JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2008-01-22-02 / NON-PRECEDENTIAL**
ID: **P-07-063-K**
DATE: **JANUARY 22, 2008**
DISPOSITION: **DENIED**
TAX TYPE: **FRANCHISE**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Protestant, COMPANY, is represented by PRESIDENT, CPA and President of Protestant. The Compliance Division of the Tax Commission (hereinafter "Division") is represented by OTC ATTORNEY, Assistant General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

An office audit of Protestant's 2005 through 2007 franchise tax returns, and 2003 through 2005 state and federal income tax returns was performed by the Division. As a result of the audit, the Division by letter dated February 16, 2007, proposed the assessment of additional franchise tax, interest and penalty against Protestant in the aggregate amount of $552.66. Protestant timely protested the proposed assessment by letter dated March 26, 2007.

On April 19, 2007, the Division referred the protest to the Office of the Administrative Law Judges (ALJ's 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]. The case was docketed as Case No. P-07-063-K and assigned to ALJ, Administrative Law Judge.[3]

A pre-hearing conference was scheduled for June 11, 2007, by *Prehearing Conference Notice* issued May 11, 2007.[4] By *Status Report* filed July 23, 2007, the parties jointly requested the issuance of a scheduling order whereby the protest would be submitted for decision pursuant to *OAC*, 710:1-5-38. A *Scheduling Order* was issued July 24, 2007.

A *Stipulation of Facts and Statement of Issue* was filed September 12, 2007. Exhibits 1 through 10 were submitted therewith. Protestant's *Brief in Chief* was filed October 17, 2007. The *Brief of the Compliance Division* was filed October 29, 2007. On November 19, 2007, the record was closed and the protest was submitted for decision.

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[1] 68 O.S. 2001, § 201 et seq.

[2] Rules 710:1-5-20 through 710:1-5-47 of the *Oklahoma Administrative Code* ("*OAC*").

[3] *See, OAC*, 710:1-5-22 and 710:1-5-30.

[4] *See, OAC*, 710:1-5-28.

FINDINGS OF FACT

Upon review of the file and records, including the *Stipulation of Facts and Statement of Issue*, the exhibits and the briefs, the undersigned finds:

A. The parties stipulate to the following:

1. On or about June 7, 2004, Protestant, an Oklahoma corporation doing business in Oklahoma, filed its 2005 Oklahoma Franchise Tax Return for the period of July 1, 2004 through June 30, 2005 (with a balance sheet as of tax year ended 12/31/03). Exhibit 1.

2. On or about January 13, 2004, Protestant filed its 2003 Oklahoma 512 corporate Income tax return (with 2003 federal 1120 corporate return attached) for the period of January 1, 2003 through December 31, 2003. Exhibit 2.

3. On its 2005 Franchise Tax Return, Protestant sought to claim $210,183.00 as current liabilities. Exhibit 1 (balance sheet, line 23 of 2005 franchise tax return) and 2 (Schedule L/balance sheet, lines 16 and 19 and lines 17 and 20, balance sheet, 2003 federal 1120[sic]).

4. On or about August 5, 2005, Protestant filed its 2006 Oklahoma franchise tax return for the period of July 1, 2005 through June 30, 2006 (with a balance sheet as of tax year ended 12/31/04). Exhibit 3.

5. On or about January 19, 2005, Protestant filed its 2004 Oklahoma 512 corporate Income tax return (with 2004 federal 1120 corporate return attached) for the period of January 1, 2004 through December 31, 2004. Exhibit 4.

6. On its 2006 Franchise Tax Return, Protestant sought to claim $252,478.00 as current liabilities. Exhibit 3 (balance sheet, line 23 of 2006 franchise tax return) and 4 (Schedule L/Balance Sheet, lines 16 and 19, and lines 17 and 20, 2004 federal 1120[sic]).

7. On or about August 24, 2006, Protestant filed its 2007 Oklahoma Franchise Tax Return for the period of July 1, 2006 through June 30, 2007 (with a balance sheet as of tax year ended 12/31/05). Exhibit 5.

8. On or about January 16, 2006, Protestant filed its 2005 Oklahoma 512-S corporate income tax return [sic] (with 2005 federal 1120-S corporate return attached) for the period of January 1, 2005 through December 31, 2005. Exhibit 6.

9. On its 2007 franchise tax return, Protestant sought to claim $205,552.00 as current liabilities. Exhibit 5 (franchise tax return balance sheet, line 23) and 6 (lines 17 and 20, 2005 [sic] federal 1120-S).

10. The Division performed an office audit of Protestant's franchise tax and Oklahoma corporate income tax returns for the above periods. The Division initially examined Protestant's 2004 Oklahoma 512 corporate income tax return and its corresponding 2006 franchise tax return

and noted that the corporate income tax return reflected the above described debt as long term, but the franchise tax return reported it as current liabilities. The Division examined the other years' income and franchise tax returns, and additionally examined Protestant's 2002 Oklahoma 512 corporate income tax return filed January 10, 2003. Exhibit 7. The Division then prepared audit work papers, including a detailed schedule of the history of the debt from December 31, 2001 through December 31, 2005, based on the information from the income tax returns, giving each reported advance a new inception date and calculating additional franchise tax due on the amount, based on its re-characterization as long-term debt for franchise tax purposes. Exhibit 8.

11. Based on the office audit, by letter dated February 16, 2007 the Division issued its assessment of additional franchise tax due for the period(s) July 1, 2004 through June 30, 2007 (franchise tax years 2005-2007) in the amount of $552.66, consisting of additional tax in the amount of $422.75, penalty in the amount of $42.28 and interest in the amount of $87.63 through April 16, 2007. Exhibit 9.

12. On March 28, 2007, the Division received Protestant's timely filed letter of protest. In the letter, Protestant stated that the only liability Protestant had during the periods in question was a bank loan in the form of a one-year note which was extended for another year if qualified. The letter also stated that the stockholder payable was an open account payable on demand. Exhibit 10.

B. Additional findings:

1. For franchise tax year 2005, the Division re-characterized as long-term debt $66,667.00 of the 2001 note in the amount of $100,000.00. Exhibit 8.

2. For franchise tax year 2006, the Division re-characterized as long-term debt $136,728.00 consisting of the total of the $100,000.00 note and $36,728.00 of a 2003 advance in the amount of $110,183.00. Exhibit 8.

3. For franchise tax year 2007, the Division re-characterized as long-term debt $140,627.00 consisting of the remaining balance of the 2001 note ($53,074.00), $73,455.00 of the 2003 advance and $14,098.00 of a 2004 advance of $42,295.00. Exhibit 8.

4. In a letter dated June 8, 2007, from ASSISTANT, Lending Assistant for LOAN OFFICER, BANK it is written that "Loan #XXX was originally in the name of PRESIDENT in the amount of $100,000.00 and the proceeds were used for investment of [Protestant]." The letter further provides "[Protestant] loan #ZZZ in the amount of $150,000.00 was made to payoff loan #XXX on June 13, 2006."[5]

5. Note #XXX issued June 13, 2001 in the name of PRESIDENT. The note history shows that it was renewed on June 13th of each year with the last renewal June 13, 2005.

[5] The letter and attached Note Inquiries, Basic Note Data(s) and Histories are received as evidence by official notice. *OAC*, 710:1-5-36.

ISSUE AND CONTENTIONS

The issue to be decided, as stipulated by the parties, is "[w]hether the Division properly re-characterized the debt reflected on [P]rotestant's corporate income tax returns as long-term debt and therefore capital employed in Oklahoma for Franchise Tax years 2005, 2006 and 2007.

Protestant contends that the loans were all due within one year from issue. Protestant further asserts that the loans were from PRESIDENT, its sole stockholder.

The Division contends that that it properly construed the loans as long term debt and correctly included them in Protestant's available capital for franchise tax purposes.

CONCLUSIONS OF LAW

WHEREFORE, premises considered, the undersigned concludes as a matter of law that:

1. The Tax Commission is vested with jurisdiction of the parties and subject matter of this protest. 68 O.S. Supp. 2002, § 221(D).

2. Every corporation organized under the laws of this state, or qualified to do, or doing business in Oklahoma in a corporate or organized capacity by virtue of creation or organization under the laws of this or any other state, territory or district, or a foreign country is subject to the terms of the Franchise Tax Code ("Code"). 68 O.S. 2001, §1201 et seq. *See*, ***Great Lakes Pipe Line Co. v. Oklahoma Tax Commission***, 204 Okla. 518, 1951 OK 123, 231 P.2d 655.

3. A "franchise or excise tax" is imposed upon every corporation or other business organization "equal to One Dollar and twenty-five cents ($1.25) for each One Thousand Dollars ($1,000.00) or fraction thereof of the amount of capital [or its equivalent] used, invested or employed" within Oklahoma. 68 O.S. 2001, § 1204. The amount of capital involved is not the subject of the tax but is the yardstick by which the amount of tax is measured. ***Scott-Rice Co. v. Oklahoma Tax Commission***, 1972 OK 75, 503 P.2d 208.

4. Franchise tax is levied on each corporation organized under the laws of this state and is measured by the amount of capital used, invested, or employed in the exercise of any power, privilege or right inuring to such organization within this state. 68 O.S. 2001, § 1203. The term "capital" as used in § 1203 is construed to include:

> Outstanding capital stock, surplus and undivided profits, which shall include any amounts designated for the payment of dividends until such amounts are definitely and irrevocably placed to the credit of stockholders subject to withdrawal on demand, plus <u>the amount of bonds, notes, debentures or other evidences of indebtedness maturing and payable more than three (3) years after issuance</u>. The term "capital" stock where herein used shall include all written evidence of interest or ownership in the control or management of a corporation or other organization. The term "evidence

> of indebtedness" where herein used shall not include any deposit made in any bank. (Emphasis Added).

68 O.S. 2001, § 1209(a).

5. "Current Liability" is defined to mean "any bond, note, debenture, or other evidences of indebtedness, or any portion thereof, payable within three (3) years or less after issuance." *OAC*, 710:40-1-2, ¶ 4. Current liability does not include "that portion of a debt which matures more than three (3) years after issuance. *Id*.

6. This case is controlled by the decision of the Court of Appeals in ***Big D Enterprises, Inc. v. Oklahoma Tax Commission***, 1995 OK CIV APP 32, 895 P.2d 743. The material facts as recited by the Court were; "Big D did not refinance its original note or roll it over into a new obligation, thereby extinguishing its original note", and "[i]nstead, Big D and its lender agreed they would 'hereby extend the time of payment of the principal indebtedness of the note' ". *Id.* at 745. Based on these facts, the Court held "[i]n so agreeing, [the] note * * * became payable six years after issuance, and the unpaid portion of that note became capital under § 1209(a)", citing *Mazzio's Corporation v. Oklahoma Tax Commission*, 1989 OK CIV APP 86, 789 P.2d 632. The Court reasoned that "the extension agreement was not a new note but was an agreement to extend the maturity date of the old note." *Id*.

7. A proposed assessment is presumed correct and the taxpayer bears the burden of showing it is incorrect, and in what respect. *OAC*, 710:1-5-47. See, ***Enterprise Management Consultants, Inc. v. Oklahoma Tax Commission***, 1988 OK 91, 768 P.2d 359, 362.

8. Protestant failed to come forward with any evidence to show the proposed franchise tax assessment is incorrect. The facts show the 2001 note was renewed on an annual basis. The facts further show the Division did not reclassify any of the stated indebtedness until after it had been carried on the books for more than three (3) years. Accordingly, the undersigned finds that the indebtedness is by definition "capital" and is required to be included in the computation of the amount of annual franchise tax levied upon and payable by Protestant. ***Big D***, *supra*.

9. Protestant's protest to the proposed franchise tax assessment should be denied.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the protest of Protestant, COMPANY, be denied. It is further ORDERED that the 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 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.