

JURISDICTION: OKLAHOMA TAX COMMISSION DECISION
CITE: 2009-06-23-02 / NON-PRECEDENTIAL
ID: P-08-009-H
DATE: JUNE 23, 2009
DISPOSITION: DENIED
TAX TYPE: INCOME
APPEAL: NO APPEAL TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

HUSBAND AND WIFE (“Protestants”) appear through attorneys ATTORNEY 1 and ATTORNEY 2, LAW FIRM. The Individual Income Tax Section of the Compliance Division (“Division”), Oklahoma Tax Commission, appears through OTC ATTORNEY 1, Assistant General Counsel, OTC ATTORNEY 2, Assistant General Counsel, and OTC ATTORNEY 3, Assistant General Counsel, Office of General Counsel, Oklahoma Tax Commission.

PROCEDURAL HISTORY

On February 7, 2008, 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 February 12, 2008, a letter was mailed to the Protestants’ Counsel stating this matter had been assigned to ALJ, Administrative Law Judge, and docketed as Case Number P-08-009-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 28, 2008, the Notice of Prehearing Conference was mailed to Counsel setting the prehearing conference for March 19, 2008.

On February 29, 2008, an Entry of Appearance was filed by OTC ATTORNEY 4⁴ and OTC ATTORNEY 1 as Co-Counsel for the Division.

On March 19, 2008, the parties submitted a Status Report in Lieu of Prehearing Conference. On March 26, 2008, a letter was mailed to Counsel advising a proposed scheduling order was to be submitted on or before May 5, 2008.

On May 2, 2008, an Entry of Appearance was filed by ATTORNEY 1 and ATTORNEY 3 as Co-Counsel for the Protestants. On May 2, 2008, a Joint Proposed Scheduling Order was submitted by Counsel. On May 8, 2008, the Scheduling Order was issued setting this

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, *supra*.

⁴ OTC ATTORNEY 4 does not appear in any filing subsequent to the Division’s Motions to Quash because of his untimely death in 2008.

matter for hearing on October 1, 2008, at 9:30 a.m., with position letters or memorandum briefs due on or before September 24, 2008.

On May 20, 2008, the Protestants' Preliminary Witness List and Preliminary Exhibit List and the Division's Preliminary Witness and Exhibit List were filed with the clerk of the court ("Clerk").

On May 27, 2008, the Protestants filed Notice of Depositions to OTC EMPLOYEE 1, OTC EMPLOYEE 2, MANAGER, OTC EMPLOYEE 3, and OTC EMPLOYEE 4. On May 27, 2008, the Taxpayers' First Set of Interrogatories and First Request for Production of Documents to the Oklahoma Tax Commission were filed with the Clerk.

On May 30, 2008, the Division's Motions to Quash Depositions of OTC EMPLOYEE 1, OTC EMPLOYEE 2, and OTC EMPLOYEE 3 ("Motions to Quash") and "To Stay Any Further Proceedings Pending a Hearing" on the Motions to Quash were filed with the Clerk. On June 3, 2008, an Order Staying Depositions was issued by the Administrative Law Judge, pending a hearing on the Motions to Quash, set for June 24, 2008, 9:30 a.m., with Protestants' response due on or before June 16, 2008.

On June 16, 2008, the Protestants' Responses to the Motions to Quash were filed with the Clerk. On June 19, 2008, OTC ATTORNEY 2 filed an Entry of Appearance as Co-Counsel for the Division. On June 20, 2008,⁵ ATTORNEY 2 filed an Entry of Appearance as Co-Counsel for the Protestants via facsimile. On June 23, 2008, the Division's Replies to the Protestants' Response to the Motions to Quash were filed with the Clerk.

On June 24, 2008, at 9:30 a.m., the hearing on the Motions to Quash was held as scheduled. On June 24, 2008, Counsel was advised by letter the decision on the Motions to Quash would be issued within fifteen (15) days from the date of hearing and the parties were to proceed with all other discovery as previously scheduled, including the depositions of other witnesses and the response deadline to the second request for discovery.

On June 26, 2008, the Clerk completed the hearing transcript ("Transcript") on the Division's Motions to Quash. On June 26, 2008, copies of the Transcript were mailed to Counsel.

On June 26, 2008,⁶ the Protestants' Response to the Division's First Request for Admissions, Answers to Interrogatories and Production of Documents was filed with the Clerk electronically. On July 1, 2008, the Protestants' Response to the Division's Second Request for Admissions, Answers to Interrogatories and Productions of Documents was filed with the Clerk.

⁵ On June 23, 2008, the original was received by the Clerk for filing.

⁶ On July 9, 2008, the original was received by the Clerk for filing.

On July 2, 2008, the Consolidated Order Denying Division's Motions to Quash Depositions was issued by the Administrative Law Judge.

On July 24, 2008, a Joint Motion to Continue Dates Set in Scheduling Order was filed by Counsel. On July 25, 2008, an Amended Scheduling Order was issued setting the hearing for October 7, 2008, at 9:30 a.m., with position letters or memorandum briefs due on or before September 30, 2008.

On August 7, 2008,⁷ the Protestants' Amended Response to the Division's Second Request for Admissions, Answers to Interrogatories and Production of Documents was filed with the Clerk via facsimile.

On August 25, 2008, an Unopposed Motion to Continue Dates Set in Scheduling Order was filed by Division's Counsel. On August 27, 2008, an Amended Scheduling Order was issued setting the hearing in this matter for December 9, 2008, at 9:30 a.m., with position or memorandum briefs due on or before December 2, 2008.

On August 29, 2008, the Protestants' Amended Preliminary Witness List was filed with the Clerk.

On October 17, 2008, an Entry of Appearance was filed by OTC ATTORNEY 3 as Co-Counsel for the Division. On October 17, 2008,⁸ the Protestants' Final Witness List and Final Exhibit List, and the Division's Final Witness and Exhibit List were filed with the Clerk via facsimile. On October 27, 2008,⁹ the Protestants' Objections to Division's Final Witness and Exhibit List was filed with the Clerk electronically.

On October 27, 2008, the Division filed its Motion in Limine to Limit Witness Testimony and Documentary Evidence ("Motion in Limine"). On November 12, 2008,¹⁰ the Protestants' Response to the Division's Motion in Limine was filed with the Clerk electronically. On November 12, 2008, the Division's Motion to Withdraw Request for Hearing on its Motion in Limine was filed with the Clerk. On November 13, 2008, the Clerk contacted OTC ATTORNEY 3 to inquire whether the Division intended to file a response to the Protestants' Objection to the Division's Motion in Limine. OTC ATTORNEY 3 advised the Clerk the Division did not intend to file a response.

On November 24, 2008,¹¹ the Protestants' "Amended" Final Exhibit List was filed with the Clerk electronically.

⁷ On August 8, 2008, the original was received by the Clerk for filing.

⁸ On October 20, 2008, the originals were received by the Clerk for filing.

⁹ On October 28, 2008, the original was received by the Clerk for filing.

¹⁰ On November 13, 2008, the original, with exhibits, was received by the Clerk for filing.

¹¹ On November 26, 2008, the original was received by the Clerk for filing.

On November 25, 2008, the Order Sustaining in Part and Denying in Part Division's Motion in Limine ("Order") was issued by the Administrative Law Judge. The Division's Motion in Limine was sustained as to the witness testimony.¹² The Division's Motion in Limine was sustained as to Exhibits 2 through 12, 14 through 22, 24, 25, 27, 29, 31, 33, and 34 and denied as to Exhibits 23, 26, 28, 30, and 32.¹³ The Division's Motion to Withdraw Request for Hearing was granted. On November 25, 2008, an Order Sustaining Protestants' Objections to Division's Final Witness and Exhibit List was issued and mailed to Counsel.

On November 25, 2008,¹⁴ a letter was received (electronically) from ATTORNEY 2 referring to the Order, which indicated the Protestants would be allowed to make "Offers of Proof" as to the substance of the excluded witnesses' testimony and exhibits to preserve the Protestants' Objections for appellate purposes. ATTORNEY 2 advised the Protestants intended to make "Offers of Proof" by having the witnesses appear and testify live, and that the Division disagreed with the Protestants' method of making "Offers of Proof" at the hearing. Counsel for the Protestants requested a teleconference to discuss the matter.

On November 26, 2008, a letter was mailed to Counsel setting a teleconference for December 2, 2008, at 9:30 a.m. On November 26, 2008, the Division filed a Memorandum with the Clerk responding to ATTORNEY 2's letter advising the Division did not object to the Protestants making "Offers of Proof" at hearing, but the Division did object to the Protestants' proposed method.

On December 1, 2008, a letter was received from ATTORNEY 2 in response to the Division's memorandum. The Protestants requested to be allowed to make "Offers of Proof" by having three (3) witnesses appear and testify at hearing on the excluded evidence, in order to preserve the Protestants' objection for appellate purposes, which should take approximately one and one-half (1½) hours.

On December 2, 2008, at 9:30 a.m., the teleconference was held with Counsel. Counsel made their respective arguments on the proposed method of the Protestants' "Offers of Proof." The Administrative Law Judge informed Counsel the Protestants could make "Offers of Proof," but not by letting witnesses appear and testify at the hearing, as this would circumvent the Order. Protestants' Counsel would be permitted to make oral "Offers of Proof" for the record in a manner to preserve the Protestants' objections, but the oral offers would be made succinctly as to the substance of the proposed testimony and the purpose for which the testimony was to be offered. Counsel was also advised the "Offer of Proof" as to ATTORNEY 1's excluded testimony would have to be made by Co-Counsel and not by ATTORNEY 1.

¹² See Order and Protestants' Final Witness List filed herein on October 17, 2008.

¹³ See Order and Protestants' "Amended" Final Exhibit List filed November 24, 2008. The Clerk confirmed by telephone the Division did not have an objection to the addition of Protestants' Exhibits 35-37, which are not included in the Order.

¹⁴ On December 3, 2008, the original was received by the Clerk for filing.

Counsel was advised the issue could be certified by Tax Commission Rule.¹⁵ Another teleconference was scheduled for 10:15 a.m. to discuss the parties' decision. At 10:15 a.m., a second teleconference was held with Counsel. Counsel agreed to certify the issue of the method to be used by the Protestants at hearing to make the "Offers of Proof." On December 2, 2008, pursuant to the two (2) teleconferences, a letter was sent electronically to Counsel confirming the parties' decision and striking the hearing set for December 9, 2008. The parties were advised to provide the Clerk with a file-stamped copy of the "Certification of Issue" filed with the Commissioners on or before December 12, 2008.

On December 2, 2008, at approximately 4:15 p.m., Counsel requested a third teleconference to advise the proposed certification had been discussed with their respective clients and the Protestants did not wish to certify the issue, but requested the hearing be placed back on the docket for hearing on December 9, 2008, at 9:30 a.m.

On December 2, 2008, the Protestants' Hearing Brief¹⁶ (received electronically) and the Brief of the Compliance Division were filed with the Clerk. On December 3, 2008, a letter was sent electronically to Counsel confirming the hearing had been placed back on the docket for December 9, 2008, at 9:30 a.m.

On December 8, 2008, a Motion to Withdraw was received after hours (electronically)¹⁷ from ATTORNEY 1 on the basis the "Protestants have deemed it necessary for ATTORNEY 1 to testify as a witness in this matter."¹⁸

On December 9, 2008, at approximately 9:25 a.m., an open hearing¹⁹ was held as scheduled. Oral arguments were heard at the beginning of the hearing on ATTORNEY 1's Motion to Withdraw. After oral arguments were heard from Counsel, the Motion to Withdraw was denied and ATTORNEY 1 remained as Co-Counsel for the Protestants.²⁰

The Protestants called one (1) witness, HUSBAND, who testified concerning the background and sale of COMPANY. The Division called one (1) witness, MANAGER, Revenue Unit Manager of the Individual Income Tax Section, Compliance Division, Oklahoma Tax Commission, who testified about the examination and adjustments to the Protestants' 2006 Oklahoma Individual Income Tax Return and as custodian of the Division's Records. The

¹⁵ OKLA. ADMIN. CODE § 710:1-5-34(b) (June 12, 1993).

¹⁶ On December 3, 2008, the original was received for filing by the Clerk.

¹⁷ The original was filed on December 9, 2008, before the hearing.

¹⁸ ATTORNEY 1 was a witness whose testimony was excluded by the Order. The Protestants proposed to have ATTORNEY 1 testify as a factual witness, to explain how 338(h)(10) works and how the Tax Commission has treated 338(h)(10) election for capital gains deduction purposes and for other tax purposes. Tr. at 7.

¹⁹ OKLA. STAT. tit. 68, § 205 (West Supp. 2008). ATTORNEY 2 waived confidentiality on behalf of the Protestants.

²⁰ Tr. at 7-9.

Protestants' Exhibits 1, 13, 30, and 35 and the Division's ("OTC") Exhibits 7 and 8 were identified, offered, and admitted into evidence.²¹ The Division's Exhibits A through C were identified, offered, and admitted into evidence.²²

The Protestants requested the exhibits excluded by the Order be deposited with the Clerk, but not be made a part of the record. Counsel's request was denied.²³ The Protestants' written "Offers of Proof"²⁴ as to testimony excluded by the Order were also identified, offered, and admitted into evidence, without objection.²⁵ For purposes of the record, Counsel requested to call the three (3) witnesses to testify. The Division objected on the grounds of relevance. The request to call the three (3) witnesses was denied in accordance with the Order.²⁶

At the conclusion of the hearing, Protestants' Counsel requested a transcript of the hearing and renewed their request to submit proposed findings of fact and conclusions of law. The Administrative Law Judge held the record open for the stated purposes, which was confirmed by a letter to Counsel on December 10, 2008. The letter advised once the transcript was completed and transmitted to Counsel, the parties would have thirty (30) days to submit proposed findings of fact and conclusions of law, and thereafter, the record would be closed and the case submitted for decision. On December 10, 2008, Protestants' Counsel filed a Request for Written Transcript with the Clerk.

On December 18, 2008, ATTORNEY 3 filed a Motion to Withdraw as Co-Counsel for the Protestants. As of January 1, 2009, ATTORNEY 3 was to be sworn in as a United States Magistrate in the United States District Court for the Northern District of Oklahoma. On December 19, 2008, an Order granting the Motion to Withdraw was issued and mailed to Counsel.

On January 7, 2009, the transcript of the December 9th hearing was mailed to Counsel. Counsel was also advised proposed findings of fact and conclusions of law were due on or before February 6, 2009, at which time the record in this matter would be closed, and this case submitted for decision.

On February 6, 2009,²⁷ the proposed findings of facts and conclusions of law of the parties were filed with the Clerk. The record in this matter was closed and this case was submitted for decision on February 6, 2009.

²¹ Tr. at 25.

²² Tr. at 46.

²³ Tr. at 29-30.

²⁴ There are three (3) written "Offers of Proof" as to the excluded testimony of ATTORNEY 1, WITNESS 1, and WITNESS 2.

²⁵ Tr. at 28-32.

²⁶ Tr. at 28.

²⁷ The Protestants' initial filing was electronic. On February 9, 2009, the original was filed with the Clerk.

FINDINGS OF FACT

Upon review of the file and records, including the record of the proceedings, the exhibits received into evidence, briefs, and the proposed findings of fact and conclusions of laws submitted by the parties, the undersigned finds:

1. COMPANY, an Oklahoma corporation,²⁸ manufacturers, supplies, and otherwise deals with ready-mixed concrete and related activities, including the transportation thereof by COMPANY'S affiliate AFFILIATE.²⁹ As of the date of the sale, COMPANY'S primary headquarters had been located in Oklahoma for approximately forty (40) years.³⁰

2. At the time of the sale, HUSBAND owned ten percent (10%) of COMPANY'S stock, with the remaining ninety-percent (90%) of the stock owned by "grantor trusts,"³¹ which are taxed as if HUSBAND is the owner of the stock for income tax purposes.³² At the time of the sale HUSBAND had "owned" the stock for approximately forty (40) years.³³

3. On April 14, 2006, a Stock Purchase Agreement ("Agreement") was entered into by LLC ("Purchaser") and the shareholders of COMPANY and AFFILIATE ("Sellers") for all the capital stock of COMPANY and AFFILIATE for \$271,000,000.00.³⁴

4. Section 7.05(i) of the Agreement³⁵ contains the following provision, to-wit:

Section 338(h)(10) Election. At the Purchaser's option, Sellers shall join Purchaser in making an election under Code Section 338(h)(10) to treat the acquisition of either or both Companies from the Sellers as a deemed sale of

²⁸ COMPANY'S "S" Corporation election for income tax purposes was effective as of April 1, 1993. *See* Division's Exhibit B.

²⁹ PROTESTANTS Exhibit 1.

³⁰ Tr. at 23-24.

³¹ "Grantor trust." A trust in which the settlor retains control over the trust property or its income to such an extent that the settlor is taxed on the trust's income. The types of controls that result in such tax treatment are set out in IRC (26 USCA) §§ 671-677. An example is the revocable trust. BLACK'S LAW DICTIONARY (8th ed. 2004), available at <http://westlaw.com>. (February 17, 2009).

³² PROTESTANTS Exhibit 13.

³³ Tr. at 24.

³⁴ Tr. at 21-23. *See* PROTESTANTS Exhibit 1. *See also* Division's Brief at 2. "The Stock Purchase Agreement also included the sale of stock of AFFILIATE, another company in which HUSBAND was a shareholder. The sale of AFFILIATE is not at issue in this matter."

³⁵ PROTESTANTS Exhibit 1 (PROTESTANTS.A.212-213). *See* Tr. at 23 and Tr. at 26-27.

the assets of COMPANY and/or AFFILIATE, as the case may be, for federal and, to the extent applicable, state and local income Tax purposes. If a Code Section 338(h)(10) election is made, Sellers and Purchaser will cooperate with one another to agree on the allocation of the “ADSP” (as defined in Treasury Regulation §§ 1.338-4 and 1.338(h)(10)-1) among the assets of COMPANY and AFFILIATE pursuant to the applicable Treasury Regulations under Section 338 of the Code (the “Allocation”) and will use the Allocation in reporting the deemed purchase and sale of the assets of COMPANY and/or AFFILIATE, as the case may be, for federal and, to the extent applicable, state and local income Tax purposes. If the parties hereto are unable to agree upon the Allocation within ninety (90) days before the due date of filing of any Tax Return for which the Allocation is relevant, the Allocation shall be made by the Independent Accounting Firm. Indemnification for any incremental taxes incurred by Seller or the Company, if any, in connection with the making of an election pursuant to Code Section 338(h)(10) shall be as provided in the provisions of Section 7.05(d).

5. On January 14, 2007, COMPANY filed its “Final” U.S. Income Tax Return for an “S” Corporation for the period January 1, 2006, through April 30, 2006 (“COMPANY’S Final Federal Return”).³⁶ COMPANY’S Purchaser exercised its option under the Agreement to treat the stock purchase as a “deemed sale of assets,” pursuant to IRC § 338(h)(10). Attached to COMPANY’S Final Federal Return is an “Asset Allocation Statement Under Section 338.”³⁷

6. On or about January 16, 2007, COMPANY filed its “Final” State of Oklahoma Small Business Corporation Income Tax Return (Form 512-S) (“COMPANY’S Final State Return”) for the period January 1, 2006, through April 30, 2006. The federal election to treat the stock purchase as a “deemed sale of assets,” pursuant to IRC § 338(h)(10), was reflected on COMPANY’S Final State Return.³⁸

7. The following statement³⁹ (“Statement”) was attached to and made part of COMPANY’S “Final” Federal and State Returns, as follows, to-wit:

Effective April 30, 2006, 100% of the stock of COMPANY (an S corporation) was purchased by:

LLC
LLC ADDRESS
E.I.N. XXX

³⁶ Division’s Exhibit B.

³⁷ *Id.* at PROTESTANTS.A.270.

³⁸ Division’s Exhibit A.

³⁹ Division’s Exhibits A (PROTESTANTS.A.353) and B (PROTESTANTS.A.272). *See Tr.* at 42-43.

LLC and the shareholders of COMPANY have made the election pursuant to IRC Section 338(h)(10) to treat the stock purchase as an asset acquisition. Regulation 1.338(h)(10)-1(d)(3)(i) provides that the selling company (COMPANY) should report the gain or loss from the deemed sale on its final tax return. This final tax return will cover the period ended as of the close of the acquisition date, April 30, 2006.

8. On August 6, 2007, the Protestants filed their Oklahoma Income Tax Return for the 2006 tax year (“2006 Return”).⁴⁰

9. On the 2006 Return, the Protestants claimed a deduction for capital gains (“Capital Gains Deduction”) received for \$230,961,244.00, of which \$203,644,920.00 was reflected as “Capital Gain From COMPANY K-1 from sale of intangibles.”⁴¹

10. On November 9, 2007, the Division issued an adjustment letter⁴² to the Protestants’ 2006 Return, which in pertinent part states as follows, to-wit:

Supporting documentation indicates your capital gain exclusion for tax year 2006 included the sale of intangibles. The capital gain exclusion for the sale of Goodwill has been disallowed. According [sic] the Oklahoma Statutes Title 68 Section 2358 the Oklahoma Capital Gains exclusion is limited to the sale of real or tangible personal property for tax year 2006. (Emphasis original).

The Division allowed the portion of the Capital Gains Deduction attributable to the sale of real or tangible personal property (\$27,316,324.00).⁴³ The Division disallowed the portion of the Capital Gains Deduction attributable to the sale of goodwill (\$203,644,920.00).

11. On January 9, 2008, the Division received a timely filed protest to the denial of \$1,635,655.00 of the income tax refund claimed on the Protestants’ 2006 Return.⁴⁴

⁴⁰ PROTESTANTS Exhibit 13. Division’s Exhibit C.

⁴¹ See Note 37 (PROTESTANTS.A.90), *supra*.

⁴² Division’s Exhibit C and OTC Exhibit 7. Attached to Division’s Exhibit C is a copy of the Protestants’ 2006 Return with the adjustments made by the Division, reducing the refund claimed from \$2,442,923.00 to \$807,268.00. The Protestants elected to have \$600,000.00 of their refund applied to 2007 estimated tax.

⁴³ *Id.*

⁴⁴ OTC Exhibit 8.

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding.⁴⁵

2. A corporation electing treatment as a Subchapter “S” Corporation under the Internal Revenue Code (“IRC”) is not subject to Oklahoma corporate income tax; however a Subchapter “S” Corporation’s shareholders shall include their proportionate share of the corporation’s federal income in each shareholder’s taxable income in the same manner and to the same extent as provided by the IRS, subject to adjustments provided in the Oklahoma Income Tax Act⁴⁶ (“Act”).⁴⁷

3. The Act imposes an income tax upon the Oklahoma Taxable Income⁴⁸ of every resident or non-resident individual who earns income within Oklahoma.⁴⁹

4. The beginning point of determining Oklahoma taxable income is Federal Adjusted Income.⁵⁰

5. Section 338 of Title 26 creates a legal fiction whereby a “purchasing corporation” in the case of a “Qualified Stock Purchase” transaction may treat the acquisition of the stock of a “Target Corporation,” if elected, as an acquisition of all of the assets of the Target Corporation at the Fair Market Value of the assets. If elected, the Target Corporation “recognizes gain or loss with respect to the transaction as if it sold all of its assets in a single transaction...and (to the extent provided in regulations) no gain or loss will be recognized on stock sold or exchanged in the transaction by members of the selling consolidated group.”⁵¹

⁴⁵ OKLA. STAT. tit. 68, § 221(D) (West Supp. 2002).

⁴⁶ OKLA. STAT. tit. 68, § 2351 et seq. (West 2001).

⁴⁷ OKLA. STAT. tit. 68, § 2365 (West 2001).

⁴⁸ OKLA. STAT. ANN. tit. 68, § 2353(12) (West 2008):

“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 hereinafter provided;

⁴⁹ OKLA. STAT. ANN. tit. 68, § 2355 (West 2008).

⁵⁰ OKLA. STAT. tit. 68, § 2353(13) (West Supp. 2006):

“Oklahoma adjusted gross income” means “adjusted gross income” as reported to the federal government (or as would have been reported by the taxpayer had a return been filed), or in the event of adjustments thereby by the federal government as finally ascertained under the Internal Revenue Code, adjusted further as hereinafter provided;

⁵¹ 26 U.S.C.A. § 338(h)(10).

6. Any term used in the Act shall⁵² have the same meaning as when used in a comparable context in the IRC, unless a different meaning is clearly required. For all taxable periods covered by the Act, the tax status and all elections of all taxpayers covered by the Act shall⁵³ be the same for all purposes material hereto as they are for federal income tax purposes except when the Act specifically provides otherwise.⁵⁴

7. A taxpayer's income tax liability is determined in accordance with the law in effect at the time the income is received.⁵⁵

8. The text of Section 2358(F) of Title 68⁵⁶ for the 2006 tax year is as follows, to-wit:

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.

...

F. 1. For taxable years beginning after December 31, 2004, a deduction from the Oklahoma adjusted gross income of any individual taxpayer shall be allowed for qualifying gains receiving capital treatment that are included in the federal adjusted gross income of such individual taxpayer during the taxable year.

2. As used in this subsection:

a. "qualifying gains receiving capital treatment" means the amount of net capital gains, as defined in Section 1222(11) of the Internal Revenue Code, included in an individual taxpayer's federal income tax return that result from:

(1) the sale of real or tangible personal property located within Oklahoma that has been directly or indirectly owned by the individual taxpayer for a holding period of at least five (5) years prior to the date of the transaction from which such net capital gains arise, or

⁵² "Generally, when the legislature uses the term 'shall,' it signifies a mandatory directive or command." See *Keating v. Edmondson*, 2001 OK 110, ¶ 13, 37 P.3d 882.

⁵³ *Id.*

⁵⁴ OKLA. STAT. ANN. tit. 68, § 2353(3) (West 2008).

⁵⁵ *Affiliated Management Corp. v. Oklahoma Tax Commission*, 1977 OK 183, 570 P.2d 335; *Wootten v. Oklahoma Tax Com'n*, 1935 OK 54, 170 Okla. 584, 40 P.2d 672.

⁵⁶ OKLA. STAT. tit. 68, § 2358(F) (West Supp. 2006). Although not at issue, the holding period for the sale of stock or ownership interest was changed from three (3) years to two (2) years by Laws 2006, c. 272, § 17 (repealed by Laws 2007, c. 1, § 59), and by Laws 2007, c. 1, § 57.

- (2) the sale of stock or the sale of a direct or indirect ownership interest in an Oklahoma company, limited liability company, or partnership where such stock or ownership interest has been directly or indirectly owned by the individual taxpayer for a holding period of at least three (3) years prior to the date of the transaction from which the net capital gains arise,
 - b. "holding period" means an uninterrupted period of time,
 - c. "Oklahoma company," "limited liability company," or "partnership" means an entity whose primary headquarters have been located in Oklahoma for at least three (3) uninterrupted years prior to the date of the transaction from which the net capital gains arise,
 - d. "direct" means the individual taxpayer directly owns the asset, and
 - e. "indirect" means the individual taxpayer owns an interest in a pass-through entity (or chain of pass-through entities) that sells the asset that gives rise to the qualifying gains receiving capital treatment.
- (1) With respect to sales of real or personal property located within Oklahoma, the deduction described in this subsection shall not apply unless the pass-through entity that makes the sale has held the property for not less than five (5) uninterrupted years prior to the date of the transaction that created the capital gain, and each pass-through entity included in the chain of ownership has been a member, partner, or shareholder of the pass-through entity in the tier immediately below it for an uninterrupted period of not less than five (5) years.
 - (2) With respect to sales of stock or ownership interest in an Oklahoma company, limited liability company, or partnership, the deduction described in this subsection shall not apply unless the pass-through entity that makes the sale has held the stock or ownership interest for not less than three (3) uninterrupted years prior to the date of the transaction that created the capital gain, and each pass-through entity included in the chain of ownership has been a member, partner or shareholder of the pass-through entity in the tier immediately below it for an uninterrupted period of not less than three (3) years.

9. The Statute fails to define "Oklahoma company," but "company" is commonly defined as "A corporation, partnership, association, joint-stock company, trust fund, or organized group of persons, whether incorporated or not..."⁵⁷ There is no dispute "Oklahoma company" includes a corporation under state law, including a corporation that has made an "S" Corporation election for income tax purposes.

⁵⁷ See Note 56, *supra*. See also BLACK'S LAW DICTIONARY (8th ed. 2004), available at <http://web2.westlaw.com> (February 24, 2009).

10. 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.⁵⁸

11. The Tax Commission Rule on the Capital Gains Deduction⁵⁹ for the 2006 tax year, is as follows, to-wit:

(a) **General provisions.** For tax years beginning on or after January 1, 2005, individual taxpayers can subtract from the Oklahoma adjusted gross income, gains reported on their Oklahoma income tax return and included in federal taxable income receiving capital treatment. The gain must be realized on or after January 1, 2005, in order to be eligible for the Oklahoma exclusion. Effective for tax years beginning on or after January 1, 2006 corporate taxpayers can subtract from the Oklahoma taxable income, gains reported on their Oklahoma income tax return and included in federal taxable income receiving capital treatment. For corporate taxpayers the gain must be realized on or after January 1, 2006 in order to be eligible for the Oklahoma exclusion.

(b) **Qualifying gains receiving capital treatment.** As used in this Section, "**qualifying gains receiving capital treatment**" means the amount of net capital gains, as defined under Internal Revenue Code Section 1222(11), [IRC §1222(11)]. The gain must be included in the federal income tax return of the taxpayer.

(1) **Sale of real or tangible personal property.** To qualify for the Oklahoma deduction, the gain must be earned as a result of the sale of real or tangible personal property located within Oklahoma. Taxpayers must have held the asset for not less than five (5) uninterrupted years prior to the date of the transaction that created the capital gain.

(2) **Sale of stock or ownership interest.** To qualify for the Oklahoma deduction, the gain must be earned as a result of the sale of stock or ownership interest in an Oklahoma company, limited liability company, or partnership and the stock or ownership interest must have been held by the taxpayer for at least three (3) uninterrupted years prior to the date of the transaction that created the capital gain.

(3) **Sale of real or tangible personal property by pass-through entities.** Net capital gains earned by member, partner, or shareholder of a pass-through entity as a result of the sale of real or tangible personal property located within Oklahoma, and included in the a taxpayer's federal taxable

⁵⁸ OKLA. STAT. ANN. tit. 75, § 250 et seq. (West 2001). *See Toxic Waste Impact Group, Inc. v. Leavitt*, 1988 OK 20, 755 P.2d 626.

⁵⁹ OKLA. ADMIN. CODE § 710:50-15-48 (June 25, 2006).

income is excludable, provided that the taxpayer has been a member of the pass-through entity for an uninterrupted period of five (5) years and that the pass-through entity has held the asset for not less than five (5) uninterrupted years prior to the date of the transaction that created the capital gain.

(4) **Sale of stock or ownership interests by pass-through entities.** Net capital gains earned by a member, partner, or shareholder of a pass-through entity as a result of the sale of stock or an ownership interest in an Oklahoma company, limited liability company, or partnership, is excludable, provided that the taxpayer has been a member of the pass-through entity for an uninterrupted period of three (3) years and that the pass-through entity has held the asset for not less than three (3) uninterrupted years prior to the date of the transaction that created the capital gain.

(5) **Installment sales.** Qualifying gains included in an individual taxpayer's federal taxable income for years after December 31, 2004, or a corporate taxpayer's federal taxable income for years after December 31, 2005, which are derived from installment sales are eligible for exclusion, provided the appropriate holding periods are met.

(c) **"Oklahoma company", "limited liability company", "partnership".** An Oklahoma company, limited liability company, or partnership is one whose primary headquarters has been located in Oklahoma for at least three (3) years prior to the capital gain transaction. The Oklahoma company, limited liability company, or partnership must meet the three (3) year rule for an uninterrupted period.

12. The goal of any inquiry into the meaning of a legislative act is to ascertain and give effect to the intent of the legislature. The law-making body is presumed to have expressed its intent in a statute's language and to have intended what the text expresses. Hence, where a statute is plain and unambiguous, it will not be subject to judicial construction, but will be given the effect its language dictates. Only where the intent cannot be ascertained from a statute's text, as occurs when ambiguity or conflict (with other statutes) is shown to exist, may rules of statutory construction be employed. Statutes that provide an exemption from taxation are to be strictly construed against the claimant.⁶⁰ Statutory construction presents a question of law.⁶¹

13. Tax exemptions, deductions, and credits depend entirely on legislative grace and are strictly construed against the exemption, deduction or credit.⁶²

⁶⁰ *Blitz U.S.A., Inc. v. Oklahoma Tax Com'n*, 2003 OK 50, ¶ 14, 75 P.3d 883. (Citations omitted).

⁶¹ *Id.* at ¶ 6.

⁶² *TPQ Inv. Corp. v. State ex rel. Oklahoma Tax Com'n*, 1998 OK 13, ¶ 8, 954 P.2d 139. (Citations omitted).

14. The Statute is a tax exemption or deduction statute, not a tax levying statute; and as such, it must be strictly construed unless authority for the deduction is clearly expressed.⁶³

15. Statutes and statutory amendments are presumed to operate prospectively, and presumption is rebutted only where intention of the Legislature to give statutes retrospective effect is expressly declared or necessarily implied from the language of the statute.⁶⁴ Doubt as to whether statute was intended to be prospective or retrospective must be resolved against retrospective application.⁶⁵ As in other matters concerning statutory interpretation, whether to give prospective or retroactive effect should be controlled by the fundamental or transcendent canon of statutory construction of giving effect to legislative design.⁶⁶

16. Words used in any statute are to be understood in their ordinary sense, except when a contrary intention plainly appears, and except also that the words hereinafter explained are to be understood as thus explained.⁶⁷

17. Whenever the meaning of a word or phrase is defined in any statute, such definition is applicable to the same word or phrase wherever it occurs, except where a contrary intention plainly appears.⁶⁸

18. In all proceedings before the Tax Commission, the taxpayer has the burden of proof.⁶⁹ A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect and in what respects.⁷⁰

⁶³ *Id.*

⁶⁴ *Department of Human Services ex rel. Pavlovich v. Pavlovich*, 1996 OK 71, 932 P.2d 1080. (Citations omitted).

⁶⁵ *Fraternal Order of Police, Lodge No. 165 v. City of Choctaw*, 1996 OK 78, 933 P.2d 261.

⁶⁶ *Houck v. Hold Oil Corp.*, 1993 OK 166, 1993 OK 167, 867 P.2d 451. (Citations omitted).

⁶⁷ OKLA. STAT. ANN. tit. 25, § 1 (West 2008).

⁶⁸ OKLA. STAT. ANN. tit. 25, § 2 (West 2008).

⁶⁹ OKLA. ADMIN. CODE § 710:1-5-47 (June 25, 1999):

In all administrative proceedings, unless otherwise provided by law, the burden of proof shall be upon the protestant to show in what respect the action or proposed action of the Tax Commission is incorrect. If, upon hearing, the protestant fails to prove a prima facie case, the Administrative Law Judge may recommend that the Commission deny the protest solely upon the grounds of failure to prove sufficient facts which would entitle the protestant to the requested relief.

OKLA. ADMIN. CODE § 710:1-5-77(b) (June 25, 1999), provides in pertinent part:

...“preponderance of the evidence” means the evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; evidence which as a whole shows that the fact sought to be proved is more probable than not.

DISCUSSION
PROTESTANTS' STATEMENT OF ISSUE

The issue presented for decision is whether the Statute and/or the Clarification allow the capital gain deduction taken by Protestants on their 2006 Oklahoma Income Tax Return for the sale of their stock in an Oklahoma company that undisputedly met the holding periods in Section 2358(F).⁷¹

PROTESTANTS' FIRST CONTENTION

The Protestants' first contention is the IRC § 338(h)(10) election made on the federal level is not binding on the state level,⁷² or that it should be disregarded.⁷³

The IRC § 338(h)(10) election is relevant because the Protestants put the election at issue and have maintained throughout this matter the election made by COMPANY'S Purchaser was not binding on the Protestants at the state level, so the transaction remained a sale of stock, instead of being treating on the state level as a "deemed sale of assets."

However, the Division has cited ample statutory authority that "Tax Elections" taken at the federal level are binding at the state level unless the Act specifically provides otherwise and the Oklahoma Supreme Court has held federal elections are binding at the state level under Section 2353(3) of Title 68, without reference to a comparable context.⁷⁴

In *GAMCO*,⁷⁵ the court specifically addressed whether a taxpayer's federal election under IRC § 338(h)(10) is an election which is binding at the state level. The court acknowledges the Act's "Piggy Back" provision,⁷⁶ which holds "the tax status and all elections of all taxpayers covered by [the Act] [to] be the same for all purposes material hereto as they are for federal income tax purposes."⁷⁷ The court held, "For federal purposes, Taxpayers elected to treat the

⁷⁰ See *Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Com'n*, 1988 OK 91, 768 P.2d 359.

⁷¹ Protestants' Proposed Findings at 7.

⁷² Protestants' Brief at 8-9.

⁷³ See *TPQ* at Note 62, *supra*.

⁷⁴ See Note 54, *supra*. See also *Matter of Income Tax Protest of Flint Resources*, 1989 OK 9, 780 P.2d 665.

⁷⁵ *General Accessory Mfg. Co. v. Oklahoma Tax Com'n*, 2005 OK CIV APP 75, 122 P.3d 476.

⁷⁶ See Note 54, *supra*.

⁷⁷ See Note 54, *supra*.

sale of stock in their Oklahoma corporation as a sale of corporate assets, and their federal election is binding for state tax purposes.”⁷⁸

COMPANY’S Purchaser elected, pursuant to the Agreement, to treat the stock purchase as a “deemed sale of assets” for state and federal income tax purposes. The Statement attached to COMPANY’S “Final” Federal and State Returns leaves no doubt about the Purchaser’s election.⁷⁹ The IRC § 338(h)(10) election made by COMPANY’S Purchaser at the federal level is binding on the Protestants at the state level for income tax purposes.

DISCUSSION
PROTESTANTS’ SECOND CONTENTION

The Protestants’ second contention⁸⁰ is stated as follows, to-wit:

1. Under the Statute, qualifying gains include those realized in connection with the sale of an ownership interest in an “Oklahoma company, limited liability company or partnership.” 68 O.S. Supp 2006 § 2358(F)(2)(a)(2).
2. The clear and unambiguous language of the Statute allows all capital gain from the sale of an Oklahoma company to qualify for deduction where such gain is triggered by the sale of ownership interests in an Oklahoma company. Where such Oklahoma company/ownership interest is sold, there is no direct exclusion of goodwill or intangibles in the Statute. The Statute defines “qualifying gains receiving capital treatment” as gains resulting from the “sale of stock or the sale of a direct or indirect ownership interest in an Oklahoma company...” Okla. Stat. tit. 68, § 2358(F)(2)(a)(2).
3. The Protestants claimed a deduction for the gain resulting from the 2006 sale of their stock in COMPANY, an Oklahoma company within the definition in the Statute that undisputedly met the holding periods. Accordingly, the gains resulting from such sale qualified for a capital gain deduction.
4. The fact that a taxpayer makes a Section 338(h)(10) Election for federal tax purposes with respect to the sale of the stock of an Oklahoma company does not mean that the resulting gain is not a “qualifying gain receiving capital gains treatment” under the Statute. In fact, the Oklahoma Tax Commission auditor that made the adjustment to Protestants’ 2006 Oklahoma income tax return testified that she did not consider whether

⁷⁸ See *GAMCO* at Note 75, *supra*.

⁷⁹ See Note 39, *supra*.

⁸⁰ Protestants’ Proposed Findings at 8-9.

Protestants made a Section 338(h)(10) Election. Accordingly, the fact that the purchaser of COMPANY, required a Section 338(h)(10) Election has no relevance here.

The language of the Statute is clear and unambiguous and its terms should be construed using their ordinary meaning as directed by the Legislature. Provisions of the Statute cannot be read in isolation as suggested by the Protestants, but must be construed in its entirety.⁸¹

The language of the Statute in pertinent part is as follows, to-wit:

- a. "qualifying gains receiving capital treatment" means the amount of net capital gains, as defined in Section 1222(11) of the Internal Revenue Code, included in an individual taxpayer's federal income tax return that result from:
 - (1) *the sale of real or tangible personal property* located within Oklahoma that has been directly or indirectly owned by the individual taxpayer for a holding period of at least five (5) years prior to the date of the transaction from which such net capital gains arise, or (Emphasis added).⁸²

The Statute contains two (2) categories which are eligible for the Oklahoma Capital Gains Deduction: (1) the sale of property located in Oklahoma and (2) the sale of stock or ownership interest in an Oklahoma company, limited liability company, or partnership (which includes an "S" Corporation).

The Statute permits a deduction for the sale of two types of property: (1) real property and (2) tangible personal property. Due to the IRC § 338(h)(10) election, the Capital Gains Deduction claimed by the Protestants on the 2006 Return is "deemed as a sale of assets," which falls under the first category, property.

The personal property at issue in this matter is "Goodwill," which is "Intangible" Personal Property, not "Tangible" Personal Property, as specifically provided in the Statute. As distinguished from tangible assets, intangibles have no intrinsic value, but do have a value related to the ownership and possession of tangible assets. Some intangibles, such as a trademark, trade name or patent, are related to an identifiable tangible asset. Goodwill, which is another intangible, is not. Often referred to as "the most 'intangible' of the intangibles," goodwill is essentially reputation that will probably generate future business.⁸³

⁸¹ *Imaging Services, Inc. v. Oklahoma Tax Com'n, Excise Tax Div.*, 1993 OK 164, 866 P.2d 1204. See *Affiliated* at Note 55, *supra*.

⁸² See Note 56, *supra*.

⁸³ "The 'good will' value of any business is the value that results from the probability that old customers will continue to trade with an established concern." *Travis v. Travis*, 1990 OK 57, 795 P.2d.96. (Citations omitted). See OKLA. STAT. ANN. tit. 60, § 315 (West 1994): "The goodwill of a business is the expectation of continued public

This reading of the Statute is also supported by the court's holding in *GAMCO*,⁸⁴ which is strikingly similar to the facts in this matter. In *GAMCO*, non-resident taxpayers owned all the stock in *GAMCO*, an Oklahoma "S" Corporation. In May 1998, pursuant to a stock purchase agreement, the taxpayers sold all their *GAMCO* stock to Masco Corporation, and, as permitted for federal income tax purposes, the parties agreed and elected to treat the stock sale as a sale of assets. In November 1998, Masco filed the original *GAMCO* federal income tax return for an "S" Corporation with the IRS. Masco reported a total property distribution other than dividends of \$26,763,441.00, of which it claimed \$21,755,970.00 as net long-term capital gain attributable to goodwill. Masco attached the parties' joint election to treat the stock sale as a sale of assets permitted by IRC § 338(h)(10). In December 1998, Masco filed the original *GAMCO* Oklahoma corporate income tax return for the period January 1, 1997 through April 30, 1998. Masco reported "Non-Resident Share of Income," i.e., the gain realized by taxpayers from the sale of all their *GAMCO* stock, of \$22,583,495.00, and paid Oklahoma income tax of \$1,355,010.00 as tax on the IRC § 338(h)(10) "deemed sale of assets." In November 2001, taxpayers filed an amended Oklahoma corporate income tax return, seeking to reclassify the "deemed sale of assets" as a sale of stock, i.e., the sale of intangible personal property for which the non-resident taxpayers bore no Oklahoma income tax liability. The return consequently listed "Non-resident Share of Income" of \$1,755,420.00, and state income tax thereon of \$105,505.00, thus arguably supporting the taxpayers' entitlement to a refund of \$1,214,345.00. In January 2002, the Audit Division denied a refund. Upon review, the Administrative Law Judge recommended denial of a refund. In March 2004, the Commission denied the claim for refund and the taxpayers appealed. The taxpayers argued their IRC § 338(h)(10) election did not bind them on the state level. The court disagreed, and concluded the fact that under Section 2358(A)(4)(b) of the Act, a sale of stock is treated as a sale of intangible personal property for state tax purposes does not mean that the legislature intended that an Oklahoma taxpayer might recharacterize what had been reported as an IRC § 338(h)(10) sale of assets for federal tax purposes in calculating Oklahoma income. The court upheld the Tax Commission's Order, which disallowed the capital gains deduction taken by the taxpayers for "intangible" personal property in the form of goodwill.

The Statute is a tax exemption or deduction statute, not a tax levying statute and as such must be strictly construed against the Protestants unless authority for the deduction is clearly expressed.⁸⁵ The language of the statute is clear and unambiguous and the Statute does not include an exclusion for "Intangible" Personal Property in the form of Goodwill for the 2006 tax year.

patronage, but it does not include a right to use the name of any person from whom it was acquired." *See also* OKLA. STAT. ANN. tit. 60, § 316 (West 1994): "The goodwill of a business is property, transferable like any other."

⁸⁴ *See GAMCO* at Note 75, *supra*.

⁸⁵ *See TPQ* at Note 62, *supra*. *See also* the canon of construction "expressio unius est exclusio alterius," which holds that to express or include one thing implies the exclusion of the other. BLACK'S LAW DICTIONARY 8th ed. 2004, available at <http://web2.westlaw.com> (February 26, 2009) and *R.R. Tway, Inc. v. Oklahoma Tax Com'n*, 1995 OK 129, 910 P.2d 972.

The Protestants have failed to meet their burden of proof the Division's disallowance of that portion of the Capital Gains Deduction taken on the 2006 Return attributable to "Intangible" Personal Property in the form of "Goodwill" was incorrect and in what respects.

DISCUSSION **PROTESTANTS' THIRD CONTENTION**

The Protestants' third and last contention is the "Amendment" to the Statute, which became effective January 1, 2008, applies to tax years 2005 and later, and allows the Protestants' Capital Gains Deduction taken on the 2006 Return. Before and after the Statute was amended,⁸⁶ Section 2358(F)(1) reads in pertinent part, as follows, to-wit:

"For tax years beginning after *December 31, 2004*, a deduction from the Oklahoma adjusted gross income of any individual taxpayer shall be allowed for qualifying gains receiving capital treatment..." (Emphasis added).

The Protestants make their argument in two (2) parts. In part one, the Protestants assert the mere fact that the effective date of the "Amendment" to the Statute is January 1, 2008, or as labeled by the Protestants the "Clarification," does not change the fact that the clear language mandates it be applied to tax years 2005 and later. Further, Oklahoma case law is clear that when the Legislature expressly provides in the statutory language for a statute to operate retrospectively, such statute will be applied accordingly, citing *Dolese*, wherein the court held, "As a general rule, statutes and statutory amendments will be construed as operating prospectively unless by express declaration or necessary implication from the language used the Legislature clearly demonstrates a contrary intent; if there is any doubt, it must be resolved against retroactivity."⁸⁷

Further, the Protestants contend Oklahoma case law has held express language in a statute trumps an effective date or emergency clause, because such "provision should be looked upon as subordinate to *the express provision contained in the body of Act...*"⁸⁸ Thus, because the Amendment (Clarification) specifically states it applies to "taxable years beginning after December 31, 2004," such language controls over the effective date.

The Division counters the first part of the Protestants' argument by also citing *Cities Services*, for the proposition "Express language will prevail over an effective date or emergency clause."⁸⁹ Yet, "In every case of doubt the doubt must be resolved against the retroactive effect."⁹⁰

⁸⁶ See OKLA. STAT. tit. 68, § 2358 (West Supp. 2006) and OKLA. STAT. tit. 68, § 2358 (West Supp. 2007).

⁸⁷ *Dolese Bros. v. State ex rel. Oklahoma Tax Com'n*, 2003 OK 4, ¶ 8, 64 P.3d 1093. (Citations omitted).

⁸⁸ *Cities Service Oil Co. v. Oklahoma Tax Com'n*, 1942 OK 307, 129 P.2d 597. (Emphasis added).

⁸⁹ *Id.*

⁹⁰ *State ex rel. Allen v. Board of Ed. of Dist. No. 74 of Muskogee County*, 1952 OK 241, 246 P.2d 368. (Citations omitted).

In *Cities Services*, the statute repealing mileage tax contained both an emergency clause making it effective upon approval (April 18, 1939) and a provision making it effective at a fixed future date (“This Act shall be in full force and effect on and after January 1, 1940), which precluded a taxpayer from recovering mileage taxes paid under protest between the date of approval and the effective date fixed in the statute. The court held, “Under constitutional provision relating to effective date of statutes, the legislature may, by adding an emergency clause to a statute, cause it to become a law on approval but, by express provision, hold its effectiveness in abeyance until a specified time.”⁹¹

The “Amendment” to the Statute, unlike the statute in *Cities Services*, does not contain an emergency clause making it effective upon approval or an express provision holding its effectiveness in abeyance until a specified time, and like the statute in *Dolese*, nothing in the Amendment expressly declares or necessarily implies a legislative intent that the Amendment should be applied to a transaction that took place during the 2006 tax year.⁹²

The second part of the Protestants’ contention is a clear reading of the Statute and Amendment reveals the Amendment did not change the law but merely clarified what was already the law,⁹³ and the Division’s denial of the portion of the Capital Gains Deduction

⁹¹ *Id.* See OK Const. Art. 5, § 58:

Time of taking effect of statutes --Emergency measures

No act shall take effect until ninety days after the adjournment of the session at which it was passed, except enactments for carrying into effect provisions relating to the initiative and referendum, or a general appropriation bill, unless, in case of emergency, to be expressed in the act, the Legislature, by a vote of two-thirds of all members elected to each House, so directs. An emergency measure shall include only such measures as are immediately necessary for the preservation of the public peace, health, or safety, and shall not include the granting of franchises or license to a corporation or individual, to extend longer than one year, nor provision for the purchase or sale of real estate, nor the renting or encumbrance of real property for a longer term than one year. Emergency measures may be vetoed by the Governor, but such measures so vetoed may be passed by a three-fourths vote of each House, to be duly entered on the journal.

⁹² The Protestants also assert the Tax Commission applied the provisions of HB 1174 retroactively. HB 1174 has an effective date of January 1, 2007, and added “estates or trusts” to the provisions of Section 2358(D) of Title 68. See PROTESTANTS Exhibit 30. See also PROTESTANTS Exhibit 35, which is a document the Division “put together in May 2008, ...for their seminar that they were having to help explain the capital gains deductions to auditors.” Tr. at 53. This document was produced by the Division well after the denial of a portion of the Protestants’ refund, and is not an interpretation by the Tax Commission. The exhibit also contains errors as to the effective dates for corporations, estates, and trusts.

The Division notes in its Brief that the Legislature does not have the power to release or extinguish an indebtedness, liability, or obligation of a corporation or an individual, which would prohibit the legislature from making the Amendment retroactive. See OK Const. Art. 5, § 58. See also *Wooten* at Note 55, *supra*.

⁹³ See *Purcell v. Santa Fe Minerals, Inc.*, 1998 OK 45, 961 P.2d 188, which found that statute with effective date post-dating production payment obligation applied to the defendant, because such statute was not in substance difference from its predecessor.

attributable to “Goodwill” was improper. In *Purcell*, the Court held the “Legislature is not presumed to perform vain and useless acts when creating law” and “Legislative voice may be used to clarify existing law, as opposed to altering its substance.”⁹⁴

The Division responds to the second part of the Protestants’ argument that the presumption of prospective operation is applicable to Oklahoma tax statutes. “Statutes are to be construed as having a prospective operation unless the purpose and intention of the Legislature to give them a retrospective effect is expressly declared or is necessarily implied from the language used.”⁹⁵

In *Wilson*, the Court held, “Where statute or a portion thereof is submitted by setting forth amended section in full, provisions of original statute which are repeated are to be considered as having been the law from the time they were first enacted, and the new provisions or changed portions are to be understood as enacted at the time the amended act takes effect and not to have any retroactive operation.”⁹⁶

The Amendment to the Statute is presumed to operate prospectively unless the legislature expressly declared that the Amendment is to operate retrospectively or such treatment is necessarily implied from the language of the Amendment. The Amendment, which became effective on January 1, 2008,⁹⁷ in pertinent part, is as follows, to-wit:

F. 1. For taxable years beginning after December 31, 2004, a deduction from the Oklahoma adjusted gross income of any individual taxpayer shall be allowed for qualifying gains receiving capital treatment that are included in the federal adjusted gross income of such individual taxpayer during the taxable year.

2. As used in this subsection:

a. “qualifying gains receiving capital treatment” means the amount of net capital gains, as defined in Section 1222(11) of the Internal Revenue Code, included in an individual taxpayer’s federal income tax return that result from:

(1) the sale of real property or tangible personal property located within Oklahoma that has been directly or indirectly owned by

⁹⁴ *Id.*

⁹⁵ See *Allen* at Note 90, *supra.* and *Pino v. United States*, 2008 OK 26, ¶ 10, 183 P.3d 1001. See also *Dolese* at Note 87, *supra.*

⁹⁶ *Wilson v. State ex rel. Okla. Tax Commission*, 1979 OK 62, 594 P.2d 1210.

⁹⁷ OKLA. STAT. ANN. tit. 68, § 2358(F) (WestSupp. 2009). According to the annotations, the portions of the Statute which were amended are delineated by an underline for additions or the strike-through symbol for deletions.

the individual taxpayer for a holding period of at least five (5) years prior to the date of the transaction from which such net capital gains arise, ~~or~~

- (2) the sale of stock or the sale of a direct or indirect ownership interest in an Oklahoma company, limited liability company, or partnership where such stock or ownership interest has been directly or indirectly owned by the individual taxpayer for a holding period of at least two (2) years prior to the date of the transaction from which the net capital gains arise, or
 - (3) the sale of real property, tangible personal property or intangible personal property located within Oklahoma as part of the sale of all or substantially all of the assets of an Oklahoma company, limited liability company, or partnership or an Oklahoma proprietorship business enterprise where such property has been directly or indirectly owned by such entity or business enterprise or owned by the owners of such entity or business enterprise for a period of at least two (2) years prior to the date of the transaction from which the net capital gains arise,
- b. “holding period” means an uninterrupted period of time. The holding period shall include any additional period when the property was held by another individual or entity, if such additional period is included in the taxpayer's holding period for the asset pursuant to the Internal Revenue Code,
 - c. “Oklahoma company,” “limited liability company,” or “partnership” means an entity whose primary headquarters have been located in Oklahoma for at least three (3) uninterrupted years prior to the date of the transaction from which the net capital gains arise,
 - d. “direct” means the individual taxpayer directly owns the asset, ~~and~~
 - e. “indirect” means the individual taxpayer owns an interest in a pass-through entity (or chain of pass-through entities) that sells the asset that gives rise to the qualifying gains receiving capital treatment.
- (1) With respect to sales of real ~~or~~ property or tangible personal property located within Oklahoma, the deduction described in this subsection shall not apply unless the pass-through entity that makes the sale has held the property for not less than five (5) uninterrupted years prior to the date of the transaction that created the capital gain, and each pass-through entity included in the chain of ownership has been a member, partner, or shareholder of the pass-through entity in the tier immediately

below it for an uninterrupted period of not less than five (5) years.

- (2) With respect to sales of stock or ownership interest in or sales of all or substantially all of the assets of an Oklahoma company, limited liability company, ~~or~~ partnership or Oklahoma proprietorship business enterprise, the deduction described in this subsection shall not apply unless the pass-through entity that makes the sale has held the stock or ownership interest for not less than two (2) uninterrupted years prior to the date of the transaction that created the capital gain, and each pass-through entity included in the chain of ownership has been a member, partner or shareholder of the pass-through entity in the tier immediately below it for an uninterrupted period of not less than two (2) years. For purposes of this division, uninterrupted ownership prior to the effective date of this act shall be included in the determination of the required holding period prescribed by this division, and

f. “Oklahoma proprietorship business enterprise” means a business enterprise whose income and expenses have been reported on Schedule C or F of an individual taxpayer’s federal income tax return, or any similar successor schedule published by the Internal Revenue Service and whose primary headquarters have been located in Oklahoma for at least three (3) uninterrupted years prior to the date of the transaction from which the net capital gains arise.

The Division acknowledges, “When construing a statute which has been amended, [the Court is] mindful that the legislature may have intended either (a) to effect a change in the existing law, or (b) to clarify that which previously appeared doubtful,”⁹⁸ but asserts the Protestants have failed to point to any clarifying language.

The Division points out the Amendment added an entirely new subsection, “2358(F)(2)(a)(3)”, which the Protestants contend qualify them for the Capital Gains Deduction for “Intangible” Personal Property attributable to goodwill. However, this subsection enlarged the Statute’s scope to include a new category of personal property, which was not previously included in the Statute, which indicates the Amendment is a substantive change in the law, not a clarification of the Statute as asserted by the Protestants. Enlarging the scope of the Statute to include assets which were not previously eligible for the Capital Gains Deduction is a change to the Statute, not a Clarification.⁹⁹

⁹⁸ Division’s Proposed Findings at 20. See *Blitz* at Note 60, *supra*. See also *In re Protest of Betts Telecom Oklahoma, Inc.*, 2008 OK CIV APP 19, ¶ 15, 178 P.3d 197.

⁹⁹ See *Betts* at Note 98, *supra*.

The Protestants have failed to overcome the presumption that the Amendment to the Statute is to be applied prospectively. As in *Wilson*, the Amendment sets forth the provisions of Section 2358(F)(1) in full, provisions of the Statute which are repeated are to be considered as having been the law from the time it was first enacted, and the new provisions or changed portions are to be understood as enacted at the time the Amendment takes effect (January 1, 2008), and not to have any retroactive operation.¹⁰⁰

CONCLUSION

The Protestants have failed to meet their burden of proof that the Division's disallowance of that portion of the Capital Gains Deduction on the 2006 Return attributable to "Intangible" Personal Property in the form of Goodwill is incorrect and in what respects.

DISPOSITION

It is the ORDER of the OKLAHOMA TAX COMMISSION, based upon the facts and circumstances of this case, the protest should be denied.

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.

¹⁰⁰ See *Wilson* at Note 96, *supra*.