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To: Warren Russell, Ohio School Boards Association

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Re.: Columbia Gas Decision

The Columbia Gas Decision

On August 6, 1999, the Board of Tax Appeals (BTA) issued its decision in an appeal by Columbia Gas Company of the Tax Commissioner's assessment of personal property taxes for tax years 1993, 1994, and 1995. Because Columbia's appeal depended entirely upon the company's claim that the Tax Commissioner's assessment violated the Equal Protection and Due Process Clauses of the U.S. Constitution, the BTA had no jurisdiction to rule on the case. The Ohio Supreme Court has held that only a Court can rule on constitutional questions. The BTA is not a Court. Therefore, the BTA cannot rule on a tax case to the extent that the taxpayers raises constitutional issues. Since the BTA could not rule on the case, it had no choice other than to affirm the original assessment by the Tax Commissioner.

In its appeal to the BTA, Columbia Gas raised the following three issues:

- 1) By assessing material, supplies, furniture, and computer equipment at 88% and assessing general business 25% for the same items, the assessment of Columbia Gas violated the Equal Protection and Due Process Clauses;
- 2) By assessing current gas inventory differently than the inventory of other businesses the assessment of Columbia Gas violated the Equal Protection and Due Process Clauses;
- 3) By assessing the remaining personal property of the company at 88%, the assessment of Columbia Gas violated Equal Protection and Due Process Clauses.

By affirming the Tax Commissioner's assessment, the BTA's decision has the effect of a *pro forma* denial of Columbia's constitutional claims. This denial clears the way for Columbia to take its appeal directly to the Ohio Supreme Court.

Background: How Ohio Taxes Gas Utilities

Ohio law imposes two taxes on gas utilities that differ from the taxes paid by general businesses. First, the State taxes the gross income of gas companies under the gross receipts tax rather than taxing the utilities' net income under the corporate franchise tax. Second, the public utility personal property tax laws provide for higher effective tax burdens on the tangible personal property of gas companies compared to the general personal property tax paid by non-utility businesses. Since the Columbia Gas case involved an appeal of the personal property tax assessments on the utility, the remainder of this summary will focus on the differences in the personal property tax treatment of gas utilities.

In its appeal, Columbia Gas divided its property into three different groups: material, supplies, furniture, and computer equipment; current gas inventory; all other personal property.

A. Material, Supplies, Furniture, and Computer Equipment

Current law establishes the true value of this property by using a depreciation schedule prescribed by the Tax Commissioner. The schedule sets the true value of property for each year depending on the type of property and its age. The specific depreciation allowances on the table resemble, but are not identical to, the allowance prescribed in the depreciation tables used by non-utility businesses under the general personal property tax. The taxable value of this property in the hands of a gas utility equals the true value multiplied by an assessment rate of 88%. The assessment rate used by non-utility businesses for comparable property is 25%.

B. Current Gas Inventory

Current gas inventory is gas stored underground on a temporary basis until the company distributes it to customers. The true value of current gas inventory equals the cost of that gas as shown on the books and records of the gas company as of December 31 of the year that precedes the tax year. For example, the true value of current gas for tax year 1999 would equal the cost of the current gas inventory stored by the company on December 31, 1998. The taxable value of the current gas inventory equals the true value multiplied by an 88% assessment rate. In contrast, the true value of the inventory of non-utility businesses equals the average cost of the inventory at the end of each month during the annual accounting period that precedes the tax year. In other words, the non-utility business adds twelve monthly values and divides by twelve to obtain an average true value. The taxable value of the non-utility business equals the true value multiplied by 25%.

C. All Other Property

This category appears to include the equipment used specifically in providing natural gas utility services and non-current gas. The equipment would include the pumping and metering equipment, as well as pipes through which the gas flows. Current law prescribes the determination of the true value of this equipment by reference to a depreciation schedule prescribed by the Tax Commissioner. The taxable value of this equipment equals 88% of the true value.

Non-current gas is gas stored underground that is not intended for distribution. The true value of non-current gas equals 35% of cost. Its taxable value equals 88% of true value.

How Much Revenue Does the Property Tax on Gas Utilities Yield?

Exact information on this point is not available outside the Department of Taxation. The Department's Annual Report for 1998 and earlier years does provide the assessed value data shown in the table below.

Table 1
Estimated Personal Property Taxes Charged to Gas Utilities, 1993 to 1997

| Tax Year | Assessed Value | Average Tax Rate in Mills | Estimated Taxes |
|----------|-----------------|---------------------------|-----------------|
| 1993 | \$1,383,200,570 | 65.03 | \$ 89,955,482 |
| 1994 | \$1,494,194,020 | 66.49 | 99,354,171 |
| 1995 | \$1,591,867,720 | 67.27 | 107,085,691 |
| 1996 | \$1,604,488,940 | 68.41 | 109,759,300 |
| 1997 | \$1,692,036,890 | 68.48 | 115,870,800 |

Table 1 uses the actual statewide assessed valuation for gas companies as reported by the Department of Taxation. The computation of the "average tax rate in mills" and "estimated taxes" were computed by Levin & Driscoll. The average tax rate equals the number of mills obtained by dividing the total taxes charged against *all* utility property in Ohio by the total valuation of *all* such utility property. Estimated taxes equal the product of the assessed value multiplied by the average tax rate. Therefore, the final column shows the estimated amount of personal property taxes paid by gas utilities on a statewide basis for each year. The average growth in the assessed valuation of gas utilities since 1992 has equaled about 4.8% per year. Growth in estimated taxes equaled about 6.1% per

year over the same period. Taxes grew faster than valuation because the growth in taxes results from the combination of higher values and higher tax rates. Tax amounts shown here represent estimated taxes charged by all local taxing authorities. School taxes would equal about 70% of the total taxes shown in the last column. Therefore, for tax year 1997 gas utilities were charged about \$81 million in school taxes.

Refunds Required if Columbia Wins Its Appeal

The case decided by the BTA involves tax years 1993, 1994, and 1995. The following assumptions appear reasonable:

- Columbia will appeal the case to the Ohio Supreme Court;
- Columbia has continued to protest assessments for later years - 1996 and after - but the Department of Taxation will hold those appeals until a final decision is made on the appeal for the earlier years;
- Other gas companies with significant amounts of taxable property have filed similar appeals;
- The true value of gas company property will continue to grow at about 4.8% per year and the effective millage rate also will continue to grow at historical rates.

Based on these assumptions, the following table (Table 2) presents estimates of the refunds that would be required, if Columbia Gas wins its appeal for 1993, 1994, and 1995 and receives refunds for subsequent years as well. The amounts shown also include refunds that other gas utilities presumably claimed for the same period.

Table 2
Estimated Tax Refunds for All Gas Utilities if Columbia Gas Wins, Tax Years 1993 to 1998

| Tax Year | School Tax Reduction | Non-School Local Gov't | Total Tax Reduction |
|----------|----------------------|------------------------|---------------------|
| 1993 | \$45,079,963 | \$19,319,984 | \$64,399,947 |
| 1994 | \$49,789,988 | \$21,338,566 | \$71,128,554 |
| 1995 | \$53,664,534 | \$22,999,086 | \$76,663,620 |
| 1996 | \$55,004,377 | \$23,573,304 | \$78,577,681 |
| 1997 | \$58,067,071 | \$24,885,888 | \$82,952,959 |
| 1998 | \$61,584,625 | \$26,393,411 | \$87,978,036 |
| Total | \$323,190,558 | \$138,510,239 | \$461,700,797 |

The refund amounts were computed by multiplying the total taxes charged to gas utilities in each year by 63/88. That fraction equals the reduction in assessed value that would occur if 88% assessment rates were reduced to 25% assessment rates.

The Department of Taxation does not publish gas utility valuations by school district. The compilation of district-by-district gas utility valuations and revenue loss estimates would require direct collection of tax data from each county auditor. In contrast to the electric utility studies, gas company property does not have the same easily defined concentrations of value that existed in power plant districts. With the possible exception of some districts that contain stored gas, no obvious focus for a gas company valuation study exists.

Columbia's Prospects

Columbia Gas claims that the existing tax treatment for gas utilities violates the Equal Protection and Due Process Clauses of the Constitution. Support for this claim comes from *MCI Telecommunications Corp. v. Limbach*, 68 Ohio St. 3d 195 (1994). In that case, the Ohio Supreme Court ruled that public utility personal property tax assessments at an 88% rate against MCI violated that company's right to equal protection of the laws because other telecommunications companies paid property taxes based on a 25% assessment rate.

To benefit from the *MCI* decision, Columbia would need to prove that some of its competitors pay taxes based on lower assessment rates. The mere fact that other non-utility businesses pay taxes based on a different assessment rate does not appear sufficient to establish a constitutional violation. The Equal Protection Clause requires similar treatment of *similarly situated* taxpayers. Columbia must show that some taxpayers that receive the general business rates of assessment are "similarly situated," i.e., they compete with Columbia at least in some aspect of the provision of natural gas services. The BTA opinion does not discuss any of the facts presented by Columbia in its case. Therefore, the opinion provides no basis for evaluating the strength of the argument for finding an equal protection violation.

In the *MCI* case, the Department of Taxation's failure to assess MCI's competitors at 88% assessment rates did not result from a policy decision to treat different taxpayers differently. Rather, it resulted from a failure to identify all of those competitors for whom the Department should use the 88% assessment rate. Since the *MCI* decision, the Department of Taxation has made greater efforts to identify all utility operations and to apply the higher assessment rates to the property of such operations on a uniform basis.

Columbia's chances for success in its appeal appear to rest upon two issues:

The Department of Taxation's success in identifying all gas utility service providers in such a way as to provide for equal treatment of Columbia and its competitors;

The extent to which the natural gas industry has become deregulated in such a way that meaningful distinctions between utility and non-utility operations simply do not exist anymore.

The BTA's decision does not contain enough information to speculate about the outcome of either of these issues.