Supreme Court of Ohio Clerk of Court - Filed April 21, 2016 - Case No. 2015-2055

In the
Supreme Court of Ohio

NAVISTAR, INC., f/k/a INTERNATIONAL AND ENGINE CORPORATION,	:	Case No. 2015-2055
Appellant,	:	Appeal on Remand from the Ohio Board of Tax Appeals
v.	:	BTA Case No. 2010-575
JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO,	:	
Appellee.	:	

BRIEF OF APPELLEE, JOSEPH W. TESTA, TAX COMMISSIONER OF OHIO

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STATEMENT OF CASE AND FACTS

A. Procedural Posture

This case involves the commercial activity tax ("CAT") credit granted under R.C. 5751.53. The credit is afforded to former Ohio corporate franchise taxpayers based on the net realizable value of those taxpayers' unused and unexpired "net operating loss carry-forwards" ("NOL carry-forwards") as of the taxpayers' fiscal year-ends in 2004 (the year prior to the phase-in of the CAT and the phase-out of the corporate franchise tax).

Under the credit computation, to determine the "net realizable value" of the Ohio NOL carry-forwards, the gross amount of the NOL carry-forwards must be reduced by the taxpayer's "valuation allowance" for those deferred tax assets, as reflected on the taxpayer's "books and records." See R.C. 5751.53(A)(6)(b).

In earlier proceedings in this case, this Court agreed with the appellee Commissioner that, as a matter of statutory law, the credit computation must be based on the taxpayer/claimant's "books and records" as maintained in compliance with "generally accepted accounting principles" or "GAAP." See *Navistar, Inc. v. Testa*, 143 Ohio St.3d 460, 2015-Ohio-3283 ("*Navistar I*") and R.C. 5751.53(A)(10) (defining "books and records").

In his final determination, as affirmed by the Board in its decision and order in *Navistar I*, the Commissioner had reduced Navistar's CAT credit to zero dollars. The Commissioner thereby denied Navistar's claimed $27 million credit, which Navistar computed on its "Amortizable Amount Report" filed in June 2006 using a 62.4% valuation allowance against its deferred tax assets as of the 2004 fiscal year-end. As the basis for its utilization of a 62.4% valuation allowance, Navistar had relied on its originally filed annual financial statement for the

2004 fiscal year that Navistar had filed with the U.S. Securities and Exchange Commission ("SEC") in February of 2005 (BTA Joint Ex. F, SEC Form 10-K).

The Commissioner rejected Navistar's reliance on the 62.4% valuation allowance because he determined that it was not in conformance with GAAP. Instead, the Commissioner applied a full 100% valuation allowance, reducing Navistar's Ohio NOL carry-forwards to a net realizable value of zero, which correspondingly reduced Navistar's claimed CAT credit to zero. In reducing the CAT credit to zero dollars, the Commissioner relied on Navistar's own restated financial statements that it had filed with the SEC in December, 2007 for the 2003-2004 fiscal years and for the first three quarter of the 2005 fiscal year (Navistar's "Restatement Financials" filed on SEC Form 10-K). See Joint BTA Ex. G.

The Court in *Navistar I*, however, did not fully resolve the matter against Navistar at that time, but, instead, remanded the case to the Board of Tax Appeals ("Board") for further consideration of the evidentiary record. Specifically, the Court directed the Board to consider the full evidentiary record to determine whether or not Navistar's 62.4% valuation allowance, as claimed on its Amortizable Amount Report, was in compliance with GAAP. See *Navistar I* at ¶ 40.

On remand, the Board found that Navistar's 62.4% valuation allowance was not in compliance with GAAP. Accordingly the Board affirmed the Commissioner's final determination based on a full 100% valuation allowance against Navistar's NOL carry-forwards and other deferred tax assets, as restated on Navistar's GAAP-compliant Restatement Financials filed with the SEC for the 2004 fiscal year. *Navistar, Inc. v. Levin [Testa],* BTA No. 2010-575 (Nov. 30, 2015), unreported ("*BTA Decision and Order*"), attached to the Appendix to this brief ("Appx.") at Appx. 1-4.

In upholding the Commissioner's computation of Navistar's CAT credit, the Board undertook a detailed examination and analysis of the documentary evidence and witness testimony. Following that discussion, the Board's decision concluded as follows:

> Therefore, based upon the foregoing, we find the commissioner's use of Navistar's restated valuation allowance was proper, as it cured "inaccuracies" and "errors" from Navistar's June 2006 valuation allowance which we conclude was not GAAP compliant.

BTA Decision and Order at 4, Appx. 4.

After the Board issued its decision, Navistar then timely filed its appeal as of right to this Court pursuant to R.C. 5717.04 challenging the Board's findings upholding the Commissioner's final determination upon its full factual consideration and analysis of the full evidentiary record.

B. Statement of Facts

The Board's decision that Navistar has now appealed to this Court includes extensive supporting citations to the documentary evidence and witness testimony admitted into evidence at the Board's evidentiary hearing. The Commissioner strongly endorses the Board's factual findings and analysis for its cogency, accuracy and pertinence.

By contrast, Navistar's initial merit brief with this Court largely ignores and mischaracterizes the Board's factual findings and analysis and the evidence on which it was based. Accordingly, in this section of this brief, the Commissioner sets forth his discussion of the pertinent facts as adduced from the Board's consideration of the full evidentiary record, in amplification of the Board's own detailed discussion and analysis.

1. *Navistar's Restatement Financials corrected billions of dollars of GAAP-compliance errors in Navistar's original 2003 and 2004 financial statements, which had grossly inflated the value of Navistar's assets and stock value and hidden hundreds of millions of dollars of income losses.*

Through its opening brief, Navistar attempts to ignore and minimize the significance of its own comprehensive correction of its financial condition for the 2003 and 2004 fiscal year-ends as a "*mere* restatement." See Navistar's opening brief ("N.Br.") at 10-11 (so characterizing Navistar's Restated Financial Statements filed with the U.S. Securities and Exchange Commission ("SEC") for those fiscal year-ends (the "Restatement Financials") on SEC Forms 10-K, admitted into evidence as BTA Joint Ex. G.

Navistar would have this Court believe that its "mere" Restatement Financials reflected differences only in Navistar's own "subjective judgment" in its financial reporting. Navistar suggests that it did not thereby correct "material" errors in its financial statement disclosures resulting from its non-compliance with generally accepted accounting principles ("GAAP"). Id.

By any measure, however, the Restatement Financials corrected Navistar's "material" errors in failing to comply with GAAP. Following investigation by the U.S. Securities and Exchange Commission ("SEC"), Navistar issued its Restatement Financials in December of 2007 for the 2003 and 2004 fiscal years and for the first three quarters of 2005. Navistar did so for the purpose of materially correcting its previous GAAP-compliance errors concerning its financial condition, as misstated on its originally filed financial statements for those reporting periods, as filed with the SEC on Forms 10-K (the annual financial statement SEC form) and on Forms 10-Q (the quarterly financial statement SEC Form). See BTA Joint Ex. F (Navistar's original SEC Form 10-K financial statement for the 2004 fiscal year filed in February, 2005).

The Restatement Financials made clear that Navistar's previous misstatements of its operating income, assets and stock value was a direct result of Navistar's use of a myriad of non-

GAAP compliant accounting methods in its originally filed financial statements for the 2003 and 2004 fiscal years. The correction of those GAAP-compliance errors resulted in Navistar reducing its net income for the 2003 and 2004 fiscal years from *positive gains of $231 million* to *losses of $373 million*, equating to a total net income reduction/correction for that two-year period of slightly more than $600 million[1].

As part of Navistar's material corrections of errors to comply with GAAP, its Restatement Financials restated the value of Navistar's U.S. "deferred tax assets," including its Ohio net operating loss carry-forwards, from over *1.2 billion to zero* dollars for the 2004 fiscal year-end (the relevant date for computing the CAT credit at issue here). See, BTA Joint Ex. G (the Restatement Financial) at 112 (reducing the previously reported "net deferred tax assets" as of October 31, 2004 by $1.209 billion, leaving a balance of $30 million, attributable to non-U.S. deferred tax assets).

Further, this more than one billion dollar reduction in the value of Navistar's deferred tax assets to zero value was a direct result of Navistar's restatement of its "valuation allowance" for its deferred tax assets to a full 100% reduction. In this way, Navistar affirmatively corrected its previous material non-compliance with GAAP in its originally filed financial statements for the 2003 through third quarter of 2005 reporting periods. See BTA Ex. G (the Restatement Financials) at 107, 109.

Navistar restated its valuation allowance for its deferred tax assets after fully considering its recent financial income history as of its 2004 fiscal year-end (as corrected by the Restatement

[1] See the Restatement Financials, Ex. G at 75 (showing Navistar's restated "net income" for its 2003 and 2004 fiscal year-ends, in the amounts of a $333 million loss and a $44 million loss, respectively) and compare to Navistar's originally filed Form 10-K for the 2004 fiscal year, BTA Joint Ex. F at 35 (showing Navistar's originally reported net income for the 2003 fiscal year in the amount of only a $17 million loss and for the 2004 fiscal year to a net income gain of $247 million for the 2004 fiscal year.

Financials to be GAAP compliant), coupled with its view of its income-generating prospects going forward from that date. Navistar then determined that it was unlikely it would generate significant positive income for the holding period of its NOL carry-forwards, against which the NOL carry-forwards could be applied to reduce Navistar's income tax liabilities in future years. Id.

It did not take long for Navistar's filing of its Restatement Financials to have direct adverse consequences to Navistar. Only three days after Navistar filed its Restatement Financials, a class action shareholder derivative/securities lawsuit was filed in federal district court in Illinois. See, *Norfolk County Retirement System et al. v. Ustian et al.,* 2010 WL 1489996 (N.D.Ill. April 13, 2010) (*"Ustian"*), Appx. 5-9.

As described by Magistrate Judge Nolan in *Ustian,* "[t]he Restatement disclosed that over that three-year period, Navistar had *misstated* its financial position and results of operations *by billions of dollars* (emphasis added)" and thereby drastically overstated its equity (stock) value; see also, *Rawat v. Navistar Intl. Corp.*, 2011 WL 3876957, at *2 (N.D.Ill. Sept. 1, 2011) (quoting Judge Nolan's description in *Ustian* of the Restatement Financials' disclosures with approval), Appx. 6-18.

In sum, in its decision below, the Board was not fooled by Navistar's attempt to re-write history and minimize or ignore the substantial materiality of the errors in GAAP reflected in its originally filed SEC financial statements for the 2004 fiscal year, and as corrected in its Restatement Financials. Instead, as further detailed below, the Board carefully and extensively reviewed the full evidentiary record and determined that Navistar's originally reported valuation allowance for its Ohio NOL carry-forwards and other U.S. deferred tax assets, as set forth on its originally filed SEC Form 10-K for the 2004 fiscal year, was not in compliance with GAAP.

2. *In fully considering the evidentiary record and rendering its findings, the BTA applied the proper GAAP standard.*

Navistar's initial merit brief notably omits discussion of the specific requirements and criteria of the applicable GAAP standard that publicly-held companies, like Navistar, are required to comply with in their financial statement disclosures to the SEC. In this way, Navistar's brief fails to provide the Court with the necessary context within which to review the Board's decision. The Commissioner does so here, with discussion and citation to the evidentiary record and pertinent text of that established GAAP standard.

a. <u>Financial Accounting Statement 109, "Deferred Income Taxes," constitutes the proper GAAP standard, as the Commissioner's outside expert accounting witness, Dr. Ray Stephens, testified</u>.

Statement of Accounting Standards No. 109, of the Financial Accounting Standards Board captioned "Accounting for Income Taxes," is the highest GAAP authority on the subject of deferred tax assets. As Dr. Ray Stephens (the Commissioner's expert accounting and SEC financial statement disclosure expert witness) testified, under the hierarchy of GAAP, the highest level of GAAP authority is set forth in the "Statements of Financial Standards" of the Financial Accounting Standards Board ("FASB"), BTA Joint Ex. D. See Dr. Stephen's BTA hearing transcript ("H.R.") at 20, 89-92, Supp. 20, 89-92. And, on the subject of deferred tax assets, FASB Statement of Accounting Standards No. 109" (hereafter often referred to as "FAS Statement 109") is the highest GAAP authority. Id. at H.R. 96-97, Supp. 96-97.

b. FAS 109 requires that the value of a company's deferred tax assets, including its gross value of NOL carry-forwards, must be reduced by a valuation allowance to net realizable value if it is more likely than not that the gross value of the deferred tax assets will not be fully utilized before the deferred tax assets' expiration dates.

Under certain circumstances, in order to properly determine the value of its NOL carry-forwards and other deferred tax assets for purposes of a company's financial statement disclosures in compliance with GAAP, a company must reduce its gross value of those deferred tax assets to their net realizable value in accordance with FAS 109. See Dr. Stephens' expert testimony at H.R. 100-105, 128-135, Supp. 100-105, 128-135.

As applied to NOL carry-forwards, the gross amount of the carry-forwards may not be realizable, in whole or in part, because the company may not have sufficient future positive income against which to apply the NOL carry-forwards over their holding periods. In other words, the NOL carry-forwards, in whole or in part, may expire as worthless and unused.[2]

The specific GAAP directive concerning a company's obligation to set forth a valuation allowance against its deferred tax assets is set forth in ¶ 17 e. of FAS 109. Under that sub-paragraph e., the company shall:

> Reduce deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The value allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized.

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[2] For Ohio corporate franchise tax purposes (under the "net income" method of computing the tax), the expiration period for the Ohio NOL carry-forwards depended on the particular taxable year in which the NOLs were originally incurred, ranging from a five-, fifteen-, or twenty- year expiration period, which tracks the parallel provision of the Internal Revenue Code, 26 U.S.C. 172(b)(1)(ii) (currently providing for "a net operating loss carryover to each of the 20 taxable years following the taxable year of the loss"). See R.C. 5733.04(I)(1).

c. In determining the valuation allowance for a company's deferred tax assets, FAS 109 requires that the company's management must weigh the positive and negative evidence, including the company's recent history of income and losses.

In addition to imposing an affirmative GAAP obligation on a company to reduce its deferred tax assets to their net realizable value pursuant to a valuation allowance under the circumstances set forth in ¶ 8e., FAS 109 sets forth the required procedures the company must follow to determine the amount of the valuation allowance. See generally, ¶¶ 17-25 of FAS 109, and Dr. Stephens' BTA testimony at H.R. 100-105, 128-135, Supp. 100-15, 128-135. Of particular guidance is ¶ 20 of FAS 109, which provides, in part, as follows:

> All available evidence, both positive and negative, should be considered to determine whether, based on the weight of the evidence, a valuation allowance is needed. Information about an enterprise's current financial position and its results of operations for the current and preceding years ordinarily is readily available. ***

Thus, in order for a company (an "enterprise") to properly determine the valuation allowance for its deferred tax assets, the company is required to undertake an evaluation of all available evidence, including information about the company's current financial position (i.e., the company's balance sheet information) and the results of operations for the current and preceding years (i.e., the company's income statement information).

It is against this backdrop of the applicable GAAP standard that the BTA rendered its decision expressly finding that, upon a full weighing of the evidentiary record, Navistar's original determination of its valuation allowance was not in accordance with GAAP.

3. *Compelling evidence supports the BTA's factual findings and analysis that Navistar's original valuation allowance for its deferred tax assets was not in compliance with GAAP.*

a. The fundamental reason why Navistar's original valuation allowance for its NOL carry-forwards and other deferred tax assets was not in compliance with GAAP follows from the "garbage in = garbage out" principle.

Because Navistar based its determination of its original valuation allowance on its consideration of materially overstated and non-GAAP compliant net income figures for its 2003 and 2004 fiscal years, the original valuation allowance was not in compliance with GAAP.

The evidence in the record establishes that Navistar's originally filed financial statement for the 2004 fiscal year misstated the results of its operations for that period by reporting a net-income gain of $247 million, when, in actuality, under GAAP, Navistar incurred a $33 million net-income loss. Similarly, the record establishes that for the 2003 fiscal year, Navistar originally reported a net income loss of $17 million, when, in actuality, under GAAP, it incurred a $330 million loss. See fn. 1, of this brief, supra (citing the pertinent respective pages of Navistar's originally filed Form 10-K for the 2004 fiscal year (BTA Joint Ex. F at 35) and Navistar's Restatement Financials, (BTA Joint Ex. G at 75).

In fact, through the testimony of Navistar's own tax manager, Carol Garnet, Navistar, itself, admitted that the underlying books and records for its 2003 and 2004 fiscal years were unreliable and non-GAAP compliant and that, as such, the company was obligated to acknowledge such errors to the public and correct the errors contained in Navistar's originally filed financial statements, via their restatement. See the *BTA Decision and Order* at 4 (citing Ms. Garnett's testimony at H.R. 302-307, 346, Supp. 302-307, 346).

Using the terminology of ¶ 20 of FAS 109, Navistar's net-income losses for the 2003 and 2004 fiscal years as corrected to be GAAP compliant, constituted "negative information"

concerning its current and recent financial operational history. By contrast, the non-GAAP compliant net income than Navistar's management had considered in determining its original valuation allowance erroneously set forth "positive information" for the 2004 fiscal year (a $247 net income gain, and only a relatively modest net income loss of $17 million for the 2003 fiscal year). In its decision below, the Board correctly recognized the fundamental significance of Navistar's erroneous reliance on its non-GAAP compliant net income figures in its original filed SEC Forms 10-K for the 2003 and 2004 tax years.

The Board expressly found that the valuation allowance that Navistar set forth in its Amortizable Amount Report in support of its claimed CAT credit "could not have complied with GAAP, because the historical information upon which that information was based, was unreliable and inaccurate, i.e., not GAAP compliant." *BTA Decision and Order* at 3, Appx. 3. In plain terms, the Board recognized that "garbage in = garbage out."

Because FAS 109 requires companies to consider their current and recent history of operations (as reflected by its net income figures), and, in Navistar's case, its management relied on income figures that were unreliable and not in compliance with GAAP, Navistar's original valuation allowance necessarily violated GAAP. As detailed below, the evidentiary record is replete with confirming evidence supporting the BTA's finding.

b. Navistar's tax manager testified to her agreement with the representations in Navistar's Restatement Financials, including that Navistar's valuation allowances for its U.S. deferred tax assets in its original financial statements for the 2003 and 2004 fiscal years were *not* GAAP compliant and were properly restated to comply with GAAP at a full 100% allowance for those years.

In its Restatement Financials, Navistar explained the reasons for its restatement of its previous valuation allowances to 100% full valuation allowances, which reduced the value of its

net U.S. and Canadian NOLs and other deferred tax assets to zero dollars as of the 2004 fiscal year-end, as follows:

> **We reassessed our need for a valuation allowance and determined that we did not apply FASB Statement No. 109 properly** and that a full valuation allowance should be established for net U.S. and Canadian deferred tax assets based on the weight of positive and negative evidence, **particularly our recent history of operating losses.**

BTA Joint Ex. G (the Restatement Financials) at 107 under the caption "Income Taxes."

At the Board's evidentiary hearing, Navistar's tax manager (and certified public accountant), Carol Garnett testified to her agreement with the above representation, which was read to her verbatim in cross-examination by the undersigned counsel. See H.R. 358-359, Supp. 358-359. Nor did Ms. Garnett attempt at any point to controvert or recant that testimony.

Likewise, in the certifications to the Restatement Financials, Navistar's top management and the independent CPA firm that conducted a comprehensive audit of Navistar's previously issued financial statements (KPMG LLP) certified that the Restatement Financials were "in conformity with U.S. generally accepted accounting principles."[3] Thus, throughout the entire course of this Ohio tax controversy, Navistar's own personnel steadfastly and without exception never have themselves repudiated any of the representations that Navistar made in its Restatement Financials, including the above-quoted representation at page 107 of the Restatement Financials.

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[3] For the representations of Navistar's outside CPA auditors, see the Restatement Financials, BTA Joint Ex. G, at numbered page 72 (the Report of Navistar's outside CPA firm auditors, KPMG LLP). For the representations of Navistar's management, see the signature page for Navistar's Restatement Financials, at numbered page E-56, E-57 (signed by Navistar's controller and principal accounting officer, John P. Walton), avowing that the Restatement Financials are being signed pursuant to "Section 13 or 15(d) of the Securities and Exchange Act of 1934" (requiring that financial statements must be in compliance with GAAP). BTA Joint Ex. G. (the Restatement Financials) at72.

One might reasonably assume that Navistar would not now attempt to deny Ms. Garnett's clear and unequivocal testimony stating that Navistar's original valuation allowance for its U.S. deferred tax assets (which included its Ohio NOL carry-forwards) was not GAAP compliant. But, that is not the case.

In its initial merit brief, Navistar mistakenly asserts as follows: "[b]ased on that knowledge of Navistar's books and records, and in consideration of the 2007 Restatement [referring to the Restatement Financials], Ms. Garnett testified that the 2004 VA [valuation allowance] complied with GAAP." N.Br. at 6, citing to H.R. 310-311, Supp. 310-311. Yet, a review of these hearing record citations simply does not support Navistar's contention. Instead, Ms. Garnett's testimony cited by Navistar in its brief simply established the obvious fact that the time Navistar had filed its Amortizable Amount Report in June of 2006, Navistar could not have then relied on the Restatement Financials (because Navistar issued it in December of 2007). In other words, unless Navistar had a time machine to go to the future, it could not have used the Restatement Financials.

Further, even prior to Navistar's filing of its Amortizable Amount Report in June of 2006, Navistar already had publicly disclosed its knowledge that its previous financial statements, including its Form 10-K for the 2004 fiscal year-end, "should no longer be relied upon because of errors in such financial statements. The Board expressly so found, citing to Ms. Garnett's hearing testimony at H.R. 345-346, Supp. 345-346, and BTA Ex. 4, Navistar's SEC Form 8-K, dated April 6, 2006, i.e., more than 75 days prior to Navistar's filing of its Amortizable Amount Report. See *BTA Decision and Order* at 3, Appx. 3.

c. As expressly found by the Board, Navistar's selected "expert witnesses," did not consider the "negative evidence" consisting of Navistar's "recent history of operating losses," as set forth in Navistar's Restatement Financials.

The BTA expressly found that in reaching their respective conclusions that Navistar's valuation allowance for its deferred tax assets was GAAP compliant, Navistar's expert accounting witnesses, Douglas Pinney and Beth Savage, failed "to have reviewed all the books and records, *especially the significant changes to the underlying financial statements that required the restatement* (emphasis added)." *BTA Decision and Order at 3*, citing to Mr. Pinney's at H.R. 418-419, and 448-449, Supp. 418-419, and 448-449.

In fact, more specifically, Mr. Pinney and Ms. Savage admitted that they did not review or consider the "negative evidence" consisting of Navistar's "recent history of operating losses," as corrected to be GAAP compliant pursuant to the Restatement Financials.[4] Thus, Mr. Pinney's and Ms. Savage's "expert" opinions were inherently invalid and unreasonably restricted, as failing to review and consider the pertinent, GAAP-compliant income figures set forth in the Restatement Financials, as the Board expressly found. *BTA Decision and Order* at 3, Appx. 3.

The Commissioner's expert accounting and SEC financial disclosure expert witness, Dr. Ray Stephens[5], on the other hand, reviewed and considered the Restatement Financials. See, his

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[4] See, Mr. Pinney's testimony at H.R. 436-437, Supp. 436-437 (testifying that he reviewed only Navistar's originally filed (non-GAAP compliant) financial statements for the 2004 fiscal year-end (BTA Joint Ex. F, also marked as BTA Ex. 37) and selected, summary records used by Navistar to prepare that financial statement. See also, Ms. Savage's testimony at H.R. 567-578, Supp. 567-578 (testifying that she reviewed only BTA Ex. 37 and the deferred tax journal entries for the Restatement Financials, which would not include any consideration of Navistar's increase of its operating losses by approximately $600 million for the 2003 and 2004 fiscal years).

[5] Dr. Stephens' expertise concerning GAAP is both comprehensive and deep, and includes demonstrated knowledge and expertise concerning the application of GAAP on the topic of

testimony at H.R. 126-139, Supp. 126-139. On the basis of his review and consideration of the Restated Financials, which constituted Navistar's public disclosure of its GAAP-compliant books and records[6], Dr. Stephens provided his expert opinion. Dr. Stephens' opined that the Commissioner's computation of Navistar's CAT credit, based on a full 100% valuation allowance against Navistar's NOL carry-forwards, was a correct application of GAAP principles under the Ohio CAT credit set forth in R.C. 5751.53. (H.R. 163-164, Supp. 163-164).

In other words, Dr. Stephens' expert witness testimony and opinion properly considered the relevant, *GAAP-compliant* history of Navistar's operating losses, whereas Navistar's expert witnesses erroneously reviewed and considered only the unreliable, non-GAAP compliant income information that Navistar had misstated in its originally filed financial statements.[7]

Deferred Income Taxes. For example, Dr. Stephens' demonstrated knowledge and expertise concerning Deferred Income Taxes includes Dr. Stephens' authoring of that portion of an "Advanced Accounting" college textbook covering "Deferred Income Taxes," see H.R. 21-22, Supp. 21-22; and presenting seminars to CPA professionals on the topic of FASB Statement No. 109, see H.R. 25-26, Supp. 25-26.

In fact, on two widely different GAAP accounting issues, the Ohio Supreme Court twice previously has expressly recognized and found authoritative Dr. Stephen's accounting expertise on "generally accepted accounting principles" and SEC financial statement disclosure matters. See, *UBS Fin. Servs. v. Levin*, 119 Ohio St.3d 286, 2008-Ohio-3821, ¶¶ 22, 28; and *Rich's Dep't Stores, Inc. v. Levin*, 125 Ohio St.3d 15, 2010-Ohio-957, ¶¶ 7, 18-19.

[6] Thus, Navistar's bare assertion in its initial merit brief that Dr. Stephens "admitted that he did not review Navistar's books and records" is patently wrong. See N.Br. at 14. Rather, Dr. Stephens reviewed and considered Navistar's ultimate "books and records" which comprehensively provided all users of Navistar's financial statements with Navistar's own GAAP-compliant disclosures of its financial condition and changes in operations. Further, Navistar's expert witnesses reviewed only a very limited subset of Navistar's non-GAAP compliant books and records. Indeed, as noted, Mr. Pinney and Ms. Savage reviewed only Navistar's originally filed SEC Form 10-K for the 2004 fiscal year and selected, summary records used by Navistar to prepare that financial statement, BTA Joint Ex. F.

[7] Finally, Navistar's attempt in its initial merit brief to discredit Dr. Stephens' testimony and expert opinion should be rejected. See N.Br. at 13-14. Navistar asserts that Dr. Stephens' testimony was "irreparably tainted" because he considered a Complaint filed by Navistar against

d. Navistar's Ohio corporate franchise tax returns for the 2005 through 2008 tax years over which that tax was phased-out showed that Navistar did not generate any positive income against which it could have applied the Ohio NOL carry-forwards that it had accrued as of its 2004 fiscal year-end.

Finally, Navistar's Ohio corporate franchise tax ("CFT') returns for the "phase-out" period of the CFT (beginning in 2005) show that Navistar did not utilize any of the first $50 million-worth of its Ohio NOL carry-forwards because Navistar continued to incur Ohio operating losses for all of those taxable years post-2005. See the testimony of Tax Commissioner Audit Administrator Ron Pottorf and the Ohio CFT returns. H.R. 254-261, Supp. 254-261, and BTA. Exs. K, 11, 12 and 13. In other words, the Ohio NOL carry-forwards that were in existence on the October 31, 2004 fiscal year-end *expired unused and worthless,* wholly consistent with Navistar's full valuation allowance, as set forth in the Restatement Financials, Ex. G at 107, 112.

Deloitte & Touche, L.L.P. ("Deloitte"), the certified public account firm that audited its originally SEC-filed financial statements for the 2003 through third quarter of 2005 fiscal periods. Notably, Navistar fails to identify any particular content of the Complaint that could possibly render Dr. Stephens' testimony and expert opinion invalid. In actuality, the Complaint quotes liberally from Navistar's Restatement Financials and other Navistar public filings with the SEC, which could hardly "taint" Dr. Stephens' testimony. The Complaint additionally alleges that Deloitte was responsible for the GAAP deficiencies in Navistar's originally filed financial statements, which likewise hardly could taint Dr. Stephens' testimony.

ARGUMENT

Proposition of Law:

> **The BTA's factual findings may not be overturned by a reviewing Court absent a showing by the appellant of a "patent abuse of discretion" by the Board of Tax Appeals.**

As this Court long and consistently has held: "[t]he board's [BTA's] determinations on issues of fact will not be disturbed absent a showing of patent abuse of discretion [.]" *General Mills Fun Group, Inc. v. Lindley*, 1 Ohio St.3d 27, 30 (1982) (citing *Southwestern Portland Cement Co. v. Lindley* 67 Ohio St. 2d 417, 421-422: and *Cardinal Federal S. & L. Assn. v. Bd. of Revision*, 44 Ohio St.2d 13, 20 (1975).

This Court's recent decisions strongly uphold the Court's "maximum deference" to the Board of Tax Appeals factual findings. *HealthSouth Corp. v. Testa*, 132 Ohio St.3d 55, 2012-Ohio-1871, ¶ 10; *Bay Mechanical & Elec. Corp. v. Testa*, 133 Ohio St.3d 423, 2012-Ohio-4312, ¶¶ 16, 34-35. In *HealthSouth*, the Court applied a "maximum deference" standard to the BTA's weighing of evidence, as follows:

> For the second time, the tax commissioner has appealed. In this appeal, the commissioner asserts that the BTA lacked sufficient evidence for its findings. We disagree. Reviewing the BTA's decision with *maximum deference* to that body's weighing of the evidence, we conclude that the BTA acted reasonably and lawfully in remanding the cause to the commissioner for a determination of a reduced tax assessment. We therefore affirm the decision of the BTA.

(Emphasis added.) *HealthSouth*, 2012-Ohio-1871 at ¶ 10.

Similarly, in *Bay Mechanical*, this Court applied a "highly deferential" standard to the Board's factual findings in favor of affirmance of the Commissioner's final determination, as follows:

> Also significant are two settled propositions that govern, respectively, the BTA's review of the tax commissioner's determinations and our review of a BTA decision. First, before the BTA, "[t]he Tax Commissioner's findings 'are

> presumptively valid, absent a demonstration that those findings are clearly unreasonable or unlawful.' " *A. Schulman, Inc. v. Levin*, 116 Ohio St.3d 105, 2007-Ohio-5585, ¶ 7, quoting *Nusseibeh v. Zaino*, 98 Ohio St.3d 292, 2003-Ohio-855, 784 N.E.2d 93, ¶ 10. It was therefore Bay's burden to rebut the presumptive validity of denying the exemption by affirmatively proving its entitlement to it. Second, under R.C. 5717.04, the question for our determination is whether the BTA's decision is reasonable and lawful, and because "[t]he function of weighing evidence and determining credibility belongs to the BTA, * * * our review of that aspect of its findings" applies the *highly deferential abuse-of-discretion* standard. *HealthSouth Corp. v. Testa,* 132 Ohio St.3d 55, 2012-Ohio-1871, ¶ 10.

(Emphasis added.) *Bay Mechanical*, 2012-Ohio-4312, at ¶ 16.

The Court in *Bay Mechanical* then emphasized that for the Court to reverse the Board's factual findings and establish that the Board "abused its discretion," the appellant must establish more than that the appellee had "substantial weaknesses" in its evidentiary presentation, as follows:

> Because (as already discussed) the BTA's determinations of the credibility of witnesses and its weighing of the evidence are subject to a highly deferential abuse-of-discretion review on appeal, we will reverse only if we find an abuse of discretion. *HealthSouth Corp.v. Testa*, 132 Ohio St.3d 55, 2012-Ohio-1871, 969 N.E.2d 232, ¶ 10. *** [t]he *HealthSouth* decision is instructive in applying the abuse-of-discretion standard in this context.
>
> *** [A]lthough the taxpayer's evidence in *HealthSouth* showed *substantial evidential weaknesses*, we nonetheless affirmed the BTA's decision to order the commissioner to issue a reduced assessment based on the totality of the record. The same broad deference that we exercised toward the BTA's judgment in *HealthSouth* is merited in this case as well.

(Emphasis added.) *Bay Mechanical*, 2012-Ohio-4312, at ¶¶ 34-35.

In the present case, the Board of Tax Appeals carefully reviewed the full evidentiary record and determined that Navistar's originally reported valuation allowance, as reflected on its originally filed SEC Form 10-K for the 2004 fiscal year, was not in compliance with GAAP. The Board's cogent review and analysis of the full evidentiary record is plainly manifest through the extensive citations to, and critical analysis of, the documentary evidence and witness

testimony. As detailed in the Statement of Facts section of this brief, Navistar's initial merit brief fictionalizes the actual evidence in the record, and mischaracterizes and misstates the Board's factual analysis of the evidentiary record, and is without any probative evidentiary support.

The Board's factual finding that Navistar's original valuation allowance for its deferred tax assets was non-GAAP compliant is amply supported by probative evidence, as demonstrated by the Board's decision's analysis of the evidence and as amplified by the Statement of Facts set forth in this brief. Accordingly, the Court should affirm.

CONCLUSION

For the above reasons, the Court should affirm the Board of Tax Appeals decision upholding the Commissioner's use of Navistar's 100% valuation allowance, as restated by Navistar in compliance with generally accepted accounting purposes, resulting in affirmance of the Commissioner's final determination of Navistar's R.C. 5751.53 commercial activity tax credit.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Brief of Joseph W. Testa, Tax Commissioner of Ohio* was served by email and U.S. mail, postage prepaid, this 25th day of April, 2016 upon the following:

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OHIO BOARD OF TAX APPEALS

NAVISTAR, INC. F/K/A INTERNATIONAL TRUCK & ENGINE CO., (et. al.),	CASE NO(S). 2010-575
Appellant(s),	(COMMERCIAL ACTIVITY TAX)
vs.	DECISION AND ORDER
RICHARD A. LEVIN, TAX COMMISSIONER OF OHIO, (et. al.),	
Appellee(s).	

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Entered Monday, November 30, 2015

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

This matter is considered on remand, after the Supreme Court determined that this board, in its decision, failed to make the limited determination "whether the valuation allowance originally reported on Navistar's Amortizable Amount Report was or was not in compliance with GAAP," i.e., generally accepted accounting principles. *Navistar, Inc. v. Testa*, 143 Ohio St.3d 460, 2015-Ohio-3283, ¶40. Thus, giving effect to such decision by the court, and acting under pertinent provisions of R.C. 5717.04, the Board of Tax Appeals certifies this matter is once again before this board for further consideration, based upon the notice of appeal, the transcript certified by the Tax Commissioner ("S.T."), the record of this board's hearing ("H.R."), and any written argument filed by the parties, including that which the parties filed on remand; accordingly, the commissioner's "motion" to strike Navistar's memorandum on remand is hereby denied.

As we stated in our earlier determination:

> "The present appeal involves the extent to which appellant may benefit from a credit applied against the CAT, a tax phased in by the Ohio General Assembly beginning in 2005 which, for many companies, served to replace the taxes imposed on personal property located and used in business in Ohio, see, generally, R.C. Chapter 5719, and the privilege of exercising a corporate franchise within the state. See, generally, R.C. 5733.01(G)(1) and (2). With respect to the former corporate franchise tax, businesses not having positive net income accumulated net operating losses which could be carried forward and deducted against future corporate franchise tax liability, recorded as a deferred tax asset on their financial statements. Recognizing that the state's transition to the CAT would result in loss of the financial value of the net operating loss carry-forward, the General Assembly established a one-time CAT credit that allowed a percentage conversion of this corporate franchise net operating loss tax credit to serve as a credit against future CAT liability. In order to take advantage of this conversion credit, a qualifying taxpayer, i.e., one with $ 50 million in unused franchise net operating loss carryforward, was required to file a report prior to July 1, 2006 disclosing the value of its deferred tax assets as of its taxable year ending in 2004 which, with certain specific adjustments, was referred to as the 'amortizable amount.' In allowing for this credit, the statute required that the amortizable amount be calculated using the taxpayer's books and records as reflected on the last day of its taxable year ending in 2004. See R.C. 5751.53(A)(6) and (8). R.C. 5751.53(A)(10) defines 'books and records' to mean 'the qualifying taxpayer's books, records, and all other information, all of which the qualifying taxpayer maintains and uses to prepare and issue its financial statements in accordance with generally accepted accounting principles.' Following submission of the aforementioned report, the Tax Commissioner was accorded until June 30, 2010 to 'audit the accuracy of the amortizable amount available to each taxpayer that will claim the credit, and adjust the amortizable amount or, if appropriate, issue any assessment or final determination, as applicable, necessary to correct any errors found upon audit.' R.C. 5751.53(D). Once approved, use of the credit is then spread out over a period extending from calendar years 2010 through 2030." *Navistar, Inc. v. Testa* (Dec. 31, 2013), BTA No. 2010-575, unreported at 2-3, footnote omitted.

In compliance with the foregoing, Navistar submitted its report to the commissioner in June 2006, listing an amortizable amount of $27,048,726, which the commissioner reduced to zero, due to appellant's subsequent restatement of its financial statements in December 2007. Through its appeal, Navistar argued that the commissioner's use of its restated financial statements from December 2007, instead of what it reported in June 2006, for determination of Navistar's CAT credit, was improper; Navistar claimed that its report, as of June 2006, "properly complied with the statutory provisions" and since the restatement of its financial statements "was not completed until almost eighteen months after" the statutory taxpayer filing deadline, the commissioner was "without authority to disallow its claimed credit based upon its restated financial statements." Id. at 5.

In its decision, the court clearly held that the commissioner, per the "plain language of R.C. 5751.53(D)," had the authority "to 'adjust' *** [Navistar's] amortizable amount on account of his review of the 'accuracy' of the reported amount." *Navistar, Inc. v. Testa*, 143 Ohio St.3d 460, 2015-Ohio-3283, ¶34. The court agreed with the commissioner's position that he could correct any errors determined through his audit before June 30, 2010, "based on information that became available to him before that date – even if the information became available only after the deadline for filing the report in June 2006." Id. at ¶34.

The court has directed us, on remand, to "determine, based on a consideration of all the evidence in accordance with *** [the court's] opinion, whether the valuation allowance originally reported on Navistar's Amortizable Amount Report was or was not in compliance with GAAP." *Navistar*, supra at ¶40.

Specifically, "if the 2007 restatement of the valuation allowance cured an earlier inaccuracy or corrected an earlier error, it lay within the tax commissioner's authority to adopt the restated valuation allowance." Id. at ¶34. But, the court went on to hold that "if the original valuation allowance is established to have been within the range acceptable under GAAP, then the later restatement of the valuation allowance does not involve error correction, and the tax commissioner lacks authority to adopt the restated allowance." Id. at ¶35.

A valuation allowance is used in calculating an entity's amortizable amount for purposes of the CAT credit. "A valuation allowance is a method by which taxpayers reduce the value of their deferred tax assets to an amount that they believe they would ultimately realize. Because it is based on future events, *** it *** is an estimate, it is a projection." H.R. at 288. Accordingly, an acceptable valuation allowance may actually be a range of numbers and/or different numbers to different people, based in both subjective information, e.g., future projections, and objective information, e.g., historical earnings, as set forth in an entity's books and records, maintained in accordance with GAAP. H.R. at 315-316, 421. See, also, R.C. 5751.53(A)(9)(a), 5751.53(A)(6)(b), 5751.53(A)(10).

In both the initial and the restated financial statements used for the valuation allowance computations, Navistar management used historical financial information that was in existence at the end of fiscal year 2004. H.R. at 355-360. Historical financial information is used in the determination of a valuation allowance. Navistar acknowledged that "the [company's] historical financial results had changed as part of the Restatement." Appellant's Merit Brief at 44. In both its federal SEC filings and the subject CAT filing, Navistar clearly indicated that pertinent information had changed, impacting the reports to be filed. S.T. at 117; *Navistar, Inc. v. Testa* (Dec. 31, 2013), BTA No. 2010-575, unreported at Footnote #5.

While Navistar may believe that the valuation allowance it claimed in its June 2006 filing was GAAP compliant, based upon the books, records and management judgment available at the time, it ignores that the underlying financials, upon which such June 2006 allowance was determined, were not accurate. H.R. at 346. Navistar, more than 75 days before filing the June 2006 amortization report with the Tax Commissioner, filed a Form 8-K with the SEC, dated April 6, 2006, specifically indicating that "prior financial statements for the fiscal years *** ended October 31st, 2002 through 2004 and all quarterly financial statements for periods after November 1st, 2002, should no longer be relied upon because of errors in such financial statements." H.R. at 345-346; Ex. 4.

Navistar's experts, in preparation for their testimony, reviewed limited information, i.e., not all of Navistar's underlying books and records, and arrived at their conclusions that Navistar's claimed valuation allowances, both in June 2006 and upon restatement, could both be consistent with GAAP, "at different points in time." H.R. at 428, 433-435, 566-567. See, also, Appellant's Merit Brief at 38, 41. We disagree with such experts' characterizations of the valuation allowances claimed as GAAP compliant; such testimony reflects only the perception that *each* valuation allowance, as reported initially and upon restatement, was properly based upon Navistar's books and records, as they existed *at the time of each report's submission*. H.R. at 418-419, 448-449. First, we question the experts' abilities to reach such a conclusion without having reviewed all of the underlying books and records, especially the significant changes to the underlying financial statements that required the restatement. More importantly, however, for purposes of accuracy in the determination of the CAT credit to be applied, each valuation allowance cannot be considered in a vacuum; the company determined that the underlying books and records contained inaccuracies that rendered them unreliable, and, as such, the company was then obligated to acknowledge such errors to the public and correct the errors contained in the financial statements, via their restatement. H.R. at 302-307. Thus, we conclude that the valuation allowance set forth in the June 2006 report could not have complied with GAAP, because the historical financial information upon which that valuation was based, was unreliable and inaccurate, i.e., not GAAP compliant.

Therefore, based upon the foregoing, we find the commissioner's use of Navistar's restated valuation allowance was proper, as it cured "inaccuracies" and "errors" from Navistar's June 2006 valuation

allowance, which we conclude was not GAAP compliant. Accordingly, the commissioner's use of the restated valuation allowance is hereby affirmed.

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

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.

[signature]

Kathleen M. Crowley, Board Secretary

2010 WL 1489996
Only the Westlaw citation is currently available.

This decision was reviewed by West editorial staff and not assigned editorial enhancements.

United States District Court,
N.D. Illinois,
Eastern Division.

NORFOLK COUNTY RETIREMENT SYSTEM and Brockton Contributory Retirement System, individually and on behalf of all others similarly situated, Plaintiffs,
v.
Daniel C. USTIAN, Robert C. Lannert, Mark T. Schwetschenau, Navistar International Corporation, and Deloitte & Touche LLP, Defendants.

No. 07 C 7014.
|
April 13, 2010.

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER

NAN R. NOLAN, United States Magistrate Judge.

***1** Plaintiffs Norfolk County Retirement System, Plumbers Local Union 519 Pension Trust and Brockton Contributory Retirement System have filed this securities fraud class action lawsuit on behalf of everyone who purchased Navistar International Corporation ("Navistar") securities from February 14, 2003 through July 17, 2006 (the putative "Class Period"). Plaintiffs charge Navistar; its President and Chief Executive Officer Daniel C. Ustian; its former Chief Financial Officer Robert C. Lannert; its former Senior Vice President, Controller, and principal accounting officer Mark T. Schwetschenau; and its former outside auditor Deloitte & Touche, LLP ("Deloitte"), with systemic accounting fraud in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and 78t(a), and Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5. The district court has dismissed the complaint as to Deloitte, and referred the matter to this court for discovery supervision. *Norfolk County Retirement Sys. v. Ustian,* No. 07 C 7014, 2009 WL 2386156 (N.D.Ill. July 28, 2009).

Currently before the court is Lead Plaintiffs' motion to compel production of documents. For the reasons set forth here, the motion is granted in part and denied in part.

BACKGROUND

At all relevant times, Navistar was a publicly traded company specializing in the manufacture and distribution of trucks, buses, and diesel engines in the United States, Canada, Mexico and Brazil. In October 2002, Navistar's stock reached a nearly ten-year low, prompting the company to attempt a restructuring plan designed to reduce operating costs and increase net income. The plan proved a failure, but Plaintiffs claim that Navistar engaged in a scheme to inflate its reported financial results to disguise continuing losses. From February 14, 2003 through July 17, 2006, Navistar allegedly overstated its net income by $677 million, reporting a net income of $361 million when the company had actually lost $316 million. Navistar also reported positive stockholder equity when, in

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truth, there was an enormous deficit ($1.8 billion in 2003 and $1.85 billion in 2004).

The complaint identifies numerous misstatements Navistar allegedly made during the Class Period as part of its scheme to defraud. According to Plaintiffs, "Navistar's publicly reported financial results created the impression that it was in a positive business cycle, marked by increasing profit and controlled operating costs." In truth, "Navistar's ability to meet or exceed guidance and consensus estimates was predicated entirely on the Defendants' improper accounting manipulations." (Cmplt.¶ 297.) By February 2005, Navistar was under informal inquiry from the Securities and Exchange Commission ("SEC").

Plaintiffs claim that beginning in December 2005, Defendants gradually started releasing information into the market regarding the alleged fraud. Between December 14, 2005 and July 17, 2006, Navistar reported that there would be (1) delays in the filing of its 2005 Form 10–K; (2) restatements of its financial results from fiscal years 2003, 2004 and the first three quarters of 2005; and (3) no further reliance on the representations of Mr. Schwetschenau. By the time Defendants made their final partial corrective disclosure on July 17, 2006, Navistar common stock had fallen by $9.33 (30%).

***2** On December 10, 2007, Navistar finally filed its 2005 Form 10–K, which described the results of the restatement and re-audit of Navistar's financial statements for 2003, 2004, and the first three quarters of 2005 (the "Restatement"). The Restatement disclosed that over that three-year period, Navistar had misstated its financial position and results of operations by billions of dollars. Three days later, on December 13, 2007, Plaintiffs filed this class action securities lawsuit. The district court appointed Norfolk County Retirement System and Plumbers Local Union 519 Pension Trust to serve as lead plaintiffs in the case. (Order of 3/18/08, Doc. 60 .)

At a hearing on September 10, 2009, the district court denied Defendants' motion to bifurcate discovery, but directed the parties to "avoid taking discovery that is ... related solely to non-class certification issues until the class motion is briefed and decided by the Court." (Tr. of 9/10/09, at 8.) The parties have agreed to participate in the Seventh Circuit's E–Discovery Pilot Program and are currently working on class discovery. (Minute Order of 9/30/09, Doc. 119.)

On December 9, 2009, Lead Plaintiffs filed a motion to compel the production of documents they claim are relevant to their impending motion for class certification. The matter was stayed while the parties attempted to settle their dispute, but the court understands that the March 9, 2010 mediation was unsuccessful. The court thus turns once again to the motion to compel. Lead Plaintiffs seek (1) documents provided to the SEC; (2) non-public documents relating to loss causation; and (3) documents Defendants agreed to produce. Defendants insist that they have now produced all documents as promised, and object that the other documents at issue are irrelevant and overly burdensome to produce.

DISCUSSION

The Federal Rules permit discovery regarding any matter, not privileged, that is relevant to the claim or defense of any party. FED. R. CIV. P. 26(b)(1). "Mutual knowledge of all the relevant facts gathered by both parties is essential to proper litigation. To that end, either party may compel the other to disgorge whatever facts he has in his possession." *In re Thomas Consolidated Indus., Inc.,* No. 04 C 6185, 2005 WL 3776322, at *6 (N.D.Ill. May 19, 2005), *aff'd* 456 F.3d 719 (7th Cir.2006) (quoting *Hickman v. Taylor,* 329 U.S. 495, 507, 67 S.Ct. 385, 91 L.Ed. 451 (1947)).

It appears that Defendants have now produced documents responsive to First Request for Production of Documents ("Request") Nos. 44, 45, 53–55, and 59–61. (Pl. Reply, at 1 n. 2.) The court thus focuses on the SEC documents and the loss causation documents.

A. SEC Documents

Request Nos. 37 and 38 seek documents Defendants produced to, or received from the SEC in connection with the agency's investigation into Navistar's financial restatement. According to Defendants, these include: (1) over one million pages of electronic and hard copy documents relating to the accounting issues under review by the SEC; (2) hundreds of thousands of emails, many with voluminous spreadsheets and other attachments in various types of file formats, along with transactional documents and drafts relating to the accounting issues under review by the SEC; (3) tens of thousands of pages of internal and external work papers related to accounting issues described in the Restatement; (4) hundreds of thousands of pages of documents relating to Navistar's Audit Committee's internal investigation into accounting

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issues in connection with the Restatement; and (5) complete forensic copies of the hard-drive images and user-drive files for ten Navistar employees, totaling over 390 gigabytes and yielding more than 3.3 million pages. (Def. Resp., at 5.)

***3** Lead Plaintiffs argue, rather weakly, that these documents are relevant because "it is likely that some documents produced to the SEC would bear on class certification issues." (Pl. Mem., at 13.) Lead Plaintiffs then attempt to supplement this position with a general assertion that, because the SEC documents "relate to Navistar's accounting issues and restatement," they must "contain information that substantially overlaps with Lead Plaintiffs' loss causation allegations." (Pl. Reply, at 12.) Defendants counter that at most, the SEC documents may be relevant to the issue of scienter, which is not pertinent to a Rule 23 analysis. In that regard, Defendants are willing to "stipulate that they will not use these documents in connection with their class certification briefing." (Def. Resp., at 5–6.)

Lead Plaintiffs concede that "the scope of the SEC production documents exceeds those related to class certification." (Pl. Reply, at 12 n. 15.) Even assuming that some of the documents may be relevant to the issue of loss causation, it would certainly be burdensome for Defendants to try and locate them from among the millions of pages of materials. In the court's view, the burden outweighs Lead Plaintiffs' minimal showing of relevance. *See Griffith v. Pepmeyer,* No. 07–cv–1130, 2009 WL 3837543, at *1 (C.D.Ill. Nov.13, 2009) ("The discovery of relevant information can be limited if ... the 'burden ... outweighs its likely benefit.' ") To get around this problem, Lead Plaintiffs posit that Defendants can just produce everything they gave to the SEC. In Lead Plaintiffs' view, the district court instructed the parties to focus on class discovery primarily because merits discovery is burdensome. Here, they speculate, the SEC documents "have already been collated, reviewed and organized" and, thus, will be easy to produce. In the absence of any production burden, Lead Plaintiffs reason, merits discovery is appropriate now. (Pl. Mem., at 14.) The court disagrees.

The district court made clear that the parties are not to take discovery relating solely to non-class certification issues. The district court carved out no exception for merits discovery that may be produced with minimal burden. To the extent that many of the SEC documents are concededly unrelated to class certification and may also be irrelevant to this lawsuit, the court declines to order Defendants to produce all SEC documents at this time. The court accepts Defendants' stipulation that they will not use those documents in connection with class certification, and denies this portion of Lead Plaintiffs' motion to compel. In light of this determination, the court need not address the parties' additional arguments regarding privilege and selective waiver.

B. Loss Causation Documents

Request Nos. 3–36, 48, 52, 56 and 57 seek non-public documents related to loss causation. Lead Plaintiffs have identified 17 disclosures Defendants made between December 14, 2005 and July 17, 2006 that they claim revealed to the market the truth regarding Defendants' alleged fraud. Defendants intend to challenge loss causation at the class certification stage, but insist that both parties can address the issue with public documents. Defendants also maintain that it will be highly burdensome to produce non-public documents at this stage of the proceedings.

1. Relevance

***4** Lead Plaintiffs have alleged a fraud-on-the-market theory of loss causation, which requires a showing "both that the defendants' alleged misrepresentations artificially inflated the price of the stock and that the value of the stock declined once the market learned of the deception." *Ray v. Citigroup Global Markets, Inc.,* 482 F.3d 991, 995 (7th Cir.2007). In Defendants' view, the Fifth Circuit best described the scope of discovery in such cases: "[l]ittle discovery from defendants is demanded by the fraud-on-the-market regimen. Its 'proof' is drawn from public data and public filings." *Oscar Private Equity Investments v. Allegiance Telecom, Inc.,* 487 F.3d 261, 267 (5th Cir.2007). *See also Basic Inc. v. Levinson,* 485 U.S. 224, 241–42, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988) ("The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business.") Consistent with this theory, Defendants are willing to stipulate that they will not utilize any non-public documents in opposing class certification. (Def. Resp., at 12.)

Lead Plaintiffs object that Defendants are construing loss causation too narrowly. They direct the court to *In re Motorola Sec. Litig.,* 505 F.Supp.2d 501 (N.D.Ill.2007), in which the plaintiff alleged that the defendants concealed their risky business dealings with a Turkish vendor ("Telsim"). Specifically, the defendants extended Telsim approximately $2 billion in vendor financing, and recognized related

revenues, despite the fact that Telsim was known to be a weak company with a "very bad public reputation for basic honesty and integrity." *Id.* at 506, 508–09. The plaintiff argued that a February 23, 2001 earnings warning revealed the truth about the bad Telsim deal, even though it attributed the company's problems to economic conditions, inventory corrections, and weak order input, without ever mentioning Telsim. *Id.* at 539. In the plaintiff's view, the earnings warning "could have served as a vehicle by which Telsim-related information began to enter the market because Motorola's deteriorating business relationship with Telsim was allegedly the catalyst for Motorola's expected earnings shortfall." *Id.* at 542.

The court discussed at length the parameters of loss causation, and ultimately concluded that "the truth a misrepresentation or omission conceals can make its way into the market, resulting in dissipation of a fraudulently inflated share price, long before a company issues a formal 'corrective' announcement." *Id.* at 543. In rejecting the defendants' argument that a corrective disclosure must identify the prior representation and reveal to the market the falsity of that representation, the court noted:

> Defendants' proposed rule would provide an expedient mechanism for wrongdoers to avoid securities fraud liability. A company that has, for example, booked revenue from non-existent contracts could simply issue some damaging announcement that appears on its face unrelated to any fraudulent scheme, e.g., a significant earnings warning citing order weakness, wait for its share price to plummet, and then disclose the wrongdoing once the damage has been done.

***5** *Id.* at 544. In such circumstances, the plaintiff "would be unable to tie its loss, i.e., the share price decline, to the fraud, rather than to the apparently unrelated announcement." *Id.*

The court agreed that "the loss causation requirement should not allow securities fraud defendants to 'immunize themselves with a protracted series of partial disclosures.' " *Id.* (quoting *Freeland v. Iridium World Communications, Ltd.,* 233 F.R.D. 40, 47(D.D.C.2006). The court thus concluded that,

> if a plaintiff shows ... that significant aspects of the still-concealed fraud in fact provided the catalyst for an anticipated failure to meet earnings forecasts, then the share price decline following an earnings warning might indeed dissipate the fraudulent price inflation; in such circumstances, there is no good reason why the earnings warning should not serve as a disclosure in which 'the relevant truth begins to leak out.' "

Id. at 546 (quoting *Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336, 342, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005)).

In this case, Lead Plaintiffs have identified a series of 17 partial disclosures that allegedly revealed problems with previously reported financial statements, internal accounting practices, and an on-going audit investigation. Lead Plaintiffs claim that, as in *Motorola,* Defendants intend to argue that there is no relationship between the text of those partial disclosures and the alleged fraud. (Pl. Reply, at 3.) In order to rebut that argument, Lead Plaintiffs want an opportunity to see if non-public documents reveal that the motivation for the disclosures was the accounting fraud, even if that is not specifically what the disclosures said.

Defendants respond that *Motorola* is inapposite to the extent it is primarily an "omissions" case, whereas Lead Plaintiffs here allege affirmative misrepresentations. In cases of omissions, Defendants posit, the proper loss causation approach is "materialization of risk," which requires Lead Plaintiffs to prove that "it was the very facts about which the defendant lied which caused [their] injuries." *Ray,* 482 F.3d at 995 (quoting *Caremark, Inc. v. Coram Healthcare Corp.,* 113 F.3d 645, 648 (7th Cir.1997)); *ABN AMRO, Inc. v. Capital Int'l Ltd.,* 595 F.Supp.2d 805, 846 (N.D.Ill.2008). Defendants contend that to the extent Lead Plaintiffs allege only fraud-on-the-market loss causation, *Motorola* does nothing to support their quest for non-public documents.

Contrary to Defendants' assertion, it is not clear that Lead Plaintiffs' loss causation theory is limited to fraud-on-the-market. Indeed, for purposes of the motion to dismiss, the district court declined to determine whether Lead Plaintiffs can proceed under a materialization of risk theory of loss causation in addition to the fraud-on-the-market theory highlighted in the complaint. *Norfolk County Retirement Sys.,* 2009 WL 2386156, at *6 n. 3. *See also Schultz v. TomoTherapy Inc.,* 676 F.Supp.2d 780, 2009 WL 5062402, at *10 (W.D.Wis. Dec.15, 2009) ("[A] plaintiff is not required

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to plead legal theories" such as materialization of risk loss causation). This remains a matter for the district court.

***6** For purposes of discovery, however, the court finds that Lead Plaintiffs are entitled to explore whether significant aspects of the still-concealed accounting fraud provided a catalyst for reporting errors in Defendants' financial statements and for disclosing an on-going audit investigation. *Motorola,* 505 F.Supp.2d at 546. Defendants argue that *In re Northfield Laboratories, Inc.,* No. 06 C 1462 (Minute Order of 2/5/09, Doc. 205), stands for the proposition that non-public information is not relevant where, as here, the defendants stipulate not to use such information in opposing class certification. The court finds *Northfield* distinguishable, however, in that the defendants in that case not only agreed to refrain from using non-public documents, but also certified that they would not argue that the subjects of those documents (SEC and Senate Finance Committee investigations) were unrelated to the alleged fraud. (*Id.*) Here, conversely, Defendants make no such certification.

2. Burden

Defendants argue that even if non-public documents are relevant to class certification, it will be unduly burdensome to produce them at this stage of the proceedings. Lead Plaintiffs requested all documents "concerning" the 17 partial disclosures and "market or analyst reaction" to them, but have now clarified that they seek only information relating to loss causation, as follows:

> documents or communications related to or reflecting the process, circumstances and reaction to the alleged loss causation disclosures. This would include certain documents identifying the contemporaneous context for the disclosure ... as well as drafts and other documents related to the decision that caused the disclosure to occur.

(Pl. Mem., at 10 and Ex. H, Letter of 11/24/09.) Defendants object that the documents potentially responsive to these requests are "practically innumerable." They note, for example, that many of the alleged corrective disclosures broadly reference Navistar's financial reporting and operations, and claim that there are "countless" documents that "touch on" these subjects. (Def. Resp ., at 14–15.) Defendants further contend that "there are likely thousands of communications and documents ... concerning 'the reasons for any increase or decline' in Navistar share price." (*Id.* at 15.)

The court acknowledges that Defendants may need to conduct a fairly extensive search in order to produce documents responsive to Lead Plaintiffs' requests. To the extent Defendants intend to make loss causation a primary issue for purposes of class certification, however, their objections are unavailing. Lead Plaintiffs have narrowed their requests to documents specifically relating to the 17 partial disclosures themselves, and excluding " 'the underlying, technical accounting or restatement issues' referenced within the disclosures." (Pl. Reply, at 8.) The court is satisfied that Defendants can produce this information, and the motion to compel these documents is granted.

CONCLUSION

***7** For the reasons stated above, Plaintiffs' Motion to Compel Production of Documents from Defendants [Doc. 137] is granted in part and denied in part.

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Ravi RAWAT and Elliott Lyons, Plaintiffs,
v.
NAVISTAR INTERNATIONAL CORPORATION, Defendant.

No. 08 C 4305.
|
Sept. 1, 2011.

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MEMORANDUM OPINION AND ORDER

MARTIN C. ASHMAN, United States Magistrate Judge.

***1** Plaintiffs Ravi Rawat and Elliott Lyons ("Plaintiffs") have brought suit against Defendant Navistar International Corp. ("Navistar") for breach of contract, breach of the covenant of good faith and fair dealing, and violations of the Illinois and Indiana Wage Payment Collection Acts. Plaintiffs are former employees of Navistar who owned vested stock options which they were unable to exercise due to a "blackout" period allegedly caused by "Navistar's failure to have current financial reporting as required by federal law." (Pltf's. First Amend. Compl. at ¶ 2). The facts surrounding this claim are fully discussed in the District Judge's denial of Plaintiffs' motion for class certification and are not set forth in detail here. *See* Dckt. No. 169. Currently before the Court is Plaintiffs' motion to compel Navistar to respond in greater detail to their First Requests for Production. The Court rules on this motion under District Judge John W. Darrah's referral for a decision pursuant to N.D. Ill. Rule 72.1. On August 2, 2011, the Court held a hearing on the motion, and after careful consideration of the parties' briefs and arguments, the Court finds that Plaintiffs' motion should be granted.

I. *Legal Standard*

A party may file a motion to compel under Fed.R.Civ.P. 37 whenever another party fails to respond to a discovery request or when its response is insufficient. Fed.R.Civ.P. 37(a). Courts have broad discretion in resolving such disputes and do so by adopting a liberal interpretation of the discovery rules. *Wilstein v. San Tropai Condo. Master Assoc.,* 189 F.R.D. 371, 375 (N.D.Ill.1999). Federal Rule of Civil Procedure 26(b)(1) provides that the "[p]arties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense." Fed.R.Civ.P. 26(b)(1). Discoverable information is not limited to evidence admissible at trial. Instead, such information is relevant "if the discovery appears reasonably calculated to lead to the discovery of admissible evidence." *Id.* However, while the scope of permissible discovery is broad, it is not unlimited. A court can limit discovery if the court believes it is unreasonably cumulative, if the party seeking discovery has already had ample opportunity to do so, or if the burden of the proposed discovery outweighs its likely benefit. Fed.R.Civ.P. 26(b)(2).

When, as here, a case arises under a court's diversity jurisdiction, the court applies the substantive law of the state in which its sits. *Republic Tobacco Co. v. North Atlantic Trading Co. .,* 381 F.3d 717, 731–32 (7th Cir.2004). The federal rules of procedure and evidence, however, invariably apply to the litigation itself, "whether or not they determine the outcome." *Allstate Ins. Co. v. Sunbeam Corp.,* 53 F.3d 804, 806 (7th Cir.1995). Most privileges, including the attorney-client privilege, are governed by state law. Fed.R.Evid. 501; *Dunn v. Washington County Hosp.,* 429 F.3d 689, 693 (7th Cir.2005). The work product doctrine, however, is analyzed solely on the basis of federal law. *Abbott Labs. v. Alpha Therapeutic Corp.,* 200 F.R.D. 401, 405 (N.D.Ill.2001).

II. *Discussion*

***2** Plaintiffs' First Requests for Production seeks three sets of documents. The first involves discovery Navistar already produced in an earlier securities class action filed in the Northern District of Illinois against a number of defendants, including Navistar, as *Norfolk County Retirement System et al. v. Ustian et al.,* No. 07 C 7014 (*"Ustian"*). That case proceeded before District Judge Robert Gettleman and was eventually settled on May 25, 2011. Plaintiffs also ask the Court to order Navistar to turn over documents it has already produced to the Securities and Exchange Commission ("SEC") as part of the SEC's investigation of Navistar. *In the Matter of Navistar Int'l Corp.,* Administrative Proceeding No. 3–13994 ("the SEC proceeding"). The SEC inquired into matters that led to the need for Navistar to issue its 2005 Form 10–K on December 10, 2007 ("the Restatement"), which detailed the results of the restatement of the company's financials for 2003, 2004 and the first three quarters of 2005. As described by Magistrate Judge Nolan in *Ustian,* "[t]he Restatement disclosed that over that three-year period, Navistar had misstated its financial position and results of operations by billions of dollars." *Norfolk County Retirement Sys. v. Ustian,* No. 07 C 7014, 2010 WL 1489996, at *2 (N.D.Ill. April 13, 2010). Plaintiffs' final request seeks documents Navistar will rely on to support its affirmative defenses.

A. The Affirmative Defense Documents

In its initial answer to Plaintiffs' complaint, Navistar asserted thirty-two affirmative defenses. These included a substantial number of defenses aimed at the potential class proposed by Plaintiffs, theories such as estoppel, res judicata, and various constitutional provisions, and the defenses of illegality and impossibility. Plaintiffs asked Navistar to identify documents in its possession that were relevant to these defenses, but Navistar declined to do so based on the grounds that such production would be unduly burdensome and would involve items protected by the work product doctrine. The company makes the same claims in its response to the motion to compel.

The work product doctrine protects documents that an attorney or a representative of a party prepares in anticipation of litigation in order to prepare or analyze a client's case. Fed.R.Civ.P. 26(b)(3); *Sandra T.E. v. South Berwyn Sch. Dist. 100,* 600 F.3d 612, 618 (7th Cir.2010). Its protection is "distinct from and broader than the attorney-client privilege." *United States v. Nobles,* 422 U.S. 225, 238 n. 11, 95 S.Ct. 2160, 45 L.Ed.2d 141 (1975) (citation omitted). A lawsuit need not be underway for the doctrine to apply "provided the prospect of litigation [is] not remote." *Mattenson v. Baxter Healthcare Corp.,* 438 F.3d 763, 768 (7th Cir.2006). This protection only prevents the disclosure of protected documents or communications, however, not the underlying facts. *See Upjohn Co. v. United States,* 449 U.S. 383, 395–96, 101 S.Ct. 677, 66 L.Ed.2d 584 (1981). As with the attorneyclient privilege, the party asserting the work product doctrine has the burden of showing all of its elements. *United States v. BDO Seidman,* 337 F.3d 802, 811 (7th Cir.2003). "A claim of privilege cannot be a blanket claim, but must be made and established on a document-by-document basis." *Allendale Mut. Ins. Co. v. Bull Data Systems, Inc.,* 145 F.R.D. 64, 86 (N.D.Ill.1992) (citing *United States v. White,* 950 F.2d 426, 430 (7th Cir.1991)).

***3** Navistar's reliance on the work product doctrine fails to meet this well-established standard on several grounds. The company does not identify any specific document that it claims is protected by the privilege, relying instead on the kind of generalized claim that has been rejected by courts in this District as insufficient to show that a privilege applies. *See Coltec Inds., Inc. v. Am. Motorists Ins. Co.,* 197 F.R.D. 368, 371 (N.D.Ill.2000) ("A claim of privilege cannot be a blanket claim, but must be made and established on a document-by-document basis."); *Schachar v. Am. Acad. of Ophthalomology, Inc.,* 106 F.R.D. 187, 191 (N.D.Ill.1985) ("The party claiming the privilege has the burden of showing the specific facts giving rise to the privilege; blanket claims of privilege are improper."); *Allendale Mut. Ins. Co.,* 145 F.R.D. at 86; *MSTG, Inc. v. AT & T Mobility LLC,* No. 08 C 7411, 2011 WL 221771, at *10 (N.D.Ill. Jan.20, 2011). Navistar bears the burden of showing, for example, what documents are at issue, when they were created, and that the principal motive behind the creation of the documents was to aid in possible future litigation. *See Binks Mfg. Co. v. Nat'l Presto Indus., Inc.,* 709 F.2d 1109, 1119 (7th Cir.1983). By not addressing these issues, Navistar has not shown why the privilege it relies on applies. Indeed, if the Court were to agree with Navistar, it would have no idea what it was ordering to be protected from discovery.

The last fact underscores that Navistar has not provided a privilege log either in response to Plaintiffs' discovery requests or as part of its response to the motion to compel. Once litigation begins, Fed.R.Civ.P. 26(b)(5) requires a party served with discovery to provide a privilege log concerning relevant documents it believes are responsive but protected by a privilege. The Rule states:

> When a party withholds information otherwise discoverable by claiming that the information is privileged or subject to protection as trial-preparation material, the party must:
>
> (i) expressly make the claim; and
>
> (ii) describe the nature of the documents, communications, or tangible things not produced or disclosed—and do so in a manner that, without revealing information itself privileged or protected, will enable other parties to assess the claim.

Fed.R.Civ.P. 26(b)(5)(A). *See also United States ex rel. Liotine v. CDW–Government, Inc.,* No. 05–033, 2010 WL 2165958, at *1 (S.D.Ill. May 28, 2010) ("The requirements of Rule 26(b)(5) are clear. Documents which are withheld under a claim of privilege must be entered into a privilege log so that the parties and the Court can determine the propriety of the claim of privilege."). A party's failure to do so can waive a privilege altogether. *See Babych v. Psychiatric Solutions, Inc.,* 271 F.R.D. 603, 608 (N.D.Ill.2010) ("[P]arties and their counsel are cautioned that a timely and adequate privilege log is required by the federal rules, and that failure to serve an adequate privilege log may result in a waiver of any protection from discovery."). Although the Court does not believe that Navistar should be found to have waived its privileges, the company's omission of a log or an explanation of why such a log could not be provided requires a finding at this point that Navistar has not shown why the work product doctrine applies to any of the documents responsive to Plaintiffs' request.

***4** Perhaps in recognition of this fact, Navistar takes a somewhat different approach and relies on the Third Circuit's decision in *Sporck v. Peil,* 759 F.2d 312 (3d Cir.1985). In *Sporck,* the defendant produced hundreds of thousands of documents in response to discovery requests. At the defendant's deposition, plaintiff's attorney demanded to know what documents the defendant's attorney had selected for review to prepare the defendant for the deposition. The Third Circuit found that, even though the documents themselves did not contain any protected work product, identifying the attorney's document selection process involved opinion work product because it would reveal counsel's trial strategy and thought process concerning the defendant's case. *Sporck,* 759 F.2d at 315–17.

Navistar's reliance on *Sporck* is misplaced under the facts of this case. *Sporck* involved opinion work product, which involves counsel's mental impressions and opinions, as opposed to ordinary work product, which "includes raw factual information." *Hollinger Int'l, Inc. v. Hollinger Inc.,* 230 F.R.D. 508, 512 (N.D.Ill.2005) (citation omitted). Unlike ordinary work product, whose protections can be overcome by the showing of a substantial need for the information, *id.* at 512, "immunity from discovery for opinion work product is absolute or nearly absolute." *United States ex rel. Yannacopoulos v. General Dynamics,* 231 F.R.D. 379, 382 (N.D.Ill.2005). Navistar does not show how the greater protections afforded opinion work product apply here and fails to distinguish *Sporck* from other cases that have disagreed with its conclusion that the mere grouping of documents by counsel constitutes opinion work product. The First Circuit, for example, has criticized *Sporck'* s reasoning as flawed "because it assumes that the revelatory nature of the sought-after information is, in itself, sufficient to cloak the information with the heightened protection of opinion work product. That is simply not the case; much depends on whether the fruits of the screening would soon be revealed in any event." *In re San Juan Dupont Plaza Hotel Fire Litig.,* 859 F.2d 1007, 1018 (1st Cir.1988); *see also Resolution Trust Corp. v. Heiserman,* 151 F.R.D. 367, 374 (D.Colo.1993); *Bohannon v. Honda Motor Co. Ltd.,* 127 F.R.D. 536, 539 (D.Kan.1989).

This Court agrees with the First Circuit's reasoning that the context in which the selection process takes place is important in determining if opinion work product is involved. *Sporck* involved the preparation of a deponent by his own attorney, an act that would not ordinarily give rise to further inquiry at a future date. By contrast, this case involves affirmative defenses that Navistar will be required to substantiate with evidence if it intends to rely on them at trial. In fact, Navistar conceded at the hearing that it would be providing a complete exhibit list of this evidence to Plaintiffs before trial, and it presents no argument on why the strict protection given to opinion work product should apply if the company ultimately intends to turn over the documents.

***5** The Court, therefore, agrees with other courts in this Circuit that have ordered the production of documents relevant to affirmative defenses. *See Burnett & Morand P'ship v. Estate of Youngs,* No. 3:10–cv–3, 2011 WL 1237950, at *3 (S.D.Ind. April 4, 2011) ("[T]he purpose of the discovery rules is to bring to light the parties' positions in an informed and controlled manner that winnows down the resolution of a dispute by identifying those facts that are clearly in dispute, and those legal theories that

are being debated.") (internal quote omitted). The Indiana court recognized that turning over documents responsive to a defense might reveal some of an attorney's thought process. *Id.* To a certain extent, however, so do the thirty-two affirmative defenses that Navistar has already asserted in this case. If Navistar believes that producing the documents supporting these claims would reveal its counsel's thoughts more than the claims themselves do, and would constitute protected opinion work product, it bears the burden of stating such an argument and demonstrating why that is the case. It has not done so with any particularity, and the Court finds that Navistar has not shown why the documents in question are protected from discovery.

Navistar also fails to show why the production of these documents would be unduly burdensome. The company claims that it should not be required to sift through the 738 items already produced as well as "other documents" to find those that relate to its affirmative defenses. Presumably, Navistar will have to do just that at some point if it actually intends to use the documents as part of its affirmative defenses at trial or, as the company stated at the hearing, when it turns them over before trial. The fact that Navistar has asserted thirty-two affirmative defenses could involve a substantial number of documents, but Navistar itself has chosen the defenses it relies on. Moreover, several factors weigh against finding that producing these documents would constitute a serious burden on Navistar. Many of the defenses, for example, concern the proposed class members, and Judge Darrah's denial of class certification makes those defenses moot, at least insofar as they relate to persons other than the named Plaintiffs. Moreover, Navistar stated at the hearing that it was agreeing to drop the defenses of illegality and impossibility, thereby further reducing the burden imposed on Navistar.

For these reasons, therefore, Plaintiffs' motion is granted on the affirmative defense issue. If Navistar believes these documents should be protected from disclosure by a privilege, it must submit a privilege log with its document production identifying those documents it believes are protected by the work product privilege. In so doing, however, Navistar must provide a log with sufficient information to make a meaningful privilege review possible. This includes details concerning the "date, author and all recipients of the document, subject matter, purpose, and an explanation as to why the document should be privileged and not produced in discovery."[1] *Coltec,* 197 F.R.D. at 373.

B. The *Ustian* and SEC Documents

***6** Plaintiffs also seek documents Navistar earlier produced in *Ustian, supra,* and the SEC investigation. The SEC documents involve materials Navistar collected and submitted to that agency as part of its investigation of events that gave rise to Navistar's need to restate its finances. *Ustian* involved a securities action brought on behalf of all individuals who had purchased Navistar's common stock from February 14, 2003 through July 27, 2006. The plaintiffs in that case alleged that Ustian and the other defendants violated Rule 10b–5 and Section 20(a) of the Securities Exchange Act, 28 U.S.C. § 1331 *et seq.,* by virtue of actions that led to the decline in the value of the company's stock. Plaintiffs claimed, for example, that Navistar's internal controls over financial reporting were materially deficient from 2003 through the April, 2006 announcement that Navistar would need to restate its financial results.

1. *Relevance*

Navistar first objects to Plaintiffs' request for these documents on the ground that they are not relevant to the issues Plaintiffs assert here. According to Navistar: (1) Plaintiffs do not need the documents they seek in order to determine what caused the blackout; (2) the blackout's cause is not even relevant; and, (3) most of the documents themselves have little relevance to the causation issue in the first place.

These contentions are not entirely devoid of merit, and the Court is mindful that Plaintiffs seek an exceptionally wide array of evidence that the Court, necessarily, has not reviewed. Balanced against this, however, are two guiding principals. First, in ruling on a motion to compel, a court "should independently determine the proper course of discovery based upon the arguments of the parties." *Gile v. United Airlines, Inc.,* 95 F.3d 492, 495–96 (7th Cir.1996). This includes consideration of the burdens of proof at stake, an issue that plays a crucial role in the Court's consideration of Navistar's arguments below. The parties' arguments must also take account of the second, and critical, principle that relevance is construed more broadly under Fed.R.Civ.P. 26(b)(1) than it is at trial. Evidence is relevant for discovery purposes if there is any possibility that it could be relevant to the subject matter of the case. *See Kodish v. Oakbrook Terrace Fire Protection Dist.,* 235 F.R.D. 447, 450 (N.D.Ill.2006). This means that discovery is not limited to the specific issues raised in the parties' pleadings "because discovery itself is designed to help define and clarify what the issues are." *Oppenheimer Fund, Inc. v. Sanders,* 437 U.S.

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340, 351, 98 S.Ct. 2380, 57 L.Ed.2d 253 (1978). It is also not constrained in a narrow way by a case's merits, "for a variety of fact-oriented issues may arise during litigation that are not related to the merits." *Id; see also Murata Mfg. Co., Ltd. v. Bel Fuse, Inc.,* 422 F.Supp.2d 934, 945 (N.D.Ill.2006). Accordingly, courts should approach discovery requests with the understanding that even if the relevance of what is sought is not entirely clear, discovery may still be warranted under the specific facts of a case. *See Wiginton v. CB Richard Ellis, Inc.,* 229 F.R.D. 568, 577 (N.D.Ill.2004) ("If relevance is in doubt, courts should err on the side of permissive discovery.").

***7** With these principles in mind, the Court finds that Plaintiffs have shown that the documents they seek are sufficiently relevant for discovery purposes to warrant their discovery. The parties disagree about how "causation" should be viewed in this case, but that issue is central to the positions of both sides. Navistar argues that discovery is not necessary to show what caused the blackout period that prevented Plaintiffs from exercising their options. It claimed at the hearing that the Restatement caused the blackout but that Navistar did not "cause" the Restatement. Instead, Navistar contended that the need to restate its financials was caused, at least in part, by third parties such as outside auditors and accountants, and that Navistar was not itself at fault. Plaintiffs strongly disagree with this analysis of events and claim that it was not the Restatement itself, but the *need* to restate that "caused" the blackout, a point Navistar essentially concedes in its brief. *See* Def's. Resp. at 2 ("Navistar's need to restate its previous financials was the cause."). Plaintiffs argue that they need data such as information concerning "control deficiencies" allegedly contained in the *Ustian* and SEC documents to show that Navistar's actions gave rise to the need to restate. [2]

In this sense, the Court agrees with Plaintiffs that Navistar's actions that allegedly created the need to restate its financials are relevant to their legal claims. Navistar claims that discovery on this issue is not relevant because Plaintiffs' underlying legal theory is itself flawed. Plaintiffs plead that Navistar's actions breached the options' contractual agreements "by failing to permit [Plaintiffs] to exercise their options and purchase shares during the term of the option." (First Amend. Compl. ¶ 56). Navistar argues that Plaintiffs' legal theories are misplaced because, instead of alleging that Navistar acted with an intent to prevent Plaintiffs from exercising their options, they contend "that because the blackout was 'caused' by Navistar by virtue of the need to restate its financials, the Company should be liable for options that expired during the blackout period." (Def's. Mot. at 6). But whether Plaintiffs' legal theories have merit or not is a substantive issue that is not under consideration here. The only issue before this Court is whether Plaintiffs are entitled to documents that are potentially relevant to its *actual* argument that Navistar's conduct gave rise to what Plaintiffs allege constitutes a breach of contract and a breach of the covenant of good faith and fair dealing. As noted above, discovery is not limited to the merits of a plaintiff's claims but includes an array of fact issues that may arise in the course of litigation. *Oppenheimer,* 437 U.S. at 351. Plaintiffs have made it very clear that they seek evidence on what gave rise to the need for Navistar to restate its financials, and whether or not they are correct that Navistar is liable to them because of acts that caused the blackout does not limit the scope of permissible discovery in the manner claimed by Navistar.

***8** Navistar complains that the *Ustian* items will not shed light on this issue because the documents it produced in that proceeding were for the most part connected with "corrective disclosures," the last of which took place in June, 2006. But that is just what Plaintiffs are seeking, as at least some of their allegations concern the events in 2003, 2004, and 2005 that gave rise to the need for Navistar to restate its earnings altogether. Navistar also claims that the SEC documents involve issues unrelated to the cause of the blackout, though it admits that some categories of information relate to accounting policies and other events that led up to the Restatement. Plaintiffs made clear at the hearing that they could not use the SEC's consent decree itself as direct evidence of their version of Navistar's alleged malfeasance because Navistar agreed with the SEC's order only for the limited purpose of that proceeding. Accordingly, Plaintiffs essentially aim to reprove at least some of the SEC's findings as part of their attempt to show how Navistar allegedly breached its contractual obligations to them.

Federal Rule of Evidence 401 states that " 'relevant evidence' means evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence." Fed.R.Evid. 401. It is certainly possible that the items Navistar describes as part of the SEC and *Ustian* disclosures—analysts' reports, SEC filings, and corrective disclosures—would meet this standard by shedding light on what the alleged "management malfeasance" that Plaintiffs claim ultimately prevented them from exercising their options involved. That is all that Rule 26(b)(1) requires for non-

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privileged documents to be discoverable, as that rule is construed "broadly to encompass any matter that bears on, or that reasonably could lead to other matter that could bear on, any issue that is or may be in the case." *Oppenheimer,* 437 U.S. at 351. Accordingly, the Court finds that both the *Ustian* and the SEC documents are relevant to Plaintiffs' claims.

2. *The Burdens of Production*

Of greater concern to the Court is Navistar's argument that producing the *Ustian* and SEC documents would be unduly burdensome. There is no question that responding to Plaintiffs' requests could be a substantial undertaking, and the Court does not minimize the fact that Navistar alleges that *Ustian* included 11,000 documents and that the SEC production contains close to 4 million pages. Notwithstanding, Navistar still bears the burden of proof on this issue. *Schachar,* 106 F.R.D. at 190 ("The party objecting to a discovery request bears the burden of showing that the request is unduly burdensome."). In order to do so, Navistar must do more than make broad assertions that producing the documents would be difficult, and the fact that an exceptionally large number of documents is involved does not speak for itself on this issue, at least under the circumstances noted below. "[I]f a party is to resist discovery as unduly burdensome, it must adequately demonstrate the nature and extent of the claimed burden by making a specific showing as to how disclosure of the requested documents and information would be particularly burdensome." *Perry v. City of Gary, Ind.,* No. 2:08–CV–280, 2009 WL 2253157, at *4 (N.D.Ind. July 27, 2009).

***9** Navistar has not met this standard as it relates to the *Ustian* documents. The company has already produced these once, and it provides no information on what it would have to do to comply with Plaintiffs' request. Navistar does not state, for example, whether a copy of its earlier production already exists, what records of its production were retained, or other specific information concerning the burden of responding to Plaintiffs. Presumably, Navistar will not be required to re-collect the documents as if they were being assembled for the first time. Nor need it sift through them to identify items it believes to be relevant to this case; Plaintiffs only ask for the documents Navistar did, in fact, produce in *Ustian,* and the company can turn those documents over to Plaintiffs without a relevance review.[3] Accordingly, Navistar has not shown how the burdens of producing these documents outweigh Plaintiffs' need to view them.

Plaintiffs also seek documents that Navistar previously collected and submitted in 2006 and 2007 as part of the SEC's investigation of events that led up to Navistar's need to restate its earnings. Navistar's principal argument concerning these documents is not merely that they involve a large number of documents, though it understandably relies on that fact. Navistar also contends that the burden is enhanced by the need to review the SEC production to determine which documents are protected by a privilege, including the attorney-client privilege and the work product doctrine. Moreover, the company argues, its burden is disproportionate to Plaintiffs' need to have these documents because at best the documents only have a limited relevance to Plaintiffs' allegations. The Court has already rejected the basis for the last of these arguments in its discussion above and turns to Navistar's two remaining grounds.

Navistar's privilege argument faces strong headwinds that the company does not address. Courts in this District have long held that "the mere claim of privilege does not justify a refusal to identify properly the information and documents requested by plaintiff." *AM Int'l, Inc. v. Eastman Kodak Co.,* 100 F.R.D. 255, 256 (N.D.Ill.1981) (internal citation omitted). In other words, a party served with discovery requests must submit a privilege log in order to assert the privileges it relies on. As explained above, Navistar has not done so, either in response to Plaintiffs' requests or as part of the motion to compel. Navistar's argument that some *future* privilege review should not be imposed on it because of the burdens that would be entailed overlooks that the time for asserting and proving privileges is now, not at an unspecified later date. The Court notes that Navistar has not argued that additional time was needed to compile a privilege log, nor has it provided any other explanation of why it has not addressed this issue in a more specific manner. As this Court has stated, "[i]f a party fails to comply with the need to provide such a privilege log, that party fails to establish that the privilege applies." *Wunderlich–Malec Sys., Inc. v. Eisenmann Corp.,* No. 05 C 4343, 2006 WL 3370700, at *8 (N.D.Ill. Nov. 17, 2006) ("The fact that the compilation of such a log is burdensome will not obviate the need for the log, particularly because there are no presumptions operating in the discovery opponent's favor.") (quoting *Abbott Labs. v. Alpha Therapeutic Corp.,* 97 C 1292, 2000 WL 1863543, at *3 (N.D.Ill.Dec.14, 2000)).

***10** Navistar's only specific reference to the privilege issue is not entirely clear. The company states: "The SEC documents would also need to be reviewed for privilege, as numerous privileged documents were produced

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to the Commission pursuant to a strict confidentiality agreement." (Def's. Resp. at 10). Navistar explains that it submitted these documents to the SEC pursuant to the selective waiver doctrine, which provides that a party may submit potentially privileged documents to a governmental agency without waiving the privilege in relation to third parties at a later date. *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.,* 244 F.R.D. 412, 430 (N.D.Ill.2006). This explanation implies that Navistar knows that at least some of the produced documents are protected, though it is unaware of the full extent of how the various privileges may apply. This suggests that Navistar did not conduct a thorough privilege review as part of the SEC production but that it did learn that some of the produced documents were protected. [4]

Even assuming that the selective waiver doctrine applies, Navistar is still fully obligated to assert and prove all the privileges it relies on in this proceeding. [5] That burden falls on Navistar, not the Court or Plaintiffs. If Navistar is unable to show these privileges with specificity because of the large number of documents it claims are involved, it could have made some showing as to why it needed time to undertake a more complete privilege review. In the alternative, the company could have explained the nature of the privilege review that took place by its outside counsel in the SEC production and provided at least a limited privilege log covering those documents that Navistar suggests it knows are privileged. Navistar has not made such arguments, and the Court has no evidence of why the attorney-client privilege and the work product doctrine apply or what documents they arguably protect from discovery.

Without such arguments, the Court is left only with generalized work product claims that are unavailing under federal law. *See Holifield v. United States,* 909 F.2d 201, 204 (7th Cir.1990); *White,* 970 F.2d at 334; *Wilstein,* 189 F.R.D. at 379. Illinois law, which governs the application of the attorney-client privilege in this diversity action, also holds that simply asserting a privilege is insufficient. *See Ekstrom v. Temple,* 197 Ill.App.3d 120, 127, 142 Ill.Dec. 910, 553 N.E.2d 424 (Ill.App.Ct.1990) ("[The] mere assertion that the matter is confidential and privileged will not suffice.") (quoting *Cox v. Yellow Cab Co.,* 161 Ill.2d 416, 419–20, 337 N.E.2d 15 (1975)); *see also Waste Mgt., Inc. v. Int'l Surplus Lines Ins. Co.,* 144 Ill.2d 178, 190, 161 Ill.Dec. 774, 579 N.E.2d 322 (1991) (stating that Illinois has "a strong policy encouraging disclosure" and confines the privilege "within the narrowest possible limits."). In the absence of a privilege log, examples of privileged documents, or specific arguments from Navistar, the Court has no basis on which to find that any part of the SEC documents is protected by a privilege for the purpose of Plaintiffs' motion to compel. Thus, as Navistar has not shown that privileges even apply here, it has not shown that production of the SEC documents would be unduly burdensome because of those privileges.

***11** The Court has a greater concern over Navistar's contention that the number of the SEC documents makes their production unduly burdensome. Navistar has submitted an affidavit of Michael Weil, Director of the Legal Consulting Digital Evidence practice of the Huron Consulting Group, which Navistar retained to assist in the SEC document production. Mr. Weil states that Navistar produced 1,170,932 hard copy pages to the SEC, as well as ten hard drives containing 3,338,221 pages. (Def's. Resp. at Ex. 4). Certainly, this is a daunting number of documents, and courts must give heed to the fact that the "benefits of the requested production must outweigh the burden of compliance with the [request]." *Northwestern Mem. Hosp. v. Ashcroft,* 362 F.3d 923, 930–31 (7th Cir.2004). When Navistar's relevance and privilege arguments are removed, however, the remaining burden of production is not as clear as the sheer volume of documents might otherwise suggest.

Navistar states that producing the documents would be difficult, but it does not explain what specific burdens will arise if it is required to reproduce documents that have already been collected and produced before. As with the *Ustian* documents, Navistar does not state whether it already has copies of the 1,170,932 hard copy documents given to the SEC, or whether it would be required to reduplicate substantial amounts of the work that went into the original production. Navistar cites relevant caselaw warning against requiring parties to undergo undue expense in producing documents—a point the Court takes seriously. But it does not argue how that principle applies in this case or what expense would be involved in giving Plaintiffs what Navistar has already given to the SEC. If Navistar already has copies of these documents, the costs would not be significant; if not, the costs would be greater. Without addressing that burden in specific terms, however, the Court has no information on the issue. "The mere fact that [it] will be required to expend a considerable amount of time, effort, or expense in answering the [request] is not a sufficient reason to preclude discovery.... By making overly general assertions of undue hardship, [Navistar] cannot avoid complying with ... discovery requests." *Schaap v. Executive Inds., Inc.,* 130 F.R.D. 384, 387 (N.D.Ill.1990) (internal citation omitted).

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The remaining portions of the SEC production appear to involve electronically stored information ("ESI"). Mr. Weil states that Navistar provided the agency with ten hard drives containing 390 gigabytes. Notably absent from Navistar's argument is any particularized statement of the burdens that would be imposed by producing the same hard drives to Plaintiffs or what the production would involve. Federal Rule of Civil Procedure 26(b)(2), which governs the limitations on the discovery of ESI, protects a party like Navistar from producing ESI "that the party identifies as not reasonably accessible because of undue burden or cost." Fed.R.Civ.P. 26(b)(2)(B). Rule 26 places the burden for showing this squarely on Navistar. *Id.* In its brief and at the hearing, Navistar addressed these burdens in terms of the need to review this information for relevance and privilege, issues that the Court has already discussed. The company does not, however, make any claim concerning the costs that it would have to bear in accessing or producing the ESI. Nor does it explain why turning over ESI that has already been gathered and produced is, in itself, unduly burdensome.

***12** Plaintiffs have not indicated that they asked Navistar to produce the SEC documents in any particular form, as Rule 34 allows them to do. Fed.R.Civ.P. 34(b)(1)(C) (stating that the requesting party "may specify the form or forms in which electronically stored information is to be produced."). Accordingly, the same rule allows Navistar to turn over ESI "in a form or forms in which it is ordinarily maintained or in a reasonably usable form or forms," and the company "need not produce the same electronically stored information in more than one form." Fed.R.Civ.P. 34(2)(E)(ii) & (iii). What this means for Navistar, however, is not asserted with the clarity or specificity required to carry Navistar's burden of proof on this issue. Neither Mr. Weil nor Navistar, for example, claims that Navistar would be required to do more than give Plaintiffs the hard drives themselves as the form in which the ESI is "ordinarily maintained." Fed.R.Civ.P. 34(2)(E)(ii). The Court does not suggest that such a simple process is what Navistar faces here, but if that is not the case, then Navistar was obligated to state that fact and to demonstrate the difficulties it would encounter. *See Susquehanna Comm. Finance, Inc. v. Vascular Resources, Inc.,* No. 1:09–CV–2012, 2010 WL 4973317, at *13 (Dec. 1, 2010) (noting that "courts have generally found that the burden rests with the party objecting to the production of metadata or ESI to show undue hardship or expense."). Navistar's argument at the hearing that it would have to review the 3,338,221 pages contained on the hard drives for relevance and privilege is unpersuasive for the reasons stated earlier.

The Court's concern on this front is lessened by the fact that Plaintiffs point out in their reply brief that the parties reached an agreement that Navistar would only produce those documents immediately relevant to the causes of the blackout, not the entire range of the SEC documents that Plaintiffs originally sought. Again, however, Navistar has provided no argument as to why it would be unduly burdensome to reduce the original request to this more narrowly-tailored set of documents. [6] Assuming for the sake of argument that Navistar would reassert its claim that it would be required to sort through the documents to determine which are relevant, Navistar does not indicate what specific burdens this would actually entail. If this were the first time that Navistar was required to produce the documents, the company's generalized burden claim would be considerably more persuasive. As it stands, the Court presumes that Navistar would not be confronted with the hard drives or the information they contain as if the company had never seen them before and that Navistar would not be required to reduplicate the efforts involved in producing them earlier to the SEC. However, neither Navistar nor Mr. Weil's affidavit addresses any of the relevant facts on this important issue, including how the documents were arranged (by topic, date, *etc.*), what prior review of them took place, what records or index of that review are currently available for reference, the time and expense involved in reviewing such a summary record, if production would be physical, electronic, or both, or if hard copies of the documents in the hard drives already exist. Whether it would be relatively easy to locate the smaller number of documents Plaintiffs have agreed to accept by consulting an index of the earlier production, or whether it would be difficult to do so because Navistar did not keep such an index, is left unaddressed.

***13** Thus, the Court has no evidence on which to determine that the production, while potentially burdensome, would impose such an undue hardship that Plaintiffs' request should be denied. Navistar has not shown why the SEC documents are not relevant, and Navistar cannot rely on privileges to support its burdensomeness argument without first asserting those privileges in compliance with well-established rules. In the absence of specific arguments from Navistar on this issue, the Court cannot conclude that the company has carried its burden of proof to demonstrate that producing materials that have already been collected, organized, and turned over to the SEC would be unduly burdensome. As with the documents

related to the affirmative defenses, however, Navistar may submit the *Ustian* and SEC documents with an appropriate privilege log if it believes that some of the produced items are protected by a privilege. Plaintiff's motion is granted on this issue.

IV. *Conclusion*

For all these reasons, the Court finds that Plaintiffs' Second Motion to Compel Discovery Compliance [Dckt. 180] is granted. In light of the number of documents at issue, the Court grants Navistar an enlarged period of time to produce the requested documents. Accordingly, within sixty days of the entry of this order, Navistar shall produce all the documents sought in Plaintiffs' motion.

ENTER ORDER:

All Citations

Not Reported in F.Supp.2d, 2011 WL 3876957

Footnotes

1 The Court agrees with *Coltec's* stress on the need for outlining these elements: "It may be overstating the obvious, but in this court's experience it is necessary; describing a document as 'legal advice' or 'work product' is not the same as *establishing* that the documents are immune from discovery." *Coltec,* 197 F.R.D. at 373.

2 Although the parties have not clarified exactly what "control deficiencies" and other terms used at the hearing and in the briefs specifically refer to, the Court assumes that they encompass allegations similar to the conclusions made by the SEC in its investigative report. The SEC stated:

> These findings do not reflect a coordinated scheme by senior management to manipulate the Company's reported results or conduct committed with the intent of personal gain. Instead, these findings reflect misconduct that resulted in large part from a deficient system of internal controls, evidenced in part by insufficient numbers of employees with accounting training, a lack of written accounting policies and procedures, and flaws in the Company's organizational structure. The internal control deficiencies, in turn, resulted from senior management's failure to dedicate sufficient resources and attention to the adequacy of Navistar's accounting and reporting functions. The deficient internal controls failed to provide adequate checks on certain employees' efforts to meet the Company's financial targets.

(Def's. Resp., Ex. 3 at 2).

3 In a footnote in its brief, Navistar suggests that privilege issues have been raised concerning the *Ustian* documents. (Def's. Resp. at 11 n. 4). The Court disagrees. Although Navistar's general response to Plaintiffs' discovery requests includes a list of standard objections—burdensomeness, privilege, breadth, *etc.*—they are not directed to any particular request. It is well established that such generalized, non-specific objections are improper and do not act as a substitute for an individualized response to each of Plaintiffs' requests. *See, e.g., In re Aircrash Disaster Near Roselawn, Ind. Oct. 31, 1994,* 172 F.R.D. 295, 306–07 (N.D.Ill.1997) (denying similar objections as "pat, generic, non-specific" responses that "are inconsistent with both the letter and the spirit of the Federal Rules of Civil Procedure."); *United Auto. Ins. v. Veluchamy,* No. 09 C 5487, 2010 WL 749980, at *5 (N.D.Ill. March 4, 2010) (finding that such "boilerplate responses" are waived as improper). By contrast, Navistar's specific response to Request No. 1 does not claim that potentially relevant documents are privileged. Thus, no privilege issue has been properly asserted concerning this discovery request.

4 At the hearing, Navistar described the production as including "tons and tons" of privileged documents, again indicating that Navistar is already aware of how specific privileges apply to a substantial number of items it produced to the SEC.

5 The Seventh Circuit has not addressed whether the selective waiver doctrine applies in this Circuit, but at least one court has adopted it when a party submits its documents pursuant to a confidentiality agreement. *See Jaffe,* 244 F.R.D. at 432–33.

6 As with the *Ustian* documents, Plaintiffs' original request does not require Navistar to review the SEC production to winnow out documents immediately relevant to the cause of the Restatement. Instead, Plaintiffs ask for the entire production itself.

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Proposed Legislation

26 U.S.C.A. § 172

§ 172. Net operating loss deduction

Currentness

(a) Deduction allowed.--There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) Net operating loss carrybacks and carryovers.--

(1) Years to which loss may be carried.--

(A) General rule.--Except as otherwise provided in this paragraph, a net operating loss for any taxable year--

(i) shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and

(ii) shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of the loss.

(B) Special rules for REIT's.--

(i) In general.--A net operating loss for a REIT year shall not be a net operating loss carryback to any taxable year preceding the taxable year of such loss.

(ii) Special rule.--In the case of any net operating loss for a taxable year which is not a REIT year, such loss shall not be carried back to any taxable year which is a REIT year.

(iii) REIT year.--For purposes of this subparagraph, the term "REIT year" means any taxable year for which the provisions of part II of subchapter M (relating to real estate investment trusts) apply to the taxpayer.

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(C) Specified liability losses.--In the case of a taxpayer which has a specified liability loss (as defined in subsection (f)) for a taxable year, such specified liability loss shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of such loss.

(D) Excess interest loss.--

(i) In general.--If--

(I) there is a corporate equity reduction transaction, and

(II) an applicable corporation has a corporate equity reduction interest loss for any loss limitation year,

then the corporate equity reduction interest loss shall be a net operating loss carryback and carryover to the taxable years described in subparagraph (A), except that such loss shall not be carried back to a taxable year preceding the taxable year in which the corporate equity reduction transaction occurs.

(ii) Loss limitation year.--For purposes of clause (i) and subsection (g), the term “loss limitation year” means, with respect to any corporate equity reduction transaction, the taxable year in which such transaction occurs and each of the 2 succeeding taxable years.

(iii) Applicable corporation.--For purposes of clause (i), the term “applicable corporation” means--

(I) a C corporation which acquires stock, or the stock of which is acquired in a major stock acquisition,

(II) a C corporation making distributions with respect to, or redeeming, its stock in connection with an excess distribution, or

(III) a C corporation which is a successor of a corporation described in subclause (I) or (II).

(iv) Other definitions.--

For definitions of terms used in this subparagraph, see subsection (h).

(E) Retention of 3-year carryback in certain cases.--

(i) In general.--Subparagraph (A)(i) shall be applied by substituting “3 taxable years” for “2 taxable years” with respect to the portion of the net operating loss for the taxable year which is an eligible loss with respect to the taxpayer.

(ii) Eligible loss.--For purposes of clause (i), the term “eligible loss” means--

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(I) in the case of an individual, losses of property arising from fire, storm, shipwreck, or other casualty, or from theft,

(II) in the case of a taxpayer which is a small business, net operating losses attributable to federally declared disasters (as defined by section 165(i)(5) and

(III) in the case of a taxpayer engaged in the trade or business of farming (as defined in section 263A(e)(4)), net operating losses attributable to such federally declared disasters.

Such term shall not include any farming loss (as defined in subsection (h)).

(iii) Small business.--For purposes of this subparagraph, the term "small business" means a corporation or partnership which meets the gross receipts test of section 448(c) for the taxable year in which the loss arose (or, in the case of a sole proprietorship, which would meet such test if such proprietorship were a corporation).

(iv) Coordination with paragraph (2).--For purposes of applying paragraph (2), an eligible loss for any taxable year shall be treated in a manner similar to the manner in which a specified liability loss is treated.

(F) Farming losses.--In the case of a taxpayer which has a farming loss (as defined in subsection (h)) for a taxable year, such farming loss shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss.

[(G) Redesignated (F)]

[**(H) to (J) Repealed.** Pub.L. 113-295, Div. A, Title II, § 221(a)(30)(A)(i), Dec. 19, 2014, 128 Stat. 4041]

(2) Amount of carrybacks and carryovers.--The entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed--

(A) with the modifications specified in subsection (d) other than paragraphs (1), (4), and (5) thereof, and

(B) by determining the amount of the net operating loss deduction without regard to the net operating loss for the loss year or for any taxable year thereafter,

and the taxable income so computed shall not be considered to be less than zero.

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(3) Election to waive carryback.--Any taxpayer entitled to a carryback period under paragraph (1) may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year. Such election shall be made in such manner as may be prescribed by the Secretary, and shall be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss for which the election is to be in effect. Such election, once made for any taxable year, shall be irrevocable for such taxable year.

(c) Net operating loss defined.--For purposes of this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

(d) Modifications.--The modifications referred to in this section are as follows:

(1) Net operating loss deduction.--No net operating loss deduction shall be allowed.

(2) Capital gains and losses of taxpayers other than corporations.--In the case of a taxpayer other than a corporation--

(A) the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includable on account of gains from sales or exchanges of capital assets; and

(B) the exclusion provided by section 1202 shall not be allowed.

(3) Deduction for personal exemptions.--No deduction shall be allowed under section 151 (relating to personal exemptions). No deduction in lieu of any such deduction shall be allowed.

(4) Nonbusiness deductions of taxpayers other than corporations.--In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence--

(A) any gain or loss from the sale or other disposition of--

(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

(ii) real property used in the trade or business,

shall be treated as attributable to the trade or business;

(B) the modifications specified in paragraphs (1), (2)(B), and (3) shall be taken into account;

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(C) any deduction for casualty or theft losses allowable under paragraph (2) or (3) of section 165(c) shall be treated as attributable to the trade or business; and

(D) any deduction allowed under section 404 to the extent attributable to contributions which are made on behalf of an individual who is an employee within the meaning of section 401(c)(1) shall not be treated as attributable to the trade or business of such individual.

(5) Computation of deduction for dividends received.--The deductions allowed by section [1] 243 (relating to dividends received by corporations) and 245 (relating to dividends received from certain foreign corporations) shall be computed without regard to section 246(b) (relating to limitation on aggregate amount of deductions).

(6) Modifications related to real estate investment trusts.--In the case of any taxable year for which part II of subchapter M (relating to real estate investment trusts) applies to the taxpayer--

(A) the net operating loss for such taxable year shall be computed by taking into account the adjustments described in section 857(b)(2) (other than the deduction for dividends paid described in section 857(b)(2)(B)); and

(B) where such taxable year is a "prior taxable year" referred to in paragraph (2) of subsection (b), the term "taxable income" in such paragraph shall mean "real estate investment trust taxable income" (as defined in section 857(b)(2)).

(7) Manufacturing deduction.--The deduction under section 199 shall not be allowed.

(e) Law applicable to computations.--In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the law applicable to such other taxable year.

(f) Rules relating to specified liability loss.--For purposes of this section--

(1) In general.--The term "specified liability loss" means the sum of the following amounts to the extent taken into account in computing the net operating loss for the taxable year:

(A) Any amount allowable as a deduction under section 162 or 165 which is attributable to--

(i) product liability, or

(ii) expenses incurred in the investigation or settlement of, or opposition to, claims against the taxpayer on account of product liability.

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(B)(i) Any amount allowable as a deduction under this chapter (other than section 468(a)(1) or 468A(a)) which is in satisfaction of a liability under a Federal or State law requiring--

(I) the reclamation of land,

(II) the decommissioning of a nuclear power plant (or any unit thereof),

(III) the dismantlement of a drilling platform,

(IV) the remediation of environmental contamination, or

(V) a payment under any workers compensation act (within the meaning of section 461(h)(2)(C)(i)).

(ii) A liability shall be taken into account under this subparagraph only if--

(I) the act (or failure to act) giving rise to such liability occurs at least 3 years before the beginning of the taxable year, and

(II) the taxpayer used an accrual method of accounting throughout the period or periods during which such act (or failure to act) occurred.

(2) Limitation.--The amount of the specified liability loss for any taxable year shall not exceed the amount of the net operating loss for such taxable year.

(3) Special rule for nuclear powerplants.--Except as provided in regulations prescribed by the Secretary, that portion of a specified liability loss which is attributable to amounts incurred in the decommissioning of a nuclear powerplant (or any unit thereof) may, for purposes of subsection (b)(1)(C), be carried back to each of the taxable years during the period--

(A) beginning with the taxable year in which such plant (or unit thereof) was placed in service, and

(B) ending with the taxable year preceding the loss year.

(4) Product liability.--The term "product liability" means--

(A) liability of the taxpayer for damages on account of physical injury or emotional harm to individuals, or damage to or loss of the use of property, on account of any defect in any product which is manufactured, leased, or sold by the taxpayer, but only if

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(B) such injury, harm, or damage arises after the taxpayer has completed or terminated operations with respect to, and has relinquished possession of, such product.

(5) Coordination with subsection (b)(2).--For purposes of applying subsection (b)(2), a specified liability loss for any taxable year shall be treated as a separate net operating loss for such taxable year to be taken into account after the remaining portion of the net operating loss for such taxable year.

(6) Election.--Any taxpayer entitled to a 10-year carryback under subsection (b)(1)(C) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to subsection (b)(1)(C). Such election shall be made in such manner as may be prescribed by the Secretary and shall be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss. Such election, once made for any taxable year, shall be irrevocable for that taxable year.

(g) Corporate equity reduction interest losses.--For purposes of this section--

(1) In general.--The term "corporate equity reduction interest loss" means, with respect to any loss limitation year, the excess (if any) of--

(A) the net operating loss for such taxable year, over

(B) the net operating loss for such taxable year determined without regard to any allocable interest deductions otherwise taken into account in computing such loss.

(2) Allocable interest deductions.--

(A) In general.--The term "allocable interest deductions" means deductions allowed under this chapter for interest on the portion of any indebtedness allocable to a corporate equity reduction transaction.

(B) Method of allocation.--Except as provided in regulations and subparagraph (E), indebtedness shall be allocated to a corporate equity reduction transaction in the manner prescribed under clause (ii) of section 263A(f)(2)(A) (without regard to clause (i) thereof).

(C) Allocable deductions not to exceed interest increases.--Allocable interest deductions for any loss limitation year shall not exceed the excess (if any) of--

(i) the amount allowable as a deduction for interest paid or accrued by the taxpayer during the loss limitation year, over

(ii) the average of such amounts for the 3 taxable years preceding the taxable year in which the corporate equity reduction transaction occurred.

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(D) De minimis rule.--A taxpayer shall be treated as having no allocable interest deductions for any taxable year if the amount of such deductions (without regard to this subparagraph) is less than $1,000,000.

(E) Special rule for certain unforeseeable events.--If an unforeseeable extraordinary adverse event occurs during a loss limitation year but after the corporate equity reduction transaction--

(i) indebtedness shall be allocated in the manner described in subparagraph (B) to unreimbursed costs paid or incurred in connection with such event before being allocated to the corporate equity reduction transaction, and

(ii) the amount determined under subparagraph (C)(i) shall be reduced by the amount of interest on indebtedness described in clause (i).

[**(F) Repealed.** Pub.L. 113-295, Div. A, Title II, § 221(a)(30)(B)(vi), Dec. 19, 2014, 128 Stat. 4041]

(3) Corporate equity reduction transaction.--

(A) In general.--The term "corporate equity reduction transaction" means--

(i) a major stock acquisition, or

(ii) an excess distribution.

(B) Major stock acquisition.--

(i) In general.--The term "major stock acquisition" means the acquisition by a corporation pursuant to a plan of such corporation (or any group of persons acting in concert with such corporation) of stock in another corporation representing 50 percent or more (by vote or value) of the stock in such other corporation.

(ii) Exception.--The term "major stock acquisition" does not include a qualified stock purchase (within the meaning of section 338) to which an election under section 338 applies.

(C) Excess distribution.--The term "excess distribution" means the excess (if any) of--

(i) the aggregate distributions (including redemptions) made during a taxable year by a corporation with respect to its stock, over

(ii) the greater of--

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(I) 150 percent of the average of such distributions during the 3 taxable years immediately preceding such taxable year, or

(II) 10 percent of the fair market value of the stock of such corporation as of the beginning of such taxable year.

(D) Rules for applying subparagraph (B).--For purposes of subparagraph (B)--

(i) Plans to acquire stock.--All plans referred to in subparagraph (B) by any corporation (or group of persons acting in concert with such corporation) with respect to another corporation shall be treated as 1 plan.

(ii) Acquisitions during 24-month period.--All acquisitions during any 24-month period shall be treated as pursuant to 1 plan.

(E) Rules for applying subparagraph (C).--For purposes of subparagraph (C)--

(i) Certain preferred stock disregarded.--Stock described in section 1504(a)(4), and distributions (including redemptions) with respect to such stock, shall be disregarded.

(ii) Issuance of stock.--The amounts determined under clauses (i) and (ii)(I) of subparagraph (C) shall be reduced by the aggregate amount of stock issued by the corporation during the applicable period in exchange for money or property other than stock in the corporation.

(4) Other rules.--

(A) Ordering rule.--For purposes of paragraph (1), in determining the allocable interest deductions taken into account in computing the net operating loss for any taxable year, taxable income for such taxable year shall be treated as having been computed by taking allocable interest deductions into account after all other deductions.

(B) Coordination with subsection (b)(2).--For purposes of subsection (b)(2)--

(i) a corporate equity reduction interest loss shall be treated in a manner similar to the manner in which a specified liability loss is treated, and

(ii) in determining the net operating loss deduction for any prior taxable year referred to in the 3rd sentence of subsection (b)(2), the portion of any net operating loss which may not be carried to such taxable year under subsection (b)(1)(D) shall not be taken into account.

(C) Members of affiliated groups.--Except as provided by regulations, all members of an affiliated group filing a consolidated return under section 1501 shall be treated as 1 taxpayer for purposes of this subsection and subsection (b)(1)(D).

(5) Regulations.--The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations--

(A) for applying this subsection to successor corporations and in cases where a taxpayer becomes, or ceases to be, a member of an affiliated group filing a consolidated return under section 1501,

(B) to prevent the avoidance of this subsection through related parties, pass-through entities, and intermediaries, and

(C) for applying this subsection where more than 1 corporation is involved in a corporate equity reduction transaction.

(h) Rules relating to farming losses.--For purposes of this section--

(1) In general.--The term "farming loss" means the lesser of--

(A) the amount which would be the net operating loss for the taxable year if only income and deductions attributable to farming businesses (as defined in section 263A(e)(4)) are taken into account, or

(B) the amount of the net operating loss for such taxable year.

(2) Coordination with subsection (b)(2).--For purposes of applying subsection (b)(2), a farming loss for any taxable year shall be treated in a manner similar to the manner in which a specified liability loss is treated.

(3) Election.--Any taxpayer entitled to a 5-year carryback under subsection (b)(1)(F) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to subsection (b)(1)(F). Such election shall be made in such manner as may be prescribed by the Secretary and shall be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss. Such election, once made for any taxable year, shall be irrevocable for such taxable year.

(i) Cross references.--

(1) For treatment of net operating loss carryovers in certain corporate acquisitions, see section 381.

(2) For special limitation on net operating loss carryovers in case of a corporate change of ownership, see section 382.

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[**(j) Repealed.** Pub.L. 113-295, Div. A, Title II, § 221(a)(30)(A)(ii), Dec. 19, 2014, 128 Stat. 4041]

[**(k) Redesignated (i)**]

CREDIT(S)

(Aug. 16, 1954, c. 736, 68A Stat. 63; Sept. 2, 1958, Pub.L. 85-866, Title I, §§ 14(a), (b), 64(b), Title II, § 203(a), (b), 72 Stat. 1611, 1656, 1678; Sept. 27, 1962, Pub.L. 87-710, § 1, 76 Stat. 648; Oct. 10, 1962, Pub.L. 87-792, § 7(f), 76 Stat. 829; Oct. 11, 1962, Pub.L. 87-794, Title III, § 317(b), 76 Stat. 889; Feb. 26, 1964, Pub.L. 88-272, Title II, §§ 210(a), (b), 234(b)(5), 78 Stat. 47, 48, 115; Dec. 27, 1967, Pub.L. 90-225, § 3(a), 81 Stat. 732; Dec. 30, 1969, Pub.L. 91-172, Title IV, § 431(b), 83 Stat. 619; Jan. 12, 1971, Pub.L. 91-677, § 2(a) to (c), 84 Stat. 2061; Oct. 4, 1976, Pub.L. 94-455, Title VIII, § 806(a) to (c), Title X, § 1052(c)(3), Title XVI, § 1606(b), (c), Title XIX, §§ 1901(a)(29), 1906(b)(13)(A), Title XXI, § 2126, 90 Stat. 1598, 1648, 1755, 1756, 1769, 1834, 1920; May 23, 1977, Pub.L. 95-30, Title I, § 102(b)(2), 91 Stat. 137; Nov. 6, 1978, Pub.L. 95-600, Title III, § 371(a), (b), Title VI, § 601(b)(1), Title VII, §§ 701(d)(1), 703(p)(1), 92 Stat. 2859, 2896, 2900, 2943; Apr. 1, 1980, Pub.L. 96-222, Title I, §§ 103(a)(15), 106(a)(1), (6), (7), 94 Stat. 214, 221; Dec. 24, 1980, Pub.L. 96-595, § 1(a), 94 Stat. 3464; Aug. 13, 1981, Pub.L. 97-34, Title II, § 207(a), 95 Stat. 225; Oct. 19, 1982, Pub.L. 97-354, § 5(a)(22), 96 Stat. 1694; Oct. 25, 1982, Pub.L. 97-362, Title I, § 102(a) to (c), 96 Stat. 1727, 1728; July 18, 1984, Pub.L. 98-369, Title I, §§ 91(d), 177(c), Title IV, § 491(d)(5), Title VII, § 722(a)(4), 98 Stat. 606, 710, 849, 973; Oct. 22, 1986, Pub.L. 99-514, Title I, § 104(b)(4), Title III, § 301(b)(3), Title IX, §§ 901(d)(4)(B), 903(a), (b), Title XIII, § 1303(b)(1), (2), Title XVIII, § 1899A(6), 100 Stat. 2105, 2217, 2380, 2383, 2658, 2958; Nov. 10, 1988, Pub.L. 100-647, Title I, §§ 1003(a)(1), 1009(c), 102 Stat. 3382, 3449; Dec. 19, 1989, Pub.L. 101-239, Title VII, § 7211(a), (b), 103 Stat. 2342, 2343; Nov. 5, 1990, Pub.L. 101-508, Title XI, §§ 11324(a), 11701(d), 11704(a)(2), 11811(a), (b)(1), (2)(A), (3), (4), 104 Stat. 1388-465, 1388-507, 1388-518, 1388-530; Aug. 10, 1993, Pub.L. 103-66, Title XIII, § 13113(d)(1), 107 Stat. 429; Aug. 20, 1996, Pub.L. 104-188, Title I, §§ 1702(h)(2), (16), 1704(t)(5), (30), 110 Stat. 1873, 1874, 1887, 1889; Aug. 5, 1997, Pub.L. 105-34, Title X, § 1082(a), (b), 111 Stat. 950; Oct. 21, 1998, Pub.L. 105-277, Div. J, Title II, § 2013(a) to (c), Title III, § 3004(a), Title IV, §§ 4003(h), 4004(a), 112 Stat. 2681-902, 2681-903, 2681-905, 2681-910; Mar. 9, 2002, Pub.L. 107-147, Title I, § 102(a), (b), Title IV, § 417(8), 116 Stat. 25, 56; Oct. 4, 2004, Pub.L. 108-311, Title IV, § 403(b)(1), 118 Stat. 1187; Aug. 8, 2005, Pub.L. 109-58, Title XIII, § 1311, 119 Stat. 1009; Dec. 21, 2005, Pub.L. 109-135, Title IV, §§ 402(f), 403(a)(17), 119 Stat. 2611, 2619; Oct. 3, 2008, Pub.L. 110-343, Div. C, Title VII, §§ 706(a)(2)(D)(v), (vi), 708(a), (b), (d), 122 Stat. 3922, 3924; Feb. 17, 2009, Pub.L. 111-5, Div. B, Title I, § 1211(a), (b), 123 Stat. 335; Nov. 6, 2009, Pub.L. 111-92, § 13(a), 123 Stat. 2992; Pub.L. 113-295, Div. A, Title II, §§ 211(c)(1)(B), 221(a)(30)(A), (B), (41)(B), Dec. 19, 2014, 128 Stat. 4033, 4041, 4044.)

Notes of Decisions (280)

Footnotes

1 1 So in original. Probably should be ''sections''.

26 U.S.C.A. § 172, 26 USCA § 172

Current through P.L. 114-115 approved 12-28-2015

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KeyCite Yellow Flag - Negative Treatment
Proposed Legislation

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

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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 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 (237)

R.C. § 5717.04, OH ST § 5717.04

Current through Files 1 to 54 of the 131st General Assembly (2015-2016) and 2015 State Issues 1 and 2.

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KeyCite Yellow Flag - Negative Treatment
Proposed Legislation

Baldwin's Ohio Revised Code Annotated
Title LVII. Taxation (Refs & Annos)
Chapter 5733. Corporation Franchise Tax (Refs & Annos)
Net Income

R.C. § 5733.04

5733.04 Definitions

Effective: October 16, 2009
Currentness

As used in this chapter:

(A) "Issued and outstanding shares of stock" applies to nonprofit corporations, as provided in section 5733.01 of the Revised Code, and includes, but is not limited to, membership certificates and other instruments evidencing ownership of an interest in such nonprofit corporations, and with respect to a financial institution that does not have capital stock, "issued and outstanding shares of stock" includes, but is not limited to, ownership interests of depositors in the capital employed in such an institution.

(B) "Taxpayer" means a corporation subject to the tax imposed by section 5733.06 of the Revised Code.

(C) "Resident" means a corporation organized under the laws of this state.

(D) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(E) "Taxable year" means the period prescribed by division (A) of section 5733.031 of the Revised Code upon the net income of which the value of the taxpayer's issued and outstanding shares of stock is determined under division (B) of section 5733.05 of the Revised Code or the period prescribed by division (A) of section 5733.031 of the Revised Code that immediately precedes the date as of which the total value of the corporation is determined under division (A) or (C) of section 5733.05 of the Revised Code.

(F) "Tax year" means the calendar year in and for which the tax imposed by section 5733.06 of the Revised Code is required to be paid.

(G) "Internal Revenue Code" means the "Internal Revenue Code of 1986," 100 Stat. 2085, 26 U.S.C.A. 1, as amended.

(H) "Federal income tax" means the income tax imposed by the Internal Revenue Code.

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(I) Except as provided in section 5733.058 of the Revised Code, "net income" means the taxpayer's taxable income before operating loss deduction and special deductions, as required to be reported for the taxpayer's taxable year under the Internal Revenue Code, subject to the following adjustments:

(1)(a) Deduct any net operating loss incurred in any taxable years ending in 1971 or thereafter, but exclusive of any net operating loss incurred in taxable years ending prior to January 1, 1971. This deduction shall not be allowed in any tax year commencing before December 31, 1973, but shall be carried over and allowed in tax years commencing after December 31, 1973, until fully utilized in the next succeeding taxable year or years in which the taxpayer has net income, but in no case for more than the designated carryover period as described in division (I)(1)(b) of this section. The amount of such net operating loss, as determined under the allocation and apportionment provisions of section 5733.051 and division (B) of section 5733.05 of the Revised Code for the year in which the net operating loss occurs, shall be deducted from net income, as determined under the allocation and apportionment provisions of section 5733.051 and division (B) of section 5733.05 of the Revised Code, to the extent necessary to reduce net income to zero with the remaining unused portion of the deduction, if any, carried forward to the remaining years of the designated carryover period as described in division (I)(1)(b) of this section, or until fully utilized, whichever occurs first.

(b) For losses incurred in taxable years ending on or before December 31, 1981, the designated carryover period shall be the five consecutive taxable years after the taxable year in which the net operating loss occurred. For losses incurred in taxable years ending on or after January 1, 1982, and beginning before August 6, 1997, the designated carryover period shall be the fifteen consecutive taxable years after the taxable year in which the net operating loss occurs. For losses incurred in taxable years beginning on or after August 6, 1997, the designated carryover period shall be the twenty consecutive taxable years after the taxable year in which the net operating loss occurs.

(c) The tax commissioner may require a taxpayer to furnish any information necessary to support a claim for deduction under division (I)(1)(a) of this section and no deduction shall be allowed unless the information is furnished.

(2) Deduct any amount included in net income by application of section 78 or 951 of the Internal Revenue Code, amounts received for royalties, technical or other services derived from sources outside the United States, and dividends received from a subsidiary, associate, or affiliated corporation that neither transacts any substantial portion of its business nor regularly maintains any substantial portion of its assets within the United States. For purposes of determining net foreign source income deductible under division (I)(2) of this section, the amount of gross income from all such sources other than dividend income and income derived by application of section 78 or 951 of the Internal Revenue Code shall be reduced by:

(a) The amount of any reimbursed expenses for personal services performed by employees of the taxpayer for the subsidiary, associate, or affiliated corporation;

(b) Ten per cent of the amount of royalty income and technical assistance fees;

(c) Fifteen per cent of the amount of all other income.

The amounts described in divisions (I)(2)(a) to (c) of this section are deemed to be the expenses attributable to the production of deductible foreign source income unless the taxpayer shows, by clear and convincing evidence, less actual expenses, or the tax commissioner shows, by clear and convincing evidence, more actual expenses.

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(3) Add any loss or deduct any gain resulting from the sale, exchange, or other disposition of a capital asset, or an asset described in section 1231 of the Internal Revenue Code, to the extent that such loss or gain occurred prior to the first taxable year on which the tax provided for in section 5733.06 of the Revised Code is computed on the corporation's net income. For purposes of division (I)(3) of this section, the amount of the prior loss or gain shall be measured by the difference between the original cost or other basis of the asset and the fair market value as of the beginning of the first taxable year on which the tax provided for in section 5733.06 of the Revised Code is computed on the corporation's net income. At the option of the taxpayer, the amount of the prior loss or gain may be a percentage of the gain or loss, which percentage shall be determined by multiplying the gain or loss by a fraction, the numerator of which is the number of months from the acquisition of the asset to the beginning of the first taxable year on which the fee provided in section 5733.06 of the Revised Code is computed on the corporation's net income, and the denominator of which is the number of months from the acquisition of the asset to the sale, exchange, or other disposition of the asset. The adjustments described in this division do not apply to any gain or loss where the gain or loss is recognized by a qualifying taxpayer, as defined in section 5733.0510 of the Revised Code, with respect to a qualifying taxable event, as defined in that section.

(4) Deduct the dividend received deduction provided by section 243 of the Internal Revenue Code.

(5) Deduct any interest or interest equivalent on public obligations and purchase obligations to the extent included in federal taxable income. As used in divisions (I)(5) and (6) 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.

(6) Add any loss or deduct any gain resulting from the sale, exchange, or other disposition of public obligations to the extent included in federal taxable income.

(7) To the extent not otherwise allowed, deduct any dividends or distributions received by a taxpayer from a public utility, excluding an electric company and a combined company, and, for tax years 2005 and thereafter, a telephone company, if the taxpayer owns at least eighty per cent of the issued and outstanding common stock of the public utility. As used in division (I)(7) of this section, "public utility" means a public utility as defined in Chapter 5727. of the Revised Code, whether or not the public utility is doing business in the state.

(8) To the extent not otherwise allowed, deduct any dividends received by a taxpayer from an insurance company, if the taxpayer owns at least eighty per cent of the issued and outstanding common stock of the insurance company. As used in division (I)(8) of this section, "insurance company" means an insurance company that is taxable under Chapter 5725. or 5729. of the Revised Code.

(9) Deduct expenditures for modifying existing buildings or structures to meet American national standards institute standard A-117.1-1961 (R-1971), as amended; provided, that no deduction shall be allowed to the extent that such deduction is not permitted under federal law or under rules of the tax commissioner. Those deductions as are allowed may be taken over a period of five years. The tax commissioner shall adopt rules under Chapter 119. of the Revised Code establishing reasonable limitations on the extent that expenditures for modifying existing buildings or structures are attributable to the purpose of making the buildings or structures accessible to and usable by physically handicapped persons.

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(10) 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 before operating loss deduction and special deductions for the taxable year, had the targeted jobs credit allowed and determined under sections 38, 51, and 52 of the Internal Revenue Code not been in effect.

(11) Deduct net interest 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 the laws of the United States prohibit inclusion of the net interest for purposes of determining the value of the taxpayer's issued and outstanding shares of stock under division (B) of section 5733.05 of the Revised Code. As used in division (I)(11) of this section, "net interest" means interest net of any expenses taken on the federal income tax return that would not have been allowed under section 265 of the Internal Revenue Code if the interest were exempt from federal income tax.

(12)(a) Except as set forth in division (I)(12)(d) of this section, to the extent not included in computing the taxpayer's federal taxable income before operating loss deduction and special deductions, add gains and deduct losses from direct or indirect sales, exchanges, or other dispositions, made by a related entity who is not a taxpayer, of the taxpayer's indirect, beneficial, or constructive investment in the stock or debt of another entity, unless the gain or loss has been included in computing the federal taxable income before operating loss deduction and special deductions of another taxpayer with a more closely related investment in the stock or debt of the other entity. The amount of gain added or loss deducted shall not exceed the product obtained by multiplying such gain or loss by the taxpayer's proportionate share, directly, indirectly, beneficially, or constructively, of the outstanding stock of the related entity immediately prior to the direct or indirect sale, exchange, or other disposition.

(b) Except as set forth in division (I)(12)(e) of this section, to the extent not included in computing the taxpayer's federal taxable income before operating loss deduction and special deductions, add gains and deduct losses from direct or indirect sales, exchanges, or other dispositions made by a related entity who is not a taxpayer, of intangible property other than stock, securities, and debt, if such property was owned, or used in whole or in part, at any time prior to or at the time of the sale, exchange, or disposition by either the taxpayer or by a related entity that was a taxpayer at any time during the related entity's ownership or use of such property, unless the gain or loss has been included in computing the federal taxable income before operating loss deduction and special deductions of another taxpayer with a more closely related ownership or use of such intangible property. The amount of gain added or loss deducted shall not exceed the product obtained by multiplying such gain or loss by the taxpayer's proportionate share, directly, indirectly, beneficially, or constructively, of the outstanding stock of the related entity immediately prior to the direct or indirect sale, exchange, or other disposition.

(c) As used in division (I)(12) of this section, "related entity" means those entities described in divisions (I)(12)(c)(i) to (iii) of this section:

(i) An individual stockholder, or a member of the stockholder's family enumerated in section 318 of the Internal Revenue Code, if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially, or constructively, in the aggregate, at least fifty per cent of the value of the taxpayer's outstanding stock;

(ii) A stockholder, or a stockholder's partnership, estate, trust, or corporation, if the stockholder and the stockholder's partnerships, estates, trusts, and corporations own directly, indirectly, beneficially, or constructively, in the aggregate, at least fifty per cent of the value of the taxpayer's outstanding stock;

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(iii) A corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under division (I)(12)(c)(iv) of this section, if the taxpayer owns, directly, indirectly, beneficially, or constructively, at least fifty per cent of the value of the corporation's outstanding stock.

(iv) The attribution rules of section 318 of the Internal Revenue Code apply for purposes of determining whether the ownership requirements in divisions (I)(12)(c)(i) to (iii) of this section have been met.

(d) For purposes of the adjustments required by division (I)(12)(a) of this section, the term "investment in the stock or debt of another entity" means only those investments where the taxpayer and the taxpayer's related entities directly, indirectly, beneficially, or constructively own, in the aggregate, at any time during the twenty-four month period commencing one year prior to the direct or indirect sale, exchange, or other disposition of such investment at least fifty per cent or more of the value of either the outstanding stock or such debt of such other entity.

(e) For purposes of the adjustments required by division (I)(12)(b) of this section, the term "related entity" excludes all of the following:

(i) Foreign corporations as defined in section 7701 of the Internal Revenue Code;

(ii) Foreign partnerships as defined in section 7701 of the Internal Revenue Code;

(iii) Corporations, partnerships, estates, and trusts created or organized in or under the laws of the Commonwealth of Puerto Rico or any possession of the United States;

(iv) Foreign estates and foreign trusts as defined in section 7701 of the Internal Revenue Code.

The exclusions described in divisions (I)(12)(e)(i) to (iv) of this section do not apply if the corporation, partnership, estate, or trust is described in any one of divisions (C)(1) to (5) of section 5733.042 of the Revised Code.

(f) Nothing in division (I)(12) of this section shall require or permit a taxpayer to add any gains or deduct any losses described in divisions (I)(12)(f)(i) and (ii) of this section:

(i) Gains or losses recognized for federal income tax purposes by an individual, estate, or trust without regard to the attribution rules described in division (I)(12)(c) of this section;

(ii) A related entity's gains or losses described in division (I)(12)(b) of this section if the taxpayer's ownership of or use of such intangible property was limited to a period not exceeding nine months and was attributable to a transaction or a series of transactions executed in accordance with the election or elections made by the taxpayer or a related entity pursuant to section 338 of the Internal Revenue Code.

(13) Any adjustment required by section 5733.042 of the Revised Code.

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(14) Add any amount claimed as a credit under section 5733.0611 of the Revised Code to the extent that such amount satisfies either of the following:

(a) It was deducted or excluded from the computation of the corporation's taxable income before operating loss deduction and special deductions as required to be reported for the corporation's taxable year under the Internal Revenue Code;

(b) It resulted in a reduction of the corporation's taxable income before operating loss deduction and special deductions as required to be reported for any of the corporation's taxable years under the Internal Revenue Code.

(15) 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 (I)(15) of this section.

(16) Any adjustment required by section 5733.0510 or 5733.0511 of the Revised Code.

(17)(a)(i) Add five-sixths of the amount of depreciation expense allowed under subsection (k) of section 168 of the Internal Revenue Code, [1] including a person's proportionate or distributive share of the amount of depreciation expense allowed by that subsection to any pass-through entity in which the person has direct or indirect ownership.

(ii) Add five-sixths of the amount of qualifying section 179 depreciation expense, including a person's proportionate or distributive share of the amount of qualifying section 179 depreciation expense allowed to any pass-through entity in which the person has a direct or indirect ownership. For the purposes of this division, “qualifying section 179 depreciation expense” means the difference between (I) the amount of depreciation expense directly or indirectly allowed to the taxpayer under section 179 of the Internal Revenue 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.

The tax commissioner, under procedures established by the commissioner, may waive the add-backs related to a pass-through entity if the person owns, directly or indirectly, less than five per cent of the pass-through entity.

(b) Nothing in division (I)(17) of this section shall be construed to adjust or modify the adjusted basis of any asset.

(c) To the extent the add-back is attributable to property generating income or loss allocable under section 5733.051 of the Revised Code, the add-back shall be allocated to the same location as the income or loss generated by that property. Otherwise, the add-back shall be apportioned, subject to division (B)(2)(d) of section 5733.05 of the Revised Code.

(18)(a) If a person is required to make the add-back under division (I)(17)(a) of this section for a tax year, the person shall deduct one-fifth of the amount added back for each of the succeeding five tax years.

(b) If the amount deducted under division (I)(18)(a) of this section is attributable to an add-back allocated under division (I)(17)(c) of this section, the amount deducted shall be allocated to the same location. Otherwise, the amount shall be apportioned

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using the apportionment factors for the taxable year in which the deduction is taken, subject to division (B)(2)(d) of section 5733.05 of the Revised Code.

(J) Except as otherwise expressly provided or clearly appearing from the context, any term used in this chapter has the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes. Any reference in this chapter to the Internal Revenue Code includes other laws of the United States relating to federal income taxes.

(K) "Financial institution" has the meaning given by section 5725.01 of the Revised Code but does not include a production credit association as described in 85 Stat. 597, 12 U.S.C.A. 2091.

(L)(1) A "qualifying holding company" is any corporation satisfying all of the following requirements:

(a) Subject to divisions (L)(2) and (3) of this section, the net book value of the corporation's intangible assets is greater than or equal to ninety per cent of the net book value of all of its assets and at least fifty per cent of the net book value of all of its assets represents direct or indirect investments in the equity of, loans and advances to, and accounts receivable due from related members;

(b) At least ninety per cent of the corporation's gross income for the taxable year is attributable to the following:

(i) The maintenance, management, ownership, acquisition, use, and disposition of its intangible property, its aircraft the use of which is not subject to regulation under 14 C.F.R. part 121 or part 135, and any real property described in division (L)(2)(c) of this section;

(ii) The collection and distribution of income from such property.

(c) The corporation is not a financial institution on the last day of the taxable year ending prior to the first day of the tax year;

(d) The corporation's related members make a good faith and reasonable effort to make timely and fully the adjustments required by division (D) of section 5733.05 of the Revised Code and to pay timely and fully all uncontested taxes, interest, penalties, and other fees and charges imposed under this chapter;

(e) Subject to division (L)(4) of this section, the corporation elects to be treated as a qualifying holding company for the tax year.

A corporation otherwise satisfying divisions (L)(1)(a) to (e) of this section that does not elect to be a qualifying holding company is not a qualifying holding company for the purposes of this chapter.

(2)(a)(i) For purposes of making the ninety per cent computation under division (L)(1)(a) of this section, the net book value of the corporation's assets shall not include the net book value of aircraft or real property described in division (L)(1)(b)(i) of this section.

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(ii) For purposes of making the fifty per cent computation under division (L)(1)(a) of this section, the net book value of assets shall include the net book value of aircraft or real property described in division (L)(1)(b)(i) of this section.

(b)(i) As used in division (L) of this section, "intangible asset" includes, but is not limited to, the corporation's direct interest in each pass-through entity only if at all times during the corporation's taxable year ending prior to the first day of the tax year the corporation's and the corporation's related members' combined direct and indirect interests in the capital or profits of such pass-through entity do not exceed fifty per cent. If the corporation's interest in the pass-through entity is an intangible asset for that taxable year, then the distributive share of any income from the pass-through entity shall be income from an intangible asset for that taxable year.

(ii) If a corporation's and the corporation's related members' combined direct and indirect interests in the capital or profits of a pass-through entity exceed fifty per cent at any time during the corporation's taxable year ending prior to the first day of the tax year, "intangible asset" does not include the corporation's direct interest in the pass-through entity, and the corporation shall include in its assets its proportionate share of the assets of any such pass-through entity and shall include in its gross income its distributive share of the gross income of such pass-through entity in the same form as was earned by the pass-through entity.

(iii) A pass-through entity's direct or indirect proportionate share of any other pass-through entity's assets shall be included for the purpose of computing the corporation's proportionate share of the pass-through entity's assets under division (L)(2)(b)(ii) of this section, and such pass-through entity's distributive share of any other pass-through entity's gross income shall be included for purposes of computing the corporation's distributive share of the pass-through entity's gross income under division (L)(2)(b)(ii) of this section.

(c) For the purposes of divisions (L)(1)(b)(i), (1)(b)(ii), (2)(a)(i), and (2)(a)(ii) of this section, real property is described in division (L)(2)(c) of this section only if all of the following conditions are present at all times during the taxable year ending prior to the first day of the tax year:

(i) The real property serves as the headquarters of the corporation's trade or business, or is the place from which the corporation's trade or business is principally managed or directed;

(ii) Not more than ten per cent of the value of the real property and not more than ten per cent of the square footage of the building or buildings that are part of the real property is used, made available, or occupied for the purpose of providing, acquiring, transferring, selling, or disposing of tangible property or services in the normal course of business to persons other than related members, the corporation's employees and their families, and such related members' employees and their families.

(d) As used in division (L) of this section, "related member" has the same meaning as in division (A)(6) of section 5733.042 of the Revised Code without regard to division (B) of that section.

(3) The percentages described in division (L)(1)(a) of this section shall be equal to the quarterly average of those percentages as calculated during the corporation's taxable year ending prior to the first day of the tax year.

(4) With respect to the election described in division (L)(1)(e) of this section:

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(a) The election need not accompany a timely filed report;

(b) The election need not accompany the report; rather, the election may accompany a subsequently filed but timely application for refund and timely amended report, or a subsequently filed but timely petition for reassessment;

(c) The election is not irrevocable;

(d) The election applies only to the tax year specified by the corporation;

(e) The corporation's related members comply with division (L)(1)(d) of this section.

Nothing in division (L)(4) of this section shall be construed to extend any statute of limitations set forth in this chapter.

(M) "Qualifying controlled group" means two or more corporations that satisfy the ownership and control requirements of division (A) of section 5733.052 of the Revised Code.

(N) "Limited liability company" means any limited liability company formed under Chapter 1705. of the Revised Code or under the laws of any other state.

(O) "Pass-through entity" means a corporation that has made an election under subchapter S of Chapter 1 of Subtitle A of the Internal Revenue Code for its taxable year under that code, or a partnership, limited liability company, or any other person, other than an individual, trust, or estate, if the partnership, limited liability company, or other person is not classified for federal income tax purposes as an association taxed as a corporation.

(P) "Electric company," "combined company," and "telephone company" have the same meanings as in section 5727.01 of the Revised Code.

(Q) "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 personal property, and intangible personal 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.

(R) "Nonbusiness income" means all income other than business income.

CREDIT(S)

(2009 H 1, eff. 10-16-09; 2004 H 362, eff. 12-30-04; 2003 H 95, eff. 9-26-03; 2002 S 261, eff. 6-5-02; 2002 S 200, eff. 9-6-02; 1999 H 471, eff. 7-1-00; 1999 S 3, eff. 7-6-99; 1998 H 770, eff. 9-16-98; 1997 H 408, eff. 10-1-97; 1997 H 215, eff. 9-29-97; 1991 H 298, eff. 7-26-91; 1989 H 111; 1988 S 386; 1987 H 171; 1986 H 428, H 1053; 1984 H 250; 1983 H 291; 1981 H 694; 1980 H 653; 1976 S 162; 1975 H 1; 1974 S 277; 1973 H 95; 1971 H 475; 1953 H 1; GC 5498-1)

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Notes of Decisions (52)

Footnotes

1 26 U.S.C.A. § 168(k).

R.C. § 5733.04, OH ST § 5733.04

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End of Document

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R.C. § 5751.53

5751.53 Priority of credits

Currentness

(A) As used in this section:

(1) "Net income" and "taxable year" have the same meanings as in section 5733.04 of the Revised Code.

(2) "Franchise tax year" means "tax year" as defined in section 5733.04 of the Revised Code.

(3) "Deductible temporary differences" and "taxable temporary differences" have the same meanings as those terms have for purposes of paragraph 13 of the statement of financial accounting standards, number 109.

(4) "Qualifying taxpayer" means a taxpayer under this chapter that has a qualifying Ohio net operating loss carryforward equal to or greater than the qualifying amount.

(5) "Qualifying Ohio net operating loss carryforward" means an Ohio net operating loss carryforward that the taxpayer could deduct in whole or in part for franchise tax year 2006 under section 5733.04 of the Revised Code but for the application of division (H) of this section. A qualifying Ohio net operating loss carryforward shall not exceed the amount of loss carryforward from franchise tax year 2005 as reported by the taxpayer either on a franchise tax report for franchise tax year 2005 pursuant to section 5733.02 of the Revised Code or on an amended franchise tax report prepared in good faith for such year and filed before July 1, 2006.

(6) "Disallowed Ohio net operating loss carryforward" means the lesser of the amounts described in division (A)(6)(a) or (b) of this section, but the amounts described in divisions (A)(6)(a) and (b) of this section shall each be reduced by the qualifying amount.

(a) The qualifying taxpayer's qualifying Ohio net operating loss carryforward;

(b) The Ohio net operating loss carryforward amount that the qualifying taxpayer used to compute the related deferred tax asset reflected on its books and records on the last day of its taxable year ending in 2004, adjusted for return to accrual, but this amount shall be reduced by the qualifying related valuation allowance amount. For the purposes of this section, the "qualifying related valuation allowance amount" is the amount of Ohio net operating loss reflected in the qualifying taxpayer's computation of the valuation allowance account, as shown on its books and records on the last day of its taxable year ending in 2004, with respect to the deferred tax asset relating to its Ohio net operating loss carryforward amount.

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(7) “Other net deferred tax items apportioned to this state” is the product of (a) the amount of other net deferred tax items and (b) the fraction described in division (B)(2) of section 5733.05 for the qualifying taxpayer's franchise tax year 2005.

(8)(a) Subject to divisions (A)(8)(b) to (d) of this section, the “amount of other net deferred tax items” is the difference between (i) the qualifying taxpayer's deductible temporary differences, net of related valuation allowance amounts, shown on the qualifying taxpayer's books and records on the last day of its taxable year ending in 2004, and (ii) the qualifying taxpayer's taxable temporary differences as shown on those books and records on that date. The amount of other net deferred tax items may be less than zero.

(b) For the purposes of computing the amount of the qualifying taxpayer's other net deferred tax items described in division (A)(8)(a) of this section, any credit carryforward allowed under Chapter 5733. of the Revised Code shall be excluded from the amount of deductible temporary differences to the extent such credit carryforward amount, net of any related valuation allowance amount, is otherwise included in the qualifying taxpayer's deductible temporary differences, net of related valuation allowance amounts, shown on the qualifying taxpayer's books and records on the last day of the qualifying taxpayer's taxable year ending in 2004.

(c) No portion of the disallowed Ohio net operating loss carryforward shall be included in the computation of the amount of the qualifying taxpayer's other net deferred tax items described in division (A)(8)(a) of this section.

(d) In no event shall the amount of other net deferred tax items apportioned to this state exceed twenty-five per cent of the qualifying Ohio net operating loss carryforward.

(9) “Amortizable amount” means:

(a) If the qualifying taxpayer's other net deferred tax items apportioned to this state is equal to or greater than zero, eight per cent of the sum of the qualifying taxpayer's disallowed Ohio net operating loss carryforward and the qualifying taxpayer's other net deferred tax items apportioned to this state;

(b) If the amount of the qualifying taxpayer's other net deferred tax items apportioned to this state is less than zero and if the absolute value of the amount of qualifying taxpayer's other net deferred tax items apportioned to this state is less than the qualifying taxpayer's disallowed net operating loss, eight per cent of the difference between the qualifying taxpayer's disallowed net operating loss carryforward and the absolute value of the qualifying taxpayer's other net deferred tax items apportioned to this state;

(c) If the amount of the qualifying taxpayer's other net deferred tax items apportioned to this state is less than zero and if the absolute value of the amount of qualifying taxpayer's other net deferred tax items apportioned to this state is equal to or greater than the qualifying taxpayer's disallowed net operating loss, zero.

(10) “Books and records” means the qualifying taxpayer's books, records, and all other information, all of which the qualifying taxpayer maintains and uses to prepare and issue its financial statements in accordance with generally accepted accounting principles.

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(11)(a) Except as modified by division (A)(11)(b) of this section, "qualifying amount" means fifty million dollars per person.

(b) If for franchise tax year 2005 the person was a member of a combined franchise tax report, as provided by section 5733.052 of the Revised Code, the "qualifying amount" is, in the aggregate, fifty million dollars for all members of that combined franchise tax report, and for purposes of divisions (A)(6)(a) and (b) of this section, those members shall allocate to each member any portion of the fifty million dollar amount. The total amount allocated to the members who are qualifying taxpayers shall equal fifty million dollars.

(B) For each calendar period beginning prior to January 1, 2030, there is hereby allowed a nonrefundable tax credit against the tax levied each year by this chapter on each qualifying taxpayer, on each consolidated elected taxpayer having one or more qualifying taxpayers as a member, and on each combined taxpayer having one or more qualifying taxpayers as a member. The credit shall be claimed in the order specified in section 5751.98 of the Revised Code and is allowed only to reduce the first one-half of any tax remaining after allowance of the credits that precede it in section 5751.98 of the Revised Code. No credit under division (B) of this section shall be allowed against the second one-half of such remaining tax.

Except as otherwise limited by divisions (C) and (D) of this section, the maximum amount of the nonrefundable credit that may be used against the first one-half of the remaining tax for each calendar year is as follows:

(1) For calendar year 2010, ten per cent of the amortizable amount;

(2) For calendar year 2011, twenty per cent of the amortizable amount, less all amounts previously used;

(3) For calendar year 2012, thirty per cent of the amortizable amount, less all amounts previously used;

(4) For calendar year 2013, forty per cent of the amortizable amount, less all amounts previously used;

(5) For calendar year 2014, fifty per cent of the amortizable amount, less all amounts previously used;

(6) For calendar year 2015, sixty per cent of the amortizable amount, less all amounts previously used;

(7) For calendar year 2016, seventy per cent of the amortizable amount, less all amounts previously used;

(8) For calendar year 2017, eighty per cent of the amortizable amount, less all amounts previously used;

(9) For calendar year 2018, ninety per cent of the amortizable amount, less all amounts previously used;

(10) For each of calendar years 2019 through 2029, one hundred per cent of the amortizable amount, less all amounts used in all previous years.

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In no event shall the cumulative credit used for calendar years 2010 through 2029 exceed one hundred per cent of the amortizable amount.

(C)(1) Except as otherwise set forth in division (C)(2) of this section, a refundable credit is allowed in calendar year 2030 for any portion of the qualifying taxpayer's amortizable amount that is not used in accordance with division (B) of this section against the tax levied by this chapter on all taxpayers.

(2) Division (C)(1) of this section shall not apply and no refundable credit shall be available to any person if during any portion of the calendar year 2030 the person is not subject to the tax imposed by this chapter.

(D) Not later than June 30, 2006, each qualifying taxpayer, consolidated elected taxpayer, or combined taxpayer that will claim for any year the credit allowed in divisions (B) and (C) of this section shall file with the tax commissioner a report setting forth the amortizable amount available to such taxpayer and all other related information that the commissioner, by rule, requires. If the taxpayer does not timely file the report or fails to provide timely all information required by this division, the taxpayer is precluded from claiming any credit amounts described in divisions (B) and (C) of this section. Unless extended by mutual consent, the tax commissioner may, until June 30, 2010, audit the accuracy of the amortizable amount available to each taxpayer that will claim the credit, and adjust the amortizable amount or, if appropriate, issue any assessment or final determination, as applicable, necessary to correct any errors found upon audit.

(E) For the purpose of calculating the amortizable amount, if the tax commissioner ascertains that any portion of that amount is the result of a sham transaction as described in section 5703.56 of the Revised Code, the commissioner shall reduce the amortizable amount by two times the adjustment.

(F) If one entity transfers all or a portion of its assets and equity to another entity as part of an entity organization or reorganization or subsequent entity organization or reorganization for which no gain or loss is recognized in whole or in part for federal income tax purposes under the Internal Revenue Code, the credits allowed by this section shall be computed in a manner consistent with that used to compute the portion, if any, of federal net operating losses allowed to the respective entities under the Internal Revenue Code. The tax commissioner may prescribe forms or rules for making the computations required by this division.

(G)(1) Except as provided in division (F) of this section, no person shall pledge, collateralize, hypothecate, assign, convey, sell, exchange, or otherwise dispose of any or all tax credits, or any portion of any or all tax credits allowed under this section.

(2) No credit allowed under this section is subject to execution, attachment, lien, levy, or other judicial proceeding.

(H)(1)(a) Except as set forth in division (H)(1)(b) of this section and notwithstanding division (I)(1) of section 5733.04 of the Revised Code to the contrary, each person timely and fully complying with the reporting requirements set forth in division (D) of this section shall not claim, and shall not be entitled to claim, any deduction or adjustment for any Ohio net operating loss carried forward to any one or more franchise tax years after franchise tax year 2005.

(b) Division (H)(1)(a) of this section applies only to the portion of the Ohio net operating loss represented by the disallowed Ohio net operating loss carryforward.

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(2) Notwithstanding division (I) of section 5733.04 of the Revised Code to the contrary, with respect to all franchise tax years after franchise tax year 2005, each person timely and fully complying with the reporting requirements set forth in division (D) of this section shall not claim, and shall not be entitled to claim, any deduction, exclusion, or adjustment with respect to deductible temporary differences reflected on the person's books and records on the last day of its taxable year ending in 2004.

(3)(a) Except as set forth in division (H)(3)(b) of this section and notwithstanding division (I) of section 5733.04 of the Revised Code to the contrary, with respect to all franchise tax years after franchise tax year 2005, each person timely and fully complying with the reporting requirements set forth in division (D) of this section shall exclude from Ohio net income all taxable temporary differences reflected on the person's books and records on the last day of its taxable year ending in 2004.

(b) In no event shall the exclusion provided by division (H)(3)(a) of this section for any franchise tax year exceed the amount of the taxable temporary differences otherwise included in Ohio net income for that year.

(4) Divisions (H)(2) and (3) of this section shall apply only to the extent such items were used in the calculations of the credit provided by this section.

CREDIT(S)

(2006 H 530, eff. 3-30-06; 2005 H 66, eff. 6-30-05)

Notes of Decisions (1)

R.C. § 5751.53, OH ST § 5751.53
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