Supreme Court of Ohio Clerk of Court - Filed November 10, 2015 - Case No. 2015-0917

In the
Supreme Court of Ohio

T. RYAN LEGG IRREVOCABLE TRUST,	:	Case No. 2015-917
Appellant/Cross-Appellee,	:	Appeal from Ohio Board of Tax Appeals
v.	:	BTA Case No. 2013-A-1469
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO	:	
Appellee/Cross-Appellant.	:	

APPENDIX TO MERIT BRIEF OF APPELLEE/CROSS-APPELLANT, JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing Appendix to Merit Brief of Appellee/Cross Appellant was served upon the following by email on this 10th day of November, 2015:

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OHIO BOARD OF TAX APPEALS

NOTICE OF APPEAL

T. RYAN LEGG IRREVOCABLE TRUST, APPELLANT 1300 Market Street, Suite 605 Wilmington, DE 13901 V. JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO, OHIO DEPARTMENT OF TAXATION, APPELLEE 30 E. Broad Street, 22nd Floor Columbus, OH 43215	))))))))))))))	CASE NO. _____ **(TRUST INCOME TAX)** ASSESSMENT AMOUNT: $1,275,579.00 AMOUNT IN CONTROVERSY: $1,275,579.00

The T. Ryan Legg Irrevocable Trust ("Legg Irrevocable Trust" or "Appellant"), by its undersigned counsel, hereby petitions the Ohio Board of Tax Appeals ("Board") to hear and determine this appeal from the Final Determination of the Office of the Tax Commissioner, Ohio Department of Taxation, ("Department"), dated March 29, 2013 ("Final Determination"), addressed to Appellant in an envelope addressed to Appellant's Counsel postmarked on April 16, 2013 and received on or about April 18, 2013, which sustains a trust income tax assessment [Assessment No. 16200913485796] in the amount of $1,275,597.00, plus interest for the taxable year ended 2006 ("Audit Period"), a copy of which is attached as Exhibit A.

Appellant requests that the Board review this matter, make findings and enter an Order:

i. Dismissing and setting aside the Department's Final Determination;

ii. Stating that Appellant is not subject to the trust income tax assessments at issue and in dispute in the Final Determination;

iii. Dismissing and setting aside all interest imposed against Appellant as erroneously imposed by the Department; and,

iv. Awarding Appellant such other relief as the Board may deem appropriate.

In support of this Notice of Appeal, Appellant states and alleges as follows:

GENERAL BACKGROUND FACTS

I. PARTIES

1. At all times relevant herein, the Legg Irrevocable Trust was a non-grantor trust, governed by Delaware law, and pursuant to Del. Code Ann. Tit. 30 § 1601(8), was a Delaware resident trust, established by T. Ryan Legg on November 14, 2005, as Grantor, and U.S. Trust Company of Delaware, as Trustee, with its principal place of business and commercial domicile in Delaware with a mailing address of 1300 Market Street, Suite 605, Wilmington, Delaware 19801.

2. At all times relevant herein, the Appellee, Ohio Department of Taxation, was empowered by and subject to the provisions of the Ohio Revised Code ("R.C."), whose responsibility it is to assess, enforce and collect various taxes imposed by the R.C., including the trust income tax.

II. ISSUES PRESENTED

3. The primary issues presented in this Notice of Appeal are whether:

[A] For the Audit Period, the Department has erroneously subjected to Ohio trust income tax the Appellant's gain on its sale of shares of TQL corporate stock by erroneously classifying this gain as a qualifying trust amount and apportioning to Ohio 100% of the gain (which is in excess of the amount authorized by law when the physical assets of the company sold are located in two or more states, as were TQL's assets),

rather than properly classifying the gain as nonbusiness income and allocating the gain entirely outside of Ohio;

[B] For the Audit Period, Ohio's disparate treatment of Appellant as to the tax treatment of its sales of corporate stock denies Appellant equal protection of the laws;

[C] For the Audit Period, Ohio's taxation of the gain constitutes an extraterritorial tax on an out-of-state taxpayer in violation of the United States Constitution; and

[D] For the Audit Period, the Department has erroneously imposed interest.

III. STATEMENT OF FACTS

4. On November 14, 2005, T. Ryan Legg ("Ryan"), as Grantor, and U.S. Trust Company of Delaware, as Trustee, ("Trustee") entered into the T. Ryan Legg Irrevocable Family Trust Agreement ("Trust Agreement").

5. The Legg Irrevocable Trust is governed by Delaware law, and pursuant to Del. Code Ann. Tit. 30, § 1601(8), the Legg Irrevocable Trust is a Delaware resident trust, domiciled in Delaware.

6. For federal income tax purposes, the Legg Irrevocable Trust is classified as a complex trust, the taxation of which is governed by Section 661 of the Internal Revenue Code of 1986, as amended ("Code").

7. Prior to the establishment of the Legg Irrevocable Trust, Ryan owned 100 shares of common stock (*i.e.*, 50% of the total shares) in Total Quality Logistics, Inc. ("TQL"), an Ohio corporation and a Subchapter S corporation for federal income tax purposes.

8. According to its website [www.tql.com], TQL "is [a] freight brokerage firm [that] specialize[s] in arranging the transportation of full truckload shipments for thousands

of companies across the country and various industry segments." Copies attached at Exhibit D.

9. During the period at issue, TQL was "located in Cincinnati, Ohio with a second office in Elkins, WV" according to TQL's website, copies attached at Exhibit E.

10. On November 14, 2005, Ryan transferred 65 shares of TQL to the Legg Irrevocable Trust.

11. On February 3, 2006, the Legg Irrevocable Trust sold its 65 shares of TQL for $18,525,000.

12. TQL did not provide the Legg Irrevocable Trust with the book value of the physical location of TQL's physical assets in Ohio and elsewhere as of the 2005 calendar year, December 31, 2005.

13. On its 2006 Ohio Fiduciary Income Tax Return (Form IT-1041), the Legg Irrevocable Trust reported to Ohio its federal taxable income, *i.e.*, specifically, the gain arising from the sale of the TQL stock, and reported its modified Ohio taxable income as "None."

IV. PROCEDURAL HISTORY

14. In its correspondence dated July 29, 2008, the Department (after conducting an audit of the Trust's Form IT-1041) proposed changes [Form IT-1041C] to apportion the TQL stock gain as business income using the special rule for the apportionment of income of a pass-through entity investor [R.C. 5747.212] in which the three-year average of TQL's three-factor apportionment was used to determine the Legg Irrevocable Trust's income apportioned to Ohio (here, over 90%) and subject to tax

thereon, attached as Exhibit B; this necessarily entailed a determination that the gain was not a qualifying trust amount.

15. The Legg Irrevocable Trust filed a timely Protest in August 2008, disputing the propriety of the Department's position and asserting, *inter alia*, that: the TQL stock gain was nonbusiness income not allocable to Ohio, citing authority that a trust's mere holding and selling of stock is not a trade or business; the disparate treatment of the Legg Irrevocable Trust by taxing the gain on sale of corporate stock denied it equal protection; and, Ohio's taxation of the gain was an extraterritorial tax on an out-of-state taxpayer in violation of the United States Constitution.

16. The Department issued a Notice of Assessment, Trust Income Tax, dated May 26, 2009, which did not, on its face, explain the Department's position, attached as Exhibit C.

17. Appellant filed a timely Petition for Reassessment on July 20, 2009, reasserting its positions set forth in its Protest and requesting a hearing.

18. A hearing was held on August 10, 2010.

19. After attempts to resolve the issue, the Department issued its Final Determination to Appellant, dated March 29, 2013 and postmarked April 16, 2013, but not received by Appellant until on or about April 18, 2013.

20. In its Final Determination, the Department erroneously upheld the trust income tax assessment in the amount of $1,275,597.00 on the basis that the gain at issue was a "qualifying trust amount" under R.C. 5747.01(BB)(2) allocable in total (100%) to Ohio – disregarding publicly available information and information believed to be in

the Department's possession (*e.g.*, TQL's 2005 Ohio tax return) that TQL had assets in other states such as West Virginia.

ISSUES

V. LEGAL ARGUMENTS

A. The Gain from the Sale of TQL Stock is Nonbusiness Income Not Allocable to Ohio

i. The TQL Stock Sale Gain is Nonbusiness Income

21. Ohio income tax is imposed on a trust's modified Ohio taxable income. R.C. 5747.02(A)&(D).[1]

22. A trust's modified Ohio taxable income is defined by reference to the Internal Revenue Code of 1986, as amended and adjusted [R.C. 5747.01(S)] and apportioned and allocated to Ohio. R.C. 5747.01(BB)(4).

23. Modified business income [R.C. 5747.01(BB)(1)] is apportioned, and modified nonbusiness income (a trust's Ohio taxable income other than apportionable income, including modified business income) [R.C. 5747.01(BB)(3)] is allocated. *See* R.C. 5747.01(BB)(4).

24. Modified nonbusiness income is the residual of a trust's modified business income. *See* R.C. 5747.01(BB)(3).

25. "Modified business income" is "the business income included in a trust's Ohio taxable income after such taxable income is first reduced by the qualifying trust amount, if any." R.C. 5747.01(BB)(1).

26. For income to be business income under R.C. 5747.01(B), it must arise from a "trade or business;" the corollary of this is that income that does not arise from a trade or

[1] Of course, the constitutional and statutory prerequisites to tax must have first been met.

business is *not* business income, but rather is nonbusiness income under R.C. 5747.01 (C).

27. For purposes of the personal income tax imposed pursuant to R.C. 5747.02, the type of income is often also indicative, in and of itself, as to whether such income is nonbusiness income. *See e.g.*, *Bosher v. Euclid Income Tax Bd. of Review*, 792 N.E.2d 181, 184 (Ohio 2003) (playing the lottery is not a trade or business); *Couchot v. State Lottery Comm'n*, 659 N.E.2d 1225, 1226 n. 1 (Ohio 1996) (observing that "lottery winnings" are nonbusiness income); *Ricchuiti v. Limbach*, 1992 WL 315352, No. 89-K-1124 (Ohio Bd. of Tax App. Oct. 23, 1992) (holding that personal services income is nonbusiness income).

28. Capital gain from the sale of corporate stock is nonbusiness income. *See* Ohio Information Release Trust 2003-01 (Apr. 14, 2003) (Q&A #16) ("[M]odified nonbusiness income generally include[s]...capital gains...from the sale of publicly-tradedstocks....").[2]

29. A trust's mere holding and selling of stock and securities is not a trade or business. *See City Bank Farmers Trust Co. v. Helvering*, 313 U.S. 121, 123-26 (1941). (holding that a trust that bought and sold stocks and bonds [*Id.* at 125 n. 3] was not engaged in a trade or business); *see also Comm'r v. Groetzinger*, 480 U.S. 23, 30-31 (1987) ("[T]he efforts of a[]...trust in asset conservation and maintenance did not constitute a trade or business.").

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[2] Notably, Ohio Information Release Trust 2003-01 also takes that position that nonbusiness income does not include income from interests in S corporations; however, as stated, the income at issue here is not from an S corporation, but rather results from a sale of corporate stock.

30. The Legg Irrevocable Trust's holding of TQL stock and the sale of same is not a trade or business under *City Bank Farmers Trust* and *Groetzinger*, and thus, the Legg Irrevocable Trust cannot be said to have a trade or business so that the Legg Irrevocable Trust's gain on the sale of TQL stock does not arise from a trade or business, and, by definition, that gain cannot be business income.

ii. The Department's Audit Determination that the TQL Stock Sale Gain Was Not a Qualifying Trust Amount was Correct and Supported by the Facts

31. A qualifying trust amount is statutorily defined as a capital gain or loss resulting from a sale of an interest in a qualifying investee (*e.g.*, shares of S corporation stock) but *only if*: (a) the book value and location of the qualifying investee's physical assets as of the immediately preceding year end are *available*[3] to the trust; and, (b) the trust owns more than 5% of the qualifying investee:

> "Qualifying trust amount" of a trust means capital gains and losses from the sale, exchange, or other disposition of equity or ownership interests in, or debt obligations of, a qualifying investee to the extent included in the trust's Ohio taxable income, but *only if* the following requirements are satisfied:
>
> (a) The book value of the qualifying investee's physical assets in this state and everywhere, as of the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, is available to the trust.
>
> (b) The requirements of section 5747.011 of the Revised Code are satisfied for the trust's taxable year in which the trust recognizes the gain or loss.
>
> *Any gain or loss that is not a qualifying trust amount is modified business income, qualifying investment income, or modified nonbusiness income, as the case may be.*

[3] "'Available' means information is such that a person is able to learn of the information by the due date plus extensions, if any, for filing the return for the taxable year in which the trust recognizes the gain or loss." R.C. 5747.01(BB)(6). This provision quite obviously goes primarily to timing.

R.C. 5747.01(BB)(2) (emphasis added).

32. In computing a trust's modified Ohio taxable income, a qualifying trust amount is multiplied by the fraction of the qualifying investee's physical assets' book value in Ohio to the book value everywhere as of the last day of the calendar year immediately prior to the day the gain was recognized [R.C. 5701(BB)(4)(b)];[4] so, as the Department had information that TQL had offices outside of Ohio, including an office in West Virginia (and presumably, TQL's 2005 Ohio tax return), the Department's assessment, even under its own position, is erroneously overstated as the fraction can only be something less than 100% Ohio.

33. A qualifying trust amount cannot be business income and, conversely, business income cannot be a qualifying trust amount. *See* R.C. 5747.01(BB)(1) ("Modified business income" means the business income included in a trust's Ohio taxable income after such taxable income is first reduced by the qualifying trust amount, if any."); *see also* R.C. 5747.01(B) (defining business income).

34. The Department's audit determination – *i.e.*, that "The capital gains reported on the 2006 return is [sic] business income..." [Exhibit B] – necessarily required a determination that such gain is *not* a *qualifying trust amount* and that the book value and location of TQL's physical assets as of the immediately preceding year end were

[4] "The qualifying trust amount multiplied by a fraction, the numerator of which is the sum of the book value of the qualifying investee's physical assets in this state on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the day on which the trust recognizes the qualifying trust amount, and the denominator of which is the sum of the book value of the qualifying investee's total physical assets everywhere on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the day on which the trust recognizes the qualifying trust amount." R.C. 5747.01(BB)(4)(b)

not "available" [R.C. 5747.01(BB)(6)] to the Legg Irrevocable Trust. *See* R.C. 5747.01(BB)(1)

35. The location of the physical assets of TQL, a corporation less than one third of which was held as a stock investment by the Legg Irrevocable Trust, would *not normally* be available to it, nor would the Trust normally be able to learn it [*see Random House, Inc. v. Tracy*, Case No. 91-A-1329 (Ohio B.T.A. May 5,1993) ("The definition of 'available' ... connotes the ability 'in the course of business,' to obtain the required information.")]; as such, R.C. 5747.01(BB)(2)(a)&(6) cannot be construed as the Department has construed it. *See Gulf Oil Corp. v. Kosydar*, 339 N.E.2d 820, 825 (Ohio 1975) ("It is the duty of the courts...to so construe a statute as to avoid unreasonable or absurd consequences.").[5]

36. The Department's years after the fact speculation that the Legg Irrevocable Trust would have somehow been able to obtain information about the book value and location of TQL's physical assets is not supported by any facts.

37. The Legg Irrevocable Trust did not and thus was not able to learn of the book value and location of TQL's physical assets as of the immediately preceding year end prior to the extended filing due date of the involved return [R.C. 5747.01(BB)(2)(a); R.C. 5747.01(BB)(6)]; accordingly, as recognized by the Department's audit determination, the involved gain cannot be a qualifying trust amount.

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[5] Further, it is unreasonable, arbitrary and unconscionable for the Department to reverse its position and assume that such information was available to the Legg Irrevocable Trust under the instant circumstances, particularly when the Legg Irrevocable Trust, a minority shareholder of a closely held company which was not an officer or director of TQL, did not then have this information.

iii. Nonbusiness Income is Allocated Out of Ohio

38. Income such as the Legg Irrevocable Trust's TQL stock sale gain that is not business income is nonbusiness income. *See* R.C. 5747.01(C).

39. Pursuant to R.C. 5747.01(BB)(4)(c)(ii), nonbusiness income is allocated to Ohio (or not) pursuant to a series of statutory rules and based on whether a taxpayer is a resident or a nonresident, the type of income and the location of the property or the taxpayer:

> All items of nonbusiness income or deduction taken into account in the computation of adjusted gross income for the taxable year by a nonresident shall be allocated to this state as follows:
>
> (1) All items of compensation paid to an individual for personal services performed in this state who was a nonresident at the time of payment and all items of deduction directly allocated thereto shall be allocated to this state.
>
> (2) All gains or losses from the sale of real property, tangible personal property, or intangible property shall be allocated as follows:
>
> * * *
>
> (c) Capital gains or losses from the sale or other transfer of intangible personal property are allocable to this state if the taxpayer's domicile was in this state at the time of such sale or other transfer.
>
> * * *
>
> (5)(a) All lottery prize awards paid by the state lottery commission pursuant to Chapter 3770 of the Revised Code shall be allocated to this state.
>
> * * * *

R.C. 5747.20(B).

40. A gain from the sale of stock including the gain at issue is allocated to the state of the taxpayer's domicile, which for the Legg Irrevocable Trust is Delaware. *See* R.C. 5747.20(B)(2)(c).

41. This confirms the conclusion that the gain recognized by the Legg Irrevocable Trust on the sale of its TQL stock resulted in nonbusiness income as the Legg Irrevocable Trust is not itself engaged in a trade or business.

42. On the date that Legg Irrevocable Trust, which is a non-resident of Ohio, sold its TQL stock, February 3, 2006, the rule regarding allocation was:

> With respect to a trust or portion of a trust that is *not a resident* as ascertained in accordance with division (I)(3)(d) of this section, the amount of its modified nonbusiness income satisfying the descriptions in divisions (B)(2) to (5) of section 5747.20 of the Revised Code.

R.C. 5747.01(BB)(4)(c)(ii). Accordingly, under this rule, the TQL stock gain is nonbusiness income and thus not allocated to Ohio.

43. This provision was amended, however, effective March 30, 2006, and now purports to apportion a gain on the sale of an interest in a pass-through entity in which the taxpayer owns a 20% or more equity interest:

> With respect to a trust or portion of a trust that is *not a resident* as ascertained in accordance with division (I)(3)(d) of this section, the amount of its modified nonbusiness income satisfying the descriptions in divisions (B)(2) to (5) of section 5747.20 of the Revised Code, <u>except as otherwise provided in division (BB)(4)(c)(ii) of this section. With respect to a trust or portion of a trust that is not a resident as ascertained in accordance with division (I)(3)(d) of this section, the trust's portion of modified nonbusiness income recognized from the sale, exchange, or other disposition of a debt interest in or equity interest in a section 5747.212 entity, as defined in section 5747.212 of the Revised Code, without regard to division (A) of that section, shall not be allocated to this state in accordance with section 5747.20 of the Revised Code but shall be apportioned to this state in accordance with division (B) of section</u>

> 5747.212 of the Revised Code without regard to division (A) of that section .

R.C. 5747.01(BB)(4)(c)(ii) (underlined text added by 2006 Ohio Laws, H. 530, §§ 101.01 & 821.06(A), effective Mar. 30, 2006).[6]

44. The change in the law confirms that the prior version required that a trust's gain from the sale of stock in an S corporation be allocated as nonbusiness income because when the General Assembly amends a statute, it intends to effect a change. *See Lynch v. Gallia County Bd. of Comm'rs*, 680 N.E.2d 1222, 1224 (Ohio 1997) ("When confronted with amendments to a statute, an interpreting court must presume that the amendments were made to change the effect and operation of the law."); 1A Norman J. Singer, *Sutherland Statutes and Statutory Construction* § 22.30 (6th ed. rev. 2002) ("[T]he mere fact that the legislature enacts an amendment indicates that it...intended to change the original act....").

45. The General Assembly changed the rule here from allocation to apportionment, but the rule did not go into effect until March 30, 2006 – over a month after the transaction at issue.

46. The General Assembly did not evidence any intent to unconstitutionally go back and attempt to retroactively change the rules for or tax a transaction that had already occurred prior to the effective date of the change. *See* Ohio Const., art. 2, § 28 ("The

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[6] R.C. 5747.212(B) ("A taxpayer, directly or indirectly, owning at any time during the three-year period ending on the last day of the taxpayer's taxable year at least twenty per cent of the equity voting rights of a section 5747.212 entity shall apportion any income, including gain or loss, realized from each sale, exchange, or other disposition of a debt or equity interest in that entity as prescribed in this section. For such purposes, in lieu of using the method prescribed by sections 5747.20 and 5747.21 of the Revised Code, the investor shall apportion the income using the average of the section 5747.212 entity's apportionment fractions otherwise applicable under section 5733.05, 5733.056, or 5747.21 of the Revised Code for the current and two preceding taxable years. If the section 5747.212 entity was not in business for one or more of those years, each year that the entity was not in business shall be excluded in determining the average.").

general assembly shall have no power to pass retroactive laws...."); *Lakengren, Inc. v. Kosydar*, 339 N.E.2d 814, 817 (Ohio 1975) ("The General Assembly in this case changed existing rules of law to its benefit, and applied those rules to events and transactions already completed under a different set of rules. That it may not do.")

47. Accordingly, the gain on the sale of the TQL stock is nonbusiness income and therefore properly allocable to the Legg Irrevocable Trust's domicile (here, Delaware); thus, the trust income tax assessment should be set aside.

B. The Department's Disparate Treatment of the Legg Irrevocable Trust as to the Tax Treatment of Its Sale of Corporate Stock Denies the Trust Equal Protection of the Laws

48. Here, taxpayers within the same class [nonresident trusts] owning and selling the same type of intangible asset [shares of corporate stock] are treated differently, and this disparate treatment denies the Legg Irrevocable Trust equal protection of the laws.

49. Such disparate treatment ostensibly implicates the constitutional right to equal protection [U.S. Const., amend. XIV; Ohio Const., art. I, § 2] which prevents Ohio from treating differently, persons who are alike in all relevant respects. *See MCI Telecomm. Corp. v. Limbach*, 625 N.E.2d 597, 600-01 (Ohio 1994); *Boothe Fin. Corp. v. Lindley*, 452 N.E.2d 1295, 1297 (Ohio 1983) ("States have great discretion in laying taxes; however, the taxing power is subject to the Equal Protection Clause.").

50. When "taxpayers within the same class owning...the same type of [personal property] are treated differently,...this treatment denies...equal protection of the laws [to the taxpayer receiving differential treatment]." *MCI*, 625 N.E.2d at 601.

51. A nonresident trust majority shareholder that sells corporate stock (*i.e.*, intangible property) *does not*, for Ohio income tax purposes, *allocate to Ohio* nonbusiness income resulting from the sale when that corporation (doing business in Ohio) is being taxed under Subchapter C of the Code. *See* R.C. 5747.01(BB)(4)(c)(ii); R.C. 5747.20(B)(2)(c).

52. In contrast, a nonresident trust majority shareholder that sells corporate stock (*i.e.*, intangible property) *apportions to Ohio some portion* of nonbusiness income resulting from the sale when that corporation (doing business in Ohio) is instead being taxed under Subchapter S of the Code. *See* R.C. 5747.01(BB)(4)(c)(ii) (via the provision added by 2006 Ohio Laws, H. 530, §§ 101.01 & 821.06(A)); R.C. 5747.212.[7]

53. As a result of the 2006 law change, the Department's position is that Ohio differentiates between nonresident trust shareholders, improperly subjecting nonresident trust S corporation shareholders to taxation upon sale of their stockwhile appropriately excepting nonresident trust C corporation shareholders.

54. "Ohio's Equal Protection Clause tracks its federal counterpart...." *Am. Ass'n of Univ. Professors v. Cent. State Univ.*, 717 N.E.2d 286, 291 (Ohio 1999). So, the analysis is the same under both.

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[7] Peculiarly, Ohio *does not* differentiate between C corporation and S corporation shareholders until, in accordance with RC 5747.212(B), the holder of the S corporation stock owns at least twenty percent of the voting interests in the S corporation "at any time during the three-year period ending on the last day of the taxpayer's taxable year." Thus, it is only upon reaching this statutorily defined ownership threshold that Ohio intervenes to apportion nonresident gains. By negative inference, gains of a nonresident with less than a twenty percent stake in an S corporation, during the requisite time period, would be allocated entirely outside of Ohio – no different than a sale of stock of a C corporation.

55. The Ohio Supreme Court, in *MCI*, *supra*, set forth the limitations that the Clauses impose on classifications made by the General Assembly:

> Equal Protection Clause of the Fourteenth Amendment, § 1, commands that no State shall "deny to any person within its jurisdiction the equal protection of the laws." Of course, most laws differentiate in some fashion between classes of persons. The Equal Protection Clause does not forbid classifications. It simply keeps governmental decision makers from treating differently persons who are in all relevant respects alike.

MCI, 625 N.E.2d at 600 (quoting *Nordlinger v. Hahn*, 505 U.S. 1 (1992)).

56. Equal Protection "protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class. The right is the right to equal treatment." *Boothe*, 452 N.E.2d at 1297 (quoting *Hillsborough v. Cromwell*, 326 U.S. 522 (1946)).

57. The 2006 amendment to R.C. 5747.01(BB)(4)(c)(ii) subjects a nonresident trust majority shareholder that sells corporate stock to tax when the income of the subject corporation doing business in Ohio is taxed as an S corporation, but does not impose tax on a nonresident trust majority shareholder that sells corporate stock when the income of the subject corporation doing business in Ohio is taxed as a C corporation.

58. Such a classification survives constitutional scrutiny only when the classification rationally furthers a legitimate state interest. *See MCI*, 625 N.E.2d at 600.

59. The classes, as drawn, can be neither arbitrary nor capricious, and must be at least rationally related to furthering the purpose of the taxing statute. *See MCI*, 625 N.E.2d at 600.

60. For state law purposes, the nature of the property interest represented by a share of stock in a corporation is the same regardless of the method of taxation of that

corporation's income – under Subchapter C or S of the Code, and no difference exists in the federal taxation of a shareholder's *sale* of their stock in a corporation – whether such is a C or an S.

61. The gain at issue here did not flow up from TQL, rather it was the gain of the Legg Irrevocable Trust which resulted from its sale of corporate stock; the difference in the federal taxation of the income of S and C corporations does not justify disparate treatment of their shareholders when the shareholders sell their corporate stock.

62. In *Boothe*, the Ohio Supreme Court rejected the bases put forward by the Department to justify the disparate treatment of the therein similarly situated taxpayers. *Boothe*, 452 N.E.2d at 1298.

63. The Court rejected the Department's primary position is *Boothe* that disparate treatment was justified as similarly situated taxpayers incurred different costs in securing the property therein at issue, but as stated, the disparate treatment did not survive rational basis review. *Id.*

64. In the hands of nonresident trust majority shareholders, a sale of their corporate stock cannot be rationally distinguished based on the methodology for taxing the income of the corporations; thus, the only possible conclusion here is that Ohio's disparate and arbitrary treatment of the sale of corporate stock denies the Legg Irrevocable Trust equal protection of the laws. So that the assessment should be set aside.

C. The Department's Taxation of the Gain Constitutes an Extraterritorial Tax on an Out-of-State Trust in Violation of the United States Constitution

65. The Due Process Clause [Const. amend. XIV § 1, "[N]or shall any State deprive any person of life, liberty, or property, without due process of law...."] requires the

existence of nexus, *i.e.*, "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Allied-Signal, Inc. v. Div. of Taxation*, 504 U.S. 768, 777 (1992) (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954)); *Black's Law Dictionary* 1070 (defining nexus as "[a] connection or link...").[8] The prerequisite to tax embodied therein forms the basis for the fundamental principle that "a State may not tax value earned outside its borders...." *Allied-Signal*, 504 U.S. at 777; *see also Quill Corp. v. North Dakota*, 504 U.S. 298, 305-06 (1992). Ohio's taxation of the Legg Irrevocable Trust and its gain at issue here violates the limitations imposed by the United States Constitution.

D. Alternative Apportionment

66. When the "standard" allocation and apportionment provisions [R.C. 5747.01(BB)(4)(a)-(c)] do not fairly represent a trust's modified Ohio taxable income, modification of these provisions is statutorily authorized and permitted by the flush text of R.C. 5747.01(BB)(4) which provides that:

> If the allocation and apportionment of a trust's income under divisions (BB)(4)(a) and (c) of this section do not fairly represent the modified Ohio taxable income of the trust in this state, the alternative methods described in division (C) of section 5747.21 of the Revised Code may be applied in the manner and to the same extent provided in that section.

R.C. 5747.01(BB)(4) (flush text). The alternative methods are:

> "[T]he taxpayer or pass-through entity may request, which request must be in writing accompanying the return or amended return, or the tax commissioner may require, in respect of all or any part of the business activity, if reasonable, any one or more of the following:
>
> (1) Separate accounting;

[8] The Commerce Clause [U.S. Const., art. I, § 8, cl. 3, granting Congress the power "to regulate commerce...among the several States...."] also requires nexus as a prerequisite to taxation.

(2) The exclusion of one or more factors;

(3) The inclusion of one or more additional factors which will fairly represent the business activity in this state;

(4) The employment of any other method to effectuate an equitable allocation of such business in this state. An alternative method will be effective only with approval of the tax commissioner.

* * * *

R.C. 5747.21(C).

67. The Legg Irrevocable Trust previously requested alternative apportionment relief in the form of the allocation of its gain on the sale of corporate stock to outside of Ohio, if it was determined to be subject to Ohio's trust income tax.

68. If determined to be subject to Ohio's trust income tax, then the Legg Irrevocable Trust respectfully requests the Board order alternative apportionment relief in the form of the allocation of its gain on the sale of corporate stock to outside of Ohio.

E. Effect of the Department's Position

69. Appellant submits that the proposed assessment of trust income tax must be reversed, as the Department's position violates multiple provisions of the Ohio Constitution, the United States Constitution, the Ohio Revised Statutes, Ohio case law and the common law.

70. The Department's position articulated above violates Ohio law, both statutory and the common law, and denies it multiple rights it is guaranteed under the Ohio and United States Constitutions.

71. The involved tax assessment at issue violates Section 3 of Article XII of the Ohio Constitution as it is non-uniform. It violates Section 5 of Article XII of the Ohio Constitution as it fails to distinctly state its object.

72. The constitutional mandates of uniformity are violated whenever a particular entity or taxpayer or class is singled out for special taxation and/or is required to bear a heavier taxing burden than other similarly situated taxpayers are required to bear. The Department has unlawfully singled out Appellant.

73. The Department's position also constitutes an impermissible classification under law and violates multiple provisions of the United States and Ohio Constitutions affording taxpayers equal protection under law and protection from arbitrary action of governmental agencies.

74. The Department's position, that the involved tax is owed by Appellant, is arbitrary, capricious and not in accordance with Sections 1 and 2 of the Ohio Constitution and the Equal Protection Clause of 14th Amendment to the United States Constitution and the statutes and regulations of Ohio. Further, the position disregards the longstanding prior administrative practices of the Department.

75. The Department's arbitrary classification and distinction violates Ohio law, as it defies the administrative regulation promulgation provisions of Chapter 119 of the Ohio Revised Code. The Department's actions also violate the Doctrine of Contemporaneous Construction.

76. No rational basis for the distinction advanced by the Department is presented, nor is there a compelling or even a legitimate State interest being served by the distinction advanced by the Department. The classification made by the Department thus being

arbitrary, it violates the Ohio Constitution, which proscribes arbitrary conduct on the part of state government. *See MCI Telecomm. Corp. v. Limbach*, 625 N.E.2d 597, 600-01 (Ohio 1994). There are no distinctions of relevance between the classes subject to the Department's arbitrary distinctions; therefore, the arbitrary line drawing violates hornbook equal protection doctrine. The position of the Department demonstrates that the classification is arbitrary and capricious, such that it is hostile, oppressive and utterly devoid of a rational basis.

77. Articles II, III and IV of the Ohio Constitution confer upon Appellant the right that no one of Ohio's three branches of government shall exercise any power properly belonging to either of the others; specifically, the executive branch shall not exercise the legislative power vested in the General Assembly of the State of Ohio.

78. The Department's actions herein violate these Constitutional provisions. Under the Ohio Constitution, only the General Assembly has the constitutional authority, and duty, to tax. It is unconstitutional and in excess of the authority granted the Department to levy any tax not expressly authorized by the General Assembly. *See* Ohio Const., Art. XII, § 3. The Department cannot unilaterally expand or retract a taxing statute in order to impose tax on any item which is not subject to taxation from the express language of the involved enabling statute. *See State ex rel. Moorehead v. Indus. Comm'n*, 857 N.E.2d 1203, 1205 (Ohio 2006). The Department cannot act as the legislating body and thereby add to a statute, as it has seemingly done here. Nor can the Department add to or detract from the involved statutes, by promulgating a policy or regulation or by instructions to tax forms.

79. The law is clear that taxing statutes will not be extended or enlarged to encompass items, activity, transactions, or conduct not specially held subject to tax by statute – yet, the Department has clearly attempted to do so here. *See* Ohio Const., Art. XII, § 5.

WHEREFORE, Appellant hereby requests a review of this matter and a hearing before the Ohio Board of Tax Appeals on the aforementioned Final Determination dated March 29, 2013, and for the following specific relief, requests that the Board enter an Order:

i. Dismissing and setting aside the Department's Final Determination;

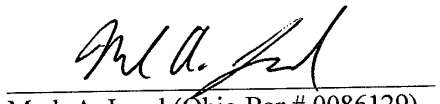
ii. Stating that Appellant is not subject to the trust income tax assessment at issue and in dispute in the Final Determination;

iii. Dismissing and setting aside all interest imposed against Appellant as erroneously imposed by the Department; and,

iv. Awarding Appellant such other relief as the Board may deem appropriate.

Dated: May 28, 2013

Respectfully submitted,



Mark A. Loyd (Ohio Bar # 0086129)

BINGHAM GREENEBAUM DOLL LLP
3500 National City Tower
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Louisville, Kentucky 40202

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COUNSEL FOR APPELLANT

T. Ryan Legg Irrevocable Trust v. Joseph W. Testa, Tax Commissioner, Ohio Department of Taxation, Case No. _____

CERTIFICATE OF FILING AND SERVICE

I hereby certify that the original and two copies of the foregoing Notice of Appeal was filed via U.S. Express Mail, with the Ohio Board of Tax Appeals, 30 East Broad Street, 24th Floor State Office Tower, Columbus, Ohio 43215-3414; and one copy served on Ohio Department of Taxation, Office of the Tax Commissioner, Appeals Management, 30 East Broad Street, 21st Floor, P.O. Box 530, Columbus, Ohio 43216-0530, this 28th day of May, 2013.

Counsel for Appellant

14585076_3.doc

Exhibit A

0000000216

Ohio | Department of Taxation
Office of the Tax Commissioner
30 E. Broad St., 22nd Floor • Columbus, OH 43215

FINAL DETERMINATION

Date: MAR 29 2013

T. Ryan Legg Irrevocable Trust
1300 Market St., Ste. 605
Wilmington, DE 19801

Re: Assessment No. 16200913485796
Trust Income Tax – 2006

This is the final determination of the Tax Commissioner with regard to a petition for reassessment pursuant to R.C. 5747.13 concerning the following trust income tax assessment:

Tax	Interest	Late Payment Penalty	Total
$1,275,597.00	$197,595.00	$395,190.00	$1,868,382.00

The petitioner, T. Ryan Legg Irrevocable Family Trust (herein after the "Trust"), an Ohio non-resident trust pursuant to R.C. 5747.01(I)(3), objects to the assessment as issued. The petitioner requested a hearing, which was held on August 10, 2010. In November 2005, T. Ryan Legg (herein after "Legg") transferred 65 shares[1] of Total Quality Logistics, Inc. (herein after "TQL"), an Ohio S Corporation, to the petitioner. The Trust sold the shares in February 2006, which created the gain at issue. The Trust was assessed when the Department determined that the gain at issue was a "qualifying trust amount" under R.C. 5747.01(BB)(2), and thus subject to Ohio taxation. The petitioner contends that the gain from the Trust's sale of stock in an Ohio S Corporation is not a qualifying trust amount, but instead is nonbusiness income allocable to the Trust's state of domicile.

Trusts are taxed on their modified Ohio taxable income. "Modified Ohio taxable income" is the sum of a trust's modified business income, qualifying trust amounts, and modified nonbusiness income. R.C. 5747.01(BB)(4)(a) through (c). Qualifying trust amounts are:

> [C]apital gains or losses from the sale, exchange, or other disposition of equity or ownership interest in, or debt obligations of, a qualifying investee to the extent included in the trust's Ohio taxable income, but only if the following requirements are satisfied:
>
> > (a) The book value of the qualifying investee's physical assets in this state and everywhere, as of the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, is available to the trust.
> >
> > (b) The requirements of section 5747.011 of the Revised Code are satisfied for the trust's taxable year in which the trust recognizes the gain or loss.

[1] Legg owned 100 shares in TQL, which constituted a 50 percent ownership interest. Thus, the Trust's 65 shares constituted a 32.5 percent ownership interest in TQL.

> Any gain or loss that is not a qualifying trust amount is modified business income, qualifying investment income, or modified nonbusiness income, as the case may be.

R.C. 5747.01(BB)(2). The petitioner's contention that the gain at issue is not a qualifying trust amount is two-fold. The petitioner asserts that 1) the Department has already admitted that the gain at issue is not a qualifying trust amount, and 2) that the book value of the qualifying investee's physical assets was not available to the Trust. The petitioner and the Department agree that, pursuant to R.C. 5747.01(BB)(2), if the gain at issue is a qualifying trust amount, then it cannot be nonbusiness income as the petitioner contends.

The petitioner's first contention is essentially an estoppel argument. During the initial stages of the audit, the Department determined that the gain at issue was business income. However, the Department later changed its position and determined that the gain at issue was a qualifying trust amount. The petitioner reasons that since the Department determined that the gain at issue was business income, and by definition business income cannot be a qualifying trust amount, that the Department has already acceded to the petitioner's contention that the gain at issue is not a qualifying trust amount. However, the doctrine of estoppel is not applicable against the state or its agencies in the exercise of governmental function. *Lemming v. Levin*, BTA No. 2008-V-94 (Jan. 27, 2009), citing *Sekerak v. Fairhill Mental Health Ctr.*, 25 Ohio St.3d 38, 39 (1986). Thus, the petitioner cannot assert that the Department acceded that the gain at issue is not a qualifying trust amount simply because the Department originally classified the gain as business income. The petitioner's estoppel argument is not well taken.

The petitioner's second contention is that the book value of the qualifying investee's physical assets was not "available" to the Trust, as required by R.C. 5747.01(BB)(2)(a). Information is "available" if it "is such that a person is able to learn of the information by the due date... for filing the return for the taxable year in which the trust recognizes the gain or loss." R.C. 5747.01(BB)(6).[2] The definition does not require any specific person to be able to learn of the information, only "a person." A person includes "individuals, firms, companies, business trusts, estates, trusts, partnerships, limited liability companies, associations, corporations, and any other business entities." R.C. 5701.01.

In order to prevail in this case, the Trust, which owned 32.5 percent of TQL and is the namesake of an individual who owns an additional 17.5 percent of TQL, must contend that no person was able to learn of the information pertaining to the gain at issue. First, it is reasonable to believe that TQL, an S corporation and thus a person, knew or was able to know the book value of the assets at issue, since the assets were related to the company. Second, it seems unlikely that a 32.5 percent owner of TQL would be unable to access the records necessary to learn the book value of the assets. Finally, the petitioner has not provided any documentation to evince that it was unable to learn the book value of the assets at issue. Thus, the information at issue was "available" to the petitioner under R.C. 5747.01(BB)(6) and its contention is not well taken. As such, the Department did not err in classifying the petitioner's gain from the sale of stock in TQL as a qualifying trust amount.

---

[2] The petitioner does not address the statutory definition of "available" as it applies to a trust's modified Ohio taxable income. Instead, the petitioner cites case law that analyzes the definition of "available" that is not in the context of a trust's modified Ohio taxable income. *See Alcan Aluminum Corp. v. Limbach*, 42 Ohio St.3d 121 (1989).

In the alternative, the petitioner contends that classifying the gain at issue as a qualifying trust amount is unconstitutional. The gain at issue satisfies the definition of a qualifying trust amount. As such, the petitioner seems to contend that R.C. 5747.01(BB)(2) is unconstitutional on its face. The Tax Commissioner is without jurisdiction to decide the constitutionality of tax statutes. *See Cleveland Gear Co. v. Limbach*, 35 Ohio St.3d 229 (1988). Furthermore, the laws of the State of Ohio are presumed to be constitutional. *See State, ex rel. Swetland v. Kinney*, 69 Ohio St.2d 567 (1982). Thus, this contention is also not well taken.

Even if the gain at issue is not a qualifying trust amount, it is still subject to taxation by Ohio. Division (BB)(4)(c) of R.C. 5747.01 defines how modified nonbusiness income is factored into a trust's modified taxable income. Prior to March 30, 2006, R.C. 5747.01(BB)(4)(c)(ii) read:

> With respect to a trust or portion of a trust that is not a resident as ascertained in accordance with division (I)(3)(d) of this section, the amount of its modified nonbusiness income satisfying the descriptions in divisions (B)(2) to (5) of section 5747.20 of the Revised Code.

Since the petitioner is a nonresident trust, the gain at issue would have been allocated to its state of domicile under this version of the statute. *See* R.C. 5747.20(B)(2)(c). However, effective March 30, 2006, R.C. 5747.01(BB)(4)(c)(ii) was amended to read:

> With respect to a trust or portion of a trust that is not a resident as ascertained in accordance with division (I)(3)(d) of this section, the amount of its modified nonbusiness income satisfying the descriptions in divisions (B)(2) to (5) of section 5747.20 of the Revised Code, <u>except as otherwise provided in division (BB)(4)(c)(ii) of this section. With respect to a trust or portion of a trust that is not a resident as ascertained in accordance with division (I)(3)(d) of this section, the trust's portion of modified nonbusiness income recognized from the sale, exchange, or other disposition of a debt interest in or equity interest in a section 5747.212 entity, as defined in section 5747.212 of the Revised Code, without regard to division (A) of that section, shall not be allocated to this state in accordance with section 5747.20 of the Revised Code but shall be apportioned to this state in accordance with division (B) of section 5747.212 of the Revised Code without regard to division (A) of that section</u>. 2006 Am.Sub.H.B. No. 530. (added text underlined).

Under the amended version of the statute, the petitioner's gain from its disposition of stock in TQL would be apportionable to Ohio because the petitioner owned more than 20 percent of TQL. *See* R.C. 5747.212(B).

The petitioner, citing *Lakengren, Inc. v. Kosydar*, contends that since this change became effective after its realization of the gain at issue, the law change cannot be applied to the petitioner's sale of its TQL stock. *See* 44 Ohio St.2d 199 (1975). However, while the effective date of the amended statute was after the petitioner's transaction, it was prior to the end of the petitioner's tax year, which ended on December 31, 2006. In *Burke International Research Corporation v. Lindley*, the Supreme Court of Ohio analyzed *Lakengren* and held that the Department's application of a law to a taxpayer whose tax year was still open during the changed law's effective date was not unconstitutional. 58 Ohio St.2d

27 (1979), *see also Coca-Cola Bottling Corp. v. Lindley*, 54 Ohio St.2d 1 (1978). Thus, even if the gain at issue in this case is not a qualifying trust amount, it is still taxable to Ohio under R.C. 5747.01(BB)(4)(c)(ii).

Finally, the petitioner requests abatement of the assessed penalty. Division (C) of R.C. 5747.15 allows the Tax Commissioner to abate a late payment penalty when the taxpayer demonstrates that the failure to comply was due to reasonable cause rather than willful neglect. The evidence and circumstances support abatement of the penalty.

Accordingly, the assessment is adjusted as follows:

Tax	Interest	Late Payment Penalty	Total
$1,275,597.00	$197,595.00	$0.00	$1,473,192.00

Current records indicate that no payments have been applied to this assessment, leaving a balance due of $1,473,192.00. However, due to payment processing and posting time lags, payments may have been made that are not reflected in this final determination. **Any unpaid balance bears post-assessment interest as provided by law, which is in addition to the above total.** Payments shall be made payable to "Ohio Treasurer Josh Mandel." Any payment made within sixty days of the date of this final determination should be forwarded to: Department of Taxation, Compliance Division, P.O. Box 1090, Columbus, Ohio 43216-1090.

THIS IS THE TAX COMMISSIONER'S FINAL DETERMINATION WITH REGARD TO THIS MATTER. UPON EXPIRATION OF THE SIXTY-DAY APPEAL PERIOD PRESCRIBED BY R.C. 5717.02, THIS MATTER WILL BE CONCLUDED AND THE FILE APPROPRIATELY CLOSED.

I CERTIFY THAT THIS IS A TRUE AND ACCURATE COPY OF THE FINAL DETERMINATION RECORDED IN THE TAX COMMISSIONER'S JOURNAL

JOSEPH W. TESTA
TAX COMMISSIONER

/s/ Joseph W. Testa

Joseph W. Testa
Tax Commissioner

Ohio | Department of Taxation

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Columbus, OH 43216-0530

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101 South Fifth St.
Louisville, KY 40202

041 CD1-A58 40202

Exhibit B

Ohio Department of
TAXATION

Business Tax Division
Pass Through Entity Tax
P.O. Box 2476
Columbus, Ohio 43216-2476
(614) 387-0232 Fax (614) 466-1582
www.state.oh.us/tax/

July 29, 2008

Grant Thornton LLP
John F. Michel, Tax Partner
4000 Smith Road, Suite 500
Cincinnati, OH 45209-1967

Re: Trust T. Ryan Legg Irrevocable Trust FEIN # 13-7453290
2006 Ohio Fiduciary Income Tax Return, Form IT 1041

Dear Mr. Michel:

The above referenced return has been reviewed.

Enclosed is Form IT –1041C reflecting changes to the above referenced 2006 Ohio Composite Income Tax Return.

The capital gains reported on the 2006 return is business income and is subject to apportionment. ORC Section 5747.01(B) defines business income. "Business income" includes income, including gain or loss, from a partial or complete liquidation of a business, including, but not limited to, gain or loss from the sale or other disposition of goodwill. If the asset that produced the income "arises out of or was created in the regular course of the taxpayer's trade or business operations," the income is business income. ORC section 5747.212 provides that a taxpayer, directly or indirectly, owning at any time during the three-year period ending on the last day of the taxpayer's taxable year at least twenty per cent of the equity voting rights of an ORC section 5747.212 entity shall apportion any income, including gain or loss, realized from each sale, exchange, or other disposition of a debt or equity interest in that entity as prescribed in this section. The prescribed method of apportionment is the average of the apportionment ratios for the current and two previous tax years.

The capital gain is apportioned using the three year average of .918307, resulting in $17,503,852.00 apportioned to Ohio (see average calculation attached).

The above mentioned changes are compiled in the enclosed corrections for 2006. The result of the adjustments is a total balance due of $1,409,562.00. Interest was calculated pursuant to ORC Section 5747.08(G).

Please respond in letter form with any questions or objections within thirty days of the date of this letter. Otherwise, payment made payable to the *Treasurer of the State of Ohio* should be remitted to my attention. Failure to respond will result in the issuance of an assessment for the amount due with updated interest and the addition of applicable penalty.

Sincerely,

Charles D. Clark

Charles D. Clark, Tax Agent
Business Tax Division
Pass-Through Entity unit
Phone: (614) 466-2302

Exhibit C

FIDUCIARY INCOME TAX RETURN -
AUDIT CHANGES

FORM IT-1041C

F.E.I.N: 13-7453290		Taxable Year Beginning: 1/1/2006
Name of Trust or Estate: T. RAYN LEGG IRREVOCABLE TRUST		Check Applicable Boxes: [ ] Simp Trust [ ] Complex trust
Fiduciary Name and Title: US TRUST COMPANY OF DELAWARE		[ ] Deced Estate [ ] Bnkrpcy Estate
		[ ] Amended Return
Address, P.O.Box	City, State, Zip Code County	

		AS - REPORTED	B - AS CORRECTED
1. Federal taxable income (from line 22 of IRS form 1041)	1	19,007,630.00	19,007,630.00
2. Net adjustments from Schedule A, line 40	2	53,373.00	53,373.00
3. Ohio taxable income (line 1 plus or minus line 2)	3	19,061,003.00	19,061,003.00
4. Allocable qualifying trust amount from Sch F, line 56 (trusts only)	4	0.00	0.00
5. Apportionable trust income from Sch G, line 59 (trusts only)	5	0.00	17,503,852.00
6. Allocated trust income from Sch H, line 62 (trusts only)	6	0.00	0.00
7. Modified Ohio taxable income (trusts add line 4, 5 and 6)	7	0.00	17,503,852.00
8a. OHIO TAXABLE INCOME (estate line 3) or tax on modified Ohio taxable income (trust line 7)	8a	19,061,003.00	17,503,852.00
8b. TOTAL OHIO TAX (amount of line 8a by tax rate see tax table)	8b		1,199,314.00
9. Credits from schedule B, line 45 (estates only)	9	0.00	0.00
10. Resident credit Sch C (estates) or Sch I (trusts); nonresident credit from Sch D (estates); business credit for estates and trusts from Sch E (attach Sch E)	10	0.00	0.00
11. Tax after nonrefundable credits (line 8b minus the amount on lines 9 and 10)	11	0.00	1,199,314.00
12. Interest penalty on underpayment of estimated tax; attach form IT 2210	12	0.00	0.00
13. Total Ohio tax (add lines 11 and 12)	13	0.00	1,199,314.00
14. Previous pmts (estimates, extensions, withholding and prior yr. credits)	14	0.00	
15. Refundable business credits (attach documentation)	15	0.00	
16. Total payments (add lines 14 and 15)	16	0.00	
17. Amount paid with previously filed return(s) plus additional tax paid after filing	17	0.00	17 0.00
18. Total of lines 16 plus 17			18 0.00
19. Refund/Credit claimed on orig return and previously amended returns			19 0.00
20. Subtract line 19 from line 18			20 0.00
21. If line 20 is less than line 13 subtract line 20 from 13 .....Amount you OWE			21 1,199,314.00
22. If line 20 is more than line 13, subtract line 13 from line 20. This is your overpayment			22 0.00
23. Amount of line 22 to be credited to next years estimated tax liability			23 0.00
24. Amount of line 22 to be refunded (subtract line 23 from line 22)			24 0.00
25. INTEREST (ONLY APPLICABLE TO AMOUNT DUE RETURNS)			25 210,248.00
26. 2210 INTEREST PENALTY 0.00 FILING PENALTY 0.00 PMT P 0.00			26 0.00
27. TOTAL BALANCE DUE (ADD LINES 21, 25, 26): MAKE CHECK PAYABLE TO "TREASURER OF STATE OF			27 1,409,562.00

SEND YOUR INQUIRIES CONCERNING THIS CORRECTION TO THE ATTENTION OF:
OHIO DEPARTMENT OF TAXATION, P.O. BOX 2476, COLUMBUS, OHIO 43266- 43216-2476

TAX AGENT: CHARLES CLARK AGENT NO. 3476 DATE

EXPLANATION OF ADJUSTMENTS:

TO ADD CAPITAL GAIN

Statute Date:

PAGE _____ OF _____

Proposed Assessment	
Total	

INTEREST CALCULATIONS
2006

13-7453290
T. RAYN LEGG IRREVOCABLE TRUST

Interest is calculated from	4/17/2006 - 08/29/2008
Tax Due/Refund	1,199,314.00
Interest Due	210,248.00
Total Due	1,409,562.00

Yearly Interest Rates

1982	6%	1986	8%	1990	11%	1994	7%	1998	9%	2002	7%	2006	6%
1983	10%	1987	6%	1991	11%	1995	9%	1999	8%	2003	6%	2007	8%
1984	9%	1988	10%	1992	10%	1996	9%	2000	8%	2004	4%	2008	8%
1985	9%	1989	11%	1993	7%	1997	9%	2001	9%	2005	5%	2009	

Yearly Interest Formula: Tax Due x Interest Rate x Number of Days Late = Interest

365 (366 in leap year)

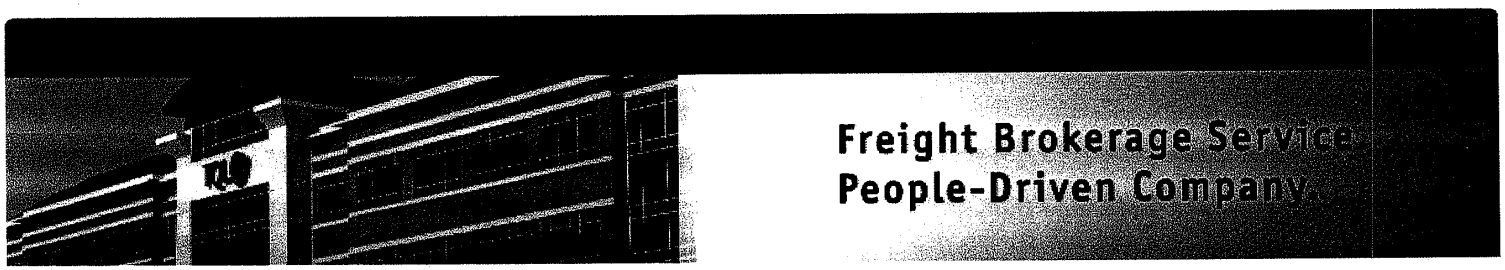
T. RAYAN LEGG IRREVOCABLE TRUST

TOTAL QUALITY LOGISTICS, INC.

IT 2023 Apportionment Ratio - 2006	0.955194
IT 2023 Apportionment Ratio - 2005	0.906275
IT 2023 Apportionment Ratio - 2004	0.893452
Total	2.754921
Average Apportionment	0.918307

Exhibit D

TC Appx. 38



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Total Quality Logistics (TQL) is the nation's 2nd largest freight brokerage firm. For over 15 years, we've specialized in arranging the transportation of full truckload shipments for thousands of companies across the country and **various industry segments.**

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TQL's more than 2,000 logistics professionals facilitate the movement of over 500,000 truckload shipments each year for more than 7,000 shipping customers. In addition to the corporate campus we built a few years ago in Cincinnati, we have offices in Chicago, Tampa, Charlotte, Charleston, Indianapolis, Denver, Columbus, Lexington, Louisville, Dayton, Erlanger, and Austin.

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Visit our Customers section and learn about our **freight brokerage service.**

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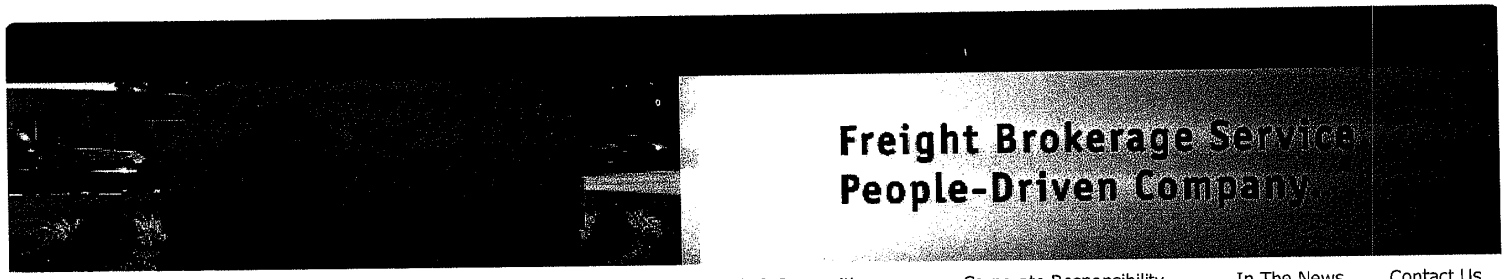
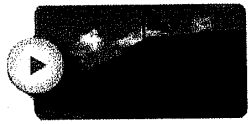
TC Appx. 39



WATCH OUR PHOTO SLIDE SHOW

See how our company's faces and locations have changed over time.



Read more about TQL's business model and approach to **freight brokerage service.**

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THE GROWTH OF OUR COMPANY

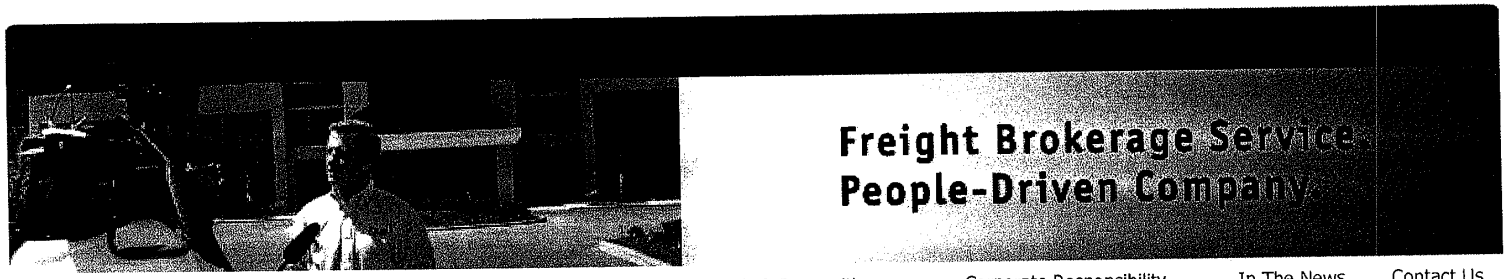
Our company was founded in 1997 by Ken Oaks. At first, Oaks focused on the transportation of produce, leveraging the experience and relationships he gained while working for years as a buyer in the industry. The perishable nature of this commodity was one of the driving forces behind our commitment to accessibility and integrity. Over the years, this commitment has helped us earn credibility, a reputation for impeccable service and has evolved into the core of our company culture.

In many ways, the Total Quality Logistics of today is a different company than it was 15 years ago. Our freight brokerage service has expanded in terms of scope and expertise. We've moved over 2 million truckloads for our customers and added over 2,000 employees. However, one thing has remained the same. The mindset of exceeding our customers' expectations is still very much a part of our DNA. We call it being "truly essential" and you can see it every day in the actions of our employees.

Sometimes the commitment is extreme, taking the shape of a missed vacation or covering a load on Christmas morning. More often than not, it's as simple as staying late on a Friday or answering a phone call at 1:00 A.M. It's about doing absolutely everything possible to never fall out on a load or helping a driver pick-up and deliver safely and on-time. It's about choosing a carrier that has proven to be reliable and trustworthy, and providing proactive, honest communication at every step of the way.

Exhibit E

TC Appx. 41



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TOTAL QUALITY LOGISTICS, INC. DEBUTS AT #374

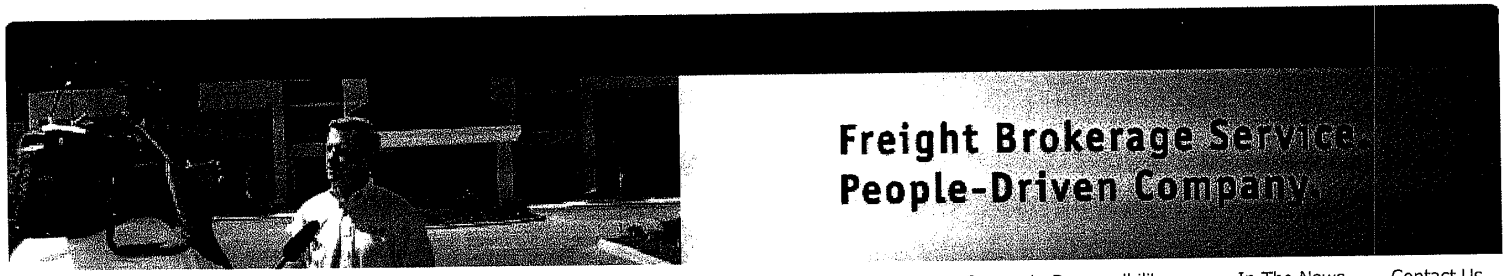
Cincinnati, OH — Total Quality Logistics, Inc. (TQL), a national third party logistics provider specializing in truckload transportation, located in Cincinnati, Ohio with a second office in Elkins, WV, made its debut on the Inc 500 list at #374 for having a three-year sales growth of 363.8 percent.

Each year, Inc magazine, which offers resources to entrepreneurs on specific business management issues, compiles a list of the nation's fastest-growing private companies based on growth and revenue. TQL's 3 year growth has increased 364% and their 2004 revenue was over $101 million. At the time the list was compiled, TQL's employee count was at 170. We are now over 300 employees and are on pace to hit 350 by year end.

TQL moves more than 90,000 loads annually for their customers. Sales for 2005 are projected to reach $200 million, an increase of nearly 100% over 2004. TQL assists more than 1,200 customers nationwide in facilitating their truckload freight movements.

To learn more about Total Quality Logistics, Inc., please call 1-800-665-6572 ext. 2180 or visit our website at **www.totalqualitylogistics.com**.

TC Appx. 42



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TOTAL QUALITY LOGISTICS REACHES 400 EMPLOYEES

Cincinnati, OH - Total Quality Logistics, Inc. (TQL), a third-party logistics provider located in Cincinnati, Ohio, has surpassed goals for employee, sales and revenue growth in each of its first eight years in business, and now employs more than 400 with its most recent hire group.

So far in January, the TQL staff has welcomed 53 talented individuals who were hired to fill a number of new positions in sales, accounting, carrier development and training. The additions to the staff were necessary to support and sustain the company's rapid sales growth, which exceeded 97% in 2004 and 90% in 2005. It is anticipated that TQL will employ more than 700 by 12/31/06.

TQL is a non-asset-based third-party logistics provider that partners with hundreds of companies nationwide to facilitate their freight movements. The TQL mission is to provide the best, most reliable truckload transportation service in the industry through proactive communication, accessibility, and reliability. These standards have resulted in a customer base of over 1,400 companies, for whom TQL moves more than 100,000 loads each year.

To learn more about Total Quality Logistics, Inc., please call 1-800-665-6572 ext. 2388 or visit our website at **www.totalqualitylogistics.com.**

IN THE SUPREME COURT OF OHIO

T. RYAN LEGG IRREVOCABLE TRUST,	:	
Appellant,	:	Case No. 2015-917
v.	:	Appeal from the Ohio Board of Tax Appeals
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO,	:	BTA Case No. 2013-A-1469
Appellee.	:	

NOTICE OF CROSS APPEAL

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Joseph W. Testa, Tax Commissioner of Ohio

FILED
JUN 15 2015
CLERK OF COURT
SUPREME COURT OF OHIO

2015 JUN 15 PM 3:20
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BOARD OF TAX APPEALS

NOTICE OF CROSS-APPEAL

Joseph W. Testa, Tax Commissioner of Ohio ("Commissioner"), hereby gives notice of his cross appeal to the Supreme Court of Ohio from a Decision and Order of the Ohio Board of Tax Appeals (the "BTA") journalized in Case No. 2013-1469 on May 5, 2015 (hereafter "*BTA Decision and Order*"). A true copy of the *BTA Decision and Order* being appealed is attached hereto as Exhibit A and incorporated herein by reference.

This cross appeal is taken as a matter of right pursuant to R.C. 5717.04, which provides, in part, that "[i]f a timely notice of appeal is filed by a party, any other party may file a notice of appeal within ten days of the date the first notice of appeal was filed or within the time otherwise prescribed in this section, whichever is later."

In the present matter, on June 3, 2015, the T. Ryan Legg Irrevocable Trust (hereafter the "Legg Trust"), filed a notice of appeal to this Court from the *BTA Decision and Order*. Accordingly, pursuant to the above-quoted language of R.C. 5717.04, the Commissioner hereby timely files this protective cross-appeal.

The appeal by the Legg Trust and this cross-appeal filed by the Commissioner herein involve the Legg Trust's challenge to Ohio income tax assessment liability for the 2006 tax year on the Legg Trust's sale of shares in Total Quality Logistics, Inc., a Subchapter S-electing corporation incorporated under Ohio law and headquartered in Cincinnati, Ohio. The Commissioner assessed the Legg Trust for its failure to timely pay Ohio income tax for the 2006 tax year on federal adjusted gross income exceeding $19 million. This unreported federal adjusted gross income arose from the capital gain that the Legg Trust earned from its sale of its shares of stock in Total Quality Logistics, Inc. (constituting a 32.5 percent ownership stake) and

other income. To determine the assessment amount, the Commissioner multiplied the more than $19 million of federal adjusted gross income by the Ohio apportionment percentage of 0.918307.

In its decision below, the BTA affirmed the Commissioner's assessment of the Legg Trust for trust income tax for several substantive reasons with which the Commissioner agrees. As a threshold jurisdictional matter, however, the BTA erred in holding that the Legg Trust's appeal was timely perfected with the approval of the trustee of the Legg Trust. See the *BTA Decision and Order* at unnumbered pages one and two. Instead, the BTA should have properly and lawfully dismissed the Legg Trust's notice of appeal to the BTA on subject matter jurisdictional grounds.

As cross-appellant, the Commissioner complains of the following errors in the Decision and Order of the Board:

1. The BTA erred, as a matter of fact and law, in holding that it had jurisdiction over the BTA notice of appeal filed by Mark Loyd allegedly on behalf of the Legg Trust. The BTA should have held that it did not have jurisdiction for at least two independent reasons:
    a. First, the Legg Trust exhausted its appeal rights by failing to timely file a BTA notice of appeal with the BTA pursuant to former R.C. 5717.02. At the time of his filing of the notice of appeal to the BTA, attorney Mark Loyd did not have the requisite authorization from the then-trustee of the Legg Trust.
    b. Second, the Legg Trust exhausted its appeal rights by failing to timely file a valid petition for reassessment with the Commissioner pursuant to R.C. 5747.13. The petition for reassessment was filed by attorneys

Mark Loyd and Kevin Ghassomian, who did not have the requisite authority from the then-Trustee of the Legg Trust to file a petition for reassessment with the Commissioner on behalf of the Legg Trust. As a consequence, because the petition for reassessment was jurisdictionally invalid, the BTA subsequently lacked authority over the notice of appeal from the Commissioner's final determination that Attorney Loyd filed with the BTA.

2. The BTA erred, as a matter of fact and law, when it found "the misstated name of the trustee on the petition for reassessment to be a typographical error and [found] that the petition for reassessment, notice of appeal, and all pleadings filed by the trust, both before and after, were properly filed by the trust's authorized representative." *BTA Decision and Order*, at unnumbered page two.
3. The BTA erred, as a matter of fact and law, when it found the following: "[T]he record, as a whole, also indicates that UBS, Mr. Legg as grantor/beneficiary of the trust, and counsel themselves, at all times, considered Greenebaum Doll & McDonald (and its successor Bingham Greenebaum Doll LLP) to be the authorized representative of the subject trust." *BTA Decision and Order*, at unnumbered page two.
4. The BTA erred as a matter of fact and law, in finding that "[I]n 2009, the trustee [of the Legg Trust] was changed again from Charles Schwab to UBS Trust." *BTA Decision and Order*, at unnumbered page two.

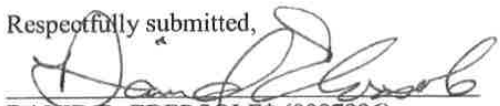
5. The BTA erred, as a matter of fact and law, in finding that Mark Loyd and Bailey Roese of Bingham Greenebaum Doll LLP had the requisite legal authority to represent the Legg Trust and make filings on its behalf throughout the proceedings at the BTA.

6. The BTA erred, as a matter of fact and law, in considering and relying upon Exhibit W, an unfounded "affidavit" allegedly from UBS Trust, for purposes of ruling on the Commissioner's motion to dismiss. Exhibit W was never offered or admitted into evidence at the BTA proceeding on the motion to dismiss. BTA hearing transcript ("Hr. Tr."), at page 48. In the proceeding on the motion to dismiss, counsel for the Commissioner strenuously objected to the "affidavit." Hr. Tr., at page 40-41. The BTA erred by failing to sustain the Commissioner's timely raised objections that the "affidavit" lacked the necessary factual foundation, was not properly authenticated, did not set forth any averment that any of the statements therein were from the personal knowledge of the affiant, constituted hearsay (and potentially multiple levels of hearsay), and failed to constitute probative and reliable evidence.

WHEREFORE,

For the above reasons, this Court should dismiss the Legg Trust's appeal on subject matter jurisdictional grounds because the Legg Trust already exhausted its appeal rights by failing to file a jurisdictionally valid petition for reassessment and a jurisdictionally valid notice of appeal to the BTA. In its Decision and Order below, the BTA erred in failing to so hold.

Respectfully submitted,



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Counsel for Appellee
Joseph W. Testa, Tax Commissioner of Ohio

CERTIFICATE OF SERVICE

I hereby certify that the foregoing Notice of Cross-Appeal was filed by hand delivery with the Ohio Supreme Court, 65 South Front St., Columbus, Ohio 43215, and the Ohio Board of Tax Appeals, 30 E. Broad St., 24th Floor, Columbus, Ohio 43215, and was served upon the following by certified mail return receipt requested this 15th day of June, 2015:

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Louisville, KY 40202

Counsel for Appellant
T. Ryan Legg Irrevocable Trust

DAVID D. EBERSOLE (0087896)

OHIO BOARD OF TAX APPEALS

T. RYAN LEGG IRRECOVABLE TRUST, (et. al.),	CASE NO(S). 2013-1469
Appellant(s),	(TRUST INCOME TAX)
vs.	DECISION AND ORDER
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO, (et. al.),	
Appellee(s).	

APPEARANCES:

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Represented by:
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101 SOUTH FIFTH STREET
LOUISVILLE, KY 40202

For the Appellee(s) - JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO
Represented by:
DAVID D. EBERSOLE
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30 EAST BROAD STREET, 25TH FLOOR
COLUMBUS, OH 43215

Entered Tuesday, May 5, 2015

Mr. Williamson, Ms. Clements, and Mr. Harbarger concur.

This matter is considered by the Board of Tax Appeals upon a notice of appeal filed herein by the above-named appellant T. Ryan Legg Irrevocable Trust ("trust"), from a final determination of the Tax Commissioner. Therein, the Tax Commissioner ("commissioner") adjusted only the penalty associated with the trust income tax assessment against appellant relating to tax year 2006. The matter was submitted to the Board of Tax Appeals upon the notice of appeal, the statutory transcript ("S.T.") certified to this board by the Tax Commissioner, the record of this board's hearing ("H.R."), and the briefs filed by counsel. We note that exhibits 16 and W, upon which this board reserved ruling as to their admission into evidence at the time of hearing, shall be received into evidence.

At the outset, this board must address a motion to dismiss filed by the commissioner; specifically, the commissioner contends that it has not been demonstrated that the trustee of the trust "authorized this appeal, as well as the Legg Trust's filing of a petition for reassessment." Motion at 2. The commissioner contends that "in order for a trust to prosecute or defend a legal action, the *trustee* must provide the necessary authorization. The trustee is the sole party who may bring or

defend an action on behalf of a trust. Without the requisite authorization of the trustee, the prosecution or defense of a legal action is invalid. *Schofield v. Cleveland Trust Co.* 149 Ohio St. 133, 144 (1948) ***." (Emphasis sic.) Motion at 1. The record establishes that in 2006, U.S. Trust Company was the trustee of the subject trust. H.R. at 98. "U.S. Trust Company was a wholly owned subsidiary of Charles Schwab and was sold by Charles Schwab at some point *** and *** Charles Schwab Bank essentially replaced U.S. Trust Company as the trustee." H.R. at 123-124. Thereafter, in 2009, the trustee was changed again from Charles Schwab to UBS Trust. H.R. at 124. The record further reflects that in August 2008, Kevin R. Ghassomian and Mark A. Loyd of Greenebaum Doll & McDonald PLLC were declared the trust's representatives by the Charles Schwab Bank, Trustee, through its senior trust officer, Shawn P. Wilson; notice of such declaration was provided to the commissioner with the trust's objections to the commissioner's audit changes to its 2006 income tax return, prior to the assessment and filing of the petition for reassessment. S.T. at 88-89. Thereafter, in May 2009, the trust was formally assessed for income tax deficiencies in 2006 and a petition for reassessment was filed in July 2009 by the stated representatives, purportedly on behalf of the Charles Schwab Bank, as trustee for the trust. S.T. at 7-45. While the record indicates that as of June 5, 2009, UBS Trust Company, N.A. had been appointed the successor trustee to the Charles Schwab Bank, contrary to the trustee listed on the petition for reassessment, the record, as a whole, also indicates that UBS, Mr. Legg as grantor/beneficiary of the trust, and counsel themselves, at all times, considered Greenebaum Doll & McDonald (and its successor Bingham Greenebaum Doll LLP) to be the authorized representative of the subject trust. As such, we consider the misstated name of the trustee on the petition for reassessment to be a typographical error and find that the petition for reassessment, notice of appeal, and all pleadings filed by the trust, both before and after, were properly filed by the trust's authorized representative. See Ex. 23; H.R. at 228. Accordingly, the motion to dismiss is hereby denied.

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

The facts leading to the instant appeal are best summarized by the commissioner in his final determination, as follows:

> "In November 2005, T. Ryan Legg *** transferred 65 shares of Total Quality Logistics, Inc., *** an Ohio S Corporation, to the petitioner [the subject trust]. The Trust sold the shares in February 2006, which created the gain at issue. The Trust was assessed when the Department determined that the gain at issue was a 'qualifying trust amount' under R.C. 5747.01(BB)(2), and thus subject to Ohio taxation. The petitioner

> contends that the gain from the Trust's sale of stock in an Ohio S Corporation is not a qualifying trust amount, but instead is nonbusiness income allocable to the Trust's state of domicile." S.T. at 1.

Specifically, Mr. Legg and his friend, Ken Oaks, had formed and operated a trucking business, Total Quality Logistics, Inc. ("TQL"), an Ohio Subchapter S corporation. Mr. Legg and Mr. Oaks each owned 50%, i.e., 100 shares each, of the business. The owners decided to part ways, and around August or September 2005, Mr. Legg stopped participating in the business and going to the office. H.R. at 96. Mr. Legg tendered his resignation in November of 2005 and thereafter created the subject trust and funded it by transferring 65 of his shares of TQL stock into it. H.R. at 57, 60-61. In December 2005, Mr. Legg entered into a purchase agreement with Mr. Oaks for the sale of the 65 shares of TQL stock. Ex. F; H.R. at 75-76. The sale closed on February 3, 2006, and the trust sold the 65 shares of TQL stock to Mr. Oaks for $18,525,000. Ex. F; H.R. at 115.

R.C. 5747.02(A) provides in pertinent part:

> "For the purpose of providing revenue for the support of schools and local government functions, to provide relief to property taxpayers, to provide revenue for the general revenue fund, and to meet the expenses of administering the tax levied by this chapter, there is hereby levied on every individual, trust, and estate residing in or earning or receiving income in this state, *** and on every individual, trust, and estate otherwise having nexus with or in this state under the Constitution of the United States, an annual tax *** *measured in the case of trusts by modified Ohio taxable income* under division (D) of this section." (Emphasis added.)

"Modified Ohio taxable income" is considered "the sum of the amounts described in division (BB)(4)(a) to (c)" of R.C. 5747.01, i.e., R.C. 5747.01(BB)(4)(a)(i) and (ii), amounts attributable to the trust's modified business income, R.C. 5747.01(BB)(1) and the trust's qualifying investment income, R.C. 5747.012; R.C. 5747.01(BB)(4)(b), amounts attributable to the "qualifying trust amount," R.C. 5747.01(BB)(2); and R.C. 5747.01(BB)(4)(c)(i) and (ii), amounts attributable to "modified nonbusiness income," R.C. 5747.01(3). R.C. 5747.01(BB) goes on to provide that "[i]f the allocation and apportionment of a trust's income under divisions (BB)(4)(a) and (c) of this section do not fairly represent the modified Ohio taxable income of the trust in this state, the alternative methods described in division (C) of section 5747.21 of the Revised Code may be applied in the manner and to the same extent provided in that section."

Thus, to the extent specified, we must review the trust's objections to the commissioner's calculations used to determine the amount of modified Ohio taxable income. Appellant first contends that the requirements in R.C. 5747.01(BB)(2)(a) and (b) for a "qualifying trust amount" have not been met, but we disagree. R.C. 5747.01(BB)(2) provides:

> "(2) 'Qualifying trust amount' of a trust means capital gains and losses from the sale, exchange, or other disposition of equity or ownership interests in, or debt obligations of, a qualifying investee to the extent included in the trust's Ohio taxable income, but only if the following requirements are satisfied:
>
> "(a) The book value of the qualifying investee's physical assets in this

> state and everywhere, as of the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, is available to the trust.
>
> "(b) The requirements of section 5747.011 *** of the Revised Code are satisfied for the trust's taxable year in which the trust recognizes the gain or loss.
>
> "Any gain or loss that is not a qualifying trust amount is modified business income, qualifying investment income, or modified nonbusiness income, as the case may be."

We find that regardless of the tenuous relationship between Mr. Legg and Mr. Oaks, the record establishes that the book value of the TQL assets was available to the trust, whether it was actually requested or not, as it was utilized by the trust's tax preparer; it was therefore "available," i.e., "a person [was] able to learn of" it. R.C. 5747.01(BB)(6). H.R. at 118, 133, 226, 241. See, also, *Alcan*, supra. Further, the commissioner represents that it is undisputed that the second requirement for a "qualifying trust amount" has been met, as the trust was a 32.5% interest holder in TQL, and therefore met the statutory 5% requirement set forth in R.C. 5747.01(BB)(2)(b). Commissioner brief at 13. The trust cites to this board's decision in *Random House, Inc. v. Tracy* (May 14, 1993), BTA No. 1991-A-1329, unreported, as support for its position that the book value was not "available" to the trust, as that term was defined therein. We find the *Random House* case inapposite herein, as it concerned a specific franchise tax statutory provision, namely, R.C. 5733.051(G), and the determination of whether the location of the payor's activities relating to patent and copyright royalties and technical assistance fees was available for purposes of allocating/apportioning such amounts to this state. As previously indicated, R.C. Chapter 5747 contains a definition of "available," and we need not look any further to conclude that the commissioner correctly determined that the information in question was "available."

Appellant next contends that the gain experienced by the trust from the sale of the stock constituted *nonbusiness* income, and, as such, was not taxable. Specifically, the trust argues that its "gain on the sale of TQL stock is nonbusiness income because the Trust did nothing more than hold and sell the TQL stock. *** These actions do not constitute a trade or business under the tax code. By definition, therefore, the TQL stock sale gain was nonbusiness income." Trust Brief at 11.

R.C. 5747.01(B) and (C) provide:

> "(B) 'Business income' means income, including gain or loss, arising from transactions, activities, and sources in the regular course of a trade or business and includes income, gain, or loss from real property, tangible property, and intangible property if the acquisition, rental, management, and disposition of the property constitute integral parts of the regular course of a trade or business operation. 'Business income' includes income, including gain or loss, from a partial or complete liquidation of a business ***."
>
> "(C) 'Nonbusiness income' means all income other than business income and may include, but is not limited to, compensation,

***capital gains ***."

Based upon the clear language of the foregoing statutory provisions, we conclude that any income arising out of a liquidation of a business, i.e., Mr. Legg's sale of his ownership interest in TQL, via his stock, constitutes "business income" in Ohio, as a gain from the partial liquidation of his interests in TQL.

Next, appellant contends that the subject trust is a non-resident trust, domiciled in Delaware, and therefore, pursuant to the version of the statute in effect at the time of the stock sale, was not liable for tax. While the trust provides that it "shall be construed and administered pursuant to the law of the State of Delaware," R.C. 5747.01(I)(3) provides that a "trust resides in this state for the trust's current taxable year to the extent *** that the trust consists directly or indirectly, in whole or in part, of assets, net of any related liabilities, that were transferred *** to the trust by *** (ii) [a] person who was domiciled in this state for the purposes of this chapter when the person *** transferred assets to an irrevocable trust, but only if at least one of the trust's qualifying beneficiaries is domiciled in this state for the purposes of this chapter during all or some portion of the trust's current taxable year[.]" The trust agreement was entered into on November 18, 2005 and the sale of the shares of stock out of the trust closed on February 3, 2006; Mr. Legg testified that he lived in Cincinnati from 2001 to mid-2006. Ex. 1; H.R. at 67-68, 71. Clearly, Mr. Legg's testimony established that he was domiciled in Ohio for at least a portion of the current tax year under consideration, i.e., 2006, and, domiciled in Ohio at both the time of transferring the stock into the trust and the time the stock was sold. Finally, the trust agreement clearly lists Mr. Legg as a beneficiary of such trust. Therefore, we find the subject trust should be taxed as a resident trust, pursuant to R.C. 5747.01(BB)(4)(c)(i).

With regard to appellant's constitutional claims, we make no finding in relation thereto. Although the Ohio Supreme Court has authorized this board to accept evidence on constitutional points, it has clearly stated that we have no jurisdiction to decide constitutional claims. *Cleveland Gear Co. v. Limbach* (1988), 35 Ohio St.3d 229; *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St.3d 195, 198.

Accordingly, we find the appellant has failed to meet its burden of demonstrating the error in the commissioner's findings. See *Kern*, supra; *Kroger*, supra; *Alcan*, supra. As such, this board finds that the Tax Commissioner's conclusions in this matter were reasonable and lawful. It is the decision and order of the Board of Tax Appeals that the final determination of the Tax Commissioner must be and hereby is affirmed.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Williamson		
Ms. Clements		
Mr. Harbarger		

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

Kathleen M. Crowley, Board Secretary

CERTIFICATE OF SERVICE

I hereby certify that the foregoing Notice of Cross-Appeal was filed by hand delivery with the Ohio Supreme Court, 65 South Front St., Columbus, Ohio 43215, and the Ohio Board of Tax Appeals, 30 E. Broad St., 24th Floor, Columbus, Ohio 43215, and was served upon the following by certified mail return receipt requested this 15th day of June, 2015:

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T. Ryan Legg Irrevocable Trust

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OHIO BOARD OF TAX APPEALS

T. RYAN LEGG IRRECOVABLE TRUST, (et. al.),	CASE NO(S). 2013-1469
Appellant(s),	(TRUST INCOME TAX)
vs.	DECISION AND ORDER
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO, (et. al.),	
Appellee(s).	

APPEARANCES:

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Entered Tuesday, May 5, 2015

Mr. Williamson, Ms. Clements, and Mr. Harbarger concur.

This matter is considered by the Board of Tax Appeals upon a notice of appeal filed herein by the above-named appellant T. Ryan Legg Irrevocable Trust ("trust"), from a final determination of the Tax Commissioner. Therein, the Tax Commissioner ("commissioner") adjusted only the penalty associated with the trust income tax assessment against appellant relating to tax year 2006. The matter was submitted to the Board of Tax Appeals upon the notice of appeal, the statutory transcript ("S.T.") certified to this board by the Tax Commissioner, the record of this board's hearing ("H.R."), and the briefs filed by counsel. We note that exhibits 16 and W, upon which this board reserved ruling as to their admission into evidence at the time of hearing, shall be received into evidence.

At the outset, this board must address a motion to dismiss filed by the commissioner; specifically, the commissioner contends that it has not been demonstrated that the trustee of the trust "authorized this appeal, as well as the Legg Trust's filing of a petition for reassessment." Motion at 2. The commissioner contends that "in order for a trust to prosecute or defend a legal action, the *trustee* must provide the necessary authorization. The trustee is the sole party who may bring or

defend an action on behalf of a trust. Without the requisite authorization of the trustee, the prosecution or defense of a legal action is invalid. *Schofield v. Cleveland Trust Co.* 149 Ohio St. 133, 144 (1948) ***." (Emphasis sic.) Motion at 1. The record establishes that in 2006, U.S. Trust Company was the trustee of the subject trust. H.R. at 98. "U.S. Trust Company was a wholly owned subsidiary of Charles Schwab and was sold by Charles Schwab at some point *** and *** Charles Schwab Bank essentially replaced U.S. Trust Company as the trustee." H.R. at 123-124. Thereafter, in 2009, the trustee was changed again from Charles Schwab to UBS Trust. H.R. at 124. The record further reflects that in August 2008, Kevin R. Ghassomian and Mark A. Loyd of Greenebaum Doll & McDonald PLLC were declared the trust's representatives by the Charles Schwab Bank, Trustee, through its senior trust officer, Shawn P. Wilson; notice of such declaration was provided to the commissioner with the trust's objections to the commissioner's audit changes to its 2006 income tax return, prior to the assessment and filing of the petition for reassessment. S.T. at 88-89. Thereafter, in May 2009, the trust was formally assessed for income tax deficiencies in 2006 and a petition for reassessment was filed in July 2009 by the stated representatives, purportedly on behalf of the Charles Schwab Bank, as trustee for the trust. S.T. at 7-45. While the record indicates that as of June 5, 2009, UBS Trust Company, N.A. had been appointed the successor trustee to the Charles Schwab Bank, contrary to the trustee listed on the petition for reassessment, the record, as a whole, also indicates that UBS, Mr. Legg as grantor/beneficiary of the trust, and counsel themselves, at all times, considered Greenebaum Doll & McDonald (and its successor Bingham Greenebaum Doll LLP) to be the authorized representative of the subject trust. As such, we consider the misstated name of the trustee on the petition for reassessment to be a typographical error and find that the petition for reassessment, notice of appeal, and all pleadings filed by the trust, both before and after, were properly filed by the trust's authorized representative. See Ex. 23; H.R. at 228. Accordingly, the motion to dismiss is hereby denied.

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

The facts leading to the instant appeal are best summarized by the commissioner in his final determination, as follows:

> "In November 2005, T. Ryan Legg *** transferred 65 shares of Total Quality Logistics, Inc., *** an Ohio S Corporation, to the petitioner [the subject trust]. The Trust sold the shares in February 2006, which created the gain at issue. The Trust was assessed when the Department determined that the gain at issue was a 'qualifying trust amount' under R.C. 5747.01(BB)(2), and thus subject to Ohio taxation. The petitioner

> contends that the gain from the Trust's sale of stock in an Ohio S Corporation is not a qualifying trust amount, but instead is nonbusiness income allocable to the Trust's state of domicile." S.T. at 1.

Specifically, Mr. Legg and his friend, Ken Oaks, had formed and operated a trucking business, Total Quality Logistics, Inc. ("TQL"), an Ohio Subchapter S corporation. Mr. Legg and Mr. Oaks each owned 50%, i.e., 100 shares each, of the business. The owners decided to part ways, and around August or September 2005, Mr. Legg stopped participating in the business and going to the office. H.R. at 96. Mr. Legg tendered his resignation in November of 2005 and thereafter created the subject trust and funded it by transferring 65 of his shares of TQL stock into it. H.R. at 57, 60-61. In December 2005, Mr. Legg entered into a purchase agreement with Mr. Oaks for the sale of the 65 shares of TQL stock. Ex. F; H.R. at 75-76. The sale closed on February 3, 2006, and the trust sold the 65 shares of TQL stock to Mr. Oaks for $18,525,000. Ex. F; H.R. at 115.

R.C. 5747.02(A) provides in pertinent part:

> "For the purpose of providing revenue for the support of schools and local government functions, to provide relief to property taxpayers, to provide revenue for the general revenue fund, and to meet the expenses of administering the tax levied by this chapter, there is hereby levied on every individual, trust, and estate residing in or earning or receiving income in this state, *** and on every individual, trust, and estate otherwise having nexus with or in this state under the Constitution of the United States, an annual tax *** *measured in the case of trusts by modified Ohio taxable income* under division (D) of this section." (Emphasis added.)

"Modified Ohio taxable income" is considered "the sum of the amounts described in division (BB)(4)(a) to (c)" of R.C. 5747.01, i.e., R.C. 5747.01(BB)(4)(a)(i) and (ii), amounts attributable to the trust's modified business income, R.C. 5747.01(BB)(1) and the trust's qualifying investment income, R.C. 5747.012; R.C. 5747.01(BB)(4)(b), amounts attributable to the "qualifying trust amount," R.C. 5747.01(BB)(2); and R.C. 5747.01(BB)(4)(c)(i) and (ii), amounts attributable to "modified nonbusiness income," R.C. 5747.01(3). R.C. 5747.01(BB) goes on to provide that "[i]f the allocation and apportionment of a trust's income under divisions (BB)(4)(a) and (c) of this section do not fairly represent the modified Ohio taxable income of the trust in this state, the alternative methods described in division (C) of section 5747.21 of the Revised Code may be applied in the manner and to the same extent provided in that section."

Thus, to the extent specified, we must review the trust's objections to the commissioner's calculations used to determine the amount of modified Ohio taxable income. Appellant first contends that the requirements in R.C. 5747.01(BB)(2)(a) and (b) for a "qualifying trust amount" have not been met, but we disagree. R.C. 5747.01(BB)(2) provides:

> "(2) 'Qualifying trust amount' of a trust means capital gains and losses from the sale, exchange, or other disposition of equity or ownership interests in, or debt obligations of, a qualifying investee to the extent included in the trust's Ohio taxable income, but only if the following requirements are satisfied:
>
> "(a) The book value of the qualifying investee's physical assets in this

> state and everywhere, as of the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, is available to the trust.
>
> "(b) The requirements of section 5747.011 *** of the Revised Code are satisfied for the trust's taxable year in which the trust recognizes the gain or loss.
>
> "Any gain or loss that is not a qualifying trust amount is modified business income, qualifying investment income, or modified nonbusiness income, as the case may be."

We find that regardless of the tenuous relationship between Mr. Legg and Mr. Oaks, the record establishes that the book value of the TQL assets was available to the trust, whether it was actually requested or not, as it was utilized by the trust's tax preparer; it was therefore "available," i.e., "a person [was] able to learn of" it. R.C. 5747.01(BB)(6). H.R. at 118, 133, 226, 241. See, also, *Alcan*, supra. Further, the commissioner represents that it is undisputed that the second requirement for a "qualifying trust amount" has been met, as the trust was a 32.5% interest holder in TQL, and therefore met the statutory 5% requirement set forth in R.C. 5747.01(BB)(2)(b). Commissioner brief at 13. The trust cites to this board's decision in *Random House, Inc. v. Tracy* (May 14, 1993), BTA No. 1991-A-1329, unreported, as support for its position that the book value was not "available" to the trust, as that term was defined therein. We find the *Random House* case inapposite herein, as it concerned a specific franchise tax statutory provision, namely, R.C. 5733.051(G), and the determination of whether the location of the payor's activities relating to patent and copyright royalties and technical assistance fees was available for purposes of allocating/apportioning such amounts to this state. As previously indicated, R.C. Chapter 5747 contains a definition of "available," and we need not look any further to conclude that the commissioner correctly determined that the information in question was "available."

Appellant next contends that the gain experienced by the trust from the sale of the stock constituted *nonbusiness* income, and, as such, was not taxable. Specifically, the trust argues that its "gain on the sale of TQL stock is nonbusiness income because the Trust did nothing more than hold and sell the TQL stock. *** These actions do not constitute a trade or business under the tax code. By definition, therefore, the TQL stock sale gain was nonbusiness income." Trust Brief at 11.

R.C. 5747.01(B) and (C) provide:

> "(B) 'Business income' means income, including gain or loss, arising from transactions, activities, and sources in the regular course of a trade or business and includes income, gain, or loss from real property, tangible property, and intangible property if the acquisition, rental, management, and disposition of the property constitute integral parts of the regular course of a trade or business operation. 'Business income' includes income, including gain or loss, from a partial or complete liquidation of a business ***."
>
> "(C) 'Nonbusiness income' means all income other than business income and may include, but is not limited to, compensation,

***capital gains ***."

Based upon the clear language of the foregoing statutory provisions, we conclude that any income arising out of a liquidation of a business, i.e., Mr. Legg's sale of his ownership interest in TQL, via his stock, constitutes "business income" in Ohio, as a gain from the partial liquidation of his interests in TQL.

Next, appellant contends that the subject trust is a non-resident trust, domiciled in Delaware, and therefore, pursuant to the version of the statute in effect at the time of the stock sale, was not liable for tax. While the trust provides that it "shall be construed and administered pursuant to the law of the State of Delaware," R.C. 5747.01(I)(3) provides that a "trust resides in this state for the trust's current taxable year to the extent *** that the trust consists directly or indirectly, in whole or in part, of assets, net of any related liabilities, that were transferred *** to the trust by *** (ii) [a] person who was domiciled in this state for the purposes of this chapter when the person *** transferred assets to an irrevocable trust, but only if at least one of the trust's qualifying beneficiaries is domiciled in this state for the purposes of this chapter during all or some portion of the trust's current taxable year[.]" The trust agreement was entered into on November 18, 2005 and the sale of the shares of stock out of the trust closed on February 3, 2006; Mr. Legg testified that he lived in Cincinnati from 2001 to mid-2006. Ex. 1; H.R. at 67-68, 71. Clearly, Mr. Legg's testimony established that he was domiciled in Ohio for at least a portion of the current tax year under consideration, i.e., 2006, and, domiciled in Ohio at both the time of transferring the stock into the trust and the time the stock was sold. Finally, the trust agreement clearly lists Mr. Legg as a beneficiary of such trust. Therefore, we find the subject trust should be taxed as a resident trust, pursuant to R.C. 5747.01(BB)(4)(c)(i).

With regard to appellant's constitutional claims, we make no finding in relation thereto. Although the Ohio Supreme Court has authorized this board to accept evidence on constitutional points, it has clearly stated that we have no jurisdiction to decide constitutional claims. *Cleveland Gear Co. v. Limbach* (1988), 35 Ohio St.3d 229; *MCI Telecommunications Corp. v. Limbach* (1994), 68 Ohio St.3d 195, 198.

Accordingly, we find the appellant has failed to meet its burden of demonstrating the error in the commissioner's findings. See *Kern*, supra; *Kroger*, supra; *Alcan*, supra. As such, this board finds that the Tax Commissioner's conclusions in this matter were reasonable and lawful. It is the decision and order of the Board of Tax Appeals that the final determination of the Tax Commissioner must be and hereby is affirmed.

BOARD OF TAX APPEALS		
RESULT OF VOTE	YES	NO
Mr. Williamson		
Ms. Clements		
Mr. Harbarger		

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

_____

Kathleen M. Crowley, Board Secretary

1993 WL 178269 (Ohio Bd.Tax.App.)

Board of Tax Appeals

State of Ohio

RANDOM HOUSE, INC., APPELLANT
v.
ROGER W. TRACY, TAX COMMISSIONER OF OHIO, APPELLEE

CASE NO. 91-A-1329
May 14, 1993

***1 (FRANCHISE TAX)**

Decision and Order

APPEARANCES:

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For the Appellee

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This cause and matter came on to be considered by the Board of Tax Appeals upon a notice of appeal filed herein on September 30, 1991, by the above-named appellant from a decision of the Tax Commissioner of the State of Ohio dated September 3, 1991. Therein, the Tax Commissioner denied appellant's application for refund of certain corporate franchise taxes paid for the tax year 1989.

The matter was submitted to the Board of Tax Appeals upon the notice of appeal, the statutory transcript certified to the Board by the Tax Commissioner, the evidence presented at a hearing before this Board on August 25, 1992, and the briefs submitted by counsel to both parties.

Appellant Random House, Inc. is a book publisher headquartered in New York City. Appellant does business in and files franchise tax returns in Ohio. On its 1989 Ohio franchise tax return, appellant allocated its royalty income on the basis of the population of the state of Ohio. Thereafter, on October 24, 1990, appellant filed a claim for refund on its 1989 return, desiring

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to apportion its royalty income instead of allocating it as it had done on the original return. The Tax Commissioner denied said request for refund because appellant failed to provide information needed to substantiate appellant's claim.

R.C. 5733.051(G) and (H) provide the relevant statutory framework herein:
"(G) Patent and copyright royalties and technical assistance fees, not representing the principal source of gross receipts of the taxpayer, are allocable to this state to the extent that the activity of the payor thereof giving rise to the payment takes place in this state. If the location of the payor's activity is unavailable to the taxpayer, such royalties and fees are apportionable under division (H) of this section." (emphasis added)

"(H) Any other net income, from sources other than those enumerated in divisions (A) to (G) of this section, is apportionable to this state on the basis of the mechanism provided in division (B)(2) of section 5733.05 of the Revised Code."

Appellant contends that the location of its payors activities was unavailable for tax year 1989 and thus, it should be permitted to apportion its royalty income pursuant to the provisions of R.C. 5733.07(H). Such information was not routinely provided to appellant by its payors, nor was it contractually provided under the terms of appellant's written agreements with its clients.

The Supreme Court has considered the definition of 'available' in a franchise tax context. Specifically, in analyzing R.C. 5733.051(F), the Court "interpreted 'available' to mean 'ascertainable.' Dictionary definitions lend support to this interpretation. Black's Law Dictionary (5 Ed.1979) 123; Webster's Third New International Dictionary (1986) 150." Alcan Aluminum Corp. v. Limbach (1989), 42 Ohio St.3d 121, 123. The Court found that actual knowledge of the location of the physical assets of a payor was not necessary; the ability to "ascertain or learn of the location" was the only requirement of the party.

***2** Here, appellant's witness credibly testified to the publishing industry practice of not providing the location of payors' activities on royalty statements. Said witness indicated that many publishing companies have very antiquated royalty systems and correspondingly, their records are very poor. She indicated that in all of her experience, she had never seen a statement or any information that would indicate a state-by-state breakdown of sales affecting the royalty income from a payor. She also indicated that Random House itself did not provide such information to its authors.

This Board finds that the definition of "available" in the context of R.C. 5733.051(G) connotes the ability, "in the course of business", to obtain the required information. In the instant matter, it is clear that appellant was not able, in the ordinary course of business, to obtain the necessary information, and to find otherwise, would place an unduly burdensome requirement on the industry itself. Arguably, the alternative provision in the subject statute was included for just such an industry situation.

Therefore, based upon the foregoing, it is the Decision and Order of the Board of Tax Appeals that the decision of the Tax Commissioner must be and hereby is reversed.

I hereby certify the foregoing to be a true and correct copy of the action of the Board of Tax Appeals of the State of Ohio, this day taken, with respect to the above matter.

Kiehner Johnson
Chairman

1993 WL 178269 (Ohio Bd.Tax.App.)

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182 Ohio App.3d 814
Court of Appeals of Ohio,
Tenth District, Franklin County.

OHIO CENTRAL RAILROAD SYSTEM, Appellant, et al.,
v.
MASON LAW FIRM CO., L.P.A. et al., Appellees.

No. 08AP–740. | Decided June 30, 2009.

Synopsis
Background: Railroad operator filed legal malpractice action against law firm that represented operator in action by former employee who was injured in course of employment. The Court of Common Pleas, Franklin County, No. 05CVA12-13634, granted summary judgment to law firm. Operator appealed.

Holdings: The Court of Appeals, Sadler, J., held that:

[1] damages recoverable by operator were limited to the $100,000 self-insurance retention (SIR) that it paid under liability insurance policy;

[2] on motion for summary judgment in legal-malpractice action brought by insured against whom a judgment was entered, collateral-source rule does not preclude courts from considering damages that insurer has paid pursuant to policy; and

[3] trial court was not authorized to allow by ratification the addition of liability insurer as real party in interest as to claims for losses exceeding SIR paid by insured; but

[4] trial court was required to determine whether insurer should be joined as an indispensable party by virtue of its interest as subrogee.

Affirmed in part, reversed in part, and remanded.

Peggy L. Bryant, J., concurred separately.

West Headnotes (13)

[1] Appeal and Error
Sufficiency of Presentation of Questions

Railroad operator sufficiently invoked collateral source rule to avoid effects of waiver in legal malpractice action against law firm that represented operator on claims brought by former employee who was injured in course of employment, where operator argued below that it was entitled to recover any damages proximately caused by law firm's negligence regardless whether those damages were paid by operator or its insurer, and regardless whether its insurers were subrogated.

Cases that cite this headnote

[2] Damages
Matter of mitigation; collateral source rule in general

Substantively, the collateral source rule is an exception to the general rule in tort actions that the measure of the plaintiff's damages is that which will make her whole; through this exception, the plaintiff is allowed to receive more than the amount of damages she actually incurred.

Cases that cite this headnote

[3] Damages
Aggravation, mitigation, and reduction of loss

As an evidentiary rule, the "collateral source rule" bars the introduction into evidence of collateral payments to the plaintiff in order to prevent the jury's consideration of such payments in determining the amount of damages.

3 Cases that cite this headnote

[4] Damages
Reduction of loss by insurance

Damages recoverable by railroad operator, in legal malpractice action against law firm that

represented operator in underlying action by former employee who was injured in course of employment, were limited to the $100,000 in self-insurance retention (SIR) paid by operator, where operator's liability insurer had paid all of operator's damages except for the SIR.

Cases that cite this headnote

[5] Damages
Reduction of loss by insurance
Judgment
Insurance cases

On a motion for summary judgment in a legal-malpractice action in which the only plaintiff is the insured against whom a judgment was entered as a result of alleged legal malpractice, the collateral-source rule does not apply so as to preclude courts from considering damages that the plaintiff's insurer, not the plaintiff-insured, has paid pursuant to that insurance policy.

2 Cases that cite this headnote

[6] Parties
Intervention, addition, or substitution of parties
Pretrial Procedure
Nonjoinder

Trial court was not authorized, in insured's legal malpractice action against law firm that represented insured in litigation by former employee, to allow by ratification the addition of insured's liability insurer as real party in interest with respect to claims for losses exceeding the $100,000 self-insurance retention (SIR) paid by insured; insured's claim for the SIR was not subject to dismissal for failure to name real party in interest, and thus there was no basis to permit ratification as an alternative to dismissal. Rules Civ.Proc., Rule 17(A).

1 Cases that cite this headnote

[7] Appeal and Error
Allowance of remedy and matters of procedure in general

A decision to allow or prohibit ratification of commencement of an action by the real party in interest is subject to review for abuse of discretion. Rules Civ.Proc., Rule 17.

3 Cases that cite this headnote

[8] Parties
Who is real party in interest

The "real party in interest" in whose name an action must be prosecuted is the party who will directly be helped or harmed by the outcome of the action. Rules Civ.Proc., Rule 17(A).

2 Cases that cite this headnote

[9] Insurance
Real party in interest

Where an insurance company pays the entire amount of a judgment, pursuant to a policy issued to an insured tortfeasor, and thereby becomes subrogated to that claim, the insurance company is the sole real party in interest in a subsequent action brought to recover the amount of that loss. Rules Civ.Proc., Rule 17(A).

2 Cases that cite this headnote

[10] Parties
Intervention, addition, or substitution of parties

Failure of insured, in legal malpractice action against law firm that represented insured in action by employee, to name liability insurer as the real party in interest with respect to claims for losses other than the $100,000 self-insured retention (SIR) paid by insured was not the result of an understandable mistake in determining the proper party to bring the malpractice claim, so as to warrant addition of insurer as a plaintiff by way of ratification; identity of proper party with respect to losses other than the SIR was not difficult to ascertain. Rules Civ.Proc., Rule 17(A).

Cases that cite this headnote

[11] Judgment

Hearing and determination

Parties

Application and proceedings thereon

Trial court was required, prior to granting summary judgment to law firm in insured's legal malpractice action on basis that insured would have expended the $100,000 self-insurance retention (SIR) under its liability policy regardless of any negligence by firm, to determine whether insurer should be joined as an indispensable party by virtue of its interest as a subrogee as to claims for losses exceeding the SIR. Rules Civ.Proc., Rule 19(A).

Cases that cite this headnote

[12] **Parties**

Discretion of court

If a trial court determines that a party is indispensable to the action, that the party is subject to service of process, and that the nonjoinder issue has not been waived, then the court has no discretion under rule governing joinder, and the party must be joined or the case dismissed. Rules Civ.Proc., Rule 19(A, B).

Cases that cite this headnote

[13] **Pretrial Procedure**

Nonjoinder

Dismissal due to a party's failure to join a necessary party is warranted only where the defect cannot be cured. Rules Civ.Proc., Rule 19(A, B).

Cases that cite this headnote

Attorneys and Law Firms

****399** Volkema Thomas L.P.A., Michael S. Miller, and Daniel R. Volkema, Columbus, for appellant, Ohio Central Railroad System.

Reminger Co., L.P.A., James J. Brudny Jr., and Gregory D. Brunton, Columbus; and The Mason Law Firm and Ronald L. Mason, Dublin, for appellees.

Opinion

SADLER, Judge.

***817** {¶ 1} Plaintiff-appellant Ohio Central Railroad System appeals from the judgment of the Franklin County Court of Common Pleas, which granted summary judgment in favor of defendants-appellees, The Mason Law Firm and Ronald L. Mason, as to appellant's claim for legal malpractice.

{¶ 2} The following facts and procedural history are taken from the record and are undisputed unless otherwise noted. On May 15, 2002, appellant's former employee, Matthew Lingo, was injured in the course of his employment when he fell while attempting to board a rail car that was not equipped with the required grab bars. Lingo suffered severe injuries, requiring a partial amputation of one leg.

{¶ 3} Appellant had purchased a policy of liability insurance from nonparty United States Fidelity & Guaranty ("USF & G"). The policy was underwritten by nonparty Certain Underwriters at Lloyds London ("Lloyds"). Nonparty Railway Claims Services, Inc. ("RCS") administered the policy pursuant to a contractual agreement between RCS and Lloyds. On September 4, 2002, RCS, acting as agent for Lloyds, engaged appellees to represent appellant in connection with anticipated litigation relating to Lingo's injury.

{¶ 4} Appellant alleged that during the course of their representation, appellees advised appellant that it could terminate Lingo's employment because Lingo had failed to return to work at some point after his injury. On September 25, 2002, Lingo sued appellant in the Franklin County Court of Common Pleas pursuant to the ****400** Federal Safety Appliance Act ("FSAA") and the Federal Employees Liability Act ("FELA"). After voluntarily dismissing his complaint, Lingo refiled it and included a claim for wrongful discharge ("*Lingo* litigation"). Appellant filed a third-party complaint for contribution and indemnification as to the FELA claim against Norfolk Southern Railway ("NSR") alleging that NSR was the entity responsible for ensuring the safety of the railcar upon which Lingo had been injured.

{¶ 5} The policy covered the FELA and FSAA claims and provided for $100,000 in self-insurance retention ("SIR"), meaning that appellant was responsible for paying the first $100,000 of any liability under the policy, including attorney fees, costs, and damages; and Lloyds was only contractually

required to ***818** indemnify appellant for any liability and/or attorney fees incurred in excess of $100,000. The evidence demonstrates, and appellant concedes, that it would have expended the full $100,000 SIR on the litigation of the FELA and FSAA claims regardless of whether appellees were negligent.

{¶ 6} In the *Lingo* litigation, NSR filed a motion for summary judgment as to appellant's claims for contribution and indemnification, and the trial court granted the motion. In October 2004, RCS discharged appellees from all representation of appellant. RCS also claimed that Lingo's wrongful-discharge claim was not covered by the policy. Appellant immediately rehired appellees to defend the wrongful-discharge claim only, but ultimately discharged appellees as trial approached. A new attorney represented appellant as to all of Lingo's claims until the conclusion of the litigation, which resulted in a $100,000 settlement of the wrongful-discharge claim and a $1.3 million jury verdict in Lingo's favor on his FELA claim. Lloyds paid the settlement and judgment.

{¶ 7} Appellant appealed from that judgment, arguing that the trial court had erred in granting summary judgment against appellant on its contribution and indemnification claims against NSR. In *Lingo v. Ohio Cent. RR., Inc.*, 10th Dist. No. 05AP–206, 2006-Ohio-2268, 2006 WL 1230670, we affirmed.

{¶ 8} On December 6, 2005, appellant filed this suit to recover damages that it alleged it suffered due to appellees' negligence in their legal representation of appellant in the *Lingo* litigation. On October 2, 2007, appellant filed an amended complaint. The two plaintiffs were designated as "Ohio Central Railroad, Inc." and RCS, "individually and as subrogor [sic] of [appellant and Lloyds]." Appellant and RCS alleged that appellees failed to properly evaluate appellant's potential liability in the *Lingo* litigation, failed to properly develop a settlement and trial preparation strategy, failed to properly evaluate and preserve claims for contribution and indemnification, and failed to correctly advise appellant regarding Lingo's termination. Appellant and RCS sought, "individually and as subrogees," damages in excess of $860,000. Appellees filed a counterclaim seeking unpaid legal fees incurred during its representation of appellant with respect to the wrongful discharge claim. [1]

{¶ 9} In the amended complaint, appellant alleged that it had incurred $100,000 in damages for settlement of the wrongful-discharge claim, defense costs of over $50,000 in the wrongful-discharge claim, additional attorney fees of over $30,000 ****401** paid for new counsel to prepare for trial, and $750,000 to $1 million it claims it would have been able to recover in contribution from NSR and others. The amended complaint further alleged:

> ***819** 23. As a direct and proximate result of the Defendants' negligence Plaintiffs, individually and as subrogees or subrogors, suffered losses in an amount in excess of $1,200,000.
>
> 24. [Appellant] has agreed to pay to LLOYDS any sums recovered in this action against [appellees] to the extent necessary to reimburse it for the monies it unnecessarily expended on the defense of the claims asserted against [appellant] by LINGO as a result of the negligence of the Defendants, *i.e.*, LLOYDS is subrogated to the claims of [appellant] against [appellees].
>
> 25. [RCS] is LLOYDS' agent for purposes of collecting and enforcing its subrogation agreement with its insured [appellant].

{¶ 10} On October 10, 2007, appellees filed a motion for summary judgment with respect to appellant's and RCS's claims. The grounds for the motion were that (1) appellees committed no malpractice; (2) appellant and RCS suffered no damages proximately caused by any alleged negligence, because, in appellant's case, it would have had to pay the SIR regardless of whether their attorneys were negligent, and in RCS's case, it paid no monies at all; and (3) RCS had no standing to bring a negligence claim because it was not the victim of the alleged negligence, and it had not paid any money in connection with the *Lingo* litigation. Appellees argued that Lloyds was the real party in interest with respect to any losses it paid as part of the settlement and judgment in the *Lingo* litigation.

{¶ 11} On November 26, 2007, appellant filed a memorandum contra and attached thereto the affidavit of its legal expert, who opined that appellees had been negligent. Appellant also argued that RCS and Lloyds are "proper parties" because they are claiming subrogation rights and, pursuant to Civ.R. 19(A), they must be included in the litigation. Curiously, however, appellant never made Lloyds a party, even in the amended complaint, and never sought to add Lloyds as a party pursuant to Civ.R. 19.

{¶ 12} Appellant also argued that its damages are not limited to the $100,000 SIR because it is the agent for Lloyds and thereby has standing to assert Lloyds' subrogated interest in all damages that Lloyds ultimately suffered. Attached to the memorandum contra was the affidavit of Arthur Wooder, an insurance-claims expert, who stated that the policy requires that appellant transfer to USF & G any funds that it recovers from appellees. Appellant argued that it was entitled to recover all damages caused by appellees' negligence, regardless of who ultimately paid out these funds.

{¶ 13} RCS voluntarily dismissed its claims against appellees, pursuant to Civ.R. 41, on March 19, 2008. On that same date, appellant filed a supplemental memorandum contra in which it noted that appellees' motion for summary judgment needed to be decided only as to it, because it was the only remaining plaintiff.

***820** {¶ 14} On August 8, 2008, the trial court issued a decision (but not an accompanying journal entry) granting appellees' motion for summary judgment. The trial court did not address the damages appellant sought that were paid by Lloyds and considered only the SIR. The court reasoned that because it was undisputed that appellant would have expended $100,000 in connection with the *Lingo* litigation regardless of whether appellees were negligent, and appellant did not expend any ****402** more than that amount in connection with the *Lingo* litigation, it had adduced no evidence that it suffered any damages proximately caused by appellees' alleged negligence.

{¶ 15} On September 9, 2008, appellant filed a motion for reconsideration, citing the standard for reconsideration applicable to App.R. 26 motions filed in courts of appeals. Appellant argued that it had relied upon the "collateral source rule" in opposing appellees' motion for summary judgment, and that the trial court had erred in not considering whether that rule precluded consideration of the fact that Lloyds had paid amounts in connection with the *Lingo* litigation beyond the $100,000 SIR. The first time that appellant had used the phrase "collateral source rule" was in its motion for reconsideration; however, it argued that it had invoked the rule in its memorandum contra to appellees' motion for summary judgment when it argued that it may recover damages caused by appellees' malpractice "regardless whether those damages were paid by [it] or its insurer, and regardless whether its insurers are subrogated."

{¶ 16} In their memorandum contra to appellant's motion for reconsideration, appellees argued that the trial court should not have applied the collateral source rule and that because Lloyds is the real party in interest with respect to all damages appellant sought that exceeded the SIR, the court was correct to have ignored these additional damages because Lloyds was not a party to the suit. Appellees cited *Shealy v. Campbell* (1985), 20 Ohio St.3d 23, 20 OBR 210, 485 N.E.2d 701, in which the Supreme Court of Ohio held, "An insurance company, which pays the entire amount of a judgment pursuant to a policy issued to an insured tortfeasor and thereafter becomes subrogated to that claim, is the sole real party in interest in a subsequent action brought against a joint tortfeasor for contribution pursuant to R.C. 2307.31(C)." Id. at syllabus.

{¶ 17} In its reply memorandum, appellant pointed out that *Shealy* remanded the case to the trial court with instructions to substitute the subrogated insurer as the plaintiff; it did not find that dismissal was warranted merely because the action had not been brought by the real party in interest. In so ruling, *Shealy* relied upon Civ.R. 17(A)'s admonition that "[n]o action shall be dismissed on the ground that it is not prosecuted in the name of the real party in interest until a reasonable time has been allowed after objection for ratification of commencement of the action by, or joinder or substitution of, the real party in interest." ***821** Civ.R. 17(A). Appellant argued that because Lloyds had ratified the commencement of the litigation, the action could proceed in appellant's name. It attached to its reply memorandum the affidavit of Dave Gardner, who identified himself therein as an authorized representative and agent of Lloyds. He averred that Lloyds has subrogation rights to any amounts that appellant recovers against appellees, and that it consented to and ratified the commencement of this action and agreed to be bound by the result thereof.

{¶ 18} Later, appellant filed a motion to add Lloyds as a party-plaintiff pursuant to Civ.R. 17(A). It again argued that Civ.R. 17(A) allows it to prosecute the action on behalf of Lloyds even if Lloyds is the real party in interest. But it also argued that pursuant to Civ.R. 17(A), an action cannot be dismissed for failure to be prosecuted in the name of the real party in interest; and, because the rule requires that reasonable time be given for ratification, joinder, or substitution of the real party in interest, the trial court should permit appellant to add Lloyds as a plaintiff in the case.

****403** {¶ 19} In their memorandum contra, appellees argued that appellant had already been given more than a reasonable amount of time to pursue joinder or ratification under Civ.R. 17(A), given that, months earlier, from the parties' summary judgment briefing had emerged the issue of whether appellant was confined to pursue only the amount it paid out for its SIR, or whether it could pursue, in its own name, the damages that Lloyds had incurred.

{¶ 20} In an entry journalized August 18, 2008, the trial court summarily denied both the motion for reconsideration and the motion to add Lloyds as a party. The court granted appellees summary judgment on all claims in appellant's complaint. Appellant timely appealed and advances two assignments of error as follows:

Assignment of Error No. 1:

The trial court erred to the substantial prejudice of plaintiff-appellant Ohio Central Railroad, Inc., in granting defendants-appellees Ronald L. Mason and the Mason Law Firm's motion for summary judgment on the ground that the plaintiff-appellant sustained no damages.

Assignment of Error No. 2:

Assuming that that [sic] the insurance company is the sole real party in interest, the trial court erred to the substantial prejudice of plaintiff-appellant Ohio Central Railroad, Inc., in failing to find a "ratification" by the plaintiff-appellant's insurer, Lloyds, in denying the plaintiffs-appellant's motion to join the insurance company to this action.

***822** We scheduled oral argument in this case, but both parties notified this court that they waived their right to participate in oral argument. Consequently, the matter was submitted to this court on the parties' briefs only.

{¶ 21} We begin with appellant's first assignment of error, which challenges the trial court's grant of summary judgment. We review the trial court's grant of summary judgment de novo. *Coventry Twp. v. Ecker* (1995), 101 Ohio App.3d 38, 654 N.E.2d 1327. Summary judgment is proper only when the party moving for summary judgment demonstrates (1) no genuine issue of material fact exists, (2) the moving party is entitled to judgment as a matter of law, and (3) reasonable minds could come to but one conclusion, and that conclusion is adverse to the party against whom the motion for summary judgment is made, when the evidence is construed in a light most favorable to the nonmoving party. Civ.R. 56(C); *State ex rel. Grady v. State Emp. Relations Bd.* (1997), 78 Ohio St.3d 181, 183, 677 N.E.2d 343.

{¶ 22} For ease of discussion, our analysis divides the damages that appellant seeks into two parts: (1) the $100,000 SIR, and (2) the remaining damages it seeks, which, it is undisputed, were incurred by Lloyds. In support of its first assignment of error, appellant does not argue that the trial court erred in determining that there was no causal connection between appellees' alleged negligence and appellant's payment of its SIR. Rather, its arguments in support of its first assignment of error are focused solely on the second category of damages—those that were paid by Lloyds.

[1] {¶ 23} Appellant argues that the collateral-source rule demands that the trial court ignore the fact that Lloyds paid any amounts under the policy in connection with the *Lingo* litigation. It argues that when the collateral source rule is applied in this case, the fact that damages were paid pursuant to the policy is irrelevant and, as such, genuine issues of material fact regarding causation and damages ****404** exist that preclude summary judgment. [2]

{¶ 24} The "collateral source rule * * * has been defined as 'the judicial refusal to credit to the benefit of the wrongdoer money or services received in reparation of the injury caused which emanates from sources other than the wrongdoer.' " ***823** *Hutchings v. Childress*, 119 Ohio St.3d 486, 2008-Ohio-4568, 895 N.E.2d 520, ¶ 30, quoting *Pryor v. Webber* (1970), 23 Ohio St.2d 104, 107, 263 N.E.2d 235.

[2] **[3]** {¶ 25} "Substantively, the collateral source rule is an exception to the general rule in tort actions that the measure of the plaintiff's damages is that which will make her whole. Through this exception, the plaintiff is allowed to receive more than the amount of damages she actually incurred. The rationale for the exception to the general rule is that benefits the plaintiff receives from a source wholly independent of the wrongdoer should not benefit the wrongdoer by reducing the amount of damages which a plaintiff might otherwise recover from him. As an evidentiary rule, the collateral source rule bars the introduction into evidence of collateral payments to the plaintiff in order to prevent the jury's consideration of such payments in determining the amount of damages." (Citations omitted.) *Klosterman v. Fussner* (1994), 99 Ohio App.3d 534, 538–539, 651 N.E.2d 64.

[4] **[5]** {¶ 26} The issue that appellant's first assignment of error presents is whether, in ruling on a motion for summary judgment in a legal-malpractice action in which the only plaintiff is the insured against whom a judgment was entered as a result of the alleged legal malpractice, the collateral-source rule precludes courts from considering damages that the *plaintiff's insurer*—not the plaintiff-insured—has paid pursuant to that insurance policy. In our view, the collateral-source rule has no application, and the trial court correctly eschewed consideration of any damages for which Lloyds had indemnified appellant.

{¶ 27} In *Cleveland Paint & Color Co. v. Bauer Mfg. Co.* (1951), 155 Ohio St. 17, 44 O.O. 59, 97 N.E.2d 545, the Supreme Court of Ohio held, "[A] subrogee who has paid an entire loss suffered by the insured must sue in his own name, as he is the only real party in interest." Id. at 25, 44 O.O. 59, 97 N.E.2d 545. In *Shealy,* the court reaffirmed its holding in *Cleveland Paint,* holding, "An insurance company, which pays the entire amount of a judgment pursuant to a policy issued to an insured tortfeasor and thereafter becomes subrogated to that claim, is the sole real party in interest in a subsequent action brought against a joint tortfeasor." Id. at syllabus.

{¶ 28} Congruently, we have held that when the plaintiff insured admits that *the insurer has paid all of the damages,* except for the insured's contractually required deductible, and that the insurer is subrogated to the insured's rights, the trial court properly limits the insured's recovery to the amount of the deductible. *Ward v. Tea* (June 13, 1989), 10th Dist. No. 88AP–1147, 1989 WL 65410. In such a case, the " 'insurer may prosecute a separate action against the party causing such injury to the extent of the amount paid ****405** under [the insurance policy].' " Id., quoting ***824** *Hoosier Cas. Co. v. Davis* (1961), 172 Ohio St. 5, 15 O.O.2d 45, 173 N.E.2d 349, paragraph two of the syllabus; see also *Cleveland Paint,* 155 Ohio St. at 25, 44 O.O. 59, 97 N.E.2d 545. In other words, the insured is the sole real party in interest with respect to its deductible or, in this case, its SIR, while the insurer is the sole real party in interest with respect to the amounts it paid pursuant to its contract with the insured. Thus, these parties may prosecute separate actions or a single action as coplaintiffs, but in either case, each is the sole real party in interest with respect to the claim for damages that it alone incurred.

{¶ 29} This case fits squarely within the holding in *Ward* because appellant admits that Lloyds has paid all its damages except for the SIR, and it is undisputed that Lloyds is contractually subrogated to appellant's rights for the amounts Lloyds paid. Though appellant and Lloyds share an interest in the sense that they can both seek to impose malpractice liability upon appellees, each has its own distinct and separate interest to pursue. Thus, under *Ward,* it was proper for the trial court to limit appellant's damages to the amount of the SIR, which, in this context, is analogous to a deductible. [3]

{¶ 30} For this reason, appellant was not entitled to seek recovery of amounts that Lloyds paid. Rather, it was entitled to seek recovery of its SIR only. On appeal, appellant does not challenge the summary judgment as to its SIR. Accordingly, the trial court correctly granted summary judgment in favor of appellees and against appellant on appellant's legal malpractice claim. For this reason, appellant's first assignment of error is overruled.

[6] {¶ 31} We now turn to appellant's second assignment of error. Therein, appellant argues that assuming that Lloyds is the real party in interest with respect to the amounts Lloyds paid—the only category of damages with which this appeal is concerned—the trial court erred in not allowing a ratification to permit the addition of Lloyds as a party-plaintiff.

***825** **[7]** {¶ 32} A decision to allow or prohibit ratification under Civ.R. 17(A) is subject to review for abuse of discretion. *Arabian Am. Oil Co. v. Scarfone* (C.A.11, 1991), 939 F.2d 1472, 1477, citing *ICON Group, Inc. v. Mahogany Run Dev. Corp.* (C.A.3, 1987), 829 F.2d 473, 476, fn. 3. [4]
****406** Civ.R. 17 requires every civil action to be prosecuted in the name of the real party in interest. *State ex rel. Jones v. Suster* (1998), 84 Ohio St.3d 70, 77, 701 N.E.2d 1002. "The requirement in Rule 17(a) that an action be prosecuted in the name of a 'real party in interest' is based on the principle that the pleadings in a case 'should be made to reveal and assert the actual interest of the plaintiff, and to indicate the interests of any others in the claim.' " *Agri–Mark, Inc. v. Niro, Inc.* (D.Mass.2000), 190 F.R.D. 293, 295, quoting *United States v. Aetna Cas. & Sur. Co.* (1949), 338 U.S. 366, 382, 70 S.Ct. 207, 94 L.Ed. 171.

{¶ 33} "The purpose behind [Civ.R. 17] is 'to enable the defendant to avail himself of evidence and defenses that the defendant has against the real party in interest, and to assure him finality of the judgment, and that he will be protected against another suit brought by the real party in interest on the same matter.' " Id., citing *Shealy,* 20 Ohio St.3d at 24–25, 20 OBR 210, 485 N.E.2d 701. Moreover, like all of the

civil rules, Civ.R. 17(A) "shall be construed and applied to effect just results by eliminating delay, unnecessary expense and all other impediments to the expeditious administration of justice." Civ.R. 1(B).

[8] {¶ 34} "The real party in interest is the party who will directly be helped or harmed by the outcome of the action." *Zuckerman v. Gray,* 11th Dist. No. 2008–T–0022, 2009-Ohio-1319, 2009 WL 738027, ¶ 13. "The person must have more than an interest in the case. He or she must have some interest in the subject matter of the litigation or is the person who can discharge the claim on which the suit is brought." *Travelers Indemn. Co. v. R.L. Smith Co.,* 11th Dist. No. 2000–L–014, 2001 WL 369677. "It has been long recognized at common law that the real party in interest was the person who, by substantive law, possessed the right to be enforced." 1 Klein & Darling, Baldwin's Ohio Civil Practice (2d Ed.2004) 927, Section 17:4.

[9] {¶ 35} As we noted above, where an insurance company pays the entire amount of a judgment, pursuant to a policy issued to an insured tortfeasor, and thereby becomes subrogated to that claim, the insurance company is the sole real party in interest in a subsequent action brought to recover the amount of that ***826** loss. *Cleveland Paint;* see also *Goldney v. Byrd,* 8th Dist. No. 88285, 2007-Ohio-1985, 2007 WL 1219261; *Keegan v. Sneed* (Oct. 16, 2000), 12th Dist. No. CA2000–02–029, 2000 WL 1530879. Thus, Lloyds is the real party in interest vis à vis any amounts it paid in connection with the *Lingo* litigation.

{¶ 36} When the present action was commenced, there were two distinct claims—a malpractice claim seeking recovery of the SIR, with respect to which appellant is the real party in interest, and a separate malpractice claim seeking recovery of the amounts Lloyds paid, with respect to which Lloyds is the real party in interest. Appellant's motion to add Lloyds as a party sought to correct the problem that the real party in interest with respect to the second claim was not present in the suit.

{¶ 37} "Civ.R. 17 * * * only allows a plaintiff to cure a real-party-in-interest problem by (1) showing that the real party in interest has ratified the commencement of the action, or (2) joining or substituting the real party in interest." ****407** *Wells Fargo Bank v. Byrd,* 178 Ohio App.3d 285, 2008-Ohio-4603, 897 N.E.2d 722, ¶ 11. Appellant argues that the trial court should have allowed it to cure through ratification. For several reasons, we disagree.

{¶ 38} First, "[t]he sole authorization for ratification in the * * * rules is the provision in Rule 17(a) for ratification as an alternative to dismissal for failure to name the real party in interest. If the court has no authority to dismiss, it has no authority to require the insurer's ratification as an alternative." June F. Entman, Compulsory Joinder of Compensating Insurers: Federal Rule of Civil Procedure 19 and the Role of Substantive Law (1994), 45 Case W.Res.L.Rev. 1, 61. Where, as here, the substantive law permits the insured to sue in its own name to recover damages for which it is the sole real party in interest,[5] the court has no authority to dismiss for failure to name the real party in interest. Thus, it has no basis upon which to allow ratification, even if, as here, the insurer is also entitled to prosecute an action as subrogee. Accordingly, the trial court did not abuse its discretion in refusing to allow ratification.

[10] {¶ 39} Even in cases in which the court does have authority to dismiss, many federal courts have held that ratification is still not an appropriate alternative to naming the real party in interest because Rule 17(a) authorizes ratification only " 'to avoid forfeiture and injustice when an understandable mistake has been made in selecting the parties in whose name the action should be brought.' " *Agri–Mark,* 190 F.R.D. at 296, quoting 6A Charles Alan Wright, Arthur R. Miller, and Mary Kay Kane, ***827** Federal Practice and Procedure (1990), Section 1555, 412; *Hobbs v. Police Jury of Morehouse Parish* (E.D.La.1970), 49 F.R.D. 176, 180; *Del Re v. Prudential Lines, Inc.* (C.A.2, 1982), 669 F.2d 93, 96.

{¶ 40} The Fed.R.Civ.P. 17 advisory committee's note accompanying the 1966 amendment stated, "Modern decisions are inclined to be lenient when an honest mistake has been made in choosing the party in whose name the action is to be filed. * * * The provision should not be misunderstood or distorted. It is intended to prevent forfeiture when determination of the proper party to sue is difficult or when an understandable mistake has been made."[6]

****408** {¶ 41} "While a literal interpretation of * * * Rule 17(a) would make it applicable to every case in which an inappropriate plaintiff was named, the Advisory Committee's Notes make it clear that this provision 'is intended to prevent forfeiture when determination of the proper party to sue is difficult or when an understandable mistake has been made.' Fed.R.Civ.P. Advisory Committee Notes, 1966 Amendment. * * *. When determination of the correct party to bring the action was not difficult and when no

excusable mistake was made, the last sentence of Rule 17(a) is inapplicable and the action should be dismissed." *Feist v. Consol. Freightways Corp.* (E.D.Pa.1999), 100 F.Supp.2d 273, 275; see also *Advanced Magnetics, Inc. v. Bayfront Partners, Inc.* (C.A.2, 1997), 106 F.3d 11, 20; *Whitcomb v. Ford Motor Co.* (M.D.Pa.1978), 79 F.R.D. 244, 245; *Wieburg v. GTE Southwest, Inc.* (C.A.5, 2001), 272 F.3d 302, 308 ("In accordance with the Advisory Committee's note, most courts have interpreted the last sentence of Rule 17(a) as being applicable only when the plaintiff brought the action in her own name as the result of an understandable mistake, because the determination of the correct party * * * is difficult"); *Intown Properties Mgt.,* ***828** *Inc. v. Wheaton Van Lines, Inc.* (C.A.4, 2001), 271 F.3d 164, 171; *Advanced Magnetics* at 20 ("the district court retains some discretion to dismiss an action where there was no semblance of any reasonable basis for the naming of an incorrect party"); *Lans v. Gateway 2000, Inc.* (D.D.C.1999), 84 F.Supp.2d 112, 120 ("it is appropriate to liberally grant leave to substitute a real party in interest when there has been an honest mistake in choosing the nominal plaintiff, meaning that determination of the proper party was somehow difficult at the time of the filing of the suit, or that the mistake is otherwise understandable"); *Metal Forming Technologies v. Marsh & McLennan Co.* (S.D.Ind.2004), 224 F.R.D. 431.

{¶ 42} But decisions "allowing parties to use the ratification device deliberately to avoid naming an insurance company as a plaintiff are inconsistent with the expressed legislative intent that the 1966 amendment [adding the last sentence to Rule 17(a)] be available only in cases of mistake." (Footnote omitted.) Entman, More Reasons for Abolishing Federal Rule of Civil Procedure 17(a): The Problem of the Proper Plaintiff and Insurance Subrogation (1990), 68 N.C.L.Rev. 893, 907–908. Moreover, ratification that sanctions avoidance of party status allows the real party in interest to control the litigation but not be subject to provisions for assessments of costs and sanctions, or to certain discovery procedures that may be used only against parties to the litigation (e.g., Civ.R. 33, governing interrogatories to parties, and Civ.R. 36, governing requests for admissions).

{¶ 43} In this case, it is not apparent, and appellant made no attempt to demonstrate to the trial court, that the failure to name the real party in interest with respect to the claim for losses other than the SIR was the result of an honest mistake under circumstances in which it was difficult to ascertain the identity of the proper party. For this reason, too, the trial court's refusal to allow ratification was not an abuse of discretion.

[11] {¶ 44} Appellant's motion to add Lloyds also argued, in the alternative, that the court should allow the addition of Lloyds through joinder. Civ.R. 19 governs joinder of parties needed for just adjudication. Civ.R. 19(A) states, "A person who is subject to service of process shall be joined as a party in the action if * * * he has an ****409** interest relating to the subject of the action as an assignor, assignee, subrogor, or subrogee. If he has not been so joined, the court shall order that he be made a party upon timely assertion of the defense of failure to join a party as provided in Rule 12(B)(7)."

[12] **[13]** {¶ 45} Though this court has recognized a timeliness requirement for motions to join the real party in interest,[7] the Supreme Court of Ohio has noted ***829** that "Civ.R. 19(A) encourages, and Ohio decisional law favors, a policy of liberally granting joinder." *Hambleton v. R.G. Barry Corp.* (1984), 12 Ohio St.3d 179, 184, 12 OBR 246, 465 N.E.2d 1298. If a trial court determines that a party is indispensable to the action, that the party is subject to service of process, and that the nonjoinder issue has not been waived, then the court has no discretion under Civ.R. 19(A) and (B), and the party must be joined or the case dismissed. *State ex rel. Gill v. Winters* (1990), 68 Ohio App.3d 497, 503, 589 N.E.2d 68. "[D]ismissal due to a party's failure to join a necessary party is warranted only where the defect cannot be cured." *State ex rel. Bush v. Spurlock* (1989), 42 Ohio St.3d 77, 81, 537 N.E.2d 641.

{¶ 46} Thus, with these authorities in mind, the trial court had a duty to determine whether the defect of parties could be cured. To do so, the trial court was required to determine whether Lloyds was indispensable to the action (by virtue of its holding an interest as a subrogee, pursuant to Civ.R. 19(A)(3)), whether Lloyds was subject to service of process, and whether the nonjoinder issue had been waived. *Gill;* see also *Hamler v. Marshall* (1986), 34 Ohio App.3d 306, 518 N.E.2d 575; *Chambers v. Stevenson* (1991), 71 Ohio App.3d 566, 594 N.E.2d 1097. Here, the trial court summarily denied appellant's motion to join Lloyds and failed to address any of these issues. Such a summary disposition of the joinder issues and subsequent dismissal of the action warrant reversal and remand for the trial court to determine whether Lloyds should be joined in accordance with the criteria set forth in Civ.R. 19. *Chambers* at 569–570, 594 N.E.2d 1097. Accordingly, appellant's second assignment of error is sustained.

{¶ 47} In summary, we overrule appellant's first assignment of error, sustain the second assignment of error, affirm in part and reverse in part the judgment of the Franklin County Court of Common Pleas, and remand this cause to that court for further proceedings in accordance with law and consistent with this decision.

Judgment affirmed in part and reversed in part, and cause remanded.

KLATT, J., concurs.

PEGGY L. BRYANT, J., concurs separately.

PEGGY L. BRYANT, Judge, concurring.
{¶ 48} While I agree with the majority's conclusion that the collateral-source rule does not apply here, I cannot fully agree with the remainder of the decision and so concur separately.

***830** {¶ 49} The decision in *Morelli v. Walker*, 8th Dist. No. 88706, 2007-Ohio-4832, 2007 WL 2729811, suggests ratification under Civ.R. 17 may be appropriate in this matter, as *Morelli* concluded that joinder of a subrogated insurance company ****410** was not necessary where the company provided a ratification affidavit, as did Lloyds in this case. We, however, need not resolve that issue, given the procedural posture of this case.

{¶ 50} More specifically, all agree that Lloyds is the real party in interest here. On the facts of this case, I have difficulty conceiving of a rationale that the trial court could apply to deny on remand the motion to join Lloyds as a party. See Civ.R. 19(A) ("[a] person who is subject to service of process shall be joined as a party in the action if * * * (3) he has an interest relating to the subject of the action as an assignor, assignee, subrogor, or subrogee"). Accordingly, I would reverse the judgment of the trial court and remand with instructions to join Lloyds as a real party in interest.

All Citations

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Footnotes

1 By notice filed August 18, 2008, appellees voluntarily dismissed their counterclaim pursuant to Civ.R. 41(A)(1)(a).

2 Appellees argue that appellant waived any argument regarding the collateral source rule because it failed to raise the issue below. However, appellant did argue below that it is entitled to recover any damages proximately caused by appellees' negligence "regardless whether those damages were paid by the Ohio Central Railroad or its insurer, and regardless whether its insurers are subrogated." Though appellant did not denominate this argument as one based upon the "collateral source rule," we view this argument as sufficiently invoking the rule so as to avoid the effects of waiver.

3 "Self-insured retentions (SIRs) and deductibles serve the same purpose, allotting a portion of the risk to the insured." Susan N.K. Gummow, No "SIR"! Insurer Can't Avoid Payment if Insured Files for Bankruptcy, April 2005, 24–3 Am.Bankr.Inst.J. 18. However, they operate in slightly different ways, in terms of triggering the insurer's duty to indemnify. "Self-insured retention is defined as 'the amount of an otherwise-covered loss that is not covered by an insurance policy and that must be paid before the insurer will pay benefits' [while] * * * [a] deductible is the amount of risk undertaken by the insured under a traditional liability insurance policy. It is the specific monetary amount set by the insurance policy for which the insured is responsible. The deductible * * * does not prevent the triggering of coverage by the policy. * * * The insurer has a duty to indemnify without regard to the deductible provision. Under this scenario, the insurer would be responsible for payment of a claim from 'dollar one' and then must seek reimbursement for the amount of the deductible from the insurer. This differs from a SIR, where the insurer would only be liable for the amounts due above the limits of the SIR." Id.

4 Civ.R. 17(A) is patterned after Fed.R.Civ.P. 17(A). See 1975 Staff Note Civ.R. 17(A) ("The first three sentences of Rule 17(A) [are] (based upon Federal Rule 17(a))[.] * * * The fourth sentence of Rule 17(A) is borrowed directly from a 1966 amendment of Federal Rule 17(a)."). Where an Ohio procedural rule is patterned after a federal counterpart, it is appropriate to use federal case law in analyzing the Ohio civil rule. See, e.g., *Grau v. Kleinschmidt* (1987), 31 Ohio St.3d 84, 31 OBR 250, 509 N.E.2d 399.

5 See ¶ 28–29, supra.

6 Professor Entman notes that "[r]atification is an anomaly that slipped into Rule 17(a) in 1966 when admiralty actions were brought under the Federal Rules of Civil Procedure. Prior to the 1966 amendments, courts * * * had taken a lax approach to the naming of parties plaintiff because of the difficulty of identifying, at least prior to the expiration of applicable

statutes of limitation, the numerous parties who may have enforceable claims arising from the loss of a ship's cargo. * * * So long as the proper plaintiff or plaintiffs ratified the action before judgment, the action could be saved and judgment entered in the name of the plaintiff on the basis of the unnamed parties' claims. * * * In 1964 the Advisory Committee on Admiralty Rules proposed the merger of civil and admiralty practice under the Federal Rules of Civil Procedure. The Committee * * * recommended several amendments to the Federal Rules of Civil Procedure to preserve, after the merger, certain distinct admiralty practices. Among the recommendations by the committee was an amendment to Rule 17(a) that would have preserved the practice of relation-back of claims through the formerly unnamed parties' ratification, joinder or substitution. * * * What apparently passed unnoticed, however, was that the provision for ratification, as an alternative to joinder or substitution, introduced into Rule 17(a) a practice that was fundamentally at odds with the rule's basic proposition that every action shall be prosecuted in the name of the real party in interest. The device of ratification * * * was the very practice, however, that the real party in interest rule was intended to abolish." (Citations omitted.) Entman, Compulsory Joinder of Compensating Insurers: Federal Rule of Civil Procedure 19 and the Role of Substantive Law, 45 Case W.Res.L.Rev. at 62–64.

7 *Foster v. Blue Cross/Blue Shield of Ohio* (Dec. 11, 1997), 10th Dist. No. 97APE03–410, 1997 WL 770997.

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188 Ohio App.3d 213
Court of Appeals of Ohio,
Tenth District, Franklin County.

WELLS FARGO BANK, N.A., et al., Appellees,
v.
SESSLEY et al., Appellants; Sand Canyon Corporation, Appellee.

No. 09AP-178. | Decided June 24, 2010.

Synopsis
Background: Bank filed complaint in foreclosure against mortgagors. Mortgagors filed cross-claims and third-party claims against bank and original mortgagee. The Court of Common Pleas, Franklin County, No. 07CVE-02-1896, entered summary judgment against mortgagors. Mortgagors appealed.

Holdings: The Court of Appeals, Connor, J., held that:

[1] real-party-in-interest problem was cured when original mortgagee was joined in the suit;

[2] absent a motion to delay resolution of summary judgment motion, trial court did not err in granting summary judgment without affording mortgagors the opportunity to conduct discovery; and

[3] evidence supported grant of summary judgment on foreclosure complaint;

[4] general references to equitable tolling without any explanation as to how it applied were insufficient to create genuine issues of material fact as would preclude summary judgment on limitations grounds;

[5] self-serving affidavit was insufficient to establish a genuine issue of material fact to preclude summary judgment on Consumer Sales Practices Act (CSPA) claim;

[6] mortgagors failed to establish conversion or breach of contract; and

[7] mortgagors failed to establish claim of fraud.

Affirmed.

West Headnotes (31)

[1] **Judgment**
Weight and sufficiency
Judgment
Matters of fact or conclusions
Judgment
Showing to be made on supporting affidavit

A moving party seeking summary judgment cannot discharge its burden by simply making a conclusory allegation that the nonmoving party has no evidence to prove its case; rather, the moving party must affirmatively demonstrate by affidavit or other evidence that the nonmoving party has no evidence to support its claims. Rules Civ.Proc., Rule 56.

1 Cases that cite this headnote

[2] **Parties**
Amendment of Defects
Parties
Want of capacity or interest
Parties
Cure of Defects by Subsequent Proceedings

Plaintiff may cure a real-party-in-interest problem by (1) showing that the real party in interest has ratified the commencement of the action or (2) joining or substituting the real party in interest. Rules Civ.Proc., Rule 17.

2 Cases that cite this headnote

[3] **Parties**
Who is real party in interest

A "real party in interest" is one who is directly benefited or injured by the outcome of the case. Rules Civ.Proc., Rule 17(A).

Cases that cite this headnote

[4] **Mortgages**
Plaintiffs

Mortgages
Holders of obligations secured

In foreclosure actions, the real party in interest is the current holder of the note and mortgage.

5 Cases that cite this headnote

[5] **Action**
Persons entitled to sue

Parties
Real Party in Interest

If a party is not a real party in interest, it lacks standing to prosecute the action.

2 Cases that cite this headnote

[6] **Action**
Persons entitled to sue

If a party lacks standing to prosecute an action, then that party may not invoke the jurisdiction of a court.

Cases that cite this headnote

[7] **Estoppel**
Assent to or Ratification of Acts of Others in General

Principal and Agent
Nature and Grounds in General

Ratification is a way that an agent can bind a principal; but ratification will not apply when the actor is not acting as the agent of the principal.

Cases that cite this headnote

[8] **Mortgages**
Plaintiffs

Mortgages
Bringing in new parties

Although bank was not the real party in interest when it filed foreclosure action because it was not the mortgagee and holder of note at that time, real-party-in-interest problem was cured when mortgagee and note-holder was joined in the suit. Rules Civ.Proc., Rules 1(B), 17(A).

6 Cases that cite this headnote

[9] **Judgment**
Hearing and determination

Trial court did not err in granting summary judgment against mortgagors in foreclosure action without affording mortgagors the opportunity to conduct discovery, where mortgagors failed to file a motion requesting delay in the trial court's resolution of the summary judgment motion. Rules Civ.Proc., Rule 56(F).

1 Cases that cite this headnote

[10] **Judgment**
Personal knowledge or belief of affiant

Judgment
Liens and mortgages

Mortgagee was entitled to summary judgment in foreclosure action against mortgagors, where mortgagee attached an affidavit to motion for summary judgment, in which the affiant averred based upon his personal knowledge that he was familiar with the records relating to mortgagors' loan, mortgagors had not made a payment on the note for a year, the note had been accelerated, and the outstanding principal balance due was $82,391.05, with a negative escrow balance of $7,507.41. Rules Civ.Proc., Rule 56(E).

2 Cases that cite this headnote

[11] **Mortgages**
Default in Payment

Mortgages
Exercise of option

Mortgages
Breach of Condition Other Than for Payment of Debt

A mortgagee is entitled to judgment after there has been a default on the conditions of the mortgage and the debt as evidenced by the note having been accelerated.

2 Cases that cite this headnote

[12] Judgment
Bar of statute of limitations

Mortgagors' general references to equitable tolling without any explanation as to how it applied were insufficient to create genuine issues of material fact regarding application of statutes of limitations as would preclude grant of summary judgment against mortgagors on their claims against mortgagee for violation of Truth in Lending Act (TILA), Home Ownership Equity Protection Act (HOEPA) and Real Estate Settlement Procedures Act (RESPA). Real Estate Settlement Procedures Act of 1974, § 2, 12 U.S.C.A. § 2601; Truth in Lending Act, §§ 102, 129, 15 U.S.C.A. §§ 1601, 1639; 12 C.F.R. § 226.

2 Cases that cite this headnote

[13] Action
Statutory rights of action

Antitrust and Trade Regulation
Private entities or individuals

Provision of Federal Trade Commission Act (FTCA) prohibiting unfair and deceptive acts and practices in or affecting commerce does not create a private right of action. Federal Trade Commission Act, § 5(a), 15 U.S.C.A. § 45(a).

Cases that cite this headnote

[14] Antitrust and Trade Regulation
Exclusive and Concurrent Remedies or Laws

The decision as to whether actions amount to unfair or deceptive practices under Federal Trade Commission Act (FTCA) must be left to the Federal Trade Commission, rather than the courts. Federal Trade Commission Act, § 5(a), 15 U.S.C.A. § 45(a).

Cases that cite this headnote

[15] Antitrust and Trade Regulation
Persons and transactions covered

Fair Debt Collection Practices Act (FDCPA) applies only to third-party debt collectors, rather than creditors or bona fide assignees. Fair Debt Collection Practices Act, § 802, 15 U.S.C.A. § 1692.

1 Cases that cite this headnote

[16] Limitation of Actions
Liabilities Created by Statute

Statute of limitations on claims under Consumer Sales Practices Act (CSPA) begins to run on the date of the violation, which may or may not coincide with the date of the underlying transaction. R.C. § 1345.01 et seq.

2 Cases that cite this headnote

[17] Judgment
Matters of fact or conclusions

Judgment
Liens and mortgages

Mortgagor's self-serving affidavit was insufficient to establish a genuine issue of material fact to preclude summary judgment on Consumer Sales Practices Act (CSPA) claim against mortgagee, alleging improper servicing or unlawful fees; affidavit contained nothing more than bare contradictions of other competent evidence and a conclusory statement of law. Rules Civ.Proc., Rule 56(E).

2 Cases that cite this headnote

[18] Judgment
Matters of fact or conclusions

A party seeking to defeat a motion for summary judgment may not simply use a self-serving affidavit to establish a genuine issue of material fact if such an affidavit contains nothing more than bare contradictions of other competent evidence and a conclusory statement of law. Rules Civ.Proc., Rule 56(E).

2 Cases that cite this headnote

[19] Conversion and Civil Theft
Assertion of ownership or control in general

Conversion and Civil Theft

Withholding of possession

A "conversion" is the wrongful exercise of dominion over property to the exclusion of the rights of the owner, or withholding it from his possession under a claim inconsistent with his rights.

Cases that cite this headnote

[20] Contracts

Grounds of action

Breach-of-contract claims require the existence of a contract, performance by the plaintiff, breach by defendant, and damage or loss to the plaintiff.

4 Cases that cite this headnote

[21] Mortgages

Between parties to mortgage or their privies

Mortgagors failed to establish claim for conversion against mortgagee based on allegations of excessive or improper fees, where mortgagors admitted that they had no knowledge about what the charges for insurance coverage should have been, nor did they know whether the insurance coverage they did have caused any damages.

Cases that cite this headnote

[22] Mortgages

Dealings and transactions between parties

Mortgagee's filing of foreclosure complaint against mortgagor did not constitute a conversion or breach of contract, where mortgagors broke a condition of mortgage by defaulting on their obligation to repay the note.

Cases that cite this headnote

[23] Mortgages

Under mortgages in general

Mortgages

Default in Payment

Mortgages

Breach of Condition Other Than for Payment of Debt

A mortgagor in possession maintains both legal and equitable ownership over the property, however, after a condition of the mortgage is broken, the legal title as between the mortgagee and mortgagor is vested in the mortgagee, subject to the equity of redemption; therefore, after a condition is broken, the mortgagee may sue for the foreclosure of its mortgage and sale of the mortgaged property.

1 Cases that cite this headnote

[24] Fraud

Fiduciary or confidential relations

The elements for a breach-of-fiduciary-duty claim include (1) the existence of a duty arising from a fiduciary relationship, (2) a failure to observe the duty, and (3) an injury resulting proximately therefrom.

9 Cases that cite this headnote

[25] Fraud

Fiduciary or confidential relations

When there is no fiduciary relationship between the parties, a breach-of-fiduciary-duty claim necessarily fails.

9 Cases that cite this headnote

[26] Debtor and Creditor

Debtor and Creditor

Generally, the relationship between a creditor and a debtor is not a fiduciary relationship but instead is governed by the principles of contract.

2 Cases that cite this headnote

[27] Fraud

Elements of Actual Fraud

To prevail on a fraud claim, a party must demonstrate: (1) a representation or, where there is a duty to disclose, concealment of a fact, (2) which is material to the transaction at hand, (3) made falsely, with knowledge of its falsity, or

with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred, (4) with the intent of misleading another into relying upon it, (5) justifiable reliance upon the representation or concealment, and (6) a resulting injury proximately caused by the reliance.

1 Cases that cite this headnote

[28] Mortgages

Between parties to mortgage or their privies

Mortgagors failed to establish fraud claim against mortgagee based on allegation that terms of the loan discussed before the closing differed from the terms of the loan actually presented during the closing, where mortgagors were fully aware of and acknowledged the differences in the loan documents before they signed them.

Cases that cite this headnote

[29] Mortgages

Between parties to mortgage or their privies

Mortgagors failed to establish fraud claim against mortgagee based on allegation that, when terms of loan presented during the closing differed from the terms of the loan discussed before the closing, they proceeded with the closing only because their mortgage broker indicated that they would be able to refinance their mortgage at more favorable rates; mortgage broker's supposition regarding mortgagors' future ability to refinance amounted to a mere prediction or opinion, as mortgagors' future ability to refinance necessarily depended upon a number of uncontrollable, outside factors.

1 Cases that cite this headnote

[30] Conspiracy

Nature and Elements in General

Conspiracy claim must be premised upon an underlying wrongful act.

Cases that cite this headnote

[31] Appeal and Error

Amendment increasing demand, or adding cause of action or defense

Ruling on a motion to add claims is reviewed on an abuse-of-discretion standard. Rules Civ.Proc., Rule 15.

Cases that cite this headnote

Attorneys and Law Firms

****74** Thompson Hine L.L.P. and Scott A. Campbell, Columbus, for appellees.

Philip Sessley and Leonadra Hutchins-Sessley, pro se.

Opinion

CONNOR, Judge.

***218** {¶ 1} Appearing pro se, defendants-appellants Philip Sessley and Leonadra Sessley appeal the decision of the Franklin County Court of Common Pleas granting summary judgment to plaintiff-appellee, Wells Fargo Bank, N.A., as Trustee for Option One Mortgage Loan Trust 2001-C, Asset-Backed Certificates, Series 2001-C ("Wells Fargo" or "appellees"), and "cross-complaint" defendant-appellee, Sand Canyon Corporation, f.k.a. Option One Mortgage Corporation ("Option One" or "appellees"). For the following reasons, we affirm the decision of the trial court.

{¶ 2} On May 15, 2001, Mr. Sessley obtained a mortgage loan from Option One in the amount of $85,500 to purchase real estate located at 963 North Nelson Road, Columbus, Ohio 43219. As a result, Mr. Sessley executed a note evidencing the debt and granted a mortgage securing the debt. These documents named Option One as the lender and mortgagee. The last payment that was made on the debt occurred in February 2006. Therefore, on February 7, 2007, Wells ***219** Fargo filed a complaint in foreclosure, in which it alleged that it was the owner and holder of the promissory note and corresponding mortgage.

{¶ 3} Before appellants filed an answer or other responsive pleading, Wells Fargo filed an amended complaint on February 26, 2007. The mortgage documents attached to each of Wells Fargo's first two complaints named Option One as the lender and mortgagee. After appellants had filed an answer and counterclaim, Wells Fargo filed a motion for

leave to file a second amended complaint, which the trial court granted. Accordingly, Wells Fargo filed its second amended complaint on April 24, 2007. Attached to the second amended complaint was the assignment of mortgage and note, which indicated that Option One had assigned the mortgage together with the note to Wells Fargo on February 28, 2007, three weeks after Wells Fargo had filed its initial complaint. The assignment was recorded on March 9, 2007. Appellants filed their answer and counterclaim to Wells Fargo's second amended complaint on May 29, 2007.

{¶ 4} On December 3, 2007, appellants sought leave to file a third amended answer and counterclaims. At this time, appellants also sought to join Option One as a "cross-complaint defendant." The trial court granted appellants' motion on March 11, 2008, and Option One filed its answer on June 30, 2008. Given the substantive allegations in appellants' "cross-complaint," we will hereinafter refer to the claims as third-party claims.

{¶ 5} On September 5, 2008, appellees filed a joint motion for summary judgment, which sought judgment in their favor on Wells Fargo's claims in addition to appellants' ****75** counterclaims and third-party claims. Appellants filed a memorandum contra, and appellees filed a reply. On October 28, 2008, the trial court granted appellees' motion.

{¶ 6} Thereafter, appellants filed various procedural motions, including two motions requesting an emergency stay of the foreclosure proceedings. During the pendency of this appeal, this court granted appellants' motion but conditioned such a stay upon the posting of a bond. After appellants failed to post a bond, the foreclosure proceedings continued forward.

{¶ 7} Appellants have appealed the trial court's judgment and raise 28 assignments of error. As best we can discern, appellants' 28 assignments of error present three general arguments. First, appellants argue that the trial court erred by granting summary judgment to appellees. Second, appellants argue that the trial court erred by denying their motion to add claims. Finally, appellants argue that the trial court erred by denying their motion for relief from judgment.

{¶ 8} With regard to the trial court's decision granting summary judgment, appellate review of summary-judgment decisions is de novo. *Helton v. Scioto* ***220** *Cty. Bd. of Commrs.* (1997), 123 Ohio App.3d 158, 162, 703 N.E.2d 841. "When reviewing a trial court's ruling on summary judgment, the court of appeals conducts an independent review of the record and stands in the shoes of the trial court." *Mergenthal v. Star Banc Corp.* (1997), 122 Ohio App.3d 100, 103, 701 N.E.2d 383. We must affirm the trial court's judgment if any of the grounds raised by the movant at the trial court are found to support it, even if the trial court failed to consider those grounds. *Coventry Twp. v. Ecker* (1995), 101 Ohio App.3d 38, 41-42, 654 N.E.2d 1327.

[1] {¶ 9} Summary judgment is proper only when the party moving for summary judgment demonstrates that (1) no genuine issue of material fact exists, (2) the moving party is entitled to judgment as a matter of law, and (3) reasonable minds could come to but one conclusion, and that conclusion is adverse to the party against whom the motion for summary judgment is made, that party being entitled to have the evidence most strongly construed in that party's favor. Civ.R. 56(C); *State ex rel. Grady v. State Emp. Relations Bd.* (1997), 78 Ohio St.3d 181, 183, 677 N.E.2d 343. Additionally, a moving party cannot discharge its burden under Civ.R. 56 by simply making a conclusory allegation that the nonmoving party has no evidence to prove its case. *Dresher v. Burt* (1996), 75 Ohio St.3d 280, 293, 662 N.E.2d 264. Rather, the moving party must affirmatively demonstrate by affidavit or other evidence allowed by Civ.R. 56(C) that the nonmoving party has no evidence to support its claims. Id.

[2] {¶ 10} In their challenges to the trial court's decision granting summary judgment, the preliminary issue is whether Wells Fargo was a real party in interest, such that it had standing to file and maintain this lawsuit. The relevant analysis hinges upon the application of Civ.R. 17(A), which provides:

> Every action shall be prosecuted in the name of the real party in interest. * * * No action shall be dismissed on the ground that it is not prosecuted in the name of the real party in interest until a reasonable time has been allowed after objection for ratification of commencement of the action by, or joinder or substitution of, the real party in interest. Such ratification, joinder, or substitution shall have the same effect as if the action had been commenced in the name of the real party in interest.

****76** Therefore, Civ.R. 17 permits a plaintiff to cure a real-party-in-interest problem by (1) showing that the real party

in interest has ratified the commencement of the action or (2) joining or substituting the real party in interest. *Ohio Cent. RR. Sys. v. Mason Law Firm Co., L.P.A.,* 182 Ohio App.3d 814, 2009-Ohio-3238, 915 N.E.2d 397, ¶ 33, citing *Wells Fargo Bank, N.A. v. Byrd,* 178 Ohio App.3d 285, 2008-Ohio-4603, 897 N.E.2d 722. Further, like other procedural rules, "Civ.R. 17(A) 'shall be construed and applied to effect just results by eliminating delay, ***221** unnecessary expense and all other impediments to the expeditious administration of justice.' " *Ohio Cent. RR. Sys.* at ¶ 33, quoting Civ.R. 1(B).

[3] **[4]** {¶ 11} In applying this rule to foreclosure actions, this court has provided:

> A real party in interest is one who is directly benefited or injured by the outcome of the case. *Shealy v. Campbell* (1985), 20 Ohio St.3d 23, 24[, 20 OBR 210, 485 N.E.2d 701]. The purpose behind the real-party-in-interest requirement is " 'to enable the defendant to avail himself of evidence and defenses that the defendant has against the real party in interest, and to assure him finality of the judgment, and that he will be protected against another suit brought by the real party [in] interest on the same matter.' " Id. at 24-25[, 20 O.B.R. 210, 485 N.E.2d 701], quoting *In re Highland Holiday Subdivision* (1971), 27 Ohio App.2d 237, 240[, 56 O.O.2d 404, 273 N.E.2d 903].
>
> In foreclosure actions, the real party in interest is the current holder of the note and mortgage. *Chase Manhattan Mtge. Corp. v. Smith,* Hamilton App. No. C-061069, 2007-Ohio-5874[, 2007 WL 3225534], at ¶ 18.

Everhome Mtge. Co. v. Rowland, 10th Dist. No. 07AP-615, 2008-Ohio-1282, 2008 WL 747698, ¶ 11-12.

[5] **[6]** {¶ 12} If a party is not a real party in interest, it lacks standing to prosecute the action. *State ex rel. Jones v. Suster* (1998), 84 Ohio St.3d 70, 77, 701 N.E.2d 1002. If a party lacks standing to prosecute an action, then that party may not invoke the jurisdiction of a court. *State ex rel. Dallman v. Franklin Cty. Court of Common Pleas* (1973), 35 Ohio St.2d 176, 64 O.O.2d 103, 298 N.E.2d 515, syllabus.

{¶ 13} Appellate courts are often presented with real-party-in-interest issues in foreclosure actions. See *Rowland*; *Byrd*; see also *First Union Natl. Bank v. Hufford* (2001), 146 Ohio App.3d 673, 767 N.E.2d 1206; *Kramer v. Millott* (Sept. 23, 1994), 6th Dist. No. E-94-5, 1994 WL 518173; *Washington Mut. Bank, F.A. v. Green,* 156 Ohio App.3d 461, 2004-Ohio-1555, 806 N.E.2d 604; *Bank of New York v. Stuart,* 9th Dist. No. 06CA008953, 2007-Ohio-1483, 2007 WL 936706; *Washington Mut. Bank v. Novak,* 8th Dist. No. 88121, 2007-Ohio-996, 2007 WL 701081; *DLJ Mtge. Capital, Inc. v. Parsons,* 7th Dist. No. 07-MA-17, 2008-Ohio-1177, 2008 WL 697400; *Mid-State Trust IX v. Davis,* 2d Dist. No. 07-CA-31, 2008-Ohio-1985, 2008 WL 1838350; *Wells Fargo Bank, N.A. v. Jordan,* 8th Dist. No. 91675, 2009-Ohio-1092, 2009 WL 625560; *US Bank, Natl. Assn. v. Marcino,* 181 Ohio App.3d 328, 2009-Ohio-1178, 908 N.E.2d 1032; *Deutsche Bank Natl. Trust Co. v. Pagani,* 5th Dist. No. 09CA000013, 2009-Ohio-5665, 2009 WL 3440028; *Wells Fargo Bank, N.A. v. Stovall,* 8th Dist. No. 91802, 2010-Ohio-236, 2010 WL 320487. However, we find the circumstances presented in *Byrd* to be most similar to those presented herein.

****77** ***222** **[7]** {¶ 14} In *Byrd,* Wells Fargo Bank initiated a foreclosure action against the mortgagors based upon a note and mortgage that identified WMC Mortgage Corporation ("WMC") as the lender and mortgagee. *Byrd,* 178 Ohio App.3d 285, 2008-Ohio-4603, 897 N.E.2d 722, ¶ 2. Wells Fargo Bank then sought summary judgment and attached an assignment dated over one month after the complaint was filed. Id. at ¶ 3. The trial court denied summary judgment and dismissed the case with prejudice. Id. at ¶ 4. On appeal, the First Appellate District initially noted that WMC had neither been joined nor substituted in the trial court's proceedings. Id. at ¶ 12. As a result, the court indicated that the only argument Wells Fargo Bank could advance was for ratification under Civ.R. 17(A). In its analysis, the *Byrd* court provided:

> Ratification is a way that an agent can bind a principal. But ratification will not apply when the actor is not acting as the agent of the principal.
>
> In this case, Wells Fargo admitted to the trial court that it was not the real party in interest when the suit was filed. Wells Fargo filed suit on its own behalf and acquired the mortgage from WMC later. It was not acting as WMC's agent. There was no evidence that WMC had "ratified" the commencement of the action-only that it had sold the mortgage to Wells Fargo. None of the documents indicated that WMC even knew about this case. For ratification to occur, the ratifying party must know what actions it is ratifying. While Wells Fargo repeatedly argued that ratification had occurred, it seemed to be confused as to which party had to ratify. Below, it argued that "Plaintiff, being a real party in interest, did ratify the commencement of this action * * *." But Civ.R. 17 makes clear that it was WMC, not Wells Fargo, that had to ratify the commencement of the action.

(Footnotes omitted.) Id. at ¶ 12-13. Based upon these circumstances, the First Appellate District affirmed the decision overruling Wells Fargo's summary-judgment motion and dismissing the matter. Id. at ¶ 16. However, it modified the dismissal from one with prejudice to one without prejudice. Id. at ¶ 20.

{¶ 15} The similarities between *Byrd* and the instant matter are clearly evident. In the instant matter, Wells Fargo was not a real party in interest when it filed this foreclosure suit because it was not the mortgagee and holder of the note at that time. Rather, it obtained the assignment after filing this suit. Much like Wells Fargo did in *Byrd,* appellees herein argue that Wells Fargo ratified the commencement of this action when it filed the assignment. Again, however, this argument misses the mark. Ratification involves the process through which an agent can bind the principal. *Byrd,* 178 Ohio App.3d 285, 2008-Ohio-4603, 897 N.E.2d 722, ¶ 12, citing *Morr v. Crouch* (1969), 19 Ohio St.2d 24, 48 O.O.2d 43, 249 N.E.2d 780. When Wells Fargo filed its initial complaint, Option One was the holder and owner of the note and mortgage. Thus, it was the principal, while ***223** Wells Fargo was the agent. See *Rowland,* 2008-Ohio-1282, 2008 WL 747698; see also *Byrd* at ¶ 13. Similar to the situation in *Byrd,* Wells Fargo filed the instant suit on its own behalf. It was not acting as Option One's agent. Based upon these circumstances, it was Option One and not Wells Fargo who had the authority to ratify. See *Byrd* at ¶ 13; see also Civ.R. 17(A) ("ratification * * * by * * * the real party in interest"). As a result, we reject appellees' argument that Wells Fargo ratified the commencement of this action by filing the assignment. Indeed, it could not have ratified its own commencement of this action.

****78** **[8]** {¶ 16} Nevertheless, one glaring distinction separates the instant matter from *Byrd.* Specifically, the *Byrd* court analyzed ratification because the real party in interest had neither been substituted nor joined in the foreclosure suit. In the instant matter, however, Option One has been involved in this suit since June 2008. Thus, the underlying concern about multiple judgments on the same debt is absent from this matter. Because Option One was joined in this matter, we find that the real-party-in-interest problem was cured. See Civ.R. 17(A); but see *Byrd* at ¶ 16; *Jordan,* 2009-Ohio-1092, 2009 WL 625560, at ¶ 23-26; *Northland Ins. Co. v. Illum. Co.,* 11th Dist. No. 2002-A-0058, 2004-Ohio-1529, 2004 WL 612889, at ¶ 17; *Travelers Indemn. Co. v. R.L. Smith Co.* (Apr. 13, 2001), 11th Dist. No. 2000-L-014, 2001 WL 369677.

{¶ 17} We believe this analysis follows the principles set forth in Civ.R. 17(A) and 1(B). We therefore respectfully disagree with the other ways that courts have decided similar issues. See *Bank of New York v. Stuart,* 9th Dist No. 06CA008953, 2007-Ohio-1483, 2007 WL 936706, citing *Campus Sweater and Sportswear Co. v. M.B. Kahn Constr. Co.* (D.C.S.C., 1979), 515 F.Supp. 64, 84-85, and *Dubuque Stone Prods. Co. v. Fred L. Gray Co.* (C.A.8, 1966), 356 F.2d 718, 723-724 ("filing the assignment with the trial court before judgment was entered was sufficient to alert the court and appellants that appellee was the real party in interest"); see also *Byrd* at ¶ 16, *Jordan* at ¶ 23-26; *Northland Ins. Co.* at ¶ 17 (generally holding that the real-party-in-interest problem is incapable of being cured after the commencement of the action). We believe *Stuart* provides a blanket rule that glosses over the underlying concerns associated with real-party-in-interest problems, while *Byrd*, *Jordan*, *Northland Ins. Co.*, and *Travelers Indemn. Co.* overlook the clear indication that such problems are capable of being cured through ratification, joinder, or substitution. See Civ.R. 17 ("Such ratification, joinder, or substitution shall have the same effect as if the action had been commenced in the name of the real party in interest"); see also *State ex rel. Jones v. Suster* (1998), 84 Ohio St.3d 70, 77, 701 N.E.2d 1002 ("lack of standing may be cured by substituting the proper party so that a court otherwise having subject matter jurisdiction may proceed to adjudicate the matter"). Because the real-party-in-interest problem was cured when Option One became a party to this ***224** litigation, we reject appellants' argument that the trial court erred by granting judgment to appellees based upon the real-party-in-interest issue.

[9] {¶ 18} Appellants next argue that the trial court improperly granted summary judgment without affording appellants the opportunity to conduct discovery. Even though appellants filed a motion to compel discovery in July 2008, which the trial court never decided, appellants failed to file a motion in accordance with Civ.R. 56(F), which provides:

> Should it appear from the affidavits of a party opposing the motion for summary judgment that the party cannot for sufficient reasons stated present by affidavit facts essential to justify the party's opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or

> discovery to be had or may make such other order as is just.

Given that appellants failed to file a Civ.R. 56(F) motion with supporting affidavits, the trial court apparently determined that its ruling on appellees' summary-judgment motion was not premature. See *Scott v. Hertz Corp.*, 10th Dist. No. 05AP-1180, 2006-Ohio-4982, 2006 WL 2734051, ¶ 12. ****79** Because appellants failed to request a delay in the trial court's resolution of appellees' summary-judgment motion, we find that the trial court did not err as to this issue. Id. at ¶ 13.

[10] {¶ 19} In regard to the trial court's decision granting appellees summary judgment, appellants argue that this was error because genuine issues of material fact exist. We must determine, therefore, whether summary judgment was properly granted.

[11] {¶ 20} It is well settled that a mortgagee is entitled to judgment after there has been a default on the conditions of the mortgage and the debt as evidenced by the note having been accelerated. *Bank One, N.A. v. Swartz*, 9th Dist. No. 03CA008308, 2004-Ohio-1986, 2004 WL 840118, ¶ 18, quoting *Metro. Sav. Bank v. Papadelis* (Sept. 13, 1995), 9th Dist. No. 2380-M, 1995 WL 542214. In the instant matter, appellees attached an affidavit to their motion for summary judgment, in which the affiant averred based upon his personal knowledge that he was familiar with the records relating to appellants' loan, appellants had not made a payment on the note since February 2006, the note had been accelerated, and as of September 3, 2008, the outstanding principal balance due was $82,391.05, with a negative escrow balance of $7,507.41.

{¶ 21} In appellants' response, rather than presenting their own evidence demonstrating that genuine issues of material fact exist, appellants presented two general positions. First, they challenge Wells Fargo's standing based upon the real-party issue, which we have already considered and decided. Second, appellants ***225** challenge the evidentiary support for appellees' motion. The Ninth Appellate District considered nearly identical arguments in *Swartz*, 2004-Ohio-1986, 2004 WL 840118. Specifically, *Swartz* provided:

> The affidavit attached to [the mortgagee's] motion for summary judgment stated that the affiant was a foreclosure specialist of [the mortgagee], that the loan file was under her immediate control and supervision, that the note and mortgage attached to the complaint are accurate copies of the original instruments, that the account was and remains in default and therefore, [the mortgagee] has exercised the option to accelerate the loan, and that the outstanding balance was $38,826.59 plus interest. This is an averment made upon personal knowledge of the affiant and it references the documents filed with the complaint. Therefore, the affidavit is sufficient to satisfy Civ.R. 56(E). Appellants have not presented evidence that the amount owed is incorrect; therefore, the affidavit is sufficient to demonstrate the outstanding debt. Furthermore, Appellants' assertions that the affidavits violate the hearsay rules of evidence are without merit. The statements in the affidavit refer to business records which are not hearsay; they are records kept in the course of regularly conducted business activity, it was the regular practice of that business activity to make the records, and the affiant stated they were in her immediate control and supervision and thereby she is a person with knowledge regarding the records. See Evid.R. 803(6).

Id. at ¶ 16. Again, appellants present the same arguments that were presented and rejected in *Swartz*. In response, we follow the well-reasoned analysis set forth by the Ninth Appellate District. Accordingly, we find that appellees provided Civ.R. 56(E) evidence supporting the position that they were entitled to judgment, while appellants failed to meet their reciprocal burden. As a result, we find no error in the trial court's decision granting summary ****80** judgment to Wells Fargo on its complaint in foreclosure.

{¶ 22} Appellants next argue that the judgment rendered by the trial court failed to resolve their counterclaims and third-party claims. After reviewing the judgment rendered by the trial court herein, it is true that there was no substantive analysis of any of appellants' claims. Instead, the trial court merely provided: "The counterclaims and cross-claims of the

Sessleys against the Trustee and Option One are dismissed with prejudice." However, despite appellants' contention to the contrary, this did resolve appellants' claims. Indeed, the trial court granted summary judgment in favor of appellee and dismissed appellants' claims. We must next consider whether such a decision was proper.

{¶ 23} Many of appellants' claims allege violations of Ohio and federal statutory law. Specifically, appellants assert that appellees violated the following: (1) the ***226** Truth in Lending Act ("TILA") as codified at 15 U.S.C. 1601 and implemented by 12 C.F.R. 226, (2) the Home Ownership Equity Protection Act ("HOEPA") as codified at 15 U.S.C. 1639, (3) the Real Estate Settlement Procedures Act ("RESPA") as codified at 12 U.S.C. 2601, (4) Section 5(a) of the Federal Trade Commission Act ("FTCA") as codified at 15 U.S.C. 45(a), (5) the Fair Debt Collection Practices Act ("FDCPA") as codified at 15 U.S.C. 1692, and (6) the Ohio Consumer Sales Practices Act ("CSPA") as codified at O.R.C. Chapter 1345. These statutory claims all fail based either upon the expiration of the statutes of limitations or upon the substantive merits of the claims.

[12] {¶ 24} Appellants' claims under TILA, HOEPA, and RESPA are all barred by the statutes of limitations applying to such actions. Depending upon the allegation and remedy sought, the statutes of limitations governing such claims are either one year or three years. See *Steel Valley Bank, N.A. v. Tuckosh,* 7th Dist. No. 04 HA 566, 2004-Ohio-4907, 2004 WL 2070810, ¶ 31; see also 15 U.S.C. 1640(e); see also 12 U.S.C. 2614. Based upon appellants' allegations, appellees violated these statutes during or before the May 15, 2001 closing. As a result, the latest appellants could have raised these claims would have been on May 15, 2004. Because appellants raised their claims on March 18, 2008, the statutes of limitations had long since expired. Appellants' general references to equitable tolling without any explanation as to how it applies to the instant matter are insufficient to create genuine issues of material fact. Indeed, appellants signed the mortgage documents at the closing and fail to explain why they were apparently unaware of the alleged violations at that time. As a result, appellants have failed to present any genuine issues of material fact with regard to their TILA, HOEPA, and RESPA claims. Accordingly, the trial court did not err in granting summary judgment and dismissing these claims.

[13] **[14]** {¶ 25} As for appellants' FTCA claims, they fail on the merits because a private right of action does not exist under section 5 of the FTCA. *Morales v. Walker Motors Sales, Inc.* (S.D.Ohio, 2000), 162 F.Supp.2d 786, 790, citing *Am. Airlines v. Christensen* (C.A.10, 1992), 967 F.2d 410; *Fulton v. Hecht* (C.A.5, 1978), 580 F.2d 1243, certiorari denied, 440 U.S. 981, 99 S.Ct. 1789, 60 L.Ed.2d 241; *Alfred Dunhill, Ltd. v. Interstate Cigar Co.* (C.A.2, 1974), 499 F.2d 232; *Holloway v. Bristol-Myers Corp.,* 158 U.S.App.D.C. 207, 485 F.2d 986; *Carlson v. Coca-Cola Co.* (C.A.9, 1973), 483 F.2d 279; *St. Martin v. KFC Corp.* (W.D.Ky., 1996), 935 F.Supp. 898; ****81** *Child World, Inc. v. S. Towne Centre, Inc.* (S.D.Ohio, 1986), 634 F.Supp. 1121. Indeed, the decision as to whether actions amount to unfair or deceptive practices under FTCA must be left to the Federal Trade Commission, rather than the courts. Id., citing *Holloway.* Accordingly, the trial court did not err in granting summary judgment and dismissing appellants' FTCA claims.

***227** **[15]** {¶ 26} Appellants' FDCPA claims fail on the merits because the FDCPA applies only to third-party debt collectors, rather than creditors or bona fide assignees. *Bank of New York v. Barclay,* 10th Dist. No. 03AP-844, 2004-Ohio-1217, 2004 WL 503935, ¶ 20, citing *Huntington Natl. Bank v. Metzenbaum* (Nov. 12, 1998), 8th Dist. No. 73723, 1998 WL 787403, quoting *Meads v. Citicorp Credit Servs., Inc.* (S.D.Ga.,1988), 686 F.Supp. 330, 333. Indeed, the FDCPA "is quite clear that it is directed at independent debt collectors and not creditors attempting to collect their own debts." Id., citing *Beck v. Alliance Funding Co.* (D.Conn., 2000), 113 F.Supp.2d 274, 275. Because appellees acted as a creditor and an assignee when they attempted to collect the debt, the trial court did not err in granting summary judgment and dismissing appellants' FDCPA claims.

[16] {¶ 27} Regarding appellants' CSPA claims, appellees argue that the statute of limitations bars such claims based upon the date of the closing. However, case law clearly provides that the statute of limitations begins to run on the date of the violation, which may or may not coincide with the date of the underlying transaction. *Varavvas v. Mullet Cabinets, Inc.,* 185 Ohio App.3d 321, 2009-Ohio-6962, 923 N.E.2d 1221, ¶ 31, citing *Montoney v. Lincoln Logs, Ltd.,* 10th Dist. No. 06AP-284, 2007-Ohio-236, 2007 WL 155451, ¶ 26; see also *Luft v. Perry Cty. Lumber & Supply Co.,* 10th Dist. No. 02AP-559, 2003-Ohio-2305, 2003 WL 21027291, ¶ 27. Indeed, this court has held that the "General Assembly explicitly recognized that a CSPA violation may occur before, during or after the underlying consumer transaction." *Montoney* at ¶ 26. Further, there is a two-year statute of limitations governing such CSPA damages claims. Id.

{¶ 28} In appellants' pleading, they allege CSPA violations that occurred during the closing in addition to violations that occurred thereafter. With regard to the alleged violations that occurred during the closing, the statute of limitations bars such claims. Again, appellants have failed to demonstrate factual issues in this regard. However, to the extent that appellants' CSPA claims present allegations of improper servicing and unlawful fees occurring from November 2006 through February 2007, we find that the statute of limitations does not bar these CSPA claims. Accordingly, the statute of limitations could not have formed the proper basis for the decision granting summary judgment. Inasmuch as appellees argue that appellants' CSPA claims are all barred by the statute of limitations, we find this argument to be unpersuasive. As a result, we must consider the substance of appellants' CSPA claims.

[17] {¶ 29} In their motion for summary judgment, appellees argued that appellants had no evidence supporting the allegations of improper servicing or unlawful fees. In support, appellees referred to the deposition testimony of appellants wherein they testified that they did not know what fees were improperly charged to or paid by them. Accordingly, appellees provided Civ.R. 56(C) ***228** evidence demonstrating that appellants had no evidence supporting their CSPA claims. See *Dresher,* 75 Ohio St.3d at 293, 662 N.E.2d 264. As a result, the burden then shifted ****82** to appellants to demonstrate genuine issues of material fact on these issues.

[18] {¶ 30} In these circumstances, appellants were required to do more than merely rely on the arguments presented in their pleading. See Civ.R. 56(E). In response to appellees' motion for summary judgment, appellants presented the same legal arguments contained in their pleading. Specifically, they generally argued that appellees' practices were not authorized under the terms of the loan, the fees imposed were the result of Option One's failure to post appellants' payments in a timely manner, and Option One incorrectly computed the fees. Appellants presented these general arguments in an attachment that they called a "declaration." Appellees filed a motion to strike this declaration, which was never ruled upon by the trial court. Aside from the issue of whether appellants' declaration met the standard for an affidavit established in Civ.R. 56(E), we note that appellants' declaration is insufficient to withstand appellees' summary-judgment motion. Indeed, it is well settled that a party may not simply use a self-serving affidavit to establish a genuine issue of material fact if such an affidavit contains nothing more than bare contradictions of other competent evidence and a conclusory statement of law. *Church v. Fleishour Homes, Inc.,* 172 Ohio App.3d 205, 2007-Ohio-1806, 874 N.E.2d 795, ¶ 34, citing *Bhatia v. Johnston* (C.A.5, 1987), 818 F.2d 418, 421-422; see also *Am. Heritage Life Ins. Co. v. Orr* (C.A.5, 2002), 294 F.3d 702, 710 (self-serving affidavits unsupported and without corroborating evidentiary materials are insufficient to create a genuine issue of material fact on summary judgment). This is precisely what appellants attempted to do in their declaration. As a result, we find that appellants failed to meet their reciprocal burden under Civ.R. 56 with regard to their CSPA claims. Accordingly, we find that the trial court did not err in granting summary judgment and dismissing appellants' CSPA claims.

{¶ 31} Having considered all of appellants' statutory claims, we must now turn to appellants' claims for conversion, breach of contract, breach of fiduciary duties, fraud, and conspiracy.

[19] **[20]** {¶ 32} Appellants' conversion and contract claims are premised upon allegations regarding duplicate insurance coverage, excessive and improper fees, and the act of filing this suit in foreclosure. The elements of conversion and breach-of-contract claims are well settled. A conversion is "the wrongful exercise of dominion over property to the exclusion of the rights of the owner, or withholding it from his possession under a claim inconsistent with his rights." *Joyce v. Gen. Motors Corp.* (1990), 49 Ohio St.3d 93, 96, 551 N.E.2d 172. As to appellants' breach-of-contract claims, such claims require "the existence of a ***229** contract, performance by the plaintiff, breach by the defendant, and damage or loss to the plaintiff." *Wildi v. Hondros College,* 10th Dist. No. 09AP-346, 2009-Ohio-5205, 2009 WL 3155136, ¶ 13, citing *Jarupan v. Hanna,* 173 Ohio App.3d 284, 2007-Ohio-5081, 878 N.E.2d 66, ¶ 18.

[21] {¶ 33} In their motion for summary judgment, appellees again referred to appellants' depositions in support of the position that appellants had no evidence supporting the allegations of excessive or improper fees, in addition to allegations of overcharges for taxes and duplicate insurance. Indeed, appellants admitted that they had no knowledge about what the charges for insurance coverage should have been, nor did they know whether the insurance coverage they did have caused any damages. As such, again, appellees provided Civ.R. 56(C) evidence supporting their motion. In response, appellants ****83** failed to demonstrate genuine issues of material fact and instead simply provided a self-serving, conclusory declaration. We accordingly find that the trial

court did not err in granting summary judgment on appellants' claims for conversion and breach of contract based upon these allegations.

[22] **[23]** {¶ 34} With regard to the allegations pertaining to the act of filing this foreclosure suit, we start by noting the well-settled principles regarding mortgages:

> The law recognizes two kinds of ownership, equitable and legal.
>
> An "equitable owner" is one who is recognized in equity as the owner of the property, because the real and beneficial use and title belong to him, although the bare legal title is invested in another.
>
> A "legal owner" is one in whom the legal title to real estate is vested, but subject to the rights of any equitable owner.

Levin v. Carney (1954), 161 Ohio St. 513, 518, 53 O.O. 390, 120 N.E.2d 92. A mortgagor in possession maintains both legal and equitable ownership over the property. Id. at 520, 53 O.O. 390, 120 N.E.2d 92. However, after a condition of the mortgage is broken, "the legal title as between the mortgagee and mortgagor is vested in the mortgagee, subject to the equity of redemption." Id. Therefore, after a condition is broken, the mortgagee may sue for the foreclosure of its mortgage and sale of the mortgaged property. Id. at paragraph three of the syllabus.

{¶ 35} Applying these rules to the instant matter, we first note that it is undisputed that a condition of the mortgage has been broken. Indeed, appellants have defaulted on their obligation to repay the note. As a result, appellees properly initiated this action in foreclosure. Therefore, the act of filing this foreclosure suit was neither a conversion nor a breach of contract. Instead, it was one potential legal remedy available to appellees based upon appellants' ***230** undisputed failure to meet their obligation to repay the note. Accordingly, the trial court did not err in dismissing appellants' conversion and breach-of-contract claims in this regard.

[24] **[25]** **[26]** {¶ 36} Appellants' breach-of-fiduciary-duty claim is based upon the documents and disclosures involved in the closing. The elements for such a claim include " ' "(1) the existence of a duty arising from a fiduciary relationship; (2) a failure to observe the duty; and (3) an injury resulting proximately therefrom." ' " *Camp St. Mary's Assn. of W. Ohio Conference of United Methodist Church, Inc. v. Otterbein Homes*, 176 Ohio App.3d 54, 2008-Ohio-1490, 889 N.E.2d 1066, ¶ 19, quoting *Thomas v. Fletcher*, 3d Dist. No. 17-05-31, 2006-Ohio-6685, 2006 WL 3702699, ¶ 13, quoting *Werthmann v. DONet*, 2d Dist. No. 20814, 2005-Ohio-3185, 2005 WL 1490372, ¶ 42. When there is no fiduciary relationship between the parties, a breach-of-fiduciary-duty claim necessarily fails. *Waffen v. Summers*, 6th Dist. No. OT-08-034, 2009-Ohio-2940, 2009 WL 1741731, ¶ 41. Generally, the relationship between a creditor and a debtor is not a fiduciary relationship but instead is governed by the principles of contract. *Stone v. Davis* (1981), 66 Ohio St.2d 74, 78, 20 O.O.3d 64, 419 N.E.2d 1094.

{¶ 37} In the instant matter, appellants have not alleged any special relationship with appellees other than the creditor-debtor relationship. Accordingly, we find no genuine issues of material fact with regard to this claim. The trial court therefore did not err in granting summary judgment as to appellants' breach-of-fiduciary-duty claim.

{¶ 38} Appellants' fraud claim is based upon two alleged misrepresentations. ****84** First, appellants raise issue with the differences between the terms of the loan discussed before the closing versus the terms of the loan actually presented during the closing. Second, appellants allege that they proceeded with the closing only because their mortgage broker indicated that they would be able to refinance their mortgage at more favorable rates.

[27] {¶ 39} To prevail on a fraud claim, a party must demonstrate:

> (a) [A] representation or, where there is a duty to disclose, concealment of a fact, (b) which is material to the transaction at hand, (c) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred, (d) with the intent of misleading another into relying upon it, (e) justifiable reliance upon the representation or concealment, and (f) a resulting injury proximately caused by the reliance.

Otterbein Homes, 176 Ohio App.3d 54, 2008-Ohio-1490, 889 N.E.2d 1066, at ¶ 14, citing ***231** *State ex rel. Illum. Co. v. Cuyahoga Cty. Court of Common Pleas*, 97 Ohio St.3d 69, 2002-Ohio-5312, 776 N.E.2d 92, ¶ 24, quoting *Russ v. TRW, Inc.* (1991), 59 Ohio St.3d 42, 49, 570 N.E.2d 1076.

[28] {¶ 40} According to the record, appellants were fully aware that the closing documents included terms that differed from those that were discussed before the closing. Indeed, appellants interrupted the closing to question their mortgage broker for at least 30 minutes regarding these differences. Therefore, appellants acknowledged the differences in the loan documents before they signed them. As a result, appellants cannot now argue that they justifiably relied upon representations provided before the closing. As a result, the differences between the terms of the loans cannot serve as the basis for appellants' fraud claim. The trial court did not err in granting summary judgment in this regard.

[29] {¶ 41} With regard to the mortgage broker's representation that appellants would be able to refinance their mortgage within two years, we note that fraud claims are generally not predicated on "a representation concerning a future event, as such representation is more in the nature of a promise or contract or constitutes mere predictions or opinions about what the future may bring." *Isaac v. Alabanza Corp.*, 7th Dist. No. 05 JE 55, 2007-Ohio-1396, 2007 WL 901596, ¶ 44, quoting *Yo-Can, Inc. v. Yogurt Exchange, Inc.*, 149 Ohio App.3d 513, 2002-Ohio-5194, 778 N.E.2d 80, ¶ 43. As this general rule relates to the instant matter, it is difficult to imagine how the mortgage broker's supposition regarding appellants' future ability to refinance could amount to anything besides a prediction or opinion. Indeed, appellants' future ability to refinance necessarily depended upon a number of uncontrollable, outside factors. As a result, we find that the mortgage broker's opinion about appellants' ability to refinance cannot serve as the basis for appellants' fraud claim against appellees. The trial court did not err in granting summary judgment in this regard.

[30] {¶ 42} With regard to appellants' conspiracy claim, such a claim must be premised upon an underlying wrongful act. See *Williams v. Aetna Fin. Co.* (1998), 83 Ohio St.3d 464, 475, 700 N.E.2d 859. Because we have upheld the trial court's granting of summary judgment on each of appellants' claims, appellants' conspiracy claim also fails. The trial court did not err in granting summary judgment on this claim.

{¶ 43} Thus, we have found unpersuasive each assignment of error pertaining to ****85** the trial court's decision to grant appellees' summary judgment and dismiss appellants' counterclaims and third-party claims. Accordingly, we overrule assignments of error three through five, seven through 17, and 19 through 28.

[31] {¶ 44} In assignment of error six, appellants argue that the trial court erred by denying their motion to add claims. Civ.R. 15 governs such motions and is reviewed on an abuse-of-discretion standard. Appellants fail to cite any legal ***232** authority or present a legal argument supporting this assignment of error. Because appellants have failed to demonstrate an abuse of discretion, we overrule assignment of error six.

{¶ 45} In assignments of error one, two, and 18, appellants argue that the trial court abused its discretion and erred by denying their postjudgment motions. However, the trial court never rendered a decision on these motions. We therefore have no decision to review. See *Tuckosh v. Cummings*, 7th Dist. No. 09 HA 4, 2009-Ohio-6401, 2009 WL 4548887, ¶ 34. Because these assignments of error are premature, we dismiss assignments of error one, two, and 18.

{¶ 46} Based upon the foregoing, we overrule assignments of error three through 17 and 19 through 28. Additionally, we dismiss assignments of error one, two, and 18. We accordingly affirm the judgment of the trial court.

Judgment affirmed.

TYACK, P.J., and McGRATH, J., concur.

All Citations

188 Ohio App.3d 213, 935 N.E.2d 70, 2010 -Ohio- 2902

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Disagreed With by Demasse v. ITT Corp., Ariz., May 25, 1999

150 Ariz. 82
Supreme Court of Arizona, In Banc.

Edward A. WAGNER and Andrea Wagner, husband and wife, Appellants,
v.
CITY OF GLOBE, a municipal corporation, Appellee.

No. 18564–PR. | June 24, 1986.

Discharged public employee brought action against city alleging breach of employment contract and wrongful discharge. The Superior Court, Gila County, James E. Don, J., entered summary judgment against discharged employee. He appealed. The Court of Appeals affirmed entry of summary judgment, and discharged employee appealed. The Supreme Court, Gordon, V.C.J., held that: (1) genuine issues of material fact existed as to whether personnel rules promulgated by city became part of employment contract, precluding summary judgment, and (2) genuine issues of material fact existed as to whether employee was wrongfully discharged for whistleblowing activities, precluding summary judgment.

Reversed and remanded.

West Headnotes (13)

[1] Labor and Employment
Termination; cause or reason in general

Every employment contract for an indefinite term is presumed to be terminable at will.

9 Cases that cite this headnote

[2] Contracts
Mutuality of Obligation

Like a bilateral contract, a unilateral contract does not require mutuality of obligation, but there is sufficient consideration in the form of services rendered.

4 Cases that cite this headnote

[3] Labor and Employment
Definite or Indefinite Term; Employment At-Will

Because at-will employment relationship is contractual, it can be modified by parties at any time just as other contracts can be modified.

12 Cases that cite this headnote

[4] Labor and Employment
Modification or rescission of contract

Presumption that employment contracts of indefinite duration are terminable at will can be modified by parties; parties may create different relationship and define parameters of that relationship, based upon totality of statements and actions regarding employment relationship.

7 Cases that cite this headnote

[5] Labor and Employment
Manuals, Handbooks, and Policy Statements

Employer's representations contained in personnel manual can become terms of employment contract and limit employer's ability to discharge employees, even though personnel policies were not bargained for at time of hiring.

5 Cases that cite this headnote

[6] Labor and Employment
Manuals, Handbooks, and Policy Statements, Adverse Action Under

In order to establish breach of employment contract claim based upon violation of personnel rules, employee must prove personnel manual actually became part of employment contract and terms of manual were breached.

7 Cases that cite this headnote

[7] Labor and Employment

Questions of law and fact as to employment status

Whether parties to employment contract intended to modify at-will contract, by use of personnel manual or otherwise, is a question of fact.

2 Cases that cite this headnote

[8] Labor and Employment

Manuals, Handbooks, and Policy Statements

Reliance on personnel manual by at-will employees is not essential predicate to action for breach of employment contract but is only one of several factors to be considered.

5 Cases that cite this headnote

[9] Judgment

Public officers and employees, cases involving

In action brought by discharged public employee, genuine issues of material fact existed as to whether personnel rules promulgated by city for the benefit of its employees became part of at-will contract, precluding summary judgment.

Cases that cite this headnote

[10] Principal and Agent

Failure to repudiate agent's acts or delay in repudiating

Affirmance of unauthorized transactions can be inferred from failure to repudiate it, especially where one would naturally be expected to speak if he did not consent.

3 Cases that cite this headnote

[11] Judgment

Public officers and employees, cases involving

In action brought by discharged public employee alleging breach of employment contract, genuine issues of material fact existed as to whether city failed to follow its own rules in discharging public employee, precluding summary judgment.

Cases that cite this headnote

[12] Labor and Employment

Reporting or Opposing Wrongdoing; Criticism and "Whistleblowing"

With regard to the "public policy exception" to the doctrine that an at-will employee may be discharged at any time without cause, whistleblowing activity of employer which serves a public purpose should be protected.

49 Cases that cite this headnote

[13] Judgment

Public officers and employees, cases involving

In action brought by discharged public employee, genuine issues of material fact existed as to whether employee was wrongfully discharged in breach of public policy for his whistleblowing activities, precluding summary judgment.

14 Cases that cite this headnote

Attorneys and Law Firms

****251 *83** Mesch, Clark & Rothschild, P.C. by Tom R. Clark, Tucson, for appellants.

William L. Tifft, Globe, for appellee.

Opinion

GORDON, Vice Chief Justice.

We granted this Petition for Review to determine whether summary judgment was properly entered against the petitioner in light of allegations that his at-will employment was terminated in breach of implied contract and in violation of public policy.

The court of appeals affirmed the entry of summary judgment by memorandum decision. *Wagner et ux v. City of Globe,*

2 CA–CIV 5361 (filed Oct. 11, 1985). We have jurisdiction pursuant to Ariz. Const. art. 6 § 5(3) and Rule 23, Ariz.R.Civ.App.P., 17A A.R.S.

As a preliminary matter, we note that summary judgment is improper if, upon examination of the entire record, it may be determined that there is a disputed fact which, if true, could affect the final judgment. *Livingston v. Citizens Utility, Inc.,* 107 Ariz. 62, 481 P.2d 855 (1971). Summary judgment is not proper where there is the slightest doubt as to the facts, *Peterson v. Valley Nat'l Bank of Phoenix,* 90 Ariz. 361, 368 P.2d 317 (1962), and even where the facts are undisputed, summary judgment is not proper if the evidence is of such a character that reasonable minds could draw different conclusions or inferences therefrom. *Livingston v. Citizens Utility, Inc., supra; Creamer v. Raffety,* 145 Ariz. 34, 699 P.2d 908 (App.1984). Moreover, when reviewing on appeal the propriety of summary judgment we will consider the record in the light most favorable to the losing party. *Livingston v. Citizens Utility, Inc., supra;* ****252 *84** *Creamer v. Raffety, supra.* With these precepts in mind, we turn to the facts.

Edward Wagner was hired as a police officer for the City of Globe on May 20, 1974. The minutes of the Globe City Council indicate that he was hired by the city council after recommendation from the police department. It is undisputed that Wagner was placed on a six-month probationary status.

Approximately two months after Wagner was hired his attention was drawn to the strange case of Mr. Hicks. Hicks had been sitting on a bus stop bench, and when approached by two police officers refused to produce any identification. He was then arrested for vagrancy pursuant to a city code section which had been amended or abolished over a year earlier. Eventually Hicks was given a ten-day jail term. Several days later Hicks approached Wagner and asked him when he would be arraigned. Wagner then determined that Hicks had been in jail for 21 days, despite his original sentence of ten days, and had not yet been arraigned. Wagner further determined that Hicks was being held under a statute amended more than a year earlier. Wagner arranged to take Hicks before the local magistrate, where he was sentenced to ninety days. Wagner then pointed out to the judge that the arrest was illegal and that Hicks had been detained eleven days beyond his original sentence. Although the judge then suspended the sentence, he became upset and indicated that he was going to talk to Wagner's chief. Later that day, the Chief of Police, Dale Van Buskirk, told Wagner he did not appreciate "big city cops" coming to Globe to tell him how to run his department. Fearing that he might be terminated, Wagner photocopied police documents which he believed would show he had done nothing wrong. In his affidavit Van Buskirk stated that Wagner was fired because "it became apparent to me that the continued employment of Patrolman Wagner ... was not in the best interest of the City...."

On August 2, 1974, Wagner received a written notice of termination from Van Buskirk effective immediately. On August 5, 1974, Wagner addressed a meeting of the city council to protest his termination. No official action was taken by the council at that time. On May 15, 1975, Wagner filed suit against the City of Globe, the city council members, and Van Buskirk, alleging wrongful discharge, slander, and racial discrimination. [1] On July 7, 1975, the city council met and approved the firing of Wagner. The trial court granted the defendant's summary judgment on all three counts on December 12, 1980. Wagner has appealed only on Count I, his allegation of wrongful discharge.

[1] Every employment contract for an indefinite term is presumed to be terminable at will. *See* Note, *Protecting At-Will Employees Against Wrongful Discharge: The Duty to Terminate Only In Good Faith,* 93 Harv.L.Rev. 1816 (1980). All parties have agreed that Wagner was an "at-will" employee; that is, his employment was for an indefinite term, at sufferance, and the employment could be terminated by either party, at will, for no cause or any cause. *See* Mauk, *Wrongful Discharge: The Erosion of 100 Years of Employer Privilege,* 21 Idaho L.Rev. 201 (1985). This principle, generally referred to as the employment-at-will doctrine, is uniquely a product of the American common law. The at-will rule has been traced to an 1877 treatise by Horace G. Wood entitled *Law of Master and Servant.* H.G. Wood, *Master and Servant* (1877). No doubt the title of the treatise says all that need be said regarding Woods' view of employment relations. [2] The doctrine of employment-at-will ****253 *85** found fertile ground in the laissez-faire climate of nineteenth century America and thrived until very recently. Increasingly, however, the doctrine is under attack. *See, e.g.,* Mauk, 21 Idaho L.Rev. 201, *supra;* Mallor, *Punitive Damages for Wrongful Discharge of At Will Employees,* 26 Wm. and Mary L.Rev. 449 (1985); Note, 93 Harv.L.Rev. 1816, *supra.* Today three-fifths of the states have recognized some form of a cause of action for "wrongful discharge". 26 Wm. and Mary L.Rev. at 452. The trend has been to modify the at-will doctrine by creating exceptions to its operation. [3] Three major exceptions have been developed: the "implied contract" exception, which relies upon proof of an implied promise

of continued employment absent just cause for termination to protect the legitimate expectations of workers, and which may be established by oral representations, a course of dealing, personnel manuals or memoranda; the "public policy" exception, which permits recovery upon a finding that the employer's conduct undermined some important public policy; and the implied covenant of "good faith and fair dealing", which protects employees from termination for bad cause. *See Wagenseller v. Scottsdale Memorial Hospital,* 147 Ariz. 370, 376, 710 P.2d 1025, 1031 (1985); *Leikvold v. Valley View Community Hospital,* 141 Ariz. 544, 545–546 n. 1, 688 P.2d 170, 171–172 n. 1 (1984).[4] Arizona recognizes all three exceptions. *Wagenseller v. Scottsdale Memorial Hospital, supra.* Petitioner Wagner raises two theories of wrongful discharge: breach of contract and violation of public policy.

BREACH OF CONTRACT

[2] **[3]** **[4]** The at-will employment relationship, despite its limitations, is nonetheless contractual. Employment contracts, particularly those which would be considered at-will, are the best and most typical examples of unilateral contracts. *See* Mauk, 21 Idaho L.Rev. at 212–213; Note, *Employee Handbooks and Employment-At-Will Contracts,* 1985 Duke L.J. 196, 212–219. Unlike a bilateral contract, a unilateral contract does not require mutuality of obligation; but there is sufficient consideration in the form of services rendered. This is true despite the fact that the employee may quit at any time. *See* 1A A. Corbin, *Corbin on Contracts* § 152, at pp. 13–14 (1963). Because the at-will employment relationship is contractual, it can be modified by the parties at any time just as other ****254** ***86** contracts can be modified. Accordingly, the presumption that employment contracts of indefinite duration are terminable at will can be modified by the parties. *Wagenseller v. Scottsdale Memorial Hospital, supra; Leikvold v. Valley View Community Hospital, supra.* The parties may create a different relationship, and define the parameters of that relationship, based upon the totality of their statements and actions regarding the employment relationship. *Wagenseller v. Scottsdale Community Hospital,* 147 Ariz. at 383, 710 P.2d at 1038.

[5] One widely accepted means of modifying the at-will contract is use or publication of personnel manuals, guides, or rules by employers. An employer's representations contained in a personnel manual "can become terms of the employment contract and limit an employer's ability to discharge his or her employees....", *Leikvold v. Valley View Community Hospital,* 141 Ariz. at 546, 688 P.2d at 172, even though the personnel policies were not bargained for at the time of hiring.

[6] Wagner claims that his discharge was accomplished in violation of the City of Globe's own personnel rules, and therefore in breach of contract. In order to establish a breach of contract claim based upon a violation of personnel rules a plaintiff must prove two things: the personnel manual actually became part of the employment contract and the terms of the manual were breached.

[7] **[8]** **[9]** Whether the parties intended to modify their at-will contract, by use of a personnel manual or otherwise, is a question of fact. *Leikvold v. Valley View Community Hospital,* 141 Ariz. at 548, 688 P.2d at 174. Evidence relevant to this decision includes the language of the personnel manual, any representations made by the employer, and the course of dealing between the employer and employee. *Id.*[5] Reliance is not an essential predicate to the action, but is only one of the several relevant factors. *Wagenseller v. Scottsdale Memorial Hospital,* 147 Ariz. at 381, 710 P.2d at 1036. Summary judgment is inappropriate where a genuine dispute exists as to material facts, *Leikvold v. Valley View Community Hospital,* 141 Ariz. at 548, 688 P.2d at 174, or where reasonable minds could draw different conclusions or inferences from undisputed facts. *Wagenseller v. Scottsdale Memorial Hospital,* 147 Ariz. at 383, 710 P.2d at 1038. Whether the personnel rules promulgated by the City of Globe for the benefit of its employees became part of Wagner's at-will contract is a factual question inappropriate for summary judgment.

Wagner also contends that the city failed to follow its own rules when he was discharged. Rule XIII of the personnel rules reads in part:

"Rule XIII. PROBATIONARY PERIOD

SECTION 3. *Rejection of Probationer:* During the probationary period, an employee may be rejected at any time *by the appointing power,* without cause and without the right of appeal. Notification of rejection in writing shall be forwarded to the probationer and a copy ****255** ***87** filed with the probationer's file." (emphasis added)[6]

[10] The gravamen of Wagner's complaint is that he was not fired by the "appointing power", as required by the personnel rule. The notification of termination came from Chief of Police Van Buskirk, even though Wagner was hired by the city council. Wagner contends that only the city council had the power to fire him; the city contends that Van Buskirk, as chief of police, had the power to fire him. The city also contends that even if Van Buskirk was not the "appointing power", the city affirmed the discharge and thereby ratified the actions of its agent. The city argues first that its inaction at the August 5, 1974, council meeting in the face of Wagner's vehement protests constitutes an implied affirmance of the discharge. An affirmance of an unauthorized transaction can be inferred from a failure to repudiate it, especially where one would naturally be expected to speak if he did not consent. Restatement (Second) of Agency § 94. While it can be plausibly argued that the failure of the city council to repudiate Van Buskirk's actions justifies an inference of assent, other interpretations are equally reasonable. The Restatement cautions that "[w]hether or not such an inference [of assent] is to be drawn is a question for the jury, unless the case is so clear that reasonable men could come to but one conclusion." *Id.*, comment a.

The city also argues that a principal can retroactively ratify the actions of its agent, and that it did so by voting on July 7, 1975, to affirm Van Buskirk's actions. Whatever the merits of respondents' argument in the ordinary case of *post hoc* ratification, they fail to persuade us here. The city council's belated attempt to affirm the dismissal came nearly two months *after* the petitioner filed suit against the city. Allowing the city to retroactively affirm Van Buskirk's actions after the commencement of the lawsuit would divest the petitioner of a "right or defense" in derogation of his right to bring the cause of action. Restatement (Second) of Agency § 90 comment a; *cf. Hall v. A.N.R. Freight System, Inc.,* 149 Ariz. 130, 717 P.2d 434 (1986) (substantive rights vest upon the filing of a lawsuit and cannot be retroactively impaired).

[11] Thus the question of whether the city's inaction on August 5, 1974, constituted an affirmance of the dismissal is properly a jury question; but as a matter of law the city's July 7, 1975, vote may not operate as a retroactive affirmance. If the jury should decide that the personnel rules did constitute a contract, they must next interpret the rules. If the terms of an agreement are clear and unambiguous, the construction of the contract is a question of law for the court. *Leikvold v. Valley View Community Hospital,* 141 Ariz. at 548, 688 P.2d at 174. However, if the terms of an agreement can reasonably be construed in more than one manner, the language is ambiguous and its construction is a question for the jury. *Id.* Our review of the personnel rules and related extrinsic evidence leaves little doubt that reasonable minds could differ over the proper construction of the rules. Consequently, summary judgment on this issue was also improper. The petitioner's claim for breach of contract is properly a question for the jury.

PUBLIC POLICY

Employees should not have to choose between their jobs and the demands of important public policy interests; thus ****256 *88** courts have developed the public policy exception to the at-will doctrine. Actions for wrongful discharge in breach of public policy are essentially breaches of duties imposed by law, and are best characterized as actions in tort rather than contract. In *Wagenseller v. Scottsdale Memorial Hospital, supra,* this Court adopted the public policy exception, noting that "[f]iring for bad cause ... violates rights guaranteed to the employee by law and is tortious." 147 Ariz. at 381, 710 P.2d at 1036. The tort of wrongful discharge in violation of public policy has been variously labeled: discharge for bad cause, retaliatory discharge, improper discharge, etc. Whatever the nomenclature, our concern remains the same: employees should not be discharged because they performed an act that public policy would encourage, or refused to do that which public policy condemns.

In its initial stage the public policy exception was designed to discourage discharges in violation of a statutory expression of public policy. *See Petermann v. Teamsters Local 396,* 174 Cal.App.2d 184, 344 P.2d 25 (1959) (seminal declaration of the public policy exception; employee discharged for refusal to commit perjury). However, an explicit statutory expression of public policy is no longer required. In *Wagenseller v. Scottsdale Memorial Hospital, supra,* we stated that "reliance on prior judicial decisions, as part of the body of applicable common law, is appropriate ... [and] we will look to the pronouncements of our founders, our legislature, and our courts to discern the public policy of this state." 147 Ariz. at 379, 710 P.2d at 1034. Public policy must truly be public, however, rather than merely private or proprietary. *Id.*

The public policy exception defies easy application because different factual patterns have been collected under the same general rubric of "public policy". Perhaps the easiest and least controversial pattern involves an employee's refusal to

participate in illegal behavior. *See Petermann v. Teamsters Local 369, supra; Vermillion v. AAA Pro Moving & Storage,* 146 Ariz. 215, 704 P.2d 1360 (App.1985). Most courts agree with the *Petermann* principle that an employee should not be faced with the dilemma of violating the law or losing his job. Another category encompasses those cases where an employee is discharged for performing an important public obligation. *See, e.g., Nees v. Hocks,* 272 Or. 210, 536 P.2d 512 (1975) (employee discharged for accepting jury duty). If the employer were permitted to discharge employees for fulfilling public obligations the will of the community would be thwarted. A third type of case involves the discharge of employees who exercise a legal right or privilege. For example, numerous states have held that the termination of an employee because he had filed a workers compensation claim violates public policy. *See, e.g., Lally v. Copygraphics,* 85 N.J. 668, 428 A.2d 1317 (1981); *Kelsay v. Motorola, Inc.,* 74 Ill.2d 172, 23 Ill.Dec. 559, 384 N.E.2d 353 (1978); *Frampton v. Central Indiana Gas Co.,* 260 Ind. 249, 297 N.E.2d 425 (1973). In California the termination of an employee for signing a union membership application violates public policy since the employee has a statutory right to join a labor organization. *Glenn v. Clearman's Golden Cock Inn, Inc.,* 192 Cal.App.2d 793, 13 Cal.Rptr. 769 (1961). The fourth type of public policy exception presents the most difficult analytic problem for courts. These cases involve the employee "whistleblower" who exposes wrongdoing on the part of his employer and is then discharged. *See* Mauk, 21 Idaho L.Rev. at 239–245.

The employee who chooses to report illegal or unsafe conduct by his employer differs significantly from the employee forced to choose between his job and actual participation in illegal behavior. The latter is the paradigmatic case of a public policy violation; in contrast the whistleblower faces the arguably less onerous choice of either ignoring the known or suspected illegality or becoming an instrument of law enforcement. Nonetheless, whistleblowing employees have gained a measure of judicial protection. *See, e.g.,* ****257 *89** *Palmateer v. International Harvester Co.,* 85 Ill.2d 124, 52 Ill.Dec. 13, 421 N.E.2d 876 (1981); *Sheets v. Teddy's Frosted Foods, Inc.,* 179 Conn. 471, 427 A.2d 385 (1980); *Harless v. First National Bank of Fairmont,* 246 S.E.2d 270 (W.Va.1978).

The petitioner asserts that he was terminated from the police force because he refused to conceal the illegal arrest and detention of Mr. Hicks and was instrumental in having Hicks brought before a magistrate. The petitioner suggests that had he acquiesced in the illegal detention he could have been personally liable to Hicks under the holding of *Creamer v. Raffety, supra* (plaintiff brought suit against law enforcement officials based on 42 U.S.C. § 1983 and claims of false arrest, false imprisonment, and malicious prosecution). If true, then Wagner's behavior would be protected as a refusal to participate in proscribed activity. *See Petermann v. Teamsters Local 369, supra; Wagenseller v. Scottsdale Memorial Hospital, supra* (nurse discharged allegedly for refusing to "moon" the audience during a skit, an act which might violate A.R.S. § 13–1402).

However, we believe that the petitioner's behavior is best characterized as whistleblowing behavior. Wagner took affirmative steps to investigate and rectify the illegal detention and called it to the attention of the police chief and city magistrate. Wagner was not forced to a Hobson's choice between his job and illegal activity; he chose to take affirmative remedial action. This Court has not previously addressed the liability of employers who terminate employees for whistleblowing activity. Our prior cases—*Leikvold v. Valley View Community Hospital* and *Wagenseller v. Scottsdale Memorial Hospital* —dealt tangentially with this issue but did not answer it.

[12] We believe that whistleblowing activity which serves a public purpose should be protected. So long as employees' actions are not merely private or proprietary, but instead seek to further the public good, the decision to expose illegal or unsafe practices should be encouraged. We recognize that there is a tension between the obvious societal benefits in having employees with access to information expose activities which may be illegal or which may jeopardize health and safety, and accepted concepts of employee loyalty, *see* Mauk, 21 Idaho L.Rev. at 239–245; nevertheless we conclude that on balance actions which enhance the enforcement of our laws or expose unsafe conditions, or otherwise serve some singularly public purpose, will inure to the benefit of the public. Indeed, our legislature has recognized that whistleblowing activity is worthy of protection. In 1985 the legislature enacted A.R.S. § 38–532, which protects state and county employees from retaliation for their whistleblowing activity. While A.R.S. § 38–532 is not applicable to this case, it evinces a legislative expression of public policy fully consonant with our decision.

The relevant inquiry is not limited to whether any particular law or regulation has been violated, although that may be important, but instead emphasizes whether some "important

public policy interest embodied in the law" has been furthered by the whistleblowing activity. *Cf. Wagenseller v. Scottsdale Memorial Hospital,* 147 Ariz. at 380, 710 P.2d at 1035 (employee may refuse to participate in behavior which violates policy of the law, even though no technical violation of the law might result); A.R.S. § 38–532(A)(2) (prohibiting retaliation against employee who exposes "mismanagement, a gross waste of monies or an abuse of authority", in contrast to "a violation of any law" (A.R.S. § 38–532(A)(1)).

Other states have already extended a measure of judicial protection to whistleblowing employees. In *Palmeteer v. International Harvester Co., supra,* the Illinois Supreme Court held that an employee who was fired for supplying information to local law enforcement authorities regarding another employee and agreeing to assist in the investigation and trial stated a cause of action for retaliatory discharge. In *Sheets v. Teddy's Frozen Foods, Inc., supra,* an employee was fired for his efforts to ensure that his employer's products complied ****258 *90** with the applicable state law relating to labeling and licensing. The Connecticut Supreme Court concluded that Sheets had a valid cause of action since "employees ... are entitled to a modicum of judicial protection when their conduct as good citizens is punished by their employers." 179 Conn. at 474, 427 A.2d at 388. Finally, in *Harless v. First Nat'l Bank of Fairmont, supra,* the West Virginia Supreme Court recognized a cause of action for an employee who alleged that his discharge was in retaliation for his attempts to require the bank to comply with the laws of the United States and West Virginia. In all of those cases the employees' actions were in furtherance of some public policy "embodied in the law" and were therefore protected.

If the petitioner's allegations are true, as we must assume they are for purposes of this appeal, then he has stated a valid cause of action for wrongful discharge in violation of public policy. No exhaustive canvass of constitutional or statutory authority is necessary to support the proposition that there is no public policy more important or fundamental than the one favoring the effective protection of the lives, liberty, and property of our people. No one will disagree with the proposition that public policy is furthered when the civil rights of our citizens are protected from abuse; for when the rights of even one citizen may be so cavalierly dispatched none may rest easy. The petitioner's successful attempt to free Hicks from illegal confinement was a refreshing and laudable exercise which should be protected, not punished. The police, who are charged with the responsibility of enforcing our laws, should be encouraged to zealously guard the civil rights of our people and not be deterred from rectifying or reporting the abuse of those rights for fear of discharge.

[13] Consequently, the trial court should not have granted summary judgment against the petitioner on his public policy claim. The petitioner has pled facts which, if proven, establish a claim for damages for wrongful termination in violation of public policy. The court of appeals should not have upheld the summary judgment. The appeals court opined that an employee must be compelled to perform an illegal act before he may claim the protection of public policy, but as this decision makes clear this position misreads prior case law and ignores the legitimate demands of public policy. As we have endeavored to show, all employees who attempt to correct problems of public interest fall within the ambit of the public policy exception to the at-will doctrine. Accordingly, the trial court is reversed and the court of appeals' opinion vacated. We remand to the trial court for further proceedings not inconsistent with this opinion.

HOLOHAN, C.J., and HAYS, CAMERON and FELDMAN, JJ., concur.

All Citations

150 Ariz. 82, 722 P.2d 250, 55 USLW 2032, 104 Lab.Cas. P 55,601, 1 IER Cases 501

Footnotes

1 Wagner is Mexican-American.

2 Ironically, workers were afforded greater protection by the reciprocal master-servant relationship than by the evolving "contractarian" philosophy of employer-employee relationships. "The principal consequence of this conceptual change was a drastic limitation in the employer's duties to her employee. While previously the master bore a customary responsibility for the servant's health and well-being, the new theory supposed that by entering into the wage bargain workers assumed the risk of on-the-job injuries." Note, *Protecting At-Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith,* 93 Harv.L.Rev. 1816, 1824–25 (1980) (citations omitted). "Under the new laissez-

faire conceptions, the commitments between employer and employee were limited; the traditional notions of mutual responsibility, and the security for the employee they entailed, were abandoned." *Id.* at 1825.

3 Despite the growing trend to create exceptions to the at-will doctrine, which may eventually swallow the rule, employers continue to cling to the doctrine. Exactly why is uncertain since it has been noted that:

> "The continuity and expertise supplied by a stable work force, the benefits from loyalty, and the savings from reduced training costs and lower turnover all contribute to the long-run success of an enterprise. Employees' fears of being replaced and the threat of unfair treatment both have a significant negative economic impact because they foster dissatisfaction and disloyalty. Recent studies of worker participation projects reveal that productivity often improves significantly with increased job security and employee participation; a cooperative employer-employee atmosphere, moreover, tends to reduce absenteeism, the turnover rate, and sabotage. Thus, the abandonment of the at-will rule may improve business productivity in the long run even though it may somewhat curtail the employer's traditional control of the work place". Note, 93 Harv.L.Rev. at 1835 (citations omitted).

4 Modification of the at-will doctrine has not been the exclusive province of the judiciary. Congressional and legislative enactments have significantly limited the application of the doctrine in some areas of labor law. There are at least fifteen federal statutes, plus their promulgated rules, which limit the at-will doctrine. 21 Idaho L.Rev. at 226 n. 109. For example, statutes protect concerted union activity, preserve minimum wage and overtime pay requirements, prohibit discrimination based on age, handicaps, race, sex, or religion, prohibit discharge because of wage garnishment or federal jury service, and protect employees who report health and safety violations. *Id.* at 227. Comparable state statutes have been enacted by many state legislatures. *Id.*

5 In *Leikvold* we also indicated that employers were free to "issue no personnel manual at all or to issue a personnel manual that clearly and conspicuously tells their employees that the manual is not part of the employment contract and that their jobs are terminable at the will of the employer with or without reason." 141 Ariz. at 548, 688 P.2d at 174. However, the absence of a personnel manual or the presence of disclaiming language in its policies may not absolutely insulate an employer from liability. If contrary written or oral assurances are given to the employee at the hiring interview or during employment, such promises may constitute implied contracts. *See Schipani v. Ford Motor Co.,* 102 Mich.App. 606, 302 N.W.2d 307 (1981); *see generally* Comment, *Limiting Employment-At-Will in Arizona: Leikvold v. Valley View Community Hospital,* 27 Ariz.L.Rev. 235 (1985) (discussing possible effect of the *Leikvold* decision on employer personnel manuals and representations).

6 This contrasts with the provisions for non-probationary employees. Rule XVII provides in part:

> "Rule XVII. SEPARATION FROM THE SERVICE
>
> Section 1. *Discharge:* An employee in the classified service may be discharged *for cause* at any time by the City Manager. Any employee who has been discharged shall be furnished with a written statement of the reasons for such actions and shall be entitled to a hearing if he so requests as provided in these rules." (emphasis added) This provision, as well as the detailed appeal provisions which follow it, implicates a limited property interest in continued employment wholly absent for probationary employees sufficient to require due process of law in connection with termination. *See Board of Regents of State Colleges v. Roth,* 408 U.S. 564, 578, 92 S.Ct. 2701, 2709–2710, 33 L.Ed.2d 548 (1972).

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KeyCite Red Flag - Severe Negative Treatment
Opinion Vacated by Gemstar Ltd. v. Ernst & Young, Ariz., May 7, 1996

183 Ariz. 148
Court of Appeals of Arizona,
Division 1, Department A.

GEMSTAR LIMITED, a former British Virgin Islands corporation; Canstar Limited, a former British Virgin Islands corporation; Kunst Corporation, Inc., a corporation; R. Pape Corporation, Inc., a corporation; Richard Holding, a corporation; H.K. Bergmann, Inc., a corporation; Kittan, Inc., a corporation; and James R. Tomasini, Plaintiffs-Appellees,
v.
ERNST & YOUNG fka Ernst & Whinney, a partnership; Edward A. Villanueva and Lynn Villanueva, husband and wife, Defendants-Appellants.

No. 1 CA-CV 92-0313. | Feb. 14, 1995. | Review Granted on issues 1, 2 and 3 and Denied on other issues Sept. 12, 1995. *

British Virgin Island corporation and its shareholders brought suit against accounting firm as result of accounting activities regarding two real estate transactions. The Superior Court of Maricopa County, Cause No. CV 89-26894, Robert D. Myers, J., awarded plaintiffs damages, and accounting firm appealed. The Court of Appeals, Jacobson, P.J., held that: (1) shareholders lacked capacity to sue, and (2) corporation did not retroactively authorize suit.

Reversed and remanded.

West Headnotes (6)

[1] Corporations and Business Organizations
Derivative or direct action

Under law of the British Virgin Islands, shareholders lacked capacity to sue corporation's accounting firm for professional negligence, breach of contract or breach of fiduciary duty in assisting in transaction by which one shareholder diverted profits which belonged to plaintiff shareholders; corporation and plaintiff shareholders suffered identical wrong, and plaintiffs had no cognizable, individual injury from firm's alleged wrongdoing, apart from injuries they suffered as shareholders.

3 Cases that cite this headnote

[2] Corporations and Business Organizations
Derivative or direct action

Under law of British Virgin Islands or Arizona, individual shareholder lacks standing to sue for recovery of individual damages for which shareholder would otherwise have cause of action when those damages arose solely from acts that caused identical injuries to the corporation, and thus proportionately reduced value of the individual's shares.

4 Cases that cite this headnote

[3] Corporations and Business Organizations
Derivative or direct action

If relationship between shareholder and tort-feasor is independent and separate from interest shareholder derives from ownership in corporation, shareholder may have personal right of action.

1 Cases that cite this headnote

[4] Corporations and Business Organizations
Derivative or direct action

Shareholders could pursue, individually, claim against corporation's accounting firm for attorney fees and costs incurred in pursuing litigation against another shareholder and his company, on theory that firm rendered substantial assistance in other shareholder's breach of fiduciary duty. Restatement (Second) of Torts § 876(b).

1 Cases that cite this headnote

[5] Limitation of Actions
Amendment of defects

Corporate ratification of shareholders' suit could not relate back to filing of suit, where ratification occurred after statutes of limitations had run. Restatement (Second) of Agency § 90.

Cases that cite this headnote

[6] Corporations and Business Organizations
Conditions precedent in general

There was no evidence that shareholders of British Virgin Islands corporation met procedural notice requirements to bring derivative suit on behalf of corporation, nor did they base their suit on any exception allowing derivative suit under law of British Virgin Islands. 16 A.R.S. Rules Civ.Proc., Rule 23.1.

Cases that cite this headnote

Attorneys and Law Firms

****1179 *149** Streich Lang by William S. Hawgood, II, Francis J. Burke, Jr., Jill B. Langley and Karen Potts, Phoenix, and Ernst & Young by Stephen N. Young, Kathryn A. Oberly and Emmett E. Eagan, Jr., Washington, DC, for appellants.

Copple, Chamberlin & Boehm, P.C. by Scott E. Boehm, and Newman, Ahern, Chambliss & Banen by Kevin T. Ahern, Phoenix, for appellees.

OPINION

JACOBSON, Presiding Judge.

This lawsuit was brought by two British Virgin Island corporations, Gemstar, Ltd., and Canstar, Ltd. ("the corporations") and five shareholders of these corporations (collectively, "plaintiffs") as a result of defendants' accounting activities regarding two Arizona real estate transactions. Plaintiffs' essential theory of recovery is that, although they authorized and executed documents prepared by defendants in 1980 by which they sold two parcels of raw land for $10 million to a nonparty, Ziggy's Opportunities, Inc. ("Opportunities"), they had an oral "share and share alike" agreement with its owner and co-shareholder of the corporations, Seigfried ("Ziggy") Wauro, that entitled them to a proportionate share of the additional profits from Ziggy's subsequent sale of the properties in 1983-84. Plaintiffs alleged that defendants' accounting conduct caused them to lose more than $4 million in additional profits that Ziggy, through Opportunities, pocketed.

In a related lawsuit against Ziggy and Opportunities arising out of these same transactions, plaintiffs successfully pursued claims of breach of contract and breach of fiduciary duty, and were awarded damages of $2,527,181.00, with a judgment totalling $4,337,994.05.[1] In a second related action, plaintiffs pursued similar claims against the attorneys involved in these transactions, but settled those claims before trial. *See Gemstar v. Goodson*, CV-89-40772, Maricopa County Superior Court ("the *Goodson* case").

In this, the third lawsuit, plaintiffs sued the accountants involved in the transactions for accounting negligence, breach of fiduciary duty, constructive fraud, breach of contract, scheme and artifice to defraud, and racketeering. After a lengthy jury trial, plaintiffs were awarded $1,500,000.00 on each of the claims of breach of fiduciary duty, providing substantial assistance to Ziggy's breach of fiduciary duty, and breach of contract, and were awarded $2,400,000.00 on the accounting negligence claim. The trial court entered judgment for damages of $2,400,000.00, prejudgment interest of $1,554,365.40, attorneys' fees of $300,000.00, and costs of $4,403.07, for a total of $4,258,768.47. After denial of their post-trial motions, defendants timely appealed.

Although defendants have presented numerous issues on appeal, we find one issue dispositive. Because we find that plaintiffs did not have capacity to sue under the circumstances and theories of this case, we need not address the remaining issues.

FACTUAL BACKGROUND

On appeal after a jury verdict, we view the facts in the light most favorable to upholding the jury verdict and judgment. *Rhue v. Dawson*, 173 Ariz. 220, 223, 841 P.2d 215, 218 (App.1992). We also view the evidence and all reasonable inferences therefrom in favor of the prevailing party. *Schnyder v. Empire Metals, Inc.*, 136 Ariz. 428, 429, 666 P.2d 528, 529 (App.1983).

The plaintiff corporations, Gemstar, Ltd., and Canstar, Ltd., were formed in 1979 as British Virgin Island corporations to take advantage of the federal capital gains tax exemption

available at that time to foreign corporations that purchased and sold United States real estate. The individual shareholder plaintiffs[2] and Ziggy agreed to incorporate Gemstar and Canstar to purchase for ****1180 *150** investment two 40-acre parcels of land that Ziggy had located in Arizona. The shareholders also agreed to share in any profit or loss on the properties in relation to their initial investment, an agreement they refer to as "share and share alike." Ziggy was named president, treasurer, and American representative director of both corporations. The corporations hired the accounting firm of Ernst & Young (formerly Ernst & Whinney) and, specifically, its partner, Edward A. Villanueva, to prepare their tax returns and unaudited financial statements. Villanueva had been Ziggy's personal accountant since 1978.

In 1979, the first parcel, at 51st Avenue and McDowell Road in Phoenix, was purchased by Canstar for $900,000; the second parcel, at 56th Street and Warner Road in Tempe, was purchased by Gemstar for $500,000.

In early 1980, Villanueva informed Ziggy that proposed federal legislation involving the Foreign Investment in Real Property Tax Act ("FIRPTA") could eliminate the federal tax savings to foreign investors by imposing capital gains tax on any resale profits of raw land. Villanueva suggested that the corporations sell the parcels prior to the passage of the pending FIRPTA provisions to take advantage of the existing capital gains exemption before the new law became effective. The shareholders contend that Ziggy told them that, because the Arizona real estate market was depressed at the time and they were unlikely to find a buyer, the corporations could sell the properties to Opportunities, Ziggy's "shell" corporation, thus preserving their tax benefits while at the same time keeping effective their original "share and share alike" agreement for when the land was sold to a third party in the future.

When Ziggy informed Villanueva of the decision to sell the land and described the details of that sale, Villanueva, for purposes of recording the parties' intent, drafted short-form "Agreements of Sale" by which, effective May 1, 1980 (prior to the effective date of FIRPTA), Canstar agreed to sell its parcel for $7 million to Opportunities and Gemstar agreed to sell its parcel for $3 million to Opportunities. The terms of the agreements were that Opportunities would pay $500 down on each parcel, with the balances and 10% interest due on October 1, 1981; the seller corporations remained responsible for mortgage payments and other expenses. Villanueva advised Ziggy to have the operative legal documents necessary to transfer and record title drawn up by a lawyer.

Ziggy presented the agreements of sale to the shareholders and told them they needed to sign them to retain their tax benefits; nevertheless, he assured them orally that their original arrangement to "share and share alike" was still in effect, although the documents of sale did not reflect that fact.

Villanueva subsequently drafted several modifications of the original agreements of sale, by which the shareholders effectively agreed to waive the corporations' right to interest already earned, and extended the due dates on the balances for another year with each modification.

In early 1983, the properties were transferred into Ziggy's subdivision trusts, for which Villanueva prepared the necessary calculations, with the corporations named as first beneficiaries to receive a minimum release price as the subdivided properties were sold by Opportunities. Unknown to the shareholders, Ziggy also utilized junior trusts to subsequently transfer the properties from Opportunities to third party buyers at a substantial profit. The corporations were ultimately paid the balance of the $10 million sales price and approximately $8 million in net profits were distributed to the shareholders. The shareholders later learned, apparently in February 1986, that Ziggy had made additional profit of approximately $4.3 million from the subsequent sales of the properties, and that profit was not proportionately shared with the other shareholders of Gemstar and Canstar. Plaintiffs sued Ziggy and Opportunities for breach of contract and breach of fiduciary duties, and were awarded a judgment, after jury trial, totalling $4.3 million.

The present suit was filed in September 1989, alleging that Villanueva failed to warn ****1181 *151** the plaintiffs of the true consequences of the 1980 agreements of sale, that he knew the true value of the parcels had appreciated significantly by the time they were transferred to the subdivision trusts, and that he knew of and assisted in Ziggy's "looting" from the corporations the excess profits from the subsequent sale of the properties in 1983 and 1984. Plaintiffs also alleged that Villanueva assisted Ziggy in orchestrating a shareholder meeting designed to cover-up Ziggy's activities and to obtain "an ill-informed and a belated ratification of Ziggy's activities."

Plaintiffs sought recovery against defendants under several theories, and ultimately prevailed at trial on their claims

of accounting negligence, breach of contract, breach of fiduciary duties, and substantial assistance in Ziggy's breach of fiduciary duties. Defendants appeal from the judgment in plaintiffs' favor totalling more than $4 million.

DISCUSSION

Plaintiffs' Capacity to Sue

Defendants contend that the trial court erred in failing to direct a verdict on all claims, based on the shareholders' incapacity to sue either individually or derivatively and the inability of the corporate plaintiffs to retroactively ratify the actions of the shareholders after the statutes of limitations had run on the corporate claims. Plaintiffs respond that the individual shareholders could sue in their individual capacities on the contract claim as beneficiaries of the corporate contracts with defendants and on the tort claims as foreseeable plaintiffs. They also argue that the corporations, retroactively restored to their legal status at the time the complaint was filed, did not need to formally ratify the shareholders' actions in order to maintain this suit.[3] This issue arose in several different contexts throughout the course of this litigation, which are described below.

a. *Procedural Background of Capacity Arguments*

In their complaint, the shareholders purported to bring the action "(i) individually, (ii) as surviving shareholders of and/or (iii) on behalf of Gemstar and Canstar." Additionally, the complaint named plaintiffs Gemstar and Canstar as "lapsed" British Virgin Island corporations (B.V.I.).

In a pretrial motion for partial summary judgment, defendants argued that "neither defunct corporations nor their former shareholders have the requisite legal capacity to bring an action for monetary injury suffered by the corporations," because (1) at the time the complaint was filed, the corporations did not exist as legal entities in the B.V.I., because their failure to pay license fees resulted in their names being stricken from the Register of Companies; and (2) under British law, which governs the capacity of a B.V.I. corporation to sue, the shareholders had no individual or derivative standing.

Plaintiffs responded that (1) the corporations had paid their fees, thus restoring their standing retroactively to the date their names had been stricken; and (2) even if restoration had not occurred, the shareholders had the right to sue both as surviving shareholders under A.R.S. § 10-105, and individually under Arizona tort law as foreseeable plaintiffs. Regarding the issue of the capacity of the corporations to sue, both parties submitted sources of British Virgin Island law in the forms of expert affidavits.[4]

****1182 *152** After a hearing on the motion,[5] the trial court ruled as follows:

> The issue before this Court is a relatively narrow one: May the shareholders of a corporation sue the corporation's CPA for the CPA's professional negligence and the CPA's breach of fiduciary duty?
>
> > ... [I]t appears that the Defendant, Villanueva, communicated only directly with Mr. Wauro, the corporate officer responsible for such day to day business as dealing with the company's CPA, although Mr. Villanueva met at least two of the shareholders other than Mr. Wauro.
> >
> > There are some facts (although not many) which demonstrate that Mr. Villanueva gave "direct advice to shareholders." ... Even if that evidence was absent or even if it would not meet the *Orme School* ... test, there are substantial inferences which can be drawn without stretching one's imagination which indicate that Mr. Villanueva knew that Mr. Wauro was giving to the other shareholders the advice and information which he, Villanueva, was giving to Wauro....
> >
> > Although Defendants properly cite the general rule that a corporation, not its shareholders, must sue a tortfeasor for harm to a corporation, there are exceptions and distinctions. One distinction is expressed in § 552 of the Restatement (Second) of Torts, which is cited with approval by Chief Justice Gordon in *Donnelly Const. Co. v. Oberg/Hunt/Gilleland*, 139 Ariz. 184, 677 P.2d 1292 (1984).... [quote of Restatement section omitted].
> >
> > Clearly the facts here create a triable issue as to whether the individual Plaintiffs were "foreseeable" and whether Villanueva knew that Mr. Wauro intended to supply the information to the Plaintiffs.
> >
> > Furthermore, as with other professionals, there have recently been dramatic changes in the standards applicable to the duty of care owned by accountants.... [citations omitted]

> This is not to say that every time a CPA gives negligent advice to a corporation, every shareholder can maintain a tort action for the damages he might sustain because the value of his stock declines. Here, we have few shareholders. The information being supplied was allegedly given to prefer Wauro's interest over the other shareholders and would, again allegedly, cause them to act in such a way that Wauro would benefit financially.
>
> ... Without using the words, Defendants are claiming that "lack of privity" precludes these Plaintiffs as individual shareholders. Justice Gordon pronounced the death knell of that antiquated principal in *Donnelly,* supra. In Arizona, accountants are liable for foreseeable injuries to foreseeable victims which proximately result from their negligent performance of their professional services. As espoused in *Fickett v. Superior Court,* 27 Ariz.App. 793, 558 P.2d 988 (1976), where a lawyer's conduct was in issue, it is necessary to balance various factors such as the extent to which the transaction was intended to affect the Plaintiff, the foreseeability of harm to him, the degree of certainty that the Plaintiff suffered injury, the closeness of the connection between the Defendant's conduct and the injuries suffered, the moral blame attached to the Defendant's conduct, and the policy of preventing future harm. When these factors are balanced here, the duty is imposed.

In a supplemental reply, defendants advised the court that they had recently become aware that plaintiffs had held an "extraordinary meeting" on July 11, 1991, after the motion for partial summary judgment regarding lack of capacity to sue had been filed, at which the shareholders had attempted to have the corporations retroactively authorize the filing of the suit. Defendants ****1183 *153** also supplied the court with a copy of the applicable B.V.I. provision that provided for retroactive restoration of the corporations' status upon payment of the license fees. [6] Defendants requested that the court dismiss all claims by the corporations because they took no actions to authorize the lawsuit until after the statutes of limitations had run on the corporate claims.

At a hearing on the supplemental reply, defendants argued (1) that corporate ratification of the suit was ineffective because the statutes of limitations had run on plaintiffs' claims, (2) that, having revived the corporations' standing, plaintiffs had eliminated their right to sue as surviving shareholders, and (3) that the shareholders had no right to sue as individuals because they claimed no harm different from the alleged corporate harm.

In response, plaintiffs argued that the damages suffered by the shareholders were not only those suffered as beneficial owners of the corporations, but also included out-of-pocket expenses they incurred in the form of attorneys' fees and incidental and consequential damages expended in all the litigations which "were necessary and natural consequences of Mr. Villanueva's activities."

The court denied the lack of capacity motion "without prejudice to the defendants to raise this issue at the close of Plaintiffs' case at the time of trial."

The issue arose again when defendants moved for directed verdicts based on their statutes of limitations and capacity motions. On those defenses, the trial court ruled that the shareholder plaintiffs were the "beneficiaries of rights and duties, including contractual duties, which ran between the Defendants and the Plaintiffs," and that "under the authority of § 552 of the Restatement (Second) of Torts, there are jury issues as to whether the individual Plaintiffs were 'foreseeable' and whether the Defendants knew that Mr. Wauro intended to supply the information to the individual Plaintiffs." The trial court denied the motion for directed verdict, based on the statutes of limitations and capacity.

The trial court also denied defendants' renewed motion after plaintiffs' counsel argued that, although the shareholders did not ratify the lawsuit until 1991, the shareholders had capacity to bring the lawsuit derivatively at the time it was filed. The trial court again denied the motions.

To put this matter in proper prospective, we find the plaintiffs' closing arguments to the jury illuminating:

> This case arises because Ziggy put money in his pocket. *Obviously, if he put the money in the corporations and it was distributed, there would be no damage at all.*
>
> ... [T]here are separate verdict forms of the corporate plaintiffs and for the other plaintiffs.... [W]e're going to get to the magic 60 percent. There's been testimony *all they want is their 60 percent of what Ziggy pocketed, but the corporations are entitled to a judgment here. And you may decide that the corporations are entitled to the full hundred percent.*
>
> ....

First, the corporations-because you're going to be having to deal with the corporations first, the testimony was really not impeached that *there was pocketed by Ziggy $4,040,000 that should have gone into the corporations.*

And that's what the corporations are entitled to get back, because what should have gone into their pocket originally they were deprived of and they did not get because of what Ernst & Whinney and Ernst & Young and Villanueva did. And that's the damages that relates to the corporation[s].

....

****1184** ***154** Now, what about the individuals?

The individuals are in a different situation in two ways.

Number one, *any judgment in their favor directly should be only 60 percent of the $4 million because that's what individually that they're entitled to.* So the 60 percent of $4 million is $2,424,000.

Number two is they were required to expend 667,800 some odd dollars for attorney's fees in the Wauro case. And you will see in connection with all of the-each claim has the same element of damages.... One, monetary losses which are the amounts received by [Ziggy] and his companies from the sale of Gemstar and Canstar's real estate assets. That's the four million and 60 percent of it.

And reasonable sums for legal fees and costs incurred in plaintiff's lawsuit against [Ziggy] if you find that as a result of the defendant's conduct it was necessary for plaintiffs to file that lawsuit.

....

And so what we ask you-that if you do find in favor of the plaintiffs, if you fill in the amount for the corporation of $4 million, and *if you do find in favor of the plaintiff shareholders that you fill in the amount of $3 million, which, rounded, consists of the 2.4 which is the 60 percent of the 4 million, plus their $600,000 of legal fees in the Wauro lawsuit.*

(Emphasis added.)

After being instructed and beginning deliberations, the jury sent the following questions to the trial judge:

> Why are separate judgments required for the corporations and shareholders?
>
> Aren't they one [and] the same? Is this clarified in the instructions?

After discussing the matter with counsel, the trial judge responded:

> There are legal reasons for the separate judgments. You should reread all of the jury instructions.

After almost a full day of deliberations, the jury returned its verdicts, awarding the corporate plaintiffs and the shareholder plaintiffs equal amounts of damages on each claim.

The issue of the shareholders' standing was again raised in defendants' motion for judgment notwithstanding the verdict. They further argued that the corporate claims were barred because the corporations' ratification of the lawsuit on July 11, 1991, occurred after the statutes of limitations had run on all claims, even under plaintiffs' theory of when the claims accrued. The trial court again denied defendants' motion, relying on the reasons previously set forth in the record.

b. *Analysis: Shareholders' Capacity to Sue*

The parties agree that the issue of plaintiffs' capacity or standing to sue is a question of law, which this court determines *de novo. See generally City of Scottsdale v. Thomas,* 156 Ariz. 551, 552, 753 P.2d 1207, 1208 (App.1988) (appellate court is not bound by trial court's conclusions of law). Additionally, the parties appear to agree, although we are not bound to that agreement, that the substantive law of the British Virgin Islands, as the place of incorporation, governs issues regarding the corporations' legal existence and capacity to sue. *See generally Restatement (Second) of Conflict of Laws,* Ch. 13, especially §§ 296 and 299 (1971) (corporate existence and capacity to sue are determined by laws of its place of incorporation). This court "can arrive at a resolution of the foreign law question on the basis of its own independent research and analysis." *Kadota v. Hosogai,* 125 Ariz. 131, 136, 608 P.2d 68, 73 (App.1980). However, we are "not required to undertake the burden of researching and determining foreign law without any assistance from the attorneys." *Id.* In this case, to the extent our resolution rests on an understanding of B.V.I. law, we have examined the parties' expert affidavits submitted to the trial court under authority of Rule 44.1, Arizona Rules of Civil Procedure. *See* note 4, *supra.*

Plaintiffs submitted the affidavit of Jay I. Bartz, an international law expert, who testified, in relevant part:

> 1. ... [U]nder B.V.I. law a company whose name is struck off the Register of ****1185 *155** Companies is not thereby "dissolved"; rather, the company continues to exist and has the power to resume its business as a going B.V.I. concern as if it had never been struck off by having its name restored to the B.V.I. Register of Companies through the payment of annual license fees, annual return fees, penalties and reinstatement fees;
>
> ....
>
> 3. The members of a B.V.I. company formed under Section 243 of the Companies Act are possessed of and may bring whatever individual tort actions they may have against company officers and agents as are permitted by the jurisdiction in which suit is brought. There is nothing under B.V.I. law which restricts such actions.

Defendants submitted the affidavit of Sydney A. Bennett, Barrister and Solicitor of the Eastern Caribbean Supreme Court since 1980, currently practicing in the B.V.I., who testified in relevant part:

> (a) It is a fundamental principle of corporate law in force in the British Virgin Islands that a company is a legal person having a separate existence from that of its members.
>
> (b) It is a further fundamental principle of English law and indeed, of the law in force in the British Virgin Islands that a person cannot as a general rule bring an action on behalf of another person to seek redress for that person in respect of wrongs done to that person by a third person.
>
> (c) It therefore follows that in any action to redress a wrong done to a company or to recover money or damages alleged to be due to it, the company is the only proper plaintiff and any such action must be carried out in the name of that company.
>
> The forementioned principles when applied to corporations are collectively referred to as the rule in **Foss v. Harbottle,** and the circumstances in which that rule is applied by the Courts were described ... in the case of **Prudential Assurance Co. Ltd. v. Newman Industries Ltd. and others (No. 2) (1982) 1 All ER 354 CA....**
>
> (d) A further consequence of the fact that a company has a separate legal identity from its members is the principle that no shareholder has any right to seek any personal remedy in respect of any loss occasioned by or in consequence of any wrong done to a company. This principle was discussed and applied by the English Court of Appeal in the case of **Prudential Assurance Co. Ltd. v. Newman Industries Ltd. and Others (No. 2) (supra)**....
>
> ....
>
> 6. The name of the company may only be used as plaintiff by the direction of the company or its directors and company's name will be struck out as plaintiff in any action instituted in its name without such authorisation. This principle is illustrated by the case of **La Compagnie De Mayville v. Whitley (1896) 1 Ch 788....**
>
> 7. Further, in my opinion one of the effects of the registration of a company under the **Companies Act Cap. 243** is to grant to a company the power to sue and be sued in its own name and the entire point and purpose of the striking of a company from the register is to put an end to the exercise by that company and of the privileges and benefits of incorporation such as the right to so conduct litigation. A company the name of which has been struck from the register is not competent to carry on litigation. **Section 240(2)** of that act allows the company to apply to be restored to the register and upon such restoration the company is deemed never to have been struck off. The retroactive effect of such restoration is to validate whatever acts the company may have carried out in the period that it was struck off, so that litigation commenced in that period would be retroactively made valid....

Based on our understanding of B.V.I. law from these sources, we conclude that we are not required to find, as a preliminary matter, whether B.V.I. law or Arizona law applies to this capacity determination, because we find no significant difference between those laws in the context of this case. *See, e.g.,* ****1186 *156** *Baroldy v. Ortho Pharmaceutical Corp.,* 157 Ariz. 574, 578, 760 P.2d 574, 578 (App.1989) (choice of law analysis begins with a determination that laws of the two jurisdiction differ in relevant applications).

[1] Plaintiffs' theory of damages, articulated under the accounting negligence, breach of contract, and breach of fiduciary duty claims, was that defendants assisted in a business transaction by which Ziggy diverted approximately $4 million in profits which belonged to the corporate plaintiffs and which should have been distributed among the shareholder plaintiffs in proportion to their shares of

stock ownership. Under this damages theory, the corporations and their shareholders suffered an identical wrong: a loss of profits from defendants' participation in Ziggy's failure to abide by the "share and share alike" agreement. Indeed, even the jury could not perceive a difference between the corporate and shareholder plaintiffs' positions on damages.

[2] The virtually universal general rule is that an individual shareholder lacks standing to sue for recovery of individual damages for which the shareholder would otherwise have a cause of action when those damages arose solely from acts that caused identical injuries to the corporation, and thus proportionately reduced the value of the individual's shares. *See generally* 12B *Fletcher Cyclopedia of the Law of Private Corporations* § 5911 at 483-84 (1993 Rev.Vol.) ("If the wrong is primarily against the corporation, the redress for it must be sought by the corporation, except where a derivative action by a shareholder is allowable, and a shareholder cannot sue as an individual"). This is the rule in the British Virgin Islands, as set forth in *Prudential Assurance Co. Ltd.:*

> But what [a shareholder] cannot do is to recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, for such a "loss" is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only "loss" is through the company, in the diminution in the value of the net assets of the company, in which he has (say) a 3% shareholding. The plaintiffs' shares are merely a right of participation in the company on the terms of the articles of association. The shares themselves, his right of participation, are not directly affected by the wrong doing. The plaintiff still holds all the shares as his own absolutely unencumbered property. The deceit practiced on the plaintiff does not affect the shares; it merely enables the defendant to rob the company.... A personal action would subvert the rule in *Foss v. Harbottle* and that rule is not merely a tiresome procedural obstacle placed in the path of a shareholder by a legalistic judiciary. The rule is the consequence of the fact that a corporation is a separate legal entity.... When the shareholder acquires a share he accepts the fact that the value of his investment follows the fortunes of the company and that he can only exercise his influence over the fortunes of the company by the exercise of his voting rights in general meeting.

1 All E.R. at 366-67, as cited in Bennett's Affidavit. This is also the rule in Arizona:

> "When there are numerous shareholders, it is apparent that each suffers relatively, depending upon the number of shares he owns, the same damage as all the others, and that each will be made whole if the corporation obtains restitution or compensation from the wrongdoer. Obviously it is sound policy to require a single action to be brought by the corporation, rather than to permit separate suits by each shareholder. In logic the result is justified, because the only right of the shareholder which has been infringed is what may be called his derivative or corporate right. Having decided to conduct their business in a corporate form, the men behind the corporation have, in the phrase of Justice Holmes, 'interposed a nonconductor' between themselves and those who deal with them in their corporate enterprise.... Even when all the stock is owned by a sole shareholder, there seems no adequate reason to depart from the general rule that the corporation and its shareholders are to be treated as distinct legal persons. Therefore, even a sole ****1187 *157** shareholder has no independent right which is violated by trespass upon or conversion of the corporation's property. Only his 'corporate rights' have been invaded,

> and consequently he cannot sue the tortfeasor in an action at law."

Hidalgo v. McCauley, 50 Ariz. 178, 182-83, 70 P.2d 443, 445 (1937), *quoting Green v. Victor Talking Machine Co.,* 24 F.2d 378 (2d Cir.), *cert. denied,* 278 U.S. 602, 49 S.Ct. 9, 73 L.Ed. 530 (1928); *see also Johnson v. Gilbert,* 127 Ariz. 410, 412, 621 P.2d 916, 918 (App.1980) ("[g]enerally, a stockholder may not bring an action in his own right, for such an action would authorize multitudinous litigation and ignore the corporate entity"); *Schroeder v. Hudgins,* 142 Ariz. 395, 398, 690 P.2d 114, 117 (App.1984) ("even where all the stock in a corporation is owned by a sole shareholder, he may not maintain an action individually for wrongs against the corporation").

[3] We note that several exceptions to this general rule exist in Arizona and elsewhere. First, if the relationship between the shareholder and the tortfeasor is independent and separate from the interest the shareholder derives from ownership in the corporation, the shareholder may have a personal right of action. *Schroeder,* 142 Ariz. at 398, 690 P.2d at 117. Other exceptions have been recognized when (1) the wrongdoer owes a duty to the individuals other than as shareholders; or (2) the wrongs were sustained only by the individual shareholders rather than the corporate entities. *Williams v. Mordkofsky,* 901 F.2d 158, 164 (D.C.Cir.1990); *see also Fletcher Cyclopedia, supra,* § 5911 at 484. Additionally, some courts have applied a limited exception to the general rule when a close corporation shareholder sues directly rather than derivatively, or when shareholders who own all the stock of a close corporation proceed against each other. *See generally Fletcher Cyclopedia, supra,* § 5911.50 at 497; *see also Johnson v. Gilbert,* 127 Ariz. at 412, 621 P.2d at 918.

However, plaintiffs have not defended their position and the trial court's ruling on the basis of any of these exceptions on appeal. Plaintiffs' justification for the right of the individual shareholders to sue is the trial court's twofold conclusions that, in Arizona, (1) accountants are liable for foreseeable injuries to foreseeable victims that are proximately caused by their accounting malpractice, and (2) that the shareholders were third party beneficiaries of the contract between defendants and the corporate plaintiffs.

We agree with the trial court's conclusion that the scope of third party professional liability is expanding as courts recognize the duties owed to victims who are not in privity with the tortfeasor. *See Donnelly Const. Co. v. Oberg/Hunt/Gilleland,* 139 Ariz. 184, 677 P.2d 1292 (1984) (professional may be liable to foreseeable victims of their negligence without a requirement of privity); *see also Fickett v. Superior Court,* 27 Ariz.App. 793, 558 P.2d 988 (1976) (attorney's duty of care in performing legal services for the client extends to the intended beneficiary); *H. Rosenblum, Inc. v. Adler,* 93 N.J. 324, 461 A.2d 138 (1983) (duty of independent auditor who furnishes an opinion to company extends to those reasonably foreseeable recipients who use the opinion for its proper business purpose, including potential investors and creditors); *Citizens State Bank v. Timm, Schmidt & Co.,* 113 Wis.2d 376, 335 N.W.2d 361 (1983) (accountant may be held liable for negligent preparation of an audit report if injury to non-privity creditor was foreseeable); *see generally Restatement (Second) of Torts* § 552 (1977) (a professional who supplies false information for guidance of others in their business transactions is liable for pecuniary loss caused by reasonable reliance of those to whom he knows the recipient intends to supply it); Romualdo P. Eclavea, Annotation, *Liability of Independent Accountant to Investors or Shareholders,* 35 A.L.R.4th 225 (1985) (generally noting the trend away from limiting liability to those in privity with accountants).

However, recognizing that liability no longer depends upon privity does not answer the question of who has standing to sue for an injury to a corporate entity. Thus, none of these cases negates defendants' basic position regarding the lack of capacity of the individual shareholders to sue for corporate injuries. Likewise, the Rule 44.1 testimony of plaintiffs' international law expert, that ****1188 *158** members of a B.V.I. company are not precluded from bringing individual tort claims against company officers and agents "as are permitted by the jurisdiction in which suit is brought," is not conclusive on this issue either.

Courts that have considered the dual issues of whether a professional defendant has a duty based on the foreseeability of injury to a non-privity plaintiff, and whether that foreseeable plaintiff is the proper party to bring the suit as an individual shareholder where the only injury suffered is by the corporation, have continued to follow the general corporate rule that a shareholder does not have standing to bring suit for a corporate injury. *See, e.g., Hunter v. Knight, Vale and Gregory,* 18 Wash.App. 640, 571 P.2d 212, 216 (1977) (stockholders could not sue accountant for corporate injury regardless of existence of accountant's duty to exercise care towards them as foreseeable beneficiaries of the contractual obligation with the corporation); *Williams,* 901 F.2d 158 (shareholders were precluded from suing attorney for malpractice in failing to obtain corporate FCC license,

even though shareholders were the intended beneficiaries of the representation; damages flowed from loss of corporate opportunity, so shareholders failed to allege cognizable injury as individuals); *Sparling v. Hoffman Constr. Co.,* 864 F.2d 635, 640 (9th Cir.1988) (even if individual shareholders have stated a cause of action to assert a federal RICO claim, they have no standing to sue where the harm is based on injuries to the corporation (citing unanimous precedent in the first, second, fifth, and sixth circuits)).

The *Hunter* court reasoned:

> Today it is generally recognized that a duty to exercise due care toward third persons in the performance of a contractual undertaking may arise independent of the contractual obligation.... Whether [the accounting firm] owed plaintiffs a duty independently of, or concurrently with, its contract with [the corporation] is a question of foreseeability.... It is not entirely unreasonable to say that an accounting firm which negligently performs financial audits for a corporation could foresee injury to that corporation's managing stockholders in addition to injury to the corporation.
>
> For purposes of this opinion, however, we need not resolve that issue. Assuming (but certainly not deciding) that [the accounting firm] owed plaintiffs a special duty in addition to the duty to the corporation, *that additional or special duty attached only by reason of plaintiffs' status as stockholders and not from circumstances independent of their status as stockholders.* As an exception to the general rule, a stockholder may maintain an action in his own right against a third party (although the corporation may likewise have a cause of action for the same wrong) when the injury to the individual resulted from the violation of some special duty owed to the stockholder but only when that special duty had its origin in circumstances independent of the stockholder's status as a stockholder.... That independent origin is nonexistent in the case at bench.

571 P.2d at 216 (emphasis added) (citations omitted). Similarly, in the case of attorney malpractice, the *Williams* court ruled:

> The District of Columbia has dispensed with the doctrine that third parties are barred for lack of privity from suing attorneys.... The third party, however, must allege more than mere harm from the conduct in question. He must show in addition that he was "the direct and intended beneficiary of the attorney-client relationship." ...
>
> ... We agree with the court that the existence of an attorney-client relationship normally is a question of fact, so that a genuine dispute would require resolution at trial.... We further agree that the question whether the [plaintiffs] were ever clients of [defendant] does not require resolution, since they fail to allege cognizable injury as individuals.
>
> The court found that the [plaintiffs] did not suffer cognizable injury because they failed to allege injury as individuals, but instead only as shareholders of [the corporation]. We have held that, under normal circumstances, stockholders may sue for ****1189 *159** corporate injury only on a derivative basis, ... but that special injuries will provide grounds for an individual suit....
>
> The special injury alleged by [plaintiffs] is loss of business opportunity due to the failed television application. That allegation is meritless. The [plaintiffs] chose to apply for the license through the corporate form of [the corporation]. The business opportunity thus belonged to [the corporation] and the [plaintiffs'] losses were derivative. Had [the corporation] declared bankruptcy, it is certain that [the plaintiffs] would not be so quick to request that we disregard the corporate form.

901 F.2d at 164.

We find this reasoning compelling. Regardless of the trial court's finding of a duty owed the shareholder plaintiffs because of the foreseeability of injury to them through defendants' accounting services, and regardless of the conclusion that they were the intended beneficiaries of defendants' contractual obligations to the corporations-findings we need not review for purposes of this opinion-the fact remains that, under the generally accepted corporate law of both Arizona and the British Virgin Islands, they had no cognizable, individual injury from defendants' alleged wrongdoing, apart from the injuries they suffered as shareholders. The damages they seek to recover from those claims are nothing more than the corporate profits they claim were diverted as a result of defendants' conduct. The "share and share alike" agreement they seek to enforce would result in those profits being channeled through the corporations to the shareholders by virtue of their proportionate corporate ownership. Because the damages suffered by the corporations and the shareholders are identical, the shareholders had no standing to sue individually on their claims of accounting negligence, breach of fiduciary duty, or breach of contract.

Because plaintiffs could not pursue these claims in their capacity as individual shareholders as a matter of law, we vacate the judgments entered in their behalf on those claims.

[4] The one remaining claim, substantial assistance in Ziggy's breach of fiduciary duty, [7] is the only claim under which the shareholders sought to recover damages they had alleged to have suffered individually, that is, the attorneys' fees and costs incurred in pursuing the *Wauro* litigation. That one claim, for approximately $600,000, is the only item sought to be awarded to reimburse the personal expenses of the plaintiff shareholders rather than the corporation. To the extent that the individual shareholders wish to pursue that claim on remand, they may do so. [8]

c. *Analysis: Capacity of Corporations to Sue*

We turn now to the corporate claims and judgments. Defendants argue that the corporate claims were likewise barred because corporate ratification of the shareholders' complaint occurred after the statutes of limitations had run on all of these claims. Plaintiffs do not directly address this issue; rather, they argue that the date of ratification is ****1190 *160** irrelevant, because "the lawsuit was authorized and filed by the Shareholders for and on behalf of the Companies ...," and that, because restoration of the corporate status under B.V.I. law was retroactive to the date of the filing of the complaint, no post-restoration ratification was necessary.

[5] We first address the issue of an untimely ratification. The following dates are relevant to this issue. The corporations were incorporated in B.V.I. on February 20, 1979. It is undisputed that on January 4, 1988, the corporate names were stricken from the B.V.I. Register of Companies for failure to pay the annual license fees. Approximately 22 months after the corporations had lapsed, on September 26, 1989, plaintiffs filed this lawsuit. Plaintiffs do not dispute that the shareholders' only official action to ratify the corporate lawsuit occurred at the extraordinary meeting on July 11, 1991, after all statutes of limitations had run on all claims, under either of the parties' theories.

Plaintiffs' contention in their answering brief that "the ratification argument is actually a thinly-disguised attack on the sufficiency of the evidence to support the jury's verdict on the statute of limitations questions" is unfounded. The statute of limitations question presented to the jury raised only the issue whether the September 1989 complaint was timely filed, and not whether the July 1991 ratification occurred within the required period to sue. Plaintiffs have not argued, either in the trial court or on appeal, that the July 1991 ratification occurred within the applicable statutes of limitations on these claims. [9]

Furthermore, plaintiffs do not contest defendants' legal premise that a ratification of the lawsuit cannot relate back to the filing of the suit when the ratification occurs after the statutes of limitations have run. Indeed, we find this premise supported by well-recognized authority. For example, *Restatement (Second) of Agency* § 90 provides:

> If an act to be effective in creating a right against another or to deprive him of a right must be performed before a specific time, an affirmance is not effective against the other unless made before such time.

As comment a to § 90 explains:

> The bringing of an action ... by a purported agent can not be ratified after the cause of action ... has been terminated by lapse of time.... [I]f another has acquired a defense against an action by the principal, the right or defense can not be destroyed by ratification.

Thus, an affirmance or ratification will be effective only if it "comes before a statute of limitations has run on the claim." *Id.* at comment c. We therefore conclude that the July 11, 1991, ratification was ineffective to validate the shareholders' suit filed in 1989 on behalf of the corporations.

The question then remains whether any other legal basis exists for the shareholders' suit brought "for or on behalf" of the corporate plaintiffs. We conclude there is no such basis.

In this case, both parties have presented evidence that, under B.V.I. law, the restoration of the corporations in July 1991 was retroactive to before the filing of the complaint; thus, any litigation commenced by the corporations during that time "would be retroactively made valid," according to defendants' expert foreign law affidavit, and the corporations would be retroactively vested with "the power to resume its business as a going B.V.I. concern as if it had never been ****1191 *161** struck off," according to plaintiffs' expert affidavit. The effect

of this restoration is that, anytime before the statutes of limitations had run, the corporations in their own right could have brought suit.[10] However, they did not do so and, as we have held, the attempted ratification after the statutes of limitations had run was ineffective.

[6] We therefore examine plaintiffs' contention that this suit was validly brought on the date it was filed, within the statutes of limitations, because the shareholders brought it on behalf of the retroactively restored corporations. Because the restoration reactivated the corporations' right to maintain their suits, this scenario is valid only if the shareholders were seeking recovery for the corporations on a derivative basis. *See, e.g., Funk v. Spalding,* 74 Ariz. 219, 225, 246 P.2d 184, 188 (1952) (if corporation is an ongoing concern at time of suit, shareholder can maintain action to recover corporate profits only in a representative capacity in a derivative suit); *see also* Rule 23.1, Arizona Rules of Civil Procedure. Plaintiffs have not argued on appeal, however, their initial position in the trial court that they had standing to bring this suit in a derivative capacity or as surviving shareholders. In examining this issue here, we merely note that, at this point, any argument that they were "surviving shareholders" under A.R.S. § 10-105 of a "dissolved" or "liquidated" corporation at the time the suit was brought would be inconsistent with their actions in reviving the "lapsed" corporate entities retroactively. Furthermore, we find no evidence on this record that plaintiffs met the procedural notice requirements of Rule 23.1, Arizona Rules of Civil Procedure,[11] to obtain such a representative standing, nor did they base their suit on one of the three exceptions allowing a derivative suit under B.V.I. law. *See generally Prudential Assurance Co. Ltd.,* 2 All E.R. at 861, *citing Edwards v. Halliwell,* (1950) 2 All E.R. 1064 at 1066-67 (derivative claims may be brought (1) where minority shareholders attempt to prevent or recover for *ultra vires* acts; (2) where shareholders seek to have an action declared void because a special resolution is required; or (3) where what has been done amounts to a fraud on the minority and suit is against wrongdoers who are in control of the company).

We conclude that plaintiffs have not established capacity to sue on behalf of the corporations, nor have they established any action by the corporations, either at the time the suit was filed or within the time to sue, that would retroactively authorize either a direct or derivative suit on behalf of the corporations on any of these claims. Because the shareholders have not established such standing, the judgments in favor of the corporations must also be vacated. Because we ****1192** ***162** have previously concluded the shareholders did not have individual capacity to sue for any claim other than the substantial assistance claim for attorneys' fees and costs incurred in the *Wauro* litigation, all other claims in this action must be dismissed as a matter of law.

For the foregoing reasons, the judgment of the trial court is reversed, and this matter is remanded for proceedings consistent with this opinion. Each party is to bear its own attorneys' fees.

CONTRERAS and TOCI, JJ., concur.

All Citations

183 Ariz. 148, 901 P.2d 1178

Footnotes

* Martone, J., of the Supreme Court, recused himself and did not participate in the determination of this matter.

1 On appeal, that judgment was affirmed in part, and remanded in part with directions to recompute the damages to conform to the evidence. *Kunst Corporation, Inc. v. Wauro,* 1 CA-CV 90-0655 (Ariz.App. mem. dec. filed July 26, 1994) ("the *Wauro* case").

2 This lawsuit involves five of the former shareholders who together held a 60% interest in the corporations. Ziggy held a 30% interest, and one remaining stockholder, who did not join these suits, held the remaining 10%.

3 Plaintiffs also argue that this defense was waived by defendants' failure to preserve it in a verified answer as required by Rule 9(i), Arizona Rules of Civil Procedure. However, this defect was cured by the trial court's granting of defendants' motion to verify their answer on September 9, 1991. Additionally, plaintiffs' contention that defendants failed to disclose this defense is not supported by the record.

4 The expert affidavits were submitted under authority of Rule 44.1, Arizona Rules of Civil Procedure, which permits the submission of any relevant source of foreign law. The substance of those affidavits is discussed more fully *infra.*

At oral argument in this court, plaintiffs' counsel represented several times to this court that the only testimony before the trial court regarding the substance of B.V.I. law came from their foreign law expert, Jay I. Bartz. However, the record

clearly discloses that, in their reply in support of their motion for summary judgment regarding the lack of capacity defense, filed in the trial court on July 22, 1991, defendants included a detailed affidavit from their foreign law expert, Sydney A. Bennett, a barrister and solicitor of the Eastern Caribbean Supreme Court, practicing in the B.V.I. That reply also included copies of the relevant case law relied on by Mr. Bennett in his affidavit.

We consider the affidavits of both experts in our discussion regarding the substance of B.V.I. law.

5 The transcript of this hearing on August 21, 1991, is not in the record on appeal. However, the trial court entered a detailed ruling in its minute entry on that date, set forth above.

6 The provision is contained in the May 2, 1986, amendment of section 240 of Cap. 243 (Brit.Virgin.Is.Corp.Code), as follows:

> *Striking off for failure to pay fee.*
>
> 240(2) Where the name of a company has been struck off the register or where its registration has been cancelled for non-payment of the annual license fee, the Registrar may, upon application made to him and subject to payment of the fees set forth in subsection (3), restore the name of the company to the register; and *where the name of a company is so restored, it shall be deemed never to have been struck off the register.*

(Emphasis added.)

7 This claim is based on *Restatement (Second) of Torts* § 876(b), which provides:

> For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he ...
>
> (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself....

This claim was not alleged in the complaint, but the trial court subsequently allowed it to be submitted the jury as supported by the evidence. This determination may have been based on an erroneous understanding of the parties' capacities to raise this claim. We therefore express no opinion whether the evidence presented at the prior trial supported the jury's determination of liability on this claim.

8 It appears that the jury did not award the shareholder plaintiffs the individual damages for $600,000 in attorneys' fees that they sought on this claim. The verdicts indicate that the jury awarded both the shareholders and the corporations $1,500,000 on the substantial assistance claim. We cannot tell what portion of this award included impermissible damages for those corporate losses the shareholders had no standing to assert. We therefore vacate the judgment on this claim as well. On remand, the shareholder plaintiffs may seek only the expenses of the *Wauro* litigation that were not paid through the corporations, but were incurred individually without reimbursement from the corporate entities.

9 In response to questioning at oral argument in this court, however, plaintiffs' counsel contended that, because a six-year statute of limitations applied to the breach of contract claim from the alleged “discovery” of the breach in June 1988, ratification of the suit on that basis was timely. However, counsel was unable to provide this court with any authority that the “discovery” rule applied to the written contract claim based on the engagement letter, and was further unable to persuade this court that this claim would not be governed by a three-year statute of limitations applicable to an oral extension of a 1981 written contract. *See generally* A.R.S. § 12-543.

Because it is not necessary to our analysis, we need not decide when the various statutes of limitations actually ran in this case. Indeed, the parties do not present that issue in this appeal. Because plaintiffs did not argue the ratification issue in this context in the trial court and have not briefed it in terms of the statutes of limitations in this court, we find they have waived any argument that ratification occurred within the statutes of limitations periods.

10 We note that if the shareholders had taken the same official action to authorize the lawsuit at the time they filed it in September 1989 as they did to ratify it in July 1991, the retroactive restoration of the corporate status might have given them a basis to sue on behalf of the corporations within the statutes of limitations. However, no evidence of such an action is present in this record, and plaintiffs do not argue that it occurred.

11 Rule 23.1, Arizona Rules of Civil Procedure, provides for shareholders to bring derivative suits on behalf of a corporation under the following conditions:

> In a derivative suit brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains.... *The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort.* ...

(Emphasis added.)

In this case, plaintiffs have provided no evidence of any demand they made of the directors to sue the defendants, or that such demand was refused. They have not pled with particularity their reasons for not making such a demand, or for not calling a formal meeting of the shareholders, of which plaintiffs were a majority, to authorize the lawsuit at the time it was filed. The only relevant allegations in the complaint were that the corporations were "lapsed" and that they were currently in litigation with Ziggy and were "unable to obtain the action Gemstar and Canstar desire from him." Plaintiffs do not argue that this is sufficient procedural notice of a derivative lawsuit, and we do not find that it meets the requirements of Rule 23.1.

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Baldwin's Ohio Revised Code Annotated
Rules of Civil Procedure (Refs & Annos)
Title IV. Parties

Civ. R. Rule 17

Civ R 17 Parties plaintiff and defendant; capacity

Currentness

(A) Real party in interest

Every action shall be prosecuted in the name of the real party in interest. An executor, administrator, guardian, bailee, trustee of an express trust, a party with whom or in whose name a contract has been made for the benefit of another, or a party authorized by statute may sue in his name as such representative without joining with him the party for whose benefit the action is brought. When a statute of this state so provides, an action for the use or benefit of another shall be brought in the name of this state. No action shall be dismissed on the ground that it is not prosecuted in the name of the real party in interest until a reasonable time has been allowed after objection for ratification of commencement of the action by, or joinder or substitution of, the real party in interest. Such ratification, joinder, or substitution shall have the same effect as if the action had been commenced in the name of the real party in interest.

(B) Minors or incompetent persons

Whenever a minor or incompetent person has a representative, such as a guardian or other like fiduciary, the representative may sue or defend on behalf of the minor or incompetent person. If a minor or incompetent person does not have a duly appointed representative the minor may sue by a next friend or defend by a guardian ad litem. When a minor or incompetent person is not otherwise represented in an action the court shall appoint a guardian ad litem or shall make such other order as it deems proper for the protection of such minor or incompetent person.

CREDIT(S)
(Adopted eff. 7-1-70; amended eff. 7-1-75, 7-1-85)

STAFF NOTES
1. Real party in interest

2. Minors or incompetent persons

3. Minors: commencing or defending an action for divorce, annulment or alimony

1. Real party in interest

1970:

The first three sentences of Rule 17(A) (based upon Federal Rule 17(a) set forth the principles included in §§ 2307.05, R.C. and 2307.08, R.C. In short, the real party in interest principles of Rule 17(A) borrow directly the real party in interest principles of the Field Code.

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In an action at common law an assignee, for example, could not sue in his own name. The Field Code, with the procedural merger of law and equity changed that, the equitable principle that the party entitled to the benefits of the suit (an assignee), as distinguished from the party with the empty legal title (the assignor), being the proper party to sue, i.e., being the "real party in interest." Of course, the Field Code and Rule 17(A) provide that a party, such as a trustee, who sues for the benefit of another is a real party in interest. Quite logically under the code and the rule if there is a partial assignment or partial subrogation, then the partial assignor and the partial assignee or the partial subrogor and the partial subrogee, both having a beneficial interest in the suit, are the real parties in interest.

The real party in interest principle does not refer to "capacity to sue." Assume that a minor is negligently injured. The minor is a real party in interest, but he does not have the capacity to sue. The minor sues under Rule 17(B) by his next friend, an adult, who does have the capacity to sue.

The fourth sentence of Rule 17(A) is borrowed directly from a 1966 amendment of Federal Rule 17(a). Assume that an administrator under a void appointment sues in good faith. Under Rule 17(A) the action is not dismissed; instead a reasonable time is permitted until the proper administrator can be substituted in order that justice might be done. The 1966 amendment of Federal Rule 17(a) "codifies" the principle enunciated in *Levinson v. Deupree*, 345 U.S. 648 (1953) and *Link Aviation, Inc., v. Downs*, 325 F. 2d 613 (D.D.C. 1963). A similar result might be accomplished under § 2309.58, R.C., the general amendment statute (*Taylor v. Scott*, 168 Ohio St. 391 (1959)); however, Rule 17(A) simply states clearly that a proper real party in interest may be substituted without the action's being dismissed.

2. Minors or incompetent persons

1970:

Rule 17(B) (quite similar to Federal Rule 17(c)) deals with suits by and against minors and incompetent persons. In effect, the rule enunciates the principles covered by §§ 2307.11, through 2307.17, R.C.

Rule 4.2(1) permits service of process upon an individual sixteen years of age or older and dispenses with additional parent or guardian service. But Rule 4.2(1) does not dispense with parent or guardian protection afforded by Rule 17(B). Hence, if a defendant is sixteen years old, he alone may be served under Rule 4.2(1). But for purposes of trial he would receive the full parent or guardian protection of Rule 17(B). In addition, Rule 55(A) provides that a default judgment may not be taken against a minor or incompetent person unless he has been represented properly by a guardian or other such representative who has appeared in the action.

3. Minors: commencing or defending an action for divorce, annulment or alimony

1975:

The amendment, effective July 1, 1975, removed Civ. R. 17(C) from the Civil Rules. It provided, as did predecessor statutes, that persons eighteen years of age or older could commence or defend actions for divorce, annulment, or alimony in their own names without the intervention of a guardian or a next friend. Am. Sub. S. B. 1, 110th General Assembly, effective January 1, 1974, lowered the age of majority from twenty-one years to eighteen years for most, but not all, purposes. Bringing or defending actions in divorce, annulment or alimony were procedures not within any of the exceptions. RC 3109.10, the general provision on majority "… of full age for all purposes…" made the provision of Civ. R. 17(C) obsolete. For that reason it was deleted by amendment.

1970:

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Rule 17(C) is simply a combination of and restatement of §§ 2307.111 and 2307.161, R.C., which have permitted a person over eighteen years of age to sue or defend in his own name in an action for divorce, annulment or alimony. Rule 17(C) is an exception to the principle that a person under twenty-one years of age must be represented in an action by an adult.

Notes of Decisions (270)

Rules Civ. Proc., Rule 17, OH ST RCP Rule 17
Current with amendments received through August 15, 2015

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Baldwin's Ohio Revised Code Annotated
Rules of Civil Procedure (Refs & Annos)
Title VII. Judgment

Civ. R. Rule 56

Civ R 56 Summary judgment

Currentness

(A) For party seeking affirmative relief

A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part of the claim, counterclaim, cross-claim, or declaratory judgment action. A party may move for summary judgment at any time after the expiration of the time permitted under these rules for a responsive motion or pleading by the adverse party, or after service of a motion for summary judgment by the adverse party. If the action has been set for pretrial or trial, a motion for summary judgment may be made only with leave of court.

(B) For defending party

A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part of the claim, counterclaim, cross-claim, or declaratory judgment action. If the action has been set for pretrial or trial, a motion for summary judgment may be made only with leave of court.

(C) Motion and proceedings

The motion shall be served in accordance with Civ.R. 5. Unless otherwise provided by local rule or by order of the court, the adverse party may serve responsive arguments and opposing affidavits within twenty-eight days after service of the motion, and the movant may serve reply arguments within fourteen days after service of the adverse party’s response. Summary judgment shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, written admissions, affidavits, transcripts of evidence, and written stipulations of fact, if any, timely filed in the action, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. No evidence or stipulation may be considered except as stated in this rule. A summary judgment shall not be rendered unless it appears from the evidence or stipulation, and only from the evidence or stipulation, that reasonable minds can come to but one conclusion and that conclusion is adverse to the party against whom the motion for summary judgment is made, that party being entitled to have the evidence or stipulation construed most strongly in the party’s favor. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

(D) Case not fully adjudicated upon motion

If on motion under this rule summary judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court in deciding the motion, shall examine the evidence or stipulation properly before it, and shall if practicable, ascertain what material facts exist without controversy and what material facts are actually and in good faith controverted. The court shall thereupon make an order on its journal specifying the facts that are without controversy, including the extent to which the amount of damages or other relief is not in controversy, and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly.

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(E) Form of affidavits; further testimony; defense required

Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated in the affidavit. Sworn or certified copies of all papers or parts of papers referred to in an affidavit shall be attached to or served with the affidavit. The court may permit affidavits to be supplemented or opposed by depositions or by further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of the party's pleadings, but the party's response, by affidavit or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If the party does not so respond, summary judgment, if appropriate, shall be entered against the party.

(F) When affidavits unavailable

Should it appear from the affidavits of a party opposing the motion for summary judgment that the party cannot for sufficient reasons stated present by affidavit facts essential to justify the party's opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or discovery to be had or may make such other order as is just.

(G) Affidavits made in bad faith

Should it appear to the satisfaction of the court at any time that any of the affidavits presented pursuant to this rule are presented in bad faith or solely for the purpose of delay, the court shall forthwith order the party employing them to pay to the other party the amount of the reasonable expenses which the filing of the affidavits caused the other party to incur, including reasonable attorney's fees, and any offending party or attorney may be adjudged guilty of contempt.

CREDIT(S)

(Adopted eff. 7-1-70; amended eff. 7-1-76, 7-1-97, 7-1-99, 7-1-15)

STAFF NOTES
2015:

Consistent with a similar amendment to Civ.R. 6(C), the amendment to Civ.R. 56(C) deletes the reference in the prior rule to “the time fixed for hearing.” The amendment also specifies, in the absence of a local rule or court order specifying a time for responding to a motion for summary judgment, a fallback time of twenty-eight days after service of the motion within which to serve responsive arguments and opposing affidavits. In the absence of a local rule or court order addressing replies, the amendment also permits the movant to serve reply arguments within fourteen days after service of the adverse party’s response. The time for filing the motion, responses, and replies is governed by Civ.R. 5(D), again in the absence of a local rule or court order specifying a different time for filing. The rule applies only in the absence of a local rule or court order providing times for briefing motions, whether or not the rule or order specifically addresses summary judgment motions, and does not supersede or affect the application of local rules or orders addressing briefing on motions.

1999:

(C) Motion and proceedings thereon

The prior rule provided that “transcripts of evidence in the pending case” was one of the items that could be considered in deciding a motion for summary judgment. The 1999 amendment deleted “in the pending case” so that transcripts of evidence from another case can be filed and considered in deciding the motion.

1997:

(A) For party seeking affirmative relief

The 1997 amendment to division (A) divided the previous first sentence into two separate sentences for clarity and ease of reading, and replaced a masculine reference with gender-neutral language. The amendment is grammatical only and no substantive change is intended.

(B) For defending party

The 1997 amendment to division (B) added a comma after the “may” in the first sentence and replaced a masculine reference with gender-neutral language. The amendment is grammatical only and no substantive change is intended.

(C) Motion and proceedings thereon

The 1997 amendment to division (C) changed the word “pleading” to “pleadings” and replaced a masculine reference with gender-neutral language. The amendment is grammatical only and no substantive change is intended.

(E) Form of affidavits; further testimony; defense required

The 1997 amendment to division (E) replaced several masculine references with gender-neutral language. The amendment is grammatical only and no substantive change is intended.

(F) When affidavits unavailable

The 1997 amendment to division (F) replaced several masculine references with gender-neutral language. The amendment is grammatical only and no substantive change is intended.

(G) Affidavits made in bad faith

The 1997 amendment to division (G) replaced a masculine reference with gender-neutral language. The amendment is grammatical only and no substantive change is intended.

1. Summary judgment

2. For party seeking affirmative relief

3. For defending party

4. Motion and proceedings thereon

5. Case not fully adjudicated upon motion

6. Form of affidavits; further testimony; defense required

7. When affidavits unavailable

8. Affidavits made in bad faith

1. Summary judgment

1970:

Rule 56 is the summary judgment rule. It is based on § 2311.041, R.C., and Federal Rule 56. The Ohio summary judgment statute was itself patterned upon Federal Rule 56. See, Wills, A Proposed Summary Judgment Statute In Ohio, 19 Ohio St. L.J. 1 (1958), Procedure Under the Ohio Summary Judgment Statute, 20 Ohio St. L.J. 613 (1959) and Wallace, *The Summary Judgment Procedure*, Personal Injury Litigation In Ohio 284 (1965).

The statute's introductory limitation that "summary judgment may be granted in… civil action [s]" has been deleted because Rule 1 determines the applicability of all the rules including Rule 56.

2. For party seeking affirmative relief

1976:

Prior to this amendment, when an action had been set for trial, a motion for summary judgment required the consent of all parties to the action. The purpose of the provision was to prevent delays in the trial of actions occasioned by the late filing of motions for summary judgment.

Rule 16(B) of the Municipal and County Court Rules of Superintendence, applicable to all trial courts, provides that priority is to be given to the case first assigned for trial in the event of a conflict in a counsel's trial assignments. That rule has resulted in the early assignment of cases for trial and an enlargement of the period of time within which consent of the parties is required for filing a motion for summary judgment.

The purpose of the amendment is to remove the consent limitation and leave the entertainment of a motion for summary judgment to the discretion of the court once the action has been set for pretrial or for trial. Under the rules of superintendence, the judge to whom an action is assigned is responsible for its expeditious determination.

1970:

Rule 56(A) is an adaptation of Federal Rule 56(a) and § 2311.041(A), R.C. It allows a claimant upon an original claim, counterclaim, cross-claim or declaratory judgment to move for summary judgment at any time after the expiration of the time for moving or pleading (generally twenty-eight days after service of the complaint) or at any time after service of a motion for summary judgment. See, Rule 12(A)(1) and (2) for time requirements. Also see Rule 6. This provision in Rule 56(A) replaces the current statutory "at issue" requirement. Under Rule 56(A) claimant may move for summary judgment after twenty-eight days from the commencement of the action--normal answer time established by Rule 12(A)(1)--or at any time after the opposing side has moved for summary judgment. Thus unlike the current practice, there is no requirement that an answer or reply be filed to put the case at issue. The rule changes the results of cases such as *Miller v. Cohen*, 3 Ohio App. 2d 71 (1965) and *Revesz v. Doehler Jarvis*, 14 Ohio App. 156 (1968), which interpreted the "at issue" provision of the statute to require the actual filing of a reply or an answer. The demise of the "at issue" requirement does not make summary judgment a substitute for default. Rule 55 applies when there is a failure to plead or defend. Rule 56 does not require an answer or reply, but it is best used when there is a dilatory answer.

Rule 56(A) concludes with the statement that the motion shall be made at a time which would delay the trial. This only with leave of court when a case is set for pretrial and only with consent of the parties when a case has been set for trial. This provision is taken from the last two sentences of § 2311.041(A), R.C. If a case has been set for pretrial or trial, summary judgment may be inappropriate.

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3. For defending party

1976:

Prior to this amendment, when an action had been set for trial, a motion for summary judgment required the consent of all parties to the action. The purpose of the provision was to prevent delays in the trial of actions occasioned by the late filing of motions for summary judgment.

Rule 16(B) of the Municipal and County Court Rules of Superintendence, applicable to all trial courts, provides that priority is to be given to the case first assigned for trial in the event of a conflict in a counsel's trial assignments. That rule has resulted in the early assignment of cases for trial and an enlargement of the period of time within which consent of the parties is required for filing a motion for summary judgment.

The purpose of the amendment is to remove the consent limitation and leave the entertainment of a motion for summary judgment to the discretion of the court once the action has been set for pretrial or for trial. Under the rules of superintendence, the judge to whom an action is assigned is responsible for its expeditious determination.

1970:

Rule 56(B) is based upon Federal Rule 56(b) with an anti-delay provision like that in Rule 56(A). The defending party against whom a claim, counterclaim or cross-claim is asserted or a declaratory judgment is sought may move for a summary judgment *at any time*, subject to the provision that he shall not delay the trial. The defending party's action in seeking a summary judgment indicates that he has notice and is represented by counsel.

4. Motion and proceedings thereon

1970:

The first sentence of Rule 56(C) is taken from Federal Rule 56(c) because the federal rule follows the service concept established in Rule 5 and Rule 12. See, Staff Notes to Rule 5 and Rule 12. The remainder of Rule 56(C) is based upon § 2311.041(C). Thus Rule 56 follows the established Ohio law as to what the court may consider upon summary judgment and the tests that the court must use in considering the documents and only the documents specified in the rule.

The rule eliminates the statute's four repetitive listings of the same supporting documents. The rule lists the supporting documents once and then states, as does the 1965 amendment to the statute: “No evidence or stipulation may be considered except as stated in this rule.” The rule continues: “A summary judgment shall not be rendered unless it appears from such evidence or stipulation and *only* therefrom.…” [Rule 56(C), emphasis added].

Rule 56 follows, *Morris v. The First National Bank & Trust Co.*, 15 Ohio St. 2d 184 (1968), which holds that there is no need for a bill of exceptions when the trial court considers only those documents enumerated in § 2311.041, R.C., (now Ohio Rule 56(C)), and when the clerk of the trial court transmits all those documents to the appellate court.

Rule 56(C) deletes the service provisions of § 2311.041(C), R.C., because Rule 5 specifies the service requirements for all papers after the original pleadings. See, Staff Note to Rule 5. Additionally Rule 56(C) requires that all supporting and opposing documents be “timely filed.” Under the rule the movant must serve and file his motion and all supporting documents at least fourteen days before the time fixed for hearing, and the opponent *should* serve and file any opposing documents at least one day before the time fixed for hearing. See Rule 6(D). The provisions of Rule 32(A)(1) require that a deposition to be used in

evidence be filed one day before the trial or hearing. The fourteen day provision of Rule 56(C) regarding movant's obligation overrides this general provision and also overrides the seven day motion hearing provision in Rule 6(D).

5. Case not fully adjudicated upon motion

1970:

Rule 56(D) is § 2311.041(C), R.C., with the list of supporting documents deleted.

6. Form of affidavits; further testimony; defense required

1970:

Rule 56(E) is § 2311.041(D), R.C.

7. When affidavits unavailable

1970:

Rule 56(F) is § 2311.041(E), R.C.

8. Affidavits made in bad faith

1970:

Rule 56(G) is Federal Rule 56(g) and is not part of § 2311.041, R.C. Rule 56(G) is a provision designed to eliminate bad faith or delaying affidavits. The rule allows the court to order the party using these affidavits to pay the opposing party that party's reasonable expenses including attorney fees "which the filing of the affidavits caused [that] party to incur…." Further the court may adjudge the "offending party or attorney… guilty of contempt."

Notes of Decisions (3417)

Rules Civ. Proc., Rule 56, OH ST RCP Rule 56
Current with amendments received through August 15, 2015

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Baldwin's Ohio Revised Code Annotated
Ohio Rules of Evidence (Refs & Annos)
Article VI. Witnesses

Evid. R. Rule 602

Evid R 602 Lack of personal knowledge

Currentness

A witness may not testify to a matter unless evidence is introduced sufficient to support a finding that the witness has personal knowledge of the matter. Evidence to prove personal knowledge may, but need not, consist of the witness' own testimony. This rule is subject to the provisions of Rule 703, relating to opinion testimony by expert witnesses.

CREDIT(S)
(Adopted eff. 7-1-80; amended eff. 7-1-07)

STAFF NOTES
1980:

Rule 602 is identical to Federal Evidence Rule 602. It conforms with prior Ohio law.

A witness is required to testify from first-hand knowledge which has been acquired by perceiving a fact through one or more of his five senses. Of course, the witness must have had an opportunity to perceive and must have actually perceived. This rule expresses the common law insistence upon the most reliable sources of information. These basic requirements may be furnished by the testimony of the witness himself. Mere mistaken perceptions do not disqualify the witness from testifying based on personal knowledge. Assessment of accuracy of perception is a matter of credibility and not ordinarily one of competence.

This rule does not disqualify a witness who testifies as to a hearsay statement, if the witness has personal knowledge of the making of the statement. In this situation, Rules 801 and 805 would be applicable. This rule would, however, prevent the witness from testifying to the truth of the subject matter of the hearsay statement if he has no personal knowledge of it.

The reference in Rule 602 to Rule 703 is designed to avoid any question of conflict between the two rules, the latter of which permits an expert to express opinions based on facts of which the expert does not have personal knowledge.

Notes of Decisions (62)

Rules of Evid., Rule 602, OH ST REV Rule 602
Current with amendments received through August 15, 2015

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Baldwin's Ohio Revised Code Annotated
Title XVII. Corporations--Partnerships (Refs & Annos)
Chapter 1701. General Corporation Law (Refs & Annos)
Books and Records

R.C. § 1701.37

1701.37 Books, records of account, minutes of proceedings, and shareholders records

Currentness

(A) Each corporation shall keep correct and complete books and records of account, together with minutes of the proceedings of its incorporators, shareholders, directors, and committees of the directors, and records of its shareholders showing their names and addresses and the number and class of shares issued or transferred of record to or by them from time to time.

(B) Upon request of any shareholder at any meeting of shareholders, there shall be produced at such meeting an alphabetically arranged list, or classified lists, of the shareholders of record as of the applicable record date, who are entitled to vote, showing their respective addresses and the number and class of shares held by each. Such list or lists when certified by the officer or agent in charge of the transfers of shares shall be prima-facie evidence of the facts shown therein. If the meeting is to be held solely or in part by means of communications equipment, then the corporation shall make the list or lists open to the examination of any shareholder or proxyholder during the whole time of the meeting on a reasonably accessible electronic network. The directors may adopt guidelines and procedures to permit the corporation to verify that any person accessing the list or lists is a shareholder or proxyholder.

(C) Any shareholder of the corporation, upon written demand stating the specific purpose thereof, shall have the right to examine in person or by agent or attorney at any reasonable time and for any reasonable and proper purpose, the articles of the corporation, its regulations, its books and records of account, minutes, and records of shareholders aforesaid, and voting trust agreements, if any, on file with the corporation, and to make copies or extracts thereof. Any written demand by an acquiring person to examine the records of shareholders for the purpose of communicating with shareholders of the issuing public corporation in connection with a meeting of shareholders called pursuant to section 1701.831 of the Revised Code shall be deemed to have been made by a shareholder of the issuing public corporation for a reasonable and proper purpose.

(D) Unless otherwise prohibited by law, if a shareholder has authorized the corporation to deliver notices of shareholder meetings required by section 1701.41 of the Revised Code to the shareholder by any means other than mail and has not rescinded that authorization, the corporation shall include the electronic mail address or other electronic contact information necessary to deliver the notice on any list or lists of shareholders prepared pursuant to division (B) or (C) of this section.

CREDIT(S)
(2002 H 278, eff. 5-16-02; 1982 H 822, eff. 11-18-82; 126 v 432)

OSBA CORPORATION LAW COMMITTEE

1955:

Division (A) in the above draft is based on the first paragraph of present Sec. 1701.72.

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Division (B) is substantially the first paragraph of present Sec. 1701.54. In this division there is a reference to “list or classified lists” of shareholders for the reason that there may be one list alphabetically arranged as to the holders of one class of shares and another list alphabetically arranged as to the holders of another class of shares, and other lists reasonably classified as to types of holdings.

“Division (C) is a revision of the second paragraph of present Section 1701.72. Under the present section a shareholder may examine the books and records and lists of shareholders without giving any reason for his exercise of the privilege (Mayer v Cincinnati Economy Drug Co, 89 App 512, 103 NE(2d) 1 (1951)). The burden is on the corporation to prove that the shareholder's purpose is unreasonable or improper. Under division (C) the shareholder will be required to state in writing the specific purpose of the desired examination. Division (C) will not permit an examination by a shareholder who refuses to state his purpose and of course if the purpose stated is unreasonable or improper, the corporation would be justified in refusing. This provision will also justify the corporation in refusing an examination of such of its records as are wholly irrelevant to the stated purpose. Division (C), however, does not go beyond this, as the shareholder who furnishes the proper written statement will be presumed to be acting in good faith and the corporation will have the burden of rebutting that presumption by proving that his actual purpose is unreasonable or improper. In several states it is required by statute that the shareholder or shareholders who desire to make the inspection must have held of record for a specified period of months at least a certain percentage of the outstanding shares. Division (C) imposes no such requirement but permits a shareholder who has recently acquired any number of shares to exercise the right of inspection upon stating specifically in writing a reasonable and proper purpose.”

In this draft no provision is made for examination of records by the holder of a voting trust certificate, but the voting trustee as the holder of record of shares will have such right of examination. In the normal case the corporation has no record of the names and holders of voting trust certificates, particularly where a bank or trust company acts as the transfer agent of the voting trust certificates.

Notes of Decisions (51)

R.C. § 1701.37, OH ST § 1701.37
Current through 2015 Files 1 to 29 of the 131st General Assembly (2015-2016) and 2015 State Issues 1 and 2.

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Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5717. Appeals (Refs & Annos)

R.C. § 5717.02

5717.02 Appeals from final determination of the tax commissioner; procedure; hearing

Effective: October 11, 2013
Currentness

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

(B) The appeals shall be taken by the filing of a notice of appeal with the board, and with the tax commissioner if the tax commissioner's action is the subject of the appeal, with the county auditor if the county auditor's action is the subject of the appeal, with the director of development services if that director's action is the subject of the appeal, or with the director of job and family services if that director's action is the subject of the appeal. The notice of appeal shall be filed within sixty days after service of the notice of the tax assessment, reassessment, valuation, determination, finding, computation, or order by the commissioner, property tax exemption determination by the commissioner or the county auditor, or redetermination by the director has been given as provided in section 5703.37, 5709.64, 5709.66, or 5733.42 of the Revised Code. The notice of appeal may be filed in person or by certified mail, express mail, facsimile transmission, electronic transmission or by authorized delivery service. If the notice of appeal is filed by certified mail, express mail, or authorized delivery service as provided in section 5703.056 of the Revised Code, the date of the United States postmark placed on the sender's receipt by the postal service or the date of receipt recorded by the authorized delivery service shall be treated as the date of filing. If notice of appeal is filed by facsimile transmission or electronic transmission, the date and time the notice is received by the board shall be the date and time reflected on a timestamp provided by the board's electronic system, and the appeal shall be considered filed with the board on the date reflected on that timestamp. Any timestamp provided by another computer system or electronic submission device shall not affect the time and date the notice is received by the board. The notice of appeal shall have attached to it and incorporated in it by reference a true copy of the notice sent by the commissioner, county auditor, or director to the taxpayer, enterprise, or other person of the final determination or redetermination complained of, but failure to attach a copy of that notice and to incorporate it by reference in the notice of appeal does not invalidate the appeal.

(C) A notice of appeal shall contain a short and plain statement of the claimed errors in the determination or redetermination of the tax commissioner, county auditor, or director showing that the appellant is entitled to relief and a demand for the relief to which the appellant claims to be entitled. An appellant may amend the notice of appeal once as a matter of course within sixty

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days after the certification of the transcript. Otherwise, an appellant may amend the notice of appeal only after receiving leave of the board or the written consent of each adverse party. Leave of the board shall be freely given when justice so requires.

(D) Upon the filing of a notice of appeal, the tax commissioner, county auditor, or the director, as appropriate, shall certify to the board a transcript of the record of the proceedings before the commissioner, auditor, or director, together with all evidence considered by the commissioner, auditor, or director in connection with the proceedings. Those appeals or applications may be heard by the board at its office in Columbus or in the county where the appellant resides, or it may cause its examiners to conduct the hearings and to report to it their findings for affirmation or rejection.

(E) The board may order the appeal to be heard upon the record and the evidence certified to it by the commissioner, county auditor, or director, but upon the application of any interested party the board shall order the hearing of additional evidence, and it may make an investigation concerning the appeal that it considers proper. An appeal may proceed pursuant to section 5703.021 of the Revised Code on the small claims docket if the appeal qualifies under that section.

CREDIT(S)

(2013 H 138, eff. 10-11-13; 2011 H 225, eff. 3-22-12; 2002 S 200, eff. 9-6-02; 2000 S 287, eff. 12-21-00; 2000 H 612, eff. 9-29-00; 1994 S 19, eff. 7-22-94; 1985 H 321, eff. 10-17-85; 1985 S 124; 1983 H 260; 1981 H 351; 1977 H 634; 1976 H 920; 1973 S 174; 1953 H 1; GC 5611)

Notes of Decisions (426)

R.C. § 5717.02, OH ST § 5717.02
Current through 2015 Files 1 to 29 of the 131st General Assembly (2015-2016) and 2015 State Issues 1 and 2.

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Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5717. Appeals (Refs & Annos)

R.C. § 5717.03

5717.03 Decisions of board of tax appeals; effects; procedures; remand for administrative determination; final orders

Effective: March 23, 2015
Currentness

(A) A decision of the board of tax appeals on an appeal filed with it pursuant to section 5717.01, 5717.011, or 5717.02 of the Revised Code shall be entered of record on the journal together with the date when the order is filed with the secretary for journalization.

(B) In case of an appeal from a decision of a county board of revision, the board of tax appeals shall determine the taxable value of the property whose valuation or assessment by the county board of revision is complained of, or in the event the complaint and appeal is against a discriminatory valuation, shall determine a valuation which shall correct such discrimination, and shall determine the liability of the property for taxation, if that question is in issue, and the board of tax appeals' decision and the date when it was filed with the secretary for journalization shall be sent by the board to all persons who were parties to the appeal before the board, to the person in whose name the property is listed, or sought to be listed, if such person is not a party to the appeal, to the county auditor of the county in which the property involved in the appeal is located, and to the tax commissioner.

In correcting a discriminatory valuation, the board of tax appeals shall increase or decrease the value of the property whose valuation or assessment by the county board of revision is complained of by a per cent or amount which will cause such property to be listed and valued for taxation by an equal and uniform rule.

(C) In the case of an appeal from a review, redetermination, or correction of a tax assessment, valuation, determination, finding, computation, or order of the tax commissioner, the order of the board of tax appeals and the date of the entry thereof upon its journal shall be sent by the board to all persons who were parties to the appeal before the board, the person in whose name the property is listed or sought to be listed, if the decision determines the valuation or liability of property for taxation and if such person is not a party to the appeal, the taxpayer or other person to whom notice of the tax assessment, valuation, determination, finding, computation, or order, or correction or redetermination thereof, by the tax commissioner was by law required to be given, the director of budget and management, if the revenues affected by such decision would accrue primarily to the state treasury, and the county auditors of the counties to the undivided general tax funds of which the revenues affected by such decision would primarily accrue.

(D) In the case of an appeal from a final determination of a local board of tax review created under section 718.11 of the Revised Code, the order of the board of tax appeals and the date of the entry thereof upon the board's journal shall be sent by the board to all persons who were parties to the appeal before the board.

(E) In the case of all other appeals or applications filed with and determined by the board, the board's order and the date when the order was filed by the secretary for journalization shall be sent by the board to the person who is a party to such appeal or application, to such persons as the law requires, and to such other persons as the board deems proper.

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(F) The orders of the board may affirm, reverse, vacate, modify, or remand the tax assessments, valuations, determinations, findings, computations, or orders complained of in the appeals determined by the board, and the board's decision shall become final and conclusive for the current year unless reversed, vacated, or modified as provided in section 5717.04 of the Revised Code. When an order of the board becomes final the tax commissioner and all officers to whom such decision has been sent shall make the changes in their tax lists or other records which the decision requires.

(G) If the board finds that issues not raised on the appeal are important to a determination of a controversy, the board may remand the cause for an administrative determination and the issuance of a new tax assessment, valuation, determination, finding, computation, or order, unless the parties stipulate to the determination of such other issues without remand. An order remanding the cause is a final order. If the order relates to any issue other than a municipal income tax matter appealed under sections 718.11 and 5717.011 of the Revised Code, the order may be appealed to the court of appeals in Franklin county. If the order relates to a municipal income tax matter appealed under sections 718.11 and 5717.011 of the Revised Code, the order may be appealed to the court of appeals for the county in which the municipal corporation in which the dispute arose is primarily situated.

(H) At the request of any person that filed an appeal subject to this section, the decision or order of the board of tax appeals issued pursuant to division (B), (C), (D), or (E) of this section shall be sent by certified mail at the requestor's expense.

CREDIT(S)

(2014 H 5, eff. 3-23-15; 2009 H 1, eff. 10-16-09; 2003 H 95, eff. 9-26-03; 1983 H 260, eff. 9-27-83; 1977 H 634; 1976 H 920; 1973 S 174; 131 v H 337; 128 v 410; 127 v 65; 1953 H 1; GC 5611-1)

Notes of Decisions (185)

R.C. § 5717.03, OH ST § 5717.03
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Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5717. Appeals (Refs & Annos)

R.C. § 5717.04

5717.04 Appeal from decision of board of tax appeals to supreme court

Effective: October 11, 2013
Currentness

This section does not apply to any decision and order of the board made pursuant to section 5703.021 of the Revised Code. Any such decision and order shall be conclusive upon all parties and may not be appealed.

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

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

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

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

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

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of the filing of such notice with the board shall be filed with the court to which the appeal is being taken. The court in which notice of appeal is first filed shall have exclusive jurisdiction of the appeal.

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

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

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

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

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

CREDIT(S)

(2013 H 138, eff. 10-11-13; 2009 H 1, eff. 10-16-09; 1987 H 231, eff. 10-5-87; 1983 H 260; 1977 H 634; 1973 S 174; 125 v 250; 1953 H 1; GC 5611-2)

Notes of Decisions (231)

R.C. § 5717.04, OH ST § 5717.04
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Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5733. Corporation Franchise Tax (Refs & Annos)
Net Income

R.C. § 5733.05

5733.05 Determination of value of capital, surplus, undivided profits, and reserves; determination of net income of corporation

Currentness

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(i) Separate accounting;

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

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

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

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

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

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

(2) The base upon which the tax is levied under division (C) of section 5733.06 of the Revised Code shall be computed by multiplying the amount determined under division (C)(1) of this section by the fraction determined under divisions (B)(2)(a) to (c) of this section and, if applicable, divisions (B)(2)(d)(ii) and (iii) of this section, and without regard to section 5733.052 of the Revised Code, but substituting “net worth” for “net income” wherever “net income” appears in division (B)(2)(c) in this section. For purposes of division (C)(2) of this section, the numerator and denominator of each of the fractions shall include the portion of any real and tangible personal property, payroll, and sales, respectively, relating to, or used in connection with

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the production of, net nonbusiness income allocated under section 5733.051 of the Revised Code. Nothing in this division shall allow any amount to be included in the numerator or denominator more than once.

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

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

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

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

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

CREDIT(S)

(2003 H 127, eff. 12-11-03; 2003 H 95, eff. 9-26-03; 2002 S 200, eff. 9-6-02; 1999 H 283, eff. 9-29-99; 1999 S 3, eff. 7-6-99; 1998 H 770, eff. 9-16-98; 1997 H 215, eff. 9-29-97; 1993 H 152, eff. 7-1-93; 1986 H 428; 1985 H 238, S 123; 1984 H 794, H 250; 1983 H 291; 1982 S 550; 1981 H 694; 1973 H 95; 1972 H 1134, H 1046; 1971 H 475; 1969 S 55; 132 v S 350; 126 v 747; 125 v 903; 1953 H 1; GC 5498)

Notes of Decisions (226)

R.C. § 5733.05, OH ST § 5733.05
Current through 2015 Files 1 to 29 of the 131st General Assembly (2015-2016) and 2015 State Issues 1 and 2.

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Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5733. Corporation Franchise Tax (Refs & Annos)
Net Income

R.C. § 5733.051

5733.051 Taxation of net income of a corporation

Currentness

For purposes of this section, "available" means information is such that a person is able to learn of the information by the due date plus extensions, if any, for filing the report for the tax year immediately following the last day of the taxable year, and "modified qualifying controlled group" means that portion of a qualifying controlled group consisting of the corporation the sale of which resulted in the gain or loss described in division (E) of this section together with all members of the qualifying controlled group owned directly or indirectly by that corporation, or the corporation that directly paid the dividend or directly made the distribution described in division (F) of this section together with all members of the qualifying controlled group owned directly or indirectly by that corporation.

Subject to section 5733.0510 of the Revised Code, net-nonbusiness income of a corporation shall be allocated and apportioned to this state as follows:

(A) Net rents and royalties from real property located in this state are allocable to this state. Net rents and royalties from real property not located in this state are allocable outside this state.

(B) Net rents and royalties from tangible personal property, to the extent such property is utilized in this state, are allocable to this state. Net rents and royalties from tangible personal property, to the extent such property is utilized outside this state, are allocable outside this state.

(C) Capital gains and losses from the sale or other disposition of real property located in this state are allocable to this state. Capital gains and losses from the sale or other disposition of real property located outside this state are allocable outside this state.

(D) Capital gains and losses from the sale or other disposition of tangible personal property are allocable to this state to the extent such property was utilized in this state prior to the property's sale or other disposition. Capital gains and losses from the sale or other disposition of tangible personal property are allocable outside this state to the extent such property was utilized outside this state prior to the property's sale or other disposition.

(E) Capital gains and losses from the sale or other disposition of intangible property which may produce income enumerated in division (F)(1) of this section are allocable on the same basis as set forth in that division, substituting the day of the sale or disposition for the day on which the payor pays the dividend or makes the distribution, but if the location of the physical assets described in that division is not available to the taxpayer, such gains and losses are apportionable under division (I) of this section. Capital gains and losses from the sale or other disposition of all other intangible property are apportionable under division (I) of this section.

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(F) “Dividends or distributions” to which this division refers are dividends directly or indirectly paid by or distributions directly or indirectly made by any person classified for federal income tax purposes as an association taxable as a corporation.

(1) Dividends or distributions which are not otherwise deducted or excluded from net income, other than dividends or distributions from a domestic international sales corporation, shall be allocated to this state by multiplying such dividends and distributions by a fraction. The numerator of the fraction is the book value of the physical assets in this state of the payor or, if the payor is a member of a modified qualifying controlled group on the last day of the payor's fiscal or calendar year ending immediately prior to the day on which the payor pays the dividend or makes the distribution, the sum of the book values of the physical assets in this state of the payor and of all the other members of the modified qualifying controlled group of which the payor is a member on the last day of the payor's fiscal or calendar year ending immediately prior to the day on which the payor pays the dividend or makes the distribution. The denominator of the fraction is the book value of the physical assets everywhere of the payor or, if the payor is a member of a modified qualifying controlled group on the last day of the payor's fiscal or calendar year ending immediately prior to the day on which the payor pays the dividend or makes the distribution, the sum of the book values of the physical assets everywhere of the payor and of all the other members of the modified qualifying controlled group of which the payor is a member on the last day of the payor's fiscal or calendar year ending immediately prior to the day on which the payor pays the dividend or makes the distribution. Dividends or distributions received from a domestic international sales corporation, or from a payor for which the location of physical assets described in this division is not available to the taxpayer, are apportionable under division (I) of this section.

(2) If the payor of a dividend or distribution, or if that payor and any members of the qualifying controlled group of which the payor is a member on the last day of the payor's fiscal or calendar year ending immediately prior to the day on which the payor pays the dividend or makes the distribution, separately or cumulatively own, directly or indirectly, on the last day of the payor's fiscal or calendar year ending immediately prior to the day on which the payor pays the dividend or makes the distribution, more than fifty per cent of the equity of a pass-through entity, then for purposes of division (F)(1) of this section the payor and the other members are deemed to own the proportionate share of the physical assets that the pass-through entity directly or indirectly owns on the last day of the payor's fiscal or calendar year ending immediately prior to the day on which the payor pays the dividend or makes the distribution.

(3) For the purposes of division (F)(3) of this section, “ upper level pass-through entity” means a pass-through entity directly or indirectly owning any equity of another pass-through entity, and “lower level pass-through entity” means that other pass-through entity. For purposes of divisions (F)(1) and (2) of this section, an upper level pass-through entity is deemed to own, on the last day of the upper level pass-through entity's fiscal or calendar year, the proportionate share of the lower level pass-through entity's physical assets that the lower level pass-through entity directly or indirectly owns on the last day of the lower level pass-through entity's fiscal or calendar year ending within or with the last day of the upper level pass-through entity's fiscal or calendar year. If the upper level pass-through entity directly and indirectly owns less than fifty per cent of the equity of the lower level pass-through entity on each day of the upper level pass-through entity's fiscal or calendar year in which or with which ends the fiscal or calendar year of the lower level pass- through entity and if, based upon clear and convincing evidence, complete information about the location and cost of the physical assets of the lower level pass-through entity is not available to the upper level pass-through entity, then for purposes of divisions (F)(1) and (2) of this section, the upper level pass-through entity shall be deemed as owning no equity of the lower level pass-through entity for each day during the upper level pass-through entity's calendar or fiscal year in which or with which ends the lower level pass-through entity's fiscal or calendar year.

(G) Net rents, net royalties, and net technical assistance fees from intangible property are allocable to this state to the extent that the activity of the payor thereof giving rise to the payment takes place in this state. If the location of a payor's activity

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is not available to the corporation, the net rents, net royalties, and net technical assistance fees are allocable or apportionable under division (I) of this section.

(H)(1) The following amounts are allocable to this state:

(a) All lottery prize awards paid by the state lottery commission pursuant to Chapter 3770. of the Revised Code;

(b) All earnings, profit, income, and gain from the sale, exchange, or other disposition of lottery prize awards paid or to be paid to any person by the state lottery commission pursuant to Chapter 3770. of the Revised Code;

(c) All earnings, profit, income, and gain from the direct or indirect ownership of lottery prize awards paid or to be paid to any person by the state lottery commission pursuant to Chapter 3770. of the Revised Code;

(d) All earnings, profit, income, and gain from the direct or indirect interest in any right in or to any lottery prize awards paid or to be paid to any person by the state lottery commission pursuant to Chapter 3770. of the Revised Code.

(2) Lottery prize awards and related earnings, profit, income, or gain with respect to lotteries sponsored by persons or agencies outside this state shall be allocated outside this state.

(I) Every other item of net nonbusiness income from sources other than those enumerated in divisions (A) to (H) of this section is allocated entirely to this state except to the extent the allocation of such item of net nonbusiness income entirely to this state is not within the taxing power of this state under the Constitution of the United States. To the extent such allocation entirely to this state would not be within the taxing power of this state under the Constitution of the United States, such item of net nonbusiness income is apportionable to this state on the basis of the mechanism provided in division (B)(2) of section 5733.05 and in section 5733.057 of the Revised Code.

CREDIT(S)

(2003 H 95, eff. 9-26-03; 2002 S 226, eff. 9-17-02; 1999 S 3, eff. 7-6-99; 1997 H 215, eff. 6-30-97; 1987 S 33, eff. 9-10-87; 1984 H 250; 1983 H 291; 1971 H 475)

Notes of Decisions (61)

R.C. § 5733.051, OH ST § 5733.051
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KeyCite Yellow Flag - Negative Treatment
Proposed Legislation

Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5747. Income Tax (Refs & Annos)
General Provisions

R.C. § 5747.01

5747.01 Definitions

Effective: September 29, 2015
Currentness

Except as otherwise expressly provided or clearly appearing from the context, any term used in this chapter that is not otherwise defined in this section has the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes or if not used in a comparable context in those laws, has the same meaning as in section 5733.40 of the Revised Code. Any reference in this chapter to the Internal Revenue Code includes other laws of the United States relating to federal income taxes.

As used in this chapter:

(A) "Adjusted gross income" or "Ohio adjusted gross income" means federal adjusted gross income, as defined and used in the Internal Revenue Code, adjusted as provided in this section:

(1) Add interest or dividends on obligations or securities of any state or of any political subdivision or authority of any state, other than this state and its subdivisions and authorities.

(2) Add interest or dividends on obligations of any authority, commission, instrumentality, territory, or possession of the United States to the extent that the interest or dividends are exempt from federal income taxes but not from state income taxes.

(3) Deduct interest or dividends on obligations of the United States and its territories and possessions or of any authority, commission, or instrumentality of the United States to the extent that the interest or dividends are included in federal adjusted gross income but exempt from state income taxes under the laws of the United States.

(4) Deduct disability and survivor's benefits to the extent included in federal adjusted gross income.

(5) Deduct benefits under Title II of the Social Security Act [1] and tier 1 railroad retirement benefits to the extent included in federal adjusted gross income under section 86 of the Internal Revenue Code [2] .

(6) In the case of a taxpayer who is a beneficiary of a trust that makes an accumulation distribution as defined in section 665 of the Internal Revenue Code, add, for the beneficiary's taxable years beginning before 2002, the portion, if any, of such

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distribution that does not exceed the undistributed net income of the trust for the three taxable years preceding the taxable year in which the distribution is made to the extent that the portion was not included in the trust's taxable income for any of the trust's taxable years beginning in 2002 or thereafter. “Undistributed net income of a trust” means the taxable income of the trust increased by (a)(i) the additions to adjusted gross income required under division (A) of this section and (ii) the personal exemptions allowed to the trust pursuant to section 642(b) of the Internal Revenue Code, and decreased by (b)(i) the deductions to adjusted gross income required under division (A) of this section, (ii) the amount of federal income taxes attributable to such income, and (iii) the amount of taxable income that has been included in the adjusted gross income of a beneficiary by reason of a prior accumulation distribution. Any undistributed net income included in the adjusted gross income of a beneficiary shall reduce the undistributed net income of the trust commencing with the earliest years of the accumulation period.

(7) Deduct the amount of wages and salaries, if any, not otherwise allowable as a deduction but that would have been allowable as a deduction in computing federal adjusted gross income for the taxable year, had the targeted jobs credit allowed and determined under sections 38, 51, and 52 of the Internal Revenue Code [3] not been in effect.

(8) Deduct any interest or interest equivalent on public obligations and purchase obligations to the extent that the interest or interest equivalent is included in federal adjusted gross income.

(9) Add any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent that the loss has been deducted or the gain has been included in computing federal adjusted gross income.

(10) Deduct or add amounts, as provided under section 5747.70 of the Revised Code, related to contributions to variable college savings program accounts made or tuition units purchased pursuant to Chapter 3334. of the Revised Code.

(11)(a) Deduct, to the extent not otherwise allowable as a deduction or exclusion in computing federal or Ohio adjusted gross income for the taxable year, the amount the taxpayer paid during the taxable year for medical care insurance and qualified long-term care insurance for the taxpayer, the taxpayer's spouse, and dependents. No deduction for medical care insurance under division (A)(11) of this section shall be allowed either to any taxpayer who is eligible to participate in any subsidized health plan maintained by any employer of the taxpayer or of the taxpayer's spouse, or to any taxpayer who is entitled to, or on application would be entitled to, benefits under part A of Title XVIII of the “Social Security Act,” 49 Stat. 620 (1935), 42 U.S.C. 301, as amended. For the purposes of division (A)(11)(a) of this section, “subsidized health plan” means a health plan for which the employer pays any portion of the plan's cost. The deduction allowed under division (A)(11)(a) of this section shall be the net of any related premium refunds, related premium reimbursements, or related insurance premium dividends received during the taxable year.

(b) Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income during the taxable year, the amount the taxpayer paid during the taxable year, not compensated for by any insurance or otherwise, for medical care of the taxpayer, the taxpayer's spouse, and dependents, to the extent the expenses exceed seven and one-half per cent of the taxpayer's federal adjusted gross income.

(c) Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income, any amount included in federal adjusted gross income under section 105 [4] or not excluded under section 106 of the Internal Revenue Code [5] solely because it relates to an accident and health plan for a person who otherwise would be a “qualifying relative” and thus

a “dependent” under section 152 of the Internal Revenue Code[6] but for the fact that the person fails to meet the income and support limitations under section 152(d)(1)(B) and (C) of the Internal Revenue Code.

(d) For purposes of division (A)(11) of this section, “medical care” has the meaning given in section 213 of the Internal Revenue Code, subject to the special rules, limitations, and exclusions set forth therein, and “qualified long-term care” has the same meaning given in section 7702B(c) of the Internal Revenue Code[7]. Solely for purposes of divisions (A)(11)(a) and (c) of this section, “dependent” includes a person who otherwise would be a “qualifying relative” and thus a “dependent” under section 152 of the Internal Revenue Code but for the fact that the person fails to meet the income and support limitations under section 152(d)(1)(B) and (C) of the Internal Revenue Code.

(12)(a) Deduct any amount included in federal adjusted gross income solely because the amount represents a reimbursement or refund of expenses that in any year the taxpayer had deducted as an itemized deduction pursuant to section 63 of the Internal Revenue Code and applicable United States department of the treasury regulations. The deduction otherwise allowed under division (A)(12)(a) of this section shall be reduced to the extent the reimbursement is attributable to an amount the taxpayer deducted under this section in any taxable year.

(b) Add any amount not otherwise included in Ohio adjusted gross income for any taxable year to the extent that the amount is attributable to the recovery during the taxable year of any amount deducted or excluded in computing federal or Ohio adjusted gross income in any taxable year.

(13) Deduct any portion of the deduction described in section 1341(a)(2) of the Internal Revenue Code, for repaying previously reported income received under a claim of right, that meets both of the following requirements:

(a) It is allowable for repayment of an item that was included in the taxpayer's adjusted gross income for a prior taxable year and did not qualify for a credit under division (A) or (B) of section 5747.05 of the Revised Code for that year;

(b) It does not otherwise reduce the taxpayer's adjusted gross income for the current or any other taxable year.

(14) Deduct an amount equal to the deposits made to, and net investment earnings of, a medical savings account during the taxable year, in accordance with section 3924.66 of the Revised Code. The deduction allowed by division (A)(14) of this section does not apply to medical savings account deposits and earnings otherwise deducted or excluded for the current or any other taxable year from the taxpayer's federal adjusted gross income.

(15)(a) Add an amount equal to the funds withdrawn from a medical savings account during the taxable year, and the net investment earnings on those funds, when the funds withdrawn were used for any purpose other than to reimburse an account holder for, or to pay, eligible medical expenses, in accordance with section 3924.66 of the Revised Code;

(b) Add the amounts distributed from a medical savings account under division (A)(2) of section 3924.68 of the Revised Code during the taxable year.

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(16) Add any amount claimed as a credit under section 5747.059 or 5747.65 of the Revised Code to the extent that such amount satisfies either of the following:

(a) The amount was deducted or excluded from the computation of the taxpayer's federal adjusted gross income as required to be reported for the taxpayer's taxable year under the Internal Revenue Code;

(b) The amount resulted in a reduction of the taxpayer's federal adjusted gross income as required to be reported for any of the taxpayer's taxable years under the Internal Revenue Code.

(17) Deduct the amount contributed by the taxpayer to an individual development account program established by a county department of job and family services pursuant to sections 329.11 to 329.14 of the Revised Code for the purpose of matching funds deposited by program participants. On request of the tax commissioner, the taxpayer shall provide any information that, in the tax commissioner's opinion, is necessary to establish the amount deducted under division (A)(17) of this section.

(18) Beginning in taxable year 2001 but not for any taxable year beginning after December 31, 2005, if the taxpayer is married and files a joint return and the combined federal adjusted gross income of the taxpayer and the taxpayer's spouse for the taxable year does not exceed one hundred thousand dollars, or if the taxpayer is single and has a federal adjusted gross income for the taxable year not exceeding fifty thousand dollars, deduct amounts paid during the taxable year for qualified tuition and fees paid to an eligible institution for the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer, who is a resident of this state and is enrolled in or attending a program that culminates in a degree or diploma at an eligible institution. The deduction may be claimed only to the extent that qualified tuition and fees are not otherwise deducted or excluded for any taxable year from federal or Ohio adjusted gross income. The deduction may not be claimed for educational expenses for which the taxpayer claims a credit under section 5747.27 of the Revised Code.

(19) Add any reimbursement received during the taxable year of any amount the taxpayer deducted under division (A)(18) of this section in any previous taxable year to the extent the amount is not otherwise included in Ohio adjusted gross income.

(20)(a)(i) Subject to divisions (A)(20)(a)(iii), (iv), and (v) of this section, add five-sixths of the amount of depreciation expense allowed by subsection (k) of section 168 of the Internal Revenue Code, including the taxpayer's proportionate or distributive share of the amount of depreciation expense allowed by that subsection to a pass-through entity in which the taxpayer has a direct or indirect ownership interest.

(ii) Subject to divisions (A)(20)(a)(iii), (iv), and (v) of this section, add five-sixths of the amount of qualifying section 179 depreciation expense, including the taxpayer's proportionate or distributive share of the amount of qualifying section 179 depreciation expense allowed to any pass-through entity in which the taxpayer has a direct or indirect ownership interest.

(iii) Subject to division (A)(20)(a)(v) of this section, for taxable years beginning in 2012 or thereafter, if the increase in income taxes withheld by the taxpayer is equal to or greater than ten per cent of income taxes withheld by the taxpayer during the taxpayer's immediately preceding taxable year, “two-thirds” shall be substituted for “five-sixths” for the purpose of divisions (A)(20)(a)(i) and (ii) of this section.

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(iv) Subject to division (A)(20)(a)(v) of this section, for taxable years beginning in 2012 or thereafter, a taxpayer is not required to add an amount under division (A)(20) of this section if the increase in income taxes withheld by the taxpayer and by any pass-through entity in which the taxpayer has a direct or indirect ownership interest is equal to or greater than the sum of (I) the amount of qualifying section 179 depreciation expense and (II) the amount of depreciation expense allowed to the taxpayer by subsection (k) of section 168 of the Internal Revenue Code, and including the taxpayer's proportionate or distributive shares of such amounts allowed to any such pass-through entities.

(v) If a taxpayer directly or indirectly incurs a net operating loss for the taxable year for federal income tax purposes, to the extent such loss resulted from depreciation expense allowed by subsection (k) of section 168 of the Internal Revenue Code and by qualifying section 179 depreciation expense, "the entire" shall be substituted for "five-sixths of the" for the purpose of divisions (A)(20)(a)(i) and (ii) of this section.

The tax commissioner, under procedures established by the commissioner, may waive the add-backs related to a pass-through entity if the taxpayer owns, directly or indirectly, less than five per cent of the pass-through entity.

(b) Nothing in division (A)(20) of this section shall be construed to adjust or modify the adjusted basis of any asset.

(c) To the extent the add-back required under division (A)(20)(a) of this section is attributable to property generating nonbusiness income or loss allocated under section 5747.20 of the Revised Code, the add-back shall be sitused to the same location as the nonbusiness income or loss generated by the property for the purpose of determining the credit under division (A) of section 5747.05 of the Revised Code. Otherwise, the add-back shall be apportioned, subject to one or more of the four alternative methods of apportionment enumerated in section 5747.21 of the Revised Code.

(d) For the purposes of division (A)(20)(a)(v) of this section, net operating loss carryback and carryforward shall not include the allowance of any net operating loss deduction carryback or carryforward to the taxable year to the extent such loss resulted from depreciation allowed by section 168(k) of the Internal Revenue Code and by the qualifying section 179 depreciation expense amount.

(e) For the purposes of divisions (A)(20) and (21) of this section:

(i) "Income taxes withheld" means the total amount withheld and remitted under sections 5747.06 and 5747.07 of the Revised Code by an employer during the employer's taxable year.

(ii) "Increase in income taxes withheld" means the amount by which the amount of income taxes withheld by an employer during the employer's current taxable year exceeds the amount of income taxes withheld by that employer during the employer's immediately preceding taxable year.

(iii) "Qualifying section 179 depreciation expense" means the difference between (I) the amount of depreciation expense directly or indirectly allowed to a taxpayer under section 179 of the Internal Revised Code, and (II) the amount of depreciation expense directly or indirectly allowed to the taxpayer under section 179 of the Internal Revenue Code as that section existed on December 31, 2002.

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(21)(a) If the taxpayer was required to add an amount under division (A)(20)(a) of this section for a taxable year, deduct one of the following:

(i) One-fifth of the amount so added for each of the five succeeding taxable years if the amount so added was five-sixths of qualifying section 179 depreciation expense or depreciation expense allowed by subsection (k) of section 168 of the Internal Revenue Code;

(ii) One-half of the amount so added for each of the two succeeding taxable years if the amount so added was two-thirds of such depreciation expense;

(iii) One-sixth of the amount so added for each of the six succeeding taxable years if the entire amount of such depreciation expense was so added.

(b) If the amount deducted under division (A)(21)(a) of this section is attributable to an add-back allocated under division (A)(20)(c) of this section, the amount deducted shall be sitused to the same location. Otherwise, the add-back shall be apportioned using the apportionment factors for the taxable year in which the deduction is taken, subject to one or more of the four alternative methods of apportionment enumerated in section 5747.21 of the Revised Code.

(c) No deduction is available under division (A)(21)(a) of this section with regard to any depreciation allowed by section 168(k) of the Internal Revenue Code and by the qualifying section 179 depreciation expense amount to the extent that such depreciation results in or increases a federal net operating loss carryback or carryforward. If no such deduction is available for a taxable year, the taxpayer may carry forward the amount not deducted in such taxable year to the next taxable year and add that amount to any deduction otherwise available under division (A)(21)(a) of this section for that next taxable year. The carryforward of amounts not so deducted shall continue until the entire addition required by division (A)(20)(a) of this section has been deducted.

(d) No refund shall be allowed as a result of adjustments made by division (A)(21) of this section.

(22) Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year, the amount the taxpayer received during the taxable year as reimbursement for life insurance premiums under section 5919.31 of the Revised Code.

(23) Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year, the amount the taxpayer received during the taxable year as a death benefit paid by the adjutant general under section 5919.33 of the Revised Code.

(24) Deduct, to the extent included in federal adjusted gross income and not otherwise allowable as a deduction or exclusion in computing federal or Ohio adjusted gross income for the taxable year, military pay and allowances received by the taxpayer during the taxable year for active duty service in the United States army, air force, navy, marine corps, or coast guard or reserve components thereof or the national guard. The deduction may not be claimed for military pay and allowances received by the taxpayer while the taxpayer is stationed in this state.

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(25) Deduct, to the extent not otherwise allowable as a deduction or exclusion in computing federal or Ohio adjusted gross income for the taxable year and not otherwise compensated for by any other source, the amount of qualified organ donation expenses incurred by the taxpayer during the taxable year, not to exceed ten thousand dollars. A taxpayer may deduct qualified organ donation expenses only once for all taxable years beginning with taxable years beginning in 2007.

For the purposes of division (A)(25) of this section:

(a) “Human organ” means all or any portion of a human liver, pancreas, kidney, intestine, or lung, and any portion of human bone marrow.

(b) “Qualified organ donation expenses” means travel expenses, lodging expenses, and wages and salary forgone by a taxpayer in connection with the taxpayer's donation, while living, of one or more of the taxpayer's human organs to another human being.

(26) Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year, amounts received by the taxpayer as retired personnel pay for service in the uniformed services or reserve components thereof, or the national guard, or received by the surviving spouse or former spouse of such a taxpayer under the survivor benefit plan on account of such a taxpayer's death. If the taxpayer receives income on account of retirement paid under the federal civil service retirement system or federal employees retirement system, or under any successor retirement program enacted by the congress of the United States that is established and maintained for retired employees of the United States government, and such retirement income is based, in whole or in part, on credit for the taxpayer's uniformed service, the deduction allowed under this division shall include only that portion of such retirement income that is attributable to the taxpayer's uniformed service, to the extent that portion of such retirement income is otherwise included in federal adjusted gross income and is not otherwise deducted under this section. Any amount deducted under division (A)(26) of this section is not included in a taxpayer's adjusted gross income for the purposes of section 5747.055 of the Revised Code. No amount may be deducted under division (A)(26) of this section on the basis of which a credit was claimed under section 5747.055 of the Revised Code.

(27) Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year, the amount the taxpayer received during the taxable year from the military injury relief fund created in section 5902.05 of the Revised Code.

(28) Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year, the amount the taxpayer received as a veterans bonus during the taxable year from the Ohio department of veterans services as authorized by Section 2r of Article VIII, Ohio Constitution.

(29) Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year, any income derived from a transfer agreement or from the enterprise transferred under that agreement under section 4313.02 of the Revised Code.

(30) Deduct, to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year, Ohio college opportunity or federal Pell grant amounts received by the taxpayer or the taxpayer's spouse or dependent pursuant to section 3333.122 of the Revised Code or 20 U.S.C. 1070a, et seq., and used to pay room or board furnished by the educational institution for which the grant was awarded at the institution's facilities, including meal plans administered by the

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institution. For the purposes of this division, receipt of a grant includes the distribution of a grant directly to an educational institution and the crediting of the grant to the enrollee's account with the institution.

(31) Deduct all business income to the extent not otherwise deducted or excluded in computing federal or Ohio adjusted gross income for the taxable year.

(B) “Business income” means income, including gain or loss, arising from transactions, activities, and sources in the regular course of a trade or business and includes income, gain, or loss from real property, tangible property, and intangible property if the acquisition, rental, management, and disposition of the property constitute integral parts of the regular course of a trade or business operation. “Business income” includes income, including gain or loss, from a partial or complete liquidation of a business, including, but not limited to, gain or loss from the sale or other disposition of goodwill.

(C) “Nonbusiness income” means all income other than business income and may include, but is not limited to, compensation, rents and royalties from real or tangible personal property, capital gains, interest, dividends and distributions, patent or copyright royalties, or lottery winnings, prizes, and awards.

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

(E) “Fiduciary” means a guardian, trustee, executor, administrator, receiver, conservator, or any other person acting in any fiduciary capacity for any individual, trust, or estate.

(F) “Fiscal year” means an accounting period of twelve months ending on the last day of any month other than December.

(G) “Individual” means any natural person.

(H) “Internal Revenue Code” means the “Internal Revenue Code of 1986,” 100 Stat. 2085, 26 U.S.C.A. 1, as amended.

(I) “Resident” means any of the following, provided that division (I)(3) of this section applies only to taxable years of a trust beginning in 2002 or thereafter:

(1) An individual who is domiciled in this state, subject to section 5747.24 of the Revised Code;

(2) The estate of a decedent who at the time of death was domiciled in this state. The domicile tests of section 5747.24 of the Revised Code are not controlling for purposes of division (I)(2) of this section.

(3) A trust that, in whole or part, resides in this state. If only part of a trust resides in this state, the trust is a resident only with respect to that part.

For the purposes of division (I)(3) of this section:

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(a) A trust resides in this state for the trust's current taxable year to the extent, as described in division (I)(3)(d) of this section, that the trust consists directly or indirectly, in whole or in part, of assets, net of any related liabilities, that were transferred, or caused to be transferred, directly or indirectly, to the trust by any of the following:

(i) A person, a court, or a governmental entity or instrumentality on account of the death of a decedent, but only if the trust is described in division (I)(3)(e)(i) or (ii) of this section;

(ii) A person who was domiciled in this state for the purposes of this chapter when the person directly or indirectly transferred assets to an irrevocable trust, but only if at least one of the trust's qualifying beneficiaries is domiciled in this state for the purposes of this chapter during all or some portion of the trust's current taxable year;

(iii) A person who was domiciled in this state for the purposes of this chapter when the trust document or instrument or part of the trust document or instrument became irrevocable, but only if at least one of the trust's qualifying beneficiaries is a resident domiciled in this state for the purposes of this chapter during all or some portion of the trust's current taxable year. If a trust document or instrument became irrevocable upon the death of a person who at the time of death was domiciled in this state for purposes of this chapter, that person is a person described in division (I)(3)(a)(iii) of this section.

(b) A trust is irrevocable to the extent that the transferor is not considered to be the owner of the net assets of the trust under sections 671 to 678 of the Internal Revenue Code [8].

(c) With respect to a trust other than a charitable lead trust, "qualifying beneficiary" has the same meaning as "potential current beneficiary" as defined in section 1361(e)(2) of the Internal Revenue Code, and with respect to a charitable lead trust "qualifying beneficiary" is any current, future, or contingent beneficiary, but with respect to any trust "qualifying beneficiary" excludes a person or a governmental entity or instrumentality to any of which a contribution would qualify for the charitable deduction under section 170 of the Internal Revenue Code.

(d) For the purposes of division (I)(3)(a) of this section, the extent to which a trust consists directly or indirectly, in whole or in part, of assets, net of any related liabilities, that were transferred directly or indirectly, in whole or part, to the trust by any of the sources enumerated in that division shall be ascertained by multiplying the fair market value of the trust's assets, net of related liabilities, by the qualifying ratio, which shall be computed as follows:

(i) The first time the trust receives assets, the numerator of the qualifying ratio is the fair market value of those assets at that time, net of any related liabilities, from sources enumerated in division (I)(3)(a) of this section. The denominator of the qualifying ratio is the fair market value of all the trust's assets at that time, net of any related liabilities.

(ii) Each subsequent time the trust receives assets, a revised qualifying ratio shall be computed. The numerator of the revised qualifying ratio is the sum of (1) the fair market value of the trust's assets immediately prior to the subsequent transfer, net of any related liabilities, multiplied by the qualifying ratio last computed without regard to the subsequent transfer, and (2) the fair market value of the subsequently transferred assets at the time transferred, net of any related liabilities, from sources enumerated in division (I)(3)(a) of this section. The denominator of the revised qualifying ratio is the fair market value of all the trust's assets immediately after the subsequent transfer, net of any related liabilities.

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(iii) Whether a transfer to the trust is by or from any of the sources enumerated in division (I)(3)(a) of this section shall be ascertained without regard to the domicile of the trust's beneficiaries.

(e) For the purposes of division (I)(3)(a)(i) of this section:

(i) A trust is described in division (I)(3)(e)(i) of this section if the trust is a testamentary trust and the testator of that testamentary trust was domiciled in this state at the time of the testator's death for purposes of the taxes levied under Chapter 5731. of the Revised Code.

(ii) A trust is described in division (I)(3)(e)(ii) of this section if the transfer is a qualifying transfer described in any of divisions (I)(3)(f)(i) to (vi) of this section, the trust is an irrevocable inter vivos trust, and at least one of the trust's qualifying beneficiaries is domiciled in this state for purposes of this chapter during all or some portion of the trust's current taxable year.

(f) For the purposes of division (I)(3)(e)(ii) of this section, a “qualifying transfer” is a transfer of assets, net of any related liabilities, directly or indirectly to a trust, if the transfer is described in any of the following:

(i) The transfer is made to a trust, created by the decedent before the decedent's death and while the decedent was domiciled in this state for the purposes of this chapter, and, prior to the death of the decedent, the trust became irrevocable while the decedent was domiciled in this state for the purposes of this chapter.

(ii) The transfer is made to a trust to which the decedent, prior to the decedent's death, had directly or indirectly transferred assets, net of any related liabilities, while the decedent was domiciled in this state for the purposes of this chapter, and prior to the death of the decedent the trust became irrevocable while the decedent was domiciled in this state for the purposes of this chapter.

(iii) The transfer is made on account of a contractual relationship existing directly or indirectly between the transferor and either the decedent or the estate of the decedent at any time prior to the date of the decedent's death, and the decedent was domiciled in this state at the time of death for purposes of the taxes levied under Chapter 5731. of the Revised Code.

(iv) The transfer is made to a trust on account of a contractual relationship existing directly or indirectly between the transferor and another person who at the time of the decedent's death was domiciled in this state for purposes of this chapter.

(v) The transfer is made to a trust on account of the will of a testator who was domiciled in this state at the time of the testator's death for purposes of the taxes levied under Chapter 5731. of the Revised Code.

(vi) The transfer is made to a trust created by or caused to be created by a court, and the trust was directly or indirectly created in connection with or as a result of the death of an individual who, for purposes of the taxes levied under Chapter 5731. of the Revised Code, was domiciled in this state at the time of the individual's death.

(g) The tax commissioner may adopt rules to ascertain the part of a trust residing in this state.

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(J) “Nonresident” means an individual or estate that is not a resident. An individual who is a resident for only part of a taxable year is a nonresident for the remainder of that taxable year.

(K) “Pass-through entity” has the same meaning as in section 5733.04 of the Revised Code.

(L) “Return” means the notifications and reports required to be filed pursuant to this chapter for the purpose of reporting the tax due and includes declarations of estimated tax when so required.

(M) “Taxable year” means the calendar year or the taxpayer's fiscal year ending during the calendar year, or fractional part thereof, upon which the adjusted gross income is calculated pursuant to this chapter.

(N) “Taxpayer” means any person subject to the tax imposed by section 5747.02 of the Revised Code or any pass-through entity that makes the election under division (D) of section 5747.08 of the Revised Code.

(O) “Dependents” means dependents as defined in the Internal Revenue Code and as claimed in the taxpayer's federal income tax return for the taxable year or which the taxpayer would have been permitted to claim had the taxpayer filed a federal income tax return.

(P) “Principal county of employment” means, in the case of a nonresident, the county within the state in which a taxpayer performs services for an employer or, if those services are performed in more than one county, the county in which the major portion of the services are performed.

(Q) As used in sections 5747.50 to 5747.55 of the Revised Code:

(1) “Subdivision” means any county, municipal corporation, park district, or township.

(2) “Essential local government purposes” includes all functions that any subdivision is required by general law to exercise, including like functions that are exercised under a charter adopted pursuant to the Ohio Constitution.

(R) “Overpayment” means any amount already paid that exceeds the figure determined to be the correct amount of the tax.

(S) “Taxable income” or “Ohio taxable income” applies only to estates and trusts, and means federal taxable income, as defined and used in the Internal Revenue Code, adjusted as follows:

(1) Add interest or dividends, net of ordinary, necessary, and reasonable expenses not deducted in computing federal taxable income, on obligations or securities of any state or of any political subdivision or authority of any state, other than this state and its subdivisions and authorities, but only to the extent that such net amount is not otherwise includible in Ohio taxable income and is described in either division (S)(1)(a) or (b) of this section:

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(a) The net amount is not attributable to the S portion of an electing small business trust and has not been distributed to beneficiaries for the taxable year;

(b) The net amount is attributable to the S portion of an electing small business trust for the taxable year.

(2) Add interest or dividends, net of ordinary, necessary, and reasonable expenses not deducted in computing federal taxable income, on obligations of any authority, commission, instrumentality, territory, or possession of the United States to the extent that the interest or dividends are exempt from federal income taxes but not from state income taxes, but only to the extent that such net amount is not otherwise includible in Ohio taxable income and is described in either division (S)(1)(a) or (b) of this section;

(3) Add the amount of personal exemption allowed to the estate pursuant to section 642(b) of the Internal Revenue Code;

(4) Deduct interest or dividends, net of related expenses deducted in computing federal taxable income, on obligations of the United States and its territories and possessions or of any authority, commission, or instrumentality of the United States to the extent that the interest or dividends are exempt from state taxes under the laws of the United States, but only to the extent that such amount is included in federal taxable income and is described in either division (S)(1)(a) or (b) of this section;

(5) Deduct the amount of wages and salaries, if any, not otherwise allowable as a deduction but that would have been allowable as a deduction in computing federal taxable income for the taxable year, had the targeted jobs credit allowed under sections 38, 51, and 52 of the Internal Revenue Code not been in effect, but only to the extent such amount relates either to income included in federal taxable income for the taxable year or to income of the S portion of an electing small business trust for the taxable year;

(6) Deduct any interest or interest equivalent, net of related expenses deducted in computing federal taxable income, on public obligations and purchase obligations, but only to the extent that such net amount relates either to income included in federal taxable income for the taxable year or to income of the S portion of an electing small business trust for the taxable year;

(7) Add any loss or deduct any gain resulting from sale, exchange, or other disposition of public obligations to the extent that such loss has been deducted or such gain has been included in computing either federal taxable income or income of the S portion of an electing small business trust for the taxable year;

(8) Except in the case of the final return of an estate, add any amount deducted by the taxpayer on both its Ohio estate tax return pursuant to section 5731.14 of the Revised Code, and on its federal income tax return in determining federal taxable income;

(9)(a) Deduct any amount included in federal taxable income solely because the amount represents a reimbursement or refund of expenses that in a previous year the decedent had deducted as an itemized deduction pursuant to section 63 of the Internal Revenue Code and applicable treasury regulations. The deduction otherwise allowed under division (S)(9)(a) of this section shall be reduced to the extent the reimbursement is attributable to an amount the taxpayer or decedent deducted under this section in any taxable year.

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(b) Add any amount not otherwise included in Ohio taxable income for any taxable year to the extent that the amount is attributable to the recovery during the taxable year of any amount deducted or excluded in computing federal or Ohio taxable income in any taxable year, but only to the extent such amount has not been distributed to beneficiaries for the taxable year.

(10) Deduct any portion of the deduction described in section 1341(a)(2) of the Internal Revenue Code, for repaying previously reported income received under a claim of right, that meets both of the following requirements:

(a) It is allowable for repayment of an item that was included in the taxpayer's taxable income or the decedent's adjusted gross income for a prior taxable year and did not qualify for a credit under division (A) or (B) of section 5747.05 of the Revised Code for that year.

(b) It does not otherwise reduce the taxpayer's taxable income or the decedent's adjusted gross income for the current or any other taxable year.

(11) Add any amount claimed as a credit under section 5747.059 or 5747.65 of the Revised Code to the extent that the amount satisfies either of the following:

(a) The amount was deducted or excluded from the computation of the taxpayer's federal taxable income as required to be reported for the taxpayer's taxable year under the Internal Revenue Code;

(b) The amount resulted in a reduction in the taxpayer's federal taxable income as required to be reported for any of the taxpayer's taxable years under the Internal Revenue Code.

(12) Deduct any amount, net of related expenses deducted in computing federal taxable income, that a trust is required to report as farm income on its federal income tax return, but only if the assets of the trust include at least ten acres of land satisfying the definition of “land devoted exclusively to agricultural use” under section 5713.30 of the Revised Code, regardless of whether the land is valued for tax purposes as such land under sections 5713.30 to 5713.38 of the Revised Code. If the trust is a pass-through entity investor, section 5747.231 of the Revised Code applies in ascertaining if the trust is eligible to claim the deduction provided by division (S)(12) of this section in connection with the pass-through entity's farm income.

Except for farm income attributable to the S portion of an electing small business trust, the deduction provided by division (S)(12) of this section is allowed only to the extent that the trust has not distributed such farm income. Division (S)(12) of this section applies only to taxable years of a trust beginning in 2002 or thereafter.

(13) Add the net amount of income described in section 641(c) of the Internal Revenue Code[9] to the extent that amount is not included in federal taxable income.

(14) Add or deduct the amount the taxpayer would be required to add or deduct under division (A)(20) or (21) of this section if the taxpayer's Ohio taxable income were computed in the same manner as an individual's Ohio adjusted gross income is computed under this section. In the case of a trust, division (S)(14) of this section applies only to any of the trust's taxable years beginning in 2002 or thereafter.

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(T) “School district income” and “school district income tax” have the same meanings as in section 5748.01 of the Revised Code.

(U) As used in divisions (A)(8), (A)(9), (S)(6), and (S)(7) of this section, “public obligations,” “purchase obligations,” and “interest or interest equivalent” have the same meanings as in section 5709.76 of the Revised Code.

(V) “Limited liability company” means any limited liability company formed under Chapter 1705. of the Revised Code or under the laws of any other state.

(W) “Pass-through entity investor” means any person who, during any portion of a taxable year of a pass-through entity, is a partner, member, shareholder, or equity investor in that pass-through entity.

(X) “Banking day” has the same meaning as in section 1304.01 of the Revised Code.

(Y) “Month” means a calendar month.

(Z) “Quarter” means the first three months, the second three months, the third three months, or the last three months of the taxpayer's taxable year.

(AA)(1) “Eligible institution” means a state university or state institution of higher education as defined in section 3345.011 of the Revised Code, or a private, nonprofit college, university, or other post-secondary institution located in this state that possesses a certificate of authorization issued by the chancellor of higher education pursuant to Chapter 1713. of the Revised Code or a certificate of registration issued by the state board of career colleges and schools under Chapter 3332. of the Revised Code.

(2) “Qualified tuition and fees” means tuition and fees imposed by an eligible institution as a condition of enrollment or attendance, not exceeding two thousand five hundred dollars in each of the individual's first two years of post-secondary education. If the individual is a part-time student, “qualified tuition and fees” includes tuition and fees paid for the academic equivalent of the first two years of post-secondary education during a maximum of five taxable years, not exceeding a total of five thousand dollars. “Qualified tuition and fees” does not include:

(a) Expenses for any course or activity involving sports, games, or hobbies unless the course or activity is part of the individual's degree or diploma program;

(b) The cost of books, room and board, student activity fees, athletic fees, insurance expenses, or other expenses unrelated to the individual's academic course of instruction;

(c) Tuition, fees, or other expenses paid or reimbursed through an employer, scholarship, grant in aid, or other educational benefit program.

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(BB)(1) “Modified business income” means the business income included in a trust's Ohio taxable income after such taxable income is first reduced by the qualifying trust amount, if any.

(2) “Qualifying trust amount” of a trust means capital gains and losses from the sale, exchange, or other disposition of equity or ownership interests in, or debt obligations of, a qualifying investee to the extent included in the trust's Ohio taxable income, but only if the following requirements are satisfied:

(a) The book value of the qualifying investee's physical assets in this state and everywhere, as of the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, is available to the trust.

(b) The requirements of section 5747.011 of the Revised Code are satisfied for the trust's taxable year in which the trust recognizes the gain or loss.

Any gain or loss that is not a qualifying trust amount is modified business income, qualifying investment income, or modified nonbusiness income, as the case may be.

(3) “Modified nonbusiness income” means a trust's Ohio taxable income other than modified business income, other than the qualifying trust amount, and other than qualifying investment income, as defined in section 5747.012 of the Revised Code, to the extent such qualifying investment income is not otherwise part of modified business income.

(4) “Modified Ohio taxable income” applies only to trusts, and means the sum of the amounts described in divisions (BB)(4)(a) to (c) of this section:

(a) The fraction, calculated under section 5747.013, and applying section 5747.231 of the Revised Code, multiplied by the sum of the following amounts:

(i) The trust's modified business income;

(ii) The trust's qualifying investment income, as defined in section 5747.012 of the Revised Code, but only to the extent the qualifying investment income does not otherwise constitute modified business income and does not otherwise constitute a qualifying trust amount.

(b) The qualifying trust amount multiplied by a fraction, the numerator of which is the sum of the book value of the qualifying investee's physical assets in this state on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the day on which the trust recognizes the qualifying trust amount, and the denominator of which is the sum of the book value of the qualifying investee's total physical assets everywhere on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the day on which the trust recognizes the qualifying trust amount. If, for a taxable year, the trust recognizes a qualifying trust amount with respect to more than one qualifying investee, the amount described in division (BB)(4)(b) of this section shall equal the sum of the products so computed for each such qualifying investee.

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(c)(i) With respect to a trust or portion of a trust that is a resident as ascertained in accordance with division (I)(3)(d) of this section, its modified nonbusiness income.

(ii) With respect to a trust or portion of a trust that is not a resident as ascertained in accordance with division (I)(3)(d) of this section, the amount of its modified nonbusiness income satisfying the descriptions in divisions (B)(2) to (5) of section 5747.20 of the Revised Code, except as otherwise provided in division (BB)(4)(c)(ii) of this section. With respect to a trust or portion of a trust that is not a resident as ascertained in accordance with division (I)(3)(d) of this section, the trust's portion of modified nonbusiness income recognized from the sale, exchange, or other disposition of a debt interest in or equity interest in a section 5747.212 entity, as defined in section 5747.212 of the Revised Code, without regard to division (A) of that section, shall not be allocated to this state in accordance with section 5747.20 of the Revised Code but shall be apportioned to this state in accordance with division (B) of section 5747.212 of the Revised Code without regard to division (A) of that section.

If the allocation and apportionment of a trust's income under divisions (BB)(4)(a) and (c) of this section do not fairly represent the modified Ohio taxable income of the trust in this state, the alternative methods described in division (C) of section 5747.21 of the Revised Code may be applied in the manner and to the same extent provided in that section.

(5)(a) Except as set forth in division (BB)(5)(b) of this section, “qualifying investee” means a person in which a trust has an equity or ownership interest, or a person or unit of government the debt obligations of either of which are owned by a trust. For the purposes of division (BB)(2)(a) of this section and for the purpose of computing the fraction described in division (BB)(4)(b) of this section, all of the following apply:

(i) If the qualifying investee is a member of a qualifying controlled group on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, then “qualifying investee” includes all persons in the qualifying controlled group on such last day.

(ii) If the qualifying investee, or if the qualifying investee and any members of the qualifying controlled group of which the qualifying investee is a member on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, separately or cumulatively own, directly or indirectly, on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the qualifying trust amount, more than fifty per cent of the equity of a pass-through entity, then the qualifying investee and the other members are deemed to own the proportionate share of the pass-through entity's physical assets which the pass-through entity directly or indirectly owns on the last day of the pass-through entity's calendar or fiscal year ending within or with the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the qualifying trust amount.

(iii) For the purposes of division (BB)(5)(a)(iii) of this section, “upper level pass-through entity” means a pass-through entity directly or indirectly owning any equity of another pass-through entity, and “lower level pass-through entity” means that other pass-through entity.

An upper level pass-through entity, whether or not it is also a qualifying investee, is deemed to own, on the last day of the upper level pass-through entity's calendar or fiscal year, the proportionate share of the lower level pass-through entity's physical assets that the lower level pass-through entity directly or indirectly owns on the last day of the lower level pass-through entity's calendar or fiscal year ending within or with the last day of the upper level pass-through entity's fiscal or calendar year. If the upper level pass-through entity directly and indirectly owns less than fifty per cent of the equity of the lower level pass-through entity on each day of the upper level pass-through entity's calendar or fiscal year in which or with which ends the calendar

or fiscal year of the lower level pass-through entity and if, based upon clear and convincing evidence, complete information about the location and cost of the physical assets of the lower pass-through entity is not available to the upper level pass-through entity, then solely for purposes of ascertaining if a gain or loss constitutes a qualifying trust amount, the upper level pass-through entity shall be deemed as owning no equity of the lower level pass-through entity for each day during the upper level pass-through entity's calendar or fiscal year in which or with which ends the lower level pass-through entity's calendar or fiscal year. Nothing in division (BB)(5)(a)(iii) of this section shall be construed to provide for any deduction or exclusion in computing any trust's Ohio taxable income.

(b) With respect to a trust that is not a resident for the taxable year and with respect to a part of a trust that is not a resident for the taxable year, “qualifying investee” for that taxable year does not include a C corporation if both of the following apply:

(i) During the taxable year the trust or part of the trust recognizes a gain or loss from the sale, exchange, or other disposition of equity or ownership interests in, or debt obligations of, the C corporation.

(ii) Such gain or loss constitutes nonbusiness income.

(6) “Available” means information is such that a person is able to learn of the information by the due date plus extensions, if any, for filing the return for the taxable year in which the trust recognizes the gain or loss.

(CC) “Qualifying controlled group” has the same meaning as in section 5733.04 of the Revised Code.

(DD) “Related member” has the same meaning as in section 5733.042 of the Revised Code.

(EE)(1) For the purposes of division (EE) of this section:

(a) “Qualifying person” means any person other than a qualifying corporation.

(b) “Qualifying corporation” means any person classified for federal income tax purposes as an association taxable as a corporation, except either of the following:

(i) A corporation that has made an election under subchapter S, chapter one, subtitle A, of the Internal Revenue Code for its taxable year ending within, or on the last day of, the investor's taxable year;

(ii) A subsidiary that is wholly owned by any corporation that has made an election under subchapter S, chapter one, subtitle A of the Internal Revenue Code for its taxable year ending within, or on the last day of, the investor's taxable year.

(2) For the purposes of this chapter, unless expressly stated otherwise, no qualifying person indirectly owns any asset directly or indirectly owned by any qualifying corporation.

(FF) For purposes of this chapter and Chapter 5751. of the Revised Code:

(1) "Trust" does not include a qualified pre-income tax trust.

(2) A "qualified pre-income tax trust" is any pre-income tax trust that makes a qualifying pre-income tax trust election as described in division (FF)(3) of this section.

(3) A "qualifying pre-income tax trust election" is an election by a pre-income tax trust to subject to the tax imposed by section 5751.02 of the Revised Code the pre-income tax trust and all pass-through entities of which the trust owns or controls, directly, indirectly, or constructively through related interests, five per cent or more of the ownership or equity interests. The trustee shall notify the tax commissioner in writing of the election on or before April 15, 2006. The election, if timely made, shall be effective on and after January 1, 2006, and shall apply for all tax periods and tax years until revoked by the trustee of the trust.

(4) A "pre-income tax trust" is a trust that satisfies all of the following requirements:

(a) The document or instrument creating the trust was executed by the grantor before January 1, 1972;

(b) The trust became irrevocable upon the creation of the trust; and

(c) The grantor was domiciled in this state at the time the trust was created.

(GG) "Uniformed services" has the same meaning as in 10 U.S.C. 101.

(HH) "Taxable business income" means business income reduced by deductions from business income and by one of the following amounts, provided that "taxable business income" shall not be less than zero:

(1) For taxable years beginning in 2015, the lesser of seventy-five per cent of Ohio business income or (a) ninety-three thousand seven hundred fifty dollars for each spouse if spouses file separate returns under section 5747.08 of the Revised Code or (b) one hundred eighty-seven thousand five hundred dollars for all other taxpayers;

(2) For taxable years beginning in 2016 and thereafter, one hundred twenty-five thousand dollars for each spouse if spouses file separate returns under section 5747.08 of the Revised Code or two hundred fifty thousand dollars for all other individuals.

CREDIT(S)

(2015 H 64, eff. 9-29-15; 2013 H 59, eff. 9-29-13; 2013 H 51, eff. 7-1-13; 2012 H 510, eff. 3-27-13; 2012 H 365, eff. 3-13-13; 2011 H 167, eff. 12-9-11; 2011 H 153, eff. 9-29-11; 2010 H 519, eff. 9-10-10; 2010 H 48, eff. 4-2-10; 2009 S 106, eff. 3-24-10; 2009 H 1, eff. 1-1-10; 2008 H 562, eff. 9-23-08; 2007 H 372, eff. 3-24-08; 2007 H 119, eff. 6-30-07; 2006 H 73, eff. 4-4-07; 2006 H 530, eff. 3-30-06 (Provisions subject to different effective dates); 2005 H 66, eff. 6-30-05; 2004 H 362, eff. 12-30-04; 2003 H 127, eff. 12-11-03; 2003 H 95, eff. 9-26-03; 2002 H 675, eff. 12-13-02; 2002 S 266, eff. 4-3-03; 2002 S 261, eff. 6-5-02; 2000 S 161, § 3, eff. 7-1-00; 2000 S 161, § 1, eff. 6-8-00; 1999 H 471, eff. 7-1-00; 1999 H 4, eff. 10-14-99; 1999 H 282, eff. 9-28-99; 1998 H 770, eff. 9-16-98; 1997 H 408, eff. 10-1-97; 1997 H 215, eff. 9-29-97; 1996 H 627, eff. 12-2-96; 1996 H 179, eff. 10-1-96; 1994 S 74, eff. 7-1-94; 1993 S 123, eff. 10-29-93; 1993 H 152; 1992 H 478; 1990 S 223, H 286; 1989 H 111,

H 61; 1988 S 386; 1987 H 171; 1986 H 428; 1985 S 121; 1984 S 307, H 250; 1983 H 291; 1981 H 694; 1980 H 653; 1974 H 971; 1973 H 95; 1972 S 464, S 472; 1971 H 475)

Notes of Decisions (86)

Footnotes

1 42 U.S.C.A. § 401 et seq.

2 26 U.S.C.A. § 86.

3 26 U.S.C.A. §§ 38, 51, 52.

4 26 U.S.C.A. § 105.

5 26 U.S.C.A. § 106.

6 26 U.S.C.A. § 152.

7 26 U.S.C.A. § 7702(B)(c).

8 26 U.S.C.A. §§ 671 to 678.

9 26 U.S.C.A. § 641(c).

R.C. § 5747.01, OH ST § 5747.01

Current through 2015 Files 1 to 29 of the 131st General Assembly (2015-2016) and 2015 State Issues 1 and 2.

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Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5747. Income Tax (Refs & Annos)
Practice and Procedure

R.C. § 5747.13

5747.13 Failure to file return or pay tax; assessment; notice; hearing; appeal; judgment; payment pending review

Effective: September 29, 2013
Currentness

(A) If any employer collects the tax imposed by section 5747.02 or under Chapter 5748. of the Revised Code and fails to remit the tax as required by law, or fails to collect the tax, the employer is personally liable for any amount collected that the employer fails to remit, or any amount that the employer fails to collect. If any taxpayer fails to file a return or fails to pay the tax imposed by section 5747.02 or under Chapter 5748. of the Revised Code, the taxpayer is personally liable for the amount of the tax.

If any employer, taxpayer, or qualifying entity required to file a return under this chapter fails to file the return within the time prescribed, files an incorrect return, fails to remit the full amount of the taxes due for the period covered by the return, or fails to remit any additional tax due as a result of a reduction in the amount of the credit allowed under division (B) of section 5747.05 of the Revised Code together with interest on the additional tax within the time prescribed by that division, the tax commissioner may make an assessment against any person liable for any deficiency for the period for which the return is or taxes are due, based upon any information in the commissioner's possession.

An assessment issued against either the employer or the taxpayer pursuant to this section shall not be considered an election of remedies or a bar to an assessment against the other for failure to report or pay the same tax. No assessment shall be issued against any person if the tax actually has been paid by another.

No assessment shall be made or issued against an employer, taxpayer, or qualifying entity more than four years after the final date the return subject to assessment was required to be filed or the date the return was filed, whichever is later. However, the commissioner may assess any balance due as the result of a reduction in the credit allowed under division (B) of section 5747.05 of the Revised Code, including applicable penalty and interest, within four years of the date on which the taxpayer reports a change in either the portion of the taxpayer's adjusted gross income subjected to an income tax or tax measured by income in another state or the District of Columbia, or the amount of liability for an income tax or tax measured by income to another state or the District of Columbia, as required by division (B)(3) of section 5747.05 of the Revised Code. Such time limits may be extended if both the employer, taxpayer, or qualifying entity and the commissioner consent in writing to the extension or if an agreement waiving or extending the time limits has been entered into pursuant to section 122.171 of the Revised Code. Any such extension shall extend the four-year time limit in division (B) of section 5747.11 of the Revised Code for the same period of time. There shall be no bar or limit to an assessment against an employer for taxes withheld from employees and not remitted to the state, against an employer, taxpayer, or qualifying entity that fails to file a return subject to assessment as required by this chapter, or against an employer, taxpayer, or qualifying entity that files a fraudulent return.

The commissioner shall give the party assessed written notice of the assessment in the manner provided in section 5703.37 of the Revised Code. With the notice, the commissioner shall provide instructions on how to petition for reassessment and request a hearing on the petition.

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(B) Unless the party assessed files with the tax commissioner within sixty days after service of the notice of assessment, either personally or by certified mail, a written petition for reassessment, signed by the party assessed or that party's authorized agent having knowledge of the facts, the assessment becomes final, and the amount of the assessment is due and payable from the party assessed to the commissioner with remittance made payable to the treasurer of state. The petition shall indicate the objections of the party assessed, but additional objections may be raised in writing if received by the commissioner prior to the date shown on the final determination. If the petition has been properly filed, the commissioner shall proceed under section 5703.60 of the Revised Code.

(C) After an assessment becomes final, if any portion of the assessment remains unpaid, including accrued interest, a certified copy of the tax commissioner's entry making the assessment final may be filed in the office of the clerk of the court of common pleas in the county in which the employer's, taxpayer's, or qualifying entity's place of business is located or the county in which the party assessed resides. If the party assessed is not a resident of this state, the certified copy of the entry may be filed in the office of the clerk of the court of common pleas of Franklin county.

Immediately upon the filing of the entry, the clerk shall enter a judgment against the party assessed in the amount shown on the entry. The judgment shall be filed by the clerk in one of two loose-leaf books, one entitled “special judgments for state and school district income taxes,” and the other entitled “special judgments for qualifying entity taxes.” The judgment shall have the same effect as other judgments. Execution shall issue upon the judgment upon the request of the tax commissioner, and all laws applicable to sales on execution shall apply to sales made under the judgment.

If the assessment is not paid in its entirety within sixty days after the assessment was issued, the portion of the assessment consisting of tax due shall bear interest at the rate per annum prescribed by section 5703.47 of the Revised Code from the day the tax commissioner issues the assessment until it is paid or until it is certified to the attorney general for collection under section 131.02 of the Revised Code, whichever comes first. If the unpaid portion of the assessment is certified to the attorney general for collection, the entire unpaid portion of the assessment shall bear interest at the rate per annum prescribed by section 5703.47 of the Revised Code from the date of certification until the date it is paid in its entirety. Interest shall be paid in the same manner as the tax and may be collected by the issuance of an assessment under this section.

(D) All money collected under this section shall be considered as revenue arising from the taxes imposed by this chapter or Chapter 5733. or 5748. of the Revised Code, as appropriate.

(E) If the party assessed files a petition for reassessment under division (B) of this section, the person, on or before the last day the petition may be filed, shall pay the assessed amount, including assessed interest and assessed penalties, if any of the following conditions exists:

(1) The person files a tax return reporting Ohio adjusted gross income, less the exemptions allowed by section 5747.025 of the Revised Code, in an amount less than one cent, and the reported amount is not based on the computations required under division (A) of section 5747.01 or section 5747.025 of the Revised Code.

(2) The person files a tax return that the tax commissioner determines to be incomplete, false, fraudulent, or frivolous.

(3) The person fails to file a tax return, and the basis for this failure is not either of the following:

(a) An assertion that the person has no nexus with this state;

(b) The computations required under division (A) of section 5747.01 of the Revised Code or the application of credits allowed under this chapter has the result that the person's tax liability is less than one dollar and one cent.

(F) Notwithstanding the fact that a petition for reassessment is pending, the petitioner may pay all or a portion of the assessment that is the subject of the petition. The acceptance of a payment by the treasurer of state does not prejudice any claim for refund upon final determination of the petition.

If upon final determination of the petition an error in the assessment is corrected by the tax commissioner, upon petition so filed or pursuant to a decision of the board of tax appeals or any court to which the determination or decision has been appealed, so that the amount due from the party assessed under the corrected assessment is less than the portion paid, there shall be issued to the petitioner or to the petitioner's assigns or legal representative a refund in the amount of the overpayment as provided by section 5747.11 of the Revised Code, with interest on that amount as provided by such section, subject to section 5747.12 of the Revised Code.

CREDIT(S)

(2013 H 59, eff. 9-29-13; 2009 H 1, eff. 10-16-09; 2002 S 200, eff. 9-6-02; 2001 H 405, eff. 12-13-01; 2000 H 612, eff. 9-29-00; 1997 H 215, eff. 9-29-97; 1993 H 152, eff. 7-1-93; 1992 S 358; 1990 H 956; 1989 H 111; 1987 H 231; 1983 H 291; 1982 H 366; 1981 H 694; 1971 H 475)

Notes of Decisions (81)

R.C. § 5747.13, OH ST § 5747.13
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KeyCite Yellow Flag - Negative Treatment
Proposed Legislation

Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5747. Income Tax (Refs & Annos)
Calculation and Allocation of Income and Deductions

R.C. § 5747.21

5747.21 Calculation of business income and deduction

Effective: September 29, 2015
Currentness

(A) This section applies solely for the purposes of computing the credit allowed under division (A) of section 5747.05 of the Revised Code, computing income taxable in this state under division (D) of section 5747.08 of the Revised Code, computing the deduction under division (A)(31) of section 5747.01 of the Revised Code, and computing the credit allowed under section 5747.057 of the Revised Code.

(B) Except as otherwise provided under section 5747.212 of the Revised Code, all items of business income and business deduction shall be apportioned to this state by multiplying business income by the fraction calculated under division (B)(2) of section 5733.05 and section 5733.057 of the Revised Code as if the taxpayer's business were a corporation subject to the tax imposed by section 5733.06 of the Revised Code.

(C) If the allocation and apportionment provisions of sections 5747.20 to 5747.23 of the Revised Code or of any rule adopted by the tax commissioner, do not fairly represent the extent of business activity in this state of a taxpayer or pass-through entity, the taxpayer or pass-through entity may request, which request must be in writing accompanying a timely filed return or timely filed amended return, or the tax commissioner may require, in respect of all or any part of the business activity, if reasonable, any one or more of the following:

(1) Separate accounting;

(2) The exclusion of one or more factors;

(3) The inclusion of one or more additional factors which will fairly represent the business activity in this state;

(4) The employment of any other method to effectuate an equitable allocation and apportionment of such business in this state. An alternative method will be effective only with approval of the tax commissioner.

The tax commissioner may adopt rules in the manner provided by sections 5703.14 and 5747.18 of the Revised Code providing for alternative methods of calculating business income and nonbusiness income applicable to all taxpayers and pass-through entities, to classes of taxpayers and pass-through entities, or only to taxpayers and pass-through entities within a certain industry.

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CREDIT(S)

(2015 H 64, eff. 9-29-15; 2013 H 59, eff. 9-29-13; 2002 S 261, eff. 6-5-02; 1997 H 215, eff. 9-29-97; 1984 H 250, eff. 7-30-84; 1971 H 475)

Notes of Decisions (3)

R.C. § 5747.21, OH ST § 5747.21
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Proposed Legislation

Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5747. Income Tax (Refs & Annos)
Calculation and Allocation of Income and Deductions

R.C. § 5747.212

5747.212 Apportionment of income by pass-through entity investor

Currentness

(A) This section applies solely for the purpose of computing the credit allowed under division (A) of section 5747.05 of the Revised Code, computing income taxable in this state under division (D) of section 5747.08 of the Revised Code, and computing the credit allowed under section 5747.057 of the Revised Code.

(B) A taxpayer, directly or indirectly, owning at any time during the three-year period ending on the last day of the taxpayer's taxable year at least twenty per cent of the equity voting rights of a section 5747.212 entity shall apportion any income, including gain or loss, realized from each sale, exchange, or other disposition of a debt or equity interest in that entity as prescribed in this section. For such purposes, in lieu of using the method prescribed by sections 5747.20 and 5747.21 of the Revised Code, the investor shall apportion the income using the average of the section 5747.212 entity's apportionment fractions otherwise applicable under section 5733.05, 5733.056, or 5747.21 of the Revised Code for the current and two preceding taxable years. If the section 5747.212 entity was not in business for one or more of those years, each year that the entity was not in business shall be excluded in determining the average.

(C) For the purposes of this section:

(1) A “section 5747.212 entity” is any qualifying person if, on at least one day of the three-year period ending on the last day of the taxpayer's taxable year, any of the following apply:

(a) The qualifying person is a pass-through entity;

(b) Five or fewer persons directly or indirectly own all the equity interests, with voting rights, of the qualifying person;

(c) One person directly or indirectly owns at least fifty per cent of the qualifying person's equity interests with voting rights.

(2) A “qualifying person” is any person other than an individual, estate, or trust.

(3) “Estate” and “trust” do not include any person classified for federal income tax purposes as an association taxable as a corporation.

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CREDIT(S)

(2005 H 66, eff. 6-30-05; 2002 S 261, eff. 6-5-02)

R.C. § 5747.212, OH ST § 5747.212
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Baldwin's Ohio Revised Code Annotated
Title LVIII. Trusts (Refs & Annos)
Chapter 5808. Powers and Duties of Trustee

R.C. § 5808.16

5808.16 Specific powers of trustee

Effective: September 12, 2008
Currentness

Without limiting the authority conferred by section 5808.15 of the Revised Code, a trustee may do all of the following:

(A) Collect trust property and accept or reject additions to the trust property from a settlor or any other person;

(B) Acquire or sell property, for cash or on credit, at public or private sale;

(C) Exchange, partition, or otherwise change the character of trust property;

(D) Deposit trust money in an account in a regulated financial-service institution;

(E) Borrow money, with or without security, and mortgage or pledge trust property for a period within or extending beyond the duration of the trust;

(F) With respect to an interest in a proprietorship, partnership, limited liability company, business trust, corporation, or other form of business or enterprise, continue the business or other enterprise and take any action that may be taken by shareholders, members, or property owners, including merging, dissolving, or otherwise changing the form of business organization or contributing additional capital;

(G) With respect to stocks or other securities, exercise the rights of an absolute owner, including the right to do any of the following:

(1) Vote, or give proxies to vote, with or without power of substitution, or enter into or continue a voting trust agreement;

(2) Hold a security in the name of a nominee or in other form without disclosure of the trust so that title may pass by delivery;

(3) Pay calls, assessments, and other sums chargeable or accruing against the securities and sell or exercise stock subscription or conversion rights;

(4) Deposit the securities with a depositary or other regulated financial-service institution.

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(H) With respect to an interest in real property, construct, or make ordinary or extraordinary repairs to, alterations to, or improvements in, buildings or other structures, demolish improvements, raze existing or erect new party walls or buildings, subdivide or develop land, dedicate land to public use or grant public or private easements, and make or vacate plats and adjust boundaries;

(I) Enter into a lease for any purpose as lessor or lessee, including a lease or other arrangement for exploration and removal of natural resources, with or without the option to purchase or renew, for a period within or extending beyond the duration of the trust;

(J) Grant an option involving a sale, lease, or other disposition of trust property or acquire an option for the acquisition of property, including an option exercisable beyond the duration of the trust, and exercise an option so acquired;

(K) Insure the property of the trust against damage or loss and insure the trustee, the trustee's agents, and beneficiaries against liability arising from the administration of the trust;

(L) Abandon or decline to administer property of no value or of insufficient value to justify its collection or continued administration;

(M) With respect to possible liability for violation of environmental law, do any of the following:

(1) Inspect or investigate property the trustee holds or has been asked to hold, or property owned or operated by an organization in which the trustee holds or has been asked to hold an interest, for the purpose of determining the application of environmental law with respect to the property;

(2) Take action to prevent, abate, or otherwise remedy any actual or potential violation of any environmental law affecting property held directly or indirectly by the trustee, whether taken before or after the assertion of a claim or the initiation of governmental enforcement;

(3) Decline to accept property into trust or disclaim any power with respect to property that is or may be burdened with liability for violation of environmental law;

(4) Compromise claims against the trust that may be asserted for an alleged violation of environmental law;

(5) Pay the expense of any inspection, review, abatement, or remedial action to comply with environmental law.

(N) Pay or contest any claim, settle a claim by or against the trust, and release, in whole or in part, a claim belonging to the trust;

(O) Pay taxes, assessments, compensation of the trustee and of employees and agents of the trust, and other expenses incurred in the administration of the trust;

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(P) Exercise elections with respect to federal, state, and local taxes;

(Q) Select a mode of payment under any employee benefit or retirement plan, annuity, or life insurance policy payable to the trustee, exercise rights under any employee benefit or retirement plan, annuity, or life insurance policy payable to the trustee, including the right to indemnification for expenses and against liabilities, and take appropriate action to collect the proceeds;

(R) Make loans out of trust property, including loans to a beneficiary on terms and conditions the trustee considers to be fair and reasonable under the circumstances, and the trustee has a lien on future distributions for repayment of those loans;

(S) Guarantee loans made by others to the settlor of a revocable trust and, if the settlor so directs, guarantee loans made by others to a third party and mortgage, pledge, or grant a security interest in the property of a revocable trust to secure the payment of loans made by others to the settlor of the revocable trust and, if the settlor so directs, loans made by others to a third party;

(T) Appoint a trustee to act in another jurisdiction with respect to trust property located in the other jurisdiction, confer upon the appointed trustee all of the powers and duties of the appointing trustee, require that the appointed trustee furnish security, and remove any trustee so appointed;

(U) Pay an amount distributable to a beneficiary who is under a legal disability or who the trustee reasonably believes is incapacitated, by paying it directly to the beneficiary or applying it for the beneficiary's benefit, or by doing any of the following:

(1) Paying it to the beneficiary's guardian of the estate, or, if the beneficiary does not have a guardian of the estate, the beneficiary's guardian of the person;

(2) Paying it to the beneficiary's custodian under sections 5814.01 to 5814.09 of the Revised Code and, for that purpose, creating a custodianship;

(3) If the trustee does not know of a guardian of the person or estate, or custodian, paying it to an adult relative or other person having legal or physical care or custody of the beneficiary, to be expended on the beneficiary's behalf;

(4) Managing it as a separate fund on the beneficiary's behalf, subject to the beneficiary's continuing right to withdraw the distribution.

(V) On distribution of trust property or the division or termination of a trust, make distributions in divided or undivided interests, allocate particular assets in proportionate or disproportionate shares, value the trust property for those purposes, and adjust for resulting differences in valuation;

(W) Resolve a dispute concerning the interpretation of the trust or its administration by mediation, arbitration, or other procedure for alternative dispute resolution;

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(X) Prosecute or defend an action, claim, or judicial proceeding in any jurisdiction to protect trust property and the trustee in the performance of the trustee's duties;

(Y) Sign and deliver contracts and other instruments that are useful to achieve or facilitate the exercise of the trustee's powers;

(Z) On termination of the trust, exercise the powers appropriate to wind up the administration of the trust and distribute the trust property to the persons entitled to it;

(AA) Employ agents, attorneys, accountants, investment advisors, and other professionals.

CREDIT(S)

(2008 H 499, eff. 9-12-08; 2006 H 416, eff. 1-1-07)

OFFICIAL COMMENT

Uniform Trust Code (2006)

This section enumerates specific powers commonly included in trust instruments and in trustee powers legislation. All the powers listed are subject to alteration in the terms of the trust. *See* Section 105. The powers listed are also subsumed under the general authority granted in Section 815(a)(2) to exercise all powers over the trust property which an unmarried competent owner has over individually owned property, and any other powers appropriate to achieve the proper management, investment, and distribution of the trust property. The powers listed add little of substance not already granted by Section 815 and powers conferred elsewhere in the Code, which are listed in the Comment to Section 815. While the Committee drafting this Code discussed dropping the list of specific powers, it concluded that the demand of third parties to see language expressly authorizing specific transactions justified retention of a detailed list.

As provided in Section 815(b), the exercise of a power is subject to fiduciary duties except as modified in the terms of the trust. The fact that the trustee has a power does not imply a duty that the power must be exercised.

Many of the powers listed in this section are similar to the powers listed in Section 3 of the Uniform Trustees' Powers Act (1964). Several are new, however, and other powers drawn from that Act have been updated. The powers enumerated in this section may be divided into categories. Certain powers, such as the powers to acquire or sell property, borrow money, and deal with real estate, securities, and business interests, are powers that any individual can exercise. Other powers, such as the power to collect trust property, are by their very nature only applicable to trustees. Other specific powers, particularly those listed in other sections of the Uniform Trust Code, modify a trustee duty that would otherwise apply. *See, e.g.*, Sections 802(h) (exceptions to duty of loyalty) and 810(d) (joint investments as exception to earmarking requirement).

Paragraph (1) authorizes a trustee to collect trust property and collect or decline additions to the trust property. The power to collect trust property is an incident of the trustee's duty to administer the trust as provided in Section 801. The trustee has a duty to enforce claims as provided in Section 811, the successful prosecution of which can result in collection of trust property. Pursuant to Section 812, the trustee also has a duty to collect trust property from a former trustee or other person holding trust property. For an application of the power to reject additions to the trust property, see Section 816(13) (power to decline property with possible environmental liability).

Paragraph (2) authorizes a trustee to sell trust property, for cash or on credit, at public or private sale. Under the Restatement, a power of sale is implied unless limited in the terms of the trust. Restatement (Third) of Trusts: Prudent Investor Rule Section

190 (1992). In arranging a sale, a trustee must comply with the duty to act prudently as provided in Section 804. This duty may dictate that the sale be made with security.

Paragraph (4) authorizes a trustee to deposit funds in an account in a regulated financial-service institution. This includes the right of a financial institution trustee to deposit funds in its own banking department as authorized by Section 802(h)(4).

Paragraph (5) authorizes a trustee to borrow money. Under the Restatement, the sole limitation on such borrowing is the general obligation to invest prudently. *See* Restatement (Third) of Trusts: Prudent Investor Rule Section191 (1992). Language clarifying that the loan may extend beyond the duration of the trust was added to negate an older view that the trustee only had power to encumber the trust property for the period that the trust was in existence.

Paragraph (6) authorizes the trustee to continue, contribute additional capital to, or change the form of a business. Any such decision by the trustee must be made in light of the standards of prudent investment stated in Article 9.

Paragraph (7), regarding powers with respect to securities, codifies and amplifies the principles of Restatement (Second) of Trusts Section 193 (1959).

Paragraph (9), authorizing the leasing of property, negates the older view, reflected in Restatement (Second) of Trusts Section 189 cmt. c (1959), that a trustee could not lease property beyond the duration of the trust. Whether a longer term lease is appropriate is judged by the standards of prudence applicable to all investments.

Paragraph (10), authorizing a trustee to grant options with respect to sales, leases or other dispositions of property, negates the older view, reflected in Restatement (Second) of Trusts Section 190 cmt. k (1959), that a trustee could not grant another person an option to purchase trust property. Like any other investment decision, whether the granting of an option is appropriate is a question of prudence under the standards of Article 9.

Paragraph (11), authorizing a trustee to purchase insurance, empowers a trustee to implement the duty to protect trust property. *See* Section 809. The trustee may also insure beneficiaries, agents, and the trustee against liability, including liability for breach of trust.

Paragraph (13) is one of several provisions in the Uniform Trust Code designed to address trustee concerns about possible liability for violations of environmental law. This paragraph collects all the powers relating to environmental concerns in one place even though some of the powers, such as the powers to pay expenses, compromise claims, and decline property, overlap with other paragraphs of this section (decline property, paragraph (1); compromise claims, paragraph (14); pay expenses, paragraph (15)). Numerous States have legislated on the subject of environmental liability of fiduciaries. For a representative state statute, see Tex. Prop. Code Ann. Section 113.025. *See also* Sections 701(c)(2) (designated trustee may inspect property to determine potential violation of environmental or other law or for any purpose) and 1010(b) (trustee not personally liable for violation of environmental law arising from ownership or control of trust property).

Paragraph (14) authorizes a trustee to pay, contest, settle, or release claims. Section 811 requires that a trustee need take only "reasonable" steps to enforce claims, meaning that a trustee may release a claim not only when it is uncollectible, but also when collection would be uneconomic. *See* Restatement (Second) of Trusts Section 192 (1959) (power to compromise, arbitrate and abandon claims).

Paragraph (15), among other things, authorizes a trustee to pay compensation to the trustee and agents without prior approval of court. Regarding the standard for setting trustee compensation, see Section 708. *See also* Section 709 (repayment of trustee expenditures). While prior court approval is not required, Section 813(b)(4) requires the trustee to inform the qualified beneficiaries in advance of a change in the method or rate of compensation.

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Paragraph (16) authorizes a trustee to make elections with respect to taxes. The Uniform Trust Code leaves to other law the issue of whether the trustee, in making such elections, must make compensating adjustments in the beneficiaries' interests.

Paragraph (17) authorizes a trustee to take action with respect to employee benefit or retirement plans, or annuities or life insurance payable to the trustee. Typically, these will be beneficiary designations which the settlor has made payable to the trustee, but this Code also allows the trustee to acquire ownership of annuities or life insurance.

Paragraphs (18) and (19) allow a trustee to make loans to a beneficiary or to guarantee loans of a beneficiary upon such terms and conditions as the trustee considers fair and reasonable. The determination of what is fair and reasonable must be made in light of the fiduciary duties of the trustee and the purposes of the trust. Frequently, a trustee will make loans to a beneficiary which might be considered less than prudent in an ordinary commercial sense although of great benefit to the beneficiary and which help carry out the trust purposes. If the trustee requires security for the loan to the beneficiary, adequate security under this paragraph may consist of a charge on the beneficiary's interest in the trust. *See* Restatement (Second) of Trusts Section255 (1959). However, the interest of a beneficiary subject to a spendthrift restraint may not be pledged as security for a loan. *See* Section 502.

Paragraph (20) authorizes the appointment of ancillary trustees in jurisdictions in which the regularly appointed trustee is unable or unwilling to act. Normally, an ancillary trustee will be appointed only when there is a need to manage real estate located in another jurisdiction. This paragraph allows the regularly appointed trustee to select the ancillary trustee and to confer on the ancillary trustee such powers and duties as may be necessary. The appointment of ancillary trustees is a topic which a settlor may wish to address in the terms of the trust.

Paragraph (21) authorizes a trustee to make payments to another person for the use or benefit of a beneficiary who is under a legal disability or who the trustee reasonably believes is incapacitated. Although an adult relative or other person receiving funds is required to spend it on the beneficiary's behalf, it is preferable that the trustee make the distribution to a person having more formal fiduciary responsibilities. For this reason, payment may be made to an adult relative only if the trustee does not know of a conservator, guardian, custodian, or custodial trustee capable of acting for the beneficiary.

Paragraph (22) authorizes a trustee to make non-pro-rata distributions and allocate particular assets in proportionate or disproportionate shares. This power provides needed flexibility and lessens the risk that a non-pro-rata distribution will be treated as a taxable sale.

Paragraph (23) authorizes a trustee to resolve disputes through mediation, arbitration or other methods of alternate dispute resolution. The drafters of this Code encourage the use of such alternate methods for resolving disputes. Arbitration is a form of nonjudicial settlement agreement authorized by Section 111. In representing beneficiaries and others in connection with arbitration or in approving settlements obtained through mediation or other methods of ADR, the representation principles of Article 3 may be applied. Settlors wishing to encourage use of alternate dispute resolution may draft to provide it. For sample language, see American Arbitration Association, Arbitration Rules for Wills and Trusts (1995).

Paragraph (24) authorizes a trustee to prosecute or defend an action. As to the propriety of reimbursement for attorney's fees and other expenses of an action or judicial proceeding, see Section 709 and Comment. *See also* Section 811 (duty to defend actions).

Paragraph (26), which is similar to Section 344 of the Restatement (Second) of Trusts (1959), clarifies that even though the trust has terminated, the trustee retains the powers needed to wind up the administration of the trust and distribute the remaining trust property.

Notes of Decisions (122)

R.C. § 5808.16, OH ST § 5808.16
Current through 2015 Files 1 to 29 of the 131st General Assembly (2015-2016) and 2015 State Issues 1 and 2.

End of Document

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UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS SIXTY-SIXTH YEAR
AT NEW YORK, NEW YORK
JULY 8 – 13, 1957

WITH PREFATORY NOTE AND COMMENTS

Approved by the American Bar Association at its Meeting at
New York, New York, July 16, 1957

UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT

The Committee which acted for the National Conference of Commissioners on Uniform State Laws in preparing the Uniform Division of Income for Tax Purposes Act was as follows:

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UNIFORM STATE LAWS
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UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT

PREFATORY NOTE

The Uniform Division of Income for Tax Purposes Act is designed for enactment in those states which levy taxes on or measured by net income.

The need for a uniform method of division of income for tax purposes among the several taxing jurisdictions has been recognized for many years and has long been recommended by the Council of State Governments. There is no other practical means of assuring that a taxpayer is not taxed on more than its net income. At present there are various formulae for determining the amount of income to be taxed in use by the states, and the differences in the formulae produce inequitable results. Many states now use the three factor formulae of this Act. The problem has been well analyzed and its historical background outlined in an article appearing in 18 Ohio State Law Journal, page 84.

The Uniform Division of Income for Tax Purposes Act is the result of conferences with the representatives of the Controller's Institute of America, the Council of State Governments and various interested individuals. It was promulgated in 1957. The comments in the present reprinting of the Act were revised and extended in February 1966 in order to clarify the solutions to some of the problems which have been experienced in securing enactment of the Act in the several states.

March 1, 1966

UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT

[Be It Enacted . . .]

SECTION 1. As used in this Act, unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

Comment

This definition refers to "the" taxpayer's trade or business as if he had one business. It is not intended by this language to require a taxpayer having several "businesses" to use the same allocation and apportionment methods for the businesses. The language permits separate treatment of different businesses of a single taxpayer. Section 18 clearly permits separate treatment.

Income from the disposition of property used in a trade or business of the taxpayer is includible within the meaning of business income.

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

Comment

The phrase "directed or managed" is not intended to permit both the state where the board of directors meets and the state where the company is managed to claim the commercial domicile. The phrase "directed or managed" is intended as two words serving the same end; not as two separate concepts.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

Comment

This definition is derived from the Model Unemployment Compensation Act which has been adopted in all states.

Compensation paid to "employees" becomes important in the payroll fraction in section 13. If a corporation is employed to provide personal services, section 18 may be used to include compensation paid to corporations in the fraction if exclusion of compensation paid to corporate agents fails to reflect adequately the business activity in the state.

(d) "Financial organization" means any bank, trust company, savings bank, [industrial bank, land bank, safe deposit company], private banker, savings and loan association, credit union, [cooperative bank], investment company, or any type of insurance company.

Comment

This definition and the definition of "public utility" in subsection (f) is necessary because section 2 excludes from allocation and apportionment under this Act, income from these two types of business activity. The exclusion is proposed because some states have separate legislation for apportionment and allocation of income of such taxpayers. If not, and the state proposes to change subsection (2) so as to apply the Act to such taxpayers, this would not necessarily detract from the uniformity objective of this Act.

(e) "Non-business income" means all income other than business income.

(f) "Public utility" means [any business entity which owns or operates for public use any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, or the production, storage, transmission, sale, delivery, or furnishing of electricity, water, steam, oil, oil products or gas].

Comment

It is expected that "public utility" will be defined to include all taxpayers subject to the control of the state's regulatory bodies on the theory that separate legislation will provide for the apportionment and allocation of the income of such taxpayers.

See Comment to the definition of "financial organization" for purpose of this definition. "Oil, oil products or gas" is not intended to be so restrictive as to treat differently a public utility, if any, which transmits or produces "gas products." The essential point of the definition is the requirement that the business excluded by this definition and subsection 2 be a "public utility." Private transmission lines and private production or storage companies are thus not excluded.

(g) "Sales" means all gross receipts of the taxpayer not allocated under sections 4 through 8 of this Act.

Comment

This all inclusive definition of sales is intended to make apportionable all income not allocated under sections 4 through 8. As indicated in the Comment to subsection 1(a) income from sales or property used in trade or business is included in apportionable income.

(h) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

SECTION 2. Any Taxpayer having income from business activity which is taxable both within and without this state, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this Act.

SECTION 3. For purposes of allocation and apportionment of income under this Act, a taxpayer is taxable in another state if (1) in that state he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Comment

This section defines, for purposes of section 2, where a taxpayer is "taxable both within and without this state." To bring this Act into operation a taxpayer must have income from business activity, and he must be taxable in this state, and also in some other state.

Two tests are used by this section to determine when a taxpayer is "taxable in another state." The first test is a fairly obvious one, the taxpayer is taxable in another state if he is actually subjected to the type of taxes listed in subparagraph (1).

The second test, in subparagraph (2) uses a "notional" or "hypothetical" standard rather than an actual one. Thus, if a corporation has its commercial domicile in state X, which has only a sales tax and no tax measured by net income, but that corporation has business activity in state A, which has this apportionment Act, state A must apportion the business income as provided in this Act so that some of it is allocated to state X, even though as a result of the tax system of state X a portion of the business income escapes income taxation. This is desirable in order to treat the business of all states equally, and in order to avoid having this Act as a factor in inducing a state to have an income tax. If it does not wish to tax income, that is no reason for a state which does wish to tax income to attempt to obtain more than its share of taxable income.

It should be noted that in subsection 1(h) the word "state" is defined broadly enough to include a foreign country. This means that "taxable in another state" within section 3 may mean a foreign country. The apportioning state, however, need consider only whether the foreign country "could have" taxed the income under the constitution of the United States if it had been a state.

While subparagraph (1) lists several types of taxes which might be actually in effect in another state, the reference in subparagraph (2) only to a "net income" tax is not intended to be more restricted in the hypothetical tax than the section is with respect to an actual tax.

SECTION 4. Rents and royalties from real or tangible personal property, capital gains, interest, dividends, or patent or copyright royalties, to the extent that they constitute non-business income, shall be allocated as provided in sections 5 through 8 of this Act.

Comment

This section is the general section on "allocating" non-business income to a state just as section 9 is the general section on apportionment of business income. Section 2 refers to an allocation and an apportionment of "net income." In "allocating" nonbusiness income to a state, the states concerned with this allocation may desire to allocate the expenses properly attributable to nonbusiness but allocable income in the same way that income is allocated so that these expenses will not be involved in determining net income from business activity where

apportionment is used. Section 18 of this Code empowers the state to make this adjustment if it wishes.

SECTION 5.

(a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible personal property are allocable to this state:

(1) if and to the extent that the property is utilized in this state, or

(2) in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

Comment

Rents from mobile tangible property are to be allocated in accordance with section 5(c). This subsection apportions the rents by a fraction based on the number of days in the state on the assumption that the rents are generally based on time of use. If the rent itself is calculated on the basis of some factor other than time, section 18 would permit a state to substitute a fraction based on this substitute factor. Thus, if the rent for a drilling rig is calculated on the basis of number of feet drilled, the "extent of utilization" in the state might also be determined on the basis of a fraction which uses "feet drilled" rather than days in the state.

SECTION 6.

(a) Capital gains and losses from sales of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales of tangible personal property are allocable to this state if

(1) the property had a situs in this state at the time of the sale, or

(2) the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

SECTION 7. Interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state.

SECTION 8.

(a) Patent and copyright royalties are allocable to this state:

(1) if and to the extent that the patent or copyright is utilized by the payer in this state, or

(2) if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect

states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

SECTION 9. All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

SECTION 10. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

Comment

The property to be included in the numerator and denominator is property producing the net income to be apportioned. If net income from property is allocated property under sections 5 through 8 such property should be excluded in constructing the fraction.

SECTION 11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals.

Comment

This section is admittedly arbitrary in using original cost rather than depreciated cost, and in valuing rented property as eight times the annual rental. This approach is justified because the act does not impose a tax, nor prescribe the depreciation allowable in computing the tax, but merely provides a basis for division of the taxable income among the several states. The use of original cost obviates any differences due to varying methods of depreciation, and has the advantage that the basic figure is readily ascertainable from the taxpayer's books. No method of valuing the property would probably be universally acceptable.

In any situation where it is impossible to ascertain original cost, section 18 may be used to determine a fair value for such property. Section 18 may also be necessary to aid in determining "net annual rental value" of tangible personal

property where the actual rent is so related to services that the part attributable to the object is difficult to determine.

Section 18 may also be used to determine a reasonable rental rate for this fraction where the actual rent is zero or nominal such as may be the case where a local government in attempting to induce an industry to come to a community supplies the property at a nominal rental.

SECTION 12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the [tax administrator] may require the averaging of monthly values during the tax period of reasonably required to reflect properly the average value of the taxpayer's property.

SECTION 13. The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the tax period.

Comment

Payroll attributable to management or maintenance or otherwise allocable to nonbusiness property should be excluded from the fraction.

Payroll "paid" should be determined by the normal accounting methods of the business so that if the taxpayer "accrues" such matters the payroll should be treated as "paid" for purpose of this section.

SECTION 14. Compensation is paid in this state if:

(a) the individual's service is performed entirely within the state; or

(b) the individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

(c) some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

Comment

This section is derived from the Model Unemployment Compensation Act. This is the same figure which will be used by taxpayers for unemployment compensation purposes.

SECTION 15. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

Comment

The sales to be included in the fraction are only the sales which produce business income. Sales which produce "capital gains" are under section 6 and are to be allocated rather than apportioned.

"Total sales" means "total net sales" after discounts and returns.

SECTION 16. Sales of tangible personal property are in this state if:

(a) the property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser.

Comment

The phrase "delivered or shipped to a purchaser" in this state includes shipments, at the designation of the purchaser, to a person in this state such as designating, while a shipment is enroute, the ultimate recipient.

Sales to the United States are treated separately. It is thought that this is justified because sales to the United States are not necessarily attributable to a market existing in the state to which the goods are originally shipped. This different treatment may also be justified because, if the goods are defense or war materials, it may be impossible to determine whether the goods ever come to rest in the state due to use of coded delivery instructions.

The section does not specify how sales from a subsidiary in the state to an out-of-state parent, such as a marketing corporation who thereupon redirects the goods back into the state, should be treated. If returns are not consolidated under existing state tax law, it may be necessary to use section 18 to make a fair representation of the business income in this situation.

SECTION 17. Sales, other than sales of tangible personal property, are in this state if:

(a) the income-producing activity is performed in this state; or

(b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

SECTION 18. If the allocation and apportionment provisions of this Act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the [tax administrator] may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Comment

It is anticipated that this Act will be made a part of the income tax acts of the several states. For that reason, this section does not spell out the procedure to be followed in the event of a disagreement between the taxpayer and the tax administrator. The income tax acts of each state presumably outline the procedure to be followed.

Section 18 is intended as a broad authority, within the principle of apportioning business income fairly among the states which have contact with the income, to the tax administrator to vary the apportionment formula and to vary the

system of allocation where the provisions of the Act do not fairly represent the extent of the taxpayer's business activity in the state. The phrases in section 18(d) do not foreclose the use of one method for some business activity and a different method for a different business activity. Neither does the phrase "method" limit the administrator to substituting factors in the formula. The phrase means any other method of fairly representing the extent of the taxpayer's business activity in the state.

SECTION 19. This Act shall be so construed so as to effectuate its general purpose to make uniform the law of those states which enact it.

SECTION 20. This Act may be cited as the Uniform Division of Income for Tax Purposes Act.

SECTION 21. [The following acts and parts of acts are hereby repealed:

(a)

(b)

(c) .]

SECTION 22. This Act shall take effect . . . . . .

Restatement (Third) Of Agency § 4.06 (2006)

Restatement of the Law - Agency

Database updated June 2014
Restatement (Third) of Agency

Chapter 4. Ratification

§ 4.06 Knowledge Requisite to Ratification

Comment:
Reporter's Notes
Case Citations - by Jurisdiction

A person is not bound by a ratification made without knowledge of material facts involved in the original act when the person was unaware of such lack of knowledge.

Comment:

a. Cross-references. Section 4.01(2) states the circumstances that constitute a ratification. Section 4.02 states the effects of ratification.

b. Effect of lack of knowledge. A person who has ratified is not bound by the ratification if it was made without knowledge of material facts about the act of the agent or other actor. Thus, ratification concerns actions that have already taken place, of which the person is aware, not actions or events that may occur in the future. The burden of establishing that a ratification was made with knowledge is on the party attempting to establish that ratification occurred. This is consistent with how the burden of establishing the existence of a relationship of agency is allocated. See § 1.02, Comment *d*. A person may be estopped to deny ratification as stated in § 4.08.

Ratification requires that the principal have actual knowledge of material facts, not notice as defined in § 1.04(4). A principal may choose to affirm without knowing the material facts. The fact that the principal had knowledge may be inferred, as may the principal's assumption of risk of lack of knowledge. See Comment *d*.

This doctrine, alternatively, has been characterized as creating an election to avoid a ratification. See Restatement Second, Agency § 91. Many contemporary cases, however, allocate the burden of showing that a ratification was made with knowledge to the party seeking to hold a person liable on the basis that the person ratified another's act. However characterized, this doctrine is analogous in effect to the contract-law doctrine that permits a party to avoid a contract when a material misrepresentation induced the party's assent to the contract. See Restatement Second, Contracts § 164. The power of avoidance is lost if the party, after knowing of the misrepresentation, manifests affirmance of the transaction to the other party or acts inconsistently with disaffirmance with regard to anything received through the transaction. Id. § 380(2). Contract-law doctrine also permits a party to avoid a transaction on the basis of unilateral mistake, but only when the effect of enforcing the contract would be unconscionable, or the other party knew of the mistake or that party's fault caused it. Restatement Second, Contracts § 153. The grounds for avoiding a ratification are broader, perhaps because the principal's ignorance is often attributable to the agent's failure to make disclosure.

Although it is sometimes said that the doctrine of ratification imposes a duty of disclosure on an agent, the source of the

principal's knowledge does not determine whether the principal is bound by a ratification. The principal's consent to be bound by what the agent has done depends on whether the principal knows the relevant facts, not the source of the principal's knowledge. However, the agent will often be the most likely source of enlightenment.

Illustration:
Illustration:

1. P deals in components of disassembled buildings and employs A to purchase such components on P's behalf. P tells A to pay no more than $1000 for any single component, which is the standard limit in P's industry for agents like A. On P's behalf, A enters into a contract to buy, for $10,000, a large chandelier from T, who has purchased an abandoned mansion and is disassembling it. A does not tell P about the contract. T contacts P to make arrangements for delivery and tells P the terms of the contract, including the origin of the chandelier. P asks T to deliver the chandelier the next day. P has ratified the contract.

If a ratification would bind multiple or coprincipals, each must affirm with knowledge of the acts to be ratified. On multiple principals represented by the same agent, see § 3.16.

c. Material facts. Not all facts are material for purposes of this doctrine. The point of materiality in this context is the relevance of the fact to the principal's consent to have legal relations affected by the agent's act. For definitions of materiality, see Restatement Second, Torts § 538(2)(a); Principles of Corporate Governance: Analysis and Recommendations § 1.25.

Illustration:
Illustration:

2. Same facts as Illustration 1, except that neither A nor T tells P that the contract contains a provision requiring P to purchase a second chandelier from T for $5000. The presence of the provision in the contract constitutes a material fact.

d. Risk of lack of knowledge. Ratification is the consequence of a choice freely made by the principal. The principal may choose to ratify the action of an agent or other actor without knowing material facts. A factfinder may conclude that a principal has made such a choice when the principal is shown to have had knowledge of facts that would have led a reasonable person to investigate further, but the principal ratified without further investigation.

Illustrations:
Illustrations:

3. Same facts as Illustration 1, except that neither A nor T tells P, and P does not otherwise know, that the chandelier will require expensive rewiring before P will be able to sell or use it. Having ratified the contract, without inspecting a chandelier that P knows has been removed from an old building, P has assumed the risk of lack of knowledge.
4. P, a manufacturer of precision tools, receives a letter from T, a purchaser with whom P deals through A, a sales representative. T writes in the letter, "We have, as you know, recently increased our order because of the impressive assurances made by A about your new return policy and improved product quality." P, whose product quality and return policy have not changed, fears that A has made false statements to T. P does not ask A or T what statements were made by A. P has ratified the contract with T.

Reporter's Notes

*a. Comparison with Restatement Second, Agency.*Restatement Second, Agency § 91(1) states that a principal who is "ignorant of material facts involved in the original transaction" at the time of affirming "and is unaware of his ignorance ... can thereafter avoid the effect of the affirmance."

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*b. Effect of lack of knowledge.*For the proposition that ratification does not reach an event that has yet to occur, see Villanueva v. Brown, 103 F.3d 1128, 1139 (3d Cir.1997) (principal's act of signing investment agreement could not ratify disbursements from trust account, which occurred over a year later); United States v. Flemmi, 225 F.3d 78, 90 (1st Cir.2000) (prosecutor could not have ratified promise of immunity allegedly made by FBI agents to government informer in conversation that occurred before alleged promise was made). See also Ercanbrack v. Crandall-Walker Motor Co., 550 P.2d 723, 725 (Utah 1976) ("Ratification of an act about which the principal knows nothing is inherently impossible").

For the proposition that the burden of establishing the ratifier's knowledge is on the party attempting to establish ratification, see, e.g., Frankenmuth Mut. Ins. Co. v. Magaha, 769 So. 2d 1012, 1022 (Fla.2000) (one asserting ratification must show principal accepted agent's conduct with full knowledge of material facts or with wilful ignorance, or that principal purposefully refrained from seeking information or intended to ratify in all events and under whatever circumstances); State Farm Mut. Auto Ins. Co. v. Weisman, 441 S.E.2d 16, 19 (Va.1994) (insurer did not show that injured motorist knew her spouse rejected higher insurance coverage). Many courts treat the ratifier's knowledge as a requirement for ratification. See Daniel S. Kleinberger, Agency and Partnership: Examples and Explanations 53 (2d ed. 2002).

On the importance of actual knowledge when the principal could have discovered the facts, see Estate of Sawyer v. Crowell, 559 A.2d 687 (Vt.1989) (lawyer did not authorize his secretary's acquiescence in investment of estate's funds in REIT instead of high-quality commercial paper when secretary placed in file letter from investment manager stating that investment had been made in REIT, after lawyer directed secretary to inquire about requirements for withdrawing estate's funds; secretary did not know investment was improper and did not tell lawyer). See also Lahnston v. Second Chance Ranch Co., 968 P.2d 32, 36 (Wyo.1998) (finding that minority shareholder who was also a director had actual knowledge of loan transactions between corporation and fellow director that were not formally authorized or ratified by formal actions of directors; minority shareholder received monthly and annual financial statements that set forth transactions between corporation and fellow director, including fellow director's claim that corporation owed money to him).

A principal's knowledge may be established circumstantially. See, e.g, Inn Foods, Inc. v. Equitable Co-operative Bank, 45 F.3d 594, 597 (1st Cir.1995) (judgment creditor ratified president's unauthorized endorsement and deposit of check into his personal account when its directors adopted resolution permitting such endorsement and deposit dated 9 days following president's presentation of check to bank; under Massachusetts law, ratification may occur when a principal deliberately shuts its eyes to available information); Carter v. St. John's Reg'l Med. Ctr., 88 S.W.3d 1, 9-10 (Mo.App.2002) (hospital ratified vice president's unauthorized contract with physician; physician worked at or in connection with hospital for 14 years, hospital board confirmed physician's privileges, including disputed right to report out on bone-marrow procedures, and physician routinely engaged in such reporting out); Martin Glennon, Inc. v. First Fid. Bank, N.A., 652 A.2d 199, 205 (N.J.Super.App.Div.1995) (mere negligence insufficient to effect ratification; although information sufficient to detect bookkeeper's forged endorsements present in employer's mail logs, "there is no basis for the slightest inference that [employer] was aware of this scheme" prior to its happenchance revelation). Signing a document that discloses a fact establishes knowledge of the fact in White v. Moriarty, 19 Cal.Rptr.2d 200, 202-203 (Cal.App.1993) (lawyer signed power of attorney that on its face purported to ratify acts of officer of corporation in which lawyer invested; power specifically referred to officer's purchase of a video camera for corporate use and to financing for purchase, which was sufficient to establish that lawyer knew material facts requisite to ratifying officer's prior act in signing promissory note in connection with financing for video-camera purchase); Wyatt v. McGregor, 855 S.W.2d 5, 13 (Tex.App.1993) (directors of corporation ratified acts of shareholder in entering into purchase transaction that, contrary to terms of prior agreement, excluded specific property because directors could have seen exclusion by comparing deed with prior agreement).

For a statement that ratification in common-law agency requires disclosure to the principal by the agent, see Lewis v. Vogelstein, 699 A.2d 327, 334 (Del.Ch.1997) ("[t]o be effective, of course, the agent must fully disclose all relevant circumstances with respect to the transaction to the principal prior to the ratification"; at issue in case is ratification by shareholders of directors' adoption of stock-option plan).

On ratification by multiple principals, see A. Terzi Prods., Inc. v. Theatrical Protective Union, 2 F.Supp.2d 485, 490-492 (S.D.N.Y.1998) (under New York law, to show that unincorporated labor union ratified tortious act, it is necessary to show that each member had full knowledge of act).

Ratification of an unauthorized transaction has been held to require that the principal know that the unauthorized transaction

may be disaffirmed. Recent cases so hold in the context of securities brokers' unauthorized transactions. See Merrill Lynch Pierce Fenner & Smith, Inc. v. Cheng, 901 F.2d 1124 (D.C.Cir.1990); Huppman v. Tighe, 642 A.2d 309, 315-316 (Md.App.1994).

*c. Material facts.*On the materiality of facts in a transactional context, see, e.g., Abuznaid v. Sirhal, 638 So. 2d 188, 189-190 (Fla.Dist.App.1994) (person whose name, without his knowledge, appeared on lease did not ratify lease agreement by paying rent); Cologne Life Reinsurance Co. v. Zurich Reinsurance (North America), Inc., 730 N.Y.S.2d 61, 68 (App.Div.2001) (question of fact whether members of reinsurance pool ratified retrocessional agreement when allegedly unaware that agreement had been executed following termination of pool manager's authority); Solon Chamber of Commerce v. Women's Gen. Hosp., 612 N.E.2d 331, 336 (Ohio App.1992) (triable issue of fact whether signature of trustees to document constituted ratification of president's transfer of property to hospital when document did not state that president had already signed deed).

On material facts when the question is whether a principal has ratified a tort, see, e.g., Prunty v. Arkansas Freightways, Inc., 16 F.3d 649, 655 (5th Cir.1994) (vice-president ratified supervisor's sexual harassment of plaintiff; vice-president "not only knew of the sexual harassment, but knew enough about the harassment to realize that [supervisor's] conduct was extreme and outrageous," despite presence of dispute as to precise details communicated to vice-president); Davis v. Mutual Life Ins. Co., 6 F.3d 367, 374 (6th Cir.1993) (insurer ratified agent's fraudulent sales methods when its officers attended agent's presentations and were aware of agent's methods; insurer also had warning from its counsel that agent was providing misleading tax information to prospective investors); Streetscenes L.L.C. v. ITC Entm't Group, Inc., 126 Cal.Rptr.2d 754, 759-760 (Cal.App.2002) (sufficient evidence film-production company ratified fraud against investors committed by film producer with whom company "had a special relationship, unique to the movie industry, that enabled [producer] to be an executive producer of [company] but allowed him space to do his own deals"; jury could find arrangement was created to give company "deniability" for producer's actions in light of frequent discussions and contacts between company representatives and producer and siting of preproduction work on producer's film on company premises).

*d. Risk of lack of knowledge.*Illustration 4 is a variation on Illustration 17 to Restatement Second, Agency § 91.

On failure to inquire once the principal is on notice of facts that would lead a reasonable person to make inquiry, see Bielicki v. Terminix Int'l Co., 225 F.3d 1159 (10th Cir.2000) (ratification occurred when supervisor failed to inquire into facts after employee told him that his application of pesticide caused occupants of space to become ill).

Case Citations - by Jurisdiction

S.D.N.Y.Bkrtcy.Ct.
Colo.App.
Iowa
Ky.
Or.App.
S.C.App.

S.D.N.Y.Bkrtcy.Ct.

S.D.N.Y.Bkrtcy.Ct.2013. Quot. in sup., cit. in ftn., com. (b) cit. in ftn. Official committee of unsecured creditors in the Chapter 11 bankruptcy case of debtor/automobile manufacturer brought an adversary proceeding against administrative agent of secured creditors that had made a $1.5 billion term loan to debtor prepetition, seeking a determination that the loan was unsecured. Granting summary judgment for defendant, this court held, inter alia, that defendant did not ratify its mistaken

inclusion of a termination statement with respect to the term-loan lien in a batch of termination statements regarding the liens on an unrelated real-estate financing such that debtor would be authorized to terminate the term-loan lien; among other things, defendant did not do anything to affirm its mistaken filing of the termination statement with respect to the term-loan lien or any other key prior acts, it had no actual knowledge that a termination statement had been filed, and it would not receive any benefit from such a termination. In re Motors Liquidation Co., 486 B.R. 596, 636, 637.

Colo.App.

Colo.App.2008. Coms. (b) and (d) quot. in sup. After plaintiff's attorney settled plaintiff's personal-injury action against defendant without plaintiff's knowledge or consent and absconded with the settlement proceeds, plaintiff reinstated his action against defendant. The trial court granted summary judgment for defendant, finding, among other things, that plaintiff had ratified the unauthorized settlement by accepting payment from the state attorneys' fund for client protection in the amount of the stolen proceeds. Reversing and remanding for reinstatement of plaintiff's complaint, this court held, inter alia, that questions of fact remained as to whether plaintiff, by submitting a pro se claim to the fund and accepting the fund's check, made an informed choice to be legally bound by his former attorney's unauthorized actions and, consequently, to thereby be barred from pursuing his personal-injury claim. Siener v. Zeff, 194 P.3d 467, 472, 473.

Iowa

Iowa, 2007. Cit. in sup. Stepdaughter, who was specifically bequeathed an interest in a duplex under testator's will, filed a claim against testator's estate after learning that the duplex had been sold without testator's knowledge before her death by her attorney-in-fact to pay for her living expenses. The trial court denied stepdaughter's claim. The court of appeals affirmed. Vacating and remanding for entry of judgment in favor of stepdaughter, this court held, inter alia, that the sale of the duplex by testator's attorney-in-fact did not result in ademption of the bequest. The court stated that an expression of intent in the indefinite future to sell assets for support was not sufficient to cause ademption under Iowa's "modified intention theory," where the testator was not aware that the specific asset had been sold. In re Estate of Anton, 731 N.W.2d 19, 27.

Ky.

Ky.2008. Quot. in ftn. Customer brought malicious-prosecution and defamation claims against pizza delivery driver, pizza store franchisee, and franchisor, after criminal charges against him for unlawful imprisonment of driver were dismissed. The trial court granted summary judgment for franchisee and franchisor. The court of appeals reversed. Reversing and reinstating the trial court's dismissal of plaintiff's claim for malicious prosecution against franchisee, this court held, inter alia, that customer's vicarious-liability/ratification theory failed as a matter of law; plaintiff failed to demonstrate that franchisee had actual knowledge that driver was fabricating his version of the events to police, or that franchisee intended to ratify driver's allegedly false statements. Papa John's Intern., Inc. v. McCoy, 244 S.W.3d 44, 53.

Or.App.

Or.App.2008. Com. (c) cit. in sup. Former husband sued former wife for specific performance, seeking an order requiring wife to convey real property to him in accordance with a settlement agreement that was designed to resolve issues on appeal from the parties' divorce. The trial court ruled that wife was not bound by the agreement because it had been entered into by her lawyer without her actual or apparent authority. Reversing and remanding, this court held that wife ratified the settlement agreement by her conduct, and thus was bound by it; wife possessed the requisite knowledge of facts material to her and husband's obligations created by the settlement agreement, and failed to repudiate the agreement before accepting the benefit of husband's significant performance under it. Lemley v. Lemley, 221 Or.App. 172, 181, 188 P.3d 468, 473.

S.C.App.

S.C.App.2001. Com. (b) cit. in sup. Husband-and-wife motorcyclists seriously injured by the negligence of an underinsured motorist sued their insurer, seeking reformation of their automobile insurance policy to include underinsured motorist (UIM) coverage in the same limits as the liability coverage in the policy. The trial court granted summary judgment for insurer. Reversing in part and remanding, this court held that factual issues remained as to whether wife was acting within her authority as husband's agent when she rejected UIM coverage, and, if not, whether insurer could assert that husband ratified wife's actions by failing to take corrective action. The court cited evidence that husband did not understand the difference between uninsured motorist (UM) coverage and UIM coverage, and that he was unaware that wife had purported to reject UIM coverage on his behalf. Stiltner v. USAA Cas. Ins. Co., 717 S.E.2d 74, 79.

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Restatement (Third) Of Agency § 4.07 (2006)

Restatement of the Law - Agency

Database updated June 2014
Restatement (Third) of Agency

Chapter 4. Ratification

§ 4.07 No Partial Ratification

Comment:
Reporter's Notes

A ratification is not effective unless it encompasses the entirety of an act, contract, or other single transaction.

Comment:

a. Cross-references. Ratification occurs under the circumstances stated in § 4.01(2).

b. Burdens accompany benefits. A person may not, by ratifying an act, obtain its economic benefits without bearing the legal consequences that accompany the act. For example, if unauthorized representations induce a third party's assent to a contract, ratification of the contract binds the ratifier to the legal consequences of the representations that induced assent to it.

Illustration:
Illustration:

1. P deals in used automobiles. A, who is P's janitor, sells a car to T, which A lacks actual or apparent authority to do. To induce T to buy the car, A tells T that, although the car has been in a flood, its operation and condition are unimpaired. A knows this statement is false. Upon discovering the truth, T refuses to pay the remainder of the purchase price. Knowing that A has made the false representation to T, P sues T to recover the remainder of the price. P has ratified A's representation.

c. Single transaction. Ratifying one transaction or act does not encompass multiple independent transactions undertaken at approximately the same time or during the same general course of conduct. Distinct but interrelated components of economic activity among the same parties may, however, constitute a single transaction for purposes of this rule.

Illustrations:
Illustrations:

2. P, an investor in real estate, believes that T is interested in purchasing property owned by S. P retains A, a real-estate broker, to arrange both a purchase by P from S and, shortly thereafter, a sale by P to T, promising to pay A a percentage commission on both the purchase and the sale. After A arranges the terms, P purchases the property from S. Soon thereafter, A arranges the terms of a sale to T. Acting without P's written authorization, A signs P's name to the sale agreement. After learning what A has done, P ratifies A's act in signing the agreement. P is bound to pay A's commission on the purchase transaction as well as the sale transaction.
3. Acting without actual or apparent authority, A purports to sell a yacht owned by P, the "Acis," to T for $100,000. A then sells a second yacht, the "Galatea," also owned by P, to T for $75,000. On hearing the facts, P faxes T: "You may keep Acis but Galatea went too cheaply." P has ratified the sale of Acis but not Galatea.

4. Same facts as Illustration 3 except that, as P knows, A purported to sell Acis to T using a written contract form containing an arbitration clause. P's ratification of A's sale of Acis binds P to the arbitration clause.

Reporter's Notes

*a. Relationship to Restatement Second, Agency.*This section corresponds in substance to Restatement Second, Agency § 96, except that § 96 does not include "act" in the black letter. However, in § 96, Comment *c* discusses affirmance of "acts done on his account by one intending to act as his servant," and Comment *e* refers to "a transaction or act of service...."

*b. Burdens accompany benefits.*For the proposition that affirmance of a contract binds the principal as to the agent's unauthorized representations, see Litchfield Nat'l Bank v. McBride, 7 N.E.2d 348, 353 (Ill.App.1937) (bank president made unauthorized representation to maker of accommodation note that bank would never collect on note, in order to induce maker to sign and deliver note and power of attorney conferring judgment, claiming note was needed to enable bank to reopen; by accepting note and presenting it to bank examiner, bank ratified president's representation and cannot enforce note against maker). The doctrine is applicable if, to induce a third party to assent to a transaction for which the agent has authority, the agent also purports to commit the principal to an unauthorized transaction. See C.Q. Farms, Inc. v. Cargill, Inc., 363 So. 2d 379, 382 (Fla.App.1978) (question for jury whether feed company ratified district manager's commitment of $250,000 line of credit to poultry raiser by enforcing lien on poultry raiser's account receivables, which poultry raiser was induced to give on basis of commitment of line of credit).

Accepting the benefit of coverage under an insurance policy by ratifying a settlement agreement binds the principal to the policy's arbitration clause in Norcal Mut. Ins. Co. v. Newton, 100 Cal.Rptr.2d 683, 697 (Cal.App.2000). On ratification of an agent's selection among coverage choices, compare Webber v. State Farm Mut. Auto. Ins. Co., 49 S.W.3d 265, 270-272 (Tenn.2001) (insured's act of filing suit against insurer to obtain benefits under policy following collision with uninsured motorist ratified contract with insurer made by insured's mother-in-law who requested coverage for insured's car; insured bound by mother-in-law's choice of statutory minimum coverage respecting uninsured motorists) with Nationwide Mut. Ins. Co. v. Powell, 292 F.3d 201, 205-206 (4th Cir.2002) (insured not bound by spouse's rejection of underinsured motorist coverage; insurer's offer of underinsured motorist coverage to spouse did not constitute a "meaningful offer" of coverage to insured, as required by state law, if spouse lacked actual or apparent authority to reject coverage on behalf of insured).

*c. Single transaction.*Illustration 2 is based on a simplified version of the facts in Friddle v. Epstein, 21 Cal.Rptr.2d 85 (Cal.App.1993). See also Barrow v. Booneville No. 1, Inc., 31 S.W.3d 90, 94 (Mo.App.2000) (on remand, landlord should be given opportunity to present evidence of issues in addition to rent in dispute between landlord and tenant prior to settlement; if landlord ratified by accepting increased rental payments, effect would be to bind landlord to all terms in amended lease). On whether an agent has engaged in separate or single acts, compare Hall v. Internet Capital Group, Inc., 271 F.Supp.2d 332, 335 (D.Me.2003) (shareholders who approved merger agreement signed by unauthorized representative ratified all provisions in agreement, including arbitration provision) with King v. White, 962 P.2d 475, 482-483 (Kan.1998) (client who ratified lawyer's unauthorized settlement of two claims did not thereby ratify lawyer's forged endorsements on settlement drafts; forgeries constituted "separate wrongful acts," and situation is not one in which "only one act confers both benefits and liabilities").

Illustration 3 is a variant on Illustration 4 to Restatement Second, Agency § 96.

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Restatement (Third) Of Agency § 4.08 (2006)

Restatement of the Law - Agency

Database updated June 2014
Restatement (Third) of Agency

Chapter 4. Ratification

§ 4.08 Estoppel to Deny Ratification

Comment:

Reporter's Notes

If a person makes a manifestation that the person has ratified another's act and the manifestation, as reasonably understood by a third party, induces the third party to make a detrimental change in position, the person may be estopped to deny the ratification.

Comment:

a. Cross-references. For estoppel to deny the existence of a relationship of agency, see § 2.05. For estoppel against an undisclosed principal, see § 2.06. For estoppel to assert a defense based on lack of written authorization, see § 3.02. A manifestation, as defined in § 1.03, may under appropriate circumstances consist of a failure to act.

b. Scope of doctrine. Ordinarily a manifestation of the type required by this section will constitute ratification under § 4.01(2)(a). It will result in a ratification that binds the person who makes the manifestation under § 4.01, and the effects of ratification as stated in § 4.02 will be operative as to the legal relations among the ratifier, the third party, and the agent. In particular, the third party to whom the manifestation is made will be able to hold the ratifier to a transaction without showing any change of position, as this doctrine requires. Moreover, a principal who ratifies an agent's prior act may not thereafter revoke the ratification. See § 4.02, Comment *b*. In contrast, the doctrine stated in this section operates only in favor of the person misled by the manifestation. The court has discretion to determine the appropriate remedy in light of all relevant circumstances. See Restatement Second, Contracts § 139.

Ratification may be impossible when the person who makes a manifestation of affirmance lacks capacity at the time of the original act. If at the time of making the manifestation the person has the capacity requisite under § 3.04 to authorize the act, the person may be estopped to deny that such capacity was present at the time of the original act. Additionally, a person may be estopped to assert failure to comply with formalities requisite to ratification. Under § 4.01, Comment *e*, a writing is necessary to ratify a transaction when written authorization is necessary to bind the principal to the transaction through the act of an agent. Estoppel is operative, as under § 3.02, when a third party changes position in reliance on a person's manifestation that a writing requisite to ratification has been executed by the person.

A person may also be estopped to deny that an act has been ratified when an element requisite to ratification cannot be established but a third party has been deceived by a manifestation of the person. For example, a person is not bound by a ratification if the person lacks knowledge of material facts and is unaware of the lack of knowledge. See § 4.06. If the ratifier thereafter learns that the ratification has misled a third party and that the third party is likely to act on the basis of the erroneous belief, failure to correct the third party's erroneous belief may justify estoppel against denying ratification.

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Reporter's Notes

*a. Relationship to Restatement Second, Agency.*The title of this section corresponds to that of Restatement Second, Agency § 103, which provides in its entirety that "[a] person may be estopped to deny that he has ratified an act or transaction."

*b. Scope of doctrine.*Relatively few cases turn solely on an application of this doctrine. At least some cases that consider whether to estop a party from denying that ratification has occurred involve conduct by the party estopped that would constitute ratification under § 4.01(2). See Abodeely v. Cavras, 221 N.W.2d 494, 504 (Iowa 1974) (act of vendors in installment-sale transaction in serving vendee with notice of forfeiture, which led to reliance and loss of income for vendee, estopped vendors from denying that their agent had authority to serve notice of forfeiture); Ercanbrack v. Crandall-Walker Motor Co., 550 P.2d 723, 725 (Utah 1976) (company did not ratify act of its salesman, who told plaintiff that his order for a truck had been accepted, by failing to tell plaintiff that order had not been accepted because neither company officer nor sales manager knew of salesman's statement to plaintiff and order form stated order was not valid unless signed by sales manager or company officer).

On failure to correct a third party's erroneous impression, see Zielinski v. Philadelphia Piers, Inc., 139 F. Supp. 408, 413 (E.D.Pa.1956) (plaintiff filed lawsuit against wrong defendant, whose vague answers to interrogatories led to delay in plaintiff's discovery of error until after statute of limitations expired; court estops defendant to deny agency relationship with party who should have been named as defendant; dictum that estoppel to deny ratification is "closely related" principle). Cf. Eastern Trading Co. v. Refco, Inc., 229 F.3d 617, 625 (7th Cir.2000) (partners may have ratified fellow partner's unauthorized trades in precious metals by failing to repudiate them following discovery; partners may have also "misled [defendant] into thinking they had ratified them," with the consequence defendant did not defraud partners).

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otherwise included in Ohio adjusted gross income.

(20)(a) Add five-sixths of the amount of depreciation expense allowed by subsection (k) of section 168 of the Internal Revenue Code, including the taxpayer's proportionate or distributive share of the amount of depreciation expense allowed by that subsection to a pass-through entity in which the taxpayer has a direct or indirect ownership interest. The tax commissioner, under procedures established by the commissioner, may waive the add-back related to a pass-through entity if the taxpayer owns, directly or indirectly, less than five per cent of the pass-through entity.

(b) Nothing in division (A)(20) of this section shall be construed to adjust or modify the adjusted basis of any asset.

(c) To the extent the add-back required under division (A)(20)(a) of this section is attributable to property generating nonbusiness income or loss allocated under section 5747.20 of the Revised Code, the add-back shall be sitused to the same location as the nonbusiness income or loss generated by the property for the purpose of determining the credit under division (A) of section 5747.05 of the Revised Code. Otherwise, the add-back shall be apportioned, subject to one or more of the four alternative methods of apportionment enumerated in section 5747.21 of the Revised Code.

(21)(a) If the taxpayer was required to add an amount under division (A)(20)(a) of this section for a taxable year, deduct one-fifth of the amount so added for each of the five succeeding taxable years.

(b) If the amount deducted under division (A)(21)(a) of this section is attributable to an add-back allocated under division (A)(20)(c) of this section, the amount deducted shall be sitused to the same location. Otherwise, the add-back shall be apportioned using the apportionment factors for the taxable year in which the deduction is taken, subject to one or more of the four alternative methods of apportionment enumerated in section 5747.21 of the Revised Code.

(B) "Business income" means income arising from transactions, activities, and sources in the regular course of a trade or business and includes income from real property, tangible property, and intangible property if the acquisition, rental, management, and disposition of the property constitute integral parts of the regular course of a trade or business operation. "Business income" includes income, including gain or loss, from a partial or complete liquidation of a business, including, but not limited to, gain or loss from the sale or other disposition of goodwill.

(C) "Nonbusiness income" means all income other than business

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entered into by the tax commissioner under division (A)(3) of this section.

Sec. 5747.21. (A) This section applies solely for the purposes of computing the credit allowed under division (A) of section 5747.05 of the Revised Code, computing income taxable in this state under division (D) of section 5747.08 of the Revised Code, and computing the credit allowed under section 5747.057 of the Revised Code. ~~Except~~

(B) Except as otherwise provided under ~~section~~ sections 5747.211 and 5747.212 of the Revised Code, all items of business income and business deduction shall be apportioned to this state by multiplying the adjusted gross income by the fraction calculated under division (B)(2) of section 5733.05 and section 5733.057 of the Revised Code as if the taxpayer's business were a corporation subject to the tax imposed by section 5733.06 of the Revised Code.

(C) If the allocation and apportionment provisions of sections 5747.20 to 5747.23 of the Revised Code or of any rule adopted by the tax commissioner, do not fairly represent the extent of business activity in this state of a taxpayer or pass-through entity, the taxpayer or pass-through entity may request, which request must be in writing accompanying the return or amended return, or the tax commissioner may require, in respect of all or any part of the business activity, if reasonable, any one or more of the following:

(1) Separate accounting;

(2) The exclusion of one or more factors;

(3) The inclusion of one or more additional factors which will fairly represent the business activity in this state;

(4) The employment of any other method to effectuate an equitable allocation of such business in this state. An alternative method will be effective only with approval of the tax commissioner.

The tax commissioner may adopt rules in the manner provided by sections 5703.14 and 5747.18 of the Revised Code providing for alternative methods of calculating business income and nonbusiness income applicable to all taxpayers and pass-through entities, to classes of taxpayers and pass-through entities, or only to taxpayers and pass-through entities within a certain industry.

Sec. 5747.212. This section applies solely for the purpose of computing the credit allowed under division (A) of section 5747.05 of the Revised Code, computing income taxable in this state under division (D) of section 5747.08 of the Revised Code, and computing the credit allowed under section 5747.057 of the Revised Code.

A pass-through entity investor that owns, directly or indirectly, at least twenty per cent of the pass-through entity at any time during the current taxable year or either of the two preceding taxable years shall apportion any income, including gain or loss, realized from the sale, exchange, or other disposition of a debt or equity interest in the entity as prescribed in this section. For such purposes, in lieu of using the method prescribed by sections 5747.20 and 5747.21 of the Revised Code, the investor shall apportion the income using the average of the pass-through entity's apportionment fractions otherwise applicable under section 5747.21 of the Revised Code for the current and two preceding taxable years. If the pass-through entity was not in business for one or more of those years, each year that the entity was not in business shall be excluded in determining the average.

Sec. 5901.02. In each county there shall be a commission known as "the veterans service commission." Except as provided in section 5901.021 of the Revised Code, the commission shall be composed of five ~~persons. Those persons shall be~~ residents of the county ~~and shall be~~ appointed to five-year terms by a judge of the court of common pleas. At the time of appointment or reappointment to the commission, no commission member appointed under this section shall be an employee of the commission or hold an elective or other appointive office of the county served by the commission.

Each member of the commission appointed under this section shall be an honorably discharged or honorably separated veteran. Within sixty days after the date of appointment, each such member ~~of the commission~~ shall file the member's form DD214 with the governor's office of veterans affairs in accordance with guidelines established by the director of that office. ~~Appointments to the commission~~ Such appointments shall be made from lists of recommended persons, in the manner specified in the following paragraph. One person shall be a representative recommended by the American Legion; one person shall be a representative recommended by the Veterans of Foreign Wars; one person shall be a representative recommended by the Disabled American Veterans; one person shall be a representative recommended by the AMVETS; and one person shall be a representative recommended by the Military Order of the Purple Heart of the U.S.A., the Vietnam Veterans of America, or the Korean War Veterans Association. If any such organization has no post or chapter located in the county, the appointment shall be made from lists of recommended persons

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satisfied for the trust's taxable year in which the trust recognizes the gain or loss.

Any gain or loss that is not a qualifying trust amount is modified business income, qualifying investment income, or modified nonbusiness income, as the case may be.

(3) "Modified nonbusiness income" means a trust's Ohio taxable income other than modified business income, other than the qualifying trust amount, and other than qualifying investment income, as defined in section 5747.012 of the Revised Code, to the extent such qualifying investment income is not otherwise part of modified business income.

(4) "Modified Ohio taxable income" applies only to trusts, and means the sum of the amounts described in divisions (BB)(4)(a) to (c) of this section:

(a) The fraction, calculated under section 5747.013, and applying section 5747.231 of the Revised Code, multiplied by the sum of the following amounts:

(i) The trust's modified business income;

(ii) The trust's qualifying investment income, as defined in section 5747.012 of the Revised Code, but only to the extent the qualifying investment income does not otherwise constitute modified business income and does not otherwise constitute a qualifying trust amount.

(b) The qualifying trust amount multiplied by a fraction, the numerator of which is the sum of the book value of the qualifying investee's physical assets in this state on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the day on which the trust recognizes the qualifying trust amount, and the denominator of which is the sum of the book value of the qualifying investee's total physical assets everywhere on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the day on which the trust recognizes the qualifying trust amount. If, for a taxable year, the trust recognizes a qualifying trust amount with respect to more than one qualifying investee, the amount described in division (BB)(4)(b) of this section shall equal the sum of the products so computed for each such qualifying investee.

(c)(i) With respect to a trust or portion of a trust that is a resident as ascertained in accordance with division (I)(3)(d) of this section, its modified nonbusiness income.

(ii) With respect to a trust or portion of a trust that is not a resident as ascertained in accordance with division (I)(3)(d) of this section, the amount of its modified nonbusiness income satisfying the descriptions in divisions (B)(2) to (5) of section 5747.20 of the Revised Code, except as otherwise

provided in division (BB)(4)(c)(ii) of this section. With respect to a trust or portion of a trust that is not a resident as ascertained in accordance with division (I)(3)(d) of this section, the trust's portion of modified nonbusiness income recognized from the sale, exchange, or other disposition of a debt interest in or equity interest in a section 5747.212 entity, as defined in section 5747.212 of the Revised Code, without regard to division (A) of that section, shall not be allocated to this state in accordance with section 5747.20 of the Revised Code but shall be apportioned to this state in accordance with division (B) of section 5747.212 of the Revised Code without regard to division (A) of that section.

If the allocation and apportionment of a trust's income under divisions (BB)(4)(a) and (c) of this section do not fairly represent the modified Ohio taxable income of the trust in this state, the alternative methods described in division (C) of section 5747.21 of the Revised Code may be applied in the manner and to the same extent provided in that section.

(5)(a) Except as set forth in division (BB)(5)(b) of this section, "qualifying investee" means a person in which a trust has an equity or ownership interest, or a person or unit of government the debt obligations of either of which are owned by a trust. For the purposes of division (BB)(2)(a) of this section and for the purpose of computing the fraction described in division (BB)(4)(b) of this section, all of the following apply:

(i) If the qualifying investee is a member of a qualifying controlled group on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, then "qualifying investee" includes all persons in the qualifying controlled group on such last day.

(ii) If the qualifying investee, or if the qualifying investee and any members of the qualifying controlled group of which the qualifying investee is a member on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the gain or loss, separately or cumulatively own, directly or indirectly, on the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the qualifying trust amount, more than fifty per cent of the equity of a pass-through entity, then the qualifying investee and the other members are deemed to own the proportionate share of the pass-through entity's physical assets which the pass-through entity directly or indirectly owns on the last day of the pass-through entity's calendar or fiscal year ending within or with the last day of the qualifying investee's fiscal or calendar year ending immediately prior to the date on which the trust recognizes the qualifying trust amount.