

The Supreme Court of Ohio Reverses Ohio Board of Tax Appeals Decision Regarding Use of the Retail Method of Accounting When Valuing Inventory

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On March 18, 2010, the Supreme Court of Ohio issued a decision styled *Rich's Dept. Stores, Inc. v. Levin*, Slip Opinion No. 2010-Ohio-957, which addressed the valuation of inventory for personal property tax purposes. In its 4-3 decision, the Court reversed the Ohio Board of Tax Appeals determination that the value assigned to merchandise held in inventory by a retailer should be reduced based upon "vendor markdown allowances." See *Rich's Dept. Stores, Inc. v. Wilkins* (Feb. 3, 2009), BTA No. 2005-T-1609, unreported.

Vendor markdown allowances are credits granted by vendors that supply merchandise to a retailer. A retailer requests these credits to compensate the retailer for having to mark down the merchandise from its expected retail price. The credits thereby maintain the expected margin performance, i.e., profit, on sales of the vendor's products. Based upon the Retail Inventory Method of Accounting ("RIM") the taxpayer in *Rich's* argued that the vendor allowances reduced the cost of its inventory, which should be recognized when determining the book value of that inventory for personal property tax purposes. The Board of Tax Appeals agreed.

On appeal, the Supreme Court of Ohio reversed. The Court first looked to the applicable Ohio Administrative Code section, Ohio Adm. Code 5703-3-17, which provides that the "true 'average inventory value of merchandise' to be estimated for taxation shall prima facie be the 'average inventory value' at cost as disclosed on the books of the taxpayer ***." The Court determined that the administrative rule amplified the general mandate that "depreciated book value shall be taken as the true value of such property." R.C. 5711.18. The Court therefore reasoned that any cost factor under Ohio Adm. Code 5703-3-17 must relate to how the inventory is carried on the books of the company.

According to the Court, the markdown allowances should not have been treated as one of the factors that comprise book value. The Court concluded that the markdown allowances were a reduction in the "cost of goods sold," which, for accounting purposes, is reflected on the taxpayer's profit and loss statement. The Court viewed this as an "after-the-fact offset against the original acquisition cost" that does not justify an adjustment to book value.

While the markdown allowances reduce profitability, and would therefore suggest a lower value of the merchandise to the taxpayer, the Court concluded that the markdown allowances were actually intended to support profitability. Consequently, “the expectation of receiving allowances stabilizes rather than reduces the value of the merchandise inventory.”

Although the Ohio personal property tax has been phased out, the *Rich’s Dept. Stores* decision is an important reminder to those who are reviewing Ohio personal

property tax returns for open years that true value of inventory under RIM should include only those costs that relate to how inventory is carried on the books. *Rich’s Dept. Stores* is also cautionary to those who may have lowered inventory values based upon the BTA’s earlier decision. The Court’s reversal of the BTA may provide additional difficulty in defending your Ohio personal property tax return if under an audit by the Department of Taxation.

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