

JURISDICTION: OKLAHOMA TAX COMMISSION DECISION
CITE: 86-11-04-04 / NON-PRECEDENTIAL
ID: P-86-104
DATE: NOVEMBER 4, 1986
DISPOSITION: DENIED
TAX TYPE: INCOME
APPEAL: NO APPEAL TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above styled cause comes on for consideration, pursuant to assignment regularly made to ALJ, Presiding Administrative Law Judge by the Oklahoma Tax Commission. The case was submitted to the undersigned for findings, conclusions and recommendations to the Oklahoma Tax Commission based on a Stipulation of Facts and of Record with attached exhibits which are not herein itemized, approved and executed by PROTESTANT ONE and PROTESTANT TWO, Protestants, and the Income Tax Division of the Oklahoma Tax Commission, by and through its representative, OTC ATTORNEY, Attorney, General Counsel's Office of the Oklahoma Tax Commission and briefs by the opposing parties.

STATEMENT OF FACTS

The respective parties by agreement adopted a Stipulation of Facts and of Record, approved and executed by the Protestants and the Division. This Stipulation of Facts and of Record, admitted as Joint Exhibit No. 1, with exhibits attached thereto and incorporated herein by reference, will be expounded upon in this discussion of the Statement of Facts.

The Protestants filed their 1983 State of Oklahoma Individual Income Tax Return, Form 511, on or about February 18, 1984. The return attached to the Stipulation of Facts and of Record as Exhibit A, was signed by the Protestants and was filed on a calendar year basis. It indicated that the Protestants were married filing jointly and that they were residents of the State of Oklahoma living in CITY, Oklahoma.

The Protestants, as indicated on Exhibit A, reported as federal adjusted gross income, line one (1), Sixty-Nine Thousand Six Hundred Twenty-nine Dollars and Fifty-Seven Cents (\$69,629.57). On line two (2) of Exhibit A, the Protestants subtracted Eight Thousand One Hundred Forty-four Dollars and Fifteen Cents (\$8,144.15) from federal adjusted gross income for interest on U.S. Government Obligations described as Treasury Bills. Such subtraction is in accordance with instruction two (2) of the specific instructions, attached to the Stipulation of Facts and of Record as Exhibit B, that accompany the State of Oklahoma Individual Income Tax Forms.

Due to the subtraction for interest on Treasury Bills, Oklahoma adjusted gross income was less than federal adjusted gross income reported on Exhibit A. Oklahoma adjusted gross income was Sixty-one Thousand Four Hundred Eighty-five Dollars and Forty-two cents (\$61,485.42), as reflected on line twelve (12) of Exhibit A.

Part III of the Oklahoma Income Tax Return is reserved for the deduction for federal income tax. Such deduction is computed, as explained by instruction eighteen (18) on Exhibit B, by determining the tax liability from the applicable federal tax table adding thereto any below the line tax that is applicable, except the self-employment tax and the social security tax on tip income not reported to employer and subtracting any applicable credits, except the foreign tax credit.

The Protestants following the computation address above, reported in Part III on line eighteen (18), an amount of Thirteen Thousand Three Hundred Eighty-nine Dollars and Seventy-three Cents (\$13,389.73) as their 1983 federal income tax, as reflected on Exhibit A.

The federal income tax deduction allowable in Part III of the Oklahoma Income Tax Return is calculated by dividing the amount shown as Oklahoma adjusted gross income on line twelve (12) of the Oklahoma Income Tax Return by the amount shown as federal adjusted gross income on line one (1) of the Oklahoma Income Tax Return. This calculation results in a percentage which is entered on line nineteen (19) of Part III of the Oklahoma Income Tax Return. The federal income tax reported on line eighteen (18) of Part III is then multiplied by the percentage entered on line nineteen (19) of Part III. The resulting amount is entered on line twenty (20) of Part III and carried over to line thirty-five (35) of Part V of the Oklahoma Income Tax Return as an adjustment necessary to arrive at Oklahoma taxable income. The maximum percentage allowable on line nineteen (19) of Part III is One Hundred percent (100%) if federal adjusted gross income and Oklahoma adjusted gross income on lines One (1) and twelve (12), respectively, are the same.

The reason federal income taxes are prorated on a ratio of Oklahoma adjusted gross income to the federal adjusted gross income, pursuant to instruction nineteen (19) on Exhibit B, is that federal income taxes are deductible only to the extent they relate to income subject to taxation in Oklahoma.

The Protestants, as reflected on Exhibit A, multiplied the amount reported as federal income tax on line eighteen (18) of Part III by One Hundred percent (100%) to arrive at Thirteen Thousand Three Hundred Eighty-nine Dollars and Seventy-three Cents (\$13,389.73) or the same amount as reported on line eighteen (18) of Part III. This amount was entered on line twenty (20) of Part III and carried over to line thirty-five (35) of Part V as an adjustment necessary to arrive at Oklahoma taxable income. The Protestants multiplied their federal income tax by One Hundred percent (100%) despite the fact that their federal adjusted gross income and Oklahoma adjusted gross income, lines one (1) and twelve (12), respectively, were not the same as indicated on Exhibit A.

The Protestants multiplied their federal income tax by One Hundred percent (100%) because, as stated in their letter of protest which had enclosed a copy of Title 31 U.S.C. § 727, both of which were attached to the Stipulation of Facts and of Record as Exhibits C and D, they felt and allege that since their Oklahoma adjusted gross income and federal adjusted gross income were different due to the deduction for interest on Treasury Bills, use of a percentage other than One Hundred percent (100%) would tax indirectly the interest on their U.S. Government Obligations. This reasoning is based on Title 31 U.S.C. § 727 which prohibits

every form of taxation that would require either the obligation or the interest there on or both, be considered, directly or indirectly, in the computation of the tax.

Upon audit by the Division, the Division adjusted the percentage allowable on line nineteen (19) of Part III for the federal income tax deduction from the Protestants' One Hundred Percent (100%) to Eighty-eight percent (88%) or the percentage determined by dividing what the Protestants reported as Oklahoma adjusted gross income on line twelve (12) of Exhibit A by what the Protestants reported as federal adjusted gross income on line one (1) of Exhibit A. Due to this adjustment, the amount of the Protestants' federal income tax deduction on line twenty (20) was reduced to Eleven Thousand Seven Hundred Eighty-three Dollars and No Cents (\$11,783.00). This amount was carried over to line thirty-five (35) and as a result increased the Protestants' Oklahoma taxable income from Twenty-eight Thousand Three Hundred Five Dollars and Forty-four Cents (\$28,305.44) as reported on line thirty-six (36) of Exhibit A to Twenty-nine Thousand Nine Hundred Twelve Dollars and Seventeen Cents (\$29,912.17). Due to the increase in Oklahoma taxable income, the Protestants' Oklahoma income tax was increased from One Thousand Six Hundred Ninety-five Dollars and Fifty-four Cents (\$1,695.54) as reported on Exhibit A to One Thousand Eight Hundred Sixty-five Dollars and No Cents (\$1,865.00).

The Division, based on the audit, on February 3, 1986 issued a proposed assessment, attached to the Stipulation of Facts and of Record as Exhibit E, against the Protestants for additional income tax and interest for the 1983 tax year in the amount of Two Hundred Twenty-six Dollars and Three Cents (\$226.03) or the difference between the amount reported by the Protestants as Oklahoma income tax on line thirty-eight (38) of Exhibit A and the amount determined as Oklahoma income tax under the audit.

The Protestants on February 20, 1986, as indicated on Exhibit C, protested the proposed assessment.

The Protestants' file was forwarded to the Legal Division of the Oklahoma Tax Commission to be set down for a hearing before the Administrative Law Judge of the Oklahoma Tax Commission. The hearing was originally set for May 30, 1986, at the hour of 10:00 a.m. in the Hearing Room of the Oklahoma Tax Commission before the Presiding Administrative Law Judge, ALJ. However, by agreement of the parties and approval of the Presiding Administrative Law Judge the hearing scheduled for May 30, 1986 was stricken from the docket and the protest was submitted for a determination based on a Stipulation of Facts and of Record and briefs by the opposing parties.

ISSUES AND CONTENTIONS

Whether it is proper to prorate the Oklahoma income tax deduction for federal income tax paid on the ratio of Oklahoma adjusted gross income to federal adjusted gross income where the difference between Oklahoma adjusted gross income and federal adjusted gross income is due to the subtraction of interest on U.S. Government obligations from federal adjusted gross income.

The Protestants contend that since their Oklahoma adjusted gross income and federal adjusted gross income were different due to the deduction for interest on U.S. Government obligations, use of a percentage other than One Hundred percent (100%) would tax indirectly the interest on their U.S. Government obligations which is prohibited by Title 31 U.S.C. § 727.

The Division contends that Title 68 O.S. 1981, Section 2358(C)(8) is applicable and controlling, that since federal taxes paid are deductible only to the extent they relate to income subject to taxation, this in and of itself indicates that the interest on U.S. Government obligations is neither being taxed directly nor indirectly by Oklahoma and that the proposed assessment as issued is correct and should be sustained.

DISCUSSION OF APPLICABLE LAW

The Oklahoma Income Tax Deduction for Federal Income Tax paid is described in Title 68 O.S. 1981, § 2358(C)(8), which provides:

- a. An individual taxpayer, whether resident or nonresident, may deduct an amount equal to the federal income taxes paid by said taxpayer during the taxable year.
- b. Federal taxes as described in subparagraph a of this paragraph shall be deductible by any individual taxpayer, whether resident or nonresident, only to the extent they relate to income subject to taxation pursuant to the provisions of the Oklahoma Income Tax Act. The maximum amount allowable in the preceding paragraph shall be prorated on the ratio of the Oklahoma adjusted gross income to federal adjusted gross income.
- c. For the purpose of this paragraph, federal income taxes paid shall mean federal income taxes, surtaxes imposed on incomes or excess profits taxes, as though the taxpayer was on the accrual basis.
- d. The provisions of this paragraph shall apply to all taxable years ending after December 31, 1978.

(Emphasis added.)

Section 2358(C)(8) and particularly the emphasized language clearly indicates that federal income taxes paid are deductible only to the extent they relate to income subject to taxation pursuant to the provisions of the Oklahoma Income Tax Act. The federal income tax deduction is prorated based on the ratio of Oklahoma adjusted gross income to federal adjusted gross income to ensure that the deduction only relates to income subject to Oklahoma income tax.

The provisions of the Oklahoma Income Tax Act of particular importance to the present controversy is Section 2358(A) and Section 2358(A)(2) which provide:

The taxable income of any taxpayer shall be adjusted to arrive at taxable income for corporations and Oklahoma adjusted gross income for individuals, as follows:

...

There shall be deducted amounts included in such income that the state is prohibited from taxing because of the provisions of the Federal Constitution, the State Constitution, federal laws or laws of Oklahoma.

Pursuant to Section 2358(A)(2) and Title 31 U.S.C.A. § 3124, the State of Oklahoma is prohibited from taxing the stocks and obligations of the United States Government and the interest thereon. Title 31 U.S.C.A. § 3124(a) provides:

Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except—

- (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and
- (2) an estate or inheritance tax.

The Protestants pursuant to Section 2358(A)(2) and Title 31 U.S.C. § 3124, as indicated in the Stipulation of Facts and of Record, subtracted from their 1983 federal adjusted gross income, interest on U.S. Government obligations described as Treasury Bills. Due to this subtraction from federal adjusted gross income, the income from interest on U.S. Government obligations was not subject to taxation pursuant to the provisions of the Oklahoma Income Tax Act.

Further, because of the subtraction of interest on U.S. Government obligations from federal adjusted gross income, Oklahoma adjusted gross income was less than federal adjusted gross income. The Protestants, however, multiplied their federal income tax paid by the maximum One Hundred percent (100%), instead of prorating the deduction on the ratio of Oklahoma adjusted gross income to federal adjusted gross income.

Section 2358(C)(8) is applicable and controlling. Section 2358(C)(8) is not ambiguous and is not susceptible to more than one interpretation. It specifically provides that the deduction for federal income tax paid is prorated on the ratio of Oklahoma adjusted gross income to federal adjusted gross income. If Oklahoma adjusted gross income is less than federal adjusted gross income the percentage allowable will never be One Hundred percent (100%).

Further, the intent of Section 2358(C)(8) is clearly express therein and provides that federal taxes are deductible only to the extent they relate to income subject to taxation. This in and of itself indicates that the State of Oklahoma by prorating the deduction for federal taxes

paid does not thereby tax either directly or indirectly the interest on U.S. Government obligations.

CONCLUSIONS

Based upon the above and foregoing findings of fact and applicable law relevant thereto, the undersigned concludes as follows:

- (1) That the Oklahoma Tax Commission has jurisdiction in this case.
- (2) That the Oklahoma Income Tax Deduction for federal income tax paid must be prorated on the ratio of Oklahoma adjusted gross income to federal adjusted gross income.
- (3) That the interest on U.S. Government obligations is not thereby taxed by the State of Oklahoma.
- (4) That the assessment of additional income tax and interest in the amount of Two Hundred Twenty-six Dollars and Three Cents (\$226.03) for the 1983 tax year is correct, and that the Protestants should be required to pay such amount of money plus interest accruing at eighteen percent (18%) per annum until paid.
- (5) That the protest should be denied and the total amount of the assessment sustained.

DISPOSITION

It is the ORDER of the OKLAHOMA TAX COMMISSION that the protest of PROTESTANT ONE and PROTESTANT TWO be denied, that the assessment of the Income Tax Division be sustained, and that the Protestants, PROTESTANT ONE and PROTESTANT TWO be required to pay the amount of additional Income Tax and interest for the 1983 tax year, plus interest assessed and accrued from the due date until paid.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.