JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2010-04-06-02 / NON-PRECEDENTIAL**
ID: **P-09-171-K**
DATE: **APRIL 6, 2010**
DISPOSITION: **SUSTAINED**
TAX TYPE: **INCOME**
APPEAL: **NO APPEAL TAKEN**

ORDER

The above matter comes on for entry of an 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 24th day of February, 2010, and being fully advised in the premises, the Commission hereby makes the following Findings of Fact and Conclusions of Law and enters the following Order.

STATEMENT OF THE CASE

On May 18, 2009, Protestant filed an amended 2005 Oklahoma nonresident income tax return claiming a refund in the amount of $37.00. By letter dated September 4, 2009, the Compliance Division of the Oklahoma Tax Commission notified Protestant that the claim for refund had been denied as barred by statute. Protestant timely filed a written protest to the refund denial.

On October 8, 2009, the Division referred the protest to the Office of the Administrative Law Judges for further proceedings pursuant to the Uniform Tax Procedure Code[1], the Oklahoma Income Tax Act ("Act")[2] and the Rules of Practice and Procedure before the Office of Administrative Law Judges[3].

A pre-hearing conference was scheduled for December 8, 2009, by *Prehearing Conference Notice* issued October 26, 2009.[4] Pursuant to the conference, a *Prehearing Conference Order* was issued setting forth the procedure whereby the protest would be submitted for decision.[5]

On January 22, 2010, the *Compliance Division's Memorandum Brief* was filed. Attached to the *Brief* were Exhibits A through G. Protestant filed a *Response to Compliance Division's*

[1] 68 O.S. 2001, § 201 et seq., as amended.

[2] 68 O.S. 2001, § 2351 et seq., as amended.

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

[4] *OAC*, 710:1-5-28(a).

[5] *OAC*, 710:1-5-28(b) and 710:1-5-38.

Memorandum Brief on February 8, 2010. Attached to the *Response* were Exhibits A and B. On February 11, 2010, the record was closed and the protest was submitted for decision.[6]

FINDINGS OF FACT

Upon review of the file and records, including the pleadings of the parties and attached exhibits, the undersigned finds:

1. Protestant filed an original 2005 nonresident Oklahoma Income Tax Return on July 10, 2006, reporting Oklahoma income tax withholding of $1,345.00, income tax due of $95.00 and a refund of income tax in the amount of $1,250.00. Exhibits A through C.[7]

2. On or about March 4, 2009, Protestant filed an amended 2005 Federal Income Tax Return. On the amended federal return, Protestant reduced the amount of her Schedule A itemized deductions by the amount of the Oklahoma income tax withheld from her Oklahoma oil and gas royalties ($1,344.75) and included the Oklahoma withholding on Schedule E (Supplemental Income and Loss schedule) as an expense (taxes) against the royalty income thereby reducing said income from the originally reported amount of $14,164.49 to an amount of $12,819.74. Exhibit C.

3. The Internal Revenue Service ("IRS") accepted Protestant's amended 2005 federal return and by letter dated April 27, 2009, notified Protestant, "[a]s you requested, we changed your account for 2005 * * *". Exhibit D.

4. On May 18, 2009, Protestant filed an amended 2005 Oklahoma nonresident income tax return reporting the IRS accepted changes to her federal taxable income, Oklahoma source income of $12,820.00 and an income tax refund of $37.00 resulting from a reported tax liability of $58.00, less Oklahoma income tax withholding of $95.00. Exhibit E.

5. By letter dated September 4, 2009, the Division notified Protestant that the claim for refund reported on her amended 2005 Oklahoma return had been denied as barred by statute. Exhibit F.

6. Protestant timely filed a written protest to the refund denial. Exhibit G.

ISSUES

The Division denied Protestant's claim for refund, as barred by § 2373 of the Oklahoma Income Tax Act ("Act"). The Division contends that the exception to the three (3) year statute of repose of § 2373, as found in § 2375(H), only applies when the IRS initiates the change or correction to the taxpayer's taxable income under the Internal Revenue Code, as opposed to a

[6] *OAC*, 710:1-5-39(a).

[7] Unless otherwise noted all referenced exhibits are exhibits to the *Division's Brief*.

change or correction initiated by the filing of an amended return by the taxpayer. Protestant contends that the Division's construction of the provisions of § 2375(H) is not supported by the language thereof.

Notwithstanding the posture of the protest as presented by the parties, the Administrative Law Judge found this case presented a dispositive superseding issue. Such issue was whether the Tax Commission is statutorily prohibited from rejecting a taxpayer's amended Oklahoma income tax return reporting the taxpayer's Oklahoma taxable income based on the IRS's final determination of the taxpayer's federal taxable income, notwithstanding that the taxable income as finally determined by the IRS is not in accord with federal case law. As we explain in this order, we find that under the facts of this matter, the Oklahoma Tax Commission is bound by the IRS determination of taxable income.

CONCLUSIONS OF LAW

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

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

2. "Taxation is an exclusively legislative function that can be exercised only under statutory authority and in the manner specified by statute." ***State, ex rel. Oklahoma Tax Commission v. Texaco Exploration & Production, Inc.,*** 2005 OK 52, ¶ 7, 131 P.3d 705, 707. Accordingly, the basis for assessing income tax or adjusting the returned income must be found in the Act.

3. An income tax is imposed upon the "Oklahoma taxable income" of every resident or nonresident individual. 68 O.S. 2001, § 2355(A). "Oklahoma taxable income" is defined to mean "'taxable income[8]' as reported (or as would have been reported by the taxpayer had a return been filed) to the federal government, and in the event of adjustments thereto by the federal government as finally ascertained under the Internal Revenue Code, adjusted further as hereinafter provided." 68 O.S. 2001, § 2353(12).

4. A taxpayer has a state statutory duty to notify the Oklahoma Tax Commission by amended state income tax report of any adjustment or correction in returned federal taxable income within one (1) year after the federal adjustment or correction has been finally determined and the Tax Commission is required to make assessment or refund within two (2) years from the date the return is filed. ***In re O'Carroll***, 1998 OK 6, ¶ 2, 952 P.2d 45.[9] See, 68 O.S. 2001, § 2375(H)(2).

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[8] Defined at 68 O.S. 2001, § 2353(10).

[9] The Supreme Court of Oklahoma construed the 1991 version of § 2375(H) which at that time allowed a taxpayer to either file an amended return reporting the corrected net income or notify the Tax Commission by letter that the information was available and provided at (H)(2), "[i]f the amount of the net income for any year of the taxpayer under this law, and as returned to the United States Treasury Department, is changed or corrected by the Internal Revenue Service". (Emphasis added). The option to notify the Tax Commission by letter was removed by Laws 1994, c. 278, § 28, eff. Sept. 1, 1994. Section (H)(2) was rewritten by Laws 1992, c. 172, § 2, emerg. eff.

5. The Tax Commission in administering the provisions of § 2375(H) is granted the authority to audit "each and every item of income, deduction, credit or any other matter related to the return where such items or matters relate to allocation or apportionment between" taxing jurisdictions, but "shall[10] be bound by the revisions made in such final determination" where such items or matters do not relate to allocation or apportionment between taxing jurisdictions. 68 O.S. 2001, § 2375(H)(4).

6. When a taxpayer fails to file a return required under the income tax laws of this state, the Tax Commission is authorized to compute, determine and assess the tax as an estimated tax on the basis of its own determination of the Oklahoma taxable income of the taxpayer, to be adjusted if and when Oklahoma taxable income is ascertained under the provisions of the Act. 68 O.S. 2001, § 2375(C).[11]

7. Tax statutes must be applied uniformly upon all taxpayers similarly situated. ***In re O'Carroll***, 1998 OK 6, ¶ 9, footnote 14, citing *Magnolia Pipe Line Co. v. Oklahoma Tax Commission*, 196 Okla. 633, 167 P.2d 884 (1946).

8. Section 2375(H) and Oklahoma Tax Commission Rule OAC 710:50-3-8 both provide that the Oklahoma Tax Commission is bound by the determination of the IRS when the IRS changes the federal income tax return by issuing its final determination except where such item of income, deduction, credit or any other matter related to the return relate to allocation or apportionment between the State of Oklahoma and some other state or federal government.

9. Regardless of the correctness of the IRS actions in accepting protestant's proposed changes in her amended federal return, the Oklahoma Tax Commission is bound by the IRS determination in such matter. Section 2375 (C) of Title 68 of the Oklahoma Statutes authorizes

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May 5, 1992. The current version of § 2375(H) was adopted by Law 1993, c.273, § 7, emerg. eff. May 27, 1993. The current version of § 2375(H) provides in part:

> 1. The period of time prescribed in Section 223 of this title, in which the procedures for the assessment of income tax may be commenced by the Oklahoma Tax Commission, shall be tolled and extended until the amount of taxable income for any year of a taxpayer under the Internal Revenue Code has been finally determined under applicable federal law and for the additional period of time hereinafter provided in this subsection.
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> 2. If, in such final determination, the amount of taxable income for any year of a taxpayer under the Internal Revenue Code is changed or corrected from the amounts included in the federal return of the taxpayer for such year and such change or correction affects the Oklahoma taxable income of the taxpayer for such year, the taxpayer, within one (1) year after such final determination of the corrected taxable income, shall file an amended return under this article reporting the corrected Oklahoma taxable income, and the Tax Commission shall make assessment or refund within two (2) years from the date the return required by this paragraph is filed and not thereafter, unless a waiver is agreed to and signed by the Tax Commission and the taxpayer.

[10] Use of the word "shall" is generally construed to impose a mandatory duty or command. See, Footnotes 8 and 9, ***In re O'Carroll***, *supra*, at ¶ 8.

[11] Section 2375(C) references §§ 223(C) and 224 of the Uniform Tax Procedure Code.

the Oklahoma Tax Commission to make its own determination of the Oklahoma taxable income of a taxpayer in certain circumstances. Those circumstances are limited to the situation described in the first sentence of that subsection, that is when a taxpayer has refused to file any return required by the Oklahoma Income Tax Act. We do not decide today whether the Oklahoma Tax Commission is bound by the final determination of the IRS when a taxpayer has refused to file a return required by the Oklahoma Income Tax Act.

10. Section 2375(H) of Title 68 of the Oklahoma Statues authorizes a taxpayer to file an amended state income tax return within one year after the IRS makes a final determination changing or correcting the taxable income from the amounts included in the federal return of such taxpayer and such change or correction affects the Oklahoma taxable income of such taxpayer for such year. The Oklahoma Supreme Court has found that this section authorizes a taxpayer to file an amended state income tax return within one year after the IRS makes a final determination of the taxable income of the taxpayer in a case where such change was, as here, sought by the taxpayer and not by the IRS.[12]

11. The protest of the taxpayer to the denial of the claim for refund is sustained.

SO ORDERED.

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.

[12] In re Holt, 1997 OK 12, 932 P.2d 1130.