to this as "construction and progress system." H.R. 145.

[\*12]

In order to derive the total taxable values claimed to have been erroneously reported on appellant's 1995 and 1996 personal property tax returns, Blough identified total project costs, including real estate and machinery and equipment. He then determined the percentage of such costs attributable solely to machinery and equipment, i.e., Project 598 -- 82.87%, Project 6506 -- 95%, Project 6241 -- 89.3%, and Project 418/410 -- 90.36%. Applying these percentages to Ford's analyses for the four projects,

he calculated engineering drawings costs attributable to machinery and equipment, i.e., Project 598 -- \$ 760,709, Project 6506 -- \$ 227,546, Project 6241 -- \$ 76,514, and Project 418/410 -- \$ 1,524,756. These costs were then depreciated by 81.8% for tax year 1996 and 88.1% for tax year 1995 in order to identify the claimed true value of engineering drawings. Multiplying these figures by the statutory assessment rate of 25%, Blough concluded that for each project the following taxable values would have been reported: Project 598 -- tax year 1996-\$ 155,565 and tax year 1995\$167,546, Project 6506 -- tax year 1996-\$ 53,644; Project 6241 -- tax year 1996-\$ 16,852 and tax year 1995\$18,038; and [\*13] Project 418/410 -- tax year 1996\$4288,179 and tax year 1995\$311,813. Ultimately, the total taxable values attributable to engineering drawings for all four projects claimed to have been erroneously reported on appellant's returns was \$ 514,240 for tax year 1996 and \$ 497,397 for tax year 1995.

In considering an appeal from a final determination of the Tax Commissioner, we acknowledge the presumption that the Tax Commissioner's findings are valid. In *Alcan Aluminum Corp. v. Limbach (1989)*, 42 Ohio St.3d 121, the Supreme Court held:

"Absent a demonstration that the commissioner's findings are clearly unreasonable or unlawful, they are presumptively valid. Furthermore, it is error for the BTA to reverse the commissioner's determination when no competent and probative evidence is presented to show that the commissioner's determination is factually incorrect. \* \* \* " *Id.* at 124. (Citation omitted.)

A taxpayer challenging a finding of the commissioner must therefore rebut the preceding presumption and establish a clear right to the relief requested. *Midwest Transfer Co. v. Porterfield (1968)*, 13 Ohio St.2d 138; [\*14] *Ohio Fast Freight, Inc. v. Porterfield (1968)*, 29 Ohio St.2d 69. Accordingly, on appeal, the taxpayer is assigned the burden of

showing in what manner and to what extent the Tax Commissioner's determination is in error. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213.

The issue in this appeal is not whether during the course of its construction projects appellant may have incurred costs attributable to the creation of engineering drawings to which personal property tax is inapplicable. Instead, the critical issue is whether appellant has met its burden of demonstrating, by sufficient competent, probative and reliable evidence the costs attributable to such drawings and the extent to which such costs were included as personal property for which tax was indeed paid. For the reasons which follow, we conclude that appellant has fallen far short of its burden in this appeal.

In reaching this conclusion, we find the Supreme Court's reasoning in *United Tel. Co. of Ohio v. Tracy* (1999), 84 Ohio St.3d 506, to be dispositive regarding the sufficiency of appellant's evidence. In *United* [\*15] *Tel. Co.*, the taxpayer, a provider of local and toll access telephone service, deducted from its personal property tax returns the value it attributed to property claimed not to be used in business. n9 However, because United Telephone had failed to retain accurate records specifically delineating the amount of such property for the years in question, it extrapolated data from a random sampling of information available to it for subsequent years. n10 Although United Telephone had information from which it could have ascertained the specific status of its property at particular time periods, it argued that the sheer volume of materials and the man hours required for such an undertaking rendered the exercise cost prohibitive. n11

n9 On its personal property tax returns for tax years 1987 through 1989, United Telephone had deducted the value of cable claimed not to be used in its business. This cable consisted of both "dead pairs," i.e., excess cable that, while operable, was not yet connected, and "bad pairs," i.e., cable that was damaged and could no longer be used.

n10 To illustrate, since its computerized grid maps for 1995 reflected the amount of dead pairs then in its system, United Telephone randomly selected such maps and worked backwards, using work orders which detailed system modifications, to reconstruct the grid maps as they presumably would have existed for each of the tax years in question. From these randomly selected grid maps, the taxpayer extrapolated the total amount of dead pairs on each of the tax listing dates. In an effort to support its estimate, the taxpayer presented the testimony of a professor of statistics who confirmed the utility and statistical reliability of the approach employed and who calculated the amount of system-wide dead pairs for the periods in question. With regard to the amount of bad pairs in its system, again while actual data was available, appellant's tax manager relied upon internally created reports and the statistical analysis performed for dead pairs in order to estimate bad pairs.

[\*16]

n11 In *United Tel. Co.*, the court commented as follows:

"In utility cases, the dollar amounts are usually large and, therefore, small changes in the numbers used to calculate the taxes may mean large changes in the dollars paid by the utility and received by the taxing authorities. For instance, in this case a one-percent change in the amount of dead and bad pairs may equate to a change of over two and one-half million dollars in the value of United Telephone's cable account. The goal in tax valuation cases is to achieve as much accuracy as possible. The burden of proving the amount of the dead and bad pairs and their value was imposed upon United Telephone." *Id.* at 511.

Although the instant appeal involves a challenge by a general business taxpayer, the amount at stake is not insignificant and presumably the preceding rationale would apply with equal force regardless of the nature of the taxpayer's business.

While this board accepted as reliable the methodology employed by United Telephone in estimating the amount of its property, the Supreme Court held otherwise, stating in part:

"The commissioner next turns to United Telephone's [\*17] attempts to prove the amount and value of its dead and bad pairs. The commissioner argues that the statistical estimates used by United Telephone

were not probative and that the BTA should not have used them to determine the amount and value of its dead and bad pairs. We agree.

"We are aware of the magnitude of the number of grid maps maintained by United Telephone and the magnitude of the effort required to accurately reconstruct all the grid maps. However, United Telephone assumed this burden when it appealed the commissioner's order. *Hatchadorian [v. Lindley (1986), 21 Ohio St. 3d 66]*, paragraph one of the syllabus. The type of evidence that is acceptable to determine accurately the amount and value of dead and bad pairs cannot be varied from case to case depending upon the number of the documents involved. Statistical estimates determined from random samples cannot be used to meet the burden of proving the amount of dead and bad pairs when there are documents available from which an accurate count of the number of dead and bad pairs can be obtained." *Id.* at 511-512.

Appellant attempts to distinguish its own facts from those in *United Tel. Co.* [\*18] by pointing out that, unlike United Telephone, there exists no actual data detailing engineering drawings costs. Thus, appellant suggests that the court's holding is restricted to only those situations in which a taxpayer favors estimates over actual and available information. We disagree. The decision in *United Tel. Co.* reaffirms the well-established proposition that a taxpayer has the burden of proving its allegations with reliable evidence and that statistical estimates, developed through a myriad of subjective determinations, fail to satisfy such a burden. See, also, *R.K.E. Trucking, Inc. v. Tracy* (May 24, 2002), BTA No. 1998-S-1316, unreported, affirmed sub nom., *R.K.E. Trucking, Inc. v. Zaino*, 98 Ohio St.3d 495, 2003-Ohio-2149.

Initially we note, as did the Tax Commissioner in his final determination, that the essential elements of appellant's cost estimates remain unverifiable and could easily vary by discipline, complexity, individual involved, etc. Exemplifying the subjective nature of appellant's analysis, Ford elected to treat drawings as new or modified based solely on the revision number set forth on the master drawings lists. n12 [\*19] Although appellant repeatedly characterizes Ford's analysis as an overly conservative approach, a taxpayer's burden on appeal is to provide neither a conservative nor liberal estimation, but rather it is required to produce reliable, verifiable information which permits an accurate and consistent accounting.

n12 Ford also admitted that the only manner by which he could actually tell whether a drawing was new or modified would be to look at each and every drawing in sequence, which he did not do.

Ford admitted he was not familiar with the specific engineering work performed in any of the projects. Thus, he relied solely upon his general experience when he made sweeping assumptions regarding the average number of hours and hourly costs required to produce the various types of drawings. Regardless of the complexity of an individual drawing, the nature of the changes which may have been required or the level of engineering firm employee who may have been involved in its creation, Ford attributed a single creation period to each drawing within a particular category despite, for example, his admission that a modified drawing may take anywhere from 1 to 80 hours to create. While Ford [\*20] indicated his figures were premised upon an "historical average," no documentation was offered to support such representations. Likewise, projected hourly costs were nothing more than averages, not based upon actual data, but instead premised upon Ford's general experience. The annual depreciation figure of 3% applied to current costs and trended back to the period in issue was based simply upon Ford's "educated guess" as to increasing engineering costs over the past decade. S.T. at 127.

With respect to Project 418/410, Ford's analysis is even more speculative. Appellant had neither the master drawing list or any of the drawings used in the project. Thus, Ford's drawings costs estimates were derived from nothing more than application of the ratio of total project capital costs to costs attributed to the Columbus brewery. While Ford may have summarily accepted that such a direct correlation exists, this board cannot.

Appellant attempts to draw comparisons between the evidence it presented and that offered by the taxpayers, and accepted by this board, in *National Distillers & Chemical Corp. v. Limbach* (Mar. 5, 1993), BTA No. 1990-X-552, unreported, affirmed (1994), 71 Ohio St.3d 214, [\*21] and *Duquesne Light Co. v. Tracy* (Nov. 6, 1998), BTA Nos. 1995-K-40, et seq., unreported. However, neither of these cases persuades us that appellant has met its burden of proof in the instant appeal.

It is not insignificant that each of the cases relied upon by appellant was decided prior to the Supreme Court's pronouncement in *United Tel Co.* In fact, in this board's decision in *United Tel. Co.*, *National Distillers* was cited as favorable authority for our acceptance of the sampling technique employed by United Telephone, a proposition subsequently rejected by the court. n13 With respect to *Duquesne Light Co.*, as recognized by the parties, the decision itself has no

precedential value as it was vacated and ultimately remanded to the Tax Commissioner following appeals to the Supreme Court. See *Duquesne Light Co. v. Tracy* (2000), 88 Ohio St.3d 1459; *Duquesne Light Co. v. Tracy* (June 2, 2000), BTA Nos. 1995-K-40, et seq., unreported (order certifying matter to the commissioner for further proceedings). Nevertheless, appellant insists that the rationale set forth within the board's decision warrants favorable consideration of its evidence [\*22] in this appeal. However, had *United Tel. Co.* been released prior to this board's decision in *Duquesne Light Co.*, it likely would have had some impact upon our consideration of the taxpayer's evidence in that case. As previously noted, the court in *United Tel. Co.* placed considerable emphasis upon the evidentiary burden imposed upon taxpayers to demonstrate the actual amount and value of property claimed to be exempt or deductible, indicating that broad-based application of estimates and sampling techniques necessarily ignores the fact that different items have different costs. n14 Such is the fallacy in appellant's presentation and argument in this case.

n13 In our decision in *United Tel. Co. of Ohio v. Tracy* (Nov. 14, 1997), BTA Nos. 1991-Z-197, et seq., unreported, we stated:

"We find the manner in which appellant calculated the costs attributable to its dead and bad cable to be a reasonable means by which to estimate its value for the years in question. The application, on a pro rata basis, of the percentage of appellant's dead and bad cable to its total cable costs is little different than the situation in which we accepted a taxpayer's claim that seventy-eight percent of the costs charged by outside plant engineers was attributable to engineering drawings. See *National Distillers & Chemical Corp. v. Limbach* (Mar. 5, 1993), B.T.A. No. 90-X-552, unreported, affirmed (1994), 71 Ohio St.3d 214. See, also, *Monsanto Co. v. Limbach* (Feb. 4, 1988), B.T.A. No. 85-F-151, unreported (finding that taxpayer had established by probative evidence the costs attributable to its scale drawings as being a percentage of the total value attributable to its machinery). As appellant has provided this Board with evidence which we consider reliable and probative as to the value of its taxable property, we accept such values for purposes of determining the amount appropriately deducted." Id. at 44-45.

[\*23]

n14 Even if we were persuaded that the rationale expressed by this board in *Duquesne Light Co.* had continued efficacy, the extent and quality of the evidence presented in that case and this one differs significantly.

Accordingly, we find the evidence upon which appellant relies to support its claimed engineering drawing costs to be significantly deficient, rendering it unreliable. Based upon the foregoing, appellant's specification of error is not well taken and is overruled. It is therefore the order of this board that the final determination of the Tax Commissioner must be, and hereby is, affirmed.

BOARD OF TAX APPEALS

RESULT OF VOTE	YES	NO	DATE
Ms. Jackson			[ILLEGIBLE WORD]
Ms. Margulies			[ILLEGIBLE WORD]
Mr. Eberhart			[ILLEGIBLE WORD]

#### Legal Topics:

For related research and practice materials, see the following legal topics:

Tax LawState & Local TaxesAdministration & ProceedingsJudicial ReviewTax LawState & Local TaxesPersonal Property TaxGeneral OverviewTax LawState & Local TaxesPublic Utilities TaxImposition of Tax

MCI Metro Access Transmission Services, LLC, and MCI WorldCom Network Services, Inc., Appellants, vs. William W. Wilkins, Tax Commissioner of Ohio, Appellee.

CASE NOS. 2004-K-749; 2004-K-750 (PUBLIC UTILITY PERSONAL PROPERTY TAX)

STATE OF OHIO -- BOARD OF TAX APPEALS

*2007 Ohio Tax LEXIS 524*

April 13, 2007

[\*1]

APPEARANCES

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OPINION:

DECISION AND ORDER

Ms. Margulies, Mr. Eberhart, and Mr. Dunlap concur.

Appellants, MCI Metro Access Transmission Services, LLC ("MCI Metro"), and MCI WorldCom Network Services, Inc. ("MWNS"), challenge final determinations issued by the Tax Commissioner denying their petitions for reassessment and affirming public utility property tax assessments issued to each entity for tax year 2003. These appeals n1 are now considered [\*2] by this board upon appellants' notices of appeal, the statutory transcripts certified by the commissioner, the record presented at hearing, and the briefs submitted on behalf of the parties. n2 In addition to the documentary exhibits admitted into evidence, appellants called as witnesses Rafael Garces, director of property tax, and Barton J. Uze, property tax representative. n3

n1 These appeals were previously consolidated by this board for purposes of a single hearing. See *MCI Metro Access Transmission Serv., LLC v. Wilkins* (Interim Order, Jan. 20, 2005), BTA No. 2004-K-749, et seq., unreported. Following hearing, the parties filed briefs addressing both appeals collectively. Upon consideration of the pertinent facts and legal issues presented, we now consider it appropriate to issue a single decision with respect to these appeals.

n2 Subsequent to this board's hearing, the Cincinnati Public School District, Cleveland Municipal School District, Mayfield City School District, Nordon Hills City School District, and the Ohio School Boards Association requested and were granted leave to file written argument in support of the Tax Commissioner's position.

n3 At hearing, Garces testified that he was "employed by MCI; specifically, MCI/WorldCom Network Services" [herein referred to as MWNS], H.R. at 21, while Uze testified he was employed by MCI. H.R. at 60. Presumably, MCI is intended to be a reference to the parent company, herein referred to as WorldCom.

[\*3]

MCI Metro and MWNS are wholly owned subsidiaries of MCI, Inc., formerly WorldCom, Inc. ("WorldCom/MCI"). In mid-2002, WorldCom/MCI, along with most of its domestic subsidiaries, filed petitions seeking bankruptcy protection. WorldCom/MCI's financial situation at the time of its bankruptcy filing was in very poor shape due in large part to allegations of fraud involving its financial reporting and the overall decline of the telecommunications industry. On May 2, 2003, prior to the ultimate emergence of WorldCom/MCI and its subsidiaries from Chapter 11 reorganization in April 2004, both MCI Metro, as a telephone company, and MWNS, as an interexchange telecommunications company, n4 filed 2003 annual reports with the Ohio Department of Taxation ("department"), in which they listed by vintage year and original acquisition cost their Ohio taxable and exempt personal property.

n4 R.C. 5727.01(D)(2) defines a "telephone company" as any person "primarily engaged in the business of providing local exchange telephone service, excluding cellular radio service, in this state." R.C. 5727.01(H) defines an "interexchange telecommunications company" as "a person that is engaged in the business of transmitting telephonic messages to, from, through, or in this state, but that is not a telephone company."

[\*4]

In accordance with the true value computation methodology prescribed by the Tax Commissioner, the total true value of MCI Metro's "general support assets," "central office assets," "information origination/termination assets," "stand alone computers," and "cable and wire facilities assets," as reflected on its Schedule C assets was \$ 63,570,814. BTA No. 2004-K-749, S.T. at 294-299. MWNS reported the total true value of similar assets at \$ 410,625,278. See BTA No. 2004-K-750, S.T. at 305-308, 312. On Schedule G of their annual reports, MCI Metro and MWNS each claimed the net book value of their assets should be approximately two-thirds less, or \$ 21,573,961 and \$ 137,003,405, respectively. BTA No. 2004-K-749, S.T. at 303; BTA No. 2004-K-750, S.T. at 312. In doing so, appellants offered the following explanation:

"As you may know, WorldCom, Inc. and substantially all of its domestic subsidiaries filed for protection under Chapter 11 of the Bankruptcy Code on July 21, 2002. On March 14, 2003, following an impairment analysis and other adjustments in accordance with generally accepted accounting principles (GAAP), WorldCom announced that it had completed a preliminary review of its [\*5] asset accounts. The result of this analysis was a write-off of all existing goodwill and a \$ 34.8 billion impairment adjustment to the carrying value of PP&E and other intangible assets as required by SFAS No. 144. The PP&E and other intangible assets will be adjusted from \$ 45 billion to approximately \$ 10 billion as of December 31, 2002. Since the audit of WorldCom will not be completed until later this year, the enclosed return was prepared using the unadjusted numbers for 2002 as the net cost of taxable property. This net cost was reduced by the amount of the announced asset adjustment to arrive at net book value. Since this net book value more accurately reflects the true value of these assets than the true value calculated using the class lives in Schedule C, the net book value has been used in this return to calculate the total taxable value." BTA No. 2004-K-749, S.T. at 304; BTA No. 2004-K-750, S.T. at 313.

Reflected by preliminary assessments issued to each company, the department's auditing personnel accepted the true values reflected in schedule C of their annual reports and disallowed the additional reductions claimed. As a result, the assessed value of MCI Metro's property [\*6] was established at \$ 15,892,700, BTA No. 2004-K-749, S.T. at 259-262, while MWNS' property had an assessed value of \$ 102,656,320. BTA No. 2004-K-750, S.T. at 102-192. Appellants timely filed petitions for reassessment, raising several objections to the denial of their proposed reductions. BTA No. 2004-K-749, S.T. at 239-252; BTA No. 2004-K-750, S.T. at 96-191.

In a subsequent letter, Barton Uze elaborated as to appellants' rationale for the requested adjustments:

"WorldCom and substantially all of its domestic United States operating subsidiaries filed for Chapter 11 Bankruptcy on July 21, 2002 \*\*\*. All of the entities involved in this appeal were domestic United States operating subsidiaries of the parent WorldCom during the 2002 tax year. The parent, WorldCom, is a holding company that conducts all of its business by and through its operating subsidiaries.

"It is unfortunate that, due to the WorldCom bankruptcy, we had no balance sheet or financials for the tax year ended December 31, 2002, to submit with our property tax returns to help you arrive at a true value for WorldCom. In addition, our 2003 property tax returns were filed using the property, plant and equipment values [\*7] as of December 31, 2001, which, at the time, was the last year we had audited financials.

"On March 13, 2003, prior to the filing of its Ohio property tax returns, WorldCom issued a press release that was provided to you when WorldCom filed these 2003 returns. n5 This press release indicated WorldCom's intent to write down the parent company's property, plant and equipment to a value of approximately \$ 10B as of December 31, 2002. This information was given to the SEC, the bankruptcy court, and other investigative agencies. We based the reduced values in our 2003 Ohio property tax returns on this press release; since we had no other financial guidance at the time we filed these returns.

"Subsequently, KPMG conducted a detailed audit of WorldCom's financials. This audit culminated in the filing of WorldCom's 10K for the fiscal year ending December 31, 2002. This 10K was filed with the SEC on Friday, March 12, 2004. The 10K contains the restated financials for 2000 and 2001 as well as first-time audited financials for 2002.

"The 2003 returns that are the subject of this appeal are based on the value of the filing entities as of December 31, 2002. These returns were initially filed [\*8] using the original, gross, pre-10K book values as of December 31, 2002. The 2001 value of property, plant and equipment for WorldCom that we used in our returns was approximately \$ 45B. This appeal is based on our claim that the actual value of the property, plant and equipment for WorldCom on December 31, 2002, as stated in the recently filed 2002 10K, is 14.9B, which is somewhat lower than we had estimated when we calculated the reduced values relating to this appeal.

"Unfortunately, this 10K does not give the value of the property, plant and equipment at the entity or asset level of detail. Also, our finance department does not have any way of determining the exact value of property, plant and equipment as of December 31, 2002, at the entity or individual asset level, and we have been informed that the company has no plans to push down the 2002 10K values to the entity or asset level. Thus, the only way we can determine a realistic, equitable, and accurate value of property, plant and equipment as of December 31, 2002, for purposes of the returns at issue, is on a parent company level based on the 2002 10K. If we take the pre-bankruptcy 2001 value of the parent company that we [\*9] used in our original 2003 returns and compare it with the actual audited December 31, 2002 value as stated in the 10K, we arrive at a value as of December 31, 2002, that is approximately one third of the of the [sic] original 2001 values we used in our original returns. Therefore, since it is impossible to determine the exact book value of the property, plant and equipment at the individual filing entity level, we submit that the reasonable method, (and only method possible), to determine this value is to multiply the original value (\$ 45B) used when the returns were filed by 33% to arrive at the actual audited 12/31/02 value (\$ 14.19B) in the 10K. It is not reasonable, accurate or equitable to base WorldCom's 2003 Ohio property tax on numbers that are not consistent with, and three times higher than, its filed 2002 10K balance sheet numbers.

"We note that the original 2001 numbers we used when we filed our 2003 returns are also no longer accurate, since they too were restated in the 10K. The WorldCom property, plant and equipment value as of December 31, 2001, went down to a restated value of \$ 21.486B after impairment write downs for both 2000 and 2001." BTA No. 2004-K-749, S.T. [\*10] at 5; BTA No. 2004-K-750, S.T. at 5. n6

n5 The March 13, 2003 press release to which reference is made appears in the statutory transcripts, see BTA No. 2004-K-749, S.T. at 242, and BTA No. 2004-K-750, S.T. at 232, and was received into evidence at this board's hearing, i.e., Ex. 5.

n6 At this board's hearing, Uze identified the letter as being one he sent to the department, but he could not recall the date on which it would have been sent. While handwritten notations appear on the letters in both statutory transcripts, it is only on the one appearing in BTA No. 2004-K-749 that portions have been underlined. As such markings do not appear to have been part of the original correspondence, they have not been included above.

In his final determinations, the commissioner denied appellants' petitions for reassessment, stating in part as follows:

"The petitioner's request to value its personal property at one-third of its historical cost because its parent booked a large writedown is at best merely a crude approximation of the value of the petitioner's telecom assets. The petitioner is asking the Department to assume that the petitioner's assets have diminished in value [\*11] in exactly the same percentage as the parent corporation's assets have been written down, even though the petitioner itself has not written down its assets on its books. Further, the petitioner has submitted no information showing its assets have been impaired to the same extent as the parent corporation's assets. Such an approximation of values based on a related corporation's writedown is not probative evidence for a deduction from taxable personal property. See *United Tel. Co. of Ohio v. Tracy* (1999), 84 Ohio St.3d 506. In challenging the assessed value, the petitioner has the burden of establishing the value of its taxable property. The information submitted does not meet this burden." BTA No. 2004-K-749, S.T. at 3; BTA No. 2004-K-750, S.T. at 3.

The present appeals ensued, with appellants specifying the following as error: n7

"The Commissioner's final determination[s are] erroneous in [their] entirety for the following reasons:

"The assessment[s], and the final determination[s] affirming [them], erroneously determined that the assets of [MCI] Metro [and MWNS] were not written down pursuant to SFAS No. 144.

"The Commissioner failed to properly [\*12] apply an alternative valuation methodology in conformance with *Texas Eastern Transmission Corp. v. Tracy* (1997), 78 Ohio St.3d 83.

"The Commissioner did not follow the Department's own guidelines as published in its 'Valuation of Public Utility Property' handbook when he blindly followed the prescribed depreciation rates to [MCI] Metro's and [MWNS] property.

"The rate of depreciation as provided by R.C. 5727.11 and as used by the Commissioner should not be used in this case since this is a special and unusual circumstance, and since an unreasonable or unjust result would occur. The depreciation calculated by the Commissioner does not result in an accurate true value of the taxpayer[s'] personal property. The taxpayer[s] [have] presented competent evidence relating to the true value of the property.

"The alternative valuation[s] proposed by [MCI] Metro [and MWNS are] a more accurate gauge of the true value of [their] property than the assessed value based on the historical costs on [their] books."

n7 We note that in the "background" portion of their notices of appeal, appellants make reference to constitutional challenges that were previously raised before the commissioner regarding the issuance of the underlying assessments. See Notices of Appeal, at P9. However, such assertions were not included in appellants' specifications of error nor argued at hearing or by way of brief. Accordingly, such issues will not be further addressed by this board. Cf. *Cleveland Gear Co. v. Limbach* (1988), 35 Ohio St.3d 229, paragraph three of the syllabus; *Castle Aviation, Inc. v. Zaino*, 109 Ohio St.3d 290, 2006-Ohio-2420.

[\*13]

Before we reach the merits of appellants' appeals, we must first dispense with a motion filed on behalf of the Tax Commissioner in which he "moves the BTA to dismiss the captioned appeals for the reason that the appellants seek reductions in the valuation of their public utility personal property, that, if granted, would 'recognize a fraud upon the public.'" Citing principles of equitable estoppel, the commissioner argues that appellants are "jurisdictionally barred" from achieving the relief requested through their appeals. However, the Tax Commissioner has not identified any failure by appellants to comply with the requirements imposed by R.C. 5717.02 necessary to invoke this board's jurisdiction. n8 In the absence of such demonstration, this board is not predisposed to find jurisdictional deficiencies where none patently exist. Cf. *Nucorp, Inc. v. Montgomery Cty. Bd. of Revision* (1980), 64 Ohio St. 2d 20, 22 ("While this court has never encouraged or condoned disregard of procedural schemes logically attendant to the pursuit of a substantive legal right, it has also been unwilling to find or enforce jurisdictional barriers not clearly statutorily [\*14] or constitutionally mandated, which tend to deprive a supplicant of a fair review of his complaint on the merits."). Accordingly, the commissioner's motion is hereby overruled.

n8 In his brief, the commissioner suggests the possibility of an alternative defect:

"As a condition for seeking administrative review pursuant to a petition for reassessment, a public utility property taxpayer/petitioner shall pay the tax assessed by the Commissioner to which the taxpayer/petitioner objects. See R.C. 5727.47. We assume, for purposes of this brief, that the appellants have complied with this jurisdictional requirement and thus are seeking refunds. If not, then their appeals to the BTA from the Commissioner's final determinations on the petitions should be properly dismissed for failure to have made such payments." Appellee's brief at 1, fn. 2.

Although raising the preceding as a possible bar to our consideration of appellants' appeals, the commissioner, who presumably is in the best position to ascertain whether appellants have complied with the requirements attendant to the filing of petitions for reassessment before him, has provided this board with no factual basis which would call into question the validity of appellants' underlying petitions. We must therefore question the timing, manner, and appropriateness of the commissioner's assertion in this instance. See, also, *Choice One Communications of Ohio, Inc. v. Wilkins* (June 9, 2006), BTA No. 2003-K-1461, et al., unreported, at 3-4, fn. 4.

[\*15]

In addition, we note that the commissioner attached to his brief several materials neither included within the statutory transcripts nor submitted during the course of this board's hearing, among them a September 8, 2005 news article obtained apparently via the Internet. Clearly, the intended purpose of such a document is evidentiary in nature and, consistent with the Ohio Supreme Court's admonition, it must be stricken from this board's consideration. See *Columbus Bd. of Edn. v. Franklin Cty. Bd. of Revision* (1996), 76 Ohio St.3d 13, 16 ("After the BTA hearing, Nestle submitted a copy of a resolution and quitclaim deed by the Franklin County Commissioners. Because these documents were not part of the original record from the BOR and were submitted after the BTA hearing, they must be disregarded by the BTA."). n9

n9 The entities granted leave to file briefs as amici curiae in this matter have likewise referred to a number of sources outside the evidentiary record developed before this board. As with the commissioner's references, such factual allegations unsupported by the existing record will likewise be disregarded. Cf. *Lakewood v. State Emp. Relations Bd.* (1990), 66 Ohio App.3d 387, 394 ("Amici curiae are not parties to an action and may not, therefore, interject issues and claims not raised by parties.").

[\*16]

In order to understand the issues presented in these appeals, it is beneficial to provide a brief background regarding the manner by which public utilities report the value of their personal property for tax purposes. Public utilities are required to annually file reports with the Tax Commissioner which will enable him to "make any assessment or apportionment required under this chapter." R.C. 5727.08. The commissioner is required to determine the "true value in money" of all such property required to be assessed. R.C. 5727.10. R.C. 5727.11 prescribes the method to be employed by the commissioner in valuing public utility property, providing in part:

"(A) Except as otherwise provided in this section, the true value of all taxable property required by division (A)(2) or (3) of section 5727.06 of the Revised Code to be assessed by the tax commissioner shall be determined by a method of valuation using cost as capitalized on the public utility's books and records less composite annual allowances as prescribed by the commissioner. If the commissioner finds that application of this method will not result in the determination of true value of the public utility's taxable property, the [\*17] commissioner may use another method of valuation."

The preceding method of determining the "true value" of personal property, whereby the capitalized costs of a public utility's property are reduced by prescribed composite annual allowances, is generally comparable to that employed by the commissioner when valuing property of general business taxpayers, i.e., the "302 computation." See R.C. 5711.18. In the context of the 302 computation, the Supreme Court has consistently recognized the reasonableness of employing a predetermined statutory formula. For example, in *Wheeling Steel Corp. v. Evatt* (1944), 143 Ohio St. 71, the Supreme Court commented:

"So far as the record in this case discloses, we see no reason for criticism of the application of the so-called '302 Computation' especially as the evidence shows and as appellant admits, it is applied generally to all taxpayers in similar situations. Of course, situations may arise where such computation would not be proper. \*\*\* Percentage depreciation is used almost universally in industry and in accounting." *Id. at 81.*

In *W.L. Harper Co. v. Peck* (1954), 161 Ohio St. 300, [\*18] the court reiterated this view:

"The law of Ohio requires that personal property used in business be taxed at its true value. Since it is impractical for the Department of Taxation to personally value all such personal property in this state, it is reasonable and lawful to use the straight-line method of depreciation in arriving at true value. This method consists of depreciating the cost of the personal property in accordance with its useful life. That is what the directive of the Department of Taxation purports to accomplish \*\*\*." *Id. at 303.*

See, also, *PPG Industries v. Kosydar* (1981), 65 Ohio St.2d 80, 83 ("This directive has been approved by this court as a practical, reasonable and lawful method and device to achieve uniform valuation of plant equipment in Ohio by prescribing annual depreciation rates in lieu of book depreciation for Ohio personal property tax purposes.").

While a statutorily prescribed formula provides a prima facie means for determining the value of personal property used in a taxpayer's business, the court has made it clear that such a formula should not be applied where it is affirmatively [\*19] demonstrated that true value will not result. As noted in *Snider v. Limbach* (1989), 44 Ohio St.3d 200, 201-202:

"Moreover, it is impractical for the commissioner to personally value all personal property in Ohio; thus, she may resort to a predetermined formula to ascertain value. *W.L. Harper Co. v. Peck* (1954), 161 Ohio St. 300, \*\*\*. However, the formula must be adjusted when special or unusual circumstances or conditions of use exist or when evidence shows that rigid application would be inappropriate. *Monsanto Co. v. Lindley* (1978), 56 Ohio St.2d 59, 62, \*\*\*. The burden to show that the commissioner's formula does not ascertain true value is met only if the appellant '\*\*\* introduces competent evidence of probative value of the personal property's true value in money.' *Alcoa v. Kosydar* (1978), 54 Ohio St.2d 477, 481, \*\*\*."

A similar point has been made with respect to the valuation of public utility property. In *Texas E. Transm. Corp. v. Tracy* (1997), 78 Ohio St.3d 83, the court held:

"Although R.C. 5727.11 [\*20] identifies the cost-based method of valuation as a means of assessing true value, the General Assembly has not restricted the commissioner's use of alternate valuation methods. In fact, in these statutes, the General Assembly specifically states that the commissioner may use 'another

method of valuation' and that he may consider 'other evidence' to determine true value. Contrary to the commissioner's assertion, in deciding true value, the BTA need not adhere to the cost-based statutory method of valuation.

\*\*\*

"The ultimate goal imposed by R.C. 5727.10 clearly is to determine the *true value* of the property taxed. *R.H. Macy Co., Inc. v. Schneider* (1964), 176 Ohio St. 94, 97 \*\*\*. If the statutory method does not yield true value, then another method of valuation may be used, whether or not there are special or unusual circumstances. Although a statute may provide a prima facie estimate or presumption of value, where rigid application of the statute would be inappropriate, the presumption of value must yield to other competent evidence reflecting true value. *Monsanto Co. v. Lindley* (1978), 56 Ohio St.2d 59, 61, 10 O.O.3d 113, 114 [\*21] \*\*\*; *W.L. Harper Co. v. Peck* (1954), 161 Ohio St. 300 \*\*\*." Id. at 85-86. (Emphasis sic and parallel citations omitted.)

In the present appeals, appellants argue that the subject assessments do not fairly represent the true value of their taxable property because such amounts are based exclusively upon historical booked costs which precede the filing of, and emergence from, bankruptcy by WorldCom/MCI and its subsidiaries. Referring to final impairment figures reflected on WorldCom/MCI's audited 2002 Form 10-K filed with the Securities and Exchange Commission and an analysis used in estimating the extent to which their assets were impaired for financial reporting purposes, appellants insist that the values previously carried on the books of WorldCom/MCI and its subsidiaries for property, plant, and equipment were significantly overstated. Citing to generally accepted accounting principles ("GAAP"), more specifically Statement of Financial Accounting Standard ("FAS") No. 144, and the "fresh-start accounting" adopted for tax year 2004 after WorldCom/MCI and its subsidiaries emerged from bankruptcy, appellants maintain that the true value of their Ohio [\*22] assets is more appropriately ascertained by applying the same percentage of impairment to their own booked costs as was found to exist at the system-wide level of their parent company.

In responding to appellants' arguments, the Tax Commissioner offers a number of objections, but we find one particularly persuasive and therefore dispositive of appellants' claims. Recently, other participants within the telecommunications industry have asserted that "true value" will not result from application of the valuation methodology prescribed by R.C. 5727.11. In support of their claims, these appellants have offered studies suggesting that their assets are entitled to a much greater depreciation rate than that provided for by application of the commissioner's prescribed composite allowances to the booked value of their assets. See, e.g., *Cincinnati Bell Tel. Co. v. Zaino* (June 10, 2005), BTA Nos. 2003-K-765, et al, unreported; *Choice One Communications of Ohio, Inc. v. Wilkins* (June 9, 2006), BTA No. 2003-K-1461, et al., unreported. In considering these assertions, this board has carefully reviewed the information relied upon in order to determine whether the valuation methodology is [\*23] sound and the conclusions reached are supported by reliable, verifiable data.

In these appeals, we are presented with virtually no information to evaluate. Appellants have offered no evidence attesting to the market value of their Ohio assets. Instead, they propose that their property simply be reduced on a pro rata basis consistent with the impairment write-down taken by their parent following its emergence from bankruptcy. We have been provided with no information which would support our drawing the conclusion that appellants' property, for public utility personal property tax purposes, was impaired to the same degree as their parent company.

Even if we were to accept appellants' claim that historical costs overstate the value of their assets, we still consider it necessary to critically review the basis upon which adjustments are sought to be made. In the present appeals, we cannot undertake such a review. Instead, appellants ask that we accept at face value an impairment analysis performed on a system-wide level which, in some undisclosed manner, purportedly took into account issues of accounting fraud and the overall decline experienced by WorldCom/MCI within the telecommunications [\*24] industry. We have little before us regarding either the entity which performed this analysis n10 or, more significantly, the data relied upon and the methodology utilized in generating the impairment estimates. Indeed, such estimates may suffer from the same deficiencies of which this board has previously been critical. We therefore cannot conclude that appellants have demonstrated, by competent and probative evidence, that the 2003 assessed values do not accurately reflect the true value of their Ohio assets.

n10 Although Garces made a few general references to Lazard, by way of brief, appellants represent that Lazard is an independent investment banking firm. Appellant's Brief at 4. In the Form 10-K filed on behalf of World-Com, the company is referred to as Lazard LLC and identified as its financial advisor. Ex. 6 at 83.

Based upon the foregoing, appellants' specifications of error are not well taken and they are therefore overruled. It is the order of this board that the Tax Commissioner's final determinations must be, and hereby are, affirmed.

**Legal Topics:**

For related research and practice materials, see the following legal topics:

Tax LawFederal Income Tax ComputationDeductions for Amortization, Depletion & DepreciationAmortization, Cost Recovery & Depreciation (IRC secs. 167-169, 171, 178, 194-195, 197, 216, 248, 280F)General OverviewTax LawFederal Income Tax ComputationValuationPersonal PropertyTax LawState & Local TaxesAdministration & Proceedings-Judicial Review

Hancor, Inc., Appellant, vs. Joanne Limbach, Tax Commissioner of Ohio, Appellee.

CASE NO. 89-H-443 (PERSONAL PROPERTY)

STATE OF OHIO -- BOARD OF TAX APPEALS

*1991 Ohio Tax LEXIS 61*

January 11, 1991

[\*1]

#### APPEARANCES

For the Appellant - John Haugawout, Vice President, Finance, Hancor, Inc., 401 Olive Street, Findlay, Ohio 45840

For the Appellee - Anthony J. Celebrezze, Jr., Attorney General of Ohio, By: M. Linda Weigand, Assistant Attorney General, State Office Tower-16th Floor, 30 East Broad Street, Columbus, Ohio 43266-0410

#### OPINION:

##### DECISION AND ORDER

This cause and matter came on to be considered upon a notice of appeal filed with the Board of Tax Appeals on June 6, 1989, from a final order of the Tax Commissioner of May 8, 1989, wherein that official modified and affirmed assessments of personal property tax for the years 1982, 1983 and 1984.

Hancor, Inc. manufactures plastic tubing, plastic septic tanks, and various other plastic products. It is incorporated in the State of Ohio, with its corporate offices located in Findlay, Ohio.

Hancor, Inc. timely filed its 1982, 1983 and 1984 personal property tax returns. Statutory Transcript (hereafter S.T.) p.p. 1, 42, 70. Upon review corrections were made thereto by the Tax Commissioner and Amended Preliminary Assessment Certificates were issued for the three tax years. Upon appeal modifications in the amended preliminary assessments [\*2] were made by the Tax Commissioner and the Appellant thereafter appealed the assessments to the Board of Tax Appeals.

This case is decided upon the notice of appeal, the Statutory Transcript furnished by the Tax Commissioner, the record of the evidentiary hearing held June 22, 1990, and the briefs submitted by the parties.

In 1981 Appellant obtained a judgment against Plastic Tubing, Inc., a North Carolina Corporation. Pursuant to the judgment, later that same year a non-interest bearing promissory note was executed by Plastic Tubing, Inc. to Hancor, Inc. in the amount of \$400,000.

Hancor, Inc. booked, in 1981, \$100,000 as a current receivable and \$100,000 as a long term receivable as a result of the judgment and note. As payments were made (the PTI note was timely paid in full) the entire \$400,000 was eventually reflected as a receivable on the company's books. Hancor never booked the face value of the note as a receivable, nor did it have any bad debt reserve for the note. Hancor, Inc. did not include the promissory note in its personal property tax returns.

The Tax Commissioner's position is that the entire \$400,000 was an "other taxable intangible" under O.R.C. section 5701.09 [\*3] and should have been included in Schedule 10, less any payments, and less any reserve maintained on the books, as authorized by O.A.C. section 5703-3-15. As indicated above, Appellant did not maintain on its books a reserve or bad debt allowance against the P.T.I. note, instead recording what it thought it would recover net as a receivable.

O.R.C. section 5709.02 "Taxable property to be entered on classified tax list and duplicate", provided as follows:

"All money, credits, investments, deposits, and other intangible property of persons residing in this state shall be subject to taxation, ---."

A judgment is a "credit" under O.R.C. section 5701.07 (*Cameron v. Cappeller, 41 Ohio St. 533 (1885)*), and an interest-bearing note is an "investment" under section 5701.06. It seems clear that a non-interest bearing note would constitute "other intangible property" under section 5701.09, O.R.C., which provided as follows:

"Section 5701.09 Other taxable intangibles; other intangible property defined.

"As used in Title LVIII[57] of the Revised Code, 'other taxable intangibles' and 'other intangible property' include every valuable right, title, [\*4] or interest not comprised within or expressly excluded from any of the other definitions set forth in sections 5701.01 to 5701.09, of the Revised Code."

Obviously, a promissory note will often have a true value --- which is what is required to be listed for personal property purposes --- different from the face amount. O.A.C. section 5703-3-15 recognizes this fact: amount. O.A.S. section 5703-3-15 recognizes this fact:

""5703-3-15 Allowances of reserves against accounts receivable

"Any taxpayer, whether individual, fiduciary or corporation, whose accounts of assets and liabilities are kept in such a way as to show accounts receivable and notes receivable as assets at face value, with proper reserves for bad debts and the like, may, in setting forth the total amount of accounts receivable, arrive at the amount thereof by deducting from the total amount of accounts receivable as per books, the total amount of such reserve or reserves; provided that in case such reserve or reserves are carried against all the accounts or notes receivable, the deductible portion of such reserves shall be the same proportion thereof as current accounts receivable (payable on demand or within one year [\*5] from date of inception) bears to total accounts receivable.

"In arriving at the amount of current accounts receivable and prepaid items used and arising out of business outside of Ohio, such proportion of the net deductible reserves, etc., as defined in the preceding paragraph, shall be deducted from the face value of foreign accounts receivable and prepaid items as the accounts receivable arising out of business transacted outside of Ohio bears to total accounts receivable."

Section 5703-3-15 merely provides authorization for listing at true value when the taxpayer's books reflect accounts and/or notes receivable at face value and reserves. That section does not require that the true value of the account or note receivable placed on the personal property tax return be arrived at in that manner. It would appear that for purposes of the personal property tax all that is required is that the promissory note be included in the appropriate schedule at its true value.

Appellant Hancor, Inc. did not include the PTI note in the 1982-1984 personal property tax returns, in any amount. The Tax Commissioner was thus correct in issuing a correction including it. She was correct [\*6] in including the full \$400,000 face amount of the note because the evidence in her possession indicated that that was the true value of the note, not because Appellant failed to maintain a "bad debt" reserve against the face value. It was then Appellant's duty in this appeal to prove that the true value of the note was less than the face amount. We find it succeeds to this degree: the true value of the note in the 1983 and 1984 returns should be reduced to reflect the \$100,000 paid in 1982 and the \$75,000 paid in 1983. [the amended 1983 and 1984 assessments reflect payments, but not correctly]. Beyond that, we do not find that Appellant has proven a true value of the note below face value.

Appellant's second contention in this appeal is that the Tax Commissioner wrongly failed to give Appellant credit [as an account or note payable] on Schedule 9 for \$3,039,000 of a revolving credit loan that was paid off on December 8, 1982. (this is a reduction from the notice of appeal, where Appellant sought credit for \$6,000,000 term and revolving credit loans paid off).

Schedule 9 requires the inclusion as "credits" of the excess of net notes and accounts receivable (due within one [\*7] year from date of inception) and prepaid expenses over notes and accounts payable (due within one year from date of inception) and accrued expenses. Appellant is here claiming that the Tax Commissioner's amended preliminary assessment wrongly failed to deduct the \$3,039,000 revolving credit loan paid off as a "note and account payable - due within one year from date of inception."

O.R.C. section 5701.07 defines "credits", the subject of Schedule 9. Quite clearly the paid off revolving credit loans must come under this definition to properly be deductible:

"Section 5701.07 Credits; current accounts; prepaid items defined.

"As used in Title LVII[57] of the Revised Code:

"(A) 'Credits' means the excess of the sum of all current accounts receivable and prepaid items used in business when added together, estimating every such account and item at its true value in money, over and above the sum of current accounts payable of the business, other than taxes and assessments.

"(B) 'Current accounts' includes items receivable or payable on demand or within one year from the date of inception, however evidenced.

"(C) 'Prepaid items' does not include tangible property.

"The sum of current [\*8] accounts payable shall not take into account an acknowledgement of indebtedness, unless founded on some consideration actually received, and believed at the time of making such acknowledgment to be a full consideration therefor, nor an acknowledgement for the purpose of diminishing the amount of credits to be listed for taxation."

Although we have the testimony of one witness that \$3,039,000 in "revolving" credit loans were paid off on December 8, 1982, we have no evidence that date was within one year from the date of inception of the loans. Even that begs the question, however, because the issue under section 5701.07 is not whether the loans were paid within one year but rather whether they were payable within one year from the date of inception. Appellant failed to introduce into evidence the written credit agreements or any other independent evidence proving the terms of these loans. We have only the testimony of Mr. John Haugawout, Vice President, Finance, of Appellant, that these were truly "revolving" credit arrangements, or otherwise payable within one year of inception. This is insufficient when the definite proof was so readily available. The nature and terms [\*9] of a loan should not be proven by mere recollection. We are thus completely unable to find that the Tax Commissioner erred in failing to deduct the \$3,039,000 to determine taxable "credits" under Schedule 9.

Appellant's third contention is that the Tax Commissioner erred in failing to subtract in Schedule 9 as "accounts payable" amounts in an "accrued consulting" account. These amounts, totaling \$6,750 in the 1982 return, \$118,852 in 1983, and \$50,168 in the 1984 return, represent expenses that were allegedly incurred in the appropriate fiscal year (1981, for the 1982 return, for example) but were not paid until the following year. The expenses involved among the three years were pension administration, personnel expenses, executive expenses, moving expenses, and agent fee expense. As explained at the evidentiary hearing the services or products were received within the taxable year, but no invoice was received prior to the close of the accounts payable system on January 15 --- Appellant was on a calendar fiscal year. Since Appellant believed that these expenses were properly accountable in the prior year, and it held its books open until mid-February, it accounted for these [\*10] expenses by putting them into "accrual" accounts, of which "accrued consulting" was one. As an example, if the invoice for fourth quarter 1981 pension administration arrived on February 1, 1982, Appellant included it in the "accrued consulting" expense account for 1981.

The Tax Commissioner in her final order denominated the "accrued consulting" account a "reserve" (as she did the "closing account" balances --- which Appellant does not here contest), apparently recognizing, in the case of this account, that the service or product was consumed in the taxable year, but finding there was no liability until a bill was received.

We find that a service or product received during the fiscal year, but not billed until after, can properly be considered an "account payable" in the fiscal year under O.R.C. section 5701.07. The liability arises upon the provision of the service or product, and can be properly accounted for during the fiscal year received.

The Tax Commissioner's brief argument on this subject states that Appellant has failed to submit proof that the expenses for which credit is here sought were incurred at all, and, moreover, has failed to prove that they were incurred --- [\*11] the goods or services provided --- in the fiscal years at issue. We must agree with the Tax Commissioner on this point. The only evidence we have that the expenses were incurred in the appropriate fiscal years is the testimony of Mr. Haugawout and certain summaries, written after the fact by Mr. Haugawout and co-workers, found in Appellant's Exhibit D. At the hearing Mr. Haugawout explained that the checks and invoices had been discarded due to the substantial passage of time. We understand that, but we find that the evidence presented is not sufficiently reliable when the crucial factor is when expenses were incurred and all evidence consists of summaries --- constructed from what records we do not know --- written after the fact. And it appears Appellant may be in possession of records which would have assisted us in this effort. Appellant's exhibit E consists of expense distribution summaries, summarized from the invoices

among other records, which lists, inter alia, expenses in the "accrued consulting" account by "transaction date" --- from Mr. Haugawout's testimony the period during which the product or service was provided. Appellant did not, however, submit expense [\*12] distribution summaries for all the expenses here sought credit for, and did not, moreover, identify orally or in writing the line or "transaction date" in the expense distribution summaries where would be found the 1981, 1982 and 1983 expenses in the "accrued consulting" account with which we are here concerned. Thus, not only is the evidence received of the existence and timing of the "accrued consulting" expenses not sufficiently reliable, it is also not the best evidence.

As to Appellant's third contention, we thus conclude that the Tax Commissioner was correct in not including the alleged expenses in the "accounts payable" factor in the section 5701.07 formula.

IT IS ORDERED that the final order of the Tax Commissioner as modified is affirmed.

**Legal Topics:**

For related research and practice materials, see the following legal topics:

Tax LawState & Local TaxesAdministration & ProceedingsAssessmentsTax LawState & Local TaxesAdministration & ProceedingsJudicial ReviewTax LawState & Local TaxesPersonal Property TaxIntangible PropertyGeneral Overview

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a true copy of the Brief of Appellant was sent by regular U.S. mail to Nicholas M. Ray, Siegal, Siegal, Johnson & Jennings Co., LPA., 3001 Bethel Road, Suite 208, Columbus, Ohio 43220, counsel for appellee, on this 22<sup>nd</sup> day of April, 2008.

  
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Assistant Attorney General