JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2010-06-22-04 / NON-PRECEDENTIAL**
ID: **P-09-004-H**
DATE: **JUNE 22, 2010**
DISPOSITION: **DENIED**
TAX TYPE: **INCOME**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

HUSBAND AND WIFE ("Protestants") appear through ACCOUNTANT, CPA. The Amended Section of the Compliance Division ("Division"), Oklahoma Tax Commission, appears through OTC ATTORNEY 1, Assistant General Counsel, and OTC ATTORNEY 2, Assistant General Counsel, Office of General Counsel, Oklahoma Tax Commission.

PROCEDURAL HISTORY

On January 14, 2009, 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 16, 2009, a letter was mailed to the Protestants' Representative stating this matter had been assigned to ALJ, Administrative Law Judge, and docketed as Case Number P-09-004-H. The letter also advised that 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 January 21, 2009, an Entry of Appearance was filed by OTC ATTORNEY 1 and OTC ATTORNEY 2 as Co-Counsel of record for the Division.

On February 10, 2009, the Notice of Prehearing Conference was mailed to the parties' Representatives setting the prehearing conference for March 3, 2009, at 2:00 p.m.

On March 3, 2009, at 2:00 p.m., the prehearing conference was held as scheduled with the parties' Representatives. On March 4, 2009, a letter was mailed to the parties' Representatives advising a proposed scheduling order was to be submitted on or before April 2, 2009.

On April 2, 2009, a Proposed Scheduling Order was filed with the clerk of the court ("Clerk"). On April 3, 2009, the Scheduling Order was issued with Stipulation of Facts due on or before August 10, 2009, along with a briefing schedule, as more fully set out therein.

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[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*.

On August 10, 2009, the Joint Stipulation of Facts and Issues, with Exhibits A through H attached thereto, were filed with the Clerk.

On September 4, 2009, the Protestants' Brief in Chief was filed with the Clerk. On September 25, 2009, the Division's Response Brief was filed with the Clerk.

On October 6, 2009, the Protestants' Reply Brief was filed with the Clerk. The record in this matter was closed and this case was submitted for decision on October 6, 2009.

STIPULATION OF FACTS

On August 10, 2009, the parties filed Joint Stipulation of Facts and Issues,[4] as follows, to-wit:

1. On or about May 23, 2001, COMPANY, a corporation which was 50% owned by protestant, was incorporated and elected S status.

2. On or about September 28, 2005, Protestants sold their interest in COMPANY pursuant to the "Asset Sale and Purchase Agreement," attached hereto as **Exhibit A.** According to the purchase agreement's Exhibit 1.1, the sale included "All goodwill relating to the Seller's Employee Staffing Business."

3. On November 17, 2008, Protestants filed an amended 2005 Oklahoma Income Tax Return. On the amended return, Protestants claimed the Oklahoma Capital Gains Deduction in the amount of $204,000 for the sale of COMPANY. The 2005 amended return is attached hereto as **Exhibit B.**

4. The capital gains claimed by Protestants are reflected as "goodwill" on the COMPANY'S 2005 Schedule D. COMPANY'S 2005 Federal Income Tax Return and 2005 Oklahoma Income Tax Return are attached, together, hereto as **Exhibit C.**

5. On November 17, 2008, Protestants filed an amended 2006 Oklahoma Income Tax Return. On the amended return, Protestants claimed the Oklahoma Capital Gains Deduction in the amount of $110,000 for the sale of COMPANY. The 2006 amended return is attached hereto as **Exhibit D.**

6. The capital gains claimed by Protestants are reflected as "goodwill" on the COMPANY'S 2006 Schedule D. COMPANY'S 2006 Federal Income Tax Return and 2006 Oklahoma Income Tax Return are attached, together, hereto as **Exhibit E.**

7. On December 31, 2008, an adjustment letter was issued to Protestants denying the capital gain deduction taken on their amended 2005 return for the reason that "goodwill," an

[4] The text of the stipulated facts is set out *in haec verba*. "***in haec vega***" (in heek v<<schwa>>r-b<<schwa>>). [Latin] In these same words; verbatim. BLACK'S LAW DICTIONARY (8TH ed. 2004), available at http://westlaw.com (Last visited October 18, 2006).

intangible, is not an allowable deduction for 2005. The adjustment letter is attached hereto as **Exhibit F.**

8. On December 31, 2008, an adjustment letter was issued to Protestants denying the Oklahoma Capital Gains Deduction taken on their amended 2006 tax return. The deduction in the amount of $110,000 was disallowed because "goodwill," an intangible, was not an allowable deduction for tax year 2006. The adjustment letter is attached hereto as **Exhibit G.**

9. On or about December 15, 2008, Protestants filed a protest letter stating that they disagreed with the adjustments made to their 2005 and 2006 tax returns. The protest letter is attached hereto as **Exhibit H.**

STATEMENT OF ISSUES

10. At issue in this matter is whether Protestants are eligible to take the Oklahoma Capital Gains Deduction in 2005 and 2006 for gains received for goodwill from the sale of COMPANY.

11. Protestants maintain that the adjustments to their 2005 and 2006 amended returns were incorrect because Senate Bill 685, which amended the Oklahoma Capital Gains Deduction contained in 68 O.S. § 2358, was a clarifying amendment, and thus allows a deduction for intangibles such as goodwill for tax years 2005 and 2006.

12. The Division maintains that the denial of Protestants' deduction for 2005 and 2006 was correct because intangibles, including goodwill, were not allowable under the Oklahoma Capital Gains Deduction in 2005 and 2006, and that the amendment which allows a deduction for intangibles did not go into effect until tax year 2008.

ADDITIONAL FINDINGS OF FACT

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

13. COMPANY, an Oklahoma corporation,[5] was engaged in the staffing services business (nurses) with its corporate office at BUSINESS ADDRESS. On the date of the sale, COMPANY'S primary headquarters had been located in Oklahoma for over four (4) years.[6]

14. WIFE and CO-OWNER each owned fifty percent (50%) of COMPANY'S stock. WIFE had "owned" the stock for over four (4) years.[7]

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[5] COMPANY'S "S" Corporation election for income tax purposes was effective as of May 23, 2001. *See* Exhibit C.

[6] Exhibit A.

[7] *Id.*

15. On September 28, 2005, an Asset Sale and Purchase Agreement ("Agreement") was entered into by COMPANY ("Seller"), BUYER ("Buyer"), and CO-OWNER and WIFE, as officers and principals ("Principals") for assets ("Acquired Assets") of COMPANY, as specified on Exhibit 1.1 attached to the Agreement. According to Section 1.3 of the Agreement, "…the Seller will deliver the Acquired Assets to Buyer along with a Bill of Sale in the form attached as Exhibit 1.3 hereto."[8]

16. According to Section 2.1 of the Agreement "Seller is a corporation duly organized and validly existing and in good standing under the laws of Seller's state of incorporation,[9] has the authority and power to own its property and to carry on its business as currently conducted ….."[10]

17. Attached to the Protestants' 2005 Amended Oklahoma Income Tax Return ("2005 Amended Return")[11] is Statement One (1), which in pertinent part states:

> LINE 2. ORIGINAL RETURN FAILED TO DEDUCT OKLAHOMA QUALIFYING CAPITAL GAIN DEDUCTION IN THE AMOUNT OF $204,000.00. TAXPAYER ACQUIRED THE INTEREST ON 05/23/2001 AND SOLD THE INTEREST ON 09/28/2005; THEREFORE THE 3 YEAR HOLDING PERIOD WAS SATISFIED. THE GAIN WAS REPORTED TO THE TAXPAYER ON SCHEDULE K-1 ISSUED BY COMPANY….

18. On December 31, 2008, the Division issued an adjustment letter[12] to the Protestants' Amended 2005 Return, which in pertinent part states:

Line Number	**Reason for Adjustment**
2	Oklahoma Capital Gain Deduction disallowed. The intangible "goodwill" is not an allowable deduction for 2005. It becomes allowable with tax year 2008.
31	The amount reported as refund has been corrected to a tax due of $8,056.00. Additional penalty and/or interest may be assessed on this amount.

[8] *Id. See* Stipulation 2. Exhibit 1.3 is not attached to Exhibit A.

[9] The Administrative Law Judge is taking judicial notice of the Oklahoma Secretary of State's Office at http://www.sooneraccess.state.ok.us to complete the factual details and background of this matter. OKLA. ADMIN. CODE § 710:1-5-36 (June 25, 1999). According to the Secretary of State's website, COMPANY has an effective date of May 23, 2001. *See* Stipulation 1.

[10] *See* Note 6, *supra.*

[11] Exhibit B. On the Protestants' 2006 Amended Return is a similar explanation. *See* Exhibit D.

[12] Exhibit F. Attached to Exhibit B is a copy of the Protestants' 2005 Amended Return with the adjustments made by the Division, disallowing the refund claimed for $5,510.00.

19. On December 31, 2008, the Division issued an adjustment letter[13] to the Protestants' 2006 Amended Oklahoma Income Tax Return ("2006 Amended Return"), which in pertinent part states:

Line Number	**Reason for Adjustment**
2	Disallow $110,000.00 Oklahoma Capital Gain Deduction representing "goodwill" from the sale of COMPANY. We are allowing the $700.00 Capital Gain Deduction for the raised cow. The intangible "goodwill" is not an allowable deduction for 2006. It becomes allowable with tax year 2008.
26	The amount reported as refund has been corrected to a tax due of $4,857.00. Additional penalty and/or interest may be assessed on this amount.

20. On December 22, 2008, the Division received a protest dated December 15, 2008, for the Division's adjustments to the Protestants' 2005 and 2006 Amended Returns, which is before the adjustments letters were mailed. The protest letter references a letter from the Division, which states, "Your letter enclosed re: 2005, 2006 & 2007 income tax years."[14]

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding.[15]

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 Act[16] ("Act").[17]

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[13] Exhibit G.

[14] Exhibit H. A copy of the referenced letter is not attached to Exhibit H.

[15] OKLA. STAT. tit. 68, § 221(D) (West Supp. 2002) and/or OKLA. STAT. tit. 68, § 207 (West 2001). From the stipulations and Exhibits F through H, the protest letter was dated sixteen (16) days before the adjustment letters were mailed by the Division. In the caption of the protest letter there is a reference to "Your letter enclosed re: 2005, 2006 & 2007 income tax years," but the letter is not part of the record. Both jurisdictional statutes are referenced because the protest was filed before the adjustment letters were issued by the Division.

[16] OKLA. STAT. tit. 68, § 2351 et seq. (West 2001).

[17] OKLA. STAT. tit. 68, § 2365 (West 2001).

3. The Act imposes an income tax upon the Oklahoma Taxable Income[18] of every resident or non-resident individual who earns income within Oklahoma.[19]

4. The beginning point of determining Oklahoma taxable income is Federal Adjusted Income.[20]

5. A taxpayer's income tax liability is determined in accordance with the law in effect at the time the income is received.[21]

6. The text of Section 2358(F) of Title 68[22] ("Statute") for the 2005 and 2006 tax years 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:

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[18] 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;

[19] OKLA. STAT. ANN. tit. 68, § 2355 (West 2008).

[20] 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;

[21] *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.

[22] 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.

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

(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.

7. 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…"[23] 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.

8. 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.[24]

9. The Tax Commission Rule ("Rule") on the Capital Gains Deduction[25] for the 2005 and 2006 tax years, 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)

[23] *Id. See also* BLACK'S LAW DICTIONARY (8th ed. 2004), available at http://web2.westlaw.com (February 24, 2009).

[24] OKLA. STAT. ANN. tit. 75, § 250 et seq. (West 2002). *See Toxic Waste Impact Group, Inc. v. Leavitt*, 1988 OK 20, 755 P.2d 626.

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

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 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.

10. 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.[26] Statutory construction presents a question of law.[27]

11. Tax exemptions, deductions, and credits depend entirely on legislative grace and are strictly construed against the exemption, deduction or credit.[28]

12. 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.[29]

13. 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.[30] Doubt as to whether statute was intended to be prospective or retrospective must be resolved against retrospective application.[31] 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.[32]

14. 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.[33]

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

[27] *Id.* at ¶ 6.

[28] *TPQ Inv. Corp. v. State ex rel. Oklahoma Tax Com'n,* 1998 OK 13, ¶ 8, 954 P.2d 139. (Citations omitted). The Protestants' Reply Brief references an Oklahoma Court of Civil Appeals Opinion, *In the Matter of the Estate of Hester v. State ex rel. Oklahoma Tax Commission,* Case No. 106,023. The *Hester* case has not been approved by the Oklahoma Supreme Court for publication and cannot be properly cited to or relied upon as authority. OKLA. STAT. ANN. tit. 20, § 30.5 (West 2002). The *Hester* case is also currently pending a decision on an Amended Petition for Writ of Certiorari. The *Hester* case cites *Wilson v. State ex rel. Oklahoma Tax Commission,* 1979 OK 62, 594 P.2d 1210, but the issue raised by the Protestants is negated by the conclusions herein that the language of the Statute is "clear and unambiguous." *See* Note 45, *infra*. *See also* OTC Order Nos. 2009-06-23-02 and 2009-06-23-03 (June 23, 2009). Although OTC Order No. 2009-06-23-03 is currently on appeal in the Supreme Court of Oklahoma (Case No. TC-107352) the effect of the Order was not stayed pending the appeal as provided by Section 225(H) of Title 68.

[29] *Id.*

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

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

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

[33] OKLA. STAT. ANN. tit. 25, § 1 (West 2008).

15. 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.[34]

16. In all proceedings before the Tax Commission, the taxpayer has the burden of proof.[35] A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect and in what respects.[36]

STATEMENT OF ISSUE

At issue in this matter is whether Protestants are eligible to take the Oklahoma Capital Gains Deduction in 2005 and 2006 for gains received for goodwill from the sale of [the Acquired Assets owned by] company.

PROTESTANTS' POSITION

Protestants maintain that the adjustments to their 2005 and 2006 Amended Returns were incorrect because Senate Bill 685, which amended the Oklahoma Capital Gains Deduction contained in 68 O.S. § 2358, was a clarifying amendment, and this allows a deduction for intangibles such as goodwill for tax years 2005 and 2006.

DIVISION'S POSITION

The Division maintains that the denial of Protestants' deduction for 2005 and 2006 was correct because intangibles, including goodwill, were not allowable under the Oklahoma Capital Gains Deduction in 2005 and 2006, and that the amendment which allows a deduction for intangibles did not go into effect until tax year 2008.

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[34] OKLA. STAT. ANN. tit. 25, § 2 (West 2008).

[35] 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.

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

DISCUSSION

The Protestants' Brief in Chief states in pertinent parts as follows, to-wit:

> Section 2358F.1.a.(2) [sic] (on which the Protestants rely) addresses the sale of stock or the sale of a direct or indirect ownership interest in an Oklahoma company, …with a holding period of at least two (2) years. The sale of stock or an ownership interest in an Oklahoma company…will necessarily include any goodwill associated with such stock or ownership interest because goodwill cannot be severed from such stock or ownership interest. The statute clearly contemplates that the sale described in this sub-paragraph is a different class of asset than the real or tangible personal property described in sub paragraph (1) because the required holding period is less for assets sold pursuant to sub-paragraph (2). The statute does not exclude any portion of the sale of stock or an ownership interest allocated to goodwill because goodwill cannot be severed from the sale of stock or an ownership interest. The sales price of a share of stock includes any goodwill associated with the company issuing the stock; likewise, the sales price of any other ownership interest in a company includes any goodwill associated with the company.
>
> The Protestants contend that the Capital Gains Deduction reported on their amended 2005 and 2006 Oklahoma Income Tax returns meet all of the requirements of O.S. Title 68, Section 2358 F before the amendment added to the statute by Senate Bill 685.
>
> …
>
> The Protestants agree that goodwill is an intangible asset; however, certain intangible assets can be sold apart from the sale of stock or an ownership interest–i.e. patents, trademarks, etc. Goodwill cannot be sold as a separate asset-it can only be sold when attached to the sale of stock or an ownership interest in a business enterprise.[37]

The Protestants' Reply Brief states in pertinent parts as follows, to-wit:

> Protestants were shareholders in COMPANY, an Oklahoma S Corporation that sold its assets on or about September 28, 2005. There is no dispute as to the above facts.
>
> The Division argues that the sale of assets by an Oklahoma S Corporation is not the sale of an ownership interest by the shareholders. Clearly when an S Corporation sells an asset the ownership interest of the shareholders in that asset is also sold-which is the reason for the definition of an "indirect" sale in

[37] Protestants' Brief in Chief at 1-2.

> Section 2358F.2.(e).[38] As a pass-through entity the gain or loss on such a sale is "passed-through" to the shareholders for income tax purposes.

As pointed out by the Division, the Protestants' position that WIFE sold her ownership interest in COMPANY is contradicted by the stipulated facts.[39] COMPANY entered into the Agreement to sell specific assets of COMPANY. The Agreement[40] states in pertinent part:

> Seller will sell, and Buyer will purchase, those assets of Seller that are listed on Exhibit 1.1 attached hereto (the "Acquired Assets") for a non-contingent price of $675,000 and an earnout (the "Purchase Price"). Buyer will not assume any liability or obligation of Seller or either Principal of any nature whatsoever, whether accrued, absolute, contingent, or otherwise.

The Division is correct, the Agreement is void of any language which supports the Protestants' position that WIFE was selling her COMPANY stock or an "ownership interest" in COMPANY as part of the Acquired Assets listed on Exhibit 1.1.

The Division response to the Protestants' position that "goodwill cannot be sold as a separate asset" is contradicted by law and pursuant to Section 1092 of Title 18, "Every corporation…may sell…all of its property and assets, including its goodwill and its corporate franchises, upon such terms and conditions and for such consideration, which may consist in whole or in part of money or other property…."[41]

In their Reply Brief, the Protestants dismiss the Division's citation to Section 1092 by stating, "The subject statute simply states that a corporation may sell its assets, 'including its goodwill'; it does not address whether or not goodwill must be attached to stock or an ownership interest. Clearly no one would buy 'goodwill' as a stand alone asset; without the transfer of the underlying assets and ownership interest in the assets there is no goodwill."[42]

The Division's position is also supported by Section 316 of Title 60, which states, "The good will of a business is property, transferable like any other,"[43] but the Protestants have failed to cite any authority for their position that goodwill cannot be severed from the sale of stock or an ownership interest for purposes of a sale of assets, as is the matter in this case.

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[38] Protestants' Reply Brief at 1-2. This is a bare statement made by the Protestants without the citation to any legal authority whatsoever and this reading of the provision is simply not supported by the clear and unambiguous language of the Statute. *See* Note 45, *infra*.

[39] Division's Response Brief at 7.

[40] *See* Exhibit A, Section 1.1 and Exhibit 1.1.

[41] OKLA. STAT. ANN. tit. 18, § 1092 (West 1999).

[42] Protestants' Reply Brief at 2.

[43] OKLA. STAT. ANN. tit. 60, § 316 (West 1994).

The Protestants' novel position is critical to the outcome of their case and distinguishes it from similar cases because of one (1) significant factual difference, WIFE and COMPANY cannot meet the five (5) year holding requirements for the sale of assets under Sections 2358(F)(2)(a)(1) and 2358(F)(2)(e)(1), even if "goodwill" could qualify under these provisions.[44] COMPANY became effective May 23, 2001. COMPANY owned the Acquired Assets, which were sold on September 28, 2005. The sale of the Acquired Assets is less than the five (5) year holding requirements provided by Sections 2358(F)(2)(a)(1) and 2358(F)(2)(e).

DISCUSSION OF STATUTE

The language of the Statute is clear and unambiguous[45] and its terms should be construed using their ordinary meaning as directed by the Legislature. Provisions of the Statute must be construed in its entirety.[46]

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).[47]

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).

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[44] *See* Note 22, *supra*. *See also* Note 45, *infra*.

[45] As pointed out by the Protestants in their Reply Brief, the Division cites OTC Order No. 2009-06-23-02 (June 23, 2009) as being "Precedential," which is incorrect. However, the distinction between a Commission Order designated as "Precedential" or "Non-Precedential" has been blurred because all OTC Orders resulting from cases heard by the Office of Administrative Law Judges are now published, not just "Precedential" Orders. *See* OKLA. STAT. ANN. tit.68, § 221(G) (West Supp. 2009) and OKLA. STAT. ANN. tit. 75, § 302 (West 2002). *See also* OTC Orders 2009-06-23-02 and 2009-06-23-03 (June 23, 2009), which also conclude the language of the Statute is "clear and unambiguous."

[46] *Imaging Services, Inc. v. Oklahoma Tax Com'n, Excise Tax Div.*, 1993 OK 164, 866 P.2d 1204. *See Affiliated* at Note 21, *supra*.

[47] *See* Note 22, *supra*.

The Statute permits a deduction for the sale of two types of property: (1) real property and (2) tangible personal 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.[48]

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 2005 and 2006 tax years.

The Protestants have failed to meet their burden of proof the Division's disallowance of the Capital Gains Deduction taken on the 2005 and 2006 Amended Returns attributable to "Intangible" Personal Property in the form of "Goodwill" was incorrect and in what respects.

The second part of the Protestants' argument 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 2005 and 2006 Amended Returns. Before and after the Statute was amended,[49] Section 2358(F)(1) reads in pertinent part, as follows, to-wit:

> "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…." (Emphasis added).

The Protestants maintain that "…Section 2358 F. should apply to all sales after December 31, 2004 as stated in the statute. If a portion of the statute applies only to sales after January 1, 2008, the statute should so state. Taxpayers should be allowed to rely on the express language of the statute. Senate Bill 685 added a clarification to Section 2358 F. as evidenced by the amendment being made a sub-paragraph of Section 2358 F. If the amendment was meant to apply to sales other than sales after December 31, 2004, the amendment should not be sub-paragraph of Section 2358 F."[50]

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[48] "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 patronage, but it does not include a right to use the name of any person from whom it was acquired."

[49] *See* OKLA. STAT. tit. 68, § 2358 (West Supp. 2006) and OKLA. STAT. tit. 68, § 2358 (West Supp. 2007).

[50] Protestants' Brief in Chief at 2.

The Division addresses the Protestants' argument by citing the *Cities Service*[51] case for the proposition "Express language will prevail over an effective date or emergency clause."[52] Yet, "In every case of doubt the doubt must be resolved against the retroactive effect."[53]

In *Cities Service*, 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."[54]

The "Amendment" to the Statute, unlike the statute in *Cities Service*, 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 the *Dolese*[55] case, 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 2005 and 2006 tax years.

The Division further addresses the Protestants' argument that the Amendment did not change the law but merely clarified what was already the law.[56] In *Purcell*, the Court held the

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[51] *Cities Service Oil Co. v. Oklahoma Tax Com'n*, 1942 OK 307, 129 P.2d 597.

[52] *Id.*

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

[54] *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.

[55] *Dolese Bros. v. State ex rel. Oklahoma Tax Com'n*, 2003 OK 4, 64 P.3d 1093.

[56] *See Purcell v. Santa Fe Minerals, Inc.*, 1998 OK 45, 961 P.2d 188.

"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."[57]

"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."[58]

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."[59]

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,[60] 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 <u>property</u> 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

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In the Protestant's Response Brief, there is reference to an article from the Oklahoma Bar Journal Section Notes (Volume 78, no. 27, page 2511), in support of their argument the Amendment was a "clarification" of the Statute, but the article is not citable as legal authority in this matter.

[57] *Id.*

[58] *See Allen* at Note 53, *supra*. *See also Dolese* at Note 55, *supra*.

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

[60] OKLA. STAT. ANN. tit. 68, § 2358(F) (West Supp. 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.

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,"[61] but asserts the Protestants have failed to point to any clarifying language.

The Amendment added an entirely new subsection, "2358(F)(2)(a)(3)" 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. 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.[62]

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

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[61] *See Blitz* at Note 26, *supra*. *See also In re Protest of Betts Telecom Oklahoma, Inc.*, 2008 OK CIV APP 19, ¶ 15, 178 P.3d 197.

[62] *Id.*

Section 2358(F)(1) in full, the 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.[63]

CONCLUSION

The Protestants have failed to meet their burden of proof that the Division's disallowance of the Capital Gains Deduction on their 2005 and 2006 Amended Returns 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.

The distinction between a Commission Order designated as "Precedential" or "Non-Precedential" has been blurred because all OTC Orders resulting from cases heard by the Office of Administrative Law Judges are now published, not just "Precedential" Orders. *See* OKLA. STAT. ANN. tit.68, § 221(G) (West Supp. 2009) and OKLA. STAT. ANN. tit. 75, § 302 (West 2002). *See also* OTC Orders 2009-06-23-02 and 2009-06-23-03 (June 23, 2009), which also conclude the language of the Statute is "clear and unambiguous."

[63] *See Wilson* at Note 59, *supra.*