JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2002-01-08-014 / NOT PRECEDENTIAL**
ID: **P9900257**
DATE: **01-08-02**
DISPOSITION: **SUSTAINED IN PART / DENIED IN PART**
TAX TYPE: **INCOME**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above matter comes on for entry of a final order of disposition by the Oklahoma Tax Commission. Having reviewed the files and records herein, the Commission hereby adopts the Findings of Fact, Conclusions of Law and Recommendation made and entered by the Administrative Law Judge on the 26th day of November, 2001, as amended on December 19, 2001, and the same, appended hereto, together herewith shall constitute the Order of the Commission.

A. Stipulated Facts

The Protestant and the Audit Division of the Oklahoma Tax Commission ("Division") hereafter) stipulate to the following facts:

1. PROTESTANT filed Oklahoma corporation income tax returns form 512, for taxable years ending 4/30/95 on 7/30/96; 4/30/96 on 3/22/97; and 4/30/97 on 7/17/97.

2. PROTESTANT filed an Oklahoma amended corporation income tax return form 512 for the taxable year ending 4/30/95.

3. That for the taxable year ending 4130/95 PROTESTANT reported the amount of Federal taxable income, as revised, on Page 1, Line 1 of the amended form 512.

4. That for the taxable years ending 4/30/96 and 4130/97 PROTESTANT reported the amounts of Federal taxable income on Page 1, Line 1 of the form 512.

5. On December 17, 1998, the Secretary of PROTESTANT agreed to changes in its Federal taxable income for the taxable years ending 4130/95, 4130/96, and 4/30/97, as reflected in a report prepared by the Internal Revenue Service.

6. The report prepared by the Internal Revenue Service showed changes as follows:

	4/30/95	4/30/96	4/30/97
Salaries and Wages	$ 6,931.00	$ 29,426.00	$ 36,905.00
Depreciation	$ 6,171.00	$ 4,379.00	($ 10,725.00)
Indian Employment Credit	$ 6,931.00	$ 29,426.00	$ 36,905.00

7. Pages 9 and 10 of the report prepared by the Internal Revenue Service showed PROTESTANT paid the following wages, which qualified for the Indian Employment Credit:

12/31/93	4/30/95	4/30/96	4/30/97
$ 56,077.00	$ 104,674.00	$ 203,208.00	$ 240,604.00

8. Page 8 of the report prepared by the Internal Revenue Service showed the amount of Indian Employment Credit earned each year was computed by multiplying the incremental increase (the qualified wages less the 1993 base year wages) by 20 Percent.

9. The report prepared by the Internal Revenue Service reduced the deductions for salaries and wages by the amount of Indian Employment Credit allowed each year.

10. The business of PROTESTANT is primarily the manufacture of private label aloe vera based cosmetics.

11. On August 30, 1999 the Oklahoma Tax Commission issued an audit report to PROTESTANT, which increased its Oklahoma taxable income by the adjustments to "Salaries and Wages" and "Depreciation" shown in the report issued by the Internal Revenue Service.

12. The Oklahoma Tax Commission revised the assessment shown in the original audit report by removing the penalty shown in that report.

13. The audit report issued by the Oklahoma Tax Commission allowed neither deductions or credits for $6,931, $29,426, and $36,905 wages paid by PROTESTANT to Indians in taxable years ending 4/30/95, 4/30/96, and 4/30/97, respectively.

B. Additional Findings of Fact Appearing in the Record

1. The Division issued a proposed assessment of Oklahoma corporate income tax on August 30,1999, based on the Internal Revenue Service Revenue Agents Report issued December 17, 1998, covering the period May 1, 1993 through April 30, 1996, resulting in additional liability for corporate income tax as follows;

Tax	$ 4,780.00
Interest	2,303.00
Penalty	478.00
TOTAL	$ 7,561.00

2. PROTESTANT timely filed its protest to the Division's proposed assessment by its Protest and Application for hearing dated September 29, 1999, pursuant to 68 O.S. § 221(C).

ISSUE

Whether the Division's denial of deductions for a portion of the wages PROTESTANT paid to its American Indian employees violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission has jurisdiction of this protest, 68 O.S. §§ 207, 221.

2. PROTESTANT claimed the federal Indian Employment Credit pursuant to federal law at 26 U.S.C. § 45A. As a result of the credit based on wages paid to American Indians, the Internal Revenue Code at 26 U.S.C. § 280C(a) disallows the deduction of wages equal to the sum of the credits allowed by Section 45A as a business expense deduction in order to calculate taxable income. Under these provisions, PROTESTANT's federal tax credits were increased and its federal tax deduction for wages paid was decreased, thereby causing a corresponding increase in its federal taxable income on the Internal Revenue Service Revenue Agents Report.

3. The Oklahoma Income Tax Act does not provide an Indian Employment Credit. Pursuant to 68 O.S. § 2353(12), "Oklahoma taxable income" means taxable income as reported to the federal government, and in the event of adjustments thereto by the federal government as finally ascertained under the Internal Revenue code. Therefore, when the Internal Revenue Service reduced PROTESTANT's wages expense in order to claim the Indian Employment Credit, PROTESTANT's federal, as well as Oklahoma, taxable income was properly increased.

4. However, new legislation in House Bill 1203 effective July 1, 2001, has provided further adjustments to PROTESTANT's Oklahoma taxable income with a new subsection at 68 O.S. § 2358(A)(8) as follows:

> In taxable years beginning after December 31, 1995, all qualified wages equal to the federal income tax credit set forth in 26 U.S.C.A., Section 45A shall be deducted from taxable income. The deduction allowed pursuant to this paragraph shall only be permitted for the tax years in which the federal tax credit pursuant to 26 U.S.C.A., Section 45A is allowed. For purposes of this paragraph "qualified wages" means those wages used to calculate the federal credit pursuant to 26 U.S.C.A., Section 45A.

Pursuant to this new law, PROTESTANT's assessment of Oklahoma corporate income tax for its 1996 taxable fiscal year beginning May 1, 1996, and ending April 30, 1997, should be adjusted to allow a deduction for all qualified wages equal to the Indian Employment Credit claimed that fiscal year. The prior fiscal years do not qualify for this treatment.

5. The issue remains for fiscal years 1993, 1994, and 1995 as to whether PROTESTANT was denied equal protection under the laws as secured by the Fourteenth Amendment. Under the rubric of equal protection PROTESTANT submits in its brief that a state may not tax the employers of a certain minority race more by disallowing a portion of the wages paid to the minority race. The record in this case is absolutely void of any evidence which would support this conclusion. The Division's assessment is based on amounts for wages expense as calculated on the Revenue Agents Report or "RAR." On the RAR, it was determined that PROTESTANT could obtain a greater federal tax benefit by using a portion of its wages for the Section 45A credit rather than as a business expense deduction. The decrease in the wages paid deduction is a function of federal law, not Oklahoma law. Once the federal election was made by PROTESTANT to claim the federal tax credit, the Oklahoma Income Tax Act provided that the resulting increase in taxable income due to the corresponding decrease in the wages paid deduction as finally ascertained under the Internal Revenue Code shall be "Oklahoma taxable income," 68 O.S. § 2353(12).

Therefore, PROTESTANT is being treated equally with all other Oklahoma corporate income taxpayers regarding the calculation of its Oklahoma taxable income. There is no evidence that the Division determined that PROTESTANT employs persons of "a certain minority race" and then disallowed its wages paid deduction. The evidence indicates that the Division assessed additional income tax based on the taxable income calculated in the RAR and did not disallow any deductions claimed by PROTESTANT on the RAR.

6. The Oklahoma Supreme Court has issued several controlling opinions regarding equal protection under facts similar to this case. First, the Court has ruled that tax exemptions and deductions are matters of legislative grace subject to the controlling authority of the United States Constitution or the Oklahoma Constitution and the Court will not construe a tax exemption so as to enlarge its scope because that is the province of the legislature, R.R. Tway, Inc. v. Oklahoma Tax Commission, 1995 OK 129, 910 P.2d 972.

State legislatures are given especially broad latitude in creating classifications and distinctions in tax statutes. Unless a classification jeopardizes the exercise of a fundamental right or it characterizes based upon an inherently suspect characteristic, the Equal Protection Clause requires only that the classification rationally further a legitimate state interest, Williams Natural Gas Co. v. State Board of Equalization, 1994 OK 150, 891 P.2d 1219.

In the case at bar the legislature enacted Section 2352(12) in order to further the legitimate state interest of raising revenue from a corporate income tax based on the ascertainable standard of federal taxable income. The Constitution does not prohibit reasonable classifications for taxation so long as they rest on a difference having a reasonable relation to the subject of legislation to the end that all persons similarly situated are treated alike, Suglove v. Oklahoma Tax Commission, 1979 OK 168, 605 P.2d 1315. There is long-standing Oklahoma authority for the principle that without legislative sanction no person has an inherent right to a tax deduction. The Supreme Court has ruled in Oklahoma Tax Commission v. Smith, 1980 OK 74, 610 P.2d 794, that:

> An income tax statute which permits variations in deductions from gross income in relation to nontaxable income, and which permits variations in the allowance of personal exemptions in relation to whether all income is taxed or not is not invalid as denying equal protection of the law, Walker v. Oklahoma Tax Commission, 196 OK 207,164 P.2d 242 (1945).

A case directly on point with the case at bar is The Matter of Flint Resources, 1989 OK 9, 780 P.2d 665. Flint Resources concerned Oklahoma corporate income tax in which the corporation elected a federal income tax credit for foreign taxes paid rather than a federal income tax deduction for foreign taxes paid. When the federal credit was taken, the Oklahoma Tax Commission did not allow an additional deduction for the foreign taxes paid on the Oklahoma return. The taxpayer contended that the Tax Commission's position was contrary to the Fourteenth Amendment, but the Supreme Court disagreed. The Supreme Court held:

> In order for a tax classification to pass constitutional muster, there must be a reasonable classification and reasonable opportunity for uniform or equal incidence upon the class created. Here, the broad classification encompasses corporations either doing business within the state or deriving income from within the state. In the absence of arbitrary distinctions, the Fourteenth Amendment does not prevent double taxation. Any double taxation arising from Oklahoma's tax of foreign taxes results not from arbitrary state action, but from a voluntary election to claim the foreign tax credit rather than the deduction from federal taxable income for taxes paid.

The Court's holding in Flint Resources is controlling authority for the case at bar. PROTESTANT's election to take a federal tax credit rather than a deduction, thereby increasing Oklahoma income tax due, is not a result of arbitrary state action, but a voluntary election on the part of PROTESTANT. The Supreme Court has ruled in Oklahoma Association for Equitable Taxation v. City of Oklahoma City, 1995 OK 62, 901 P.2d 800, that statutes are interpreted to avoid constitutional conflict, and all reasonable doubt is applied in favor of a statute's validity. A statutory discrimination will not be set aside if any set of facts reasonably may be conceived to justify it.

7. The protest should be denied in part and sustained in part.

DISPOSITION

It is the DETERMINATION of the OKLAHOMA TAX COMMISSION, based upon the specific facts and circumstances of this case, that the income tax protest of PROTESTANT be denied in part as to tax years 1993, 1994, and 1995, and be sustained in part as to tax year 1996.

ADDENDUM TO FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

1. That notice of the adjustment to the assessments was filed of record in this cause on December 14, 2001.

2. That the Division revised the income tax assessment to an amount of $3892.00, consisting of tax in the amount of $1710.00 and interest accrued through January 15, 2002, in the amount of $2182.00.

3. That the aggregate amount in controversy for income tax is $3892.00.

4. That the adjustment complies with the recommendations set forth in the findings.

5. That the Protestant was provided notice of the adjustment.

6. That the Protestant did not file a response to the adjustments.

It is further DETERMINED that the aggregate amount in controversy, inclusive of any additional accrued and accruing interest, be fixed as the deficiency due and owing.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are not 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.