JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2011-08-30-06 / NON-PRECEDENTIAL**
ID: **P-10-118-H**
DATE: **AUGUST 30, 2011**
DISPOSITION: **DENIED**
TAX TYPE: **CORPORATE INCOME**
APPEAL: **PENDING; S.CT. 109886**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

COMPANY ("Protestant") appears through attorney, ATTORNEY, FIRM. The Corporate Income Section, Compliance Division ("Division") of the 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 April 20, 2010, 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 Office of Administrative Law Judges*.[2] On April 21, 2010, a letter was mailed to ATTORNEY stating this matter had been assigned to ALJ, Administrative Law Judge, and docketed as Case Number P-10-118-H. The letter also advised ATTORNEY that a Notice of Prehearing Conference would be sent by mail and enclosed a copy of the *Rules of Practice and Procedure Before the Office of Administrative Law Judges.*[3] On April 27, 2010, OTC ATTORNEY 1 and OTC ATTORNEY 2 filed an Entry of Appearance as Co-Counsel of record for the Division. On April 30, 2010, the Notice of Prehearing Conference was mailed to the last-known address of ATTORNEY, setting the prehearing conference for June 7, 2010, at 9:30 a.m.

On June 4, 2010, the Division filed a Status Report-In-Lieu of Prehearing Conference requesting additional time for the parties to discuss the issues. On June 4, 2010, a letter was mailed to Counsel advising that a status report was due on or before August 6, 2010.

On August 6, 2010, the Division filed the Status Report requesting a briefing cycle, setting stipulations to be due no earlier than November 1, 2010. On August 19, 2010, the Scheduling Order was issued as more fully set forth therein.

On November 5, 2010, the Division filed a Status Report advising that information had not been received from ATTORNEY necessary to draft the stipulations and requested that the

[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] *Id.*

Scheduling Order issued on August 19, 2010, be stricken and a new scheduling order issue allowing sixty (60) days for discovery so that the Division could obtain the necessary information it had requested on August 25, 2010.[4] On November 8, 2010, a letter was received by the Court Clerk[5] from ATTORNEY joining in the Division's request and advising that the information requested by the Division had been received and would be forwarded to Co-Counsel. On November 24, 2010, an Amended Scheduling Order was issued as more fully set forth therein.

On March 22, 2011, the Division filed a Motion to Extend the Scheduling Order because the Protestant had failed to provide a copy of the sales agreement requested. On March 23, 2011, an Amended Scheduling Order was issued with stipulations due on April 22, 2011, and position letters or briefs due on or before May 4, 2011.

On April 22, 2011, the Joint Stipulation of Facts was filed with Exhibits A through E attached thereto. On April 22, 2011, a Joint Motion to Strike Scheduling Order and Reset the Matter for Briefing Cycle was filed with the Court Clerk. On April 27, 2011, an Amended Scheduling Order was issued with the Protestant's brief-in-chief due May 26, 2011, the Division's response brief due June 10, 2011, and the Protestant's reply brief due June 20, 2011, if desired, at which time this case would be submitted for decision.

On May 26, 2011, an Unopposed Motion To Extend Briefing Scheduling was filed by ATTORNEY.

On June 1, 2011, a Second Amended Scheduling Order was issued with the Protestant's brief-in-chief due on June 1, 2011, the Division's response brief due June 16, 2011, and the Protestant's response brief due on June 24, 2011, if desired, at which time this case would be submitted for decision. On June 1, 2011, the Protestant's Brief in Chief was filed with the Court Clerk. On June 16, 2011, the Division's Response Brief was filed with the Court Clerk. On June 24, 2011, the Protestant's Reply Brief was filed with the Court Clerk. The record in this matter was closed and this case was submitted for decision on June 28, 2011.

JOINT STIPULATION OF FACTS

On April 22, 2011, the parties filed Joint Stipulation of Facts,[6] as follows, to-wit:

I. PREAMBLE

NOW, THEREFORE, it is hereby stipulated for the purpose of the above-styled Protest by and between the parties hereto, through their respective representatives, that the facts

[4] A copy of the August 25th letter requesting information was attached thereto.

[5] OKLA. ADMIN. CODE § 710:1-5-10(c)(2) (June 25, 1999).

[6] 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.

contained herein shall be taken to be true for purposes of the resolution of this controversy, including appeals, if any, and for no other purpose. The parties specifically reserve the right to offer such additional evidence as may from time to time be permitted by the authority having jurisdiction over this controversy. Further, the parties preserve all rights to object to any stipulation herein on any grounds, including, but not limited to, the ground of relevancy. Unless otherwise indicated, all stipulations hereinafter refer solely to the audit period, 2008. All Exhibits to the Stipulation are made a part of and incorporated into the Stipulation.

II. STATEMENT OF THE ISSUE

Whether the Oklahoma Capital Gains Deduction, 68 O.S. § 2358(D), unconstitutionally discriminates against out-of-state taxpayers.

III. PROCEDURAL FACTS

1. By letter dated February 17, 2010, the Division proposed to adjust COMPANY'S 2008 Oklahoma Small Business Corporation Income Tax Return. Included in its adjustments was the denial of COMPANY'S claim for the Oklahoma Capital Gains Deduction ("Deduction") taken under 68 O.S. § 2358(D). Exhibit "A" (Adjustment Letter);

2. No assessment or denial of refund resulted from the Division's adjustments to COMPANY'S 2008 return because the tax effect of the Division's adjustments would occur at the shareholder level as COMPANY had elected tax treatment as a [sic] S Corporation. *Id.*;

3. By letter dated April 7, 2010, COMPANY timely protested the Division's proposed adjustments. Exhibit "B" (Protest Letter);

4. The denial of the Oklahoma Capital Gains Deduction, 68 O.S. § 2358(D), is the only adjustment under protest.

5. The Protest of COMPANY is properly before the Commission.

IV. GENERAL FACTS

6. COMPANY is a corporation electing treatment as a [sic] "S Corporation" for tax purposes and was incorporated in California in 1970;

7. SHAREHOLDER has been the sole shareholder of COMPANY since 1996, first acquiring twenty-two percent (22%) of his interest in 1986 and the remaining seventy-eight percent (78%) of his interest in 1996;

8. At the time of COMPANY's sale on September 18, 2008, COMPANY was registered to do business in Florida, Oklahoma, California, Michigan, and Iowa;

9. Prior to COMPANY's sale on September 18, 2008, COMPANY's primary headquarters were located in CITY X, Florida;

10. COMPANY is a manufacturer of polymer concrete and fiberglass handholes and pads for electric, water, and telephone company utilities;

11. COMPANY'S business activities in Oklahoma consisted of manufacturing handholes; its Oklahoma manufacturing facility was located at OKLAHOMA ADDRESS.

12. On September 18, 2008, COMPANY entered into a stock purchase agreement with PURCHASER to sell all the assets of COMPANY. Pursuant to the purchaser's election, the stock sale was treated as an asset sale under I.R.C. § 338(h)(10). Exhibit "C" (Sales Agreement);

13. The assets transferred on September 18, 2008, had been owned for over three (3) years by COMPANY. Exhibit "D" (COMPANY's 2008 Federal Return);

14. On or around August 10, 2009, COMPANY filed its 2008 Form 512-SX, amended Oklahoma Small Business Corporation Income Tax Return, claiming the Oklahoma Capital Gains Deduction for gains received from the sale of COMPANY in the amount of $49,776,316.00. Exhibit "E" (COMPANY's 2008 Oklahoma amended return). Applying COMPANY's reported Oklahoma apportionment factor of 7.1606% to the total gains received resulted in an exclusion from Oklahoma taxable income in the amount of $3,564,283.00;

15. COMPANY included the gain received from the sale of COMPANY as a capital gain on its 2008 Form 1120S, Federal Income Tax Return. Exhibit "D" (COMPANY's 2008 Federal Return).

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding.[7]

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[8] ("Act").[9]

3. The Act imposes an income tax upon the Oklahoma Taxable Income[10] of every resident or non-resident individual who earns income within Oklahoma.[11]

---

[7] OKLA. STAT. tit. 68, § 221(D) (West Supp. 2002).

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

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

[10] OKLA. STAT. ANN. tit. 68, § 2353(12) (West 2008):

4. The beginning point of determining Oklahoma taxable income is Federal Adjusted Income.[12]

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."[13]

6. Any term used in the Act shall[14] 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 shall[15] be the same for all purposes material hereto as they are for federal income tax purposes except when the Act specifically provides otherwise.[16]

7. A taxpayer's income tax liability is determined in accordance with the law in effect at the time the income is received.[17]

> "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;

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

[12] 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;

[13] 26 U.S.C.A. § 338(h)(10).

[14] "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.

[15] *Id.*

[16] OKLA. STAT. ANN. tit. 68, § 2353(3) (West 2008).

[17] *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.

8. The text of Section 2358(D) of Title 68[18] for the 2008 Tax Year in pertinent parts are as follows, to-wit:

> 1. For taxable years beginning after December 31, 2005, the taxable income of any corporation, estate or trust, shall be further adjusted for qualifying gains receiving capital treatment. Such corporations, estates or trusts shall be allowed a deduction from Oklahoma taxable income for the amount of qualifying gains receiving capital treatment earned by the corporation, estate or trust during the taxable year and included in the federal taxable income of such corporation, estate or trust.
>
> 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 the federal income tax return of the corporation, estate or trust that result from:
>
> …
>
> (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 where such property has been directly or indirectly owned by such entity owned by the owners of such entity, and used in or derived from such entity for a period of at least three (3) years prior to the date of the transaction from which the net capital gains arise,
>
> …
>
> 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… (Emphasis added.)

9. Section 2358(D) of Title 68[19] 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…"[20] There is no dispute "Oklahoma

[18] OKLA. STAT. tit. 68, § 2358(D) (West Supp. 2008). *See* OKLA. ADMIN. CODE § 710:50-15-48 (June 25, 2007).

[19] *Id.*

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

company" includes a corporation (domestic or foreign) that has made an "S" Corporation election for income tax purposes.

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.[21]

11. 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.[22] Statutory construction presents a question of law.[23]

12. Tax exemptions, deductions, and credits depend entirely on legislative grace and are strictly construed against the exemption, deduction or credit.[24]

13. Section 2358(D) of Title 68[25] 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.[26]

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.[27]

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.[28]

---

[21] 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.

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

[23] *Id.* at ¶ 6.

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

[25] *See* Note 18, *supra*.

[26] *Id.*

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

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

16. In all proceedings before the Tax Commission, the taxpayer has the burden of proof.[29] A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect and in what respects.[30]

PROTESTANT'S POSITION

COMPANY's position is that the income tax scheme adopted in Oklahoma clearly discriminates against non-resident taxpayers in its treatment of capital gains. The application of Section 2358(D) of Title 68 ("Deduction")[31] in this matter unfairly discriminates against Oklahoma non-residents in violation of the Privileges and Immunities, the Equal Protection, and the Commerce Clauses of the U.S. Constitution. "While decisions have allowed a disparity of treatment of non-residents where valid reasons exist, the Privileges and Immunities Clause prohibits such conduct when there is no substantial reason for the discrimination beyond the fact that the taxpayer is a citizen of another state."[32] In support of its position, COMPANY cites to the *Lunding*[33] case in which the U.S. Supreme Court held that a New York law which effectively denied only non-resident taxpayers an income tax deduction for alimony paid was a violation of the Privileges and Immunities Clause. In its discussion, the Court stated, "The object of the Privileges and Immunities Clause is to 'strongly … constitute the citizens of the United States one people,' by 'plac[ing] the citizens of each State upon the same footing with citizens of other States, so far as the advantages resulting from citizenship in those States are concerned."[34] The Court went on to recognize that state legislatures have discretion in formulating tax policy based on local needs.[35] In addressing this issue the Court indicated that

---

[29] 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.

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

[31] *See* Note 18, *supra*.

[32] COMPANY's Brief-in-Chief at 3.

[33] *Lunding v. New York Tax Appeals Tribunal*, 522 U.S. 287, 118 S.Ct. 766.

[34] *Id. Supreme Court of New Hampshire v. Piper*, 470 U.S. 274, 105 S.Ct. 272.

[35] *Id. See Madden v. Kentucky*, 309 U.S. 83, 605 S.Ct. 406.

where non-residents are subject to different treatment, there must be "reasonable grounds" for different treatment.[36] The Court restated the rule that in order for a state to justify its position as between resident and non-resident taxpayer, it must demonstrate that (1) there is a substantial reason for the difference in treatment; and (2) the discrimination practice against non-residents bears a substantial relationship to the state's objective.[37] COMPANY states, "In the case at bar, the Division cannot meet the burden of the *Piper* test. No substantial reason for the different treatment exists nor is there any substantial relationship to the state's taxing objective."[38] (Emphasis original.) In other decisions the U.S. Supreme Court has recognized that states cannot discriminate against non-residents and based its decisions on violation of the Equal Protection Clause[39] and finally the U.S. Supreme Court has invalidated state taxing schemes as violation of the protections afforded by the Commerce Clause.[40]

DIVISION'S POSITION

The Division's position can be summarized as follows, to-wit:

- The deduction does not violate the Privileges and Immunities Clause of the U.S. Constitution because the headquarters requirement (A) carries out the deduction's purpose to increase investment in Oklahoma's economy and (B) bears a substantial relationship to the deduction's purpose.[41]

  A. The Deduction does not discriminate against nonresidents because residents and nonresidents must meet the same requirements to qualify for the Deduction.[42]

---

[36] *Id. Travis v. Yale & Town Mfg. Co.*, 252 U.S. 60, 40 S.Ct. 228.

[37] *Id. See* Note 34, *supra.*

[38] COMPANY's Brief in Chief at 3.

[39] *See Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 105 S.Ct. 1676. *See Panhandle Producers & Royalty Owners Assoc. v. Okla. Tax Com'n*, 2007 OK CIV APP 68, 162 P.3d 960.

[40] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076.

[41] To determine whether a taxing scheme "deprives a party of rights secured by the Federal Constitution," *St. Louis S.W.R. Co. v. Arkansas ex rel. Norwood*, 235 U.S. 350, 35 S.Ct. 99, courts will look to the substance of the law and its "operation and effect…as applied and enforced by the State." *Id.* Yet "inequalities that result not from hostile discrimination, but occasionally and incidentally in the application of a tax system that is not arbitrary in its classification, are not sufficient to defeat the law." *Lunding v. New York Tax Appeals Tribunal*, 522 U.S. 287, 118 S.Ct. 766. Division's Response Brief at 5.

[42] The Deduction does not discriminat[e] between residents and nonresidents. Rather, as the language clearly states, the Deduction is available to any corporation…so long as the gains the taxpayer receives qualify. The Deduction's availability to any corporation…clearly shows the Legislature's intention to make the Deduction widely available. This broad applicability carries out the Deduction's self-evident purpose to promote long-term investment in Oklahoma's economy by offering incentives to those investing in companies doing business here. *Id.* at 6.

B. The headquarters requirement increases investment in Oklahoma's economy by ensuring that taxpayers receiving the Deduction have made a long-term investment in Oklahoma.[43]

C. The headquarters requirement bears a substantial relationship to the Deduction's purpose of increasing long-term investment in Oklahoma because it establishes that a taxpayer has made a long-term investment in Oklahoma's economy.[44]

- The Deduction does not violate the Equal Protection Clause of the U.S. Constitution because it applies equally to residents and non-residents.[45]

A. The Deduction furthers a legitimate state purpose because it encourages investment in Oklahoma's economy.[46]

B. The Deduction bears a reasonable relationship to the goal of promoting long-term investment in Oklahoma's economy.[47]

---

[43] States are not required to "provide to nonresidents the same manner of tax credits available to residents. Our precedent allows States to adopt justified and reasonable distinctions between residents and nonresidents in the provision of tax benefits, whether in the form of tax deductions or credits." *See* Note 39, *supra.* *Id.* at 9. As the Deduction has a substantial reason for any difference the Court finds in the treatment of residents and nonresidents, it only remains to be shown that any discrimination against nonresidents bears a substantial relationship to the Deduction's purpose of increasing long-term investment in Oklahoma's economy. *Id.* at 11.

[44] The Oklahoma Legislature, using their broad discretion in classification of tax matters, determined that companies who had been headquartered in Oklahoma for a minimum of three (3) years were sufficiently established in Oklahoma so that the State was justified in permitting a deduction from income tax. (Citation omitted.) *Id.* at 12. *See* Note 33, *supra.*

[45] The Legislature, through taxing statutes, may "classify persons and the origin of their incomes, and may apportion deductions or exemptions, provided the classifications and apportionment are reasonable and related to the object of taxation." *Fent v. Okla. Tax Com'n*, 2004 OK 59, 99 P.3d 241. (Citations omitted.) *Id.* at 14.

[46] The Deduction does not classify on the basis of residency. The Deduction is available to any taxpayer, whether the taxpayer is a resident or non-resident…there are limitations on the Deduction as to the gains which qualify for capital treatment. The headquarters requirement in [the Deduction] requires that the entity in which stock or a business interest is sold have its primary headquarters in Oklahoma for 3 years prior to the date of the sale. The U.S. Supreme Court considers a statute's purpose to bring in new business to be valid so long as it does not impermissible discriminate against foreign corporations. *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 105 S.Ct. 1676. *Id.* at 15-16. The general rule in Oklahoma is that all that is required [for income tax classification to be constitutional] is that there be reasonable classification and reasonable opportunity for uniform or equal incidence upon the class created." *Id.* at 17. As the Deduction applies equally to all taxpayers, there is equal opportunity for both residents and non-residents to take the deduction. *Id.*

[47] If a "classification is neither capricious nor arbitrary, and rests upon some reasonable consideration of difference or policy, there is no denial of the equal protection of the law." *EOG Resources Marketing, Inc. v. Oklahoma State Bd. of Equalization*, 2008 OK 95, 196 P.3d 511. The headquarters requirement is similar to a "durational residence" requirement, which has been upheld by the U.S. Supreme Court as being reasonably related to a state's objective. (Citation omitted.) *Id.* at 18. The Deduction is reasonably related to the state's objective of encouraging long-term investment in Oklahoma's economy.

- The Deduction does not discriminate against interstate commerce because the requirements for qualification are exactly the same for both residents and non-residents.[48]

  A. The Deduction does not facially discriminate against interstate commerce because both residents and non-residents must meet the same requirements to qualify for the Deduction.[49]

  B. Any burden imposed upon interstate commerce by the Deduction is not excessive because the headquarters requirement imposes an incidental cost compared to Oklahoma's legitimate interest in increasing long-term investment in its economy.[50]

COMPANY'S REPLY

COMPANY replies that "The Compliance Division's central theme appears to be that because the [Deduction] has a requirement that a company locate its headquarters in Oklahoma, that requirement presumes that a taxpayer has made a long-term investment in Oklahoma's economy and as such is entitled to preferential treatment for capital gains purposes. In the instant case, COMPANY did business in Oklahoma for much longer than three years at its manufacturing facility in CITY, Oklahoma prior to taking the deduction. The technical requirement that it had to maintain its "primary headquarters" in Oklahoma for three more years gives rise to the discriminatory nature of the deduction. This requirement does not bear a "reasonable relationship" to the Division's pronounced goal that the [Deduction's] purpose is to promote long-term investment in Oklahoma's economy. COMPANY's CITY plant clearly demonstrates its long term investment in Oklahoma's economy."[51]

[48] Protestant cites the four prong test set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, as the standard to evaluate whether a state taxing scheme violates the Commerce Clause. A corporation operating in multiple states may be assessed tax for its fair share of the burden it imposes on a state's resources… However, the *Complete Auto* test is inapplicable here where the challenged statute is a deduction from tax, not an imposition of tax. (Citations omitted.) *Id.* at 21.

[49] A plain reading of the statute shows that the Deduction is not facially discriminatory. The Deduction is available to "any corporation …whose gains meet the statutory requirements. *Id.* at 22.

[50] As a non-resident and resident must meet the same requirements to qualify for the Deduction, the Deduction does not discriminate, even incidentally, against interstate commerce. (Citation omitted.) *Id.* at 25.

[51] COMPANY's Reply Brief at 1.

DISCUSSION

The parties stipulated that the issue to be decided in this matter is as follows, to-wit:

> Whether the Oklahoma Capital Gains Deduction unconstitutionally discriminates against out-of-state taxpayers.[52]

Many states regulate the taxation of the capital gains and losses of taxpayers. A number of states allow taxpayers to deduct capital gains from their taxable income, while other states tax all or part of the amount of a taxpayer's capital gains. The State of Oklahoma is one of the states that taxes capital gains, unless the taxpayer (individuals/corporations, etc.) (resident/nonresident) qualify for the Deduction. COMPANY asserts that the Deduction unconstitutionally discriminates against out-of-state taxpayers because of the requirement that the entity's "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…"[53] COMPANY cites numerous cases in its briefs to support its position, but when COMPANY's argument is examined closely, it does not support a conclusion that the Deduction is unconstitutional, rather COMPANY's argument is based upon the Deduction as it is applied to the specific facts in this matter.

---

[52] The Division's "work papers" for COMPANY's 2008 Return reflects five (5) explanation of adjustments, as follows, to-wit:

> A) Taxes based on or measured by income shall not be allowed as a deduction in arriving at apportionable income (including Foreign Income Tax). 68 O.S. Section 2358(A)(5) and Permanent Rule 710:50-17-51(1).
>
> B) Deductions incurred in producing income of non-unitary nature shall be allocated on the same basis as the income. 68 O.S. Section 2358(A)(4) and Permanent Rule 710:50-17-51(18).
>
> C) The deduction for qualifying gains receiving capital treatment on the sales of assets of a foreign based corporation has been denied. O.S. 68 Section 2358(D) and Permanent Rule 710:50-15-48.
>
> D) Net rental income from non-unitary property is to be separately allocated. 68 O.S. Section 2358(A)(4) and Permanent Rule 710:50-17-51(12).
>
> E) The sales factor shall include only sales (line 1, form 1120) and does not include sales or revenue from items other than sales to be included in the formula even though other types of income (royalties, interest, capital gains, and other income) are included in the apportioned income. 68 O.S. Section 2358(A)(5)(c) and Permanent Rule 710:50-17-71(1)(A).

See Exhibit A. From the stipulated Issue the only adjustment made by the Division, which is at issue in this matter, is (C). *See also* Stipulation 4. "The Division audited COMPANY's amended 2008 return and denied the Oklahoma Capital Gain Deduction taken because COMPANY was not headquartered in Oklahoma for three (3) years prior to the sale as required by statute. COMPANY otherwise met the requirements of [the Deduction]." Division's Response Brief at 2.

[53] *See* Note 18, *supra*.

JURISDICTION TO DECIDE CONSTITUTIONAL ISSUE

The Supreme Court of Oklahoma held in *Dow Jones,*[54] "We agree with the Commission that, as an administrative agency, it is powerless to strike down a statute for constitutional repugnancy. Within the framework of Oklahoma's tripartite distribution of government powers, the authority to invalidate an unconstitutional enactment resides *solely* in the judicial department. Art. 7, § 1, Okl. Const.[55] confers on administrative agencies only that quantum of 'judicial power' which is necessary to support their exercise of adjudicative authority in individual proceedings brought before them. The power assigned to boards and commissions is not coextensive with that which is vested in the courts. Every statute is hence constitutionally valid until a court of competent jurisdiction declares otherwise."[56]

CONCLUSION

The Division's position is supported by ample Oklahoma case law. The Statute is deemed constitutionally valid until a court of competent jurisdiction determines otherwise.

DISPOSITION

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

OKLAHOMA TAX COMMISSION

---

[54] *Dow Jones & Company, Inc. v. State ex rel. Oklahoma Tax Com'n*, 1990 OK 6, 787 P.2d 843. (Citations omitted).

[55] OK Const. Art. 7, § 1, (West 2006) states as follows, to-wit:

> The judicial power of this State shall be vested in the Senate, sitting as a Court of Impeachment, a Supreme Court, the Court of Criminal Appeals, the Court on the Judiciary, the State Industrial Court, the Court of Bank Review, the Court of Tax Review, and such intermediate appellate courts as may be provided by statute, District Courts, and such Boards, Agencies and Commissions created by the Constitution or established by statute as exercise adjudicative authority or render decisions in individual proceedings. Provided that the Court of Criminal Appeals, the State Industrial Court, the Court of Bank Review and the Court of Tax Review and such Boards, Agencies and Commissions as have been established by statute shall continue in effect, subject to the power of the Legislature to change or abolish said Courts, Boards, Agencies, or Commissions. Municipal Courts in cities or incorporated towns shall continue in effect and shall be subject to creation, abolition or alteration by the Legislature by general laws, but shall be limited in jurisdiction to criminal and traffic proceedings arising out of infractions of the provisions of ordinances of cities and towns or of duly adopted regulations authorized by such ordinances.

[56] *See* Note 54, *supra*. (Citations omitted). (Emphasis original).

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.

NOTE: 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."