

JURISDICTION: OKLAHOMA TAX COMMISSION DECISION
CITE: 2009-03-10-02 / NON-PRECEDENTIAL
ID: P-05-003-H
DATE: MARCH 10, 2009
DISPOSITION: SUSTAINED
TAX TYPE: SALES
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 30th day of December, 2008, the Commission denies the Application for Hearing En Banc of the Compliance Division, and makes the following Findings of Fact and Conclusions of Law and enters the following order.

PROCEDURAL HISTORY

On January 24, 2005, the protest file was received by the Office of Administrative Law Judges 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 January 25, 2005, a letter was mailed to Counsel stating this matter had been assigned to ALJ, Administrative Law Judge, and docketed as Case Number P-05-003-H. The letter also advised Counsel 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*.³ On February 9, 2005, OTC ATTORNEY 1, Senior Deputy General Counsel, and OTC ATTORNEY 2, Assistant General Counsel, filed an Entry of Appearance as Co-Counsel for the Division. On February 10, 2005, the Notice of Prehearing Conference was mailed to Counsel setting the prehearing conference for February 23, 2005, at 10:00 a.m.

On February 23, 2005, at 10:00 a.m., the prehearing conference was held as scheduled. On February 24, 2005, a letter was mailed to Counsel, pursuant to the prehearing conference, directing the Division to provide the Protestants and the clerk of the court ("Clerk") a copy of the audit file within ten (10) days from the date of the letter. The parties were also directed to file a status report on or before March 25, 2005.

On March 4, 2005, the Division filed a copy of the audit file with the Clerk. On March 24, 2005, OTC ATTORNEY 3 filed a Notice of Substitution of Attorney with the Clerk. On March 25, 2005, OTC ATTORNEY 3 filed the Status Report requesting an additional thirty (30) days to review the protest file and meet with Protestants' Counsel.

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

² OKLA. ADMIN. CODE §§ 710:1-5-20 through 710:1-5-47.

³ See Note 2.

On March 25, 2005, ATTORNEY filed a letter with the Clerk which "...constitutes an amendment to the protest of taxpayer, LLC (the "Taxpayer"), of the proposed sales tax assessment by the Oklahoma Tax Commission dated August 23, 2004. MEMBER, manager, member and as an individual hereby adopts such protest (and all of the arguments therein) filed by the Taxpayer on or about October 21, 2004."

On March 28, 2005, a letter was mailed directing Counsel to file a status report on or before April 25, 2005. On April 22, 2005, the Division filed the Status Report advising the parties agreed a scheduling order should be entered in this matter, including sufficient time for discovery.

On April 26, 2005, the Scheduling Order was issued setting this matter for hearing on July 21, 2005, at 9:30 a.m., with position letters or memorandum briefs due on or before July 14, 2005.

On May 10, 2005, the Preliminary Witness and Exhibit Lists of the Audit Division and the Taxpayer's [sic] Preliminary List of Witnesses and Exhibits were filed with the Clerk.

On May 20, 2005, the Taxpayer's [sic] Motion for Extension of Discovery Request Time to Submit was filed with the Clerk. On May 25, 2005, there being no objection by the Division, an Order Granting Motion was issued extending the time for submission of discovery requests to May 27, 2005.

On May 27, 2005, the Taxpayers' First Set of Interrogatories, Requests for Production of Documents, and Requests for Admissions and the Division's Request for Production of Documents and Audit Division's Interrogatories were filed with the Clerk.

On June 23, 2005, the Division filed a Motion for Scheduling Order Change. On June 29, 2005, an Order Granting Motion for Scheduling Order Change was mailed to Counsel setting the hearing on September 21, 2005, at 9:30 a.m., with position letters or memorandum briefs due on or before September 14, 2005.⁴

On July 20, 2005, the Taxpayers [sic] Response to Request for Production of Documents and Taxpayers [sic] Response to Interrogatories were filed with the Clerk. On July 20, 2005, the Oklahoma Tax Commission's Answers to Interrogatories, Response to Request for Production and Response to Request for Admissions were also filed with the Clerk.

On July 21, 2005, the Protestants filed a Motion for Scheduling Order Change because Counsel for the Protestants had a conflict with the hearing date. The Division did not have an objection to the request. On July 29, 2005, an Order Granting Motion for Scheduling Order Change was mailed to Counsel setting the hearing for September 26, 2005, at 9:30 a.m., with September 29, 2005, at 9:30 a.m., as a date for continuing the hearing if needed. Position letters or memorandum briefs were due on or before September 19, 2005.

⁴ The Discovery completion deadline was set for July 20, 2005, with Final Witness Lists and Exhibit Lists due August 31, 2005.

On August 22, 2005, the Division filed a Memorandum requesting an Extension of Time to File or Appear due to the relocation of the Office of General Counsel. On August 23, 2005, the Division filed a Notice of Revision "...to correct a computational error resulting from the audit program."

On September 2, 2005, the Protestants filed a Motion for Continuation of Hearing citing the Division's motion of August 22nd and scheduling conflicts of the Protestants' witnesses due to the start of SPORTS season. On September 16, 2005, an Order Granting Motion for Continuation of Hearing was mailed to Counsel setting the hearing for May 9, 2006, at 9:30 a.m., with a continuance date of May 10, 2006, at 9:30 a.m., if needed. Position letters or memorandum briefs were due on or before May 2, 2006.⁵

On April 18, 2006, the Final Witness and Exhibit Lists of the Audit Division and the Taxpayer's [sic] Final List of Witnesses and Exhibits were filed with the Clerk. On May 2, 2006, OTC ATTORNEY 3 contacted the Clerk to request one (1) additional day to file the Division's brief. Protestants' Counsel did not have an objection. A memorandum was placed in the court file to memorialize the conversations, and the Administrative Law Judge's approval of the oral request.

On May 2, 2006, the Taxpayer's [sic] Position Statement was filed with the Clerk. On May 3, 2006, the Position Letter of the Audit Division of the Oklahoma Tax Commission was filed.

At the request of the Administrative Law Judge, Status Teleconferences were held with Counsel on May 5th and May 8th to discuss a possible jurisdictional issue raised in the Taxpayers' Position Statement. On May 8, 2006, a letter was mailed to Counsel, pursuant to the teleconferences, striking the hearing set for May 9th and 10th from the docket. Protestants' Counsel was to file a motion to dismiss and notice of hearing date, no later than May 12, 2006, with the hearing on the motion to be held on May 30, 2006, at 1:30 p.m.

On May 11, 2006, the Taxpayer's [sic] *Motion to Dismiss* and Brief in Support were filed and the Order Setting Hearing for May 30, 2006, at 1:30 p.m., was issued. On May 19, 2006, the Audit Division's Response to Taxpayer's [sic] Motion to Dismiss and Brief in Support were filed with the Clerk. On May 30, 2006, the Taxpayer's [sic] Reply to Audit Division's Response to Taxpayer's [sic] Motion to Dismiss was filed with the Clerk.

The hearing on the Protestants' *Motion to Dismiss* was held as scheduled on May 30, 2006, at 1:30 p.m. Two (2) witnesses were called to testify at the hearing, SUPERVISOR, Audit Supervisor, Compliance Division f/k/a the Audit Division, Oklahoma Tax Commission, and AUDITOR, Oklahoma Project Manager for AUDITING COMPANY.⁶ The Division's Exhibits

⁵ Final Witness Lists and Exhibit Lists were due on or before April 18, 2006.

⁶ AUDITOR was employed by the Tax Commission August 20, 1973, through June 30, 1981, and July 1, 1982, through March 31, 2004. See Division's Answers to Interrogatories at 8. AUDITOR held various positions with the Tax Commission, but his last position with the Division was as an administrator, and before that in the field audit area for sales and use taxes. Tr. at 16.

A through E were identified, offered, and admitted into evidence. At hearing, Protestants' Counsel requested the Administrative Law Judge take judicial notice⁷ of the Oklahoma Tax Commission's Answers to Interrogatories, Response to Request for Production and Response to Request for Admissions ("Answers"). Division's Counsel did not have an objection.⁸

At the conclusion of the hearing, the Administrative Law Judge kept the record open for the Division to submit documents as directed during the hearing and for the parties to submit proposed findings of fact and conclusions of law.

On June 13, 2006, the Audit Division's Submission of Documents ("Submission") was filed with the Clerk. On June 22, 2006, the Court Reporter retained by the Protestants filed the original transcript of the hearing held on May 30, 2006. On June 23, 2006, Counsel was advised by letter any relevant motions could be filed on or before July 10, 2006. Each party had until July 20, 2006, to file a response to the other's motion(s), if desired.

On July 10, 2006, the Division filed a Request for Extensions of Time to File Motions and Responses Thereto, based upon the passage of SB 1084, which contained a retroactive exemption affecting this matter. The Protestants' Counsel did not have an objection to the request. On July 11, 2006, an Order Granting Request for Extensions was issued extending the date for the filing of any relevant motion(s) to September 25, 2006, with responses due on or before October 5, 2006.

On September 20, 2006, the Division filed a Request for Extensions of Time to File Motions and Responses Thereto based upon the retroactive exemption contained in SB 1084. The Protestants needed additional time to provide information to the Division and the Division needed time to revise the proposed sales tax assessments. Counsel for the Protestants did not have an objection. On September 22, 2006, an Order Granting Request for Extensions was issued extending the date for the filing of any relevant motion(s) to October 25, 2006, with response(s) due on or before November 6, 2006.

On October 20, 2006, the Protestants filed a Request for Extensions of Time to File Motions and Responses Thereto. Division's Counsel did not have an objection. On October 23, 2006, an Order Granting Request for Extensions was issued extending the date for the filing of any relevant motion(s) to December 27, 2006, with responses due on or before January 8, 2007.

On December 12, 2006, the Protestants filed a *Notice of Pending Settlement* requesting all deadlines in this matter be extended indefinitely. The Division, through OTC ATTORNEY 3, had agreed to a "proposed" settlement of the pending protest. The "proposed" settlement was pending approval by the Commissioners of the Oklahoma Tax Commission. On December 13, 2006, an Order was issued vacating the filing dates set by the Order of October 23, 2006. Counsel was directed to advise the Administrative Law Judge of any decision by the Commissioners concerning the "proposed" settlement agreement.

⁷ OKLA. ADMIN. CODE § 710:1-5-36 (July 11, 1996).

⁸ Tr. at 24.

On January 2, 2007, the MUNICIPAL GROUP filed a *Petition for Declaratory Judgment and Permanent Injunctive Relief* in the District Court of COUNTY, Case No. CJ-XXXX-XX, challenging the constitutionality of the retroactive provisions contained in SB 1084.

On August 18, 2008, Division's Counsel filed a Status Report, with a copy of the Judgment ("Judgment") entered March 5, 2008, in *The Oklahoma Municipal League v. Oklahoma Tax Commission*, in the District Court of Oklahoma County, Case No. CJ-2007-16, which held "...the sections of sales tax exemption found at 68 O.S. Supp. 2007 §§ 1356(58) and 1357(5) that made the exemptions retroactive are unconstitutional and, therefore, should be severed" and "the exemption under 68 O.S. Supp 2007 § 1356(58) first became permissible on the effective date of the statute March 6, 2006." The status report further advised the "...parties' efforts to resolve the above-referenced matter subsequent to the entry of the Judgment have not been successful." Counsel also requested to file motion(s) on or before September 16, 2008, with responses due on or before September 26, 2008. On August 19, 2008, Counsel was advised by letter any motions could be filed on or before September 16, 2008, with responses due on or before September 26, 2008.

On September 16, 2008, the Protestants filed a Motion to Strike the Oklahoma Tax Commission Audit Division's Submission of Documents and Brief in Support. On September 26, 2008, the Division's Response to Motion to Strike Oklahoma Tax Commission Audit Division's Submission of Documents and Brief in Support was filed with the Clerk. On October 8, 2008, an Order Denying Motion to Strike was issued by the Administrative Law Judge.

On November 6, 2008, the Taxpayer's [sic] Proposed Findings of Fact and Conclusions of Law, and the Proposed Findings of Fact and Conclusions of Law and Recommendations of the Compliance Division were filed with the Clerk. The record in this matter was closed and the case submitted for decision on November 7, 2008.

FINDINGS OF FACT

Upon review of the file and records, including the record of the proceedings, the exhibits received into evidence, and the filings of the parties, the undersigned finds:

1. On July 1, 1997, the Oklahoma Tax Commission ("Tax Commission"), through the Commissioners,⁹ entered into an "Agreement for Administration of the Sales Tax Ordinance" ("Sales Tax Agreement") for the City/Town of MUNICIPALITY ("The Municipality"), with an

⁹ OKLA. STAT. ANN. tit. 68, § 102 (West 2001), which states in pertinent part:

The "Oklahoma Tax Commission" is hereby created, and shall possess such duties, powers and authority as are hereinafter defined, and as are now or as may hereafter be conferred upon it by law. The Tax Commission shall consist of three (3) persons to be appointed by the Governor of the State of Oklahoma by and with the consent of the State Senate of the State of Oklahoma.

expiration date of June 30, 1998. The Sales Tax Agreement states in pertinent parts,¹⁰ as follows, to-wit:

14. The Municipality agrees that the Commission shall have the authority to assess, to collect, to enforce and to prosecute the municipal sale tax penalties and interest thereon, including any tax, penalty and interest liability existing on the date of this Agreement. The Municipality agrees that the Commission shall have all the powers of enforcement in regard to municipal sales tax, penalties and interest as are granted or vested in the Municipality. *And, the Municipality agrees to refrain from any assessment, collection, enforcement or prosecution of the municipal sales tax except as specified in this Agreement.*

...

17. It is recognized and acknowledged that the Municipality may elect to augment the Commission's enforcement of municipal sales tax. *The Municipality agrees to refrain from any efforts to augment the Commission's enforcement of municipal sales tax except as specified by written Amendment to the Agreement approved by the Municipality and the Commission.* (Emphasis added).

2. On August 8, 2001, the Tax Commission and the MUNICIPAL GROUP¹¹ entered into an "Agreement for Independent Audit Administration Program" ("Audit Administration Agreement"),¹² which states in pertinent parts, as follows, to-wit:

¹⁰ Submission Exhibit 5. The Sales Tax Agreement was signed by all three (3) Commissioners, with attestation by the Assistant Secretary of the Tax Commission, and the Mayor of the Municipality, with attestation by the City Clerk. The Sales Tax Agreement was approved as to form by an/the Assistant Municipal Counselor and signed by the Director of the Taxpayer Assistance Division. There is also an agreement for use tax, which mirrors the Sales Tax Agreement.

See Judgment at 1, which states in pertinent part, "The Oklahoma Tax Commission and member cities and towns of the MUNICIPAL GROUP have entered into contracts, as permitted by 68 O.S. Supp. 2007, § 2702, for the purpose of the Commission collecting sales tax revenue on behalf of the cities and remitting the same to the applicable municipality." However, the provision fails to state the Sales Tax Agreement expired by its own terms on June 30, 1998.

¹¹ MUNICIPAL GROUP is a non-profit corporation organized under the laws of the State of Oklahoma with the general purpose of promoting the welfare of cities and towns in Oklahoma. *See* Judgment at 1.

¹² Submission Exhibit 3, which indicates it is Exhibit A, Page 1 of 3. On August 7, 2001, the Audit Administration Agreement was executed by the Executive Director of MUNICIPAL GROUP and on August 22, 2001, by the Administrator of the Tax Commission.

See Note 9. The Oklahoma Tax Commission shall appoint an administrator who shall serve at the pleasure of the Commission and who shall be the administrative officer of the Commission and manage the activities of the employees provided for in Section 104 of Title 68 and Section 105 of Title 68.

1. The OTC will provide MUNICIPAL GROUP with the minimum qualifications for an independent audit administrator to coordinate and manage all phases of an independent audit program on behalf of a municipality. The independent audit administrator must meet the minimum qualifications as established by the OTC...
 2. MUNICIPAL GROUP will identify independent audit program administrators, who (1) meet and maintain the minimum qualifications as established by the OTC and (2) notify MUNICIPAL GROUP that they are interested in the program under terms established by MUNICIPAL GROUP to further the interests of municipalities...
 3. *OTC agrees to enter into an augmentation agreement with a municipality if the municipality engages the services of an independent audit program administrator identified by MUNICIPAL GROUP pursuant to this Agreement.... (Emphasis added).*
3. In April 2002, the MUNICIPAL GROUP issued a Notice to Audit Administrators (“Notice”), which contained the “Criteria for Approving Qualified Independent Audit Program Administrator”¹³ that “This [sic] following entities have met the minimum qualifications set by the Oklahoma Tax Commission for the Independent Audit Administration Program. REPRESENTATIVE, AUDITING COMPANY, BUSINESS ADDRESS.”¹⁴
4. On July 1, 2003, Council Agenda Item No. VI. GGGGGG, a resolution authorizing a sole source agreement for independent audit management services with AUDITING COMPANY was approved and adopted by The City Council of The Municipality and Mayor of The Municipality.¹⁵
 5. On July 1, 2003, The Municipality and AUDITING COMPANY entered into an “Agreement for Independent Audit Management Services” (“AUDITING COMPANY Agreement”),¹⁶ which states in pertinent parts, as follows, to-wit:
 - WHEREAS, City desires to hire or retain the services of AUDITING COMPANY *as a duly authorized agent of the Oklahoma Tax Commission* (OTC) to engage in audit activities in an attempt to facilitate collection of tax revenues on behalf of City;

¹³ These are the minimum qualifications which were to be issued by the Tax Commission by the terms of the Audit Administration Agreement.

¹⁴ Submission Exhibit 4, which indicates that it is Exhibit B, Page 1 of 4.

¹⁵ Submission Exhibit 1.

¹⁶ Submission Exhibit 2. The AUDITING COMPANY Agreement was signed on behalf of The Municipality by the Mayor of The Municipality, attested by the City Clerk, and on behalf of AUDITING COMPANY by PRESIDENT, President. The AUDITING COMPANY Agreement was also reviewed for form and legality by an/the Assistant Municipal Counselor. Submission Exhibits 3 and 4 were attachments to this exhibit. *See* Notes 12 and 14.

- AUDITING COMPANY shall render tax-auditing services to City. Specifically, AUDITING COMPANY will render multi-city coordinated tax auditing services on behalf of City and other participating Oklahoma cities/towns/counties in an attempt to identify taxes, penalties, and/or interest which may be owed from taxpayers to City.
- The “Agreement for Independent Audit Administration Program” between the MUNICIPAL GROUP and the OTC dated August 8, 2001 is incorporated by reference into this agreement. See Exhibit A. Further, the “Criteria for Approving Qualified Independent Audit Program Administrator” established by the MUNICIPAL GROUP as a result of this agreement is also being incorporated by reference. See Exhibit B.
- *OTC shall fully retain and be responsible for audit review, assessment, and collection of sales and/or use tax, interest, and/or penalty discovered by AUDITING COMPANY.* City shall retain and be responsible for audit review, assessment and collection of other local taxes.
- *The Administrator of OTC has final authority on the interpretation of sales and/or use tax audit adjustments.* The Finance Director of City has final authority on interpretation of local tax adjustments.
- The per hour billing rates for each personnel of AUDITING COMPANY shall be for each participating taxing jurisdiction as follow:

One taxing jurisdiction	\$79
Two or more taxing jurisdictions	\$59
- *AUDITING COMPANY, acting in its capacity as an agent of the OTC,* may disclose confidential information to the City where the information disclosed specifically and directly relates to the City as provided by Title 68 of the Oklahoma Statutes, Section 205(c)(7) and (23), and Title 11, Section 22-107. (Emphasis added).

6. The Tax Commission and The Municipality did not enter into a written “Amendment” to the Sales Tax Agreement, approved by the Commissioners, when The Municipality entered into the AUDITING COMPANY Agreement.¹⁷

7. The Tax Commission and The Municipality did not enter into an “Augmentation Agreement” to the Audit Administration Agreement when The Municipality entered into the AUDITING COMPANY Agreement.¹⁸

8. The Tax Commission and AUDITING COMPANY did not enter into a contract to conduct a “state” sales tax audit on the LLC.¹⁹

¹⁷ See Note 10.

¹⁸ See Note 12.

¹⁹ Tr. at 31-34. See Answers at 7 and 12-13.

9. AUDITING COMPANY was not “an authorized agent” of the Tax Commission at the time AUDITING COMPANY conducted the municipal “sales” tax audit on the LLC.²⁰

10. The LLC owns the FRANCHISE, a minor league SPORTS franchise located in MUNICIPALITY. MEMBER is a Manager/Member of the LLC (“Member”).

11. The LLC was initially selected for an audit by The Municipality for failure to remit “municipal” sales tax for August 2003 through December 2003. However, the LLC had filed and remitted “state” and “municipal” sales tax for August 2003 through December 2003, but due to a posting error it appeared the LLC had not. This problem was corrected by the Central Processing Division of the Tax Commission prior to the commencement of the audit.²¹

12. On May 12, 2004, The Municipality, by and through ASSISTANT MANAGER, Assistant City Manager/Finance Director, sent a letter to the LLC stating the LLC had been selected for a “routine sales and/or use tax audit examination to be performed at your place of business in the near future. Our authorized agent, AUDITING COMPANY, will be contacting you to schedule this examination of your business... The audit is for the purposes of enforcement and collection of the local sales/use tax, accommodations & lodging tax, admissions tax and/or franchise fees, levied in the City of MUNICIPALITY as set forth in its ordinances....”²²

13. The audit of the LLC was conducted by AUDITOR, an employee of AUDITING COMPANY, an independent auditing firm hired by The Municipality.²³

14. The Municipality fully disclosed to the LLC that AUDITING COMPANY was an “authorized agent” for The Municipality. From the initial meeting and continuing through the presentation of the work papers, the LLC voluntarily provided its records. The LLC did not object to the review of its records by AUDITOR.²⁴

15. AUDITOR summarized the records, prepared work papers, and provided a copy of the work papers to the LLC and the original work papers and audit file to the Division.²⁵

16. SUPERVISOR reviewed AUDITING COMPANY’S work papers (“First Work Papers”), the supporting audit file, and the audit findings.²⁶

²⁰ See Note 19. See also Submission Exhibits 1 through 5.

²¹ See Note 7. The court file contains a copy of the field audit file, which the Administrative Law Judge is taking judicial notice of to complete the factual details and background of this audit.

²² Division’s Exhibit A.

²³ Tr. at 17-18.

²⁴ Tr. at 17-19, 22, and 25. Division’s Exhibits A, B and C.

²⁵ Tr. at 20 and 25.

²⁶ Tr. at 12.

17. On August 23, 2004, the Division, through SUPERVISOR, issued proposed sales tax assessments, consisting of state and municipal sales tax, against the Protestants for July 1, 2001, through May 31, 2004 (“Audit Period”),²⁷ as follows, to-wit:

Tax Due:	\$261,686.80
Interest @ 15% through 09/30/04:	<u>68,562.48</u>
Tax & Interest Due Within 30 Days:	\$330,249.28
30 Day Delinquent Penalty @ 10%:	<u>26,168.70</u>
Tax, Interest & Penalty Due After 30 Days:	\$356,417.98

18. During the Audit Period, the LLC did not collect, report, or remit state or municipal use tax to the Tax Commission.²⁸

19. On August 23, 2004, the Division issued a proposed use tax assessment against the LLC, consisting of state and municipal use tax, for the Audit Period in the amount of \$19,337.65, plus penalty and interest.²⁹

20. On October 20, 2004, a timely filed protest to the proposed state and municipal sales tax assessments was received by the Division.³⁰

21. On August 23, 2005, the Division filed its Notice of Revision (“Second Work Papers”) to the proposed state and municipal sales tax assessments against the Protestants for the Audit Period,³¹ as follows, to-wit:

Taxable Sales:	State	City	Totals
\$3,179,165.93			
Tax	\$143,062.50	\$119,942.90	\$263,005.40
Interest	\$ 37,586.69	\$ 31,031.06	\$ 68,617.75
Penalty	\$ 14,306.25	\$ 11,994.31	\$ 26,300.56
Totals	\$194,955.44	\$162,968.27	\$357,923.71

²⁷ Division’s Exhibit D. The assessment states, “Sales Tax was not collected and/or remitted from the sale of advertising and miscellaneous sales of tangible personal property.”

²⁸ See Note 7.

²⁹ The proposed use tax assessment was not protested, and was paid in full by the LLC.

³⁰ Division’s Exhibit E.

³¹ See Notice of Revision filed herein. The Division filed the revision due to an audit program error, which excluded the calculations of all the items for the final month of the Audit Period from the summary schedule.

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding.³²

2. In the administration of the *Uniform Tax Procedure Code*³³ or any state tax law, the Tax Commission may make, or cause to be made by its employees or agents, an examination or investigation of the place of business, the tangible personal property, equipment and facilities, and the books, records, papers, vouchers, accounts and documents of any taxpayer. It shall be the duty of every taxpayer and of every director, officer, agent, or employee of every taxpayer to exhibit to the Tax Commission, or to the employees or agents of such Tax Commission, the place of business, the tangible personal property, equipment and facilities, and the books, records, papers, vouchers, accounts and documents of such taxpayer, and to facilitate any such examination or investigation so far as it may be in his or her power so to do.³⁴

3. If any taxpayer shall fail to make any report or return as required by any state tax law, the Oklahoma Tax Commission, from any information in its possession or obtainable by it, may determine the correct amount of tax for the taxable period. If a report or return has been filed, the Tax Commission shall³⁵ examine such report or return and make such audit or investigation as it may deem necessary. If, in cases where no report or return has been filed, the Tax Commission determines that there is a tax due for the taxable period, or if, in cases where a report or return has been filed, the Tax Commission shall determine that the tax disclosed by such report or return is less than the tax disclosed by its examination, it shall in writing propose the assessment of taxes or additional taxes, as the case may be, and shall mail a copy of the proposed assessment to the taxpayer at the taxpayer's last-known address. Proposed assessments made in the name of the "Oklahoma Tax Commission" by its authorized agents shall be considered as the action of the Tax Commission.³⁶

4. The Tax Commission may contract with private auditors or audit firms to audit the books of individuals, firms, or corporations which the Tax Commission believes may owe the State of Oklahoma additional tax monies.³⁷

5. The Tax Commission and The Municipality are authorized by statute to enter into contractual agreements for the Tax Commission to collect taxes levied by the municipality and enforce and assess penalties thereon,³⁸ which states in pertinent parts as follows, to-wit:

³² OKLA. STAT. ANN. tit. 68, § 221(D) (West Supp. 2007).

³³ See Note 1.

³⁴ OKLA. STAT. tit. 68, § 206(a) (West 2001).

³⁵ Generally, when the legislature uses the term "shall", it signifies a mandatory directive or command. See *Keating v. Edmondson*, 2001 OK 110, 37 P.3d 882.

³⁶ OKLA. STAT. tit. 68, § 221(A) (West Supp. 2002).

³⁷ OKLA. STAT. ANN. tit. 68, § 262 (West 2001).

The governing body of any incorporated city or town and the Oklahoma Tax Commission are authorized and empowered to enter into contractual agreements whereby the Oklahoma Tax Commission shall have authority to assess, to collect and to enforce any taxes or, penalties or interest thereon, levied by such incorporated city or town, and remit the same to such municipality. Said assessment, collection, and enforcement authority *shall apply to any taxes, penalty or interest liability existing at the time of contracting*. Upon contracting, the Oklahoma Tax Commission shall have all the powers of enforcement in regard to such taxes, penalties and interest as are granted to or vested in the contracting municipality. Such agreement shall provide for the assessment, collection, enforcement, and prosecution of such municipal tax, penalties and interest, in the same manner as and in accordance with the administration, collection, enforcement, and prosecution by the Oklahoma Tax Commission of any similar state tax except as provided by agreement. *The municipality shall agree to refrain from any assessment, collection, or enforcement of the municipal tax except as specified in the agreement...*

...

Provided that the Oklahoma Tax Commission and the governing body of any incorporated city or town may enter into contractual agreements whereby the municipality would be authorized to implement or augment the enforcement, collection and prosecution of the municipal tax in those contracting municipalities and to provide for the satisfaction of refunds or credits to taxpayers. Such agreements shall and are hereby authorized to provide that the municipality and the Oklahoma Tax Commission may exchange necessary information to effectively carry out the terms of such agreements. The municipality, its officers and employees shall preserve the confidentiality of such information in the same manner and be subject to the same penalties as provided by Section 205 of this title, provided that the municipal prosecutor and other municipal enforcement personnel may receive all information necessary to implement or augment the enforcement and prosecution of municipal sales tax ordinances. Any sum or sums collected or required to be collected pursuant to a municipal sales tax levy shall be deemed to be held in trust for the municipality, and, as trustee, the collecting vendor shall have a fiduciary duty to the municipality in regards to such sums and shall be subject to the trust laws of this state. (Emphasis added).

6. 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.³⁹

³⁸ OKLA. STAT. tit. 68, § 2702 (West Supp. 2002).

³⁹ OKLA. STAT. ANN. tit. 75, § 250 et seq. (West 2001).

7. The *Rules of Practice and Procedure before the Oklahoma Tax Commission* (“*Rules*”)⁴⁰ shall govern all contested proceedings before the Tax Commission or its delegated Administrative Law Judge. The *Rules* shall be given the most reasonable meaning, taken in their total context, and will be construed to secure due process in the proper resolution of every controversy. The *Rules* shall not be construed to limit legal rights or obligations of any party.⁴¹

DISCUSSION

The Protestants’ arguments are stated as follows, to-wit:

- I. AUDITING COMPANY lacked the requisite authority to conduct an audit of the Protestants, thus the assessment rendered by the OTC as a result of such audit is void as a matter of law.
- II. OTC failed to comply with the requirements of OTC Rule 710:65-5-4.⁴²

The Division’s argument is primarily procedural, that neither of the reasons stated by the Protestants are grounds for dismissal by the Jurisdictional Rule. The Division also asserts there was full disclosure to the LLC that AUDITING COMPANY was an “authorized agent for The Municipality” from the initial meeting through the presentation of the First Work Papers and the LLC voluntarily provided its records, without objection, but if the LLC had objected, the audit could have been conducted by an auditor employed by the OTC.⁴³

This matter presents a case of first impression on procedural and legal issues. To address these issues, the proposed sales tax assessments must be broken down into their components, which consist of “state sales tax” and “municipal sales tax.”

⁴⁰ See Note 2.

⁴¹ OKLA. ADMIN. CODE § 710:1-5-21.

⁴² OKLA. ADMIN. CODE § 710:65-5-4 (June 26, 2003), which states in pertinent part:

If, upon examination of the books of account and records of the person filing the tax return, facts are obtained which, in the opinion of the Commission, warrant an adjustment of the tax liability reported, the following procedure shall be followed:

- (1) **Notice and demand.** A proposed assessment report will be prepared and mailed to the taxpayer. This report will contain an explanation of adjustments together with a recomputation of tax in accordance with such adjustments. The notice of adjustments and the demand for payment (if additional tax is due) or any other notice or demand upon the person filing the return required by law shall be sent to him at his last known address. In the alternative, the Commission may cause to be served upon such person a written statement of the computation of tax due.

⁴³ See Note 24.

STATE SALES TAX

First, it must be determined whether the Tax Commission had the statutory authority to issue the proposed assessments of “state sales tax” against the Protestants for the Audit Period, based upon the audit conducted by AUDITING COMPANY.

The Oklahoma Legislature granted the Tax Commission the authority to enforce the provisions of the *Uniform Tax Procedure Code*⁴⁴ to promulgate and enforce all necessary rules for the purpose of making and filing of all reports required under any state tax law, and such rules as may be necessary to ascertain and compute the tax payable by any taxpayer subject to taxation under any state tax law; and may, at all times, exercise such authority as may be necessary to administer and enforce each and every provision of any state tax law.⁴⁵

The *Uniform Tax Procedure Code*⁴⁶ contemplates three (3) basic audit scenarios. First, the Tax Commission may make, or cause to be made by its employees or agents, an examination or investigation of a taxpayer’s books and records;⁴⁷ second, the taxpayer fails to file any report or return required by any state tax law;⁴⁸ and third, the taxpayer files the report or return required by any state tax law.⁴⁹

In the first situation, the Tax Commission or its “authorized agent” may audit the taxpayer’s books and records. In the second situation, the Tax Commission can determine the correct amount of tax for the taxable period “from any information in its possession or obtainable by it.”⁵⁰ In the third situation, the Tax Commission must examine the report or return and audit the taxpayer’s books and records.⁵¹

The first scenario does not apply because the Tax Commission did not perform an audit of the LLC’s books and records. The Tax Commission was authorized by statute to contract with AUDITING COMPANY to perform audits as its “authorized agent,” but the Tax Commission did not enter into a contract with AUDITING COMPANY, which is not in dispute.

The AUDITING COMPANY Agreement provides The Municipality “...desires to hire or retain the services of AUDITING COMPANY *as a duly authorized agent of the Oklahoma Tax*

⁴⁴ See Note 1.

⁴⁵ OKLA. STAT. tit. 68, § 203 (West Supp. 2003).

⁴⁶ See Note 1.

⁴⁷ See Note 34.

⁴⁸ See Note 36.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

Commission (OTC)...”⁵² (Emphasis added). The authority to appoint AUDITING COMPANY “as a duly authorized agent of the Tax Commission” was granted statutorily to the Commissioners by the Legislature. The Municipality does not have the statutory authority to appoint AUDITING COMPANY “as a duly authorized agent of the Tax Commission.”

The second scenario does not apply (as it did for the proposed use tax assessment) because the LLC had filed sales tax reports for the Audit Period and remitted “state” and “municipal” sales tax. Initially, the LLC was selected for an audit by The Municipality for failure to remit “municipal” sales tax for August 2003 through December 2003.

However, the posting error was corrected prior to the commencement of the audit.⁵³ By statute, the Tax Commission could not determine the correct amount of “state” sales tax from “any information in its possession or obtainable by it”⁵⁴ (the AUDITING COMPANY audit). The Tax Commission was required by statute to examine the LLC’s sales tax reports for the Audit Period and audit the LLC’s books and records, but the Division chose to rely on the AUDITING COMPANY audit, without examining the LLC’s sales tax reports and conducting its own audit of the LLC’s books and records for the Audit Period. The Division reviewed the AUDITING COMPANY audit and approved the First Work Papers prepared by AUDITOR, and SUPERVISOR issued the proposed assessments, which included “state” sales tax.⁵⁵

The Tax Commission failed to comply with the statutory requirements of Section 206(a) of Title 68,⁵⁶ Section 221(a) of Title 68⁵⁷ and Section 262 of Title 68⁵⁸ before issuing the proposed assessments, which included “state” sales tax against the Protestants pursuant to Section 221(d) of Title 68.⁵⁹

⁵² See Note 16.

⁵³ See Note 21.

⁵⁴ See Note 36.

⁵⁵ Tr. at 12.

⁵⁶ See Note 34.

⁵⁷ See Note 36.

⁵⁸ See Note 37.

⁵⁹ OKLA. STAT. tit. 68, § 221(A) (West Supp. 2002), which states in pertinent part:

If, in cases where no report or return has been filed, the Tax Commission determines that there is a tax due for the taxable period, or if, in cases where a report or return has been filed, the Tax Commission shall determine that the tax disclosed by such report or return is less than the tax disclosed by its examination, it shall in writing propose the assessment of taxes or additional taxes, as the case may be, and shall mail a copy of the proposed assessment to the taxpayer at the taxpayer's last-known address. Proposed assessments made in the name of the "Oklahoma Tax Commission" by its authorized agents shall be considered as the action of the Tax Commission.

MUNICIPAL SALES TAX

“Our Constitution vests the whole matter of taxation exclusively within the power of the Legislature as limited by the Constitution.”⁶⁰ Article X, Section 20 of the Oklahoma Constitution provides:

The Legislature shall impose taxes for the purpose of any county, city, town, or other municipal corporation, but may, by general laws, confer on the proper authorities thereof, respectively, the power to assess and collect such taxes.

Pursuant to this authority, the Legislature has enacted taxing authority for municipal government and counties.⁶¹

Section 2702 of Title 68,⁶² provides the Tax Commission and The Municipality “...may enter into contractual agreements whereby the municipality would be authorized to implement or augment the enforcement...of the municipal tax....”

The Tax Commission and The Municipality did enter into a Sales Tax Agreement on July 1, 1997, with an expiration date of June 30, 1998.⁶³

Pursuant to the terms of the expired Sales Tax Agreement, The Municipality agreed to refrain from any efforts to augment the Tax Commission’s enforcement of “municipal” sales tax “except as specified by written Amendment” to the Sales Tax Agreement, “approved by [T]he Municipality and the [Tax] Commission.”⁶⁴

The Tax Commission and The Municipality did not enter into a “written Amendment” to the Sales Tax Agreement or the Audit Administration Agreement, which would allow The Municipality to augment the Tax Commission’s enforcement of “municipal” sales tax.

The Tax Commission and The Municipality failed to comply with the provisions of Section 2702 of Title 68,⁶⁵ the Sales Tax Agreement,⁶⁶ and the Audit Administration

⁶⁰ Op. Atty. Gen. No. 2003-29 (June 30, 2003). (Citations omitted).

⁶¹ OKLA. STAT. tit. 68, § 2701 (West Supp. 2003).

⁶² See Note 38.

⁶³ It is the Protestant’s position pursuant to Section 2702 of Title 68, “assessment, collection, and enforcement authority shall be limited to any taxes, penalty or interest liability existing at the time of contracting,” which would exclude the Audit Period in this matter since the Sales Tax Agreement expired by its own terms on June 30, 1998.

⁶⁴ See Note 10.

⁶⁵ See Note 38.

⁶⁶ See Note 10.

Agreement,⁶⁷ by entering into a contract (without approval by the Commissioners) to “augment” the collection of “municipal” sales tax by AUDITING COMPANY.

MOTION TO DISMISS

The *Motion to Dismiss* recites in its opening sentence that it is brought “pursuant to Oklahoma Tax Commission Rule 710:1-5-46(c) and the request of the Administrative Law Judge (the “ALJ”) . . .” Oklahoma Tax Commission Rule 710:1-5-46(c) provides:

(c) **Dismissal for lack of jurisdiction.** The Tax Commission is without jurisdiction to consider a protest that is not filed within the time provided by statute. The question of the Commission's jurisdiction to consider a protest may be raised at any time, by a party, the Administrative Law Judge, or the Commission itself. Questions as to the authority, propriety, or timeliness of the tax division's action or proposed action shall not be raised by a motion to dismiss, but shall be raised as defenses to such action or proposed action, as a part of or addition to the protest.

This rule puts a limit on a taxpayer’s right to have the Tax Commission consider a protest to a proposed assessment. In this case, it is the assessment which the taxpayer wishes to have dismissed, not the protest. The rule does not provide for the dismissal of an assessment. It specifically prohibits raising questions as to the authority of a tax division’s action by way of a motion to dismiss. This rule is limited to providing a basis for dismissal of a protest when the taxpayer fails to timely file a protest or when the Tax Commission otherwise does not have jurisdiction to consider a protest. It is procedurally inappropriate to use this rule as a basis for a motion to dismiss an assessment.

Although it was not proper for Protestant to bring a Motion to Dismiss an assessment pursuant to OAC 710: 1-5-46(c), it was proper for the Protestant to bring a Motion to Dismiss an assessment pursuant to the request of an Administrative Law Judge. The hearing held on May 30, 2006, was not a hearing on the merits which addressed all the issues in this matter. Tax protest hearings are conducted by Administrative Law Judges who have the authority to determine, within the requirements of the statutes and the rules of the Oklahoma Tax Commission, the manner in which such protests will be conducted. It is proper under the *Rules* for the Administrative Law Judge to bifurcate issues in cases such as this one. The issues raised by Protestant’s Motion to Dismiss were issues which, if determined in protestant’s favor, would be dispositive of this case. There is no indication in the record or the documents filed by the parties in this matter that the Division was prevented from presenting any evidence, testimony, or exhibits which would be relevant to the issues raised in Protestant’s Motion to Dismiss. The interests of judicial economy and efficiency are served by limiting the hearing on Protestant’s Motion to Dismiss in this matter to those issues raised by Protestant’s Motion which could result in a final disposition of this matter.

The documents filed in this matter indicate that the parties viewed the *Motion to Dismiss* differently. The opening sentence of the protestant’s motion requests “an Order dismissing the

⁶⁷ See Note 12.

sales tax deficiency notice dated August 23, 2004 (the “Assessment”).” The Division’s response to the *Motion to Dismiss* sets out the two reasons put forth by the protestant for dismissal and then asserts “Division submits that neither of the reasons stated by Protestant are grounds for dismissal **of the protest** on jurisdictional grounds as provided in OAC 710:1-5-46.” The *Motion to Dismiss* in clear and unambiguous language requests an Order dismissing the assessment and not an order dismissing the protest. It would not benefit the protestant to dismiss the protest and would in fact be contrary to protestant’s interest to urge a motion to dismiss the protest. The Division’s response to the *Motion to Dismiss* argues that the protest should not be dismissed. It notes that dismissal is not proper under Rule OAC 719:1-5-46, which is the only rule which addresses dismissal. In so far as it goes, that is a correct interpretation of the rule. However, the rule only addresses dismissal of a protest and not dismissal of the underlying assessment.

In this case, the Tax Commission and The Municipality failed to comply with the mandatory statutory requirements before the Tax Commission issued the proposed assessments of “state” and “municipal” sales tax; and, as a result, the Division was without authority to issue the assessments at issue in this case.

The Division maintains, “Never once during this time frame did [LLC] object to the review of its records by AUDITING COMPANY. Had [LLC] objected, the audit could have been conducted by an auditor employed by the OTC.”⁶⁸

The Division fails to cite any authority for the proposition that the LLC’s failure to object to AUDITING COMPANY conducting the audit waives the mandatory statutory requirements imposed on the Tax Commission and The Municipality by the Legislature before the Tax Commission issued the proposed “state” and “municipal” sales tax assessments.

The *Rules*⁶⁹ shall be given the most reasonable meaning, taken in their total context, and will be construed to secure due process in the proper resolution of every controversy. The *Rules* shall not be construed to limit legal rights or obligations of any party.⁷⁰ There is nothing in the record that suggests the Compliance Division was prevented from presenting any testimony, exhibits or other evidence relevant to the issues raised in Protestant’s Motion to Dismiss. Such issues are dispositive of this case.

The Tax Commission did not conduct the underlying audit; it was conducted by AUDITING COMPANY, which was not “an authorized agent” of the Tax Commission. For purposes of Section 2702, the Sales Tax Agreement, and the Audit Administration Agreement, The Municipality also failed to enter into the statutorily required written amendment (approved by the Commissioners), which would allow The Municipality to augment the Tax Commission’s enforcement of “municipal” sales tax.

⁶⁸ See Division’s Response to Motion to Dismiss at 2.

⁶⁹ See Note 2.

⁷⁰ OKLA. ADMIN. CODE § 710:1-5-21.

Because we find that the Oklahoma Tax Commission was without authority to issue the subject assessments, we do not consider Protestant's argument that the assessments should be dismissed for failure of the Division to comply with the requirements of the Tax Commission Rule OAC 710:65-5-4.

ORDER

The protest filed in this matter is sustained and the sales tax deficiency notices dated August 23, 2004, as revised August 23, 2005, issued by the Oklahoma Tax Commission against the LLC d/b/a FRANCHISE and MEMBER, as manager member and as an individual are hereby dismissed.

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.