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Contesting Ohio's True Value Procedures; Use Of Quasi-Appraisal Evidence Rejected

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Cincinnati Bell Telephone Company ("CBT") recently challenged the Commissioner's determination of the value of its personal property used in business during 2000, 2001 and 2002.¹ CBT argued: (1) that the rate at which its property is taxed is disproportionate to that of its competition, thereby resulting in violations of the Equal Protection clauses of the Ohio and United States Constitutions; (2) that the method typically applied by the Commissioner in determining the value of depreciable business property reported by telephone companies does not accurately reflect the value of CBT's property due to increased market competition, dramatic technological advances, and an absence of a resale market; and (3) that the Commissioner erred in taxing certain equipment attached to its motor vehicles which are used in delivering telecommunications services to the public.

The Constitutional Argument

With regard to the Constitutional argument advanced by CBT, the Ohio Board of Tax Appeals ruled that it did not have the authority to consider the argument.

The Motor Vehicle Component Argument

CBT next asserted that tax was erroneously assessed on property permanently mounted on motor vehicles used to deliver telecommunications services to its customers. The Board ruled: "[g]iven the absence of evidence regarding such equipment, we cannot conclude that [CBT] has met its burden of proof. Accordingly, we reject [CBT's] arguments relating to this issue."

The Valuation Argument

CBT argued that the assessments issued by the Commissioner resulted in an overvaluation of its property. CBT presented the testimony of, and a valuation study prepared by, Ray L. Hodges, a senior consultant with Technology Futures, Inc. ("TFI").

¹ *Cincinnati Bell Telephone Company v. Zaino*, Ohio BTA Case Nos. 2003-K-765 and 1612 (June 10, 2005).

The TFI study reviewed specific categories of CBT's plant and equipment, i.e., switching equipment, circuit equipment, aerial and buried metallic cable, and non-metallic cable, and concluded that each should be depreciated at faster rates with lower floor values than applicable under the rates prescribed by the Commissioner. Applying the resulting rates to the net cost of assets within these categories, the TFI study ultimately expressed values for each category for each of the years in issue.

The Statutory Standard

Before considering the TFI study, the Board noted that R.C. 5727.11 prescribes the specific method to be employed by the Commissioner in valuing public utility property.

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

The Board noted that the composite annual allowances prescribed by the Commissioner for use by public utilities in valuing their taxable property are similar in purpose and effect to the "302 computation directive" used by general business taxpayers. With regard to the use of the 302 computation directive, the Court has frequently noted that it provides a generally effective means for determining value. Still, the Supreme Court of Ohio has repeatedly held that the directive should not be applied when it is affirmatively demonstrated by a taxpayer that special or unusual circumstances exist or because rigid application would be inappropriate. One challenging the use of the 302 computation directive must bring forth competent and probative evidence of the true value of its property. There are three acceptable methods of meeting this burden: (1) direct evidence of the property's value; (2) proof of special or unusual circumstances effecting the value of the property; or (3) proof that the use of the 302 computation produces an unjust or unreasonable result.

The Board held that the same standards apply when challenging the value of public utility property determined by reference to historic costs and the Commissioner's prescribed allowances.

Inadequate Direct Evidence of Value

The Commissioner conceded that where direct evidence of value is offered, such as an appraisal like that presented in *Texas E. Transm. Corp. v. Tracy* (1997), 78 Ohio St.3d 83, a public utility need not demonstrate the existence of special and unusual

circumstances in order to deviate from booked costs less prescribed allowances. However, the Commissioner argued that the TFI study offered by CBT was not direct evidence of value, but instead merely proposed accelerated depreciation rates compared to those prescribed by the Commissioner. Therefore, the Commissioner argued, CBT was not relieved of its obligation to prove that special and unusual circumstances exist. The Board agreed.

[W]e agree with the Commissioner that [the TFI study] is not an alternate method of valuing property as was presented in *Texas E. Transm.* The valuation evidence presented in that case was an appraisal which had been prepared by an individual holding the designations of Member of the Appraisal Institute and Certified Assessment Evaluator from the International Assessing Officers. In order to derive the opinion of value which he ultimately expressed for the property in his unit-appraisal, he employed approaches often considered in the appraisal of property, i.e., a cost approach, an income approach, and a stock and debt analysis. In this instance, the TFI study is not an alternate valuation method, e.g., an appraisal, but is instead an effort to demonstrate that the depreciation schedules generally applicable to [CBT's] property fail to adequately account for the competitive and technological changes which are currently impacting the telecommunications industry. Given the nature of [CBT's] evidence, we consider it appropriate to proceed to address whether [CBT] has demonstrated the existence of special and unusual circumstances.

No Special and Unusual Circumstances

The Commissioner persuaded the Board that the evidence upon which CBT relied demonstrated that CBT was in the same position, with its property subject to the same rates, as other telephone companies in Ohio. In the Board's words:

Although [CBT] argues it should not be required to show it is different from the remainder of its industry, such is the fundamental nature of proving the existence of "special and unusual circumstances."

*** *** ***

A review of [CBT's] evidence reveals that it has not demonstrated that special and unusual circumstances exist. Indeed, as asserted by the commissioner, the evidence offered by appellant suggests that the factors impacting the value of its property similarly affect others within its industry. While the providers with whom [CBT] competes may be

unique to its market, [CBT's] evidence demonstrates that it is far from alone regarding the competitive forces with which it must deal and the impact technological progress is generally having upon participants in the telecommunications industry. (Parenthetical matter added.)

No Proof of Unreasonable Results

With regard to whether the use of historic cost reduced by the composite allowances called for in R.C. 5727.11 produces an unjust or unreasonable result, the Board acknowledged that it was required to ascertain from the evidence before it whether that was the case. Discussing the evidence, the Board noted that the TFI study found that CBT's property had been, and will continue to be, impacted significantly by increased competitive forces arising from several sources, rapid technological change occurring within the telecommunications industry, the growth of the Internet, and, in some instances, anticipated mortality factors. With respect to each category of property reviewed, the nature and extent of these factors was elaborated upon.

The Board also noted that, in estimating the rates at which CBT's property would effectively be displaced, the TFI study indicated that various publications, studies, and models had been relied upon. These studies and models (1) forecast the impact new technology and increased competition has upon existing businesses and technology, (2) predict the rate at which businesses engage in technology substitution, and (3) predict the rate at which consumers begin adopting newer technologies.

Ultimately, based upon its review of the telecommunications industry, the market in which CBT operates, and expectations regarding the changes likely to impact both, the TFI study recommended schedules similar in style to those prescribed by the Commissioner. Different, however, is the fact that these proposed schedules address individual assets within the composite groups reflected within the Commissioner's prescribed allowances and the rates and time periods at which such assets should be depreciated. With respect to switching and circuit equipment, the TFI study recommends a ten-year life span with a five percent floor being reached in the last year, while underground metallic cable, aerial metallic cable, buried metallic cable, and non-metallic cable are ascribed a fifteen-year life span with a floor value at or near zero.

After considering the body of evidence presented by CBT, the Board found that it did not establish that the Commissioner's use of historic costs, reduced by the composite allowances called for in R.C. 5727.11, produces an unjust or unreasonable result. In the Board's words:

In reviewing [CBT's] evidence, we are persuaded that the telecommunications industry, as a whole, is undergoing continuing and dynamic change. Clearly, since 1996, [CBT] and other ILECs, and indeed all market participants, have experienced increased and varied competition. Similarly, as is the case in most industries, technological advancements

have resulted in the elimination, modification, or enhancement of many preexisting forms of technology.

However, we are not convinced that the manner by which appellant attempts to account for the impact of such factors results in an accurate and reliable representation of true value or, for that matter, that application of the rates prescribed by the commissioner will necessarily create an unjust or unreasonable result. Although the TFI study references certain historical and market data unique to appellant, it is heavily weighted to account for events anticipated to occur generally within the telecommunications industry in the future. Because it is premised upon conjecture regarding future events, its conclusions are incapable of objective verification. Where, as here, there exists little or no historical data to effectively test the validity of the numerous assumptions made, errors can easily occur regarding the timing and impact the cited factors may have upon the value of appellant's property.

* * *

Accordingly, while the forecasting studies and models relied upon within the TFI study may be useful to appellant in the development of its long-range business plans, we do not find it a reliable means by which to determine the value of appellant's property for the specific tax listing dates in issues in these appeals.

We also find unsupported and unreasonable the suggestion that appellant's assets would be rendered valueless after a certain number of years despite their continued use with appellant's network.■



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