

Ohio Board of Tax Appeals Decision Generally Supports Use of Retail Inventory Method of Accounting

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On February 3, 2009, the Ohio Board of Tax Appeals issued a decision styled *Rich's Department Stores, Inc. v. Wilkins*, Case No. 2005-T-1609, which addressed the valuation of inventory for personal property tax purposes. Of special interest to retailers, the BTA's decision generally supported use of the "Retail Inventory Method" of accounting ("RIM") to determine the value of inventory to be reported for personal property tax purposes.

Although the Ohio personal property tax phased out of existence last year, this decision may still have relevance for a number of taxpayers. First, to the extent any taxpayer has not been applying RIM in calculating inventory value, there is a potential refund opportunity for open years. While many taxpayers likely have applied RIM accounting, the ability to use this methodology in valuing inventory may have been overlooked by some given that it is not expressly referenced in the relevant Ohio administrative code provision – O.A.C. 5703-3-17 -- as a permissible adjustment to inventory value.

Second, as the case highlights, the Ohio Department of Taxation on audit has been taking an aggressive position in denying downward adjustments to inventory values under RIM accounting principles. In *Rich's* the Department disputed the taxpayer's manner of adjusting its inventory value, which was accomplished through securing credits from vendors. Such credits, which the taxpayer requested in order to maintain

margin performance on sales of the vendors' products, were used to reduce the taxpayer's accounts payable balance with respect to such vendors. To account for such credits, and reflect a corresponding increase in margin performance, the taxpayer effectively recorded a reduction to its cost of goods sold.

The Department asserted that such adjustments were reductions to inventory book value not expressly authorized under O.A.C. 5703-3-17 in determining inventory value. The BTA rejected this argument on the basis that the RIM adjustments are reflected in the cost of the taxpayer's inventory, as opposed to being an adjustment to book value. In other words, amounts received from a vendor are properly viewed as a reduction of the price of the vendor's product and, therefore, a reduction of its customer's cost of sales.

In light of the foregoing, while the tax has phased-out, you may consider reviewing your Ohio personal property returns for open tax years to determine whether your company has taken advantage of the lower inventory values allowed under Rule 5703 3 17 (cash discounts and net markdowns) and the attached case (RIM and vendor allowances). For those under audit, the BTA's decision in *Rich's* may provide additional assistance for you in defending your return position. The Department of Taxation has until March 5 to appeal this determination.

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