JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2012-07-24-01 / NON-PRECEDENTIAL**
ID: **P-10-955-K**
DATE: **JULY 24, 2012**
DISPOSITION: **DENIED**
TAX TYPE: **GROSS PRODUCTION**
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 (hereinafter "Division") is represented by OTC ATTORNEY, Assistant General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

Protestants timely filed their 2007 Oklahoma Resident Income Tax Return (Form 511) claiming a refund in the amount of $2,017.00. The special exemption claimed on the return was disallowed, and by letter dated March 11, 2008, Protestants were notified that their refund had been reduced to an amount of $1,962.00. Protestants did not protest this adjustment. Upon audit of the return, the Division disallowed $1,963.00 of the income tax withholding credit claimed on the return, and by letter dated April 20, 2010, proposed the assessment of additional income tax, interest and penalty against Protestants in the aggregate amount of $2,799.02. Protestants timely protested the proposed assessment by letters mailed June 14th and 15th, 2010.

On September 1, 2010, the Division referred the protest to the Office of the Administrative Law Judges for further proceedings in accordance with the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure Before the Office of the Administrative Law Judges[2]. The case was docketed as Case No. P-10-955-K and assigned to ALJ, Administrative Law Judge.[3]

By *Order Granting Motion to Hold in Abeyance* issued October 4, 2010, upon Division's *Motion to Hold in Abeyance* and Protestant's *Response to Motion to Hold in Abeyance*, further proceedings in this matter were stayed pending a final determination in a case involving the same parties and subject matter which was on appeal as Supreme Court Case No. 108,127.

By letter dated December 15, 2011, the parties were advised that a *Mandate* had been issued in Supreme Court Case No. 108,127 and directed the parties to file a status report on or before January 19, 2012, indicating how they wish to proceed in this matter.

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

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

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

Pursuant to the status report filed January 13, 2012, a pre-hearing conference was scheduled for March 1, 2012, by *Prehearing Conference Notice* issued January 17, 2012.[4] Pursuant to the conference, a hearing was scheduled for April 12, 2012, by *Notice of Hearing* issued March 2, 2012.[5]

An open hearing[6] was held as scheduled. As a preliminary matter, the Division objected to the presentation of any evidence or argument with respect to the snag and application of Protestants' 2010 income tax refund to the 2007 proposed income tax liability. In support of the objection, the Division argued that the facts were unknown. Protestants argued that the fact the 2010 refund was snagged and applied to the 2007 proposed assessment makes the circumstances relevant. Based on the Division's objection and not knowing the facts, the Court denied the admission of any evidence or argument with respect to the snag of Protestants' 2010 refund.

Protestant, HUSBAND was sworn and made a statement concerning the basis of the protest. Protestants' Exhibits 1 through 16 were admitted into evidence without objection. AUDITOR, Division Auditor testified with respect to the records of the Division, the audit of Protestants' 2007 return and the reason for the disallowance of the withholding tax credit. Division's Exhibits A through E, and G were admitted into evidence. At the conclusion of the hearing, the record was closed and the protest was submitted for decision.[7]

FINDINGS OF FACT

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

1. At all times relevant, Protestants were Oklahoma residents. Division's Exhibit A[8].

2. Protestant, HUSBAND, 11/16th degree Indian blood is a citizen of the NATION, one of the Five Civilized Tribes of Oklahoma. Paragraph 3, Facts in the Case, *Position Letter* filed April 4, 2012 by Protestants.

3. During tax year 2007, Protestants received royalties in the amount of $27,972.81 from oil and/or gas produced in the counties of COUNTY A and COUNTY B, State of Oklahoma. Protestants' Exhibit 5[9]; Division's Exhibit A[10].

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

[5] *OAC*, 710:1-5-29. The Notice indicates that it is dated February 2nd, 2012. This is a typographical error.

[6] Confidentiality of the proceeding was waived. See, 68 O.S. Supp. 2009, § 205.

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

[8] Copy of Protestants' 2007 State of Oklahoma Resident Income Tax Return, Form 511 and attachments filed February 4, 2008.

[9] List of Real Property Assets of Protestant, HUSBAND.

[10] *Consolidated Form 1009 for Tax Year 2007* issued by the Department of the Interior, Office of the Special Trustee for American Indians. The land from which the oil and/or gas was produced was inherited by Protestant, HUSBAND from DECEDENT, a full blood TRIBE Indian whom received the property as an

4. The *Consolidated Form 1099* reported "[e]xpenses related to oil and gas royalties" in the amount of $1,952.77 which have been identified and confirmed to be gross production and petroleum excise taxes withheld from the oil and/or gas income and remitted by the oil and gas companies to the State of Oklahoma. Division's Exhibit G[11]; Protestants' Exhibit 16[12].

5. Protestants timely filed their 2007 Oklahoma income tax return reporting Oklahoma taxable income of $22,653.00, income tax due of $829.00, Oklahoma withholding of $2,846.00 and an income tax refund of $2,017.00. Division's Exhibit A.

6. Protestants submitted with their 2007 Oklahoma income tax return, documentation (W-2 from Protestant, HUSBAND'S employer – LLC) of Oklahoma income tax withheld during 2007 of $882.68. Division's Exhibit A.

7. The special exemption claimed by Protestants (age 65 or older) was initially disallowed as a calculation error due to the amount of federal adjusted gross income reported on the return exceeding $25,000.00. See 68 O.S. 2001, § 2358(D)(1)(c)(1).

8. The Account Maintenance Division notified Protestants of said disallowance by letter dated March 11, 2008, and the resulting increase of income tax due to an amount of $884.00 and reduction of the income tax refund claimed to an amount of $1,962.00. Division's Exhibit B.

8. This adjustment to Protestants' 2007 return was not protested.

9. The Division audited Protestants' 2007 return and adjusted the reported amount of Oklahoma withholding of $2,846.00 to $883.00[13]. By letter dated April 20, 2010, the Division notified Protestants of the proposed adjustment to their 2007 return and the resulting proposed assessment of additional income tax, interest and penalty in the aggregate amount of $2,799.02, consisting of tax in the amount of $1,963.00[14], interest accrued through June 21, 2010 in the amount of $639.72 and penalty in the amount of $196.30. Division's Exhibit C.

10. Protestant timely protested the proposed assessment. Division's Exhibits D and E.

ISSUE AND CONTENTIONS

original allotment. The oil and gas leases are held in trust in DECEDENT'S name under the control of the United States Department of Interior. Paragraphs 1 through 4, Facts in the Case, Protestants' *Position Letter*.

[11] United States Department of the Interior, Minerals Management Service letter dated November 23, 2009.

[12] United States Department of the Interior, Office of the Special Trustee for American Indians letter dated April 15, 2009.

[13] Oklahoma income tax withholding of $882.68 as reported on the W-2 was rounded up to $883.00.

[14] The Auditor testified that the One Dollar ($1.00) difference between the amount refunded to Protestants ($1,962.00) and the amount of income tax assessed ($1,963.00) resulted from a rounding issue described as the difference between the use of the tax table to compute the tax and the computer generated refund.

The issue presented for decision is whether the gross production and petroleum excise taxes withheld from Protestants' oil and/or gas royalty income may be claimed on their income tax return as Oklahoma income tax withholding.

Protestants contend that they are due a credit or refund of the gross production and petroleum excise taxes withheld from their oil and/or gas royalties. In support of this contention, Protestants in the letter of protest identified three (3) assignments of error. First, Protestants contend that the Division should be barred from making the assessment because the Division failed to assess the tax within the three year statute of limitations during which Protestants could seek a refund of the withheld gross production and petroleum excise taxes. Second, Protestants contend that the adjustment is based on production derived from restricted Indian land which is exempt from taxation. Third, Protestants contend that the determination to initially allow the refund creates a presumption that the evidence relied upon in allowing the refund is correct.

In the *Position Letter*, Protestants argue that the gross production and petroleum excise taxes are essentially the same as withheld income taxes as the taxes were withheld from their gross unearned income. Protestants further argue that the Constitution of the State of Oklahoma and Enabling Act prevented Congress from enacting the May 10, 1928 Act which allows the State of Oklahoma to collect taxes on all minerals, including oil and gas produced on or after April 26, 1931, from restricted allotted lands of members of the Five Civilized Tribes of Oklahoma. Protestants further argue that the May 28, 1928 Act is superceded by the Acts of 1947 and 1955.

The Division submits that the only issue which may be considered in this matter is whether Protestants can treat the gross production and petroleum excise taxes withheld from oil and gas royalties as withheld income taxes. The Division argues that Protestants' protest must be denied as a matter of law as there is no statutory provision allowing Protestants' action.

CONCLUSIONS OF LAW

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

1. Jurisdiction of the parties and subject matter of this action is vested in the Tax Commission. 68 O.S. Supp. 2002, § 221(D).

2. This matter is governed by the Oklahoma Income Tax Act.[15] ***State, ex rel. Oklahoma Tax Commission v. Texaco Exploration & Production, Inc.,*** 2005 OK 52, ¶ 7, 131 P.3d 705, 707.

3. The amount deducted and withheld as tax by an employer making payment of wages during any calendar year shall be allowed as a credit to the recipient of the income as income taxes paid. 68 O.S. 2001, § 2385.5. See, 68 O.S. 2001, § 2357(A).

4. "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

[15] 68 O.S. 2001, § 2351 et seq., as amended.

665, 673. In order to be allowed, authority for the deduction or credit 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).

5. "No assessment of any tax levied under the provisions of any state tax law except as provided in this section, shall be made after the expiration of three (3) years from the date the return was required to be filed or the date the return was filed, whichever period expires the later[.]" 68 O.S. Supp. 2006, § 223(A). A proposed assessment of income taxes tolls the statute of limitations. ***In re Income Tax Protest of F & M Bancorporation and Subsidiaries***, 2005 OK CIV APP 6, 105 P.3d 837.

6. "Any assessment, correction or adjustment made as a result of an office audit shall be presumed to be the result of an audit of the report or return only, and such office audit shall not be deemed a verification of any item in the report or return unless the item shall have been made the subject of a hearing before the Tax Commission, and the correctness and amount of such item determined at such hearing; and such office audit shall not preclude the Tax Commission from subsequently making further adjustment, correction or assessment as a result of a field audit of the books and records of the taxpayer, wherever located, or upon disclosures from any source other than the return." 68 O.S. Supp. 2002, § 221(B). "If a report or return has been filed, the Tax Commission shall examine such report or return and make such audit or investigation as it may deem necessary." 68 O.S. Supp. § 221(A).

7. "Except as otherwise provided by law, claims for refunds which are required to be paid by the Oklahoma Tax Commission shall be paid from funds in the official depository clearing account of the Tax Commission, derived from collections from the same source from which the overpayment occurred." 68 O.S. 2001, § 228.1. Refunds of income taxes "shall be paid out of the 'Income Tax Withholding Refund Account', created by Section 2385.16 of this title, in the same manner as refunds are paid pursuant to such section." 68 O.S. 2001, § 2373. The Income Tax Withholding Refund Account consists of estimated income tax payments, 68 O.S. 2001, §§ 2385.9; and payments received by the Tax Commission transmitted by employers for taxes withheld from the wages of employees. 68 O.S. 2001, § 2385.16.

Claims for refund of gross production and petroleum excise taxes on the proceeds from oil and/or gas production are governed by the provisions of the Gross Production Tax Code, 68 O.S. 2001, § 1001 et seq.; and the Petroleum Excise Tax Code, 68 O.S. 2001, § 1101 et seq.; specifically §§ 1008 and 1106, not § 2373 of the Oklahoma Income Tax Act. ***Bruner v. Oklahoma Tax Commission***, 2006 OK CIV APP 21, 130 P.3d 767. Gross production and petroleum excise taxes are taxes levied in lieu of ad valorem taxes during the year in which the minerals, oil and/or gas are reduced to possession by production. ***Apache Gas Products Corp. v. Oklahoma Tax Commission***, 1973 OK 34, 509 P.2d 109, overruling *In re Skelton Lead & Zinc Company's Gross Production Tax for 1919*, 81 Okla. 134, 197 P. 495.

8. In administrative proceedings, the burden of proof is on the taxpayer to show in what respect the action or proposed action of the Tax Commission is incorrect. *OAC*, 710:1-5-47. ***In re***

Adway Properties, Inc., 2006 OK CIV APP 14, 130 P.3d 302; ***Geoffrey, Inc. v. Oklahoma Tax Commission***, 2006 OK CIV APP 27, 132 P.3d 632.

9. Every statute is deemed constitutionally valid until a court of competent jurisdiction declares otherwise. ***State ex rel York v. Turpen***, 1984 OK 26, 681 P.2d 763, 767. The Tax Commission is not empowered to decide the constitutional validity of a taxing statute. ***Dow Jones & Company, Inc. v. Oklahoma Tax Commission***, 1990 OK 6, 787 P.2d 843, 845.

ANALYSIS

1. The proposed assessment of additional income tax, interest and penalty issued against Protestants for the 2007 tax year was made within three (3) years of the filing date of the return and is therefore, timely. 68 O.S. Supp. 2006 § 223(A).

2. The State of Oklahoma is not prohibited from imposing gross production and petroleum excises taxes on production from allotted Indian lands. ***Bruner***, supra at ¶ 9.

3. Protestants' 2007 income tax return was initially adjusted by the Tax Commission's computer system to correct what was essentially a calculation error. This adjustment did not verify each and every item on the return and did not preclude further adjustment to the return as the result of an audit. 68 O.S. Supp. 2002, § 221(A) and (B).

4. Protestants have failed to prove their claim. They have not shown any statutory authority permitting them to treat gross production and petroleum excise taxes withheld from the proceeds of their oil and gas royalty interest as the functional equivalent of state income taxes withheld from wages as a credit against their income tax liability for tax year 2007.

5. The assessment was issued to recapture the withholding tax credit allowed Protestants and refunded to them for the 2007 tax year. Division's Exhibit C; testimony of the Auditor. Therefore, the income tax assessed for the 2007 tax year should be reduced $1.00 to equal the amount of the refund, and the penalty and interest adjusted accordingly.

DISPOSITION

THEREFORE, based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the protest of Protestants, HUSBAND AND WIFE be denied. It is further ORDERED that the proposed assessment be adjusted in accordance herewith, and that the resultant amount, 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."