ORIGINAL

IN THE OHIO SUPREME COURT

On Appeal from the Ohio Board of Tax Appeals

RICH'S DEPARTMENT STORES, INC.,

Appellee,

vs.

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

Appellant.

CASE NO. 09-437

Appeal from Board of Tax Appeals
Case No. 2005-T-1609

APPENDIX TO BRIEF OF APPELLANT, TAX COMMISSIONER OF OHIO

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IN THE SUPREME COURT OF OHIO

Appeal from the Ohio Board of Tax Appeals

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RICH'S DEPARTMENT STORES, INC., :
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Appellee, :
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v. :
:
WILLIAM W. WILKINS, TAX :
COMMISSIONER OF OHIO, :
[RICHARD A. LEVIN] :

Appellant. :

Appeal from BTA
Case No. 2005-T- 1609

NOTICE OF APPEAL

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FILED
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NOTICE OF APPEAL

Richard A. Levin (as successor to William W. Wilkins), Tax Commissioner of Ohio, hereby gives notice of his appeal as of right, pursuant to R.C. 5717.04, to the Supreme Court of Ohio from the Decision and Order of the Ohio Board of Tax Appeals ("BTA") dated February 3, 2009 in BTA Case No. 2005-T-1609, entered on the journal of the proceedings on February 3, 2009. This appeal is filed in accordance with Section 5717.04, Ohio Revised Code, and Section 3(A)(1), S. Ct. Prac. R. II. A true copy of the Decision and Order of the BTA from which appeal is sought is attached hereto and incorporated herein by reference. This notice of appeal is being filed within thirty days of the entry of the attached BTA decision and order as required by statute and rule.

The errors in the Decision and Order of the BTA of which the Commissioner complains are as follows:

(1) The BTA erred, as a matter of fact and law, in reducing the Commissioner's determinations of the monthly average true values of the merchandising inventory of Rich's Department Stores, Inc. ("Rich's") for the 2000, 2001, and 2002 tax years, as set forth in the final assessment certificates issued to Rich's for those tax years (hereafter referred to as "the Commissioner's inventory valuations"). The BTA should have affirmed the Commissioner's inventory valuations in the amounts determined and assessed by the Commissioner pursuant to R.C. 5711.15 and R.C. 5711.03.

(2) The BTA erred, as a matter of fact and law, in failing to apply the proper burden of proof pertaining to the Commissioner's inventory valuations. Under the proper

burden-of-proof standard, Rich's had the affirmative burden of showing the Commissioner's inventory valuations to be "clearly unreasonable or unlawful," and of demonstrating clearly both the manner and extent of any claimed error in the Commissioner's inventory valuations. Under a proper application of these affirmative burden-of-proof requirements, the BTA should have affirmed the Commissioner's inventory valuations in their entirety.

(3) The BTA erred, as a matter of fact and law, in misapplying and misinterpreting R.C. 5711.15, R.C. 5711.03 and Ohio Adm. Code 5703-3-17 ("O.A.C. 5703-3-17") (the Commissioner's administrative rule concerning the "retail inventory method" for valuing merchandising inventory). Under a proper interpretation and application of these statutes and this administrative rule, the BTA should have affirmed the Commissioner's inventory valuations and denied any additional reductions from the Commissioner's inventory valuations claimed by Rich's and granted by the BTA.

(4) The BTA erred, as a matter of fact and law, in misapplying the retail inventory method of valuing merchandising inventory, and by ordering the Commissioner to reduce the Commissioner's inventory valuations to amounts lower than the monthly average true values of such inventories as determined by the Commissioner under his application of O.A.C. 5703-3-17.

(5) The BTA erred, as a matter of fact and law, in determining that the Commissioner's inventory valuations, as reduced by the amounts for "markdown allowances" claimed by Rich's, result in the "book values" of inventories under the "retail inventory method." Rather, as testified to by Dr. Stephens, granting reductions from the Commissioner's assessed inventory valuations sought by Rich's for "markdown

allowances" would result in inventory "true values" that would be: (i) substantially lower than the retail inventory method "book values"; (ii) substantially lower than the lowest acceptable "fair values" of such inventories, as defined under generally accepted accounting principles ("GAAP"); and (iii) substantially lower than the "true values" of the inventory for Ohio personal property tax purposes, as determined under application of the bedrock principle of Ohio property valuation that the "best evidence of true value is a recent arm's-length sale of the subject property."

(6) The BTA erred, as a matter of fact and law, in ordering the Commissioner to reduce the monthly average true value of Rich's inventories by any of the claimed amounts of "markdown allowances" because, as Dr. Stephens testified, allowing such reductions for Rich's claimed markdown allowances to the Commissioner's valuations would result in monthly average true values of Rich's inventories that are substantially lower than: (i) retail inventory method "book value," (ii) GAAP "fair value," and (iii) Ohio personal property tax "true value."

(7) The BTA erred, as a matter of fact and law, by misunderstanding and misapplying the "prima facie" valuation methodology set forth in O.A.C. 5703-3-17. Contrary to the BTA's express misunderstanding (*Decision and Order* at 10-11), application of the methodology set forth in O.A.C. 5703-3-17 does not result in a determination of the "book value" of inventory under the "retail inventory method." Rather, as Dr. Stephens testified, the methodology set forth in O.A.C. 5703-3-17 allows for reductions in the merchant's original acquisition costs of the inventories that are in addition to, and not within the scope of, the reductions allowed by GAAP for

determining inventory "book value" under the retail inventory method. Specifically, in determining inventory "book value" under the retail inventory method, GAAP does not permit any reduction in the valuation of inventories for "aggregate markdowns, at cost (taking into consideration markdown cancellations and additional mark-ups at cost) which are reflected on the books of the taxpayer for the succeeding three months following the close of the accounting period for the current tax year," as provided in the first paragraph of O.A.C. 5703-3-17. (The reduction set forth in this quoted language of O.A.C. 5703-3-17 hereafter will be referred to as the "next-quarter-markdown reduction.") Thus, in this fundamental way, the BTA's statements concerning the relationship between the retail inventory method (as determined under GAAP) and the valuation methodology set forth in O.A.C. 5703-3-17 are erroneous.

(8) In calculating the monthly average true values of Rich's inventories under O.A.C. 5703-3-17, the Commissioner substantially reduced Rich's inventory "book values" by the amounts claimed by Rich's as next-quarter-markdown reductions. Consequently, contrary to the BTA's erroneous analysis and findings in its Decision and Order, the Commissioner's inventory valuations, as set forth in the final assessment certificates issued to Rich's, were in amounts substantially lower than Rich's monthly average retail inventory method "book values." By applying O.A.C. 5703-3-17 to determine true values lower than the book values of Rich's inventories, the Commissioner essentially used that Rule to grant a claim for deduction from book value, in order to reflect the price reductions offered to a retailer's customers in the clearance sales that are customarily held during the three

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true copy of the Notice of Appeal was sent by certified U.S. mail to: Mark A. Engel, Bricker & Eckler, LLP, 9075 Centre Point Drive, Suite 440, West Chester, Ohio 45069-4891, counsel for Appellee, on this 5th day of Mar, 2009.

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OHIO BOARD OF TAX APPEALS

Rich's Department Stores, Inc. Appellant, vs. William W. Wilkins, Tax Commissioner of Ohio, Appellee.	))))))))))	CASE NO. 2005-T-1609 (PERSONAL PROPERTY TAX) DECISION AND ORDER

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Entered FEB 3 2009

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

Rich's Department Stores, Inc. ("Rich's") appeals from thirty-four final assessment certificates issued by the Tax Commissioner from Rich's request for a final assessment and partial refund of personal property assessments for tax years 2000, 2001, and 2002. Rich's argues that the commissioner erroneously determined the true value of Rich's retail inventory because the commissioner failed to consider vendor markdown allowances when determining cost. For the following reasons, we reverse the commissioner's assessment with regard to this issue.[1]

During the period now before us, Rich's was a national chain of retail department stores, which operated in Ohio under the name of "Lazarus."[2] To account for its retail inventory values, Rich's uses what is known as the "Retail Inventory Method" of accounting ("RIM"). RIM is based upon the concept that the cost value of inventory on hand bears the same relationship to retail value as the original cost bore to the original retail value. In other words, the purchase mark-up figured when the inventory is put into stock may be applied to the inventory valued at retail to reduce it to cost. See Emmit, Department Stores (Stanford University Press), at 178. RIM "basically consists of taking the retail sales price of the merchandise in stock and deducting therefrom the percentage markup by departments." *R.H. Macy Co., Inc. v. Schneider* (1964), 176 Ohio St. 94, at 97.

At hearing, Rich's presented the testimony of Laurie Velardi, operating vice-president of divisional accounting, who discussed Rich's use of the Retail Inventory Method. According to Ms. Velardi, RIM was developed in the 1920s to assist retailers that stocked large amounts of different items. H.R. Vol. I at 96. Under this method, retailers assign inventory values based on average cost. H.R. Vol. I at 97. At the end of each accounting period, all additions and reductions at retail are considered to arrive at the ending inventory at retail. H.R. Vol. I at 96-98. Applying

[1] Rich's had listed other specifications of error in its notice of appeal. However, at hearing, Rich's indicated that it is no longer pursuing those other specifications. H.R. Vol. I at 11.

[2] During this period, Rich's was a subsidiary of Federated Department Stores, Inc. Federated changed its name to "Macy's" in August of 2007, and all of its stores now operate under the Macy's name.

RIM, inventory at retail is then reduced by the percentage mark-up to establish the average inventory cost for all items sold in that department. H.R. Vol. I at 96.

Rich's terms its percentage mark-up as "margin performance." H.R. Vol. I at 18, 98. Christy Golden, Rich's director of merchant learning and development, testified that a margin performance is essentially the profit margin that Rich's makes on its merchandise. H.R. at 18. Whenever Rich's purchases merchandise from a vendor, the two agree to a margin performance that is expected for the merchandise over a given period of time. H.R. Vol. I at 19 & 36-39. While the retail price for an item of merchandise is set by market value, H.R. Vol. I at 37, the margin performance is based upon an average amount of expected profit. Thus, when Rich's and a vendor discuss margin performance, there is an understanding that the retail price of the merchandise may undergo some adjustment.[3] H.R. at 38.

Rich's applies two basic types of markdowns to adjust retail price. The first type, known as a point-of-sale ("POS") markdown, is temporary. Rich's generally uses a POS markdown in connection with a promotional event, such as a "one-day sale." H.R. at 38. At the conclusion of the POS event, the price of the merchandise would revert to the higher, pre-sale price. H.R. at 38. The second type of markdown is known as a permanent markdown, or "hardmark." H.R. at 39. When Rich's determines that an item can no longer be sold at its then current price, i.e., its rate of sale slows, Rich's takes a series of permanent markdowns. H.R. at 39. Hardmarks are

[3] Ms. Golden stressed, however, that only margin performance is discussed with vendors, never price. Ms. Golden testified that buyers are prohibited from discussing retail prices with a vendor. H.R. Vol. I at 41.

essentially a recognition that the merchandise is underperforming. H.R. Vol. I at 23, 39, and 45.

While some hardmarks are anticipated, the sale rate of the merchandise may be slower than expected. As a result, Rich's may attempt to move the merchandise by applying additional hardmarks. H.R. Vol. I at 26. These additional hardmarks, however, reduce the margin percentage. H.R. Vol. I at 26 & 30. Rich's provides each of its vendors with weekly updates on that vendor's margin performance. H.R. Vol. I at 24. In addition, Rich's buyers stay in communication with vendors during the selling season in order to discuss the performance of the vendor's merchandise. Id. When a margin performance drops below the anticipated percentage, Rich's buyers will discuss the situation with the vendor and seek to negotiate a monetary contribution from the vendor. H.R. Vol. I at 98. This contribution is garnered to bring the margin performance back to the original level:

> "[Ms. Golden] So what would happen is, you know – so if it were that tan jacket that wasn't selling as well, so we would have had prior conversations with [the vendor] about the performance *** and when it gets to the point we have exhausted really other ways of trying to sell it better and we realize it really isn't the item, it's not going to sell, then what happens with the vendor is we talk to them about, you know, 'Here is where your sales were on the item. Here is where your inventory was. This is what the expected sell through was on the merchandise. We have a lot more inventory than what we had expected to have right now because it's not selling, and , you know, and I had to take $50,000 in markdowns and *** I only planned $40,000 on this item, you know, can you contribute $10,000 to this merchandise?'" H.R. Vol. I at 30.

According to Ms. Golden, vendors have as much interest in Rich's business success as the retailer does, because Rich's is a place where the vendor's merchandise can be showcased. To maintain a good business relationship, the vendor will frequently make the contribution. H.R. Vol. I at 27.

The contribution is known as a "vendor markdown allowance ("MDA"). However, the MDA is not actually a cash amount paid to Rich's. When Rich's obtains an MDA, it issues a debit memo against the accounts payable due to the vendor, which effectively both reduces the amount Rich's owes to its vendor and lowers its cost of goods sold, thereby increasing margin performance. H.R. Vol. I at 33. MDAs are credited to amounts owed on merchandise subsequently ordered from the vendor, not on the actual merchandise at issue.

Beverly Peralta, operating vice-president of accounts payable, testified that once a vendor authorizes an MDA, the amount is entered into Rich's computer system by the buyer. H.R. Vol. I at 70. The MDA passes through the accounts payable system, and the system searches for financial coverage. In other words, the system verifies that Rich's owes enough to the vendor in order to deduct the amount of the MDA. H.R. Vol. I at 70-71. Once the MDA posts, the accounts payable to that vendor is reduced by the MDA amount. H.R. Vol. I at 72.

Ms. Velardi testified that Rich's systems process MDAs into its stock ledger, where margin performance is calculated using RIM on a departmental level. H.R. Vol. I at 105. MDAs show up as a credit to retail inventory, a corresponding credit to cost inventory, and decrease to markdowns. H.R. Vol. I at 106. This ultimately results in a reduction of the costs of goods sold, and an increase in margin performance, and is recorded on Rich's profit and loss statement as a debit on Rich's cost of goods liability. H.R. Vol. I at 157.

In the matter before us, Rich's argues that MDAs should be recognized as a reduction in its cost of goods, thereby reducing the taxable value of its inventory. The commissioner counters that MDAs are in the nature of a contribution to margin – an increase in Rich's profit rather than a reduction in the costs of goods.

In support, the commissioner presented the testimony of Dr. Ray Stephens, a former Senior Academic Fellow of the Office of Chief Accountant, Securities and Exchange Commission, and currently the director of the School of Accountancy at Ohio University. Dr. Stephens is also a former faculty member of the Lazarus Management Institute, which is an executive development program for managers. H.R. Vol. II at 8. Dr. Stephens testified as to general accounting principles that apply to inventory. Dr. Stephens testified that, under Accounting Research Bulletin 43 of the Financial Accounting Standards Board ("FASB"), inventory valuation is based upon fair value, which is defined as either market value or replacement cost, whichever is lower. H.R. Vol. II at 9-10. He further testified that, under RIM, inventory value is an amount that maintains the gross profit percentage. "Because it maintains the gross profit percentage that was originally intended *** it maintains the anticipated markup in our normal profit that is embedded in the markup from the original cost to the selling price, that as you take markdowns, that you apply that percentage, which means you maintain the normal gross profit percentage." H.R.

Vol. II at 17-18. Based upon this standard, Dr. Stephens opined that any vendor allowances would be applied as a reduction in the overall markdowns applied to the price of the merchandise, not as a reduction in the inventory value. H.R. Vol. II at 21.

We now turn to our review of Rich's specification of error. In doing so, we observe that the findings of the Tax Commissioner are presumptively valid. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121. Consequently, it is incumbent upon a taxpayer challenging a determination of the commissioner to rebut the presumption and to establish a clear right to the requested relief. *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138. In this regard, the taxpayer is assigned the burden of showing in what manner and to what extent the commissioner's determination is in error. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213.

Every taxpayer that engages in business within the state of Ohio must annually file a personal property tax return with the county auditor of each county where property used in the business is located. R.C. 5711.02. Under R.C. 5711.101, a fiscal year taxpayer must report taxable property "as of the close of business at the end of his fiscal year." R.C. 5711.15 provides the method for listing and valuing tangible personal property held in inventory:

> "A merchant in estimating the value of the personal property held for sale in the course of his business shall take as the criterion the average value of such property, as provided in this section of the Revised Code, which he has had in his possession or under his control during the year ending on the day such property is listed for taxation, or the part of such year during which he was engaged in business. Such average shall be ascertained by taking the

amount in value on hand, as nearly as possible, in each month of such year, in which he has been engaged in business, adding together such amounts, and dividing the aggregate amount by the number of months that he has been in business during such year."

Upon review of the parties' briefs, we determine that there are three issues we must consider in the course of this appeal: 1) Do MDAs reduce Rich's cost, and therefore the true value of its inventory, or do MDAs reduce the amount of hardmarks applied to retail? 2) Does Ohio Adm. Code 5703-3-17 prohibit the treatment of MDAs as a reduction to a retailer's book value? 3) Has Rich's met its burden of establishing true value?

As to the first issue, we find that MDAs are indeed a reduction in inventory cost that should be recognized for personal property tax purposes. A review of all of the testimony before this board evidences that MDAs are a common feature in the retail business and are treated by retailers as a reduction in the cost of goods. Cost, for purposes of personal property tax, is not actual cost but inventory value. *Higbee Co. v. Evatt* (1942), 140 Ohio St. 325, at 329.[4] The method has the advantage of automatically recognizing a decline in inventory value due to the impaired value of the merchandise. The application of MDAs as a reduction in cost is also supported by FASB, which oversees the development of accounting practices: "[C]ash

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[4] We note that this case was provided to the board through a "Supplemental Brief of Appellee." Rich's has objected to the commissioner's request that we take notice of this case, on the grounds that it was filed after the briefing schedule and is not a statement of additional authority determined after the briefing. We grant the commissioner's request to file this citation for our review.

consideration[5] received by a customer from a vendor is presumed to be a reduction of the prices of the vendor's products or service and should, therefore, be characterized as a reduction of cost of sales when recognized in the customer's income statement." EITF[6] Abstract No. 02-16, at ¶4. Ohio case law has further recognized that markdowns are evidence bearing upon the question of inventory value. *Higbee*, supra.[7] See, also, *R.H. Macy & Co. v. Bowers* (June 24, 1963), BTA No. 49960, affirmed, supra.

Nor do we find Dr. Stephens' testimony to be supportive of the commissioner's position. We concur with Dr. Stephens that, under the "conventional" retail inventory method, markups, but not markdowns, are considered when determining a cost-to-retail ratio. See Kieso & Weygandt, Intermediate Accounting (7th Ed.) at 451. However, in the matter now before us, the cost ratio, i.e., the margin percentage, is known. The question is not how we arrive at the margin but what adjustments must be made to the underlying factors (retail pricing and cost) to maintain the intended margin. Moreover, Rich's treatment of MDAs conforms to the "lower of cost or market" standard for the cost of inventory testified to by Dr. Stephens. He testified that, under RIM, "the inventory value on the financial statements is an amount that maintains the gross profit percentage," which relates to

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[5] "Cash consideration" is defined as including both cash payments and credits that the vendor's customer can apply against amounts owed to the vendor. EITF Abstract No. 02-16, at Ex. 02-16B.

[6] "EITF" refers to FASB's Emerging Issues Task Force. The EITF is an organization formed by FASB in 1984 to provide assistance with timely financial reporting. The primary purpose of the task force is to identify emerging issues and resolve them with a uniform set of practices before divergent methods arise and become widespread. See http://www.fasb.org/eitf/about_eitf.shtml

[7] The court stressed in *Higbee* that the BTA is not absolutely bound by this evidence but must determine value within the exercise of its discretion. Moreover, the court found in *Higbee*, supra, that the taxpayer could not rely upon evidence of markdowns because it had failed to challenge the application of an administrative formula applied to deductions in inventory value; thus, that appellant was bound to the value arrived at under the formula. Id. at 330.

the lower of cost or market. H.R. Vol. II at 13. In short, we find nothing in Dr. Stephens' testimony to refute the evidence presented by Rich's.

Next, the commissioner argues that Ohio Adm. Code 5703-3-17 prohibits Rich's from applying MDAs to reduce its inventory values. The commissioner is to administer the personal property tax laws, adopting any necessary rules "so that all taxable property shall be listed and assessed for taxation." R.C. 5711.09. Accordingly, for inventory purposes, the commissioner has promulgated Ohio Adm. Code 5703-3-16 and 5703-3-17. Ohio Adm. Code 5703-3-16 provides that the value of any inventory required to be listed on the average basis shall be determined as provided by R.C. 5711.15 and 5711.16. Ohio Adm. Code 5703-3-17 provides:

> "The true 'average inventory value of merchandise' to be estimated for taxation shall prima facie be the 'average inventory value' at cost as disclosed by the books of the taxpayer, after making proper adjustments for cash discounts and merchandise shrinkage, less the aggregate net markdowns, at cost, (taking into consideration markdown cancellations and additional mark-ups at cost) which are reflected on the books of the taxpayer for the succeeding three months following the close of the annual accounting period of the current tax year.
>
> "Any taxpayer using the 'retail inventory method of accounting', who has cause to file a true value claim with his Personal Property Tax return as authorized by Revised Code 5711.18, should request an extension of time for filing as provided by Revised Code 5711.04, in order that such claim and return when filed will be in conformity with the foregoing."

The commissioner maintains that, under Ohio Adm. Code 5703-3-17, reductions to the book value of inventory, as determined using RIM, may be allowed only for "cash discounts," merchandise shrinkage," and "aggregate net markdowns," reflected on the taxpayer's books for the last three months of the annual accounting period of the current tax year. The commissioner argues that MDAs are "clearly not 'merchandise shrinkage,' nor are they 'net markdowns' occurring during the three months after the close of the applicable taxable year." Appellee's Amended Brief at 19. Relying upon Dr. Stephens' testimony, the commissioner further asserts that MDAs are not "cash discounts." Dr. Stephens testified that the term "cash discounts" would not apply to MDAs because "the cash discounts that would be applied to the cost of the inventory that's still on hand would not include the inventory that had already been sold." H.R. Vol. II at 23.

Our reading of the rule does not support the commissioner's proposed interpretation. Under the plain terms of the rule, the average inventory value is to be based on the average inventory value "at cost as disclosed by the books of the taxpayer." Once cost is determined on the books of the taxpayer, the rule permits additional adjustments for cash discounts, merchandise shrinkage and net markdowns. These adjustments are made only after the cost of the inventory is determined. As we have previously discussed, cost, as disclosed on Rich's books, includes MDAs. This reading is consistent with Dr. Stephens' testimony. He stated that the three adjustments referred to in Ohio Adm. Code 5703-3-17 are for adjustments from book value. H.R. Vol. II at 26. Here, we are not concerned with a reduction from book value but with those factors that comprise book value.

Rich's has provided us with competent and probative evidence of how it arrived at its book value. Ms. Velardi testified as to how the MDAs pass through Rich's accounts payable and price change systems. These systems track both the price and cost of Rich's merchandise. H.R. Vol. I at 102. Ms. Velardi further testified about how the MDAs flow through Rich's stock ledger and general ledger. The ledger accounts translate Rich's internal data into RIM data at a divisional level. H.R. Vol. I at 105. The ledger accounts are shown on Rich's cost of goods sold, which, in turn, is reflected on Rich's profit and loss statements as a reduction in the cost of goods sold. Rich's also provided copies of various statistical accounts that it uses to track purchases at retail, MDAs, accounts payable, and the accumulation of its data for its general ledger. See, e.g., Appellant's Exs. 4, 5, 6 and 7. All of this information is pertinent to determining the book value of Rich's merchandise.

Moreover, the rule applies to adjustments made during the first three months of the year *following* the close of the current tax year. Our understanding of the rule is that, if a retailer has inventory in place at the close of the current tax year, and if that retailer recognizes an adjustment in the first three months following the end of the tax year, the retailer may nevertheless apply the adjustment back to that tax year being reported. This is recognition that the utility of an inventory item may be impaired at the end of the current tax year; however, any adjustment for that impairment may not show up on the retailer's books until after the close of that year.

Finally, the commissioner argues that we must reject Rich's specification of error because Rich's evidence relies upon estimates of the actual MDAs rather than upon actual MDAs from each store. In support, the commissioner relies upon *United Tel. Co. of Ohio v. Tracy* (1999), 84 Ohio St.3d 506 and *MCI Metro Access Transm. Servs., LLC, et al., v. Wilkins* (Apr. 13, 2007), BTA Nos. 2004-K-749, 750, unreported, affirmed 2008-Ohio-5057. *United Tel.* concerned the valuation of fiber contained in telephone cables that were either reserved for future use or were no longer useable. These were referred to as "dead and bad pairs." The taxpayer did not maintain a record of its dead and bad pairs. So, in order to calculate a value for these pairs, the taxpayer submitted a statistical estimate of the number of dead and bad pairs in its network based upon a random sampling. Noting that the taxpayer had records in its possession upon which it could reconstruct the actual number of dead and bad pairs at issue, the court rejected the statistical estimate. The court stated, "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 on United Telephone." Id. at 511. This duty was imposed upon the taxpayer despite the magnitude of the effort it would require. The court reasoned that the taxpayer has "assumed this burden when it appealed the commissioner's order." Id. at 512.

In *MCI Metro Access*, supra, the taxpayer challenged the commissioner's finding of value under the 302 computation. The taxpayer provided this board no evidence of value. Instead it asked that its property simply be reduced on a pro rata basis consistent with the impairment write-down taken by its parent corporation following the parent's emergence from bankruptcy. We declined to accept the argument, noting that the taxpayer failed to present evidence that was sufficiently probative to show that the value of its personal property was impaired to the same degree as that of the parent company. Id. at 14. On appeal, the Franklin County Court of Appeals concurred, noting in its affirmance that "the record did not require the tax commissioner or BTA to conclude, based upon appellant's proposed methodology, that the Ohio taxable property at issue mirrored the various assets comprising MCI/WorldCom's world-wide property, or that appellants' Ohio property suffered the same percentage of impairment as the parent company." *MCI Metro Access*, 2008-Ohio-5057, at ¶25.

We do not find these cases to be relevant to the issue now before us. *United Tel.*, supra, concerned the valuation of distinct property, i.e., the actual numbers of dead and bad pairs. The appeal now before us does not concern the valuation of each specific item of inventory. Instead, the cost of inventory that is reported is an average based upon the average cost-to-retail ratio. This is the very nature of RIM accounting, and the method of accounting expressly adopted by statute. R.C. 5711.15. Moreover, unlike the situation in *United Tel.*, Rich's does not rely upon a random sampling of MDAs. Its values are based upon the MDAs actually applied and the cost shown on its books.

With regard to *MCI Access*, supra, we reiterate that the valuation under consideration is based upon RIM. This is not an attempt to apply an across-the-board reduction where there are discrete items of property that are to be valued. Here, Rich's provided through numerous witnesses and documents evidence indicating the amount of MDAs applied, how the MDAs are tracked through its accounts payable system, how the MDAs are applied to reduce cost, how that reduction in cost is shown on its profit and loss statements, and how margin is tracked on Rich's ledgers. Various documents have been submitted showing both the MDA information and its impact on cost. Additionally, the inter-county returns are included in the statutory transcript. The totality of this evidence is sufficiently probative to support Rich's specification that the commissioner erred in not granting Rich's claim for a reduction in inventory value of 6.739% in tax year 2000, 8.536% in tax year 2001, and 10.187% in tax year 2002.

In conclusion, we find that Rich's specification of error is well taken. We therefore determine that the Tax Commissioner's failure to consider Rich's vendor markdown allowances was unreasonable and unlawful. Consistent with this decision, the Board of Tax Appeals orders the Tax Commissioner to grant the requested claim for a reduction in Rich's 2000, 2001, and 2002 inventory value.

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. Van Meter

Sally F. Van Meter, Board Secretary

5703-3-17 "Average inventory value of merchandise" of taxpayer using "retail inventory method of accounting".

The true "average inventory value of merchandise" to be estimated for taxation shall prima facie be the "average inventory value" at cost as disclosed by the books of the taxpayer, after making proper adjustments for cash discounts and merchandise shrinkage, less the aggregate net markdowns, at cost, (taking into consideration markdown cancellations and additional mark-ups at cost) which are reflected on the books of the taxpayer for the succeeding three months following the close of the annual accounting period of the current tax year.

Any taxpayer using the "retail inventory method of accounting", who has cause to file a true value claim with his Personal Property Tax return as authorized by Revised Code 5711.18, should request an extension of time for filing as provided by Revised Code 5711.04, in order that such claim and return when filed will be in conformity with the foregoing.

HISTORY: (former TX-41-16); Eff 11-18-57

Rule promulgated under: RC 5703.14

Tax Commissioner's Administrative Rule Relating to Retail Inventory Method, Rule No. TX-41-16, Effective 4/10/48

"Beginning with the tax year 1948, the true 'average inventory value of merchandise' to be estimated for taxation shall prima facie be the 'average inventory value' at cost as disclosed by the books of the taxpayer, after making proper adjustments for cash discounts and merchandise shrinkage, less the aggregate net mark-downs, at cost, (taking into consideration mark-down cancellations and additional mark-ups at cost) which are reflected on the books of the taxpayer for the succeeding three months following the close of the annual accounting period of the current tax year.

"Any taxpayer using the 'retail inventory method of accounting,' who has cause to file a true value claim with his personal property tax return as authorized by Section 5389, General Code, should request an extension of time for filing as provided by Section 5367, General Code, in order that such claim and return when filed will be in conformity with the foregoing,"

R.C. 5711.03 Listing of taxable property.

Except as provided in sections 5711.01 to 5711.36 of the Revised Code, all taxable property shall be listed as to ownership or control, valuation, and taxing districts as of the beginning of the first day of January, annually, except that taxable personal property and credits used in business shall be listed as of the close of business of the last day of December, annually, and deposits not taxed at the source shall be listed as of the day fixed by the tax commissioner for the listing of deposits taxed at the source pursuant to section 5725.05 of the Revised Code. The subsequent transfer of any taxable property shall not authorize any taxpayer to omit the same from his return nor the assessor to fail to assess the same in the manner required, although such return or assessment is not made until after such transfer. When a person or taxpayer engages in business in this state on or after the first day of January, in any year, he shall list all his taxable property, except inventory, as to value, ownership and taxing districts as of the date he engages in business. In listing inventory as to ownership and taxing districts he shall list the probable average value intended to be used in business from the date he engages in business until the first day of January next thereafter. The valuation of all property, including average inventory, to be returned for taxation shall be determined by multiplying the value, or average value of such property by a fraction whose numerator is the number of full months engaged in business during the year of engaging in business, and whose denominator is twelve, unless he shows the assessor, under oath, and by producing a copy of the return or assessment, that the same property has been listed or assessed for taxation for said year in this state.

Effective Date: 09-27-1983

R.C. 5711.15 Valuation of merchandise offered for sale.

A merchant in estimating the value of the personal property held for sale in the course of his business shall take as the criterion the average value of such property, as provided in this section of the Revised Code, which he has had in his possession or under his control during the year ending on the day such property is listed for taxation, or the part of such year during which he was engaged in business. Such average shall be ascertained by taking the amount in value on hand, as nearly as possible, in each month of such year, in which he has been engaged in business, adding together such amounts, and dividing the aggregate amount by the number of months that he has been in business during such year.

As used in this section a "merchant" is a person who owns or has in possession or subject to his control personal property within this state with authority to sell it, which has been purchased either in or out of this state, with a view to being sold at an advanced price or profit, or which has been consigned to him from a place out of this state for the purpose of being sold at a place within this state.

Effective Date: 08-15-1957

R.C. 5711.18 Valuation of accounts and personal property - procedure - income yield.

In the case of accounts receivable, the book value thereof less book reserves shall be listed and shall be taken as the true value thereof unless the assessor finds that such net book value is greater or less than the then true value of such accounts receivable in money. 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 net book value of accounts receivable or depreciated book value of personal property must be made in writing by the taxpayer at the time of making the taxpayer's return; and when such return is made to the county auditor who is required by sections 5711.01 to 5711.36, inclusive, of the Revised Code, to transmit it to the tax commissioner for assessment, the auditor shall, as deputy of the commissioner, investigate such claim and shall enter thereon, or attach thereto, in such form as the commissioner prescribes, the auditor's findings and recommendations with respect thereto; when such return is made to the commissioner, such claim for deduction from depreciated book value of personal property shall be referred to the auditor, as such deputy, of each county in which the property affected thereby is listed for investigation and report.

Any change in the method of determining true value, as prescribed by the tax commissioner on a prospective basis, shall not be admissible in any judicial or administrative action or proceeding as evidence of value with regard to prior years' taxes. Information about the business, property, or transactions of any taxpayer obtained by the commissioner for the purpose of adopting or modifying any such method shall not be subject to discovery or disclosure.

Effective Date: 09-29-2000

R.C. 5711.26 Commissioner may make 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.

Effective Date: 07-01-1985

R.C. 5717.02 Appeal from final determination by tax commissioner - procedure - hearing.

Except as otherwise provided by law, 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 taken to the board of tax appeals by the taxpayer, by the person to whom notice of the tax assessment, reassessment, valuation, determination, finding, computation, or order by the commissioner is required by law to be given, by the director of budget and management if the revenues affected by such decision would accrue primarily to the state treasury, or by the county auditors of the counties to the undivided general tax funds of which the revenues affected by such decision would primarily accrue. Appeals from the redetermination by the director of development under division (B) of section 5709.64 or division (A) of section 5709.66 of the Revised Code may be taken to the board of tax appeals by the enterprise to which notice of the redetermination is required by law to be given. Appeals from a decision of the tax commissioner concerning an application for a property tax exemption may be taken to the board of tax appeals by a school district that filed a statement concerning such application under division (C) of section 5715.27 of the Revised Code. Appeals from a redetermination by the director of job and family services under section 5733.42 of the Revised Code may be taken by the person to which the notice of the redetermination is required by law to be given under that section.

Such appeals shall be taken by the filing of a notice of appeal with the board, and with the tax commissioner if the tax commissioner's action is the subject of the appeal, with the director of development if that director's action is the subject of the appeal, or with the director of job and family services if that director's action is the subject of the appeal. The notice of appeal shall be filed within sixty days after service of the notice of the tax assessment, reassessment, valuation, determination, finding, computation, or order by the commissioner or redetermination by the director has been given as provided in section 5703.37, 5709.64, 5709.66, or 5733.42 of the Revised Code. The notice of such appeal may be filed in person or by certified mail, express mail, or authorized delivery service. If the notice of such appeal is filed by certified mail, express mail, or authorized delivery service as provided in section 5703.056 of the Revised Code, the date of the United States postmark placed on the sender's receipt by the postal service or the date of receipt recorded by the authorized delivery service shall be treated as the date of filing. The notice of appeal shall have attached thereto and incorporated therein by reference a true copy of the notice sent by the commissioner or director to the taxpayer, enterprise, or other person of the final determination or redetermination complained of, and shall also specify the errors therein complained of, but failure to attach a copy of such notice and incorporate it by reference in the notice of appeal does not invalidate the appeal.

Upon the filing of a notice of appeal, the tax commissioner or the director, as appropriate, shall certify to the board a transcript of the record of the proceedings before the commissioner or director, together with all evidence considered by the commissioner or director in connection therewith. Such appeals or applications may be heard by the board at its office in Columbus or in the county where the appellant resides, or it may cause its examiners to conduct such hearings and to report to it their findings for affirmation or rejection. The board may order the appeal to be heard upon the record and the evidence certified to it by the commissioner or director, but upon the application of any interested party the board shall order the hearing of additional evidence, and it may make such investigation concerning the appeal as it considers proper.

Effective Date: 09-06-2002

TITLE 15 - COMMERCE AND TRADE

CHAPTER 2B - SECURITIES EXCHANGES

§ 78j–1. Audit requirements

(a) In general

Each audit required pursuant to this chapter of the financial statements of an issuer by a registered public accounting firm shall include, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission—

(1) procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts;

(2) procedures designed to identify related party transactions that are material to the financial statements or otherwise require disclosure therein; and

(3) an evaluation of whether there is substantial doubt about the ability of the issuer to continue as a going concern during the ensuing fiscal year.

(b) Required response to audit discoveries

(1) Investigation and report to management

If, in the course of conducting an audit pursuant to this chapter to which subsection (a) of this section applies, the registered public accounting firm detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, the firm shall, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission—

(A) (i) determine whether it is likely that an illegal act has occurred; and

(ii) if so, determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects, such as fines, penalties, and damages; and

(B) as soon as practicable, inform the appropriate level of the management of the issuer and assure that the audit committee of the issuer, or the board of directors of the issuer in the absence of such a committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of such firm in the course of the audit, unless the illegal act is clearly inconsequential.

(2) Response to failure to take remedial action

If, after determining that the audit committee of the board of directors of the issuer, or the board of directors of the issuer in the absence of an audit committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of the firm in the course of the audit of such firm, the registered public accounting firm concludes that—

(A) the illegal act has a material effect on the financial statements of the issuer;

(B) the senior management has not taken, and the board of directors has not caused senior management to take, timely and appropriate remedial actions with respect to the illegal act; and

(C) the failure to take remedial action is reasonably expected to warrant departure from a standard report of the auditor, when made, or warrant resignation from the audit engagement;

the registered public accounting firm shall, as soon as practicable, directly report its conclusions to the board of directors.

(3) Notice to Commission; response to failure to notify

An issuer whose board of directors receives a report under paragraph (2) shall inform the Commission by notice not later than 1 business day after the receipt of such report and shall furnish the registered public accounting firm making such report with a copy of the notice furnished to the

Commission. If the registered public accounting firm fails to receive a copy of the notice before the expiration of the required 1-business-day period, the registered public accounting firm shall—

(A) resign from the engagement; or

(B) furnish to the Commission a copy of its report (or the documentation of any oral report given) not later than 1 business day following such failure to receive notice.

(4) Report after resignation

If a registered public accounting firm resigns from an engagement under paragraph (3)(A), the firm shall, not later than 1 business day following the failure by the issuer to notify the Commission under paragraph (3), furnish to the Commission a copy of the report of the firm (or the documentation of any oral report given).

(c) Auditor liability limitation

No registered public accounting firm shall be liable in a private action for any finding, conclusion, or statement expressed in a report made pursuant to paragraph (3) or (4) of subsection (b) of this section, including any rule promulgated pursuant thereto.

(d) Civil penalties in cease-and-desist proceedings

If the Commission finds, after notice and opportunity for hearing in a proceeding instituted pursuant to section 78u–3 of this title, that a registered public accounting firm has willfully violated paragraph (3) or (4) of subsection (b) of this section, the Commission may, in addition to entering an order under section 78u–3 of this title, impose a civil penalty against the registered public accounting firm and any other person that the Commission finds was a cause of such violation. The determination to impose a civil penalty and the amount of the penalty shall be governed by the standards set forth in section 78u–2 of this title.

(e) Preservation of existing authority

Except as provided in subsection (d) of this section, nothing in this section shall be held to limit or otherwise affect the authority of the Commission under this chapter.

(f) Definitions

As used in this section, the term "illegal act" means an act or omission that violates any law, or any rule or regulation having the force of law. As used in this section, the term "issuer" means an issuer (as defined in section 78c of this title), the securities of which are registered under section 78l of this title, or that is required to file reports pursuant to section 78o (d) of this title, or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

(g) Prohibited activities

Except as provided in subsection (h) of this section, it shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Commission) that performs for any issuer any audit required by this chapter or the rules of the Commission under this chapter or, beginning 180 days after the date of commencement of the operations of the Public Company Accounting Oversight Board established under section 7211 of this title (in this section referred to as the "Board"), the rules of the Board, to provide to that issuer, contemporaneously with the audit, any non-audit service, including—

(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

(2) financial information systems design and implementation;

(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

(4) actuarial services;

(5) internal audit outsourcing services;

(6) management functions or human resources;

(7) broker or dealer, investment adviser, or investment banking services;

(8) legal services and expert services unrelated to the audit; and

(9) any other service that the Board determines, by regulation, is impermissible.

(h) Preapproval required for non-audit services

A registered public accounting firm may engage in any non-audit service, including tax services, that is not described in any of paragraphs (1) through (9) of subsection (g) of this section for an audit client, only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i) of this section.

(i) Preapproval requirements

(1) In general

(A) Audit committee action

All auditing services (which may entail providing comfort letters in connection with securities underwritings or statutory audits required for insurance companies for purposes of State law) and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer.

(B) De minimus[1] exception

The preapproval requirement under subparagraph (A) is waived with respect to the provision of non-audit services for an issuer, if—

(i) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor during the fiscal year in which the nonaudit services are provided;

(ii) such services were not recognized by the issuer at the time of the engagement to be non-audit services; and

(iii) such services are promptly brought to the attention of the audit committee of the issuer and approved prior to the completion of the audit by the audit committee or by 1 or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

(2) Disclosure to investors

Approval by an audit committee of an issuer under this subsection of a non-audit service to be performed by the auditor of the issuer shall be disclosed to investors in periodic reports required by section 78m (a) of this title.

(3) Delegation authority

The audit committee of an issuer may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant preapprovals required by this subsection. The decisions of any member to whom authority is delegated under this paragraph to preapprove an activity under this subsection shall be presented to the full audit committee at each of its scheduled meetings.

(4) Approval of audit services for other purposes

In carrying out its duties under subsection (m)(2) of this section, if the audit committee of an issuer approves an audit service within the scope of the engagement of the auditor, such audit service shall be deemed to have been preapproved for purposes of this subsection.

(j) Audit partner rotation

It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.

(k) Reports to audit committees

Each registered public accounting firm that performs for any issuer any audit required by this chapter shall timely report to the audit committee of the issuer—

(1) all critical accounting policies and practices to be used;

(2) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and

(3) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.

(l) Conflicts of interest

It shall be unlawful for a registered public accounting firm to perform for an issuer any audit service required by this chapter, if a chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for the issuer, was employed by that registered independent public accounting firm and participated in any capacity in the audit of that issuer during the 1-year period preceding the date of the initiation of the audit.

(m) Standards relating to audit committees

(1) Commission rules

(A) In general

Effective not later than 270 days after July 30, 2002, the Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements of any portion of paragraphs (2) through (6).

(B) Opportunity to cure defects

The rules of the Commission under subparagraph (A) shall provide for appropriate procedures for an issuer to have an opportunity to cure any defects that would be the basis for a prohibition under subparagraph (A), before the imposition of such prohibition.

(2) Responsibilities relating to registered public accounting firms

The audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.

(3) Independence

(A) In general

Each member of the audit committee of the issuer shall be a member of the board of directors of the issuer, and shall otherwise be independent.

(B) Criteria

In order to be considered to be independent for purposes of this paragraph, a member of an audit committee of an issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee—

(i) accept any consulting, advisory, or other compensatory fee from the issuer; or

(ii) be an affiliated person of the issuer or any subsidiary thereof.

(C) Exemption authority

The Commission may exempt from the requirements of subparagraph (B) a particular relationship with respect to audit committee members, as the Commission determines appropriate in light of the circumstances.

(4) Complaints

Each audit committee shall establish procedures for—

(A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

(B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

(5) Authority to engage advisers

Each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.

(6) Funding

Each issuer shall provide for appropriate funding, as determined by the audit committee, in its capacity as a committee of the board of directors, for payment of compensation—

(A) to the registered public accounting firm employed by the issuer for the purpose of rendering or issuing an audit report; and

(B) to any advisers employed by the audit committee under paragraph (5).

Footnotes

[1] So in original. Probably should be "De minimis".

(June 6, 1934, ch. 404, title I, § 10A, as added Pub. L. 104–67, title III, § 301(a), Dec. 22, 1995, 109 Stat. 762; amended Pub. L. 107–204, title II, §§ 201(a), 202–204, 205 (b), (d), 206, title III, § 301, July 30, 2002, 116 Stat. 771–775.)

TITLE 15 - COMMERCE AND TRADE
CHAPTER 98 - PUBLIC COMPANY ACCOUNTING REFORM AND CORPORATE RESPONSIBILITY
SUBCHAPTER I - PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

§ 7213. Auditing, quality control, and independence standards and rules

(a) Auditing, quality control, and ethics standards

(1) In general

The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants designated pursuant to paragraph (3)(A) or advisory groups convened pursuant to paragraph (4), and amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(2) Rule requirements

In carrying out paragraph (1), the Board—

(A) shall include in the auditing standards that it adopts, requirements that each registered public accounting firm shall—

(i) prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report;

(ii) provide a concurring or second partner review and approval of such audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board); and

(iii) describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the issuer, required by section 7262 (b) of this title, and present (in such report or in a separate report)—

(I) the findings of the auditor from such testing;

(II) an evaluation of whether such internal control structure and procedures—

(aa) include maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

(bb) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and

(III) a description, at a minimum, of material weaknesses in such internal controls, and of any material noncompliance found on the basis of such testing.

(B) shall include, in the quality control standards that it adopts with respect to the issuance of audit reports, requirements for every registered public accounting firm relating to—

(i) monitoring of professional ethics and independence from issuers on behalf of which the firm issues audit reports;

(ii) consultation within such firm on accounting and auditing questions;

(iii) supervision of audit work;

(iv) hiring, professional development, and advancement of personnel;

(v) the acceptance and continuation of engagements;

(vi) internal inspection; and

(vii) such other requirements as the Board may prescribe, subject to subsection (a)(1) of this section.

(3) Authority to adopt other standards

(A) In general

In carrying out this subsection, the Board—

(i) may adopt as its rules, subject to the terms of section 7217 of this title, any portion of any statement of auditing standards or other professional standards that the Board determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups of accountants that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and

(ii) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).

(B) Initial and transitional standards

The Board shall adopt standards described in subparagraph (A)(i) as initial or transitional standards, to the extent the Board determines necessary, prior to a determination of the Commission under section 7211 (d) of this title, and such standards shall be separately approved by the Commission at the time of that determination, without regard to the procedures required by section 7217 of this title that otherwise would apply to the approval of rules of the Board.

(4) Advisory groups

The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include practicing accountants and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section.

(b) Independence standards and rules

The Board shall establish such rules as may be necessary or appropriate in the public interest or for the protection of investors, to implement, or as authorized under, title II of this Act.

(c) Cooperation with designated professional groups of accountants and advisory groups

(1) In general

The Board shall cooperate on an ongoing basis with professional groups of accountants designated under subsection (a)(3)(A) of this section and advisory groups convened under subsection (a)(4) of this section in the examination of the need for changes in any standards subject to its authority under subsection (a) of this section, recommend issues for inclusion on the agendas of such designated professional groups of accountants or advisory groups, and take such other steps as it deems appropriate to increase the effectiveness of the standard setting process.

(2) Board responses

The Board shall respond in a timely fashion to requests from designated professional groups of accountants and advisory groups referred to in paragraph (1) for any changes in standards over which the Board has authority.

(d) Evaluation of standard setting process

The Board shall include in the annual report required by section 7211 (h) of this title the results of its standard setting responsibilities during the period to which the report relates, including a discussion of the work of the Board with any designated professional groups of accountants and advisory groups described in paragraphs (3)(A) and (4) of subsection (a) of this section, and its pending issues agenda for future standard setting projects.

(Pub. L. 107–204, title I, § 103, July 30, 2002, 116 Stat. 755.)

TWELFTH EDITION — 2007 FASB UPDATE

INTERMEDIATE ACCOUNTING

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handles merchandise with widely varying rates of gross profit. In these situations, the company may need to apply the gross profit method by subsections, lines of merchandise, or a similar basis that classifies merchandise according to their respective rates of gross profit. The gross profit method is normally unacceptable for financial reporting purposes because it provides only an estimate. GAAP requires a physical inventory as additional verification of the inventory indicated in the records. Nevertheless, GAAP permits the gross profit method to determine ending inventory for interim (generally quarterly) reporting purposes, provided a company discloses the use of this method. Note that the gross profit method will follow closely the inventory method used (FIFO, LIFO, average cost) because it relies on historical records.

WHAT DO THE NUMBERS MEAN?

THE SQUEEZE

Managers and analysts closely follow gross profits. A small change in the gross profit rate can significantly affect the bottom line. In 1993, Apple Computer suffered a textbook case of shrinking gross profits. In response to pricing wars in the personal computer market, Apple had to quickly reduce the price of its signature Macintosh computers—reducing prices more quickly than it could reduce its costs. As a result its gross profit rate fell from 44 percent in 1992 to 40 percent in 1993. Though the drop of 4 percent seems small, its impact on the bottom line caused Apple's stock price to drop from $57 per share on June 1, 1993, to $27.50 by mid-July 1993.

As another example, Debenham, the second largest department store in the United Kingdom, experienced a 14 percentage share price decline. The cause? Markdowns on slow-moving inventory reduced its gross margin.

Source: Alison Smith, "Debenham's Shares Hit by Warning," Financial Times (July 24, 2002), p. 21.

RETAIL INVENTORY METHOD

OBJECTIVE 6
Determine ending inventory by applying the retail inventory method.

Accounting for inventory in a retail operation presents several challenges. Retailers with certain types of inventory may use the specific identification method to value their inventories. Such an approach makes sense when a retailer holds significant individual inventory units, such as automobiles, pianos, or fur coats. However, imagine attempting to use such an approach at **Target**, **True-Value Hardware**, **Sears Holdings**, or **Bloomingdale's**—high-volume retailers that have many different types of merchandise. It would be extremely difficult to determine the cost of each sale, to enter cost codes on the tickets, to change the codes to reflect declines in value of the merchandise, to allocate costs such as transportation, and so on.

An alternative is to compile the inventories at retail prices. For most retailers, an observable pattern between cost and price exists. The retailer can then use a formula to convert retail prices to cost. This method is called the **retail inventory method. It requires that the retailer keep a record of (1) the total cost and retail value of goods purchased, (2) the total cost and retail value of the goods available for sale, and (3) the sales for the period.** Use of the retail inventory method is very common. For example, **Safeway** supermarkets uses the retail inventory method, as does **Target Corp.**, **Wal-Mart**, and **Best Buy**.

Here is how it works at a company like **Best Buy**: Beginning with the retail value of the goods available for sale, Best Buy deducts the sales for the period. This calculation determines an estimated inventory (goods on hand) at retail. It next computes the **cost-to-retail ratio** for all goods. The formula for this computation is to divide the cost of total goods available for sale at cost by the total goods available at retail price. Finally, to obtain ending inventory at cost, Best Buy applies the cost-to-retail ratio to the ending inventory valued at retail. Illustration 9-17 shows the retail inventory method calculations for Best Buy (assumed data).

ILLUSTRATION 9-17
Retail Inventory Method

BEST BUY (current period)		
	Cost	Retail
Beginning inventory	$14,000	$ 20,000
Purchases	63,000	90,000
Goods available for sale	$77,000	110,000
Deduct: Sales		85,000
Ending inventory, at retail		$ 25,000

Ratio of cost to retail ($77,000 ÷ $110,000) = 70%
Ending inventory at cost (70% of $25,000) = $17,500

There are different versions of the retail inventory method. These include the **conventional** method (based on lower-of-average-cost-or-market), the **cost** method, the **LIFO retail** method, and the **dollar-value LIFO** retail method. Regardless of which version a company uses, the IRS, various retail associations, and the accounting profession all sanction use of the retail inventory method. One of its advantages is that a company like **Target** can approximate the inventory balance **without a physical count.** However, to avoid a potential overstatement of the inventory, Target makes periodic inventory counts. Such counts are especially important in retail operations where loss due to shoplifting or breakage is common.

The retail inventory method is particularly useful for any type of interim report, because such reports usually need a fairly quick and reliable measure of the inventory. Also, insurance adjusters often use this method to estimate losses from fire, flood, or other type of casualty. This method also acts as a **control device** because a company will have to explain any deviations from a physical count at the end of the year. Finally, the retail method **expedites the physical inventory count** at the end of the year. The crew taking the physical inventory need record only the retail price of each item. The crew does not need to look up each item's invoice cost, thereby saving time and expense.

Retail-Method Concepts

The amounts shown in the "Retail" column of Illustration 9-17 represent the original retail prices, assuming no price changes. In practice, though, retailers frequently mark up or mark down the prices they charge buyers.

For retailers, the term **markup** means an additional markup of the original retail price. (In another context, such as the gross profit discussion on page 435, we often think of markup on the basis of cost.) **Markup cancellations** are decreases in prices of merchandise that the retailer had marked up above the original retail price.

In a competitive market, retailers often need to use **markdowns,** which are decreases in the original sales prices. Such cuts in sales prices may be necessary because of a decrease in the general level of prices, special sales, soiled or damaged goods, overstocking, and market competition. Markdowns are common in retailing these days. **Markdown cancellations** occur when the markdowns are later offset by increases in the prices of goods that the retailer had marked down—such as after a one-day sale, for example. Neither a markup cancellation nor a markdown cancellation can exceed the original markup or markdown.

To illustrate these concepts, assume that Designer Clothing Store recently purchased 100 dress shirts from Marroway, Inc. The cost for these shirts was $1,500, or $15 a shirt. Designer Clothing established the selling price on these shirts at $30 a shirt. The shirts were selling quickly in anticipation of Father's Day, so the manager added a markup of $5 per shirt. This markup made the price too high for customers, and sales slowed. The manager then reduced the price to $32. At this point we would say that the shirts at Designer Clothing have had a markup of $5 and a markup cancellation of $3.

Right after Father's Day, the manager marked down the remaining shirts to a sale price of $23. At this point, an additional markup cancellation of $2 has taken place, and a $7 markdown has occurred. If the manager later increases the price of the shirts to $24, a markdown cancellation of $1 would occur.

Retail Inventory Method with Markups and Markdowns—Conventional Method

Retailers use markup and markdown concepts in developing the proper inventory valuation at the end of the accounting period. To obtain the appropriate inventory figures, companies must give proper treatment to markups, markup cancellations, markdowns, and markdown cancellations.

To illustrate the different possibilities, consider the data for In-Fusion Inc., shown in Illustration 9-18. In-Fusion can calculate its ending inventory at cost under two assumptions, A and B. (We'll explain the reasons for the two later.)

Assumption A: Computes a cost ratio after markups (and markup cancellations) but before markdowns.

Assumption B: Computes a cost ratio after both markups and markdowns (and cancellations).

ILLUSTRATION 9-18
Retail Inventory Method with Markups and Markdowns

	Cost	Retail
Beginning inventory	$ 500	$ 1,000
Purchases (net)	20,000	35,000
Markups		3,000
Markup cancellations		1,000
Markdowns		2,500
Markdown cancellations		2,000
Sales (net)		25,000

IN-FUSION INC.

	Cost		Retail
Beginning inventory	$ 500		$ 1,000
Purchases (net)	20,000		35,000
Merchandise available for sale	20,500		36,000
Add: Markups		$3,000	
Less: Markup cancellations		(1,000)	
Net markups			2,000
	20,500		38,000
(A) Cost-to-retail ratio $\frac{\$20,500}{\$38,000} = 53.9\%$			
Deduct:			
Markdowns		2,500	
Less: Markdown cancellations		(2,000)	
Net markdowns			500
	$20,500		37,500
(B) Cost-to-retail ratio $\frac{\$20,500}{\$37,500} = 54.7\%$			
Deduct: Sales (net)			25,000
Ending inventory at retail			$12,500

The computations for In-Fusion are:

Ending inventory at retail × Cost ratio = Value of ending inventory
Assumption A: $12,500 × 53.9% = $6,737.50
Assumption B: $12,500 × 54.7% = $6,837.50

The question becomes: Which assumption and which percentage should In-Fusion use to compute the ending inventory valuation? The answer depends on which retail inventory method In-Fusion chooses.

One approach uses only assumption A (a cost ratio using markups but not markdowns). It approximates the lower-of-average-cost-or-market. We will refer to this approach as the **conventional retail inventory method** or the **lower-of-cost-or-market approach.**

To understand why this method considers only the markups, not the markdowns, in the cost percentage, you must understand how a retail business operates. A markup normally indicates an increase in the market value of the item. On the other hand, a markdown means a decline in the utility of that item. Therefore, to approximate the lower-of-cost-or-market, we would consider markdowns a current loss and so would not include them in calculating the cost-to-retail ratio. Omitting the markdowns would make the cost-to-retail ratio lower, which leads to an approximate lower-of-cost-or-market.

An example will make the distinction between the two methods clear: In-Fusion purchased two items for $5 apiece; the original sales price was $10 each. One item was subsequently written down to $2. Assuming no sales for the period, **if markdowns are considered** in the cost-to-retail ratio (assumption B—the **cost method**), we compute the ending inventory in the following way.

ILLUSTRATION 9-19
Retail Inventory Method Including Markdowns—Cost Method

Markdowns Included in Cost-to-Retail Ratio

	Cost	Retail
Purchases	$10	$20
Deduct: Markdowns		8
Ending inventory, at retail		$12

Cost-to-retail ratio $\frac{\$10}{\$12} = 83.3\%$

Ending inventory at cost ($12 × .833) = $10

This approach (the cost method) reflects an **average cost** of the two items of the commodity without considering the loss on the one item. It values ending inventory at $10.

If markdowns are not considered in the cost-to-retail ratio (assumption A—the **conventional retail method**), we compute the ending inventory as follows.

ILLUSTRATION 9-20
Retail Inventory Method Excluding Markdowns—Conventional Method (LCM)

Markdowns Not Included in Cost-to-Retail Ratio

	Cost	Retail
Purchases	$10	$20

Cost-to-retail ratio $\frac{\$10}{\$20} = 50\%$

	Cost	Retail
Deduct: Markdowns		8
Ending inventory, at retail		$12

Ending inventory, at cost ($12 × .50) = $6

Under this approach (the conventional retail method, in which markdowns are **not considered**), ending inventory would be $6. The inventory valuation of $6 reflects two inventory items, one inventoried at $5 and the other at $1. It reflects the fact that In-Fusion reduced the sales price from $10 to $2, and reduced the cost from $5 to $1.[14]

[14]This figure is not really market (replacement cost), but it is net realizable value less the normal margin that is allowed. In other words, the sale price of the goods written down is $2, but subtracting a normal margin of 50 percent ($5 cost, $10 price), the figure becomes $1.

Statutes.

In the Supreme Court of Ohio

APPEAL FROM THE BOARD OF TAX APPEALS OF THE DEPARTMENT OF TAXATION OF OHIO.

No. 29059.

ROLLMAN AND SONS COMPANY,
a Corporation,
Appellant,

v.

WILLIAM S. EVATT,
Tax Commissioner of Ohio,
Appellee.

No. 29060.

ROLLMAN AND SONS COMPANY,
a Corporation,
Appellant,

v.

WILLIAM S. EVATT,
Tax Commissioner of Ohio,
Appellee.

No. 29061.

ROLLMAN AND SONS COMPANY,
a Corporation,
Appellant,

v.

WILLIAM S. EVATT,
Tax Commissioner of Ohio,
Appellee.

BRIEF OF ROLLMAN AND SONS COMPANY.

STATEMENT OF THE CASE.

Appellant (hereinafter called Rollman) filed with its personal property tax returns for 1936, 1938 and 1939, a claim for reduction of its merchandise inventory from book value to true value, as authorized by Section 5389, General Code. In each case the claim for reduction was allowed in part, the amount allowed being arrived at by the Tax Commission, in disregard of the evidence submitted with each of Rollman's claims, by arbitrarily applying a formula known as "the aged inventory rule." An appeal was taken to the Board of Tax Appeals and a hearing had before a referee. No evidence was offered to sustain the Tax Commission's valuation. Rollman, on the other hand, offered evidence of its actual experience over a period of years in the sale of aging merchandise. This evidence was not contradicted or questioned. Nevertheless, without supporting evidence and without supporting findings, the Board of Tax Appeals approved the Tax Commission's valuation, holding that "the assessment * * * is in all respects correct."

THE ISSUES.

The following questions of law are therefore presented for decision by this Court: Whether it is reasonable and lawful for the Board of Tax Appeals (a) **wholly to ignore and disregard evidence that is not contradicted and not questioned,** and (b) **without any supporting evidence whatever, to rubber-stamp a valuation predicated exclusively on a rule-of-thumb whose basis is not disclosed in the record.**

THE FACTS.

Rollman operates a department store in Cincinnati. In each of the years 1936, 1938 and 1939 it filed personal property tax returns, as required by Section 5367, G. C., in which its merchandise inventory was listed at average book value, as authorized by Section 5382, G. C. Each return was accompanied by a claim for reduction of the book value of inventory to its true value, as provided for in Section 5389, G. C.

THE ACCOUNTING BACKGROUND.

The book value of Rollman's merchandise, or inventory, and its records in respect thereto, are kept under a system, used generally by all of the larger department stores in this state and in the United States, known as the "retail system." (Record, pages 4 and 5.) Under this system, merchandise coming into a store is given a "retail selling price." The difference between the cost of the incoming merchandise and the retail selling price is known as the "mark-up." The mark-up is intended to cover the merchant's cost of doing business and a reasonable profit. Detailed records are kept of the retail selling price, the mark-up, and the relation, in percentage, that the mark-up bears to the retail selling price. Thus, if the store buys $500,000 worth of merchandise and gives it a retail selling price of $750,000, it has a record of having on hand an inventory of $750,000 at "retail," a mark-up of $250,000, and a "per cent of mark-up" of 33⅓%, which is to say that the mark-up is 33⅓% of the retail selling price. Cost of the inventory may then, at any time, be arrived at by deducting the per cent of mark-up from the retail selling price of the goods.

As new merchandise is purchased, its retail selling price and mark-up are added to the store's records, and a new per cent of mark-up is figured, depending on the relation that the total mark-up bears to the total retail selling price of the entire stock of merchandise. Thus, going back to the example given above, after new merchandise has been added, we may have a stock of goods having a retail selling price of $875,000, a mark-up of $306,250 and a per cent of mark-up of 35%. Cost may then be arrived at by deducting the per cent of mark-up from the retail selling price of the total inventory, and would be in this case $578,750.

On the other hand, when the retail selling price of an item, or a number of items, of merchandise is reduced, the amount of the reduction, described as a "mark-down," (Record, pages 23 and 24) is deducted from the record of the total retail selling price. Thus, to return again to our example, if a total mark-down of $25,000 in the retail selling price is made, we will have a retail inventory of $850,000 and an inventory at **cost** of $552,500.

From day to day, as sales of merchandise are made, the amount of sales in dollars is deducted from the retail inventory. Likewise, from day to day, new merchandise is received in the store and its retail selling price is added to the store's record of total retail selling price, or retail inventory, and the mark-up on the new merchandise is added to the store's record of mark-up and at the same time the amount of new mark-up is reflected in the per cent of mark-up.

Thus, the cost of inventory may be determined at any time from the records of the store by reducing the retail selling price of the whole inventory by the per cent of mark-up. The correctness of these book figures in the case of Rollman was checked at least once a year on January 31, when an actual count was made of each item of merchandise in the store, the total of retail selling price thus obtained being then compared with the total

retail selling price on the books of the company and corrections made, if necessary. This actual count of merchandise is termed a "physical inventory." (Record, pages 9 and 10.)

The advantages of the retail system to the merchant are numerous, but the principal advantage is that it affords him a continuing check on the course of his business. The Tax Commission and its agents were thoroughly familiar with this system and all of their calculations, with respect to Rollman's inventories, were based on it.

The "average book value" listed in Rollman's tax returns for the years 1936, 1938 and 1939, was obtained by adding together the monthly retail inventories for the preceding year, reducing the total to **actual cost** by deducting the net per cent of mark-up, and dividing that amount by twelve. (Record, pages 13 and 14.)

THE CLAIMS FOR REDUCTION AND DATA IN SUPPORT THEREOF.

The figures contained in Rollman's tax returns and claims for reduction from book value may be summarized as follows:

SCHEDULE 1.

	1936 Return	1938 Return	1939 Return
1. Total Inventories at Cost	$7,086,365.	$9,208,760.	$7,616,503.
2. Average Inventory ...	640,697.	767,396.	634,708.
3. Discounts Earned	43,977. (6.86%)	53,748. (7.%)	44,302. (6.98%)
4. Net Book Value	596,719.	713,648.	590,406.

	1936 Return	1938 Return	1939 Return
5. Deduction Claimed	93,088. (15.6%)	115,610. (16.2%)	95,646. (16
6. True Value Claimed	503,631.	598,038.	494,760.

(The returns and claims from which the above fig are taken are appellee's Exhibits A through O.)

The Tax Commission of Ohio, predecessor of the Commissioner, accorded the relief sought by Rollman part, and reduced the book value of the inventorie the following amounts:

SCHEDULE 2.

	1936 Return	1938 Return	1939 Return
1. Discounts Earned	$43,977. (6.86%)	$53,748. (7.%)	$44,302. (6
2. Deduction Allowed	46,970. (7.33%)	53,015. (6.90%)	40,524. (6

(The above figures are taken from appellee's Exh D (1936), I (1938) and N (1939). From this point we may disregard the items "Discounts Earned" this portion of Rollman's claim was granted in ful the Tax Commission and is not in dispute.)

It should be noted in the above schedules that, whe Rollman claimed that the average book value of it ventories of 1936, 1938 and 1939 should be reduced spectively, 15.6%, 16.2% and 16.2%, in order to ar at the "true value" thereof, the Tax Commission allo reductions in those years, respectively, of 7.33%, and 6.38%.

The reductions allowed by the Commission (Sche 2, line 2) were the result of the application to ea Rollman's average inventories of a formula, adopted

ed by the Commission to give recognition to the price eductions that would have to be made in the future efore all of the merchandise in the inventory could be ld. The Commission's formula is as follows:

Merchandise 1 to 6 months old, reduce 5%.

Merchandise 7 to 12 months old, reduce 10%.

Merchandise over 12 months old, reduce 20%.

An example of the application of the formula may be en in appellee's Exhibit D.

The reductions claimed by appellant were based upon s actual experience on the price reductions it had made items of merchandise in its inventories in years prior the year in which each claim for reduction was made; at is to say, in making each claim, Rollman took into count the percentages by which it had reduced its in- ntories in price in previous years before they were mpletely sold out. To arrive at this actual experience, actual count was made of all merchandise in stock as January 31 in each year and a record kept thereafter price reductions made on each item of that specific ventory until the whole was disposed of. (Record, ges 16, 23 and 24.)

With its 1936 return, Rollman claimed that the average ok value of its inventory should be reduced 15.6%. To monstrate the validity of its claim, Rollman inserted erein a schedule showing the amount and percentages which its physical inventories taken on January 31, 933 and 1934 were reduced in price before being closed , as follows:

SCHEDULE 3.

Inventory Date	Actual Inventory	Amount Reduced		Per C... Redu...
1/31/1933	$317,545.	$ 50,304.		15.8...
1/31/1934	526,206.	81,534.		15.5...
	$843,751.	$131,838.	Average Reduction	15.6...

(The above figures were taken from appellant's Exhi... 1, Record page 47.)

In its return, Rollman claimed the average reducti... of 1933-1934. The Tax Commission applied its form... and reduced the average book value by 7.33%.

In its return for the year 1938, a claim for a reducti... from book to true value of 16.2% was made. Rollm... again submitted figures showing the amount and p... centages by which previous inventories had been redu... in price before being sold out:

SCHEDULE 4.

Inventory Date	Actual Inventory	Amount Reduced		Per C... Redu...
1/31/1933	$ 317,545.	$ 50,304.		15.8...
1/31/1934	526,206.	81,534.		15.5...
1/31/1935	541,509.	92,727.		17.1...
1/31/1936	481,986.	78,069.		16.2...
	$1,867,246.	$302,634.	Average Reduction	16....

(The above figures are taken from appellant's Exhi... 2, page 48; also shown in appellee's Exhibit H, page ...

In its 1938 return, Rollman claimed the average 19... 1936 actual reduction of 16.2%, but the Commission ag... applied its formula and allowed a reduction of 6.... (Schedule 2, line 2, column 2.)

...its 1939 return, Rollman claimed the average book ...e of its inventory should be reduced 16.2% (Schedule ...ne 5, column 3) to the true value thereof, and, in ...port of its contention, furnished the following figures ...ecting its actual experience:

SCHEDULE 5.

...ntory ...te	Actual Inventory	Amount Reduced		Per Cent Reduction
.../1933	$ 317,545.	$ 50,304.		15.8%
.../1934	526,206.	81,534.		15.5%
.../1935	541,509.	92,727.		17.1%
.../1936	481,986.	78,069.		16.2%
.../1937	613,076.	99,894.		16.3%
	$2,480,322.	$402,528.	Average % Reduction	16.2%

...he above figures appear in appellant's Exhibit 3, ...e 49.)

...s in the two prior years in question, Rollman again ...med that the average book value of its 1939 inventory ...ld be reduced by the amount that its actual experi... indicated it would have to be reduced before its ...l disposition, to-wit, 16.2%, rather than by the rule-of-...b used by the Commission. Again the Commission ...lied its formula, this time resulting in a reduction of ...%. (Schedule 2, line 2, column 3.)

...addition to the figures summarized in the foregoing ...edules, Rollman furnished the Commission, with re-...ct to each of its claims, a complete breakdown (appel-...'s Exhibits C, H and M) of the price reductions that ...ade on each of its January 31 inventories. However, ...thout affording Rollman an opportunity for hearing or argument, the Commission applied its formula to of the inventories in question, and determined their eral "true values" to be "book values" less the am resulting from the application of the Commission's mula. (Schedule 2, line 2, columns 1, 2 and 3.)

PROCEEDINGS BEFORE THE BOARD

Appeals were then taken by Rollman to the Boa Tax Appeals, where the three appeals were consoli and heard as one. Rollman was given a hearing b a referee representing the Board and was permitt file with the Board a brief in support of its conten Its 1936, 1938 and 1939 tax returns, including the c and all supporting data, were put in evidence by co for the appellee, **but no proof was adduced in su of appellee's determinations.**

The hearing before the Board's referee was he June 5, 1941, and the lapse of time between the upon which the Tax Commission's determinatio value were made and the date of the aforesaid he placed Rollman in the fortunate position of being to put in evidence **its actual experience with resp actual price reductions made on inventories taken i of the years in question (1936 and 1938).** In add to the information which was before the Tax Comm with respect to reductions in value of Rollman's i tories in prior years, the Board of Tax Appeals before it for consideration Rollman's actual expe of reduction in value of its inventories for **years inv** and years **subsequent** thereto.

ollowing schedule summarizes the evidence of mark-downs in price of inventories on hand from r 1933 to the year 1938, inclusive:

SCHEDULE 6.

[illegible]	Actual Inventory	Amount Reduced	Per Cent Reduction
1933	$317,545.	$ 50,304.	15.8%
1934	526,206.	81,534.	15.5%
1935	541,509.	92,727.	17.1%
1936	481,986.	78,069.	16.2%
1937	613,076.	99,894.	16.3%
1938	556,011.	119,864.	21.5%

e figures appearing in Schedule 6 are taken from hedule heretofore set forth with the exception of ventory of January 31, 1938. The information with t to that inventory is found in appellant's Ex-)

of the utmost importance to note that the fore- igures (Schedule 6) had taken on a tremendously significance at the time they were presented to the Whereas, when they were considered by the Tax ssion they represented the cumulative past expe- upon which Rollman's claims for reduction from true value of its inventories were based, when re submitted to the Board they represented **actual nce with inventories then being valued by the** Thus Rollman claimed that the book value of ry listed in its 1936 tax return should be reduced %; actually, its physical inventory taken on Jan- 1935 was reduced 17.1% and its physical inven- January 31, 1936 was reduced 16.2% before the merchandise of which they were composed was fi sold. Appellant claimed in its 1938 return that the value of its inventory listed therein should be red 16.2%. Actually, its physical inventory of Janua 1937 was reduced 16.3% before being disposed of. its 1939 return, appellant claimed that the book val its inventory as listed should be reduced by 16.2%, subsequent events proved that price reductions aggr ing 21.5% were made before its physical invento January 31, 1938 was sold out. (Record, pages 23 to

The evidence offered by Rollman was uncontrad unchallenged and unimpeached. Nevertheless, the B of Tax Appeals affirmed the action of the Tax Com sion in each of the three cases.

ARGUMENT.

Beginning with the journal entry of the Board of Appeals in each case, the utter illegality of the proceeding is apparent on the face of the record. entry in Case No. 3780, for example, in which Roll 1936 return was in question, recites that:

> "The Board * * * finds * * * that appellan claims in its beginning inventory for the fisca years 1933 and 1934 it experienced an actual los due to mark-downs in the amount of 15.6% an that therefore, in the light of this experience, i is entitled to a deduction from the average book value of its merchandising inventory for th year 1936 in said amount of 15.6%, or $93 088.00."

In addition, the Board had before it the uncontrad testimony of G. B. Lonneman, Secretary and Trea

llman, that (Record, page 23) appellant's January 935 physical inventory had **actually** been reduced % before it was completely disposed of. Thus, not id the Board have before it Rollman's actual expe with its 1933 and 1934 physical inventories, which, irect way supported the reasonableness and pro of Rollman's claim for a reduction of 16.2%, but ewise had before it the fact that the January 31, nventory had suffered **actual reductions** of 17.1%, urther, that the inventory of January 31, 1936 (just y-nine days subsequent to tax listing day, January 36) had suffered **actual reductions of 16.2%**. More the Board had before it the figures (Schedule 6) strating Rollman's experience with inventory re ons in **subsequent** years. In the teeth of all of the nce, the entry goes on to say that:

> "The Board further finds that each monthly nventory in appellant's return for said year, re pectively, reflects all previous mark-downs; at appellant is not entitled to any further de iction from the average book value of its mer handising inventory than that allowed by the ax Commission; and that the assessment here fore made by the Tax Commission is in all spects correct."

reason for the finding that "each monthly inven * * reflects all **previous** mark-downs" is somewhat re. It is, of course, true; it is true as to every ory in every department store in the state of Ohio the retail system. The Tax Commission knew it l of its calculations were based on it. The finding ems to indicate a misconception of the issues on the part of the Board. Of course, the book value o inventory of merchandise will on any day under retail accounting system reflect mark-downs taken to such day. The point is that there will inevitabl further and additional mark-downs. The progre marking down of items of merchandise in an inven as of any given date, is an inescapable and sad experi every retailer must go through in order to move his and make way for fresh goods. Consequently, an in tory is never worth the book figures at which it is car if it is to be sold it will have to be sold for less. Tax Commission recognized that fact and allowed ce reductions from book value, not because of pre mark-downs (already reflected in the book figure) because of the certainty that further mark-downs w have to be made. So the question before the Board not whether a reduction from book value was p the question concerned the amount of reduction to Rollman was entitled. The Tax Commission arbit applied its formula, the propriety and applicabili which it made no effort to establish. Rollman, o other hand, presented evidence of actual experience a period of years, demonstrating the utter inadequa the formula in the circumstances. Yet, according Board of Tax Appeals, "the assessment * * * ma the Tax Commission is in all respects correct."

No finding of fact appears in the entry to suppor conclusion.

To sum up, the Board took notice of, but re Rollman's experience prior to the year of the ret

regarded the testimony in the record bearing upon lman's actual experience in 1936 and subsequent rs; at the same time, it recognized that book value not true value, but limited the amount of the re- tion to the amount resulting from the arbitrary ap- ation of the rule-of-thumb employed by the Tax Com- sion, and found the action of the Commission to be n all respects correct."

The Tax Commission and Rollman are agreed upon at st one thing, which, seemingly, escaped the Board, and t is the theory upon which the reduction of a mer- ant's inventory from book value to true value, as thorized by the legislature (Section 5389, G. C.) can based—namely, the theory of "profitable use" of operty. It is well described by Mr. Justice Brewer in **C. C. & St. L. R. R. v. Backus**, 154 U. S. 439 (1984), rein, at page 444, this language may be found:

> "* * * the value of property results from the use to which it is put and varies with the profit- ableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use. The amount and profitable character of such use determines the value, and if property is taxed at its actual cash value, it is taxed upon something which is created by the uses to which it is put. * * *"

llman purchased the numerous items in its inventory the purpose of selling them at a profit, and to that d it added to the cost of each item sufficient mark-up over its cost of doing business, plus a reasonable fit to itself. But, regardless of price reductions made in the past, on tax listing day and on the last day each month of the year preceding it, or for that matter on any day, appellant knew, as every merchant knows that, in the future, substantial price reductions would have to be made on a certain portion of inventory in order to sell it. These prospective, but certain, reductions adversely affect the profitable use of the property, and true value is decreased in proportion to the reduction. The theory of the profitable use of a merchandise inventory was recognized generally by the Tax Commission and this policy has been followed by its successor, the Tax Commissioner. Recognition has been accorded the theory by applying the "aged merchandise formula," described herein, and reducing the book value of the inventory by the amount resulting from the application of the formula. However, instead of accepting the reductions resulting from the use of the Commission's rule-of-thumb method, Rollman filed claims, with each of its returns for the years in question, asking that its inventories be reduced by amounts which its experience indicated would more nearly approximate the actual price reductions that it would have to make, and the claims were accompanied by detailed supporting data. In each case the Commission concurred in Rollman's basic contention that book value was not the true value of its inventories, but instead of allowing the reductions claimed by appellant it merely applied its formula and reduced the book value of the inventory by that amount. This action of the Commission was unreasonable and arbitrary on its face.

Returning to the decision of the Board respecting

the value of Rollman's 1936 inventory, we may start with the admitted fact that its book value was not its true value in money but that true value was book value less the amount that the inventory would, in the future, have to be reduced in price before it could be sold. There is no disagreement between Rollman and appellee on this point. The sole dispute was as to the amount of the reduction. Rollman claimed that it should be reduced 16.2%. The Commission allowed 7.33%. The uncontradicted evidence before the Board was that Rollman's January 31, 1936 inventory, which was in stock thirty days after tax listing day and contained the great bulk of the goods in stock on tax listing day, had actually been reduced 16.2% before being completely sold out. The Board was not free to disregard this positive and undisputed evidence. As stated by the Circuit Court of Appeals for the Sixth Circuit, in **Rookwood Pottery Company v. Comm.**, 45 F. (2d) 43, 45 (1930):

> "We see no reason why the taxpayer did not make its case when it put in proofs clearly and distinctly tending to show this value; **and when proofs so introduced remained unchallenged by contrary proofs or destructive analysis,** it was the duty of the commissioner to decide the issue in accordance with the proof then appearing before him; and it was, we think the duty of the Board to take the same view." (Boldface added.)

To the same effect is **O'Rear v. Comm.**, 80 F. (2d) 473 (C. C. A. 6th, 1935) in which Judge Simons said:

> "* * * the taxpayer makes out his case when he has put in proof clearly and distinctly tending to show a determining fact, and the proofs remain unchallenged."

In addition, the Board had before it unimpeache[d evi-]
dence of reductions actually made in Rollman's phy[sical]
inventories from 1933 to 1938, inclusive. The Bo[ard's]
entry can lead only to the conclusion that it consid[ered]
that it could not take into account events transpi[ring]
after tax listing day. In this conclusion it was griev[ously]
in error. **American Steel & Wire Co. v. Board of R[evi-]**
sion, 139 O. S. 388, 392; **United States v. Morgan**, 31[3 U.]
S. 408, 85 L. ed. 1429 (1941); **Sinclair Refining Co[. v.]**
Jenkins Petroleum Process Co., 289 U. S. 689; 77 L[. ed.]
1449 (1933); **H. H. Miller Industries Co. v. Comm[.]**, [..]
F. (2d) 412 (C. C. A. 6th, 1932); **Nachod and U. S. Si[gnal]**
Corp. v. Helvering, 74 F. (2d), 164 (C. C. A. 6th, 19[..]);
American Chemical Paint Co. v. Comm., 66 F. (2d)[, ...]
(C. C. A. 3rd, 1933). In the words of Mr. Justice [Car-]
dozo in the **Sinclair Refining Co.** case, supra:

> "Experience was * * * available to correct un[-]
> certain prophecy. Here is a book of wisdom tha[t]
> courts may not neglect. We find no rule of law
> that sets a clasp upon its pages and forbids us
> to look within."

Having thus rejected all of the evidence before it[, the]
Board nevertheless found that appellant was "no[t en-]
titled to any further reduction in its inventory than[...]
found by the Tax Commission." **It did not disclos[e the]**
basis for this conclusion. As stated in **Tex-Penn Oil [Co.]**
v. Comm., supra:

> (p. 523) "* * * The board ignored the testi[-]
> mony of these witnesses as it had to do in order
> to reach the conclusion that it did. It fixed the
> value of $7 per share for the stock, but just how
> it reached this figure is not disclosed. It cer[-]
> tainly ignored all the evidence without showing
> that it possessed independent knowledge itself
> of the value of the property or stock involved[.]

> [*] * The Board may not ignore and reject all
> [t]he evidence as to value and reach a conclusion
> [b]ased upon other facts and factors without dis-
> [c]losing them."
>
> (p. 524) "Tested by the actual after events,
> [a] valuation of anything like (the Board's valua-
> [t]ion) is grotesque."

[Su]ch a procedure is plainly unreasonable, unlawful
[and] a denial of due process. **Boggs & Buhl v. Comm.**, 34
[F. (]2d), 859 (C. C. A. 3rd, 1929); **Pittsburgh Hotels Co.**
[v. C]omm., 43 F. (2d), 345 (C. C. A. 3rd, 1930); **Planters**
[Ope]rating Co. v. Comm., 55 F. (2d), 583 (C. C. A. 8th,
[...]); **West Ohio Gas Co. v. P. U. C. O.**, 294 U. S., 79; 79
[L. e]d., 773.

[W]hatever basis the Board had for its decision is not
[disc]losed in the record. Its conclusion is wholly unsup-
[port]ed by any evidence in this case and, therefore, under
[the] rule repeatedly announced by the United States
[Sup]reme Court, can not stand. As stated by Mr. Justice
[Car]dozo in the case of **Ohio Bell Telephone Co. v. Public**
[Ut]ilities Comm., 301 U. S., 292 (1937), at page 303:

> "* * * how was it possible for the appellate
> [c]ourt to review the law and the facts and intelli-
> [g]ently decide that the findings of the Commis-
> [s]ion were supported by the evidence when the
> [e]vidence that it approved was unknown and un-
> knowable?"

[W]hat the Board did was to whitewash the use of the
[fi]ve, ten and twenty per cent formula by the Tax Com-
[m]ission. The basis for that formula, the supporting data,
[if a]ny, is not set forth anywhere in the record and as Mr.
[Ju]stice Cardozo pointed out in the Ohio Bell case, supra,
[is] "unknown and unknowable."

[T]hat is not due process of law.

It will probably be contended by appellee that a p sumption validates the Board's determination. Such presumption can be no more than a procedural devi The second syllabus found in the case of **Lunsford** **Comm.**, 62 F. (2d) 740 (1933) clearly states this rule the following language:

> "The presumption that determination by Commissioner is correct is procedural, and can not survive clear and distinct proof to the contrary."

Many other cases are to the same effect, includi **Manchester Board & Paper Co. v. Comm.**, 90 F. (2d), (C. C. A. 4th, 1937).

CONCLUSION.

There is more involved here than the amount of disputed tax. The issues are fundamental and f reaching. They go to the roots of our system of law government. May an administrative agency perform quasi-judicial functions ignore and disregard posit uncontradicted, unchallenged evidence? The answe "No." Must an administrative tribunal support orders by appropriate findings of fact? Unless it m as the United States Supreme Court recently has poi out, judicial "review has indeed become a perfunct process." **United States v. Carolina Freight Carr** **Corp.**, 62 S. Ct., 722 (March 2, 1942). Must an admi trative tribunal's findings of fact and order thereon supported by substantial evidence? Repeatedly United States Supreme Court has answered in the affi ative—there must be evidence and it must be **in** **record. Helvering v. Tex-Penn Oil Co.**, 300 U. S., (1937); **Ohio Bell Telephone Co. v. Public Utili** **Comm.**, 301 U. S., 292 (1937); **Railroad Comm. of C**

v. Pacific Gas & Electric Co., 302 U. S., 388 (1938); **ester Telephone Corp. v. United States**, 307 U. S., (1939).

ese are **minimum safeguards.** It is the historic tion and responsibility of the courts to see that they ot evaded.

e orders of the Board of Tax Appeals here in tion are unreasonable and unlawful. They constitute ial of due process of law. If permitted to stand, will introduce into the jurisprudence of this state **alien concept of the supremacy of arbitrary will.** The ers should be reversed.

Respectfully submitted,

DARGUSCH, CAREN, GREEK & KING,

Attorneys for Appellant
The Rollman & Sons Co.

APPENDIX

EXHIBIT I.

Notice of Appeal and Assignment of Error.

No. 29059.

In the Supreme Court of Ohio

ROLLMAN AND SONS COMPANY,
a Corporation,
Appellant,

vs.

WILLIAM S. EVATT,
Tax Commissioner of Ohio,
Appellee.

NOTICE OF APPEAL.

Appellant, Rollman and Sons Company, Cincinnati, Ohio, hereby gives notice of appeal to the Supreme Court of Ohio, from the final entry of the Board of Tax Appeals of the Department of Taxation of Ohio, entered on the 27th day of January, 1942, as follows:

"BEFORE THE BOARD OF TAX APPEALS DEPARTMENT OF TAXATION OF OHIO.

Rollman and Sons Company,
Cincinnati, Ohio,
Appellant,
v.
William S. Evatt,
Tax Commissioner,
Appellee.

Entry No. 37[illegible]

This day this cause came on to be heard and was submitted on the transcript of the proceedings before the Tax Commission, the evidence and briefs.

The Board of Tax Appeals being fully advised in the premises finds that appellant in filing its tax return for the year 1936 listed the average book value of its merchandising inventory at $640,697.00 and filed therewith a claim for deduction from said book value for cash discounts of $43,977.00 and for aged inventory of $93,088.00; that on August 31, 1936, the Tax Commission made an assessment against appellant for said year on the basis of the book value of said average inventory from which it allowed as deductions the claim in full for cash discounts and also allowed for aged inventory $46,970.00; that appellant uses what is known as the retail inventory method and listed its inventory in said return according to said method; that appellant claims that on its beginning inventory for the fiscal years 1933 and 1934 it experienced an actual loss due to mark-downs in the amount of 15.6 per cent and that therefore, in the light of this experience, it is entitled to a deduction from the average book value of its merchandising inventory for the year 1936 in said amount of 15.6 per cent or $93,088.00.

The Board further finds that each monthly inventory in appellant's return for said year, respectively, reflects all previous mark-downs; that appellant is not entitled to any further deduction from the average book value of its merchandising inventory than that allowed by the Tax Commission; and that the assessment heretofore made by the Tax Commission is in all respects correct.

It is therefore ordered that the assessment here
made by the Tax Commission be, and the same her
affirmed.

I hereby certify the foregoing to be a true and co
copy of the action of the Board of Tax Appeals o
Department of Taxation this day taken with resp
the above matter.

Harry J. Rose,
Secretary

ASSIGNMENTS OF ERROR.

Appellant states that the following errors appe
said entry and in the record of the proceedings in
cause:

1. The failure and refusal of the Board of Tax Ap
to consider and give effect to the unimpeached an
controverted evidence adduced by appellant of the
value in money of the property in question.

2. The complete failure of evidence to suppor
finding and determination of the Board of Tax Ap

3. The failure of appellee to produce any evi
whatsoever of the validity of his determination o
value of the property in question at any stage o
proceedings in this cause.

4. The decision of the Board of Tax Appeals mak
presumption of validity attaching to the determin
of appellee conclusive and unimpeachable.

5. The value affirmed by the decision of the Boa
Tax Appeals is in excess of the true value in mon
appellant's property.

excessive valuation of appellant's property af-
by the Board of Tax Appeals constitutes a taking
without due process of law in contravention of
urteenth Amendment to the Constitution of the
States of America and Article I, Section 1 of the
onstitution.

iam S. Evatt, Tax Commissioner of the Depart-
Taxation of Ohio, is designated appellee herein.

appeal is on questions of law and fact.

ROLLMAN AND SONS COMPANY,
By *Its Attorneys,*
Dargusch, Caren, Greek & King,
17 S. High St., Columbus, Ohio.

Acknowledgment.

pt of a copy of a Notice of Appeal to the Supreme
of Ohio in the above entitled cause is hereby
ledged on this, the 26th day of February, 1942.

Wm. S. Evatt, *Tax Commissioner.*

ROOF OF FILING OF NOTICE OF APPEAL WITH THE BOARD OF TAX APPEALS.

undersigned hereby certifies that appellant, Roll-
nd Sons Company, filed its Notice of Appeal in the
ntitled cause with the Board of Tax Appeals of

the Department of Taxation of Ohio on the 26th d
February, 1942, and filed a written demand requ
said Board to file with the Supreme Court a ce
transcript of the record of the proceedings of said
pertaining to the decision in the above entitled ca

HARRY J. ROSE,
Secretar

EXHIBIT II.

Notice of Appeal and Assignments of Error.

No. 29060.

In the Supreme Court of Ohio

ROLLMAN AND SONS COMPANY,
a Corporation,
Appellant,

vs.

WILLIAM S. EVATT,
Tax Commissioner of Ohio,
Appellee.

NOTICE OF APPEAL.

Appellant, Rollman and Sons Company, Cincinnati, hereby gives notice of appeal to the Supreme Court Ohio, from the final entry of the Board of Tax Appeals the Department of Taxation of Ohio, entered on the day of January, 1942, as follows:

BEFORE THE BOARD OF TAX APPEALS
DEPARTMENT OF TAXATION OF OHIO.

Rollman and Sons Company, Cincinnati, Ohio, *Appellant,* v. William S. Evatt, Tax Commissioner, *Appellee.*	Entry No. 7958.

This day this cause came on to be heard and was su mitted on the transcript of the proceedings before Tax Commission, the evidence and briefs.

The Board of Tax Appeals being fully advised in premises finds that appellant in filing its tax return the year 1936 listed the average book value of its m chandising inventory at $767,396.69 and filed there a claim for deduction from said book value for cash counts of $53,748.00 and for aged inventory of $115,610 that on September 1, 1938, the Tax Commission made assessment against appellant for said year on the b of the book value of said average inventory from wh it allowed as deductions the claim in full for cash counts and also allowed for aged inventory $53,302 that appellant uses what is known as the retail inven method and listed its inventory in said return accor to said method; that appellant claims that on its be ning inventory for the fiscal years 1933 to 1936, inclu it experienced an actual loss due to mark-downs in amount of 16.2 per cent and that therefore, in the ligh this experience, it is entitled to a deduction from average book value of its merchandising inventory for year 1938 in said amount of 16.2 per cent or $115,610

The Board further finds that each monthly inven in appellant's return for said year, respectively, re all previous mark-downs; that appellant is not enti to any further deduction from the average book val its merchandising inventory than that allowed by the Commission; and that the assessment heretofore made the Tax Commission is in all respects correct.

is therefore ordered that the assessment heretofore by the Tax Commission be, and the same hereby is med.

hereby certify the foregoing to be a true and correct of the action of the Board of Tax Appeals of the partment of Taxation this day taken with respect to above matter.

Harry J. Rose,
Secretary.

ASSIGNMENTS OF ERROR.

ppellant states that the following errors appear in entry and in the record of the proceedings in said se:

The failure and refusal of the Board of Tax Appeals onsider and give effect to the unimpeached and un overted evidence adduced by appellant of the true in money of the property in question.

The complete failure of evidence to support the ing and determination of the Board of Tax Appeals.

The failure of appellee to produce any evidence tsoever of the validity of his determination of the of the property in question at any stage of the eedings in this cause.

The decision of the Board of Tax Appeals makes the mption of validity attaching to the determination ppellee conclusive and unimpeachable.

The value affirmed by the decision of the Board of Appeals is in excess of the true value in money of llant's property.

The excessive valuation of appellant's property affirmed by the Board of Tax Appeals constitutes a tak thereof without due process of law in contravention the Fourteenth Amendment to the Constitution of United States of America and Article I, Section 1 of Ohio Constitution.

William S. Evatt, Tax Commissioner of the Depa ment of Taxation of Ohio, is designated appellee here

Said appeal is on questions of law and fact.

ROLLMAN AND SONS COMPANY,
By *Its Attorneys,*
DARGUSCH, CAREN, GREEK & KING
17 S. High St., Columbus, Oh

Acknowledgment.

Receipt of a copy of a Notice of Appeal to the Supre Court of Ohio in the above entitled cause is her acknowledged on this, the 26th day of February, 194

WM. S. EVATT, *Tax Commissioner.*

PROOF OF FILING OF NOTICE OF APPEAL WITH THE BOARD OF TAX APPEALS.

The undersigned hereby certifies that appellant, R man and Sons Company, filed its Notice of Appeal in above entitled cause with the Board of Tax Appeal the Department of Taxation of Ohio on the 26th day February, 1942, and filed a written demand reques said Board to file with the Supreme Court a certi transcript of the record of the proceedings of said Bo pertaining to the decision in the above entitled cause

HARRY J. ROSE,
Secretary

EXHIBIT III.

Notice of Appeal and Assignments of Error.

No. 29061.

In the Supreme Court of Ohio

ROLLMAN AND SONS COMPANY,
a Corporation,
Appellant,

vs.

WILLIAM S. EVATT,
Tax Commissioner of Ohio,
Appellee.

NOTICE OF APPEAL.

ppellant, Rollman and Sons Company, Cincinnati, hereby gives notice of appeal to the Supreme Court io, from the final entry of the Board of Tax Appeals Department of Taxation of Ohio, entered on the ay of January, 1942, as follows:

BEFORE THE BOARD OF TAX APPEALS DEPARTMENT OF TAXATION OF OHIO.

Rollman and Sons Company, Cincinnati, Ohio, *Appellant,* v. William S. Evatt, Tax Commissioner, *Appellee.*	Entry No. 9094.

This day this cause came on to be heard and wa mitted on the transcript of the proceedings befo Tax Commission, the evidence and briefs.

The Board of Tax Appeals being fully advised premises finds that appellant in filing its tax retu the year 1939 listed the average book value of it chandising inventory at $634,709.00 and filed the a claim for deduction from said book value for cas counts of $44,302.00 and for aged inventory of $95, that on September 1, 1939, the Tax Commissioner m assessment against appellant for said year on the of the book value of said average inventory from he allowed as deductions the claim in full for cas counts and also allowed for aged inventory $40, that appellant uses what is known as the retail inv method and listed its inventory in said return ac to said method; that appellant claims that on its ning inventory for the fiscal years 1933 to 1937, in it experienced an actual loss due to mark-down amount of 16.2 per cent and that therefore, in the this experience, it is entitled to a deduction fr average book value of its merchandising inventory year 1939 in said amount of 16.2 per cent or $95

The Board further finds that each monthly in in appellant's return for said year, respectively all previous mark-downs; that appellant is not to any further deduction from the average book its merchandising inventory than that allowed by Commissioner; and that the assessment heretof by the Tax Commissioner is in all respects corre

therefore ordered that the assessment heretofore by the Tax Commissioner be, and the same hereby rmed.

ereby certify the foregoing to be a true and correct f the action of the Board of Tax Appeals of the tment of Taxation this day taken with respect to ove matter.

Harry J. Rose,
Secretary.

ASSIGNMENTS OF ERROR.

ppellant states that the following errors appear in ntry and in the record of the proceedings in said

he failure and refusal of the Board of Tax Appeals sider and give effect to the unimpeached and un- verted evidence adduced by appellant of the true n money of the property in question.

e complete failure of evidence to support the and determination of the Board of Tax Appeals.

e failure of appellee to produce any evidence ever of the validity of his determination of the f the property in question at any stage of the dings in this cause.

e decision of the Board of Tax Appeals makes the ption of validity attaching to the determination llee conclusive and unimpeachable.

e value affirmed by the decision of the Board of ppeals is in excess of the true value in money of nt's property.

Summary of RDS Merchandising Inventory Valuations as Reported, as Amended by the Tax Commissioner, and as Reduced by the BTA

		Tax Year 2000 FYE 01/1999		Tax Year 2001 FYE 01/2000		Tax Year 2002 FYE 01/2001	
(1)	12 Month Average Inventory -	118,649,116	*S.T. 277*	115,026,945	*S.T. 280*	118,028,259	*S.T. 283*
(2)	Cost Departments	38,476	*S.T. 277*	64,995	*S.T. 280*	40,588	*S.T. 283*
(3)	**12 Month Average Inventory - As Filed & Before Next-Quarter-Markdowns Under Ohio Adm. Code 5703-3-17**	**118,687,592**	*(1) + (2)*	**115,091,940**	*(1) + (2)*	**118,068,847**	*(1) + (2)*
(4)	Ohio Adm Code 5703-3-17 Next-Quarter-Markdowns - As Filed	16,582,096	*S.T. 277*	17,676,875	*S.T. 280*	17,389,190	*S.T. 283*
(5)	(4) / (3)	14.0%		15.4%		14.7%	
(6)	**Average Inventory Subject to Tax - As Filed**	**102,105,496**	*(3) - (4)*	**97,415,065**	*(3) - (4)*	**100,679,657**	*(3) - (4)*
(7)	Ohio Adm Code 5703-3-17 Next-Quarter-Markdowns - As Amended by the Commissioner	21,468,251	*S.T. 98*	24,016,957	*S.T. 99*	27,476,288	*S.T. 100*
(8)	(7) / (3)	18.1%		20.9%		23.3%	
(9)	**Average Inventory Subject to Tax - As Amended by the Commissioner**	**97,219,341**	*(3) - (7)*	**91,074,983**	*(3) - (7)*	**90,592,559**	*(3) - (7)*
(10)	Percentage Reduction for Vendor Markdown Allowances	6.739%	BTA Ex. 9	8.536%	BTA Ex. 9	10.187%	BTA Ex. 9
(11)	Reduction Allowed by the BTA	6,551,611	*(9) * (10)*	7,774,161	*(9) * (10)*	9,228,664	*(9) * (10)*
(12)	**Average Value Based on BTA Decision**	**90,667,730**	*(9) - (11)*	**83,300,822**	*(9) - (11)*	**81,363,895**	*(9) - (11)*

GLOSSARY

The information set forth by row is as follows:

- Row 1: Captioned "12 Month Average Inventory," this row sets forth the average monthly RIM book values of RDS' Ohio merchandising inventories in the aggregate (total of all Ohio taxing districts) as reported by RDS in attachments to its applications for final assessment (the same book values as set forth in its originally filed Ohio returns);

- Row 2: Captioned "Cost Departments," this row sets forth very small increases from the book values in Row 1 as a result of adding inventory not accounted for using RIM via the stock ledger report. This inventory is tracked separately at cost;

- Row3: Captioned "12 Month Average Inventory-As Filed and Before Next-Quarter Markdowns Under Ohio Adm. Code 5703-3-17," this row simple adds Rows 1 and 2;

- Row 4: Captioned "Ohio Adm Code 5703-3-17 Next-Quarter Markdowns - As Filed," this row sets forth the "next-quarter-markdown" reduction amounts claimed by RDS in its originally filed Ohio returns;

- Row 5: This row sets forth, in relation to RDS' RIM book values, the percentage reductions for the next-quarter markdowns that RDS sought in its originally filed Ohio returns;

- Row 6: Captioned "Average Inventory Subject to Tax – As Filed," this row is derived from subtracting Row 5 from Row 3 and sets forth the inventory valuations reported by RDS on its originally filed returns, on which it paid the tax;

- Row 7: Captioned "Ohio Adm Code 5703-3-17 Next-Quarter-Markdowns – As Amended by the Commissioner," the amounts on this line are actual next-quarter-markdowns obtained during the audit for Ohio retail locations. RDS used companywide estimates to arrive at the "Ohio Adm Code 5703-3-17 Next-Quarter-Markdowns – As Filed" (Row 4);

- Row 8: This row sets forth, in relation to RDS' RIM book values, the percentage reductions for the actual next-quarter markdowns allowed by the Commissioner as a result of the audit conducted;

- Row 9: Captioned "Average Inventory Subject to Tax – As Amended by the Commissioner," this row is derived from subtracting Row 7 from Row 3 and sets forth the inventory valuations assessed by the Commissioner using actual next-quarter markdowns;

- Row 10: Captioned "Percentage Reduction for Vendor Markdown Allowances," RDS computed a broad annual percentage estimate pursuant to which RDS' total annual VMDAs for all of its stores throughout the United States are divided by its total merchandising inventory purchases for all of its stores throughout the United States. Mathematically, the percentage calculation is as follows: Total annual VMDAs / Total annual merchandise purchases. BTA Ex. 9, T. I. at 164-169;

- Row 11: Captioned "Reduction Allowed by the BTA," this row is derived by multiplying Row 9 by Row 10 and sets forth the amount of reduction sought by RDS and allowed by the BTA for vendor markdown allowances;

- Row 12: Captioned "Average Value Based on BTA Decision," this row is derived from subtracting Row 11 from Row 9 and sets forth the inventory valuations based on the BTA's decision.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing *Appendix to Brief of Appellant, Tax Commissioner of Ohio* was served upon the following via regular U.S. Mail on this 29th day of June 2009:

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