In the Supreme Court of Ohio

Navistar, Inc., f/k/a International Truck and Engine Corporation,	:	Case No. 2014-0140
Appellant,	:	
v.	:	Appeal from the Ohio Board of Tax Appeals
Richard A. Levin, Tax Commissioner of Ohio,	:	
Appellee.	:	BTA Case No. 2010-575

REPLY BRIEF OF APPELLANT NAVISTAR, INC.

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INTRODUCTION

A. The solitary issue before this Court is whether the Tax Commissioner may ignore the date specified by the General Assembly as the date on which amounts are to be certified for purposes of calculating the Commercial Activity Tax ("CAT") credit. Yet, the Attorney General avoids this issue in his brief by asking this Court to go beyond what is statutorily permissible and to rely upon misstatements of fact and law.

1. Rather than a "derogation" or an "act of grace" (as suggested by the Attorney General), the CAT Credit is intended to protect Ohio manufacturers from financial losses that would have occurred due to the phase-out of Ohio's franchise tax.

The Tax Commissioner has improperly denied an Ohio manufacturer with over a century of compliance, tax payments and economic contribution to this state the benefit of a credit which the General Assembly provided for and clearly intended it to receive. Navistar, Inc. ("Navistar") has been manufacturing trucks at its plant in Springfield, Ohio since 1902, employing generations of Ohioans in the process. Through good economic times and bad, Navistar never turned its back on Ohio. Yet, the Commissioner now tries to deny Navistar its lawful credit, even though the credit was expressly intended to protect Ohio manufacturers like Navistar.

The statute at issue, R.C. 5751.53, grants longtime Ohio franchise taxpayers like Navistar a commercial activity tax ("CAT") credit for unused net operating loss carryforwards and other deferred tax assets ("NOLs") that would have otherwise been available to reduce Ohio franchise taxes, had the franchise tax not been replaced by the CAT. ***In fact, executive administration within the Ohio Department of Taxation drafted the very credit statute that the Attorney General now attacks.*** The Department's Deputy Commissioner testified that when Ohio's longstanding corporate franchise tax was being replaced by the CAT, the Commissioner worked with Ohio manufacturers to respond to their concerns about what would happen to the large amounts of NOLs that they had built up over many years, but which would now become worthless under the new CAT. The Commissioner's executive administration worked closely with the manufacturers and came "to an agreement on both the concept and the language of what became * * * Ohio Revised Code 5751.53." (H.R. II at 5047; Supp. 688.) Navistar proved that it meets every single condition of the Commissioner's own statute.

The Commissioner also initially budgeted for Navistar's credit. An administrator with the Tax Analysis Division of the Ohio Department of Taxation testified before the BTA that the Department did a 20-year analysis and budgeted for an amount that included a credit for Navistar. (*See* H.R. III at 481, 479-486; Supp. 664-672.) The Department's original projections of revenue impact resulting from the new CAT credit were based on data from previously-filed corporate franchise tax returns and applications filed in 2006 to claim the credit. (Appellant's Ex. 47, 48, 49; Supp. 1520-1524.).

But the Attorney General now is attempting to add a new requirement that the executive administration within the Department could have put in the statute but chose not to. There is no authority – either in the language of the statute, in the case law, or anywhere else in Ohio law – that allows this. The Commissioner is bound to apply the statute exactly as it was written, and exactly as it was intended.

ARGUMENT

A. There is nothing in Ohio law that requires the application of the rule of strict construction where a statute is clear on its face. Rather, the statute must be applied as written.

The Commissioner seeks to deny Navistar its lawful credit by arguing that the statute must be strictly construed and "any doubt" concerning the facts and law must be construed against Navistar. The Commissioner cannot rely on strict construction to avoid the result clearly required by a plain reading of the law. This is not a "doubtful case," and there is no ambiguity in the language of the statute or its application to Navistar. To the contrary, the statutory language is clear, and the General Assembly's intent to lock in the Valuation Allowance on a date certain is absolutely unmistakable. When, as here, the language in the statute is not ambiguous, black letter law requires that it must be applied, not interpreted. *Sears v. Weimer,* 143 Ohio St. 312 (1944), paragraph 5 of the syllabus ("An unambiguous statute is to be applied, not interpreted"); *State ex rel. Foster v. Evatt*, 144 Ohio St. 65 (1944), at paragraph 8 of the syllabus ("[t]here is no authority, under any rule of statutory construction, to add to, enlarge, supply, expand, extend, or improve the provision of a statute to meet a situation not provided for ***."). See, also, *Slingluff v. Weaver*, 66 Ohio St. 621 (1902); *Apex Powder Corp. v. Peck* (1954), 162 Ohio St. 189, 192; *Holiday Inns v. Limbach*, 48 Ohio St. 3d 34 (1990); *Cleveland Elec. Illum. Co. v. Cleveland*, 37 Ohio St. 3d 50 (1980), paragraph 3 of the syllabus.

1. **The ambiguity the Attorney General posits is of his own manufacture. There is no ambiguity in the statute.**

To avoid this result, the Attorney General tries to create an ambiguity or uncertainty that simply does not exist. This Court has expressly prohibited what the Commissioner's counsel is trying to do here, holding that one cannot manufacture an ambiguity as a means to open the door for a desired statutory interpretation. *See, e.g., Slingluff, supra,* at 626-28. This Court has recognized that a court that interprets an unambiguous statute is, in reality, engaging in legislation – which is not the role of courts but of the General Assembly. *Sears, supra*, at 316; *Campbell v. City of Carlisle,* 127 Ohio St. 3d 275 (2010).

2. The statute was drafted by the Commissioner and enacted by the General Assembly to serve an important policy purpose.

It is critical to understand that the CAT credit statute was drafted by the Commissioner to serve an important tax policy purpose – to aid the Ohio manufacturers. As the tax reform proposals were moving forward, a group of Ohio manufacturers approached the Commissioner and expressed concern about what would happen to the large NOLs they had built up over the years, but had not yet been able to use. (H.R. III at 498-99; Supp. 682-683.) The concern was adverse financial statement impact. The manufacturers "stated that they had a concern that deferred tax assets they held as a result of having net operating losses under the net income base of corporate franchise tax would now find that those deferred tax assets were without worth under a new regime where they would be taxed under a gross receipts tax. And so they were seeking an amendment to the CAT statute that would give them some sort of relief." (Id.).

The Commissioner agreed that it was important to provide Ohio manufacturers with the relief they requested, so his working group worked closely with the manufacturers and came "to an agreement on both the concept and the language of what became * * * Ohio Revised Code 5751.53." (H.R. III at 504; Supp. 688.) According to the Deputy Commissioner, ***the credit was designed to be "at least to some degree, a replacement for the deferred tax assets that were lost" and would help these manufacturers avoid a "balance sheet hit."*** (H.R. III at 499, 501; Supp. 683, 655) He testified that "[t]here were several drafts of proposed language that went back and forth between the Deputy Commissioner and the group of concerned taxpayers, but ultimately they managed to settle on some agreed-upon language." (Id. at 504; Supp. 688.) That "agreed-upon language" now appears in R.C. 5751.53.

There is no need to resort to strict construction here when ***both the statutory language and underlying purpose are crystal clear.*** Navistar proved before the BTA that it not only satisfied each and every element of the credit statute, but that it properly followed the statutory directives to compute the $27,048,726 amortizable amount claimed on its CAT-NOL Report. Thus, this Court need only apply the statute to conclude that Navistar is entitled to the full amount of the credit it has claimed.

B. The statute does not provide for any post-closing amendments to the Valuation Allowance. The time provided for the Commissioner to review a manufacturer's CAT credit report does not expand the period that can be audited. The period that can be reviewed expired on June 30, 2006.

The Commissioner must concede that the restated Valuation Allowance he seeks to use here did not appear on Navistar's books until late 2007, well beyond the October 31, 2004 statutory reference date. (Appellant's Ex. 41; H.R. II at 310, 311, 323, 416; Supp. 494-495, 507, 600.) The statute does not provide for an "amended" Valuation Allowance and – even though there were a record number of restatements in 2005 when the CAT credit statute was adopted[1] – the General Assembly did not make any exceptions for changes based on a restatement. There is nothing in Ohio law – as it relates to this tax, this credit and this statute – that permits any adjustment to the Valuation Allowance, even in light of a subsequent discovery that the historical books and records were not maintained in accordance with GAAP. As such, the Commissioner is wrong as a matter of law.

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[1] H.R.. III at 539; Supp. 723, noting that "more than a thousand companies in the U.S. * * * restated earnings in 2005." *See also,* Turner and Weirich, *"A Closer Look at Financial Statement Restatements: Analyzing the Reasons Behind the Trend,"* The CPA Journal (Dec. 2006)..

1. **There is nothing in R.C. 5751.53, including the definition of "books and records" in R.C. 5751.53(a)(10), that allows the Commissioner to use the restated books.**

According to the Attorney General, when a corporate taxpayer amends its books for a previous fiscal year to correct for errors in GAAP for that previous fiscal year, the Commissioner must use the GAAP-compliant books for that previous year, rather than the taxpayer's uncorrected, non-GAAP compliant books. This is wrong. Ohio law does not allow either the Commissioner or Navistar to use Navistar's corrected financial statements to calculate the CAT credit.

2. **The Commissioner's Reliance upon Ohio franchise tax cases is simply incorrect. Franchise tax authorities do not apply to a CAT matter.**

   a. **The General Assembly adopted different standards for the CAT Credit.**

Whatever merit the Commissioner's arguments may have under the franchise tax law, this is not the law that applies to this CAT credit. The Commissioner's fatal error, therefore, is his failure to recognize what even his own executive staff acknowledged: that the Ohio CAT is a completely new and different way of taxing corporate entities, and thus has nothing in common with the old franchise tax. (H.R. III at 497; Supp. 681.) The CAT statute incorporates an element of finality that stands in stark contrast to the franchise tax statutes, cases and related audit authority. For example:

- Unlike the franchise tax, the CAT statutes contain no generally-applicable provisions for amended returns. See R.C. 5733.031(C), 5733.067(D).
- Unlike the franchise tax, there are no exceptions for federal corrections that impact the NOL. See R.C. 5733.031(C), (requiring a taxpayer to report changes in Ohio franchise tax liability brought on as a result of changes made to a taxpayer's federal taxable income by the IRS ("RAR"), even if these changes occurred outside the normal statutory period). ***Unlike the franchise tax, the Commissioner's ability to audit and assess for CAT credit purposes is significantly curtailed.***

- Under the franchise tax, NOLs were taken as a dollar-for-dollar deduction to reduce taxable income. Under the CAT, the NOLs are used in a much more indirect fashion. Instead of a straight dollar-for-dollar deduction, a lump sum "value" is assigned to the unused NOLs that the company had accumulated by the end of 2004 and this serves as the measure of a credit to be taken on a pro-rated basis over the course of twenty years. There was therefore a need – for the first time under Ohio law – to establish some kind of means to estimate the actual worth of the NOLs. The financial reporting concept of a "Valuation Allowance" was the means selected for this purpose. It was a completely new element that, prior to its introduction as part of the CAT credit formula, had never before been a part of Ohio state tax law in any way.

b. The franchise tax cases relied upon by the Commissioner do not apply, and the BTA's adoption of those cases was therefore error.

The Commissioner cites to *National Tube Co. v. Peck*, 159 Ohio St. 3d 98 (1953), *SHV North America Corp. v. Tracy,* 70 Ohio St. 3d 395 (1994), *Grey Horse, Inc. v. Limbach*, 66 Ohio St. 3d 631 (1993), and *Shook National Corp. v. Tracy,* BTA No. 1990-X-1596 (Dec. 23, 1992). Every one of these cases is a franchise tax case and thus does not apply here. They stand for the proposition that book value controls when determining the net worth of a company for Ohio franchise tax purposes. With that basic legal proposition, Navistar agrees. But those cases have nothing do with a restatement, much less anything to do with the CAT statute at issue here. The Commissioner ignores the many critical differences between the CAT credit statute and the franchise tax law. His narrow focus on "GAAP-compliant books and records" fails to properly take these differences into account, and thus imposes new requirements not authorized by the statute.

3. The GAAP issue in this case is qualitatively different from anything ever considered by Ohio courts. Thus, the Commissioner's focus on "GAAP compliant books and records" in franchise tax cases is inapposite.

The decisions cited by the Commissioner are likewise distinguishable because the GAAP errors in those cases differ in a material way from the GAAP issue here. Unlike clear-cut mathematical or accounting errors, an "error" with respect to the Valuation Allowance suggests that the company's subjective prediction of whether it will be able to actually use its NOLs in the future was in fact wrong. But, because a Valuation Allowance represents nothing more than a prediction of future tax savings, there is no "one right answer." All of Navistar's witnesses in this case testified that there is a range of values acceptable under GAAP. (H.R. II at 385, 426; Supp. at 569, 608. H.R. III at 535.) Likewise, FAS 109 itself makes it clear that Valuation Allowances are in part subjective. In fact, it is only after many years have passed – and with the benefit of considerable hindsight – that one could determine if the Valuation Allowance actually turned out to be a good prediction. (H.R. II at 425; Supp. at 609.) The "GAAP-compliant" argument fails in this unique context.

C. The Commissioner corrupts the applicable accounting principles to inappropriately suggest that, since the restated Valuation Allowance is different than the original Valuation Allowance, the restated allowance must be correct. Such is not the case. Both Valuation Allowances are correct from their subjective points in time. Both are GAAP- Compliant.

1. The Valuation Allowance that Navistar used complied with GAAP at the end of Navistar's FYE 2004 and on June 30, 2006, which was the mandatory cut-off date for filing the CAT-NOL report to elect the credit.

At the outset, the Commissioner's case collapses because his entire argument assumes that the Valuation Allowance that Navistar used was not GAAP-compliant. This is simply not the case. The amounts Navistar used to calculate its credit amount, including the Valuation Allowance, were those on its books and records on the statutory reference date of October 31, 2004, as reflected in the certified financial statements it filed with the SEC on February 15, 2005. (Nav. Ex. 37. H.R. II at 412-14, 418-19: Supp. at 596-598, 602-603.) Those books had been certified by the company's outside public auditor, and Navistar believed based on facts known at that time that the Valuation Allowance complied with GAAP. Navistar's experts testified that with the information that was available to Navistar at the time its Report was due in June of 2006, the Valuation Allowance then on its books was supportable under GAAP. (H.R. II at 428-29; Supp. 612-613. H.R. III at 551-52, 556-58; Supp. 735-736, 740-741.)

A single phrase in a single footnote in the Restatement is the sole basis for the argument that the original Valuation Allowance was not GAAP-compliant. The Attorney General's misguided allegation that Navistar's FYE 2004 Valuation Allowance was not prepared in accordance with GAAP relies entirely on the following language from the restated 10K: "[Navistar] did not apply FASB Statement No. 109 properly." The Attorney General fails, however, to read this language in the context of the entire sentence in which it is written. The entire sentence provides that:

> We reassessed our need for a Valuation Allowance and determined that we did not apply FASB Statement No. 109 properly and that a full Valuation Allowance should be established for net U.S. and Canadian deferred tax assets *based on the weight of positive and negative evidence, particularly our recent history of operating losses.*

(Jt. Ex. G at 107; Supp. 961). (Emphasis added).

Read in its entirety, Navistar reassessed the need for a Valuation Allowance following all the accounting adjustments made to income during the restatement and those changes resulted in this ***"recent history of operating losses" not known at the time of the original 10K and CAT Credit Report filing.*** Further, "based on the weight of positive and negative evidence" and "particularly [Navistar's] recent history of operating losses," it was determined that under this revised weighting of evidence relying entirely on the negative evidence of recent losses, a full Valuation Allowance was more likely than not reasonable under FAS 109.

Testimony at the BTA hearing unequivocally confirms this. Mr. Doug Pinney, a FASB 109 expert, explained that when read in its full context, this footnote simply reflects the changed circumstances and new information that the company was now required to consider as part of its Valuation Allowance determination. He testified that the footnote text does not, as the Attorney General asserts, necessarily mean that the original Valuation Allowance was not in accordance with GAAP. To the contrary, he confirmed that both the original and restated Valuation Allowances are consistent with GAAP, but at different points in time. (H.R. II at 427-28; Supp. 611-612. *See also,* H.R. III at 556-57; Supp. 740-741). Thus, the Attorney General fails to account for the expert testimony that unequivocally established that it was only with the new historical numbers – and with the benefit of hindsight – that Navistar concluded in December 2007 that GAAP rules required it to change the original Valuation Allowance. (H.R. II at 428-29; Supp. 623-24. H.R. III at 551-52, 556-58; Supp. 735-36, 740-41. H.R. II at 314-16; Supp. 498-500.)

Indeed, ***every single one of Navistar's witnesses*** emphasized that the change in Valuation Allowance was the result of additional information about the company's financial performance that was not available when the original Valuation Allowance was determined. (Id.). Once Navistar considered all of the Restatement adjustments, years that had previously had either reported profits or slight losses had changed, and those years were not reporting greater losses or had changed from a profit to a loss. Because the GAAP rules require a heavy emphasis on historical loss, and due to the fact that as a result of the Restatement, Navistar now had larger cumulative operating losses in the most recent past years, management re-weighed the restated financial information and subsequently increased the Valuation Allowance in the Restatement. (H.R. II at 317, 331-332; Supp. 501, 515-516). But ***none of this means that Navistar's original Valuation Allowance amount was not reasonable and GAAP-compliant at that time.***

The fact Navistar "knew" that its books were being restated at the time it filed its Report is equally irrelevant. Navistar used the only Valuation Allowance that existed when it made the binding election to convert its unused NOLs into a CAT credit. There were no other books available at that time. (H.R. II at 311, 429; Supp. 495; H.R. Vol. III at 551-52, 556; Supp. 735-736, 740.) ***Each of Navistar's experts concluded that the Valuation Allowance that Navistar used to compute the credit was the appropriate one to use***, inasmuch as it reflected the circumstances, available evidence and best judgment that was available ***as of the June 30, 2006 filing deadline***. (H.R. II at 407-409, 421, 455; Supp. 591-593, 605, 639. H.R. III at 551-52, 556-58; Supp. 735-736, 740-743. H.R. II at 314-16; Supp. 498-500.)

There is an immediate "cause and effect" relationship among a corporation's income/loss, its tax expense, the deferred tax it carries, and the Valuation Allowance it may be required to have. Thus, in a restatement, a Valuation Allowance will always be on the list of issues to be examined. (H.R III at 536, 543-44; Supp. 720, 727-728.) In other words, any time that the company's income/loss changes, it is required to review the Valuation Allowance again. In Navistar's case, it took until December of 2007 to reconstruct the detailed information to issue the restated financials. (H.R. II at 304; Supp. 488). The review of the deferred tax assets begins very late in the restatement process, after all the adjustments to pre-tax income have been made. The very last piece of this process is the Valuation Allowance analysis.

In short, although Navistar did change the Valuation Allowance – when all restatement data was in at the end of 2007 and with the benefit of complete hindsight – ***this does not mean that the original Valuation Allowance itself did not comply with GAAP.*** The Commissioner's position must therefore fail on this point alone.

2. The "realizable value" of Navistar's NOLs and other deferred tax assets was not zero. Navistar has used all of the NOLs on its books for 2004.

The Commissioner relies exclusively on the December 10, 2007 Restatement and asserts that "by taking a 'full Valuation Allowance' against its deferred tax assets, Navistar restated the value of its NOLs from over a billion dollars to zero dollars." Central to this argument, therefore, is the unjustified assumption that the Restatement more accurately reflects the "realizable value" of Navistar's NOLs. This is just plain wrong. While the Commissioner would have this Court believe that the NOLs were worthless, the uncontroverted evidence presented at the BTA hearing showed that ***Navistar has gone on to use virtually all of the NOLs that were on its books in 2004.*** In fact, Navistar eliminated nearly all of its Valuation Allowance in September 2011, reinstating more than $1.4 billion in deferred tax assets on its balance sheet and underscoring yet again just how much value its NOLs actually had. (Nav. Ex. 53 and 54; H.R. Vol. II at 326-27; Supp. 510-11.)

For the same reason, the Commissioner's assertion that the zero-value Valuation Allowance in the later, restated financials was the "most accurate" is equally meritless. Leaving aside the simple fact that R.C. 5751.53 does not call for either the most "up to date," the "most accurate" or a restated Valuation Allowance, the Valuation Allowance that the Commissioner wants to use here predicted that *none* of Navistar's NOLs would be used. Hindsight now tells us that this cannot possibly be the "most accurate" Valuation Allowance, given the fact that Navistar actually used its NOLs. Navistar's witnesses testified that ***the original Valuation Allowance***, with the benefit of complete hindsight, ***was the more "accurate" prediction of the value of the NOLs***. (H.R.II at 425-26; Supp. 609-10. H.R. III at 559-60; Supp. 743-44.) The Commissioner did not refute this expert testimony and introduced no other evidence to the contrary.

3. Valuation Allowances constantly fluctuate, and the Commissioner cannot pick the Valuation Allowance most favorable to his position. He is limited to the Valuation Allowance reported as of the statutory deadline.

Because it is in part based on future performance, a Valuation Allowance is little more than management's "prediction" of whether a company will be able to actually use its NOLs or other deferred assets in the future. Thus, a Valuation Allowance effective as of date certain may be changed multiple times upon review. (See, generally, H.R. II at 315-420; Supp. 499-604). In fact, the Valuation Allowance is constantly under review. Whenever a corporation closes its books at the end of the month (or quarterly and yearly), the manufacturer's deferred tax assets change based upon the company's performance over that month. (See H.R. II at 288-289; 472-473). Because the manufacturer adjusts its deferred tax assets each month, the Valuation Allowance is modified correspondingly. This is why a Valuation Allowance is persuasive for only a date certain – a single "snapshot" in time. Tomorrow's Valuation Allowance will, by the very fact that a business continues to operate, fluctuate based upon the manufacturer's most recent activity. Every single day that passes, facts replace estimates. When actual results replace predicted results, the amount of deferred taxes change and the amount of the Valuation Allowance is correspondingly altered. This is precisely why the General Assembly (with the Tax Commissioner's urging) mandated a point in time from which to measure the CAT credit, *i.e,* the books and records existing as of 2004 year-end as reflected in its report due by the filing deadline of June 30, 2006.

If the Commissioner's view that a Valuation Allowance on some date other than October 31, 2004 can be used, he cannot stop with the restated Valuation Allowance on Navistar's books in December 2007. Public companies like Navistar are required, on a quarterly basis for financial reporting purposes, to review information and, based upon current facts and circumstances, make an assessment of whether it is more likely than not its deferred tax benefits will be realized through the generation of future taxable income. (H.R. II at 289-90; Supp. 473-44.) Due to these required quarterly reviews and constant revisions, Valuation Allowances frequently fluctuate, particularly in a cyclical industry like Navistar's. They go up and down on a regular basis, depending on the information that becomes available at each new point in time.

These constant quarterly revisions demonstrate just why the Commissioner's position in this case is both patently unfair and administratively unworkable. If he is not going to use the Valuation Allowance that was on Navistar's books in 2004 he cannot simply choose to use the highest Valuation Allowance that produces the lowest CAT credit and then stop there. For if the Commissioner is correct in his argument that a later Valuation Allowance must be used to calculate the CAT credit, then he must go even further and use the even later Valuation Allowance that is now on Navistar's books. The Attorney General's argument runs to the absurd in that one would have to conclude that there are no time limitations on calculating the credit over its 20-year lifespan. The credit would need to be recalculated annually based upon the most up-to-date information. For any given year, the credit would either be decreased or increased based upon new information. Thus, under the facts in this case, the Tax Commissioner would decrease the 2004 credit based upon the December 2007 restatement but would then be required to increase the credit in any open year impacted by the subsequent reinstatement of Navistar's deferred assets in 2011.

Because the Valuation Allowance is constantly changing, any so-called "accuracy" is constantly changing as well. This alone illustrates the absurdity of the Commissioner's position, since it is only the Valuation Allowance that was on Navistar's books on its 2004 year-end that matters under the statute.

D. There is no authority under R.C. 5751.53 for the Commissioner to audit the "accuracy" of the Valuation Allowance amount itself.

To be sure, the Commissioner retains authority to audit the amortizable amount and the Commissioner could do so – within the limits of his authority – until June 30, 2010. R.C. 5751.53(D) But the Commissioner confuses his authority to audit the "accuracy of the amortizable amount" with some so-called authority to audit the "accuracy of the Valuation Allowance."

Indeed, the Commissioner's powers are defined by statute and thus his audit authority in this context is necessarily curtailed by the language of R.C. 5751.53 as a whole. That language unambiguously instructs the taxpayer to calculate the amortizable amount using the Valuation Allowance that was on the books in 2004. When the audit authority in R.C. 5751.53(D) is read – as it must be – against these clear statutory directives, it is clear that the Commissioner's ability to "audit" the Valuation Allowance piece of the credit formula is limited only to first determining whether the taxpayer had booked a Valuation Allowance on the last day of 2004, and if so, whether it had reduced its NOLs by this amount for purposes of the CAT credit.

The statutory mandate also reflects both the unique nature of the Valuation Allowance concept and the role it was intended to serve for purposes of this credit. By insisting on finality in the Valuation Allowance amount, both the Commissioner and the General Assembly implicitly recognized the inherent limitations in "auditing" a prediction that has an entire range of acceptable values and for which there is no accounting concept of "accuracy." Even the Commissioner's own rule reflects that his role was to "substantiate" the information supplied with the report, "including substantiation of any information supplied with the report * * * that the deferred tax asset amounts ***were booked*** on the taxpayer's financial statements."

O.A.C. 5703-29-11(A)(3). (Emphasis added). Noticeably absent from this rule is any authority to inquire as to whether the Valuation Allowances that "were booked" were "accurate," GAAP-compliant or subsequently amended. It is clear from both the statute and the rule that the Commissioner was not to determine what the Valuation Allowance *should be*, but to simply accept the judgment the taxpayer had already made. With respect to the Valuation Allowance, therefore, his role was limited to substantiating that the Valuation Allowances on the report "were booked" on the last day of the taxpayer's 2004 taxable year and properly applied to compute the credit.

1. The Commissioner never "audited" Navistar's Valuation Allowance.

The Commissioner concedes that Navistar did reduce its Ohio NOL carryforwards by the Valuation Allowance on its original 2004 books, but claims that he must determine whether the realizable value of [Navistar's] NOL carryforwards, as of the 2004 fiscal year end, complies with GAAP. There is no such authority in the statute. And even if there were, that's not what the Commissioner's Audit Division did here.

Navistar claimed a total amortizable amount of $27,048,726 in its CAT NOL Report. *See* Joint Ex. E, at page 1. The Commissioner's Executive Director of Audit testified before the BTA that the Commissioner never "audited" this amount, and thus the $27,048,726 in fact is not in controversy. (H.R. II at 239-41; Supp. 423-425.) Indeed, hearing testimony confirms that the Commissioner *never* audited Navistar's Valuation Allowance as shown on its books and records on October 31, 2004 – he just replaced the original Valuation Allowance with the later, restated one. (H.R. II at 241, 245, 247; Supp. 425, 429, 431). When the restated Valuation Allowance was netted against Navistar's gross NOLs, the credit amount was reduced to zero. Acting without authority from the statute, the Audit Division therefore made an impermissible policy determination that Navistar was not entitled to the credit, simply because it restated its Valuation Allowance.

E. The Attorney General poisons the record with innuendo by improperly referencing an Illinois Complaint filed by Navistar's parent corporation in unrelated litigation.

1. The BTA expressly forbade the use of the Illinois Complaint as an admission against interest.

The Attorney General improperly bases much of his brief on so-called "facts" and factual innuendos that are not even part of the record. Several times throughout the BTA merit hearing, the Commissioner attempted to have witnesses testify about a Complaint filed by Navistar International Corporation, appellant's parent, in now-settled litigation against the accounting firm of Deloitte & Touche in U.S. District Court for the Northern District of Illinois. (Commissioner's Ex. 8; "the Complaint"). ***The Board did not allow this.*** The Commissioner then asked the Board to take judicial notice of the Complaint, asking it to accept the Complaint as an admission against interest by Navistar. ***The Board did not allow this.*** Instead, the Attorney Examiner explicitly ruled that the Complaint could "come in as a part of the record, but * * * the ***statements in [the Complaint] will not be taken as either admissions against interest or statements by a party opponent.*** That's my ruling." (H.R. II at 371-72; Supp. at 555-556.)

2. The Attorney General may not use allegations in a Complaint as "facts."

Ohio law establishes that a pleading may not be introduced into the record as substantive evidence in support of a claim. Civ.R. 8(G); *Vitanza v. First Natl. Supermarkets, Inc.* (June 24, 1993), Cuyahoga App. No. 62906, unreported, and *Cross-Country Inns. Inc. v. Habegger Corp.* (Mar. 16, 1995), Franklin App. No. 94APE01-92, unreported. Yet, this is precisely what the Commissioner has done through the Illinois Complaint. Navistar stresses that the Illinois Complaint is not a statement of fact but a set of unproven allegations that have not been considered by any court, nor have the allegations been admitted to by the accounting firm. See *Hoaglin Holdings. Ltd. v. Goliath Mortgage*, 2004-Ohio-3473, the court held that "a Complaint (or answer) is a lawyer's document and is not for the jury [i.e., trier of fact]."

3. **Although not appealing the BTA's ruling on the limited utility of the Complaint, the Attorney General improperly employs the Complaint in direct contradiction to the BTA's order.**

The Commissioner blatantly disregards the BTA's ruling. The allegations in the Complaint are not "facts" in this case, are not "admissions" by Navistar, and may not be offered as substantive proof of anything pertaining to these proceedings. Nonetheless, the Commissioner cites to the allegations in the Complaint as if they were part of the record. He then mischaracterizes these so-called "facts," all in express disregard of the BTA's clear ruling to the contrary. Ultimately, the Commissioner tries to use the Complaint to mislead this Court into believing that Navistar's original 10-K was fraudulently misrepresented. This is absolutely wrong.

4. **The Attorney General mischaracterizes the allegations raised in the Complaint which pertain to matters unrelated to this appeal. Moreover, the Illinois Court dismissed some allegations of fraud, and, ultimately, the matter was settled, with no party admitting to any of the allegations contained in the Complaint.**

The Attorney General completely mischaracterizes the nature of the allegations, thereby prejudicing the record against Navistar. ***None of the allegations in the Illinois Complaint relate to the CAT credit at issue.*** In fact, ***none of the allegations in the Complaint were made by a party in this case***. The Illinois litigation was filed by Navistar International Corporation, which is a separate legal entity from Navistar, Inc., the appellant in this matter. Also, ***none of the allegations in the Illinois Complaint are proven "facts."*** To the contrary, in July 2012, the Illinois Circuit Court dismissed, without prejudice and with leave to re-plead, some of Navistar International Corporation's counts for fraud, fraudulent concealment, and breach of fiduciary duty. Then, in December 2012, the litigation was settled by the parties without having been decided by the court in Illinois. The fact that the Attorney General continues to reference the Complaint in his briefs only emphasizes his desperation to shift the focus of this litigation away from the primary issue: limits of the Tax Commissioner's authority under R.C. 5751.53.

F. The Commissioner's suggestion to the contrary, Navistar has no intention of abandoning its claims and arguments in support of its appeal.

The Tax Commissioner's last argument is a hypothetical one which can be ignored by the Court. The Commissioner states that if Navistar abandons its claim that its CAT credit was based on its books and records that complied with generally accepted accounting principles, then the Commissioner has another rebuttal. See, *Brief of Appellee* at 29. Navistar has not and will not "abandon" its position so the Commissioner's argument is moot.

CONCLUSION

The Court should look beyond the Commissioner's misleading statements, his misrepresentation of facts, and the purposeful confusion of the law and record in this matter to focus on the one, true issue in this case. Specifically, whether the Tax Commissioner may ignore the date specified by the General Assembly as the date on which amounts are to be certified for purposes of calculating the CAT credit.

For all of the reasons set forth in its merit and reply briefs, Navistar asks this Court to a) find that the BTA erred in permitting the Tax Commissioner to consider financial statements not in existence as of the June 30, 2006 statutory deadline, and b) reinstate Navistar's CAT credit as set forth in its report filed with the Tax Commissioner on June 27, 2006.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Appellant's Reply Brief and attached was delivered via email and U.S. regular mail to counsel for appellee, Mike DeWine, Attorney General of Ohio, and Barton A. Hubbard, Assistant Attorney General, 30 East Broad Street, 25th Floor, Columbus, Ohio 43215, on November 13, 2014.

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