

[Cite as *MCI Metro Access Transm. Servs. v. Levin*, 2008-Ohio-5057.]

IN THE COURT OF APPEALS OF OHIO
TENTH APPELLATE DISTRICT

MCI Metro Access Transmission Services, LLC et al.,	:	
	:	No. 07AP-398
Appellants-Appellants,	:	(BTA No. 2004-K-749)
	:	and
	:	No. 07AP-399
	:	(BTA No. 2004-K-750)
v.	:	
	:	(REGULAR CALENDAR)
[Richard A. Levin], Tax Commissioner of Ohio,	:	
	:	
Appellee-Appellee.	:	

O P I N I O N

Rendered on September 30, 2008

Jones Day, Todd S. Swatsler, Kerstin Sjoberg-Witt, and Charles M. Steines, for appellants.

Nancy H. Rogers, Attorney General, Barton A. Hubbard, and Ryan P. O'Rourke, for appellee.

APPEALS from the Board of Tax Appeals

BROWN, J.

{¶1} In these consolidated appeals, appellants, MCI Metro Access Transmission Services, LLC ("MCI Metro") and MCI WorldCom Network Services, Inc. ("MWNS"), appeal from a decision and order of the Ohio Board of Tax Appeals ("BTA"), affirming final determinations by appellee, Ohio Tax Commissioner ("tax commissioner"), denying

appellants' petitions for reassessments and affirming public utility property tax assessments issued to each appellant for the tax year 2003.

{¶2} The following facts, which are essentially undisputed, are drawn primarily from the BTA's decision and order journalized April 13, 2007. Appellants are wholly-owned subsidiaries of MCI, Inc., formerly WorldCom, Inc. ("MCI/WorldCom"); appellant MCI Metro is a telephone company, and appellant MWNS is an inter-exchange telecommunications company. In 2002, MCI/WorldCom, as well as most of its domestic subsidiaries, filed petitions for bankruptcy protection.

{¶3} On May 2, 2003, both MCI Metro and MWNS (collectively "appellants") filed 2003 annual reports with the Ohio Department of Taxation (the "department"), in which appellants listed by vintage year and original acquisition cost their Ohio taxable and exempt personal property. Based upon the "true value" computation methodology prescribed by the tax commissioner, MCI Metro's "general support assets," "central office assets," "information origination/termination assets," "stand alone computers," as well as "cable and wire facilities assets," as reflected on its Schedule C assets, was valued at \$63,570,814. MWNS reported a total true value of \$410,625,278 for similar assets. On Schedule G of their annual reports, appellants each claimed that the net book value of their assets should be approximately two-thirds less, or \$21,573,961 and \$137,003,405, respectively.

{¶4} In a letter to the department dated April 30, 2003, the property tax manager for MCI/WorldCom offered the following explanation for the claimed reduction in net book value:

As you may know, WorldCom, Inc. and substantially all of its domestic subsidiaries filed for protection under Chapter 11 of the Bankruptcy Code on July 21, 2002. On March 14, 2003, following an impairment analysis and other adjustments in accordance with generally accepted accounting principles (GAAP), WorldCom announced that it had completed a preliminary review of its asset accounts. The result of this analysis was a write-off of all existing goodwill and a \$34.8 billion impairment adjustment to the carrying value of PP&E and other intangible assets as required by SFAS No. 144. The PP&E and other intangible assets will be adjusted from \$45 billion to approximately \$10 billion as of December 31, 2002. Since the audit of WorldCom will not be completed until later this year, the enclosed return was prepared using the unadjusted numbers for 2002 as the net cost of taxable property. This net cost was reduced by the amount of the announced asset adjustment to arrive at net book value. Since this net book value more accurately reflects the true value of these assets than the true value calculated using the class lives in Schedule C, the net book value has been used in this return to calculate the total taxable value.

{¶5} The department's auditing personnel accepted the true values as set forth in Schedule C of appellants' annual reports, and disallowed appellants' claimed additional reductions. As a result, the department established an assessed value for MCI Metro's property in the amount of \$15,892,700, and an assessed value for MWNS's property in the amount of \$102,656,320.

{¶6} As part of the bankruptcy reorganization process, MCI/WorldCom restated its revenues and expenses, and wrote down the value of its assets for the year ending December 31, 2002. On November 10, 2003, appellants filed a petition with the tax commissioner, requesting a reassessment of their taxable property. Appellants argued that the write-down of MCI/WorldCom's assets, representing approximately two-thirds of its value, entitled appellants to a reassessment pursuant to R.C. 5727.47. On April 20, 2004, MCI/WorldCom emerged from Chapter 11 bankruptcy reorganization.

{¶7} On May 18, 2004, appellants' petitions for reassessment came for hearing before the tax commissioner. On June 22, 2004, the tax commissioner issued final determinations denying appellants' petitions for reassessment and affirming the public utility property tax assessments issued to each entity for tax year 2003.

{¶8} Appellants filed an appeal with the BTA from the tax commissioner's final determinations. On December 20, 2005, the matter came for hearing before the BTA.

{¶9} During the hearing, appellants presented two witnesses, Rafael Garces, and Bart Uze. Garces, the director of property tax for MWNS, testified that the values carried on the parent company MCI/WorldCom's books prior to bankruptcy were "seen as being excessively high." (Tr. 28.) According to Garces, the values for appellants' property, as computed by the tax commissioner, failed to account for impairment of those assets as reflected in the write-down of the parent company's assets. Uze, the property tax representative for MCI/WorldCom, testified that the parent company utilized an impairment analysis of its assets resulting in an impairment reduction ratio of 79.63 percent. Uze testified that the ratio was then applied to appellants' Ohio assets to arrive at the proposed reduced assessment values.

{¶10} On April 13, 2007, the BTA issued a decision and order affirming the determinations of the tax commissioner. The BTA found that appellants had failed to demonstrate, by competent and probative evidence, that the 2003 assessed values did not reflect the true value of their Ohio assets.

{¶11} On appeal, appellants set forth the following five assignments of error for this court's review:

1. The Board acted unreasonably and unlawfully by failing to value Appellants' taxable public utility personal property at its true value as of December 31, 2002.
2. The Board acted unreasonably and unlawfully by affirming the Tax Commissioner's assessments, which were based solely upon outdated book values that did not represent true value, and which the Tax Commissioner conceded overstated the value of Appellants' property as of December 31, 2002.
3. The Board acted unreasonably and unlawfully in rejecting Appellants' claim that their property was significantly impaired (*i.e.*, that the book values substantially overstated the true value of Appellants' property) despite the fact that such impairment was fully recognized in the audited financial statements of Appellants' parent company, MCI, Inc., and properly reflected in Appellants' claimed values in accordance with generally accepted accounting principles as set forth in Financial Accounting Standards Board, Statement No. 144 ("FAS 144").
4. The Board acted unreasonably and unlawfully in refusing to recognize and apply generally accepted accounting principles, including FAS 144, in determining the true value of Appellants' property.
5. The Board acted unreasonably and unlawfully in characterizing Appellants' competent and probative evidence of true value as mere estimates and rejecting that evidence.

{¶12} Appellants' assignments of error are interrelated and will be considered together. Under these assignments of error, appellants challenge in general the BTA's rejection of appellants' argument that the tax commissioner's assessments did not reflect the true value of their Ohio taxable property.¹ Appellants maintain that the BTA acted unreasonably and unlawfully in rejecting their claims that the property at issue was significantly impaired based upon generally accepted accounting principles ("GAAP").

¹ We note that amicus briefs in support of appellee tax commissioner have been filed by the Ohio School Board Association, as well as (a joint brief on behalf of) the Cincinnati Public School District, the Cleveland Metropolitan School District, the Mayfield City School District, and the Nardon Hills City School District.

{¶13} R.C. 5717.04 provides for appeals from orders of the BTA, and states in part:

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.

{¶14} In *Lovell v. Levin*, 116 Ohio St.3d 200, 2007-Ohio-6054, at ¶23-24, the Ohio Supreme Court discussed a reviewing court's standard of review from a decision of the BTA as follows:

In reviewing a BTA decision, this court looks to see whether that decision was "reasonable and lawful." *Columbus City School Dist. Bd. of Edn. v. Zaino* (2001), 90 Ohio St.3d 496, 497, 739 N.E.2d 783; R.C. 5717.04. This court "will not hesitate to reverse a BTA decision that is based on an incorrect legal conclusion." *Gahanna-Jefferson Local School Dist. Bd. of Edn. v. Zaino* (2001), 93 Ohio St.3d 231, 232, 754 N.E.2d 789. But "[t]he BTA is responsible for determining factual issues and, if the record contains reliable and probative support for these BTA determinations," this court will affirm them. *Am. Natl. Can Co. v. Tracy* (1995), 72 Ohio St.3d 150, 152, 648 N.E.2d 483.

The burden of proof rests on the taxpayer "to show the manner and extent of the error in the Tax Commissioner's final determination." *Stds. Testing Laboratories, Inc. v. Zaino*, 100 Ohio St.3d 240, 2003-Ohio-5804, 797 N.E.2d 1278, ¶30. The Tax Commissioner's findings "are presumptively valid, absent a demonstration that those findings are clearly unreasonable or unlawful." *Nusseibeh v. Zaino*, 98 Ohio St.3d 292, 2003-Ohio-855, 784 N.E.2d 93, ¶10.

{¶15} R.C. 5727.10 provides in part that the tax commissioner shall annually determine, in accordance with R.C. 5727.11, "the true value in money of all taxable property * * * required by section 5727.06 of the Revised Code to be assessed by the

commissioner." Further, "[t]he commissioner shall be guided by the information contained in the report filed by the public utility and such other evidence and rules as will enable the commissioner to make these determinations." *Id.*

{¶16} R.C. 5727.11 addresses methods of valuation for public utilities, and R.C. 5727.11(A) states as follows:

Except as otherwise provided in this section, the true value of all taxable property, except property of a railroad company, required by 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.

{¶17} The Ohio Supreme Court has recognized that it is "impractical for the commissioner to personally value all personal property in Ohio," and, therefore, the commissioner "may resort to a predetermined formula to ascertain value." *Snider v. Limbach* (1989), 44 Ohio St.3d 200, 201. Despite the fact that R.C. 5727.11 "identifies the cost-based method of valuation as a means of assessing true value, the General Assembly has not restricted the commissioner's use of alternate valuation methods." *Texas Eastern Transmission Corp. v. Tracy* (1997), 78 Ohio St.3d 83, 85. Rather, if the statutory method fails to yield true value, "another method of valuation may be used, whether or not there are special or unusual circumstances." *Id.*, at 86. Accordingly, while a statute may provide a prima facie estimate or presumption of value, "where rigid application of the statute would be inappropriate, the presumption of value must yield to other competent evidence reflecting true value." *Id.*

{¶18} A taxpayer's burden to show that the commissioner's formula does not ascertain true value "is met only if the appellant '*** introduces competent evidence of probative value of the personal property's true value in money.'" *Snider*, supra, at 201, quoting *Alcoa v. Kosydar* (1978), 54 Ohio St.2d 477, 481.

{¶19} In the present case, appellants assert that they presented evidence establishing that the cost-based statutory method set forth in R.C. 5727.11(A) does not yield true value. On this issue, appellants argued before the tax commissioner and the BTA that, due to substantial impairment of MCI/WorldCom's assets, the carrying values set forth in MCI/WorldCom's pre-bankruptcy financial records significantly overstated the true value of their personal property, affecting in turn the true value of appellants' Ohio assets.

{¶20} According to appellants, the impairment was reflected in their Ohio assets using a pro rata allocation method for the impairment of long-lived assets explicitly required by Statement of Financial Accounting Standards No. 144 ("FAS 144"). Under this method, appellants maintain, they first determined the percentage of impairment that existed with respect to all of MCI/WorldCom's assets (at the parent level). Specifically, the impairment percentage was determined by comparing the book value of MCI/WorldCom's property as of December 31, 2001 (\$45.665 billion) to the impaired value of MCI/WorldCom's property as reflected in the un-audited books effective December 31, 2002 (\$9.3 billion). Appellants then applied this same impairment percentage (79.63 percent) to the historical book costs associated with appellants' Ohio personal property, resulting in taxable values of \$5,393,490 for MCI Metro and \$34,250,850 for MWNS. Following the final audit, the impairment percentage changed to

68.93 percent, and the recalculations resulted in appellants' proposed taxable values of \$8,227,687 for MCI Metro, and \$52,249,154 for MWNS.

{¶21} Both the tax commissioner and the BTA considered and rejected appellants' methodology whereby appellants sought a nearly two-thirds reduction in the assessed values of their Ohio property based upon an impairment analysis of the parent MCI/WorldCom's assets. The tax commissioner deemed appellants' request to value their personal property at one-third of the historical cost, based upon the fact the parent company booked a large write-down, to be "at best merely a crude approximation of the value of the petitioner's telecom assets." The tax commissioner found significant the fact that appellants had "not written down [their Ohio] assets on its books," but nonetheless were asking the department to "assume" that appellants' Ohio assets "have diminished in value in exactly the same percentage as the parent corporation's assets have been written down[.]" The commissioner further found that appellants had submitted "no information showing that its assets have been impaired to the same extent as the parent corporation's assets."

{¶22} The BTA, in affirming the decision of the tax commissioner, similarly rejected appellants' argument that the true value of their Ohio assets is appropriately ascertained by applying the same percentage of impairment to their own booked costs as was found to exist at the system-wide level of their parent company. The BTA further determined that it could not review the basis upon which the adjustments were sought because "appellants ask that we accept at face value an impairment analysis performed on a system-wide level which, in some undisclosed manner, purportedly took into account issues of accounting fraud and the overall decline experienced by WorldCom/MCI within

the telecommunications industry." Thus, the BTA concluded, appellants failed to show, by competent and probative evidence, that the 2003 assessed values did not accurately reflect the true value of appellants' Ohio assets.

{¶23} As noted by both the tax commissioner and the BTA, the impairment percentage appellants sought to apply to the capitalized acquisition costs of their Ohio property was based, not upon an analysis of appellants' Ohio assets but, instead, on an analysis of the assets of the parent company (MCI/WorldCom). On this point, the record indicates that appellants, in correspondence with the department, made clear they did not intend to perform an analysis of the Ohio assets at issue. Specifically, in a letter sent by MCI/WorldCom employee Uze to the department, and cited in the BTA's decision and order of April 13, 2007, Uze stated that MCI/WorldCom's 2002 10-K "[u]nfortunately * * * does not give the value of the property, plant and equipment at the entity or asset level of detail." Uze further informed the department that "our finance department does not have any way of determining the exact value of property, plant and equipment as of December 31, 2002, at the entity or individual asset level, and we have been informed that the company has no plans to push down the 2002 10K values to the entity or asset level."

{¶24} As noted by the tax commissioner, appellants' decision to rely solely upon an analysis of the parent company's world-wide assets, rather than evidence of its Ohio property, effectively meant that the BTA was required to assume that the parent company's entire system-wide telecommunications plant property was, on average, of comparable age, condition, and use as appellants' own Ohio taxable property. Part of the record before the tax commissioner included MCI/WorldCom's "Unaudited Consolidated

Statement of Operations for the Month Ended February 28, 2003," which listed over 200 subsidiaries of MCI/WorldCom, including various global enterprises. According to the "Management's Discussion and Analysis of the Results of Operations," contained in that document, WorldCom's "extensive, advanced facilities-based global communications network" offerings included data services, internet related services, commercial voice services, and international communications services. In addition, the consolidated statement also noted that MCI/WorldCom "provides a broad range of consumer and wholesale communications services, including long distance voice and data communications, consumer local voice communications, wireless messaging, private line services, DSL, and dial-up Internet access services."

{¶25} The BTA found the evidence presented by appellants insufficient to support a conclusion that appellants' property was impaired to the same degree as that of the parent company. Upon review, we cannot conclude that the BTA acted unreasonably in rejecting appellants' methodology that was dependent, not upon write-downs/adjustments to appellants' Ohio assets, but, rather, upon the parent company's purported system-wide impairment. Here, the record did not require the tax commissioner or BTA to conclude, based upon appellants' proposed methodology, that the Ohio taxable property at issue mirrored the various assets comprising MCI/WorldCom's world-wide property, or that appellants' Ohio property suffered the same percentage of impairment as the parent company. See *Alcoa*, supra, at 483 (rejecting appraisal which ignored actual cost of expenses, but, instead, relied upon appraiser's estimates of value); *United Telephone Co. v. Tracy* (1999), 84 Ohio St.3d 506, 512 (affirming tax commissioner's denial of telephone company's use of statistical estimates of costs as not probative evidence of actual value).

{¶26} Moreover, as the BTA alluded to in its decision, the fact that the parent company engaged in massive accounting fraud added a further layer of uncertainty to appellants' proposed application of a system-wide impairment analysis to the Ohio assets. Such fraud was acknowledged by appellants' witnesses before the BTA, and was further reflected in the admissions by MCI/WorldCom in its 10-K filings with the Securities Exchange Commission ("SEC"). Specifically, MCI/WorldCom, in a Form 10-K filed with the SEC, dated March 8, 2004, stated that an internal audit of the company's capital expenditure accounting "determined that certain transfers from line cost expenses * * * to capital accounts in the amount of \$3.9 billion during 2001 and the first quarter of 2002 were not made in accordance with GAAP." The "line costs" referenced above are fees MCI/WorldCom paid to third-party telecom network providers for the transmission of voice and data over the third-party provider's networks, and these costs constituted MCI/WorldCom's single largest operating expense. *In re WorldCom, Inc. Sec. Litig.* (S.D.N.Y.2005), 352 F.Supp.2d 472, 477. As noted by one commentator, instead of treating these line costs as capitalized expenses (i.e., assets to be written down over future periods), MCI/WorldCom's line cost disbursements "should have been recorded as current operating expenses[.]" Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 Conn.L.Rev. 915, 935.

{¶27} In addition to irregularities by MCI/WorldCom in accounting for line costs, the parent company also manipulated its books regarding its "charges to income and classification of assets in connection with acquisitions[.]" *In re WorldCom Sec. Litig.* (S.D.N.Y.2003), 294 F.Supp.2d 392, 401.

{¶28} In addressing the issue of accounting fraud, the tax commissioner argues that the impairment reduction offered by appellants implicitly assumes that the capitalized acquisition costs for the Ohio assets reflected "the same fraudulent overcapitalization percentage as the average fraudulent overcapitalization reflected on the parent's consolidate balance sheet[.]" (Brief of Appellee, at 4.) The tax commissioner maintains that appellants presented no evidence that the capitalized acquisition costs reported on their Ohio public utility personal property tax returns for the 2003 tax year were fraudulently overstated, and, thus, it would require mere speculation to determine whether or not, and to what extent, appellants' historical capitalized acquisition costs include any such fraudulent overcapitalization. We agree with the tax commissioner that there was no evidence as to whether, or to what extent, the capitalizing of line costs by the parent company affected appellants' Ohio assets (nor was there evidence whether other irregularities by the parent company affected the value of appellants' Ohio property). Moreover, we note the record contains little or no evidence as to which assets within the umbrella of the parent MCI/WorldCom's numerous subsidiaries were improperly valued due to accounting irregularities.

{¶29} Appellants maintain that the BTA erred in rejecting their use of FAS 144 impairment analysis (and "fresh start accounting"), arguing that such analysis was in accordance with GAAP. However, in addition to the previous discussion regarding appellants' proposed application of a system-wide impairment analysis in relation to appellants' Ohio property, the BTA noted that appellants presented "little [evidence] regarding either the entity which performed this analysis," including "the data relied upon and the methodology utilized in generating the impairment estimates." Thus, the BTA

determined that it was unable to ascertain whether the impairment figures themselves were reasonable. We note that appellants' witness Garces, who testified regarding the FAS 144 impairment analysis, did not perform the analysis himself. Rather, according to Garces, The Lazard Company performed this analysis. Specifically, Garces stated that it was his "understanding" that Lazard performed a discounted cash flow of the MCI system to develop a value for the assets and to develop the impairment related to those assets. (Tr. 36.)

{¶30} The BTA is afforded "great latitude in determining the weight to be given evidence and the credibility of witnesses before it," and it is "not required to adopt the valuation fixed by any expert or witness." *Snider*, supra, at 202. Rather, "[v]alue for tax purposes is a question of fact, and this finding is primarily within the province of the taxing authorities." *Id.* In the instant case, apart from the impairment percentages listed, there was little testimony or evidence as to the methodology used in calculating the impairment. Further, as already noted, whatever factors were utilized by the parent company's accounting firm in arriving at an impairment reduction percentage for MCI/WorldCom's assets, there was a lack of probative evidence before the tax commissioner and the BTA as to whether those factors equally affected the subject Ohio property. Thus, the BTA was not required to accept, at face value, the final FAS 144 impairment numbers and/or percentages introduced by appellants.

{¶31} The Ohio Supreme Court has "consistently determined that the burden is upon the taxpayer to affirmatively demonstrate" the inapplicability or unfairness of the statutory method of computation. *Westinghouse Elec. Corp. v. Lindley* (1980), 64 Ohio St.2d 31, 33. Here, we find that the BTA's rejection of appellants' methodology as

probative evidence of the true value was reasonable and lawful, and we find no error with the BTA's conclusion that appellants failed to prove the tax commissioner's determination of value did not accurately reflect true value.

{¶32} Accordingly, appellants' first, second, third, fourth, and fifth assignments of error are overruled, and the decision and order of the Board of Tax Appeals, affirming the tax commissioner's final determinations, is hereby affirmed.

Order affirmed.

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