

JURISDICTION: OKLAHOMA TAX COMMISSION - DECISION
CITE: 2008-02-19-02 / NON-PRECEDENTIAL
ID: P-06-159-K
DATE: FEBRUARY 19, 2008
DISPOSITION: SUSTAINED
TAX TYPE: INCOME
APPEAL: NO APPEAL TAKEN

ORDER

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, including the Findings of Fact, Conclusions of Law and Recommendations made and entered by the Administrative Law Judge on the 27th day of December, 2007, the Commission makes the following Findings of Fact and Conclusions of Law and enters the following order.

STATEMENT OF THE CASE

An office audit of Protestant's Oklahoma corporation income tax returns for tax years 2003 and 2004 was conducted by the Audit Division of the Oklahoma Tax Commission. As a result of the audit, the Division disallowed a portion of the accrued income tax deductions claimed by Protestant on the returns thus reducing Protestant's 2004 income tax refund and by letter dated June 14, 2006, notified Protestant of the proposed adjustments. Protestant timely protested the proposed adjustments by letter dated July 21, 2006.

On August 29, 2006, the Division's file was referred to the Office of the Administrative Law Judges ("ALJ's Office") for further proceedings consistent with the Uniform Tax Procedure Code¹ and the Rules of Practice and Procedure before the Oklahoma Tax Commission². The protest was docketed as Case No. P-06-159-K and assigned to ALJ, Administrative Law Judge.³

A pre-hearing conference was scheduled for October 24, 2006, by *Prehearing Conference Notice* issued September 21, 2006.⁴ Pursuant to the conference, the parties were directed to file a status report. Upon *Status Report* filed February 9, 2007, a *Status Conference* was scheduled for March 6, 2007. Pursuant to the status conference, a *Prehearing Conference Order* was issued setting forth the procedure by which this matter would be submitted for decision.⁵

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 OAC, 710:1-5-22(b).

⁴ OAC, 710:1-5-28.

⁵ OAC, 710:1-5-28(b) and 710:1-5-38.

A *Joint Stipulation of Facts* was filed July 18, 2007. Exhibits A through C were submitted with the *Joint Stipulation*. Protestant's *Brief in Chief* was filed September 5, 2007. The *Reply Brief of the Audit Division* was filed October 1, 2007. The *Reply Brief of Petitioner* was filed October 22, 2007, whereupon the record was closed and the protest was submitted for decision.⁶

FINDINGS OF FACT

Upon review of the file and records, including the *Joint Stipulation of Facts*, the exhibits attached thereto and the pleadings of the parties, the Commission adopts the Findings of Fact proposed by the Administrative Law Judge as follows:

The following facts are taken from Protestant's *Brief in Chief*, *Statement of Facts*⁷, to-wit:

1. Protestant is an Oklahoma corporation with a fiscal year ended February 28.
2. During its taxable year ended February 28, 2004, Protestant purchased \$250,000.00 of Venture Capital Credit from an unrelated third party for cash in the sum of \$225,000.00.
3. Protestant timely filed its Oklahoma corporation income tax returns for the tax years 2003 and 2004.

The following facts are taken from a combination of Protestant's *Brief in Chief*, *Statement of Facts*, the *Joint Stipulation of Facts* and the exhibits submitted with the *Joint Stipulations*, to-wit:

1. On its 2003 tax return, Protestant reported zero (0) tax due by claiming an Oklahoma accrued income tax deduction of \$130,610.00 against its Oklahoma combined income of \$2,307,448.00, income tax due of \$130,610.00 on its Oklahoma combined taxable income of \$2,176,838.00 and \$130,610.00 of the \$250,000.00 Venture Capital Credit.
2. As computed by Protestant, \$119,390.00 of the \$250,000.00 Venture Capital Credit was available for carry forward to the 2004 tax year.
3. Upon audit of the 2003 tax return, the Division disallowed the accrued income tax deduction, thus finding income tax due of \$138,447.00 on Oklahoma combined taxable income of \$2,307,448.00, to which \$138,447.00 of the \$250,000.00 Venture Capital Credit was applied for a tax due of zero (0).
4. As computed by the Division, \$111,553.00 of the \$250,000.00 Venture Capital Credit was available for carry forward to the 2004 tax year.

⁶ OAC, 710:1-5-39.

⁷ The Division acquiesces to the fact pattern set out in Protestant's *Brief in Chief*. *Reply Brief of the Audit Division*, *Statement of Facts*.

5. On its 2004 tax return, Protestant reported an income tax refund of \$46,754.00 by claiming an Oklahoma accrued income tax deduction of \$117,637.00 against its Oklahoma combined income of \$2,494,910.00, income tax due of \$142,636.00 on its Oklahoma combined taxable income of \$2,377,273.00, tax previously paid of \$70,000.00 and a Venture Capital Credit of \$119,390.00.

6. The Division's audit of Protestant's 2004 tax return results in a proposed income tax refund of \$34,017.00, which is arrived at by allowing an Oklahoma accrued income tax deduction of \$35,983.00, thus disallowing \$81,654.00 of the accrued income tax deduction claimed by Protestant, finding an income tax due of \$147,536.00 on the Oklahoma combined taxable income of \$2,458,927.00 and applying to the income tax due, the tax previously paid of \$70,000.00 and a Venture Capital Credit of \$111,553.00.

7. By letter dated June 14, 2006, the Division notified Protestant of the proposed adjustments to Protestant's 2003 and 2004 Oklahoma corporation income tax returns.

8. Protestant timely protested the proposed adjustments by letter dated July 21, 2006.

9. The Division disallowed the Oklahoma accrued income tax deductions claimed by Protestant on its 2003 and 2004 Oklahoma corporation income tax returns to the extent that Protestant's income taxes for those years were paid or reduced by the Venture Capital Credits.

10. The amount in controversy is \$12,737.00, the difference between the income tax refund claimed by Protestant and the refund proposed by the Division for the 2004 tax year.

ISSUES AND CONTENTIONS

The issue presented for decision is whether under *OAC*, 710:50-17-51(5) the Division erred in disallowing Protestant's Oklahoma accrued income tax deductions to the extent Protestant's Oklahoma taxable income was covered by a purchased transferable credit against the Oklahoma tax due on said income.

Protestant admits that 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. However, Protestant contends that the submission of a credit certificate to the Commission constitutes a transfer of property in satisfaction of its income tax liability and therefore, tax accrual should be allowed. In support of this contention, Protestant cites Private Letter Ruling 200348002, wherein the Internal Revenue Service ruled that the submission of a transferable state credit certificate to offset a taxpayer's state income tax liability was analogous to the transfer of property in satisfaction of the liability and thus was a deductible payment of state income taxes. Protestant seeks to interpret the rule in a manner which makes a distinction between taxes which are covered by an earned credit and taxes which are covered by a purchased credit. It contends that the sentence in the rule which reads "Tax accrual is allowed on the amount of income for which tax is actually paid" should be construed to clarify and put into context the sentence of the Rule which reads "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." In the alternative, Protestant

contends that it has a deductible loss equal to its adjusted basis (purchase price) in the credit certificate since it transferred said property to the Commission without receiving any valuable consideration in return.

The Division contends that tax accrual is only allowed on the amount of income for which tax is actually paid, that the use of a credit is not the actual payment of tax and therefore accrual is not allowed on the amount of the credit used. The Division argues that Protestant's reliance on the Private Letter Ruling is misplaced since it has no precedential affect, can only be relied upon by the taxpayer requesting the ruling and presents facts and law which are distinguishable from the facts and law of this protest. The Division further contends that Protestant has not incurred a deductible loss from the transfer of its credit certificate since the certificate was credited to the extent of its face amount against the tax owing by Protestant in tax years 2003 and 2004.

CONCLUSIONS OF LAW

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

1. Jurisdiction of the parties and subject matter of this proceeding is vested in the Oklahoma Tax Commission. 68 O.S. 2001, § 207(c).

2. An Oklahoma income tax is "imposed on the Oklahoma taxable income of every corporation doing business within this state or deriving income from sources within this state." 68 O.S. 2001, § 2355(C). The "Oklahoma taxable income" of a corporation is its " '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 hereinafter provided." 68 O.S. 2001 § 2353(12).

3. A credit against the tax imposed by § 2355 of the Oklahoma Income Tax Act ("Act")⁸ is allowed for investment in qualified venture capital companies whose purpose is to establish or expand the development of business and industry within Oklahoma. 68 O.S. 2001, § 2357.7(A). The credit is twenty percent (20%) of the cash amount invested in qualified venture capital companies which is subsequently invested in an Oklahoma business venture by the qualified venture capital company, and may only be claimed for a taxable year during which the qualified venture capital company makes an investment in an Oklahoma business venture. 68 O.S. 2357.7(C). The credit to the extent not previously used is transferable to and by subsequent transferees for a period of three (3) years from the date of investment in the Oklahoma business venture. 68 O.S. 2001, § 2357.7(F). See *OAC*, 710:50-15-77.

4. Pursuant to its authority to facilitate the administration, enforcement and collection of any taxes levied by the tax laws of the State of Oklahoma, the Tax Commission with respect

⁸ 68 O.S. 2001, § 2351 et seq., as amended.

to the “Determination of Taxable Corporate Income”⁹ promulgated *OAC*, 710:50-17-51.¹⁰ This rule provides in pertinent part:

Adjustments to arrive at Oklahoma taxable income for corporations

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:

* * * * *

(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.

(Emphasis original). Appendix A¹¹ provides:

⁹ Part 5 of Subchapter 17 of Chapter 50, Title 710 of the Oklahoma Administrative Code.

¹⁰ Amended at 9 Ok Reg 3031, eff 7-13-92; [last amended], at 21 Ok Reg 2571, eff 6-25-04.

¹¹ Added at 9 Ok Reg 3031, eff 7-13-92.

COMPUTATION OF TAX ACCRUAL WHEN TAX CREDITS ARE ALLOWABLE	
1. Oklahoma Income before tax accrual	_____
2. Allowable Oklahoma credits	_____
COMPUTATION OF ACCRUED TAX ALLOWED	
A. Oklahoma Income (Line 1 above)	_____
B. Amount from Line 2 , above, divided by 6%	_____
C. Subtract Line B from Line A	_____
D. Divide Line C by 17.6667 (If Line D is less than 0, enter 0)	_____
3. Subtract Line D from Line 1 above (Enter Line 3 above on Line 1 , Page 1, of your Oklahoma Corporation Income Tax Form 512.)	_____
TOTAL TAX DUE	_____
TAX ACCRUAL ALLOWED	_____
TAX CREDIT ALLOWED	_____

5. Rules promulgated pursuant to the Administrative Procedures Act,¹² are presumed to be valid until declared otherwise by a district court of this state or the Supreme Court. 75 O.S. 2001, § 306(C). They are valid and binding on the persons they affect, have the force of law and are prima facie evidence of the proper interpretation of the matter to which they refer. 75 O.S. 2001, § 308.2(C).

Great weight is accorded an agency's construction of a statute when the administrative interpretation is made contemporaneously with the enactment of the statute and the construction is longstanding and continuous by the agency charge with its execution. *Schulte Oil Co., Inc. v. Oklahoma Tax Commission*, 1994 OK 103, 882 P.2d 65. Where the Legislature is made repeatedly aware of the operation of the statute according to the construction placed upon it by an agency and the Legislature has not expressed its disapproval with the agency's construction, the Legislature silence may be regarded as acquiescence in the agency's construction, *R.R. Tway, Inc. v. Oklahoma Tax Commission*, 1995 OK 129, 910 P.2d 972; and the agency's construction is given controlling weight and will not be disregarded except in cases of serious doubt, *Cox v. Dawson*, 1996 OK 11, 911 P.2d 272.

The rules and regulations of an administrative agency which implement the provisions of a statute are valid unless they are beyond the scope of the statute, are in conflict with the statute or are unreasonable. See, *Arkansas Louisiana Gas Co. v. Travis*, 1984 OK 33, 682 P.2d 225;

¹² 75 O.S. 2001, § 250 et seq., § 301 et seq.

Boydston v. State, 1954 OK 327, 277 P.2d 138. Agency rules need not be specifically authorized by statute, but must generally reflect the intent of the Legislature as expressed in the statute. *Jarboe Sales Company v. Oklahoma Alcoholic Beverage Laws Enforcement Commission*, 2003 OK CIV APP 23, 65 P.3d 289. As a general rule, it is presumed that administrative rules and regulations are fair and reasonable, and that the complaining party has the burden of proving the contrary by competent and convincing evidence. *State ex rel. Hart v. Parham*, 1966 OK 9, 412 P.2d 142.

6. "Deductions [and credits against tax] are a matter of legislative grace rather than judicial intervention." *Flint Resources Company v. Oklahoma Tax Commission*, 1989 OK 9, 780 P.2d 665, 673. In order to be allowed, authority for the deduction sought must be clearly expressed. *Home-State Royalty Corporation v. Weems*, 1935 OK 1043, 175 Okla. 340, 52 P.2d 806 (1935). None may be allowed in absence of a statutory provision therefor. *Id.* See, *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440, 54 S.Ct. 788, 78 L.Ed. 1348 (1934).

7. The disposition of this protest depends on the proper interpretation of the language of OAC, 710:50-17-51(5). We have previously determined that administrative rules should not be interpreted in a manner which conflicts with statutory provisions. See *Order of the Oklahoma Tax Commission No. 99-02-08-007*. Subsection E of Section 2357.8 of Title 68 of the Oklahoma Statutes provides:

The Tax Commission is directed to immediately develop a system for registration of any income tax credits issued pursuant to Section 2357.7 et seq. of this title and a system which permits verification that any tax credit claimed upon an income tax return is validly issued and properly taken in the year of claim and ensures that any transfers of the income tax credit are not unduly restricted or hindered.

The Commission concludes that an interpretation of OAC 710:50-17-51 (5) which prohibits the deduction of amounts paid for a purchased transferable credit used by the taxpayer to cover Oklahoma Accrued Income Tax would unduly hinder or restrict the transfers of such credit.

8. Protestant's protest to the Division's proposed income tax adjustments for the 2003 and 2004 tax years should be and the same is hereby sustained to the extent of allowing a deduction for amounts paid for purchase of transferable credits used to cover Oklahoma Accrued Income Tax.

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.