JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2011-10-18-07 / NON-PRECEDENTIAL**
ID: **P-11-194-K**
DATE: **OCTOBER 18, 2011**
DISPOSITION: **DENIED**
TAX TYPE: **INCOME**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Protestants, HUSBAND AND WIFE, appear pro se. The Compliance Division of the Oklahoma Tax Commission ("Division") is represented by OTC ATTORNEY, Assistant General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

Protestants filed their 2006 Oklahoma income tax return claiming an Oklahoma net operating loss carry forward deduction from 2005 of $196,640.00 and a refund in the amount of $13,470.00. The Division audited the return and Form 511 NOL Schedule A, *Computation of Oklahoma Net operating Loss for Tax Year 2005* and accompanying Net Operating Loss Worksheet filed June 15, 2010, correcting the amount of the 2005 net operating loss. As a result of the audit, the Division disallowed a portion of the 2005 Oklahoma net operating loss carry forward to the 2006 tax year and by letter dated June 21, 2010, assessed additional income tax, interest and penalty against Protestants. Protestants timely protested the proposed assessment.

On March 21, 2010, the Division referred the protest to the Office of the Administrative Law Judges for further proceedings pursuant to the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure before the Office of Administrative Law Judges[2]. The protest was docketed as Case No. P-11-194-K and assigned to ALJ, Administrative Law Judge.[3]

A pre-hearing conference was scheduled for May 3, 2011, by *Prehearing Conference Notice* issued April 7, 2011.[4] Pursuant to the conference, an *Order* was issued directing the Division to file a motion for summary disposition on or before June 6, 2011, and allowing Protestants to file a response on or before July 6, 2011.[5]

The Division's *Motion for Summary Disposition* ("*Motion*") with Exhibits A through E attached thereto was filed June 6, 2011.[6] A *Response* to the *Motion* was filed June 28, 2011. A hearing was requested in the *Response*. A hearing was scheduled for August 1, 2011, by *Notice*

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[1] 68 O.S. 2001, § 201 et seq.

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

[3] *OAC*, 710:1-5-22(b).

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

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

[6] *OAC*, 710:1-5-38.

of Hearing issued July 7, 2011. The hearing was limited to receiving evidence of whether Protestants failed to properly elect to forego the carryback of their 2005 net operating loss.

A closed hearing[7] was held as scheduled in accordance with the hearing notice. Protestant, HUSBAND, gave a statement with respect to Protestants' implicit intent in regard to the 2005 net operating loss, the reason they did not elect to carryback the 2005 net operating loss and the timing of the Division's assessment. HUSBAND also questioned SUPERVISOR, Audit Supervisor, regarding the Oklahoma net operating loss income tax forms and instructions. Protestants' Exhibits 1 through 5 were admitted into evidence. SUPERVISOR also testified with respect to the records of the Division and the reasons for the adjustment of Protestants' 2006 income tax return. Division's Exhibits A through E were admitted into evidence. Upon conclusion of closing arguments, the record was closed and the protest was submitted for decision.[8]

FINDINGS OF FACT

Upon review of the file and records, including the recording of the hearing and the exhibits received into evidence, the undersigned finds:

1. Protestants' 2005 Oklahoma income tax return reported a loss of $201,656.00 and a refund of $11,645.00. Division's Exhibit A.

2. Protestants admit that a written statement electing to forego the net operating loss ("NOL") carryback period was not included with the 2005 return. Testimony of HUSBAND.

3. The Form 511 NOL Schedule A, *Computation of Oklahoma Net Operating Loss for Tax Year* _____ can be downloaded from the website of the Oklahoma Tax Commission without the instructions to the form and does not contain a box that can be checked to signify the election to forego the carryback period, nor state the consequences if an election is not made. Protestants' Exhibits 2 and 3; Testimony of SUPERVISOR.

4. Nothing on Form 511 NOL Schedule A informs the taxpayer that the Oklahoma NOL is carried back 2 years and forward 20 years. Protestants' Exhibit 2; Testimony of SUPERVISOR.

5. The Form 511 Schedule B allows a taxpayer to designate the year an NOL is carried to. Protestants' Exhibit 2; Testimony of SUPERVISOR.

6. Protestants did not amend their 2003 and 2004 Oklahoma income tax returns to carryback the 2005 Oklahoma NOL. Testimony of HUSBAND and SUPERVISOR.

7. The 2005 Oklahoma NOL was not carried back to 2003 and 2004 because of the cost of amending those returns. Testimony of HUSBAND.

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[7] Confidentiality of the proceeding was invoked. 68 O.S. 2001, § 205, as amended.

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

8. If Protestants had amended their 2003 and 2004 returns by carrying back the 2005 Oklahoma NOL, Protestants would have been eligible to receive refunds in the aggregate amount of $6,965.00. Protestants' Exhibit 1.

9. Protestants' 2006 Oklahoma income tax return claimed an Oklahoma NOL on Schedule 511-A in the amount of $196,640.00 and a refund of $13,470.00. Division's Exhibit 2.

10. Neither Form 511 NOL Schedule A nor Schedule B was filed with the 2006 return and the return did not otherwise specify the year in which the NOL was generated. Division's Exhibit 2.

11. On June 15, 2010, the Division received the Form 511 NOL Schedule A and Net Operating Loss Worksheet for tax year 2005 from Protestants. Division's Exhibit C.

12. The Form 511 NOL Schedule A for tax year 2005 corrected the loss previously reported on Protestants' 2005 Oklahoma income tax return to an amount of $147,199.00. See Division's Exhibits A and C.

13. The Division audited Protestants' 2006 return and Form 511 Schedule A for tax year 2005. Testimony of SUPERVISOR.

14. The Division applied $86,413.00 of the corrected 2005 Oklahoma NOL to the 2003 tax year leaving a carryback balance of $60,786.00. Oklahoma NOL – Schedule B prepared by the auditor.[9]

15. The Division applied $37,723.00 of the NOL carryback balance to the 2004 tax year leaving a carryover balance of $23,063.00. See note 9.

16. The carryover balance of the 2005 Oklahoma NOL was applied to the 2006 tax year resulting in an audited Oklahoma taxable income of $91,588.00 as opposed to the reported Oklahoma taxable income of negative $51,695.00. See note 9.

17. The amount of additional tax assessed that is attributable to the disallowance of a portion of the 2005 Oklahoma NOL carryover is $4,418.68. Protestants' Exhibit 5; E-mail message from SUPERVISOR to OTC ATTORNEY 2 dated December 7, 2010. See note 9.

18. The proposed income tax assessment issued against Protestants for the 2006 tax year is dated June 21, 2010. Division's Exhibit D.

19. Protestants timely protested the proposed assessment by letter dated August 18, 2010. Division's Exhibit E.

[9] Evidence by official notice. *OAC*, 710:1-5-36. The audit work papers were included in the file received from the Division.

20. The amount in controversy is $4,418.68, exclusive of penalty, and accrued and accruing interest.

ISSUE AND CONTENTIONS

The issue presented for decision is whether Protestants sustained their burden of proof to show they properly elected to forego the carryback period with respect to their corrected 2005 Oklahoma NOL.

Protestants argue that their statement of the election to forego the carryback period is obvious since they did not amend their 2003 and 2004 returns and they carried forward the total amount of the 2005 Oklahoma NOL to their 2006 return. Protestants further argue that the fact a written election is required to be submitted with the loss return is not evident, but is buried in the fine print of a separate instruction form that a prudent man would not know to look for.

Protestants also argue that due to the timing of the assessment they are precluded from amending their prior returns and the Division is receiving a tax windfall. In support of this argument, Protestants would show that had they been notified in a timely manner the refunds for the 2003 and 2004 tax years would have more than offset the taxes due for the 2006 tax year.

Additionally, Protestants seek a waiver of the penalty and interest assessed for the 2006 tax year if the assessment is upheld.

The Division contends that the adjustment to the amount of the Oklahoma NOL carryover to Protestants' 2006 Oklahoma return is correct since Protestants did not submit a written election to forego the carryback period with their 2005 loss year return. In support of this contention, the Division cites 68 O.S. Supp. 2006, § 2358(A)(3); *OAC*, 710:50-17-51(4); I.R.C. § 172; and the Form 511-A NOL Instructions. The Division further contends that Protestants are not entitled to receive refunds for tax years 2003 and 2004 because the amounts are barred by the statute of limitations against income tax refunds, citing 68 O.S. 2001, § 2373 and ***Neer v. State ex. rel. Oklahoma Tax Commission***, 1999 OK 41, ¶ 2, 982 P.2d 1071, 1073.

Whether Protestants should receive a waiver of the penalty and/or interest assessed and accruing is not addressed herein as this Office is not authorized to waive penalty and/or interest. See, 68 O.S. 2001, § 220. The authority to waive penalty and interest or any portion thereof ordinarily accruing by reason of a taxpayer's failure to pay a state tax within the statutory period allowed for its payment lies with the three (3) members of the Oklahoma Tax Commission or their designees. 68 O.S. 2001, § 220(A).

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. Supp. 2002, § 221(C) and (D).

2. At issue herein is the procedure applicable to the exploitation of an Oklahoma NOL for Oklahoma income tax purposes. An individual may deduct an Oklahoma NOL from taxable income[10] to arrive at Oklahoma adjusted gross income[11] in accordance with § 2358(A)(3) of the Oklahoma Income Tax Act[12], which provides in pertinent part:

> (A) The taxable income of any taxpayer shall be adjusted to arrive at * * * Oklahoma adjusted gross income for individuals, as follows:
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> * * * * * * * * *
>
> (3) The amount of any federal net operating loss deduction shall be adjusted as follows:
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> * * * * * * * * *
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> (b) For carryovers and carrybacks to taxable years beginning after December 31, 1980, the amount of any net operating loss deduction allowed for the taxable year shall be an amount equal to the aggregate of the Oklahoma net operating loss carryovers and carrybacks to such year. Oklahoma net operating losses shall be separately determined by reference to Section 172 of the Internal Revenue Code, 26 U.S.C., Section 172, as modified by the Oklahoma Income Tax Act, Section 2351 et seq. of this title, and shall be allowed without regard to the existence of a federal net operating loss. For tax years beginning after December 31, 2000, and ending before January 1, 2008, the years to which such losses may be carried shall be determined solely by reference to Section 172 of the Internal Revenue Code, 26 U.S.C., Section 172, with the exception that the terms 'net operating loss' and 'taxable income' shall be replaced by 'Oklahoma net operating loss' and 'Oklahoma taxable income' * * *".

68 O.S. Supp. 2004, § 2358(A)(3)(b). See *OAC*, 710:50-15-53[13].

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[10] Defined in pertinent part to mean "with respect to any taxpayer * * * the 'taxable income', * * * and any other 'taxable income' as defined in the Internal Revenue Code as applies to such taxpayer or any other income of such taxpayer". 68 O.S. 2001, § 2353(10).

[11] Defined at 68 O.S. 2001, § 2353(13).

[12] 68 O.S. 2001, § 2351 et seq., as amended.

[13] This rule provides in pertinent part:

(a) Oklahoma net operating losses shall be separately determined by reference to Section 172 of the Internal Revenue Code and will be calculated utilizing Oklahoma Form 511-NOL Schedule A for resident individuals * * * .

(b) The years to which such losses may be carried shall be determined by reference to Section 172 of the Internal Revenue Code, as follows:

* * * * * *

(5) For net operating losses incurred for tax years beginning on or after January 1, 2001, and before

3. IRC, § 172 provides in part:

> (a) **Deduction allowed**. There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year.
>
> (b) **Net operating loss carrybacks and carryovers**.
>
> (1) **Years to which loss may be carried**.
>
> (A) General rule. Except as otherwise provided in this paragraph, a net operating loss for any taxable year –
>
> (i) shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and
>
> (ii) shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of the loss.
>
> (2) **Amount of carrybacks and carryovers**. The entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the 'loss year') shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried.
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> (3) **Election to waive carryback**. Any taxpayer entitled to a carryback period under paragraph (1) may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year. Such election shall be made in such manner as may be prescribed by the Secretary, and shall be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss for which the election is to be in effect. Such election, once made for any taxable year, shall be irrevocable for such taxable year.

4. The election to forego the carryback period under § 172(b)(3) shall be made by a statement attached to the return (or amended return) for the taxable year. 26 C.F.R. § 301.9100-12T(d); T.R. § 301.9100-T(d). The election must be made by the due date (including extensions) of the return for the loss year and once made is irrevocable for that year. 34 Am.Jur. 2d Federal Taxation, § 17303. The statement required when making an election shall indicate the section under with the election is being made and shall set for the information to identify the election, the period for which it applies, and the taxpayer's basis or entitlement for making the election. 26 C.F.R. § 301.9100-12T(d); T.R. § 301.9100-T(d); and 34 Am.Jur. 2d Federal Taxation, § 17303.

December 31, 2006, the loss carryback shall be for a period as allowed in the Internal Revenue Code.

(c) Resident individuals will use Oklahoma Form 511-NOL Schedule B to compute the amount of loss absorbed in each intervening year. * * * *

5. The instructions for Form 511 NOL provide for 2001 through 2007 and for 2009 and subsequent Oklahoma NOLs, an election may be made to forego the NOL carryback period. Protestants' Exhibit 3. The election is made by "[a] written statement of the election * * * [submitted as] part of the timely filed Oklahoma loss year return or to an amended return for the NOL year filed within six months of the due date of your original return (excluding extensions)." Id.

6. "Deductions are a matter of legislative grace rather than judicial intervention." ***Flint Resources Company v. Oklahoma Tax Commission***, 1989 OK 9, 780 P.2d 665, 673. In order to be allowed, authority for the deduction must be clearly expressed. ***Home-State Royalty Corporation v. Weems***, 1935 OK 1043, 175 Okla. 340, 52 P.2d 806 (1935). None may be allowed in absence of a statutory provision therefor. *Id*. *See*, ***New Colonial Ice Co. v. Helvering***, 292 U.S. 435, 440, 54 S.Ct. 788, 78 L.Ed. 1348 (1934).

7. Tax statutes are penal in nature. ***Globe Life and Accident Insurance Company v. Oklahoma Tax Commission***, 1996 OK 39, 913 P.2d 1322. Penal statutes are to be strictly construed. ***Mid-Continent Pipeline Co. v. Crauthers***, 1954 OK 61, 267 P.2d 568. Strict construction with respect to a penal statute is that which refuses to extend the law by implication or equitable consideration and confines its operations to cases clearly within the letter of the statute, as well as within its spirit or reason. ***State ex rel. Allen v. Board of Education of Independent School Dist. No. 74 of Muskogee County***, 1952 OK 241, 206 Okla. 699, 246 P.2d 368.

8. When a statute creates both a right and a remedy for its enforcement, the statutory remedy is generally exclusive. ***Apache Corp. v. Oklahoma Tax Commission***, 2004 OK 48, ¶ 11, 98 P.3d 1061, 1064, citing *R.R. Tway, Inc. v. Oklahoma Tax Commission*, 1995 OK 129, 910 P.2d 972, 978. A mandatory procedural tax statute must be followed to obtain the statutory relief prescribed. Id. at ¶ 10.

9. Taxpayers are charged with knowledge of the laws that affect them. Oklahoma Tax Commission Order No. 2006-03-23-07 (Prec.), *citing Ponder v. Ebey*, 1944 OK 271, 194 Okla. 407, 152 P.2d 268; *Anderson Nat'l Bank v. Luckett*, 321 U.S. 233, 64 S.Ct. 599 (1994). Ignorance of the law, standing alone, is no defense. The rule, long-standing and well-known, is found in ***Campbell v. Newman***, 1915 OK 538, ¶3, 151 P. 602, 603 which cites *Utermehle v. Norment*, 197 U.S. 40, 25 S.Ct. 291, 49 L.Ed. 655 (1905), "We know of no case where mere ignorance of the law, standing alone, constitutes any excuse or defense against its enforcement. It would be impossible to administer the law if ignorance of its provisions were a defense thereto."

10. A statement of election to forego the NOL carryback period submitted with the loss year return is a mandatory procedural requirement of § 2358(A)(3) when read in conjunction

with IRC § 172. See, 68 O.S. 2001, § 2353(3).[14] Protestants have not shown compliance with this requirement. Accordingly, Protestants' protest should be denied.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the income tax protests of Protestants, HUSBAND AND WIFE, be denied. Without consideration of the waiver request, it is further ORDERED that the amount in controversy, inclusive of any additional accrued and accruing interest be fixed as the deficiency due and owing.

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.

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."

[14] The section provides in part that "the tax status and all elections of all taxpayers covered by [the Act] shall be the same for all purposes material hereto as they are for federal income tax purposes except when [the Act] specifically provides otherwise".