TAX MANAGEMENT ASSOCIATES, INC.

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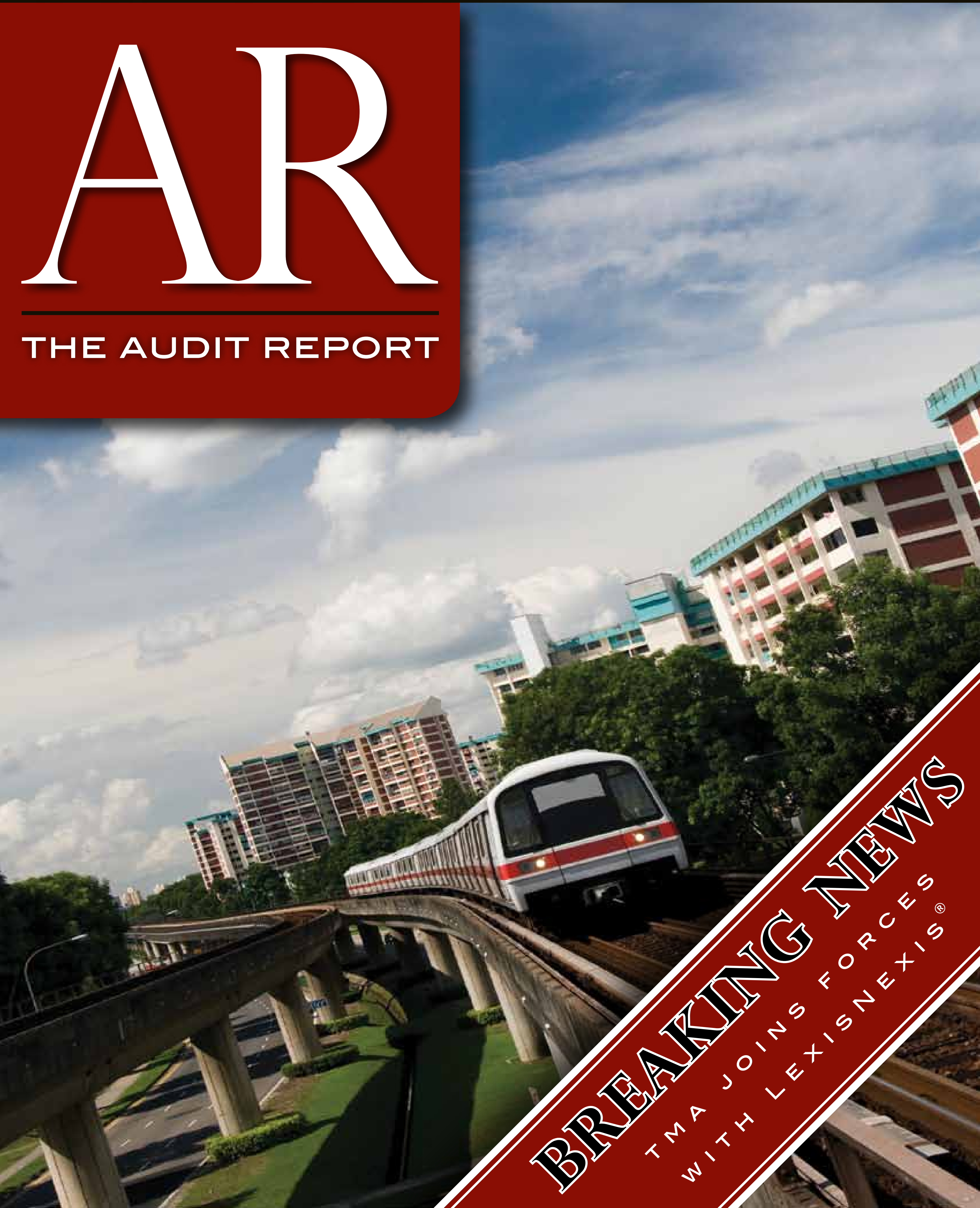
THE AUDIT REPORT



BREAKING NEWS

TMA JOINS FORCES WITH LEXISNEXIS®

Fighting Fraud

Two Companies Join Forces to Combat Waste, Fraud, and Abuse | *by Ryan Hunter*

Tax Management Associates, Inc (TMA) is excited to announce a new alliance with data specialist LexisNexis®.

Since 1979, TMA has been in the business of assisting state and local governments administer ad valorem taxation. In that time, we've used our skills and knowledge developing programs responsible for discovering over thirty-five billion dollars ($35,000,000,000) in tax value across more than 450 clients.

The Principal Residence Exemption (PRE, or "Homestead") Audit Program we pioneered in Michigan is one of these. TMA checks the validity of Homestead Exemptions and ensures that received exemptions are truly meeting the criteria set forth by state law. The success of this program has not only helped our Michigan clients recover more than $80,000,000 dollars in lost revenue, and created a more uniform and equitable tax base, but also caught the attention of LexisNexis.

Given LexisNexis' comprehensive database of public records information and TMA's experience in research and discovery, the partnership between the two companies is a natural one, and opens the door to a limitless amount of data to be used for compliance efforts. In addition to an expanded PRE program, our clients will see services offered in other areas as well, including state income tax fraud, short and long term rental discovery, and the discovery of unreported assets such as boats, planes, and recreational vehicles.

> "LexisNexis® aligns well with our core mission …We are delighted to join forces with LexisNexis® to help fight fraud."

In the coming months, expect to hear more about our alliance with LexisNexis and the ways this partnership can help save your jurisdiction millions of dollars and stop waste, fraud, and abuse where it occurs. In the mean time, please read the press release below for more information, or give us a call at 1-800-951-5350.

LexisNexis and Tax Management Associates Join Forces to Help State and Local Governments Discover and Recover Revenue

Relationship allows state and local governments to identify areas of tax fraud and abuse

New York, NY, on June 28, 2011

LexisNexis Risk Solutions today announced a strategic alliance with Tax Management Associates, Inc. (TMA) to accelerate its Revenue Discovery and Recovery programs for state and local

To learn more about any of TMA's services, visit www.tma1.com or contact us at 1-800-951-5350

governments. The programs identify areas of waste, fraud or abuse and seek to increase state and local government revenues through careful administration of existing tax sources.

Through the alliance with TMA, LexisNexis has established two new programs, Homestead Exemption Fraud Detection and State Income Tax Refund Fraud. The programs are designed to help government agencies find taxpayers who are out of compliance with state and or local laws, or those individuals who are deliberately trying to fraud the government.

"Individuals not paying their fair share along with government agencies making improper payments significantly contributes to the growing tax gap, more than $300 billion per year," said Haywood Talcove, chief executive officer, LexisNexis Special Services Inc. "Our alliance with TMA helps uncover these types of behaviors in order to prevent tax increases and restore funding to community programs."

The new programs are designed to detect some of the most common fraudulent patterns that state and jurisdictions are currently paying, including: people in prison, deceased, claiming multiple homestead exemptions or tax refunds, undisclosed renters and stolen identities. Overall, the new programs will help state and local governments discover and recover revenue that can significantly improve funding for other programs, such as education and law enforcement.

"LexisNexis aligns well with our core mission of integrating knowledgeable experts with cutting edge technology," said Richard (Chip) Cooke, Jr., Vice President Sales and Marketing, TMA. "We are delighted to join forces with LexisNexis to help fight fraud."

The South Carolina Association of Counties is pursuing just such a program for its membership. 'We hope that compliance efforts in this area will ultimately increase equity and uniformity in the property tax base for the taxpayers of the State of South Carolina.'

In the coming months, LexisNexis and TMA will leverage their respective skill sets in data and investigation to examine locally filed homestead exemptions on residential property, as well as personal income tax refunds, in order to detect fraud. Beyond the initial alliance, LexisNexis and TMA will continue to develop new and valuable ways to combat waste, fraud and abuse in the overall tax system.

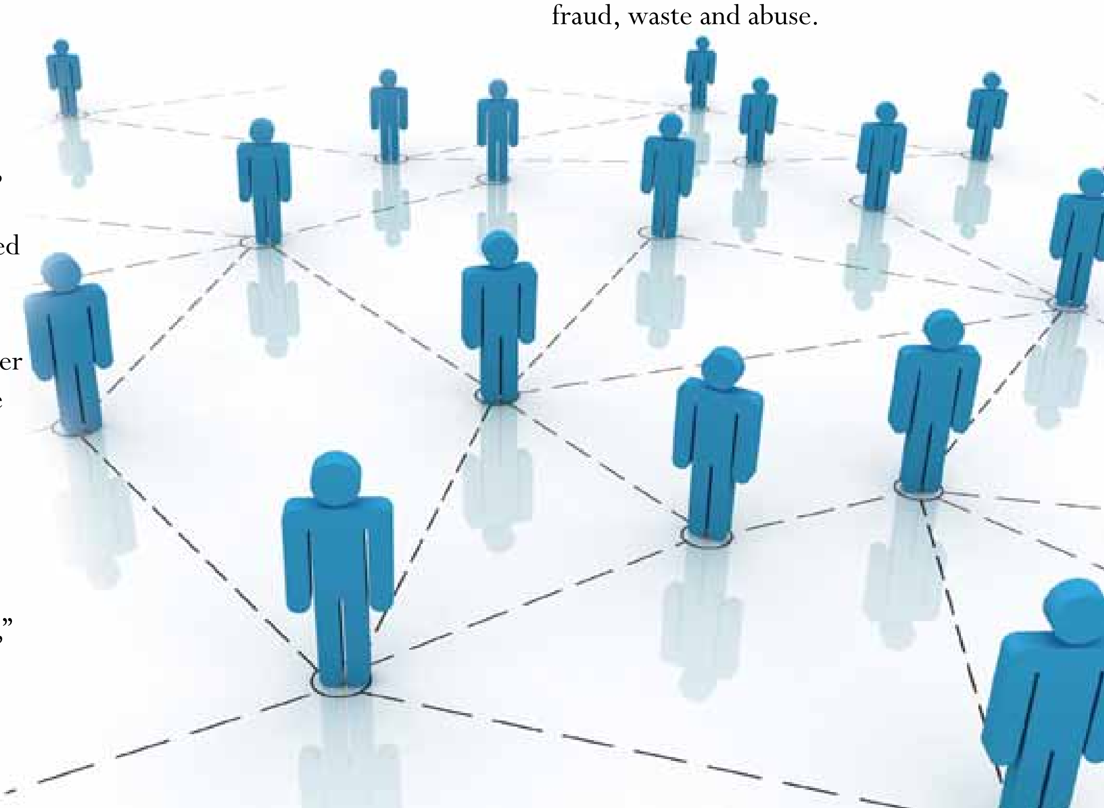
For more information, please visit TMA on the web at www.tma1.com and LexisNexis at www.lexisnexis.com/government.

LexisNexis®

About LexisNexis® Risk Solutions

LexisNexis Risk Solutions (www.lexisnexis.com/risk/) is a leader in providing essential information that helps customers across all industries and government predict, assess and manage risk. Combining cutting-edge technology, unique data and advanced scoring analytics, Risk Solutions provides products and services that address evolving client needs in the risk sector while upholding the highest standards of security and privacy. LexisNexis Risk Solutions is part of Reed Elsevier, a leading publisher and information provider that serves customers in more than 100 countries with more than 30,000 employees worldwide.

LexisNexis helps law enforcement, intelligence, revenue and social services agencies in the government industry enhance investigations, derive insight from complex data sets, and combat fraud, waste and abuse.



The Big Picture

In Assessment, Don't Miss the Forest for the Trees | *by Kirk Boone*

Assessment and appraisal are a blend of art and science. There are formulas, equations, and procedures. There are ordinances, statutes, and binding case law that must be followed. Along with establishing the Appraisal Subcommittee, Congress also gave The Appraisal Foundation, a nonprofit educational organization, authority to set qualifications and standards for appraisers. There are assessment and appraisal courses that are taught by competent private and public organizations. The courses teach us how to properly assess, how to calculate obsolescence, how to determine a capitalization rate, how to make adjustments to sales, and how to properly calculate an assessment level.

So why are there disagreements about assessment and appraisal? There are lots of individual reasons. The main one is that the definition of an appraisal is, "an opinion of value." And opinions certainly vary. But with all of these rules, why are the opinions so different?

Several times at the North Carolina Property Tax Commission I have seen the county's value at hundreds of millions of dollars, and the taxpayer's opinion at less than half of that. So how do hard fast rules and equations result in such variances? I like mathematics,

"Perhaps this is when experience causes us to question the result, and that's the art of assessment"

and in mathematics, there is usually only one correct answer. Maybe that's why I find assessment so challenging!

In this article, I want to focus on the big picture, the forest. When all of the rules (the trees) have been applied, and the end result just doesn't make sense, should we accept the end result? Perhaps this is when experience causes us to question the result, and that's the art of assessment. What do we do when owners of a large manufacturing facility, for example, can demonstrate abnormal functional or economic obsolescence, they use sound techniques to calculate the obsolescence, they subtract the calculated amount from the RCN less normal depreciation, and the final number comes out and it just doesn't make sense?

Let me share with you an important case from North Carolina that became binding in the state when it was decided by the North Carolina Court of Appeals. Tax Management Associates was the auditing firm hired by the county and…well I won't tell you the result. Read on and hopefully you will agree it is an interesting case and shows that just knowing the rules doesn't get you the correct result.

First, let me pose these three questions:

If you have any questions or comments about this article, please contact Kirk Boone at 1-800-951-5350

1. When using the cost approach to appraise taxpayer's property, should the assessor consider only the cost of property owned by the taxpayer to determine the value of the taxpayer's property?

2. If the property consists of two machines used in conjunction, when one would be much more efficient, does that demonstrate functional obsolescence of the two machines?

3. When using the income approach, should actual rates or market rates be used?

First, a summary of the case. Some of these names may have changed; this text is taken from the decision, written several years ago. In re Appeal of Westmoreland, 174 NC App 692 (04-1181)

This appeal concerns the tax value of the Roanoke Valley Energy Facility ("ROVA"), which consists of two coal-fired generating facilities. The first facility, ROVA I, has the capacity to generate 165 net megawatts of electricity from pulverized coal. It commenced commercial operations on 29 May 1994. The second facility, ROVA II, has the capacity to generate 44 net megawatts of electricity from pulverized coal, and it commenced commercial operation on 1 June 1995. ROVA I and II operate as wholesale generators and sell their electricity to Virginia Power and Light Company ("VEPCO") pursuant to two separate Power Purchasing and Operating Agreements ("PPAs") entered into in January of 1989 and June of 1990. Under the PPAs, taxpayer agreed to build and operate the subject facilities and to supply VEPCO with electricity at a set price for twenty-five years from the respective commercial operations date, with possible extensions on each PPA of up to five years. On 10 May 2001, the County Assessor implemented an audit program to verify the accuracy of personal property listings that were filed by businesses for the 1996 through 2001 tax years. An audit of taxpayer's records for those years showed a variance between the capitalized cost of its personal property assets reported in taxpayer's accounting records and the cost reported by taxpayer on its personal property listings that were filed with the county. Specifically, the discovery audit revealed taxpayer under- reported its personal property assets by approximately $75 million each year. Based upon the audit, the Tax Administrator determined taxpayer did not properly list its business personal property and issued a discovery and appraisal as directed by N.C. Gen. Stat. § 105-312. The county retained independent appraisers to assess the true value of taxpayer's facilities using both the cost approach and income approach methodology of valuation. Applying the cost approach method, the appraisers used the Cost Index and Depreciation Schedules promulgated by the North Carolina Department of Revenue to assess taxpayer's property. They considered, but made no adjustments for, functional or economic obsolescence. Under the income approach, the appraisers used the income projections based on the income earned under the PPAs, instead of the spot market prices for electric power for the years in question. Using these two approaches, the appraisers determined that the total true value of taxpayer's personal property was roughly $200 million for each year 1996-2001. The taxpayer's appraiser concluded that the total true value of taxpayer's property was roughly $115 million for each of those years.

Answer to question 1: [these are excerpts from the decision, please enjoy the entire case on our website at www.tma1.com In re Appeal of Westmoreland, 174 NC App 692 (04-1181)]

Taxpayer first argues that the County's discovery was arbitrary and illegal because the assessment included the cost of a $5 million water treatment plant that taxpayer built but later transferred to the Town of Weldon. We disagree. Under N.C. Gen. Stat. § 105-291 (2003), the Department of Revenue has the power to (1) "prescribe the forms, books, and records to be used in the listing, appraisal, and assessment of property and in the levying and collection of property taxes, and how the same shall be kept" and (2) "develop and recommend standards and rules to be used by tax supervisors and other responsible officials in the appraisal of specific kinds and categories of property for taxation." As permitted by Department of Revenue regulations, the County guidelines provide that the acquisition cost of property includes "installation, sales tax, freight, and all other costs incurred with obtaining the property and making it ready for its intended use." It follows that the acquisition cost determination in the instant case must include any amount spent in order to make taxpayer's personal property ready for use. In the instant case, the County is not assessing taxpayer directly as the owner of the water treatment plant but is, instead, assessing the treatment plant's costs as part of the acquisition and development costs associated with the ROVA I and

II facilities pursuant to its guidelines. The vice-president of the taxpayer testified that appellant considered the building of the water treatment plant a development cost and if the plant had not been built, Westmoreland (the taxpayer) would have had huge capacity restraints in the future. The taxpayer also listed the cost of the water plant as an asset on its books and capitalized the cost each year on its federal tax returns; further indicating taxpayer treated the construction of the water plant as an indirect cost when building its facilities. Thus, there is competent evidence that the water plant's cost was incurred to make the boilers and other machinery ready for use. Since the County's guidelines require it to tax all costs necessary to make personal property ready for its intended use, excluding this type of cost in the instant case would result in assessment inequities when compared to what is required of similar taxpayers in Halifax County. Accordingly, as there is substantial evidence to support the Commission's finding that the cost of the water treatment plant was necessary to make taxpayer's property ready for its intended use, such cost was properly included in the County's discovery assessment.

Answer to question 2: [with excerpts from the decision]

Taxpayer next asserts the County's assessment was illegal and arbitrary because it failed to take into account functional obsolescence when using the cost approach method of valuating its personal property. Specifically, taxpayer argues the assessment should have factored in functional obsolescence based on the fact that the construction of one larger plant producing 209 kilowatts would have been less expensive than building two smaller plants during the years assessed. We disagree.

Part of the cost approach is deducting for depreciation, which is "a loss of utility and, hence, value from any cause . . . the difference between cost new on the date of appraisal and present market value." Depreciation may be caused by deterioration, which is a physical impairment, such as structural defects, or by obsolescence, which is "an impairment of desirability or usefulness brought about by changes in design standards (functional obsolescence) or factors external to the property (economic obsolescence)." In re Appeal of Stroh Brewery, 116 N.C. App. 178, 186, 447 S.E.2d 803, 807 (1994). The Business Personal Appraisal Manual published by the North Carolina Department of Revenue's Ad Valorem Tax Division defines functional obsolescence as a "loss in value due to impairment of functional capacity . . . inherent in the property itself." North Carolina Dept. Of Revenue Ad Valorem Tax Division, Business Personal Property Appraisal Manual, 7-17 (1995). These factors include overcapacity, inadequacy or changes in the state of the art, or poor design. Id.

Taxpayer's argument does not speak to any technological or design factors inherent in the ROVA I or II facilities that impair the property's desirability or usefulness. Its argument merely states that, if it had been aware of all the additional contracts, it could have saved money by tooling once to meet those contracts rather than tooling twice. However, the circumstances of taxpayer's business dealings does not impact the current functionality of the two facilities. The record indicates both plants have outstanding performance records, operate above industry standards in production, have no environmental problems, and have been consistently profitable. Based on these factors and the possible benefits to having two facilities instead of one, the county's independent appraiser rejected the argument that taxpayer's personal property was functionally obsolescent.

Although taxpayer presented evidence to the contrary, there is substantial evidence to support the Commission's conclusion that the County properly considered the effect of functional obsolescence, Moreover, taxpayer failed to offer competent, material, and substantial evidence that any error in assessing functional obsolescence resulted in the amount of the County's assessment substantially exceeding the true value of its property. (Note: Don't miss this part; this is where the court is being successful in not missing the forest for the trees!) The assessment offered into evidence by taxpayer's expert failed to analyze what effect building one coal plant instead of two would have on the tax valuation. Instead, the assessment dealt with calculating a functional obsolescence penalty based on the cost of replacing taxpayer's coal burning facility with a gas powered facility. Taxpayer's expert testified at the hearing that, even absent the functional obsolescence penalty he assigned in his assessment, there "[wa]s a functional penalty alone in the pulverized coal facility as a pulverized coal facility, because. . .in essence, one facility would have cost perhaps $20-30 million 1ess[.]"This qualified and speculative statement, standing alone and unsupported by independent research, does not constitute substantial evidence to establish there has been an overvaluation of taxpayer's property. Accordingly, we find the Commission properly considered the evidence on functional obsolescence and find no error.

Answer to question 3: [with excerpts from the decision]

Taxpayer next argues the County's discovery assessment failed to take into account economic obsolescence when valuing taxpayer's personal property, rendering the assessment arbitrary and illegal. Specifically, taxpayer asserts the County's income approach erroneously relied solely on the income projections under the PPAs instead of looking at the spot market prices at the time of the assessment dates. Taxpayer contends that this failure to study the spot market price for electricity gave the County "no basis to determine the existence of economic obsolescence and correctly complete its cost approach valuation."

Citing prior case law, the court demonstrated that it would be an error to only consider the normal market rents when the operating agreement between a mall developer and an anchor store was the normal market standard. We observed that a mall developer must first secure anchor department stores prior to construction in order to attract both customers and tenant stores and, thereby, make the mall viable. Id., 119 N.C. App. 475, 458 S.E.2d at 925. Accordingly, the operating agreement between the mall developer and the anchor store, which defines each party's respective rights and obligations, customarily offered anchor stores lower rental rates and purchase prices in exchange for the anchor store's promise "to operate only as a department store and . . . not to sell the property to any entity other than an acceptable anchor department store."

In this case , the income received under the PPAs are an integral part of the market for taxpayer's property; therefore, any assessment of this property's income must factor in the revenue streams received under these PPAs. The existence of the PPA is not something unique to this facility but was a market standard during the tax years in question. Accordingly, the proper market against which to judge the value of taxpayer's plants under the income approach is that consisting of the existing facilities with the PPAs, and taxpayer's argument that the County's cost approach failed to factor in economic obsolescence is rejected.

In conclusion, the questions I posed are simply stated and with limited facts. Given only the rules and those limited facts, I would probably answer yes to those questions myself. However, given the whole forest there is a different outcome. Please don't miss the forest for the trees.

I hope you will send me your comments at kirk.boone@tma1.com, and please enjoy reading the entire case on our website.