JURISDICTION:	OKLAHOMA TAX COMMISSION
CITE:	2006-02-23-05
ID:	P-04-177-K
DATE:	FEBRUARY 23, 2006
DISPOSITION:	SUSTAINED
TAX TYPE:	AD VALOREM – 5 YEAR MANUFACTURER'S EXEMPTION
APPEAL:	NONE TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above taxpayer protests the Ad Valorem Division's denial of the taxpayer's application for a manufacturer's five-year ad valorem tax exemption for failure to meet the increased payroll requirement. After a hearing, the Administrative Law Judge entered findings of fact, conclusions of law, and a recommendation that the Division recalculate taxpayer's payroll and payroll increase, if any. We granted the Division's request for a hearing before the Commission *en bane*.

Now, having heard and considered the arguments of the parties and having reviewed the files and records herein, and being fully advised, we enter the following order, sustaining the taxpayer's protest.

FINDINGS OF FACT

1. Taxpayer, COMPANY, a manufacturer, is a Subchapter S corporation. Several of the shareholders of the corporation are also employees of the company.

2. In 2003, the company acquired additional facilities in ANYTOWN, Oklahoma, and added 61 full-time employees to its payroll. On March 12, 2004, taxpayer filed an application for the first year of a manufacturer's five-year ad valorem tax exemption on the acquired facility. According to the taxpayer's application, the average of the company's 3rd and 4th quarter payrolls for the year prior to the acquisition (2002) was $6,151,500 per quarter. The application reported the average quarterly payroll for the same periods subsequent to the acquisition (2003) to be $8,197,463, an increase of over $2 million per quarter, or an annualized payroll increase of over $8 million.

3. In 2002, taxpayer paid to two of the company's shareholders the sum of $11 million to allow them to pay the income taxes due as a result of the Subchapter S status of COMPANY. These shareholders were also employees of the company. In 2003, taxpayer distributed approximately $6.3 million to shareholder employees in addition to their salaries. These distributions were characterized as "bonuses" and were included on the company's quarterly wage reports to the Oklahoma Employment Security Commission ("OESC"). The payroll figures submitted by the taxpayer in its application for an ad valorem exemption did not include these distributions.

4. Taxpayer's exemption application was approved in part by the County Assessor and Board of Equalization of FAKE County, and forwarded to the Tax Commission's Ad Valorem

Division ("Division") for verification and review as provided by law. As part of that review, the Division examined the totals of the third and fourth quarter OESC quarterly wage reports for 2002 and 2003. The wage totals reported on those reports included the distributions paid to the shareholder employees.

5. The average of the 3rd and 4th quarter wages reported to the OESC for 2002, including the distributions to shareholder employees, was $11.6 million; for 2003 it was $10.13 Million. This equates to a quarterly *decrease of* approximately $1.5 million, for an annualized payroll decrease of $6 million, rather than the $8 million increase asserted in the application.

6. The Division denied taxpayer's 2004 application for a manufacturing exemption *for* "*insufficient* increase of payroll," and taxpayer protests.

CONCLUSIONS OF LAW

1. Pursuant to the Oklahoma Constitution and implementing statutes, a qualifying manufacturing firm shall be exempt from the levy of any ad valorem taxes upon new, expanded or acquired manufacturing facilities for a period of five years. OKLA. CONST. Art. X, §6B; 68 O.S. Supp. 2003, §2902. As applicable here, taxpayer's application for the exemption "shall be granted only if there is a net increase in annualized payroll at the facility of at least One Million Dollars ($1,000,000)." 68 O.S. Supp. 2003, § 2902(C)(4)(a)(ii). The statute also provides:

> The Oklahoma Tax Commission shall verify all payroll information through the Oklahoma Employment Security Commission. Payroll shall be verified by the Oklahoma Tax Commission by using the average of the third and fourth quarter Oklahoma Employment Security Commission reports of the calendar year immediately preceding the year for which initial application is made for base-line payroll.
>
> ***
>
> "For purposes of this section, calculation of the amount of increased payroll shall be measured from the start of initial construction or expansion to the completion of such construction or expansion or for three (3) years from the start of initial construction or expansion, whichever occurs first."

68 O.S. Supp. 2003, §2902(C)4).

2. Taxpayer argues that the Division's use of only the third and fourth quarter OESC wage report totals of 2002 and 2003 in determining taxpayer's annualized payrolls is erroneous; that the distributions paid to shareholder employees should not be considered in calculating annualized payroll; and that the statute's imposition of any payroll requirement at all is

unconstitutional, [1]' We conclude that the Division's use of the third and fourth quarter reports of 2002 and 2003 for verification purposes was proper, and that the payroll provisions set forth in §2902 fall well within the Constitutional provision's mandate. However, we agree with the taxpayer that the non- salary distributions to shareholder employees were properly excluded from "payroll" for purposes of §2902, and that the consideration of only the totals shown by the OESC reports, which included those distributions, was erroneous.

3. The fundamental rule of statutory construction is to ascertain and, if possible, give effect to the intention and purpose of the legislature as expressed in a statute. *Samson Hydrocarbons Co. v. Oklahoma Tax Commission,* 1998 OK 82, 976 P.2d 532. The legislative intent behind a statute is to be ascertained from the whole act in light of its general purpose and object. *TRW/Reda Pump v. Brewington,* 829 P.2d 15 (Okla. 1992). Further, statutes must be read to render every part operative, and to avoid rendering arty part superfluous or useless. *Bryant v. Commissioner of the Dept. of Public Safety, State of Okla.,* 1996 OK 134, 937 P.2d 496.

4. As to the constitutionality of the statute, the Constitution provides that the Legislature "shall define the term 'manufacturing facility' for purposes of the ad valorem. tax exemption provided by this section *in order to promote full employment of labor resources within the state"* and "shall enact laws to carry out [this section's] provisions." OKLA. CONST. Art. X, § 6B(D) and (E) (emphasis added). Clearly, the Legislature's requirement that, in order to qualify for the exemption, a manufacturing facility show an increase in payroll by virtue of the facility's acquisition, construction or expansion, is well within and consistent with that mandate.

5. We further conclude that the Division's comparison of the average of the third and fourth quarters of 2003 (the "base-line" payroll) with the same period of the previous year is reasonable and consistent with the statute. First the use of the third and fourth quarters of 2003, the calendar year immediately preceding the year for which initial application for exemption was made (2004), is mandated by statute. 68 O.S.Supp.2003, §2902(C)(4)(a)(ii). This post-acquisition payroll, once annualized, is the "base-line" payroll, *ibid.,* which must be maintained or increased in succeeding exemption years, and which must be at least $1 million greater than the annualized payroll level existing *prior* to the acquisition, new construction or expansion.[2] Secondly, although the statute does not specify *which* pre-acquisition period or periods should be annualized and compared to the base-line payroll, we think that the use of the same quarters of the prior year is a reasonable method of making an accurate comparison.

This is also similar to the method prescribed by 68 O.S. 2001, §2357.4, which provides for an income tax credit for an increase in the number of employees engaged in manufacturing. That section provides that "[t]he number of new employees shall be determined by comparing the monthly average number of full-time employees...for the final quarter of the taxable year *with the corresponding period of the prior taxable year." Id.,* subsec. (F) (emphasis added). We

[1] 'Taxpayer also argues that a 2005 amendment to §2902, Laws 2005, c. 479, §22, retroactively eliminates any requirement of an increase in payroll for the ad valorem tax year 2004, and also retroactively authorizes taxpayer to elect to exclude all payments to oer-employees from its payroll. While we do not agree that the 2005 amendment is retroactive, in view of our decision in this case we do not reach this argument.

[2] The whole tenor of the statute is that the required increase in payroll be measured and compared from a time *prior* to the acquisition, construction or expansion to a time *afterward.* 68 *OS.* Supp. 2003, §2902(C)(4).

do not agree that the Division's use of the prior year's third and fourth quarter reports for comparison was improper.

6. However, we do not think that the Division can simply compare the totals shown by one set of OESC reports with that shown by another, and. arrive at an irrebuttable presumption as to the taxpayer's payroll for purposes of §2902. The taxpayer must be given an opportunity to explain any discrepancies or variations between the payroll shown on the taxpayer's application and the total "wages" shown by OESC records.

7. Obviously, employee bonuses that are part of the employee's compensation for his services are to be considered in calculating the employer's "payroll." *See,* BLACK'S LAW DICTIONARY (8th ed. 2004), *payroll;* I.R.C. § 61, Treas. Reg. §1.61-2. At the same time, whether payments to shareholder employees are additional compensation for their services as employees or are made for some purpose unrelated to their employee status is a question of *fact.* Here, we find and conclude that the non-salary distributions to these shareholder employees were not part of their compensation for services as employees, and, accordingly, were not part of protestant's payroll for purposes of §2902.

8. For the foregoing reasons, taxpayer's protest should be sustained.

DISPOSITION

IT IS, THEREFORE, ORDERED that the within and foregoing protest is sustained.

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.