JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2012-02-14-05 / PRECEDENTIAL**
ID: **P-10-352-K**
DATE: **FEBRUARY 14, 2012**
DISPOSITION: **DENIED**
TAX TYPE: **INCOME**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

PROTESTANT ("Protestant") is represented by ATTORNEY 1 and ATTORNEY 2, Attorneys at Law, FIRM. The Compliance Division ("Division") of the Oklahoma Tax Commission is represented by OTC ATTORNEY, Assistant General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

The Division audited Protestant's 2006 Oklahoma income tax return; corrected the reported federal adjusted gross income by excluding certain out-of-state income, and disallowed the Oklahoma Capital Gains Deduction claimed on the return in the amount of $499,008.00. As a result of the audit, the Division by letter dated April 12, 2010, proposed the assessment of additional income tax, interest and penalty against Protestant for the 2006 tax year in the aggregate amount of $61,515.15. Protestant filed a timely written protest to the proposed assessment.

The protest was docketed as Case Number P-10-352-K and assigned to ALJ, Administrative Law Judge.[1] Pursuant to this Office's request, the Division's file was forwarded on July 9, 2010. A *Supplement to the Protest of [Protestant]* was filed July 14, 2010.

A pre-hearing conference was scheduled for August 5, 2010, by *Prehearing Conference Notice* issued July 15, 2010. On August 6, 2010, the Division's complete file was forwarded to this Office in accordance with the directive of the undersigned at the pre-hearing conference.

A status conference was scheduled for September 2, 2010. Pursuant to the conference, the parties were directed to file a proposed procedural schedule for the submission of this case for decision. The parties were also notified that the other related protests would be held in abeyance pending the outcome of this case.

Pursuant to the *Joint Proposed Scheduling Order* filed December 7, 2010, a *Scheduling Order and Notice of Hearing* ("*Order*") was issued setting forth the procedure by which the protest would be submitted for decision. The *Order* also scheduled a hearing in this cause for May 10, 2011.

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

A *Joint Motion for Extension of Scheduling Order* ("*Motion*") was filed March 24, 2011, which *Motion* was granted by *Order Granting Request for Extension of Time and Amending Scheduling Order*. The *Order* rescheduled the hearing for June 9, 2011.

On May 5, 2011, the Court's *Order* was issued granting the parties' *Joint Motion to Strike Amended Scheduling Order*, cancelling the hearing scheduled for June 9, 2011 and setting forth the dates in accordance with the *Amended Joint Proposed Scheduling Order* for the parties to file a stipulation of facts and briefs.

A *Joint Stipulation of Facts and Issues* ("*Stipulation*") was filed May 18, 2011. Exhibits A through H were attached to the *Stipulation*. *Protestant's Opening Brief* was filed June 30, 2011. The *Reply Brief of the Compliance Division* and Appendix "A" were filed July 20, 2011. *Protestant's Reply Brief in Support of Protest* and Appendix "A" were filed August 8, 2011. On August 8, 2011, the record was closed and the protest was submitted for decision[2].

FINDINGS OF FACT

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

A. The parties stipulate to the following:

1. In or around November of 2000, Protestant acquired an interest in LLC ("LLC"), an Oklahoma limited liability company. Prior to the date of Protestant's acquisition of this interest, LLC was party to an operating agreement which formed LC ("LC"), an Oklahoma limited liability company, for purposes of operating a surgery center at HOSPITAL.

2. LC sold all the assets of its business pursuant to the "Asset Purchase Agreement by and among LC and LP and LLC2 and CORPORATION" dated September 25, 2006. The asset purchase agreement is attached [to the Stipulation] as **Exhibit A**[3]. According to the asset purchase agreement, the sale included "all goodwill associated with the Center and the Assets," among other tangible and intangible assets owned by LC. Asset Purchase Agreement, p. 3.

3. The sale of LC's assets was completed on December 31, 2006, in accordance with the Closing Statement. The Closing Statement is attached [to the Stipulation] as **Exhibit B**[4].

4. Protestant filed his original 2006 Oklahoma Individual Income Tax Return on or about April 13, 2007. The 2006 Return is attached [to the Stipulation] as **Exhibit C**. On the 2006 return, Protestant claimed the Oklahoma

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

[3] Emphasis original.

[4] See Note 3. The designation of each document as an exhibit is highlighted in bold.

Capital Gains Deduction in the amount of $499,008 for gains from the sale of assets of LC. The $499,008 was attributable to goodwill.

5. On April 12, 2010, an adjustment letter was issued to Protestant denying the Oklahoma Capital Gains Deduction, correcting the amount of Federal Adjusted Gross Income ("AGI"), and excluding out of state income. The April 12, 2010, adjustment letter is attached [to the Stipulation] as **Exhibit D**.

6. Protestant timely protested the Division's adjustment by letter dated June 3, 2010. The protest letter is attached [to the Stipulation] as **Exhibit E**.

7. There were other individual taxpayers similarly situated to Protestant who held interests in LLC and claimed the same deduction as Protestant on the gains they realized from the sale of LC. These other taxpayers likewise received adjustment letters from the Division and accordingly filed protests on the same grounds as Protestant. However, their protests have been held in abeyance pending the outcome of Protestant's case as they all involve the same transaction.

8. Protestant then filed a supplemental protest letter on July 14, 2010, again protesting the denial of the Oklahoma Capital Gains Deduction. The supplemental protest is attached [to the Stipulation] as **Exhibit F**.

9. Following his protest of the Division's April 12th adjustment, Protestant filed an amended 2006 Oklahoma Individual Income Tax Return on September 1, 2010, to correct the issues with Federal AGI and out of state income as filed on the original return. The amended 2006 return is attached [to the Stipulation] as **Exhibit G**.

10. The Division adjusted the amended 2006 return by letter dated November 5, 2010. The second adjustment again denied the Oklahoma Capital Gains Deduction, but accepted Protestant's other changes, thereby resolving all outstanding issues other than the Capital Gains Deduction. The November 5, 2010, adjustment letter is attached [to the Stipulation] as **Exhibit H**.

ISSUES AND CONTENTIONS

In the Statement of Issues, the parties stipulate to the following:

1. At issue in this matter is whether Protestant is eligible to take the Oklahoma Capital Gains Deduction in 2006 for gains received for goodwill and other intangibles from the sale of LC.

2. Protestant contends that at the time of filing his 2006 tax returns, 68 O.S. Supp. 2006, § 2358 allowed him to deduct the capital gains from the sale of his interest in LC, including tangible assets, goodwill and other intangible assets. Protestant further contends that the subsequent amendment of 68 O.S. § 2358 by

Senate Bill 685 was a clarification of the legislature's intention to allow the Oklahoma Capital Gains Deduction for gains received from the sale of intangible assets, such as those Protestant received from the sale of LC.

3. The Division maintains that the denial of Protestant's deduction for 2006 was correct because intangibles, including goodwill, were not allowable under the Oklahoma Capital Gains Deduction in 2006. The Division further maintains that the amendment of 68 O.S. § 2358 by Senate Bill 685 was not a clarifying amendment and the deduction for intangibles did not go into effect until tax year 2008.

CONCLUSIONS OF LAW

1. Jurisdiction of the parties and subject matter of this proceeding is vested in the Oklahoma Tax Commission. 68 O.S. 2001, § 221.

2. "Taxation is an exclusively legislative function that can be exercised only under statutory authority and in the manner specified by statute." ***State, ex rel. Oklahoma Tax Commission v. Texaco Exploration & Production, Inc.,*** 2005 OK 52, ¶ 7, 131 P.3d 705, 707. Accordingly, the basis for assessing income tax must be found in the Oklahoma Income Tax Act ("Act").[5]

3. A taxpayer's income tax liability is determined in accordance with the law in effect at the time the income is received. ***Affiliated Management Corp. v. Oklahoma Tax Commission***, 1977 OK 183, 570 P.2d 335; ***Wootten v. Oklahoma Tax Commission***, 1935 OK 54, 170 Okla. 584, 40 P.2d 762.

4. The provisions of the Act at issue is the capital gains deduction codified at § 2358(F)[6] which provides:

> 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:

[5] 68 O.S. 2001, § 2351 et seq.

[6] Laws 2006, c. 272, § 17. Section 27 of Chapter 272, Laws 2006 provides that § 17 shall become effective January 1, 2006. The amendment changed the holding period required for the deduction of capital gains from the sale of stock or the sale of a direct or indirect ownership interest in an Oklahoma company, limited liability company, or partnership from three (3) years to two (2) years.

(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 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,

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 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.

5. Section 2358(F) was amended in 2007[7] by adding a third category of deductible capital gains, to-wit: "[Gains from] 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". 68 O.S. Supp. 2007, § 2358(F)(2)(a)(3).

6. "Deductions [and credits against tax] 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 sought 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. The provisions of the Oklahoma Capital Gains Deduction are unambiguous. *Crook v. State of Oklahoma, ex rel. Oklahoma Tax Commission*, Slip Op. 107,352, OBJ Vol. 81, No. 15, May 29, 2010 (OK CIV APP 4th, May 5, 2010), unpublished; Oklahoma Tax Commission Order No. 2009-06-23-03; Oklahoma Tax Commission Order No. 2009-06-23-02; and Oklahoma Tax Commission Order No. 2010-06-22-04. Where a statute is unambiguous, statutory construction is unnecessary, and the terms of the statute must be given their plain meaning. ***Blitz U.S.A., Inc. v. Oklahoma Tax Commission***, 2003 OK 50, ¶ 14, 75 P.3d 883, 888.

8. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect, and in what respect. *OAC*, 710:1-5-47. *See*, ***Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission***, 1988 OK 91, 768 P.2d 359, 362, citing *Continental Oil Co. v. Oklahoma State Bd. of Equalization*, 1976 OK 23, 570 P.2d 315, 317. Failure to provide evidence which is sufficient to show an adjustment to the proposed assessment is warranted will result in the denial of the protest. Id.

9. Protestant contends that the gain realized from the sale of LC is a deductible capital gain under § 2358(F)(2)(a)(2) since he sold his ownership interest in an Oklahoma company. In support of this contention, Protestant argues that the scope of the language "sale of a direct or indirect ownership interest" does not exclude the sale of an intangible asset such as goodwill.

As argued by the Division, Protestant's contention is not supported by the facts of this case. The sale giving rise to the gain was a sale of assets via an "Asset Purchase Agreement", not the sale of ownership interests in LC.

[7] Laws 2007, c. 346, § 3, eff. Jan. 1, 2008.

10. Protestant also contends that the 2007 amendment to § 2358(F) was a clarifying amendment and should be applied retroactively. In support of this contention, Protestant argues that the express language of the statute makes the amendment applicable to "taxable years beginning after December 31, 2004". Protestant further argues that an examination of the effect of the amendment implies that the legislature intended the amendment to have retroactive effect. In support of this argument, Protestant asserts that the proximity in scope of the three subdivisions does not constitute a complete re-writing of the section, a deletion of existing broad language, the addition of a specific exclusion, an irreconcilable conflict with the prior version of the section, or an addition of an entirely new subject.

The Division contends that Protestant's argument regarding the express language of the statute fails to take into account the plain language of the statute prior to the amendment and ignores the effective date of the amendment. The Division further cites the holding in ***Crook***, *supra* that the 2007 amendment did not "meet the criteria for retroactive application" because the 2006 version of the statute was not ambiguous or unclear, the amendment added a new category of deduction and the amendment placed conditions on the new category of deduction which were not present in the existing categories of deductions.

In amending a statute, the legislature may have intended either to effect a change in the existing law or to clarify that which previously appeared doubtful. ***Blitz***, *supra*, at ¶ 19. See, ***In re Protest of Betts Telecom Oklahoma, Inc***., 2008 OK CIV APP 19, 178 P.3d 197. Amendments to a statute can be used to ascertain the meaning of the prior statute. ***Quail Creek Golf and Country Club v. Oklahoma Tax Commission***, 1996 OK 35, ¶ 10, 913 P.2d 302, 304.

Statutes and statutory amendments are presumed to operate prospectively unless expressly declared otherwise, or retrospective effect is necessarily implied by the language of the statute. ***Department of Human Services ex rel. Pavlovich v. Pavlovich***, 1996 OK 71, 932 P.2d 1080, 1082. Doubt as to whether a statute was intended to be prospective or retrospective must be resolved against retrospective application. ***Fraternal Order of Police, Lodge No. 165 v. City of Choctaw***, 1996 OK 78, 933 P.2d 261, 271. Express language will prevail over an effective date or emergency clause. ***Cities Service Oil Co. v. Oklahoma Tax Commission***, 1942 OK 307, ¶ 15, 129 P.2d 597, 599.

"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." ***Wilson v. Oklahoma Tax Commission***, 1979 OK 62, ¶ 6, 594 P.2d 1210, 1212.

Neither the express language nor the application of the provisions of the 2007 amendment to § 2358(F) reflect the legislature's intent to clarify the existing law. Accordingly, the 2007 amendment to § 2358(F), effective January 1, 2008, is not applicable in this proceeding.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the income tax protest of Protestant, PROTESTANT, be denied. 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