ORIGINAL

IN THE SUPREME COURT OF OHIO
Appeal From the Ohio Board of Tax Appeals

Rich's Department Stores, Inc.	:	
	:	
Appellee	:	Case No. 09-437
	:	
v.	:	
	:	
William W. Wilkins	:	
[Richard A. Levin]	:	
Commissioner of Ohio	:	
	:	
Appellant	:	

MERIT BRIEF OF APPELLEE RICH'S DEPARTMENT STORES, INC.

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TABLE OF CONTENTS

APPENDIX

TABLE OF AUTHORITIES

Page

CASES

STATUTES

REGULATIONS

OTHER AUTHORITIES

IN THE SUPREME COURT OF OHIO
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Rich's Department Stores, Inc.	:	
	:	
Appellant	:	
	:	Case No. 09-437
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	:	BTA Case No. 2005-T-1609
William W. Wilkins	:	
[Richard A. Levin],	:	
Commissioner of Ohio	:	
	:	
Appellee	:	

STATEMENT OF FACTS

This appeal originates from applications for final assessment of personal property tax relating to the Ohio personal property tax returns for tax years 2000, 2001, and 2002 filed by Rich's Department Stores, Inc. ("Rich's"). (ST. 436-665; Supp. 998-1227). During the years in issue, Rich's was a subsidiary of Federated Department Stores, Inc. (TrI. 66-67, 94, 163; Supp. 22, 29, 46; Ex. 10-15; Supp. 1235-1310, 319-632). Federated Department Stores, Inc., changed its name to Macy's, Inc. ("Macy's") in August of 2007. (TrI. 163; Supp. 46). Rich's operated several retail department stores in Ohio under the trade name "Lazarus" during the tax years 2000 - 2002. (TrI. 17; Supp. 9).

Rich's is a national chain of retail department stores. (TrI. 14; Supp. 9; Exs. 10-15; Supp. 1235-1310, 319-632). Rich's department stores sell soft goods, *e.g.*, fashion clothing such as jackets, shirts, dresses and trousers, and hard goods such as cosmetics and handbags. (TrI. 20-21, 31; Supp. 10, 13; Exs. 10-15; Supp. 1235-1310, 319-632). Rich's purchases its retail merchandise from many different vendors and, like other retailers, carries massive amounts of inventory. (TrI. 20-21, 23-24, 97; Supp. 10, 11, 29; Exs. 10-15; Supp. 1235-1310, 319-632).

Ms. Laurie Velardi, Macy's Operating Vice-President of Divisional Accounting, is responsible for the financial reporting of sales, profit margin, and inventory for all operating divisions. Ms. Velardi explained that Rich's uses the retail inventory method of accounting ("RIM") to account for its retail inventory values. RIM is the retail industry standard for inventory accounting. (TrI. 96; Supp. 29). It is an accepted method of inventory accounting under Generally Accepted Accounting Principles ("GAAP") and is accepted by the Ohio Department of Taxation. (TrI. 237, 249; Supp. 64, 67; TrII. 8; Supp. 99).

RIM was developed to help retailers account for the mass quantities of fungible items that comprise their inventories by assigning inventory values based on the *average* cost of *all* items. Thus, RIM differs from cost accounting which focuses of the *specific* costs of each *individual* item in inventory. (TrI. 97; Supp. 29).

Initially, RIM inventory value at retail is determined by application of the retail markup and recorded by Rich's. At the end of the accounting period all additions and reductions at retail are considered to arrive at the ending inventory at retail. The ending inventory at retail is then reduced by the departmental markup to establish the average inventory cost for all items sold in the department for the accounting period. The average inventory cost is reflected in Cost of Goods Sold for the accounting period. Under RIM, a retail department's average inventory cost applies to all inventory items within that department. (TrI. 96-98; Supp. 29-30).

Retailers often receive vendor markdown allowances ("MDAs") that reduce the price they pay for their inventory. (TrI. 21, 34, 155-157; Supp. 10, 14, 44). Ms. Christy Godden, the Director of Merchant Learning and Development, described how MDAs work in the retail industry. (TrI. 17-62; Supp. 9-21). Her responsibilities include supervising development and training for all merchants (*e.g.*, merchandise buyers and planners) in all divisions of Macy's. (TrI. 12; Supp. 8).

Ms. Godden explained that MDAs are a way for vendors to reduce the price that a retailer pays for merchandise that is not selling as well as planned. (TrI. 17-18, 34; Supp. 9-10, 14). Not all vendors participate in MDAs, but MDAs are common throughout the retailing industry especially with regard to fashion or "trendy" merchandise. (TrI. 20-21, 69; Supp. 10, 22). A retailer's buyers negotiate with their vendors constantly, in person, over the phone, and via email. (TrI. 24-25; Supp. 11). The parties agree to a margin goal before the retail season begins. (TrI. 18, 23; Supp. 10, 11). The margin goal is simply an understanding that the vendor's merchandise should be saleable by the retailer at a certain profit margin across its stores. (TrI. 18-24; Supp. 10-11). A retailer's profit margin is the difference between what a retailer pays for merchandise and the price at which the retailer sells that merchandise. (TrI. 18-19; Supp. 10). "Margin performance" means the amount of profit margin a retailer actually makes on merchandise relative to the agreed-upon margin goal. (TrI. 18-19; Supp. 10). Margin performance is a calculated average of how much merchandise in a particular line sells at the agreed-upon margin versus that which sells at a lower margin. (TrI. 18-25; Supp. 10-11). Both parties go into the season understanding that MDAs may be granted to support the retailer's margin if the vendor's merchandise underperforms. (TrI. 23, 39, 45; Supp. 11, 15, 16).

If merchandise does not sell as planned, a retailer is forced to "take a markdown." This means the retailer must reduce the retail price of the merchandise in order to sell it. A "hardmark" permanently reduces the retail price of merchandise. (TrI. 38-39; Supp. 15). A retailer may be forced to hardmark merchandise several times so that merchandise will sell. (TrI.

26, 39; Supp. 12, 15). Each time a retailer is forced to take a hardmark, the margin performance of that item is reduced. (TrI. 19, 33-34; Supp. 10, 13-14).

Retailers measure margin performance from vendor to vendor. (TrI. 18-19, 27; Supp. 10, 12). Retailers provide each vendor with daily updates regarding that vendor's margin performance and discuss the vendor's margin performance constantly throughout the season. (TrI. 24-30; Supp. 11-13). Therefore, when margin performance is below plan, vendors agree to MDAs that decrease the price a retailer paid for underperforming merchandise and thereby insure an acceptable margin performance. (TrI. 18, 33-34; Supp. 10, 13-14).

MDAs are never set forth in a written agreement. (TrI. 29; Supp. 12). Instead, a vendor verbally agrees to provide them. When margin performance suffers and a specific amount is agreed upon, the vendor authorizes the retailer to credit the amount of an MDA to the amount the retailer owes the vendor. (TrI. 47-48; Supp. 17).

When a vendor authorizes a specific amount for a MDA, the Rich's buyer enters the amount of the MDA into the Rich's system. Those data then flow through the Rich's accounts payable system. The accounts payable system automatically searches for "financial coverage," *i.e.*, amounts currently due to the vendor. The MDA then posts to that particular vendor's account, and the accounts payable balance for that vendor is reduced by the MDA amount. (TrI. 70-72; Supp. 23).

Ms. Velardi then explained how Rich's internal data systems transfer the buyer's MDA entry through Rich's accounts payable system and also through Rich's price change system. Rich's tracks all changes in the retail price of its merchandise (markups and markdowns) in its price change system. The accounts payable system records changes in both the price *and* the cost of the merchandise. The accounts payable system processes an MDA as a credit to receipts (*i.e.*, a *negative* receipt) and a debit to accounts payable. The price change system records the MDA as a "markdown cancellation" that offsets the negative receipt in accounts payable. (TrI. 101-103; Supp. 30-31).

Ms. Velardi also described how MDAs flow through Rich's stock ledger and general ledger accounts. (TrI. 105-107; Supp. 31-32). Rich's internal data systems feed data, including MDAs, into the stock ledger which feeds the general ledger. (TrI. 105-115; Supp. 31-34; Ex. 4-7; Supp. 189-318, 1229-1230). The ledger accounts translate Rich's internal data into RIM accounting data at the divisional level. (TrI. 105; Supp. 31). MDAs are translated as a credit to retail inventory, a corresponding credit to cost inventory, and a decrease to markdowns. (TrI. 106; Supp. 32). The ledger data is visible as a component of Rich's Cost of Goods Sold. (TrI. 104-106; Supp. 31-32). The net effect of MDAs is to reduce the price Rich's paid vendors for its merchandise, and that reduced price is shown on Rich's Profit and Loss Statement as a reduction to Cost of Good Sold. (TrI. 34, 104-106, 157; Supp. 14, 31-32, 44).

The data in Rich's general ledger reside in various statistical accounts. Rich's maintains its statistical account data in the ordinary course of its business. Rich's management uses statistical accounts for managerial purposes such as reviewing a division's operating performance and how much the division's margin is affected by MDAs. (TrI. 110, 127; Supp. 33, 37).

Ms. Velardi identified exhibits representing the accounts that track MDAs and purchases at retail, as well as the account from the accounts payable system that tracks individual MDAs at the division level. (Exs. 4-6; Supp. 189-318; TrI 108-114; Supp. 32-34).

Like margin and cost, Rich's tracks MDAs for each accounting period at the operating division level. (TrI 104; Supp. 31). Rich's calculated an MDA adjustment for each tax year by dividing MDAs at retail for the division by purchases at retail for the division. (TrI. 165; Supp. 46; Ex. 4-5, 9; Supp. 189-192, 1233). The resulting percentage equals the percentage by which MDAs reduced the amount Rich's paid its vendors. Thus, the value of Rich's retail inventory should be reduced by the same percentage.

Under RIM, inventory is fungible and inventory costs are averaged. All inventory classified within the same department, company-wide has the same RIM average cost. (TrI. 97; Supp. 29). Therefore, the same MDA reduction percentage that applies to Rich's total inventory values is identical to the MDA reduction percentage that applies to Rich's Ohio stores' inventory values. (TrI. 147-148; Supp. 42). Thus, Rich's reduced the Ohio stores' inventory values by the MDA percentage to arrive at the true value of its Ohio stores' inventory for tax years 2000, 2001, and 2002. (TrI. 164-171; Supp. 46-48).

Ms. Sherry Rehbock, the agent who investigated the refund claims, has been a tax agent with the Department of Taxation since 1990. (TrI. 200-202; Supp. 55-56). Mr. John Nolfi, the Department's Administrator of the Personal Property Tax Division for the past two years and a department employee since 1981, also testified. (TrI. 235-236; Supp. 64). Both agreed that under RIM, retailers derive the cost of inventory by reducing retail inventory by the average retail markup. (TrI. 206; Supp. 57). Both stated that it is Department practice when determining inventory values to look beyond the Balance Sheet in order to determine the true value of inventory. (TrI. 207-208, 239, 252-253; Supp. 57, 65, 68). Mr. Nolfi and Ms. Rehbock both agreed that the book cost of inventory is merely the starting point in determining true value for personal property tax purposes. (TrI. 207-208, 239, 252; Supp. 57, 65, 68). Both testified that inventory value should reflect all costs to acquire inventory; even those that do not appear on the Balance Sheet and may appear on the Income Statement (*i.e.*, Profit and Loss Statement). In fact, it is department policy to include costs reflected on the Income Statement that are deemed appropriate in order to increase the cost of inventory and determine its true value. (TrI. 208, 252-253; Supp. 57, 86).

Mr. Nolfi also testified that adjustments to the value of inventory on account of MDAs had been made in other cases in order to resolve some outstanding controversies. (TrI 251; Supp. 68).

Dr. Ray Stephens, an accounting professor, also testified. (TrII. 6; Supp. 99). He agreed that RIM is recognized under GAAP. (TrII. 8; Supp. 99). He agreed that it is common in the retail industry for vendors to provide MDAs to retailers that reduce the retailers' Cost of Goods Sold. (TrII. 19; Supp. 102). And, he testified that under RIM, the cost of inventory is calculated by applying the normal profit margin to the retail selling price. (TrII. 16-18; Supp. 101-102).

In this case, the Tax Commissioner refused to look beyond the Balance Sheet book values to determine Rich's inventory values for personal property tax purposes. (TrI. 222-223; Supp. 61). The Tax Commissioner's correspondence states that the Tax Commissioner denied reductions in Rich's inventory value solely because they were reflected on the Income Statement and not on the Balance Sheet. (ST. 123; Supp. 758).

In its decision and order, the BTA found that, based upon the evidence that was presented, MDAs in fact reduced the cost of inventory to a retailer. *Rich's Dept. Stores, Inc. v Wilkins*, (Feb. 3, 2009), BTA No. 2005-T-1609, at 8. Further, it found this treatment comported with generally accepted accounting principles ("GAAP") and was consistent with the testimony of the Tax Commissioner's witness, Dr. Ray Stephens, because "the inventory value on the financial statements is an amount that maintains the gross profit percentage." Id. at 9.

The Board also concluded that MDAs related to the determination of the cost of inventory, and that the inquiry preceded, and was not precluded by, application of Ohio Adm. Code 5703-3-17. Id. at 11.

Finally, the BTA determined that Rich's had satisfied its burden of proof as to the amount of the adjustment. It recognized that inventory is fungible and that under RIM, the cost of inventory is an average. Cost is a product of retail price and the margin of specific lines of inventory over the entire division, and was not calculated on a store-by-store basis. The adjustment was based on all the actual MDAs for the division. Thus, the BTA concluded that a reduction in cost was proper. Id. at 14-15.

The Tax Commissioner took his appeal pursuant to R.C. 5717.04, contesting the factual findings of the Board.

ARGUMENT

Proposition of Law:

> **Reductions in the cost of a merchant's inventory, made by the vendor of the inventory in order to maintain the merchant's normal margin, must be considered in determining the value of the inventory for purposes of the personal property tax.**

MDAs reduce the cost of inventory to Rich's. The Tax Commissioner refused to consider MDAs in determining the value of Rich's inventory on the basis that it was reflected on the income statement, rather than on the balance sheet. The BTA recognized that, based on the evidence presented to it and consistent with generally accepted accounting principles, MDAs should be considered in determining the value of Rich's inventory. The decision of the BTA is both reasonable and lawful. It should, therefore, be affirmed.

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I. Statutory and case law framework provide that net book value is the starting point for determining "true value" for personal property tax purposes, but that other evidence of value must also be considered.

In Ohio during tax years 2000-2002, personal property held as retail inventory was taxed according to its true value. R.C. 5711.22. This Court has unwaveringly held that "true value" is the ultimate goal sought in determining inventory values for personal property tax purposes. *R. H. Macy Co. v. Schneider* (1964), 176 Ohio St. 94, 96-7, 197 N.E.2d 807; *Youngstown Sheet & Tube Co.* (1975), 44 Ohio St.2d 96, at 98, 338 N.E.2d 366.

Although inventory is reported based upon its average value, R.C. 5711.15, the average value is based upon the depreciated book value of property unless the Tax Commissioner determines that the true value of the property is greater, or lesser, than the net book value. R.C. 5711.18. In making the determination of true value, R.C. 5711.21(A) provides that "whenever any taxable property is required to be assessed at its true value in money or at any percentage of true value, the assessor shall be guided by the statements contained in the taxpayer's return and such other rules and evidence as will enable the assessor to arrive at such true value."

In other words, the net book value of retail inventory is only the statutory starting point and is "merely evidence of true value" for personal property tax purposes. *Youngstown Sheet & Tube*, 44 Ohio St.2d at 100 (interpreting *Macy*); *PPG Industries, Inc. v. Kosydar* (1981), 65 Ohio St. 2d 80, 417 N.E.2d 1385.

However, such *prima facie* evidence of value does "not diminish the duty of (the Tax Commissioner) to consider other competent evidence indicating that book value is greater or less than the true value in money, nor (does it) imply that depreciated book value is the sole measure of true value." *Youngstown Sheet & Tube*, 44 Ohio St. 2d at 99, citing *Willard Storage Battery Co. v. Peck* (1954), 161 Ohio St. 197, 118 N.E.2d 514. For personal property tax purposes, then, the Tax Commissioner has an affirmative duty to consider "other competent evidence" of true value. *Id.*; R.C. 5711.18.

II. MDAs reduced the amount Rich's paid for its merchandise and therefore reduced Rich's inventory values for the tax years 2000-2002.

MDAs are common in the retail industry and are reductions in the price retailers pay their vendors for merchandise. (TrI. 17-34; Supp. 9-14). When a vendor wishes to sell and a retailer wishes to purchase certain lines of merchandise, the parties discuss the past and expected performance of the vendor's merchandise. (TrI. 20, 29, 69; Supp. 10, 12, 22). As part of that discussion, the vendor and retailer may agree that if the retailer cannot sell the merchandise that preserves an agreed-upon margin, the vendor will reduce the price the retailer paid for the merchandise by granting an MDA. (TrI. 23-31; Supp. 11-13). If merchandise does not sell as expected and falls short of the negotiated margin goal, the merchandise vendor grants an MDA (reducing the amount the retailer pays the vendor). Several witnesses, including Dr. Stephens, agreed that the MDA preserves margin by reducing the price paid for merchandise by the retailer. (TrI. 34, 155, 157; Supp. 14, 44; TrII. 19; Supp. 102).

Under GAAP, MDAs are recognized as reductions in price to the retailer. (TrII. 45; Supp. 108). The Financial Accounting Standards Board ("FASB"), the financial accounting industry leader in GAAP development and interpretation, has published guidance through its Emerging Issues Task Force ("Task Force") that characterizes MDAs as reductions in the price paid for inventory. FASB, EITF Abstract Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, *available at* http://www.fasb.org/st/. EITF Abstract Issue No. 02-16 paragraph no. 4 states that allowances received by a retailer from a vendor are "presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be characterized as a reduction of the cost of sales when recognized in the customer's income statement."

III. The decision of the BTA that MDAs reduce the price paid for inventory, and hence its value, is reasonable and lawful.

The Tax Commissioner denied Rich's refund request solely because the competent evidence of the true value of Rich's inventory was reflected on its Cost of Goods Sold on Rich's Profit and Loss Statement instead of its Balance Sheet. (ST. 123; Supp. 758). The BTA concluded that the Tax Commissioner violated the law and the Department's consistent practice when he chose not to apply MDAs as reductions to the true value of Rich's inventories.

Neither the statutes, nor the cases interpreting them, provide that only information reflected on the balance sheet may be considered in arriving at the true value of inventory. Rather, R.C. 5711.18 and R.C. 5711.21 place an affirmative duty on the Tax Commissioner to determine the true value of taxable property, and that that official must consider all evidence of value. Indeed, even Ms. Rehbock and Mr. Nolfi testified that *one should look beyond* the Balance Sheet to ascertain all inventory acquisition costs and adjustments. (TrI. 207-209; Supp. 57).

In this case, the evidence is unambiguous and consistent: Under RIM, MDAs reduce the price paid for the inventory and hence its true value. (TrI. 34, 101, 104-106, 157; Supp. 14, 30, 31-32, 44; TrII. 19; Supp. 102). The BTA recognized that the Tax Commissioner failed to consider any evidence other than net book value into the valuation he assigned to Rich's retail inventories for the periods in question. The Tax Commissioner wrongly ended his valuation at the statutory starting point – *prima facie* book value – when he shunned the extensive evidence supporting Rich's position. Rich's plainly showed how MDAs reduce its inventory acquisition cost and thus the taxable value of its inventory. That information is clearly reflected on Rich's books and records that were submitted to the Tax Commissioner and to the BTA. The BTA considered this evidence, as it was required to do. It weighed the evidence, as it was required to do. Based upon the evidence presented to it, and the law applicable to the issue, the BTA reached the conclusion that it did. Its decision is reasonable and lawful. Therefore, it must be affirmed. R.C. 5717.04.

IV. The Tax Commissioner's Arguments

In his initial brief, the Tax Commissioner makes five main arguments. First, he claims the decision of the BTA is unreasonable and unlawful because it does not follow generally accepted accounting principles. Second, he claims the decision unlawfully takes the value of Rich's inventory below its net book value. Next, he claims the BTA ignored the testimony of its witness, Dr. Ray Stephens. He asserts that he has already provided a "generous" reduction in value through the application of Ohio Adm. Code 5703-3-17. And finally, he claims Rich's failed to establish the extent of the adjustment to which it was entitled. None of these arguments has any merit and all of them should be rejected by the Court.

A. Generally accepted accounting principles are merely evidence of value; true value, and not merely book value, is the ultimate goal of property taxation.

The Tax Commissioner first claims that the decision of the BTA unlawfully takes the value of Rich's inventory below the lower of cost or market, and therefore violates generally accepted accounting principles ("GAAP"). This argument ignores clear evidence in the record to the contrary, and is erroneously premised upon the assertion that GAAP is the inviolate goal of property taxation. For these reasons, the argument should be rejected.

GAAP is not the goal of personal property taxation. Rather, it is "true value" that is the basis for property taxation. *Youngstown Sheet & Tube Co. v. Kosydar* (1975), 44 Ohio St. 2d 96, 338 N.E.2d 366; *R. H. Macy Co. v. Schneider* (1964), 176 Ohio St. 94, 197 N.E.2d 807. This

Court recognized that "generally accepted accounting principles and practices are merely evidence of value." *Youngstown Sheet & Tube Co.*, 44 Ohio St. 2d at 99. As we discussed earlier in this brief, it is the duty of the Tax Commissioner to consider all evidence of value, including information contained in the books and records of the taxpayer and its return.

Even if we concede that GAAP somehow sets some limit as to the value of the property, the assertion that consideration of MDAs takes the value of Rich's inventory below the lower of cost or market is simply wrong. Dr. Stephens testified that the lower range of permissible value under RIM is that amount that results from taking the net realizable value and applying the normal profit. (TrII 9; Supp. 99). Again, slightly differently, Dr. Stephens testified that under GAAP, inventory value should be the amount that maintains the gross profit percentage (TrII 13, 16, 17; Supp. 100, 101).

He then described his understanding of MDAs as follows: "My understanding of a vendor markdown allowance is that it's *an allowance against cost* of the inventory that would be *allowed because the normal selling price was not obtained* by the retail merchant." (TrII 19; Supp. 102) (emphasis added).

This testimony is consistent with the description of MDAs provided by both Ms. Godden and Ms. Velardi. They both described how the MDA has nothing to do with price. Rather, because Rich's had to reduce the retail price more than was anticipated in order to try to sell the inventory, the MDA allows Rich's to preserve its margin by reducing the cost of the inventory. (TrI. 18, 22-27, 53, 155-156; Supp. 10, 11-12, 18, 24).

When the retail price of inventory is reduced in order to sell inventory, margin performance is reduced below that anticipated by the parties. In order to maintain the normal, expected margin, cost must be reduced. That is the function of MDA. It permits Rich's to maintain the normal profit margin. That is precisely what GAAP describes as the lower boundary of cost. The Tax Commissioner's argument to the contrary is without merit.

B. Net book value is merely the starting point to determine value, not the ending point.

Next, the Tax Commissioner argues that recognizing MDAs unlawfully takes the value of Rich's inventory below net book value, and that this violates a long-standing administrative practice of the department. In short, the Tax Commissioner asserts that net book value is the ending point of his inquiry as to the value of the inventory. That assertion is wrong.

Book value is the starting point of the Tax Commissioner's inquiry into value. R.C. 5711.18; R.C. 5711.21; *PPG Industries, Inc. v. Kosydar* (1981), 65 Ohio St. 2d 80, 417 N.E.2d 1385, at paragraph one of the syllabus. Even Ms. Rehbok and Mr. Nolfi recognized that book value is the starting point, not the ending point, of the quest for value. (TrI 207-208, 239, 252; Supp. 57, 65, 68). Indeed, they both testified that the department routinely looks beyond the balance sheet to other portions of the taxpayers accounting records, including their income statements, in order to increase the cost of inventory to determine its true value. (TrI 208, 252-253; Supp. 57, 68). Ms. Rehbok agreed that there may be adjustments found in a taxpayer's accounting records that would cause a taxpayer to return an item at a figure that is higher, *or lower*, than the nominal book value of that item (TrI 210; Supp. 58).

Rich's retains copious information regarding MDAs in its accounting records that were presented to the BTA. It presented extensive, unrebutted testimony regarding the collection and maintenance of that information to the BTA. The BTA correctly looked at the book value of the inventory as the starting point of the determination of value. It looked at other evidence that MDAs reduced the price that Rich's paid to its vendors in order to maintain the normal margin and found that evidence persuasive and credible. The Tax Commissioner's assertion that the

BTA unlawfully looked beyond the book value of the inventory is without merit and should be rejected.

C. The BTA appropriately weighed and considered the testimony of Dr. Stephens. This Court will not re-weigh the evidence.

The Tax Commissioner complains that in reaching its decision the BTA ignored the testimony of Dr. Stephens. Clearly that isn't the case. The BTA devoted several pages of its decision to Dr. Stephens' testimony. *Rich's Dept. Stores, Inc.* at 6-7, 9-11. Based upon all the evidence presented in the case, it concluded that Dr. Stephens' testimony was neither supportive of the Tax Commissioner's argument, Id. at 9, nor sufficient to refute the evidence presented by Rich's, Id. at 10.

As the trier of fact, the BTA has great discretion to determine the credibility and weight to be accorded to the testimony of any witness. *Cardinal Fed. Sav. & Loan Assn. v. Cuyahoga Cty. Bd. of Revision* (1975), 44 Ohio St 2d 13, 336 N.E.2d 433. This Court is not a super board of tax appeals. *Hercules Galion Products, Inc. v. Bowers* (1960), 171 Ohio St. 176, 168 N.E.2d 404. On appeal, it will not reweigh the evidence. *Inter-City Foods v. Kosydar* (1972), 30 Ohio St. 2d 159, 283 N.E.2d 161; *Shugarman Surgical Supply, Inc. v. Zaino*, 97 Ohio St. 3d 183, 2002-Ohio-5809, 777 N.E.2d 244.

The Tax Commissioner's complaint is that the BTA failed to adopt its view of the testimony of its witness. That is no basis for reversing the BTA's decision. The BTA listened to the evidence, it considered the evidence and it weighed the evidence before it reached its conclusions. That is exactly what it is supposed to do. There is probative and credible evidence in the record that supports its conclusions. Its decision is both reasonable and lawful in this regard.

D. The adjustment provided by Ohio Adm. Code 5703-3-17, "generous" or not, does not apply to this case.

The Tax Commissioner devotes a great deal of discussion to the adjustment to the value of inventory authorized by Ohio Adm. Code 5703-3-17. He asserts that this "generous" adjustment subsumes the adjustment to cost that Rich's seeks. He also claims that the rule does not authorize the adjustment Rich's seeks. Therefore, the Tax Commissioner contends that the adjustment for MDAs should not be granted.

Ohio Adm. Code 5703-3-17 provides in part:

"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." (emphasis added).

This rule provides for an adjustment to the value of the inventory based upon the net markdowns for the first three months following the end of the current tax year. This adjustment is made to the cost of the inventory. The adjustment for MDAs that Rich's claims is based on the fact that MDAs reduce the cost of the inventory. The determination of cost is a step precedent to the adjustment authorized by the rule. It is not an adjustment that is based on the rule. The BTA recognized this simple, yet important, distinction. *Rich's Dept. Stores, Inc.* at 8, 11. Even Ms. Rehbok recognized that distinction (Trl 214; Supp. 59). It is the failure of the Tax Commissioner to recognize this distinction that is fatal to his claim.

The BTA understood the simple questions that were presented to it by this appeal: (1) Whether MDAs reduce the cost of inventory to Rich's; (2) whether Ohio Adm. Code 5703-3-17 prohibits the adjustment requested by Rich's; and (3) whether Rich's demonstrated the true value of the inventory. *Rich's Dept. Stores, Inc.* at 8. The BTA rebuffed the Tax Commissioner's efforts to distract it from those important questions. This Court should not be seduced by those efforts, either, and should affirm the decision of the BTA.

MDAs reduce the price that Rich's pays for its inventory. Essentially, it reduces the cost of the inventory. Even Dr. Stephens (TrII 19; Supp. 102) agreed with Ms. Godden and Ms. Velardi that MDAs reduce the cost of the inventory. MDAs are not gifts. They are negotiated by the parties at the commencement of the selling season. Both parties recognize that if an item doesn't perform as anticipated, the vendor will provide an MDA to Rich's, thereby reducing the cost of the inventory, in order to preserve the normal margin of the item. It is a factor in determining the price paid by Rich's for the inventory in an arm's-length transaction. The MDA must be considered.

Ohio Adm. Code 5703-3-17 is an adjustment that is made *once cost is determined.* The Tax Commissioner has pointed to no authority for the proposition that he may, by rule, institute a practice that vitiates the statutory requirement of determining the true value of property for taxation. The fact the Tax Commissioner has promulgated a rule that provides for some additional adjustment, generous or otherwise, has nothing to do with the cost, and thus the true value, of the inventory. Ms. Rehbok recognized the adjustment authorized by the rule was separate from the issue of cost presented by the MDAs. (TrI 214; Supp. 59). Mr. Nolfi also recognized this distinction when he testified that the adjustment sanctioned by the rule was a claim for reduction from book value. (TrI 249; Supp. 67).

The Tax Commissioner suggests the rule encompasses the adjustment requested by Rich's. There is no evidence of that in the record. Mr. Nolfi's testimony about the rule is consistently couched in terms of "I think" (TrI 238; Supp. 65) or "I would assume" (TrI 245, 246; Supp. 66, 67). Nobody who was involved in the promulgation of the rule appeared or testified. The BTA is not required to accept the opinion of any witness. It was not required to make the finding asserted by the Tax Commissioner based on such speculation.

Finally, both Dr. Stephens and Mr. Nolfi testified about problems with the rule. Those problems have nothing to do with whether or not MDAs reduce the cost of inventory. Those problems are accounting problems regarding whether the adjustment made by the rule comports with GAAP, or take value below book value. They are irrelevant to the resolution of this case. The BTA's decision to refuse to accept those concerns as a basis for rejecting the adjustment based upon the MDAs is reasonable and lawful.

E. Rich's proved the extent of its reduction.

Finally, the Tax Commissioner claims the BTA's decision is unlawful because Rich's used samples and averages to determine the adjustment to which it was entitled. This argument ignores the facts and evidence that are present in this case and misapplies the law. It fails to recognize that inventory is fungible and the fundamental premise that underlies RIM that the inventory cost that is reported is, itself, an average. Rich's did not present samples, but rather presented detailed information regarding the extent of the MDAs for each tax year. The BTA correctly addressed the issue and its decision should be upheld.

Rich's provided detailed testimony and offered numerous exhibits proving how and how much Rich's MDAs reduced Ohio stores' inventory values. Rich's proved how its internal accounts payable system tracks MDAs. Rich's proved how MDAs reduce Rich's inventory cost and how that is exhibited on its Profit and Loss Statement. Rich's proved how margin is tracked in the stock ledger for all its inventory. Rich's provided exhibits that indicated all the MDAs that were taken each tax year. In short, Rich's proved that the Tax Commissioner unreasonably and unlawfully failed to establish true value when he denied Rich's claimed reductions of inventory book values for tax years 2000, 2001, and 2002.

Therefore, the Tax Commissioner's citations to *United Telephone Co. of Ohio v. Tracy* (1999), 84 Ohio St. 3d 506, 1999-Ohio-366, 705 N.E.2d 679 and *MCI Metro Access Trans. Servs., LLC v. Levin*, Franklin App. Nos. 07AP-398 and 07AP-399, 2008-Ohio-5057, is misplaced and irrelevant. Those cases involved the determination of the value of discrete assets and involved adjustments based on a sampling of records or assets. That isn't the case here. Retail inventory is taxed as a fungible mass for the entire division, not as individual assets. Under RIM, the cost of the inventory that is reported for tax purposes is itself an average that is based on the average margin for all the inventory for the entire division. It is not based on Ohio stores only. MDAs, like the margin of the Ohio inventory, are based on the entire performance of the specific lines of inventory for the entire division.

Unlike the cases cited by the Tax Commissioner, the adjustment that is requested is not based on a sample of inventory or MDAs, but rather, like the values that are reported, is based on all the MDAs actually received for all inventory of the division. In both cases cited by the Tax Commissioner, the taxpayer had incomplete records and failed to present the detailed back-up information upon which their adjustment was based. In this case, Rich's presented not only the complete, detailed information, but also the testimony of the person who was responsible for verifying the information. The amount of the adjustment was documented and verifiable. It clearly applied to the inventory located in the Ohio stores.

The danger expressed by the Court and the Board in those two cases simply is not present here. The BTA succinctly recognized this critical distinction. *Rich's Dept. Stores, Inc.* at 14. There was sufficient evidence in the record to support the BTA's conclusion. It properly applied the law. Its decision is lawful and should be affirmed.

CONCLUSION

The polestar of property taxation is the true value of the property. The evidence in this case clearly and uniformly demonstrated that MDAs are a mechanism that reduces the price that Rich's pays for its inventory. As a result, MDAs must be considered in determining the cost, and hence the value, of the inventory of a merchant. The Tax Commissioner erred when he failed to base the value of Rich's inventory on its true value. The BTA correctly recognized this and, based upon both the evidence presented and the settled law, held that MDAs reduce the cost, and hence are an adjustment to the value, of Rich's inventory. That decision is reasonable and lawful. Therefore, it must be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a copy of the foregoing Brief of Appellee, Rich's Department Stores, Inc., was served by United States First Class mail, postage prepaid, on this 29th day of July 2009, to Richard Cordray, Esq., Ohio Attorney General, and Barton A. Hubbard, Esq., Assistant Attorney General, Taxation Section, 30 East Broad Street, 25th Floor, Columbus, Ohio 43215, attorneys for the Tax Commissioner of Ohio.

Mark A. Engel

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APPENDIX

§ 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.

HISTORY: RS § 2740; S&C 1444; 56 v 175, § 11; 91 v 351; GC §§ 5382, 5381; 114 v 714; Bureau of Code Revision, 10-1-53; 127 v 650. Eff 8-15-57.

§ 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.

HISTORY: RS § 2739; 83 v 80; GC § 5389; 114 v 715; 115 v 565; 116 v PtII, 253; 118 v 657; 119 v 34; 123 v 777; Bureau of Code Revision, 10-1-53; 129 v 582(957) (Eff 1-10-61); 148 v H 612. Eff 9-29-2000.

5711.21 Rules governing assessments.

(A) In assessing taxable property the assessor shall be governed by the rules of assessment prescribed by sections 5711.01 to 5711.36 of the Revised Code. Wherever any taxable property is required to be assessed at its true value in money or at any percentage of true value, the assessor shall be guided by the statements contained in the taxpayer's return and such other rules and evidence as will enable the assessor to arrive at such true value. Wherever the income yield of taxable property is required to be assessed, and the method of determining between income and return or distribution of principal, or that of allocating expenses in determining net income, or that of ascertaining the source from which partial distributions of income have been made is not expressly prescribed by sections 5711.01 to 5711.36 of the Revised Code, the assessor shall be guided by the statements contained in the taxpayer's return and such general rules as the tax commissioner adopts to enable the assessor to make such determination.

(B) For tax years before tax year 2009, the true value of the boilers, machinery, equipment, and any personal property used to generate or distribute the electricity shall be the sum of the following:

(1) The true value of the property as it would be determined under this chapter if none of the electricity were distributed to others multiplied by the per cent of the electricity generated in the preceding calendar year that was used by the person who generated it; plus

(2) The true value of the property that is production equipment as it would be determined for an electric company under section 5727.11 of the Revised Code multiplied by the per cent of the electricity generated in the preceding calendar year that was not used by the person who generated it; plus

(3) The true value of the property that is not production equipment as it would be determined for an electric company under section 5727.11 of the Revised Code multiplied by the per cent of the electricity generated in the preceding calendar year that was not used by the person who generated it.

(C) For tax years before tax year 2009, the true value of personal property leased to a public utility or interexchange telecommunications company as defined in section 5727.01 of the Revised Code and used by the utility or interexchange telecommunications company directly in the rendition of a public utility service as defined in division (P) of section 5739.01 of the Revised Code shall be determined in the same manner that the true value of such property is determined under section 5727.11 of the Revised Code if owned by the public utility or interexchange telecommunications company.

Effective Date: 12-31-1989; 06-30-2005

5711.22 Listing and rates of personal property tax.

(A) Deposits not taxed at the source shall be listed and assessed at their amount in dollars on the day they are required to be listed. Moneys shall be listed and assessed at the amount thereof in dollars on hand on the day that they are required to be listed. In listing investments, the amount of the income yield of each for the calendar year next preceding the date of listing shall, except as otherwise provided in this chapter, be stated in dollars and cents and the assessment thereof shall be at the amount of such income yield; but any property defined as investments in either division (A) or (B) of section 5701.06 of the Revised Code that has not been outstanding for the full calendar year next preceding the date of listing, except shares of stock of like kind as other shares of the same corporation outstanding for the full calendar year next preceding the date of listing, or which has yielded no income during such calendar year shall be listed and assessed as unproductive investments, at their true value in money on the day that such investments are required to be listed.

Credits and other taxable intangibles shall be listed and assessed at their true value in money on the day as of which the same are required to be listed.

Shares of stock of a bank holding company, as defined in Title 12 U.S.C.A., section 1841, that are required to be listed for taxation under this division and upon which dividends were paid during the year of their issuance, which dividends are subject to taxation under the provisions of Chapter 5747. of the Revised Code, shall be exempt from the intangibles tax for the year immediately succeeding their issuance. If such shares bear dividends the first calendar year after their issuance, which dividends are subject to taxation under the provisions of Chapter 5747. of the Revised Code, it shall be deemed that the nondelinquent intangible property tax pursuant to division (A) of section 5707.04 of the Revised Code was paid on those dividends paid that first calendar year after the issuance of the shares.

(B) For tax years before tax year 2009, boilers, machinery, equipment, and personal property the true value of which is determined under division (B) of section 5711.21 of the Revised Code shall be listed and assessed at an amount equal to the sum of the products determined under divisions (B)(1), (2), and (3) of this section:

(1) Multiply the portion of the true value determined under division (B)(1) of section 5711.21 of the Revised Code by the assessment rate for the tax year in division (G) of this section;

(2) Multiply the portion of the true value determined under division (B)(2) of section 5711.21 of the Revised Code by the assessment rate in section 5727.111 of the Revised Code that is applicable to the production equipment of an electric company;

(3) Multiply the portion of the true value determined under division (B)(3) of section 5711.21 of the Revised Code by the assessment rate in section 5727.111 of the Revised Code that is applicable to the property of an electric company that is not production equipment.

(C) For tax years before tax year 2009, personal property leased to a public utility or interexchange telecommunications company as defined in section 5727.01 of the Revised Code and used directly in the rendition of a public utility service as defined in division (P) of section 5739.01 of the Revised Code shall be listed and assessed at the same percentage of true value in money that such property is required to be assessed by section 5727.111 of the Revised Code if owned by the public utility or interexchange telecommunications company.

(D)(1) Merchandise or an agricultural product shipped from outside this state and held in this state in a warehouse or a place of storage without further manufacturing or processing and for storage only and for shipment outside this state, but that does not qualify as "not used in business in this state" under division (B)(1) or (2) of section 5701.08 of the Revised Code, is nevertheless not used in business in this state for property tax purposes.

(2) Merchandise or an agricultural product owned by a qualified out-of-state person shipped from outside this state and held in this state in a public warehouse without further manufacturing or processing and for temporary storage only and for shipment inside this state, but that does not qualify as "not used in business in this state" under division (B)(1) or (2) of section 5701.08 of the Revised Code, is nevertheless not used in business in this state for property tax purposes.

(3) As used in division (D)(2) of this section:

(a) "Qualified out-of-state person" means a person that does not own, lease, or use property, other than merchandise or an agricultural product described in this division, in this state, and does not have employees, agents, or representatives in this state;

(b) "Public warehouse" means a warehouse in this state that is not subject to the control of or under the supervision of the owner of the merchandise or agricultural product stored in it, or staffed by the owner's employees, and from which the property is to be shipped inside this state.

(E) Personal property valued pursuant to section 5711.15 of the Revised Code and personal property required to be listed on the average basis by division (B) of section 5711.16 of the Revised Code, except property described in division (D) of this section, business fixtures, and furniture not held for sale in the course of business, shall be listed and assessed at twenty-three per cent of its true value in money for tax year 2005 and at the percentage of such true value specified in division (G) of this section for tax year 2006 and each tax year thereafter.

(F) All manufacturing equipment as defined in section 5711.16 of the Revised Code shall be listed and assessed at the following percentage of its true value in money:

(1) For all such property not previously used in business in this state by the owner thereof, or by related member or predecessor of the owner, other than as inventory, before January 1, 2005, zero per cent of true value;

(2) For all other such property, at the percentage of true value specified in division (G) of this section for tax year 2005 and each tax year thereafter.

(G) Unless otherwise provided by law, all other personal property used in business that has not been legally regarded as an improvement on land and considered in arriving at the value of the real property assessed for taxation shall be listed and assessed at the following percentages of true value in money:

(1) For tax year 2005, twenty-five per cent of true value;

(2) For tax year 2006, eighteen and three-fourths per cent of true value;

(3) For tax year 2007, twelve and one-half per cent of true value;

(4) For tax year 2008, six and one-fourth per cent of true value;

(5) For tax year 2009 and each tax year thereafter, zero per cent of true value.

(H)(1) For tax year 2007 and thereafter, all personal property used by a telephone company, telegraph company, or interexchange telecommunications company shall be listed as provided in this chapter and assessed at the following percentages of true value in money:

(a) For tax year 2007, twenty per cent of true value;

(b) For tax year 2008, fifteen per cent of true value;

(c) For tax year 2009, ten per cent of true value;

(d) For tax year 2010, five per cent of true value;

(e) For tax year 2011 and each tax year thereafter, zero per cent of true value.

(2) The property owned by a telephone, telegraph, or telecommunications company shall be apportioned to each appropriate taxing district as provided in section 5727.15 of the Revised Code.

(I) During and after the tax year in which the assessment rate equals zero per cent, the property described in division (E), (F), (G), or (H) of this section shall not be listed for taxation.

(J) Divisions (E), (F), (G), and (H) of this section apply to the property of a person described in divisions (E)(3) to (10) of section 5751.01 of the Revised Code. Division (J) of this section does not prevent the application of the exemption of property from taxation under section 5725.25 or 5725.26 of the Revised Code.

Effective Date: 09-26-2003; 06-30-2005

Ohio Department of TAXATION
tax.ohio.gov

Tax Rules: Final: 5703-3

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.

Effective: 11-18-57 as TX-41-16

Promulgated under: 5703.14

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

APPEARANCES:

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Entered February 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.