JURISDICTION:	OKLAHOMA TAX COMMISSION
CITE:	2007-01-11-02 (Non-Precedential)
ID:	P-05-101-H
DATE:	JANUARY 11, 2007
DISPOSITION:	DENIED
TAX TYPE:	INCOME
APPEAL:	PENDING, CIV. APP. TC-104301

FINDINGS OF FACT AND CONCLUSIONS OF LAW

PROCEDURAL HISTORY

On June 10, 2005, the protest file was received by this office for further proceedings consistent with the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure Before the Oklahoma Tax Commission.[2] On August 9, 2005, a letter was mailed to the Protestant stating that this matter had been assigned to ALJ, Administrative Law Judge, and docketed as Case Number P-05-101-H. The letter also advised the Protestant that a Notice of Prehearing Conference would be sent by mail and enclosed a copy of the *Rules of Practice and Procedure Before the Oklahoma Tax Commission.* On August 24, 2005, the Notice of Prehearing Conference was mailed to the last known address of the Protestant, setting the prehearing conference for October 5, 2005, at 1:30 p.m.[3] On October 4, 2005, a Joint Motion for Continuance was filed by the parties to allow additional time to conduct an informal conference to expedite the resolution of this matter. On October 4, 2005, the motion was granted and a Notice of Prehearing Conference was mailed to the parties resetting the prehearing conference for October 27, 2005, at 2:00 p.m. The prehearing conference was held as scheduled. The parties requested additional time to expedite the resolution of this matter. On October 28, 2005, a letter was mailed to the parties directing that a status report was to be filed on or before November 28, 2005. On November 28, 2005, the Division filed a Status Report advising that a Proposed Scheduling Order had been submitted to Counsel for the Protestant. On November 30, 2005, a letter was mailed to the parties stating that the proposed scheduling order was to be filed on or before January 5, 2006. On December 9, 2005, the Proposed Scheduling Order was submitted. On December 14, 2005, the Scheduling Order was issued in accordance with the parties' request.

On May 11, 2006, the parties filed the Stipulation of Facts in this matter. On May 12, 2006, the Protestant's Brief was filed and re-filed on May 15, 2006, with the exhibits attached thereto. On May 26, 2006, the Response Brief of the Division was filed. On June 15, 2006, the Reply Brief of the Protestant was filed. On May 26, 2006, the Response Brief of the Division was filed and on June 22, 2006, a Corrected Response Brief was filed by the Division. On June 30, 2006, a Motion to File Response to Protestant's Reply was filed by the Division. The Protestant was given until July 17, 2006, to file a response to the Division's motion. On July 17, 2006, the Protestant filed its Objection to the Division's Motion. On July 19, 2006, an Order Granting Motion to File Response to Protestant's Reply was issued by the undersigned. The Protestant was given until August 2, 2006, for filing a reply. On August 2, 2006, the Protestant filed its Reply to Division's Second Response Brief. The record in this matter was closed on August 2, 2006, and this case was submitted for decision.

STIPULATION OF FACTS

This matter has been submitted for decision on briefs at the request of the parties.[4] The following facts were stipulated,[5] as follows, to-wit:

1. Protestant does business both within and without the State of Oklahoma.

2. On or about August 21, 2000, Protestant filed its Oklahoma Corporation Income Tax Return (Form 512) for the tax year ending December 31, 1999. Exhibit A.

3. On or about September 24, 2001, Protestant filed its Oklahoma Corporation Income Tax Return (Form 512) for the tax year ending December 31, 2000. Exhibit B.

4. On or about February 10, 2003, Protestant filed its Oklahoma Corporation Income Tax Return (Form 512) for the tax year ending December 31, 2001. Exhibit C.

5. On or about September 15, 2003, Protestant filed its Oklahoma Corporation Income Tax Return (Form 512) for the tax year ending December 31, 2002. Exhibit D.

6. On or about September 15, 2004, Protestant filed its Oklahoma Corporation Income Tax Return (Form 512) for the tax year ending December 31, 2003. Exhibit E.

7. On or about April 8, 2005, the Division issued its assessment for the tax periods 1999, 2000, 2001, 2002 and 2003 in the amount of Three Hundred Two Thousand Six Hundred Sixty-two Dollars ($302,662.00), consisting of One Hundred Ninety-nine Thousand Two Hundred Seventy-nine Dollars ($199,279.00) tax, plus Ninety-two Thousand and Eight Dollars ($92,008.00) in interest through June 9, 2005 and penalty in the amount of Eleven Thousand Three Hundred Seventy-five Dollars ($11,375.00). Exhibit F.

8. On or about June 2, 2006, the Protestant timely filed its written protest to the assessment. Exhibit G.

9. On or about May 2, 2006, the Division issued its revised assessment for the tax periods 1999, 2000, 2001, 2002 and 2003 in the amount of Three Hundred Four Thousand Six Hundred Seventy-four Dollars ($304,674.00), consisting of One Hundred Eighty-four Thousand Five Hundred Thirty-three Dollars ($184,533.00) tax, plus One Hundred Nine Thousand Five Hundred Two Dollars ($109,502.00) interest through July 2, 2006 and penalty in the amount of Ten Thousand Six Hundred Thirty-nine Dollars ($10,639.00). Exhibit H.

ADDITIONAL FINDINGS OF FACT

Upon review of the file and records, including the record of the proceedings, Stipulation of Facts, the exhibits received into evidence, and the briefs, the undersigned finds:

10. The "Revised" Assessment issued by the Division on May 2, 2006, acknowledges that the statute of limitations for the assessment of additional tax for the 1999 and 2000 tax years has expired.[6]

11. The Protestant is a foreign[7] corporation (Pennsylvania Corporation) doing business[8] both within and without the State of Oklahoma.[9] The Protestant operates radio stations in Oklahoma, Florida, and Pennsylvania. In Oklahoma the Protestant owns and operates KABC-FM, KDEF-FM, KGHI-FM, and KJKL-AM in BIG CITY, KMNO-FM in OTHER CITY, and KPQR-FM in RANDOM CITY.[10]

12. The Protestant is a member of an affiliated[11] group of companies, which file a consolidated Federal Corporation Income Tax Return. The Protestant files a separate Oklahoma Corporate Income Tax Return.[12]

13. The Protestant claimed interest expenses on its U.S. Corporation Tax Returns[13] (Form 1120) as follows, to-wit:

2003	2002	2001	2000	1999
$8,274,329	$2,427,356	$4,179,699	$5,883,439	$4,619,130

14. The "Revised" assessment for the 2003, 2002, and 2001 tax years ("Audit Periods") issued by the Division on May 2, 2006, is as follows, to-wit:

	2003	2002	2001	Totals
Tax (6%)	$ 116,349	$ 176,615	$ 93,659	$ 386,623
Less Tax Previously Paid	(144,612)	(57,478)	0.00	(202,090)
Additional Tax Due/Overpayment	(28,263)	119,137	93,659	184,533
2003 Overpayment Applied to 2001			(28,263)	
Balance of Tax Due	0.00	119,137	65,396	184,533
Penalty @ 5%	0.00	5,957	4,682	10,639
Interest @ 15% through 06/30/06	0.00	58,899	50,603	109,502
Total Tax, Penalty and Interest	$ 0.00	$ 183,993	$ 120,681	$ 304,674

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding.[14]

2. The Tax Commission has promulgated rules as provided by law to facilitate the administration, enforcement, and collection of taxes and other levies enacted by the Oklahoma Legislature with respect to income.[15]

3. The rules promulgated pursuant to the Administrative Procedures Act are presumed to be valid and binding on the persons they affect and have the force of law.[16]

4. Oklahoma imposes an income tax of six percent (6%) upon the Oklahoma Taxable Income of every corporation doing business within Oklahoma or deriving income from sources within Oklahoma.[17]

5. "Oklahoma Taxable Income" means "taxable income" as reported (or as would have been reported by the taxpayer had a return been filed) to the federal government, and in the event of adjustments thereto by the federal government as finally ascertained under the Internal Revenue Code, adjusted further as provided in the Oklahoma Income Tax Act.[18]

6. The starting point for computing Oklahoma Taxable Income is the taxable income shown before the Net Operating Loss and Special Deduction Line of the Federal Income Tax Return ("Line 28"). Federal Taxable Income is used for each separate corporation doing business in Oklahoma, whether a Consolidated Federal or a Consolidated Oklahoma Income Tax Return is filed.[19] The "Revised" Assessment[20] issued by the Division correctly states the starting point for computing Oklahoma Taxable Income for the Audit Periods.

7. All adjustments provided for under Oklahoma Income Tax Statutes are made from the starting point of Federal Taxable Income ("Adjustments Rule").[21]

8. "Unitary Income" means income derived from the conduct of each separate business in more than one state, all the factors of which are essential to determining the ultimate gain derived from the business enterprise as a whole, and not from its component parts which are too closely connected and necessary to each other to justify division or separate allocation. Each corporation must calculate its own Oklahoma Taxable Income/Loss separately, even when included in a Consolidated Return.[22]

9. Taxes based on or measured by income[23] are not deductible in computing the net apportionable income or loss of a unitary business enterprise.[24] The type of taxes that are based on or measured by income are:

(i) State and Local Income Taxes,
(ii) Foreign Income Taxes, and
(iii) some Franchise Taxes that are based on or measured by income.[25]

State and Local Taxes are added to the starting point of Federal Taxable Income, not subtracted, as stated by the Protestant.[26]

10. Partnership income or loss shall be separately allocated.[27] Generally, other income, unless it is separately allocable under Section 2358(A)(4), is apportionable.[28] The "Revised" assessment issued by the Division correctly states the Partnership Income or Loss separately allocated.

11. Income or loss derived from a unitary business enterprise shall be apportioned to Oklahoma on the basis of the average of three factors consisting of property, payroll, and sales or gross revenue.[29] There is no dispute that the Protestant is a "Unitary Business Enterprise" and that its income or loss is apportioned on the basis of the average of property, payroll, and sales for the Audit Periods.

12. Legislative intent controls statutory interpretation.[30] Intent is ascertained from the whole act in light of its general purpose and objective[31] considering relevant provisions together to give full force and effect to each.[32] The Court presumes that the Legislature expressed its intent and that it intended what it expressed.[33]

13. Statutes are interpreted to attain that purpose and end[34] championing the broad public policy purposes underlying them.[35]

14. Only where the legislative intent cannot be ascertained from the statutory language, i.e. in cases of ambiguity or conflict, are rules of statutory construction employed.[36] However, where the statutory language is ambiguous or uncertain, a construction is applied to avoid absurdities.[37]

15. The unitary business rule is a recognition of two imperatives:

> . . . the States' wide authority to devise formulae for an accurate assessment of a corporation's intrastate value or income; and the necessary limit on the States' authority to tax value or income which cannot in fairness be attributed to the taxpayer's activities within the State.[38]

The Division takes the position that "[a]lthough Protestant seems greatly confused regarding the purpose and legitimacy of the Division's interest expense adjustment, similar adjustments are used by a number of states to adjust expenses between unitary and non-unitary income and by the Internal Revenue Service regarding allocation of expense between domestic and foreign source income."[39]

However, the Protestant asserts that it "does not dispute the legality of the [Adjustments] Rule ("Oklahoma Administrative Code 710:50-17-51-6"), 68 O.S. §2358(A) ("Apportionment Method") or the ratio-based methodologies established therein," but "merely disputes that the Commission's *application* of <u>both</u> the Separate Allocation Method and the Apportionment Method is contrary to the plain language of the [Adjustments] Rule and [Apportionment Method] and unfairly diluting Protestant's interest expense by duplicating the disallowance of interest expense under both methods."[40]

The Protestant further states that "[t]he Oklahoma Apportionment Ratios for the tax periods at issue were: . . . 45.4588% (2001), 44.1303% (2002) and 44.1867% (2003). These ratios are not in dispute by the parties."[41] Therein lies the key to unlocking the dispute between the parties and the application of the Adjustments Rule, the Apportionment Rule (Oklahoma Administrative Code 710:50-17-71), and the Apportionment Method.

The parties' interpretations of how the Adjustments Rule, the Apportionment Rule, and the Apportionment Method should be applied (using the 2003 tax year, as representative of the Audit Periods) is illustrated as follows:

	Division's Position 2003	Protestant's Position 2003
Net Taxable Income	$ 145,372	$ 145,372
Add:		
Taxes Based Upon Income [42]	58,177	(58,177)
Interest Expense Disallowed	*4,324,404*	*8,274,329*
Total Additions:	*4,382,581*	*8,216,152*
Deduct Separately Allocated Items:		
Dividends	(100,203)	(100,203)
Interest Income	(83,218)	(83,218)
Net Gain (Loss) From 4797	30,957	30,957
Rental Income	(312,149)	(312,149)
Partnership Income (Loss)[43]	(464,238)	(504,879)
Total Deductions	(928,851)	(969,492)
Net Apportionable Income	*3,599,102*	*7,392,032*
Oklahoma Ratio	**44.1867%**	**44.1867%**
Oklahoma Apportionable Income	*1,590,324*	*3,266,295*
Add Items Separately Allocated to Oklahoma:		
Interest Income	790	790
Net Gain (Loss) from 4797	152	152
Partnership Income [44]	464,238	504,879
Oklahoma Accrued Tax[45]	(116,349)	
Interest Expense Allocated to Oklahoma		*(3,949,925)*
Total Additions	348,831	*(3,444,104)*
Oklahoma Taxable Income	*$ 1,939,155*	*$ (177,809)*

The text of the pertinent provision of the Adjustments Rule[46] to adjust expenses *allocated to nontaxable income* is as follows, to-wit:

> **Expenses allocated to nontaxable income**. 68 O.S. § 2358(A)(4)[47] provides that deductions should be allocated to assets that may produce nontaxable income. When a corporation has an investment in subsidiaries, other corporation's bonds, U.S. Obligations or other types of securities that produce income which is excluded from Oklahoma income, an adjustment is required. *The expense adjustment is used to more clearly reflect true income. The manner in which this adjustment is made is as follows: A fraction, or percentage, is computed by dividing the average of investment in assets, the income from which is nontaxable by the average of total assets. This result is then applied to certain expenses claimed on the return.* Generally, interest expense is the only expense against which this result is applied. However, facts and circumstances may indicate that other expenses should be considered in this allocation. This adjustment will be considered in all cases where deemed appropriate. [See: 68 O.S. § 2358(A)(4)] (Emphasis added.)

The Adjustments Rule provides that deductions should be allocated to assets that may produce income which is not taxable to Oklahoma. The Adjustments Rule includes the formula by which the adjustment is to be made. Once the adjustment is made, the *disallowed* portion of the expense is then added back into Federal Taxable Income and subjected to adjustment.[48]

Accordingly, the Interest Expense Adjustments for the Audit Periods are calculated as follows, to-wit:

	2003	2002	2001
Total Beginning and Ending Investments[49]	$ 90,949,079	$ 90,949,078	$ 90,948,582
Average Investments	45,474,540	45,474,539	45,474,291
Total Beginning and Ending Assets.[50]	174,022,351	172,718,724	176,405,959
Average Assets	87,011,176	86,359,362	88,202,980
Ratio (Average Investments/Average Assets)[51]	52.2628%	52.6573%	51.5564%
Interest Expense Per Federal Return (Line 18)	8,274,329	2,427,356	4,179,699
Interest Expense *Disallowed* (Ratio times Interest Expense)[52]	$ 4,324,404	$ 1,278,180	$ 2,154,902

The language of the Adjustments Rule is plain and unambiguous. Once the Interest Expense Adjustment is calculated using the formula, then the "result" (Interest Expense *Disallowed*) is applied to interest expenses claimed by the Protestant on its U.S. Corporation Income Tax Return (Form 1120), Line 18. This portion of the Protestant's interest expense is not allowed as a deduction because it does not relate to Oklahoma Taxable Income and that figure is added to Federal Taxable Income, along with taxes based or measured by income (State and Local Income Taxes). This reading of the Adjustments Rule is further supported, when read in conjunction with the provisions of Section 2358(A)(4) and Section 2358(A)(5) of Title 68.[53]

All items separately allocated under the Adjustments Rule, such as Dividends, Interest Income, Capital Gains (Loss)-4797, Rental Income, and Partnership Income (Loss), are deducted, resulting in Net Apportionable Income.

What does not appear to be at dispute between the parties is the Division's calculation of the Apportionment Ratios for the Audit Periods. Using the Apportionment Formula in the Apportionment Rule and the Apportionment Method (Total Within Oklahoma Divided by the Total Within and Without Oklahoma), the Apportionment Ratios for the Audit Periods are calculated as follows, to-wit:

	2003	2002	2001
Property	37.0033%	37.4581%	38.5570%
Payroll	46.2757%	43.5852%	43.8538%
Sales	49.2810%	51.3477%	53.9656%
Total Percent	132.5600%	132.3910%	136.3764%

Average Percent (Ratio)	44.1867%	44.1303%	45.4588%

The Apportionment Ratio is then applied to Net Apportionable Income, resulting in Oklahoma Apportionable Income. The Apportionment Ratio is not applied to the total interest expense claimed on the federal return to determine a figure for "Oklahoma Allowed Expense" as stated by the Protestant.[54]

Items separately allocated to Oklahoma, such as Interest Income, Capital Gain (Loss)-4797, and Partnership Income (Loss), are added or deducted depending on whether the item is income or loss, resulting in Oklahoma Net Income Before Tax. Oklahoma Accrued Tax is then subtracted from Oklahoma Net Income Before Tax resulting in Oklahoma Taxable Income.[55]

The Protestant has failed to meet its burden of proof that the "Revised" assessment of income tax for the Audit Periods is incorrect and in what respects.

DISPOSITION

It is the ORDER of the undersigned Administrative Law Judge, based upon the specific facts and circumstances of this case, that the protest to the "Revised" income tax assessment for the Audit Periods should be denied.

It is further ORDERED that the total amount of income tax and penalty assessed for the Audit Periods should be fixed as the Protestant's deficiency and those amounts should be determined as due and owing, including interest, accrued and accruing.

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.

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[1] OKLA. STAT. ANN. tit. 68, § 201 et seq. (West 2001).

[2] OKLA. ADMIN. CODE §§ 710:1-5-20 through 710:1-5-47 (June 11, 2005).

[3] OKLA. STAT. ANN. tit. 68, § 208 (West 2001). The notice was mailed to the Protestant c/o REPRESENTATIVE , ACCOUNTING FIRM, LLP, 123 FAKE STREET, BIG CITY, Texas 12345.

[4] OKLA. ADMIN. CODE § 710:1-5-38 (June 25, 1999):

> When a taxpayer in an administrative proceeding does not request an oral hearing, or the parties agree that an oral hearing is not needed, the Administrative Law Judge will base the Findings, Conclusions and Recommendations on the position letters and briefs submitted by the parties. The Administrative Law Judge will mail notice of a date certain for each party to submit a position letter or brief setting out therein the statement of facts, issues to be determined, contentions and statutory and case law relied upon to support his contentions.

The Administrative Law Judge may schedule a conference between the parties if it is deemed necessary to clarify the positions of the parties.

[5] The text of the Stipulation of Facts is set out verbatim.

[6] Exhibit H. *See* OKLA. STAT. ANN. tit. 68, § 223(A) (West 2001):

> A. No assessment of any tax levied under the provisions of any state tax law except as provided in this section, shall be made after the expiration of three (3) years from the date the return was required to be filed or the date the return was filed, whichever period expires the later, and no proceedings by tax warrant or in court without the previous assessment for the collection of such tax shall be begun after the expiration of such period. No assessment shall be required if a report or return, signed by the taxpayer, was filed and the liability evidenced by the report or return has not been paid. If the assessment has been made within the limitation period set forth in this subsection, the tax may be collected by tax warrant or court proceeding, but only if the tax warrant is issued or the proceeding begun within ten (10) years after the assessment of the tax has become final.

See also Division's Response Brief filed May 26, 2006.

[7] OKLA. STAT. ANN. tit. 18, § 1130(A) (West Supp. 2006):

> As used in the Oklahoma General Corporation Act, the words 'foreign corporation' means a corporation organized pursuant to the law of any jurisdiction other than this state.

[8] OKLA. STAT. ANN. tit. 68, § 1202 (West 2001):

> When the term "doing business" is used in this article, it shall mean and include each and every act, power or privilege exercised or enjoyed in this State, as an incident to, or by virtue of the powers and privileges acquired by the nature of such organizations, as are enumerated in the preceding section.

[9] Brief of Protestant filed May 12, 2006.

[10] Exhibit G.

[11] OKLA. ADMIN. CODE § 710:40-1-2 (June 26, 2003).

[12] *See* Note 9.

[13] Exhibits A through E.

[14] OKLA. STAT. ANN. tit. 68, § 221(D) (West Supp. 2006).

[15] OKLA. ADMIN. CODE § 710:50-1-1 (Text current through June 1, 2006).

[16] OKLA. STAT. ANN. tit. 75, § 250 et seq. (West 2001).

[17] OKLA. STAT. ANN. tit. 68, § 2355(C) (West Supp. 2006).

[18] OKLA. STAT. ANN. tit. 68, § 2353(12) (West Supp. 2006).

[19] OKLA. ADMIN. CODE § 710:50-17-50 (Text current through May 15, 2006). *See* Oklahoma Tax Commission Order No. 2005-04-19-13 (April 19, 2005), 2005 WL 1827937 (Okl. Tax. Com.).

[20] Exhibit H. *See* Protestant's Brief filed May 12, 2006. The Protestant agrees with the Division's starting point for the Audit Periods.

[21] OKLA. ADMIN. CODE § 710:50-17-51 (June 25, 2004):

> The following is a partial list and not inclusive of all the allowable and unallowable adjustments that may be made to Federal taxable income to arrive at Oklahoma taxable income for corporations:
>
> (1) **Taxes based on income**. [See: 68 O.S. § 2358(A)(5)]
> (A) Taxes based on or measured by income shall not be allowed as a deduction.
> (B) Type of taxes that are based on or measured by income are:
> (i) State and Local Income Taxes,
> (ii) Foreign Income Taxes, and
> (iii) some Franchise Taxes that are based on or measured by income.
>
> …
>
> (2) **Federal income taxes**. Federal Income Taxes are not deductible.
>
> …
>
> (5) **Oklahoma accrued income tax**. Oklahoma will allow a deduction for Oklahoma Accrued Income Tax. The Oklahoma Accrued Income Tax is computed by dividing Oklahoma Net Income by the number 21 (twenty-one) for tax years beginning after December 31, 1984, and the number 26 (twenty-six) for tax years beginning before January 1, 1985. For tax years beginning after December 31, 1989, the number 17.6667 shall be used. There is no deduction for Oklahoma Accrued Income Tax when Oklahoma Net Income is a loss. [See: 68 O.S. § 2358(A)(5)] When credits are allowed, the accrual of Oklahoma tax will not be allowed on the amount of Oklahoma taxable income that is covered by the credit. Tax accrual is allowed on the amount of income for which tax is actually paid. The example in Appendix A of this Chapter shows how the accrual should be calculated. A schedule such as the example should be attached and submitted with Form 512.
> (6) **Expenses allocated to nontaxable income**. 68 O.S. § 2358(A)(4) provides that deductions should be allocated to assets that may produce nontaxable income. When a corporation has an investment in subsidiaries, other corporation's bonds, U.S. Obligations or other types of securities that produce income which is excluded from Oklahoma income, an adjustment is required. The expense adjustment is used to more clearly reflect true income. The manner in which this adjustment is made is as follows: A fraction, or percentage, is computed by dividing the average of investment in assets, the income from which is nontaxable by the average of total assets. This result is then applied to certain expenses claimed on the return. Generally, interest expense is the only expense against which this result is applied. However, facts and circumstances may indicate that other expenses should be considered in this allocation. This adjustment will be considered in all cases where deemed appropriate. [See: 68 O.S. § 2358(A)(4)]
> (7) **Interest income.**
> (A) **U. S. obligations**. Interest income from U.S. obligations are excluded from Federal taxable income to arrive at Oklahoma taxable income. Interest income received from FNMA, GNMA, or the Internal Revenue Service is not income from an obligation of the U.S. government and cannot be excluded to arrive at Oklahoma taxable income.
> (B) **Other interest income**.
> (i) Interest income is to be directly allocated to the domiciliary situs of the taxpayer; except that interest income received from accounts receivable income shall be included in apportionable income.
> (ii) There shall be added to Oklahoma taxable income, interest income on obligations of any state or political subdivision thereof which is not otherwise exempted pursuant to Federal laws or laws of this State, to the extent said interest is not included in federal taxable income or adjusted gross income.

(8) **Dividends**. Dividends are to be allocated to the domiciliary situs of the taxpayer. [See: 68 O.S. § 2358(A)(4)(b)]

…

(12) **Net rental income and safe harbor leasing**. The following provisions apply to the treatment of net rental income and safe harbor leasing:

(A) Net Rental Income is separately allocated. [See: 68 O.S. § 2358(A)(4)]

(B) A schedule of Net Rental Income is required to be filed with the return showing gross income and all expenses (depreciation, repairs, taxes, interest, general and administrative expense, etc.).

…

(14) **Capital gains or loss - 4797 gains or loss**.

(A) Gains (losses) from the sale or other disposition of unitary assets or any other assets used in the unitary enterprise are apportionable. [See: 68 O.S. § 2358(A)(5)]

(B) Gains (losses) from sale of property, the income from which is separately allocated shall also be separately allocated.

(15**) Partnership income or loss from corporate partners**.

(A) Partnership income or loss shall be separately allocated. [See: 68 O.S. § 2358(A)(4)]

(B) The Oklahoma distributive share of partnership income as determined under 68 O.S. § 2358 and 68 O.S. § 2362 shall be allocated to Oklahoma.

…

(18) **Deductions related to directly allocated income/loss**. Deductions incurred in producing income of a nonunitary nature shall be allocated on the same basis as the income. (Examples: Liquidation of subsidiaries, worthless stock loss, bad debts due subsidiaries on sale of stock, etc.) [See: 68 O.S. § 2358(A)(4)]

…

[22] OKLA. ADMIN. CODE § 710:50-17-70 (Text is current through May 15, 2006). *See Matter of Income Tax Protest of Ashland Exploration, Inc.*, 1988 OK 23, 751 P.2d 1070.

[23] OKLA. STAT. tit. 68, § 2358(A)(5) (West Supp. 2004). *See* OKLA. ADMIN. CODE § 710:50-17-51(1)(A) (June 25,2004).

[24] "A business that operates in more than one state is a 'unitary business' for income tax purposes when operations conducted in one state benefit and are benefited by operations in one or more states and where the various aspects are so interdependent and of such mutual benefit that they are considered to form one integral business." *Geoffrey, Inc. v. Oklahoma Tax Commission*, 2006 OK CIV APP 27, 132 P.3d 632 *citing Flint Resources Company v. Oklahoma Tax Commission*, 1989 OK 9, 780 P.2d 665.

[25] OKLA. ADMIN. CODE § 710:50-17-51(1)(B) (June 25, 2004).

[26] *See* Protestant's Brief filed May 12, 2006, Page 10.

[27] OKLA. ADMIN. CODE § 710:50-17-51(15)(A) (June 25, 2004).

[28] OKLA. ADMIN. CODE § 710:50-17-51(20) (June 25, 2004).

[29] OKLA. STAT. tit. 68, § 2358 (A)(5) (West Supp. 2004).

See OKLA. ADMIN. CODE § 710:50-17-71 (June 25, 2001):

Income or loss derived from a unitary business enterprise shall be apportioned to Oklahoma on the basis of the average of three factors consisting of property, payroll and sales or gross revenue.

…

(1) **Sales factor**.

(A) **Sales factor**. The sales factor shall include only sales and does not include sales or revenue which are separately allocated.

(i) Oklahoma does not allow receipts from items other than sales to be included in the formula even though other types of income (royalties, interest, capital gains, and other income) are included in the apportioned income.

(ii) The provisions of (A) and (A)(i) of this paragraph apply to the sales factor for most corporations, with the exception of gross receipts being used as a basis for a financial organization or other organizations whose sales do not represent their principal activity.

(B) **Throwback of Oklahoma sales**. If taxpayer is not doing business in the destination state of the shipment, then those sales of tangible personal property are considered to have a situs in Oklahoma if the property is shipped from an office, warehouse, factory or other place of storage in Oklahoma.

…

(2) **Property factor**.

(A) **Original costs (average).** The property factor is the average value at original cost of the taxpayer's real and tangible personal property owned or rented and used in this State during the tax period to the total average of all real and tangible personal property owned or rented and used everywhere.

…

(C) **Rental property**. Rental property is valued at eight (8) times the net annual rent expense.

(D) **Property separately allocated**. Property, the income from which is separately allocated in 68 O.S. §2358(A)(4), shall not be included in determining the property factor.

(3) **Payroll factor**.

(A) **Payroll factor**. The numerator is the total compensation for services rendered in the state during the tax period, and the denominator is the total compensation for services rendered everywhere during the tax period.

…

(C) **Officers**. Officers' salaries, wages and other compensation are not part of the computation of the payroll factor, for tax years beginning after December 31, 1982.

…

[30] *World Publishing v. Miller*, 2001 OK 49, ¶7, 32 P.3d 829.

[31] *Id.* at ¶7.

[32] *Id.* at ¶7.

[33] *Id.* at ¶7.

[34] *Id.* at ¶7.

[35] *Id.* at ¶7.

[36] *Id.* at ¶7.

[37] *Id.* at ¶7.

[38] *Matter of Income Tax Protest of Griffin Television, Inc.*, 1994 OK 35, 877 P.2d 588.

[39] *See* Response Brief of the Audit Division filed May 26, 2006, Page 7.

[40] *See* the Reply Brief in Support of Protestant filed June 15, 2006, Page 4.

[41] *See* Brief in Support of Position of Protestant filed May 12, 2006, Page 2, Note 1.

[42] *See* Note 21.

[43] *See* Note 26. The Protestant incorrectly includes "miscellaneous" income in its figure for Partnership Income (Loss). The revised assessment correctly states the figure for Partnership Income (Loss).

[44] *See* Note 43.

[45] OKLA. ADMIN. CODE § 710:50-17-51(5) (June 25, 2004).

[46] OKLA. ADMIN. CODE § 710:50-17-51(6) (June 25, 2004).

[47] OKLA. STAT. tit. 68, § 2358 (A) (West Supp. 2004):

> For all tax years beginning after December 31, 1981, taxable income and adjusted gross income shall be adjusted to arrive at Oklahoma taxable income and Oklahoma adjusted gross income as required by this section.
>
> A. The taxable income of any taxpayer shall be adjusted to arrive at Oklahoma taxable income for corporations and Oklahoma adjusted gross income for individuals, as follows:
>
> …
>
> 4. Items of the following nature shall be allocated as indicated. Allowable deductions attributable to items separately allocable in subparagraphs a, b and c of this paragraph, whether or not such items of income were actually received, shall be allocated on the same basis as those items:
>
> a. Income from real and tangible personal property, such as rents, oil and mining production or royalties, and gains or losses from sales of such property, shall be allocated in accordance with the situs of such property;
> b. Income from intangible personal property, such as interest, dividends, patent or copyright royalties, and gains or losses from sales of such property, shall be allocated in accordance with the domiciliary situs of the taxpayer, except that:
> (1) where such property has acquired a nonunitary business or commercial situs apart from the domicile of the taxpayer such income shall be allocated in accordance with such business or commercial situs; interest income from investments held to generate working capital for a unitary business enterprise shall be included in apportionable income; a resident trust or resident estate shall be treated as having a separate commercial or business situs insofar as undistributed income is concerned, but shall not be treated as having a separate commercial or business situs insofar as distributed income is concerned,
> (2) income from such property which is required to be allocated pursuant to the provisions of paragraph 5 of this subsection shall be allocated as herein provided;
> c. Net income or loss from a business activity which is not a part of business carried on within or without the state of a unitary character shall be separately allocated to the state in which such activity is conducted;
>
> …

5. The net income or loss remaining after the separate allocation in paragraph 4 of this subsection, being that which is derived from a unitary business enterprise, shall be apportioned to this state on the basis of the arithmetical average of three factors consisting of property, payroll and sales or gross revenue enumerated as subparagraphs a, b and c of this paragraph. Net income or loss as used in this paragraph includes that derived from patent or copyright royalties, purchase discounts, and interest on accounts receivable relating to or arising from a business activity, the income from which is apportioned pursuant to this subsection, including the sale or other disposition of such property and any other property used in the unitary enterprise. Deductions used in computing such net income or loss shall not include taxes based on or measured by income. Provided, for corporations whose property for purposes of the tax imposed by Section 2355 of this title has an initial investment cost equaling or exceeding Two Hundred Million Dollars ($200,000,000.00) and such investment is made on or after July 1, 1997, or for corporations which expand their property or facilities in this state and such expansion has an investment cost equaling or exceeding Two Hundred Million Dollars ($200,000,000.00) over a period not to exceed three (3) years, and such expansion is commenced on or after January 1, 2000, the three factors shall be apportioned with property and payroll, each comprising twenty-five percent (25%) of the apportionment factor and sales comprising fifty percent (50%) of the apportionment factor. The apportionment factors shall be computed as follows:

a. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property everywhere owned or rented and used during the tax period.
   (1) Property, the income from which is separately allocated in paragraph 4 of this subsection, shall not be included in determining this fraction. The numerator of the fraction shall include a portion of the investment in transportation and other equipment having no fixed situs, such as rolling stock, buses, trucks and trailers, including machinery and equipment carried thereon, airplanes, salespersons' automobiles and other similar equipment, in the proportion that miles traveled in Oklahoma by such equipment bears to total miles traveled,
   (2) Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer, less any annual rental rate received by the taxpayer from subrentals,
   (3) The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the Oklahoma Tax Commission may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property;

b. The payroll factor is a fraction, the numerator of which is the total compensation for services rendered in the state during the tax period, and the denominator of which is the total compensation for services rendered everywhere during the tax period. "Compensation", as used in this subsection means those paid-for services to the extent related to the unitary business but does not include officers' salaries, wages and other compensation.
   (1) In the case of a transportation enterprise, the numerator of the fraction shall include a portion of such expenditure in connection with employees operating equipment over a fixed route, such as railroad employees, airline pilots, or bus drivers, in this state only a part of the time, in the proportion that mileage traveled in Oklahoma bears to total mileage traveled by such employees,
   (2) In any case the numerator of the fraction shall include a portion of such expenditures in connection with itinerant employees, such as traveling salespersons,

in this state only a part of the time, in the proportion that time spent in Oklahoma bears to total time spent in furtherance of the enterprise by such employees;

c. The sales factor is a fraction, the numerator of which is the total sales or gross revenue of the taxpayer in this state during the tax period, and the denominator of which is the total sales or gross revenue of the taxpayer everywhere during the tax period. "Sales", as used in this subsection does not include sales or gross revenue which are separately allocated in paragraph 4 of this subsection.

(1) Sales of tangible personal property have a situs in this state if the property is delivered or shipped to a purchaser other than the United States government, within this state regardless of the FOB point or other conditions of the sale; or the property is shipped from an office, store, warehouse, factory or other place of storage in this state and (a) the purchaser is the United States government or (b) the taxpayer is not doing business in the state of the destination of the shipment.

(2) In the case of a railroad or interurban railway enterprise, the numerator of the fraction shall not be less than the allocation of revenues to this state as shown in its annual report to the Corporation Commission.

(3) In the case of an airline, truck or bus enterprise or freight car, tank car, refrigerator car or other railroad equipment enterprise, the numerator of the fraction shall include a portion of revenue from interstate transportation in the proportion that interstate mileage traveled in Oklahoma bears to total interstate mileage traveled.

(4) In the case of an oil, gasoline or gas pipeline enterprise, the numerator of the fraction shall be either the total of traffic units of the enterprise within Oklahoma or the revenue allocated to Oklahoma based upon miles moved, at the option of the taxpayer, and the denominator of which shall be the total of traffic units of the enterprise or the revenue of the enterprise everywhere as appropriate to the numerator. A "traffic unit" is hereby defined as the transportation for a distance of one (1) mile of one (1) barrel of oil, one (1) gallon of gasoline or one thousand (1,000) cubic feet of natural or casinghead gas, as the case may be.

(5) In the case of a telephone or telegraph or other communication enterprise, the numerator of the fraction shall include that portion of the interstate revenue as is allocated pursuant to the accounting procedures prescribed by the Federal Communications Commission; provided that in respect to each corporation or business entity required by the Federal Communications Commission to keep its books and records in accordance with a uniform system of accounts prescribed by such Commission, the intrastate net income shall be determined separately in the manner provided by such uniform system of accounts and only the interstate income shall be subject to allocation pursuant to the provisions of this subsection. Provided further, that the gross revenue factors shall be those as are determined pursuant to the accounting procedures prescribed by the Federal Communications Commission.

In any case where the apportionment of the three factors prescribed in this paragraph attributes to Oklahoma a portion of net income of the enterprise out of all appropriate proportion to the property owned and/or business transacted within this state, because of the fact that one or more of the factors so prescribed are not employed to any appreciable extent in furtherance of the enterprise; or because one or more factors not so prescribed are employed to a considerable extent in furtherance of the enterprise; or because of other reasons, the Tax Commission is empowered to permit, after a showing by taxpayer that an excessive portion of net income has been attributed to Oklahoma, or require, when in its judgment an insufficient portion of net income has been attributed to Oklahoma, the elimination, substitution, or use of additional factors, or reduction or increase in the weight of such prescribed factors. Provided, however, that any such variance from such prescribed factors which has the effect of increasing the portion of net income attributable to Oklahoma

> must not be inherently arbitrary, and application of the recomputed final apportionment to the net income of the enterprise must attribute to Oklahoma only a reasonable portion thereof.
>
> …
>
> (Emphasis added.)

[48] *See* Oklahoma Tax Commission Order No. 2005-04-19-13 (April 19, 2005), 2005 WL 1827937 (Okl. Tax. Com.).

[49] *See* Exhibits A through E, the Protestant's Federal Returns. Schedule L, Line 9, Column B plus Column D divided by 2 equals Average Investments.

[50] *See* Note 49. Schedule L, Line 15, Column B plus Column D divided by 2 equals Average Assets.

[51] OKLA. STAT. tit. 68, § 2358(A)(4) (West Supp. 2004) and OKLA. ADMIN. CODE § 710:50-17-51(4) (June 25, 2004).

[52] *See* Note 49.

[53] *See* Note 49.

[54] *See* Note 47.

[55] *See* Note 20. Using the 2003 tax year as an example, "Accrued Tax" is calculated as follows: 2,055,504 (Oklahoma Net Income Before Tax) divided by 17.6667 equals 116,349 (Accrued Tax).