JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2016-08-16-25 / NON-PRECEDENTIAL**
ID: **P-14-036-H**
DATE: **AUGUST 16, 2016**
DISPOSITION: **SUSTAINED**
TAX TYPE: **INCOME / CAPITAL GAINS**
APPEAL: **NONE TAKEN**

ORDER

The above matter comes on for entry of a final order of disposition by the Oklahoma Tax Commission. Having reviewed the files and records herein, the Commission hereby adopts the Findings of Fact, Conclusions of Law and Recommendation made and entered by the Administrative Law Judge on the 30th day of June, 2016, appended hereto, together herewith shall constitute the Order of the Commission.

SO ORDERED

FINDINGS OF FACT, CONCLUSIONS OF LAW AND RECOMMENDATION

NOW on this 30th day of June 2016, the above-styled and numbered cause comes on for consideration under assignment regularly made by the Oklahoma Tax Commission to ALJ, Administrative Law Judge. HUSBAND and WIFE ("Protestants") appear through attorneys, ATTORNEY 1, and ATTORNEY 2, FIRM. The Compliance Division ("Division") of the Oklahoma Tax Commission appears through OTC ATTORNEY 1, Deputy General Counsel, Office of General Counsel, Oklahoma Tax Commission.

PROCEDURAL HISTORY

On April 9, 2014, 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 9, 2014,

[1] OKLA. STAT. ANN. tit. 68, § 201 *et seq.* (West 2014).

[2] OKLA. ADMIN. CODE §§ 710:1-5-20 through 710:1-5-47.

the Court Clerk ("Clerk")[3] mailed the Introductory Letter to the Protestants' Representative[4] that ALJ Administrative Law Judge ("ALJ") was assigned to this matter, which is docketed as Case Number P-14-036-H. The letter also advised the Protestants that a Prehearing Teleconference Notice would be sent by mail and enclosed a copy of the *Rules of Practice and Procedure Before the Office of Administrative Law Judges.*[5] On April 11, 2014, OTC ATTORNEY 1 filed an Entry of Appearance as Division's Counsel. On April 15, 2014, the Clerk mailed the Prehearing Teleconference Notice to the last-known address of the Protestants' Representative, setting the prehearing conference for June 5, 2014, at 10:30 a.m.[6]

On June 5, 2014, the Division filed a Status Report In Lieu of Prehearing Conference stating that the parties requested the ALJ to set this matter for hearing. On June 6, 2014, the ALJ issued the Scheduling Order, setting this matter for hearing on September 18, 2014, at 9:30 a.m. On June 19, 2014, the Division filed a Status Reporting advising that the Protestants had retained Counsel and requested that the ALJ strike the June 6th Scheduling Order. On June 19, 2014, the ALJ acknowledged receipt of the Status Report and advised the parties, that upon receipt of an Entry of Appearance by ATTORNEY 1, the ALJ would strike the June 6th Scheduling Order.

On September 15, 2014, the ALJ acknowledged receipt of the Power of Attorney for ATTORNEY 1, struck the June 6th Scheduling Order, and set a status report to be filed by October 13, 2014.

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[3] OKLA. ADMIN. CODE § 710:1-5-10(c)(2) (August 27, 2015).

[4] At this stage of the case, a CPA represented the Protestants.

[5] *Id.* Unless otherwise noted herein, the ALJ notified the parties by letter.

[6] OKLA. STAT. ANN. tit. 68, § 208 (West 2014). The Clerk mailed the notice to the Protestants' Representative at ADDRESS.

On October 13, 2014, by e-mail, ATTORNEY 1 filed an Entry of Appearance as Counsel for the Protestants and a Status Report requesting time to negotiate with the Division regarding potential resolution of this matter.[7] On October 14, 2014, the ALJ advised the parties to file a status report by October 31, 2014. On October 31, 2014, the Division filed the Status Report advising that the parties were ready to proceed.

On December 31, 2014, the parties filed a Joint Proposed Scheduling Order, as more fully set forth therein.

On January 5, 2015, the ALJ issued an Amended Scheduling Order, setting this matter for hearing on May 19, 2015, at 9:30 a.m., as more fully set forth therein. On January 15, 2015, the Division filed its Preliminary Witness and Exhibit List. On January 20, 2015, the Protestants filed their Preliminary Witness & Exhibit List.

On March 2, 2015, ATTORNEY 1 filed a Notice of Change of Address with the Clerk.

On April 21, 2015, the Division filed its Final Witness and Exhibit List.

On May 8, 2015, the ALJ held a Teleconference at the request of Counsel to discuss the pressing scheduling difficulties in this matter (OTC ATTORNEY 1 would be on maternity leave). The ALJ struck the January 5th Amended Scheduling Order and directed the parties to file a status report by September 15, 2015.

On September 14, 2015, the parties filed a Joint Proposed Scheduling Order. On September 15, 2015, the ALJ issued the Scheduling Order, setting this matter for hearing on December 10, 2015. On September 29, 2015, the Division filed its Final Witness and Exhibit List.

[7] On October 14, 2014, the Clerk received the hard copy of the Entry of Appearance and Taxpayers' Status Report.

On December 3, 2015, the Protestants filed their Pretrial Brief, with Exhibits 1 through 6, attached thereto. On December 3, 2015, the Division filed its Brief.[8] On December 9, 2015, the Division filed a Joint Status Report and Request to Strike Hearing, which confirmed a Teleconference with the ALJ on December 8, 2015. The parties requested to strike the December 10, 2015 hearing to allow Counsel to draft and file (1) a stipulation of facts and (2) briefs in response to the hearing briefs filed in this matter December 3, 2015. On December 9, 2015, Counsel filed an Amended Joint Proposed Scheduling Order. On December 10, 2015, the ALJ struck the September 15th Scheduling Order and issued an Amended Scheduling Order, as more fully set forth therein. On December 18, 2015, ATTORNEY 2 filed an Entry of Appearance as Co-Counsel for the Protestants.

On January 26, 2016, the parties filed Joint Stipulation of Facts and Issues, with Exhibits 1 through 21, attached thereto.

On February 8, 2016, the Division filed its Reply Brief to the Protestants' Brief filed December 3, 2015. On February 8, 2016, the Protestants filed their Response Brief to the Division Pretrial Brief filed December 3, 2015. On February 9, 2016, the ALJ closed the record and this matter submitted for decision on February 8, 2016.

On March 28, 2016, the ALJ advised the parties in pertinent parts, as follows, to-wit:

> On December 8, 2015, the ALJ held Teleconferences with Counsel on the captioned matter at 11:00 a.m. and 12:51 p.m. During the 11:00 a.m. Teleconference, the ALJ brought to Counsels' attention, that the record did not contain basic foundational documents reflecting that LLC or HOLDING COMPANY were registered with the Oklahoma Secretary of State.
>
> The ALJ also informed Counsel that the ALJ routinely takes judicial notice (710:1-5-36 (July 11, 2013)) of the Oklahoma Secretary of State's website at https://www.sos.ok.gov to verify basic foundation

[8] The Division did not attach any Exhibits to its Brief.

> facts, and according to Oklahoma Secretary of State's website, neither entity is shown as being registered to do business in the State of Oklahoma.
>
> During the 12:51 p.m. Teleconference, ATTORNEY 1 mentioned that he had spoken with PETROLEUM COMPANY'S General Counsel, who indicated that the entities had to be registered with Oklahoma Secretary of State, but the record is silent as to these matters.
>
> The ALJ is pulling this matter from decision, and opening the record for the Protestants to provide the following:
>
> - LLC'S registration with the Oklahoma Secretary of State
>
> HOLDING COMPANY's registration with the Oklahoma Secretary of State.
>
> - Certificate of Merger filed with the Oklahoma Secretary of State.
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> The ALJ directs the Protestants to provide the requested documents **on or before Wednesday, April 27, 2016.** If the Protestants provide the documents, the ALJ will close the record and resubmit this matter for decision.
>
> If the entities did not register to do business with the Oklahoma Secretary of State, the ALJ directs the Protestants to file a Status Report **on or before Wednesday, April 27, 2016.** The ALJ will direct the parties to file Supplemental Briefs addressing the failure to register, and what effect, if any, the failure to register has on the captioned matter. (Emphasis original.)

On April 26, 2016, the Protestants filed the Taxpayers' Status Report, with Annex I and Annex II, attached.

On May 2, 2016, the ALJ acknowledged the filing of the Taxpayers' Status Report, identifying Annex 1, as ALJ 1, and Annex 2, as ALJ 2, which the ALJ admitted into evidence. The ALJ closed the record and submitted this matter for decision as of May 2, 2016.

JOINT STIPULATION OF FACTS AND ISSUES

On January 26, 2016, the parties filed Joint Stipulation of Facts and Issues,[9] 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 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. Unless otherwise stated, the parties waive all rights to object to any stipulation herein on any grounds, except as to relevancy. All Exhibits to the Stipulation are made a part of and incorporated into the Stipulation.

II. STATEMENT OF THE ISSUES

The parties agree and stipulate that the main issue to be determined in this matter is whether Protestants qualify for the Oklahoma Capital Gains Deduction, 68 O.S. 2011, § 2358(F), as claimed on their 2012 Oklahoma income tax return for the sale of stock of HOLDING COMPANY, specifically, whether HOLDING COMPANY meets the definition of an "Oklahoma company, limited liability company, or partnership" as defined by Section 2358(F)(2)(c). In evaluating whether HOLDING COMPANY meets that definition, the following issues must be decided:

1. Whether the merger of LLC with and into HOLDING COMPANY was a mere change of the form of legal organization of the same company;

2. Whether Protestants are entitled to "tack" the headquarters periods of HOLDING COMPANY and LLC in order to meet the three year headquarters period; and

3. Whether HOLDING COMPANY maintained its primary headquarters in Oklahoma for a three year period prior to Protestants' sale of stock.

[9] 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 (9TH ed. 2009), available at http://westlaw.com.

III. PROCEDURAL FACTS

1. Protestants filed their amended 2012 Oklahoma individual income tax return on or about November 13, 2013. Exhibit 3.

2. By letter dated December 6, 2013, the Division proposed to adjust Protestants' amended 2012 return based on its disallowance of Protestants' claim for the Oklahoma Capital Gains Deduction. Exhibit 1.

3. By letter dated January 28, 2014, Protestants timely protested the Division's proposed adjustment. Exhibit 2.

4. The Protestants protest is properly before the Administrative Law Judge.

IV. GENERAL FACTS

5. LLC was a limited liability company organized under the laws of the state of Delaware. Exhibit 5. The original Limited Liability Company Agreement for LLC was executed on May 21, 2007. See Exhibit 6, p. 1 ("Background").

6. LLC maintained its primary headquarters in Tulsa, Oklahoma from its date of formation through the date of merger; the sole asset of LLC was ownership of 100% of the stock of PETROLEUM COMPANY.

7. Protestants acquired their ownership interests in LLC on April 7, 2009, and September 18, 2009. See Exhibit 4.

HOLDING COMPANY is a corporation organized under the laws of the state of Delaware. The Certificate of Incorporation for HOLDING COMPANY was filed with the Delaware Secretary of State on August 12, 2011. Exhibit 7.

8. HOLDING COMPANY has maintained its primary headquarters in Tulsa, Oklahoma from its date of formation.

9. In 2011, HOLDING COMPANY and LLC entered into an Agreement and Plan of Merger. Exhibit 12.

10. On December 19, 2011, the Certificate of Merger of LLC with and into HOLDING COMPANY was filed with the Delaware Secretary of State. Exhibit 13. Upon consummation of such merger, HOLDING COMPANY owned 100% of the stock of PETROLEUM COMPANY.

V. ADDITIONAL INFORMATION

11. PETROLEUM COMPANY was a corporation organized under the laws of the state of Delaware. The Certificate of Incorporation for PETROLEUM

COMPANY was filed with the Delaware Secretary of State on October 10, 2006. Exhibit 15.

12. PETROLEUM COMPANY has maintained is primary headquarters in Tulsa, Oklahoma from its date of formation.

13. PETROLEUM COMPANY registered to do business in the state of Oklahoma on October 27, 2006. Exhibit 16.

14. On December 30, 2013, the Certificate of Ownership merging PETROLEUM COMPANY into HOLDING COMPANY., and changing the name of the surviving corporation into "PETROLEUM COMPANY[,"] was filed with the Secretary of State of Delaware. Exhibit 17. Subsequent to such merger, the surviving corporation (formerly known as HOLDING COMPANY.) filed its Certificate of Qualification with the Secretary of State of Oklahoma on January 9, 2014. Exhibit 18.

VI. JOINT EXHIBITS

The parties stipulate to the authenticity of the following exhibits while preserving all rights to object to any listed document on any grounds, including, but not limited to, the ground of relevancy.

1. December 6, 2013 Adjustment Letter;
2. January 28, 2014 Protest Letter, with attachments;
3. 2012 Oklahoma Amended Resident Individual Income Tax Return, Form 511 X, filed by Protestants;
4. 2012 Amended U.S. Individual Income Tax Return, Form 1040X, filed by Protestants;
5. Articles of Organization of LLC, filed with the Delaware Secretary of State on May 17, 2007;
6. Second Amended and Restated Limited Liability Company Agreement of LLC;
7. Certificate of Incorporation of HOLDING COMPANY filed with the Delaware Secretary of State on August 12, 2011.
8. Amended and Restated Certificate of Incorporation of HOLDING COMPANY, filed with the Delaware Secretary of State on December 19, 2011;
9. Bylaws of HOLDING COMPANY.;
   HOLDING COMPANY Amended and Restated Bylaws;
10. Excerpts from the Prospectus for HOLDING COMPANY.
11. Agreement and Plan of Merger by and between LLC and HOLDING COMPANY.;
12. Certificate of Merger of LLC with and into HOLDING COMPANY, filed with the Delaware Secretary of State on December 19, 2011;

13. Form S-1 Registration Statement for HOLDING COMPANY filed with the United States Securities and Exchange Commission on October 2, 2012;
14. Certificate of Incorporation of PETROLEUM COMPANY, filed with the Delaware Secretary of State on October 10, 2006;
15. Certificate for Qualification of PETROLEUM COMPANY, filed with the Oklahoma Secretary of State on October 27, 2006;
16. Certificate of Ownership merging of PETROLEUM COMPANY with and into HOLDING COMPANY, and changing the name of the surviving corporation to "PETROLEUM COMPANY", filed with the Secretary of State of Delaware on December 30, 2013;
17. Post-merger Certificate of Qualification of PETROLEUM COMPANY (formerly known as HOLDING COMPANY), filed with the Oklahoma Secretary State on January 9, 2014;
18. Form 10-K of PETROLEUM COMPANY filed with the United States Securities and Exchange Commission on February 26, 2015;
19. Affidavit of AFFIANT;
20. Affidavit of HUSBAND.

FINDINGS OF FACT

Upon review of the file and records, including the record of the proceedings, the exhibits received into evidence, the briefs, Stipulations, and Protestant's May 2, 2016 Status Report, the undersigned finds:

21. The Operating Company registered to do business in the State of Oklahoma on October 27, 2006.[10]

22. Based on the fact that the LLC's sole asset/activity was ownership of the stock of the Operating company, company management concluded that it was not necessary to register the LLC to do business in Oklahoma; thus no Certificate of Qualification was filed for the LLC with the Oklahoma Secretary of State. *See* Paragraph 5 of the Affidavit of HUSBAND, attached as Exhibit 3 to the Joint Stipulations.[11]

23. Based on the fact that the Holding Company's sole asset/activity was ownership of the stock of the Operating Company, company management concluded that it was not necessary to register the Holding Company to do

[10] *See* Taxpayers' Status Report. *See also* ALJ 1, and Paragraph 14 of Article V (Additional Information) of the Joint Stipulations and Exhibit 16 to the Joint Stipulations.

[11] *Id.*

business in Oklahoma; thus no Certificate of Qualification was filed for the Holding Company with the Oklahoma Secretary of State.[12]

24. The Operating Company was merged with and into the Holding Company on December 30, 2013, with the name of the surviving corporation being changed to "PETROLEUM COMPANY." (*i.e.*, the name previously used by the Operating Company). Subsequent to such merger, the surviving corporation filed its Certificate of Qualification with the Oklahoma Secretary of State on January 9, 2014.[13]

CONCLUSIONS OF LAW

1. The Legislature vested the Oklahoma Tax Commission with jurisdiction over the parties and subject matter of this proceeding.[14]

2. The Act imposes an income tax upon the Oklahoma Taxable Income of every resident or non-resident individual who earns income within Oklahoma.[15]

3. The beginning point of determining Oklahoma Taxable Income is Federal Adjusted Income.[16]

4. Any term used in the Act shall[17] 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

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[12] *Id. See Paragraph 8 of the Affidavit of HUSBAND, attached to Exhibit 3 to the Joint Stipulations.*

[13] *Id. See* ALJ 2, and Paragraph 15 of Article V (Additional Information) of the Joint Stipulations and Exhibits 17 and 18 to the Joint Stipulations.

[14] OKLA. STAT. ANN. tit. 68, § 207 (West 2014).

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

[16] OKLA. STAT. ANN. tit. 68, § 2353(13) (West 2008):

> "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;

[17] "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.

shall[18] be the same for all purposes material hereto as they are for federal income tax purposes except when the Act specifically provides otherwise.[19]

5. A taxpayer's income tax liability is determined in accordance with the law in effect at the time the income is received.[20]

6. The text of Section 2358(F) of Title 68 ("Deduction") for the 2012 Tax Year is as follows,[21] to-wit:

> F.1. For taxable years beginning after December 31, 2004, a deduction from the Oklahoma adjusted gross income of any individual taxpayer shall be allowed for qualifying gains receiving capital treatment that are included in the federal adjusted gross income of such individual taxpayer during the taxable year.
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> 2. As used in this subsection:
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> a. "qualifying gains receiving capital treatment" means the amount of net capital gains, as defined in Section 1222(11) of the Internal Revenue Code, included in an individual taxpayer's federal income tax return that result from:
>
> > (1) the sale of real property 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,
> > (2) the sale of stock or the sale of a direct or indirect ownership interest in an Oklahoma company, limited liability company, or partnership where such stock or ownership interest has been directly or indirectly owned by the individual taxpayer for a holding period of at least two (2) years prior to the date of the transaction from which the net capital gains arise, or
> > (3) the sale of real property, tangible personal property or intangible personal property located within Oklahoma as part of the sale of all or substantially all of the assets of an Oklahoma company, limited liability company, or partnership or an

[18] *Id.*

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

[20] *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.

[21] OKLA. STAT. tit. 68, § 2358(F) (West Supp. 2010).

> Oklahoma proprietorship business enterprise where such property has been directly or indirectly owned by such entity or business enterprise or owned by the owners of such entity or business enterprise for a period of at least two (2) years prior to the date of the transaction from which the net capital gains arise,

b. "holding period" means an uninterrupted period of time. The holding period shall include any additional period when the property was held by another individual or entity, if such additional period is included in the taxpayer's holding period for the asset pursuant to the Internal Revenue Code,

c. "Oklahoma company," "limited liability company," or "partnership" means an entity whose primary headquarters have been located in Oklahoma for at least three (3) uninterrupted years prior to the date of the transaction from which the net capital gains arise,

d. "direct" means the individual taxpayer directly owns the asset,

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 property or tangible personal property located within Oklahoma, the deduction described in this subsection shall not apply unless the pass-through entity that makes the sale has held the property for not less than five (5) uninterrupted years prior to the date of the transaction that created the capital gain, and each pass-through entity included in the chain of ownership has been a member, partner, or shareholder of the pass-through entity in the tier immediately below it for an uninterrupted period of not less than five (5) years.
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> (2) With respect to sales of stock or ownership interest in or sales of all or substantially all of the assets of an Oklahoma company, limited liability company, partnership or Oklahoma proprietorship business enterprise, the deduction described in this subsection shall not apply unless the pass-through entity that makes the sale has held the stock or ownership interest for not less than two (2) uninterrupted years prior to the date of the transaction that created the capital gain, and each pass-through entity included in the chain of ownership has been a member, partner or shareholder of the pass-through entity in the tier immediately below it for an uninterrupted period of not less than two (2) years. For purposes of this division, uninterrupted ownership prior to the effective date of this act shall be included in the determination of the required holding period prescribed by this division, and

> f. "Oklahoma proprietorship business enterprise" means a business enterprise whose income and expenses have been reported on Schedule C or F of an individual taxpayer's federal income tax return, or any similar successor schedule published by the Internal Revenue Service and whose primary headquarters have been located in Oklahoma for at least three (3) uninterrupted years prior to the date of the transaction from which the net capital gains arise.

7. 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.[22]

8. The Tax Commission Rule on the Deduction[23] for the 2012 Tax Year is as follows, to-wit:

> (a) **General provisions.** For tax years beginning on or after January 1, 2005, individual taxpayers can subtract from the Oklahoma adjusted gross income, gains reported on their Oklahoma income tax return and included in federal taxable income receiving capital treatment. The gain must be realized on or after January 1, 2005, in order to be eligible for the Oklahoma exclusion. Effective for tax years beginning on or after January 1, 2006 corporate taxpayers can subtract from the Oklahoma taxable income, gains reported on their Oklahoma income tax return and included in federal taxable income receiving capital treatment. For corporate taxpayers the gain must be realized on or after January 1, 2006 in order to be eligible for the Oklahoma exclusion.
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> (b) **Qualifying gains receiving capital treatment.** As used in this Section, **"qualifying gains receiving capital treatment"** means the amount of net capital gains, as defined under Internal Revenue Code Section 1222(11), [IRC §1222(11)]. The gain must be included in the federal income tax return of the taxpayer.
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> (1) **Sale of real or tangible personal property.** To qualify for the Oklahoma deduction, the gain must be earned as a result of the sale of real or tangible personal property located within Oklahoma. Taxpayers must have held the asset for not less than five (5) uninterrupted years prior to the date of the transaction that created the capital gain.
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> (2) **Sale of stock or ownership interest.** To qualify for the Oklahoma deduction, the gain must be earned as a result of the sale of stock or ownership interest in an Oklahoma company, limited liability company, or partnership and the

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

[23] OKLA. ADMIN. CODE § 710:50-15-48 (June 25, 2007).

stock or ownership interest must have been held by the taxpayer for at least three (3) uninterrupted years prior to the date of the transaction that created the capital gain. For tax year 2006 and subsequent tax years, the stock or ownership interest must have been held by the individual taxpayer for at least two (2) uninterrupted years prior to the date of the transaction that created the capital gain. Non individual taxpayer's stock or ownership interest must have been held for at least three (3) uninterrupted years prior to the date of the transaction that created the capital gain.

(3) **Sale of real or tangible personal property by pass-through entities.** Net capital gains earned by member, partner, or shareholder of a pass-through entity as a result of the sale of real or tangible personal property located within Oklahoma, and included in the a {sic} taxpayer's federal taxable income is excludable, provided that the taxpayer has been a member of the pass-through entity for an uninterrupted period of five (5) years and that the pass-through entity has held the asset for not less than five (5) uninterrupted years prior to the date of the transaction that created the capital gain.

(4) **Sale of stock or ownership interests by pass-through entities.** Net capital gains earned by a member, partner, or shareholder of a pass-through entity as a result of the sale of stock or an ownership interest in an Oklahoma company, limited liability company, or partnership, is excludable, provided that the taxpayer has been a member of the pass-through entity for an uninterrupted period of three (3) years and that the pass-through entity has held the asset for not less than three (3) uninterrupted years prior to the date of the transaction that created the capital gain. For tax year 2006 and subsequent tax years, the stock or ownership interest must have been held by the individual taxpayer for at least two (2) uninterrupted years prior to the date of the transaction that created the capital gain. Non individual taxpayer's stock or ownership interest must have been held for at least three (3) uninterrupted years prior to the date of the transaction that created the capital gain.

(5) **Installment sales.** Qualifying gains included in an individual taxpayer's federal taxable income for years after December 31, 2004, or a corporate taxpayer's federal taxable income for years after December 31, 2005, which are derived from installment sales are eligible for exclusion, provided the appropriate holding periods are met.

(c) **"Oklahoma company", "limited liability company", "partnership".** An Oklahoma company, limited liability company, or partnership is one whose primary headquarters has been located in Oklahoma for at least three (3) years prior to the capital gain transaction. The Oklahoma company, limited liability company, or partnership must meet the three (3) year rule for an uninterrupted period.

9. 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.[24] Statutory construction presents a question of law.[25]

10. Where the Legislature is made repeatedly aware of the operation of the statute according to the construction placed upon it by an agency and the Legislature has not expressed its disapproval with the agency's construction, the Legislature silence may be regarded as acquiescence in the agency's construction;[26] and the agency's construction is given controlling weight and will not be disregarded except in cases of serious doubt.[27]

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

12. The Deduction is a tax exemption or deduction statute, not a tax levying statute; and as such, it must be strictly construed unless authority for the deduction is clearly expressed.[29]

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

[25] *Id.* at ¶ 6.

[26] *R.R. Tway, Inc. v. Oklahoma Tax Commission*, 1995 OK 129, 910 P.2d 972.

[27] *Cox v. Dawson*, 1996 OK 11, 911 P.2d 272.

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

[29] *Id.*

13. 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.[30]

14. 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.[31]

15. In all proceedings before the Tax Commission, the taxpayer has the burden of proof.[32] A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect and in what respects.[33]

DISCUSSION

In *CDR*,[34] the Supreme Court of Oklahoma held that the "…[D]eduction for capital gains for taxpayers that were headquartered in Oklahoma for three years prior to the sale that triggered the gains does not violate Dormant Commerce Clause." In that case, CDR's headquarters was

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

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

[32] 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.

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

[34] *CDR Systems Corp. v. Oklahoma Tax Comm'n*, 2014 OK 31, 339 P.3d 848.

not in the State of Oklahoma for three years prior to the sale as required by the Deduction. Specifically, CDR's primary headquarters was located out-of-state.

This matter presents a case of first impression, Whether HOLDING COMPANY ("HOLDING COMPANY") meets the definition of an "Oklahoma company, limited liability company, or partnership" as defined by Section 2358(F)(2)(c), based on the following issues,[35] to-wit:

> 1. Whether the merger of LLC ("LLC") with and into HOLDING COMPANY was a mere change of the form of legal organization of the same company;
>
> 2. Whether Protestants are entitled to "tack" the headquarters periods of HOLDING COMPANY and LLC in order to meet the three year headquarters period; and
>
> 3. Whether HOLDING COMPANY maintained its primary headquarters in Oklahoma for a three year period prior to Protestants' sale of stock.

There is no dispute that the LLC maintained its primary headquarters in Tulsa, Oklahoma, from the date of the LLC's formation (May 21, 2007)[36] through the date of merger (December 11, 2011)[37] and that HOLDING COMPANY maintained its primary headquarters in Tulsa, Oklahoma from its date of formation.[38] There is no dispute the Protestants' meet the two (2) year holding period required for the stock sale.[39]

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[35] *See* Statement of the Issues at 5 at 2.

[36] *Id. See* General Fact 5 at 2.

[37] *See* General Fact 11 at 3.

[38] *See* General Facts 6 and 9 at 7.

[39] *See* Division's Brief at 7-8. The Protestants acquired ownership interests in LLC on April 7, 2009, and September 18, 2009. Pursuant to the Agreement and Plan of Merger, the Protestants' exchanged their LLC units for HOLDING COMPANY stock. Because of the structure of the merger transaction, Protestants' holding period in the HOLDING COMPANY stock includes the period of time during which they held their ownership interest in LLC. *See also* IRC §§ 358(a) and 1223(1). Section 2358(F)(2)(b), expressly provides for inclusion of a prior holding period when such holding period is

The issue is "Whether the merger of LLC into HOLDING COMPANY was a mere change in the form of legal organization of the same company, and if so, whether the Protestants are entitled to "tack" the headquarters periods of LLC (May 21, 2007 to December 11, 2011) and HOLDING COMPANY (December 11, 2011 to December 30, 2013) to meet the requirement of Section 2358(F)(2)(c), which states as follows,[40] to-wit:

> "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,

The Protestants assert "…under the legal theories of 'mere continuation,' 'continuity of business enterprise,' and 'successor liability,' the law treats the LLC and HOLDING COMPANY , as the same company, both before the merger when it operated as a limited liability company, and after the merger as it operates as a corporation."[41] In support of their assertion, the Protestants cite to the Oklahoma Supreme Court's decision in *Crutchfield*,[42] a case of first impression. In *Crutchfield*,[43] the Court held "Employer corporation's successor once-removed was not a 'mere continuation' of employer, and thus could not be liable to former employee for employee's unpaid severance compensation, since employer's corporate entity did not continue after sale from successor to successor once-removed; employer, successor, and successor once-removed had no common directors or officers, employer and successor sold assets for adequate

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included for the asset pursuant to the Internal Revenue Code, which is commonly referred to as "tacking." On June 18, 2012 and December 20, 2012, the Protestants' sold their stock. *See* Stipulated Exhibits 3-4.

[40] *See* Note 21, *supra.*

[41] Taxpayers' Pretrial Brief at 6.

[42] *Id. Crutchfield v. Marine Power Engine Co.*, 2009 OK 27, 209 P.3d 295.

[43] *Id.*

consideration, and employer maintained only a de jure existence after sale of all of its assets."[44] As a general rule, when one company sells or otherwise transfers all of its assets to another company, the successor is not liable for the debts and liabilities of the seller.[45] Exceptions to the rule are as follows,[46] to-wit:

1. an agreement to assume such debts or liabilities;
2. the corporations are consolidated or merger;
3. the transaction was fraudulent; or
4. the purchasing corporation is a mere continuation of the selling company.[47]

The Protestants state, "As the facts set forth above clearly show, the LLC and the Corporation are the same 'Oklahoma company [,][‘] with the same assets, operations and key personnel, which has had its primary headquarters in Tulsa, Oklahoma, since its inception in 2007."[48]

The Division replies, "The gains at issue arose from Protestants' sale of stock of [HOLDING COMPANY] on June 19, 2012, and December 20, 2012. In order for the gains to qualify for the Deduction, [HOLDING COMPANY] would need to have maintained its primary headquarters in Oklahoma for an uninterrupted three year period immediately prior to the sales. Therefore, for the portion of the stock sold on June 19, 2012, [HOLDING COMPANY] must have been headquartered in Oklahoma since at least June 19, 2009; for the portion of the stock sold on December 20, 2012, [HOLDING COMPANY] must have been headquartered in

[44] *Id.* (Citations omitted.)

[45] *Id. See Pullis v. United States Elec. Tool Co.*, 1977 OK 36, 561 P.2d 68.

[46] *Id.* (Citations omitted.)

[47] *Id.* "The mere continuation exception covers a re-organization of a corporation." "We specifically noted the lack of any of the following facts in the record concerning the predecessor corporation after the sale: the makeup of its management and ownership; the number of its employees; its location; the extent of its assets and business activities; and the duration of its existence."

[48] Taxpayers' Pretrial Brief at 6. *See* Stipulated Exhibit 21.

Oklahoma since at least December 20, 2009. …shows that [HOLDING COMPANY] did not come into existence until its formation on August 15, 2011, which is approximately two years short of the three year headquarters period required to qualify for the Deduction."[49] The Division citing *Wells Fargo*,[50] "that in a merger, 'the acquired and acquiring corporations have no post-merger existence beyond the surviving corporation," and that "following a merger, the law treats the acquired corporation as though it has always been part of the surviving entity."[51] Here, the surviving entity following the merger is [HOLDING COMPANY], which was formed on August 15, 2011. At the time of the sale of stock in 2012, [HOLDING COMPANY] had not been in existence for three years as required by [Deduction]. Therefore, the requirements of the Deduction cannot be met, and Protestants are not entitled to the Deduction for gains related to the sale of [HOLDING COMPANY] stock.[52] Federal rules on tacking relate specifically to calculation of a holding period for federal purposes. …The federal holding period provisions have no bearing on ***where*** an entity's headquarters is located, not the length of time during which that headquarters is located in a particular state. (Emphasis original.) As no comparable provision exists in the Internal Revenue Code, reference to the federal tacking rules for purposes of determining a headquarters period is inappropriate. Further, the plain language of the Deduction specifically allows application of federal tacking for purposes of determining a taxpayer's holding period for purposes of the Deduction, but no similar language exists in the definition of "Oklahoma company," in section 2358(F)(2)(c). The Legislature could have

[49] Division's Brief at 8-9.

[50] *Id.* at 12. *Wells Fargo v. Co. v. United States*, 117 Fed.Cl. 30, 114 A.F.T.R.2d 2014-5021, 2014-2 USTC P 50,344.

[51] *Id.*

[52] Division's Brief at 12.

included such language if it intended to allow tacking for purposes of determining a headquarters period."[53]

The Protestants respond, "The merger was effectuated to merely change the form of legal entity in order to change to a corporation status for the IPO. The sole asset of the LLC pre-merger and [HOLDING COMPANY] post-merger was 100% of the outstanding stock of the operating Company.[54] "The [Division] has also argued in its Brief that tax exemptions and credits are strictly construed. [Protestants] do not dispute this fact. However, [Division] has been anything but uniform in the way it applies statutory exemptions through the years, and more specifically, how it treats companies involved in a corporate restructuring."[55] The Protestants cite *TPQ*,[56] where there was an engineering company already in existence, and a corporate management group formed a holding company to acquire all of the stock of the engineering company. The parent company then filed for an investment credit based upon its hiring of "new workers" from the engineering firm. The OTC took the position that the statute required a net increase in the number of full-time employees after the investment, and the only difference in the company was new ownership. The OTC argued the acquisition of all the stock of the engineering firm by the holding company was only a change in corporate form. The Oklahoma

[53] *Id.* at 13.

[54] Taxpayers' Response at 1. *See* Stipulated Exhibits 20-21. "[HOLDING COMPANY] was formed August 12, 2011. [HOLDING COMPANY] did not have any assets or actual business operations prior to the Merger …" On October 27, 2006, PETROLEUM COMPANY registered to do business in the State of Oklahoma. *See also* Stipulations 14-15, and 18. On December 30, 2013, [HOLDING COMPANY] changed its name to PETROLEUM COMPANY"

[55] *Id.* at 4.

[56] *Id. TPQ Inv. Corp. v. State ex rel. Oklahoma Tax Com'n*, 1998 OK 13, 954 P.2d.

Supreme Court agreed with the OTC's position, and disallowed the credit sought because the two companies were really just part of a corporate restructuring.[57]

The Division replies, "While the Deduction does not prohibit a change in form or structure of an entity, the facts of this matter show that no mere change in form or structure occurred."[58] "While the 'idea behind the merger' may have been conversion for purposes of restructuring the companies …the form of the merger must control."[59] "The federal holding period provisions have no bearing on *where* an entity's headquarters is located, nor the length of time during which that headquarter is located in a particular state. (Emphasis original.) As no comparable provision exists in the Internal Revenue Code, reference to the federal tacking rules for purposes of determining a headquarters period is inappropriate."[60] "The Legislature exercised that authority in defining an 'Oklahoma company,'…as an entity having its primary headquarters located in Oklahoma for *at least* three (3) uninterrupted years prior to the date of the transaction giving rise to the gains. (Emphasis original.) If the Legislature had intended to allow two entities to tack their headquarters periods together to meet that requirement, it had the ability to do so. No such language appears in the statute."[61] "Documentation reviewed by the Division…shows that [HOLDING COMPANY] did not come into existence until its formation on August 15, 2011, which is approximately two years short of the three year headquarters period required to qualify for the Deduction."[62]

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[57] *Id.*

[58] *See* Division's Reply Brief at 3.

[59] *Id.* at 6. *See* Protestants' Pretrial Brief at 6.

[60] *Id.* at 7.

[61] *Id.* at 10-11.

[62] Division's Brief at 9.

In *CDR*,[63] the Supreme Court of Oklahoma held "Most if not all states, have tax incentives whose primary purpose is to attract business to the state and to promote economic development within the state. Oklahoma is no different. The Oklahoma Capital Gains Deduction was passed by the Legislature to promote significant business investment in Oklahoma's economy." As previously noted, the "primary headquarters" for CDR was located **out-of-state**. In this matter, that is not the case. LLC's premerger "primary headquarters" has been located at the same address in Tulsa, Oklahoma since May 21, 2007 and remains at that address, post-merger.[64]

The Division emphasizes that the Deduction specifically provides that the Protestants can "tack" the inclusion of the pre-merger holding period of the stock to meet the two (2) year holding requirement,[65] and denying the "tacking" of the pre-merger headquarters period to meet the three (3) year headquarter requirement, because the corporate reorganization was a merger; instead of a conversion.[66] The Oklahoma Supreme Court's test in *Pullis*[67] includes both merger and consolidation, without distinguishing between the choices of corporate reorganization.

Paraphrasing the Tax Commission's reasoning in another statutory interpretation case, since legislation is never read in isolation, nor applied in a vacuum, there is a duty when construing a statute to do so harmoniously with other provisions of the Act, it is reasonable to assume that an understanding and awareness of one provision of the Act would be influenced by

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[63] *See* Note 34, *supra.*

[64] *See* Notes 36-38, *supra.*

[65] *See* Notes 21, 23, and 39, *supra.*

[66] Division's Brief at 9-12.

[67] *See* Note 45, *supra.*

awareness of the provisions of entire Act.[68] Such is the case in this matter; the Division's interpretation is read in isolation, so that the Division's interpretation of "Oklahoma Company" defeats the purpose of the Deduction, "…to attract business to the state and to promote economic development within the state."[69] HOLDING COMPANY is a "mere continuation" of the LLC. As such, the Protestants are entitled to "tack" the headquarters periods of LLC and HOLDING COMPANY in order to meet the three (3) year headquarters period contained in the Deduction. This conclusion is in accord with Legislative intent, and brings continuity to the Division's treatment of corporate reorganizations pursuant to the Deduction, *TPQ*,[70] and *CDR*.[71]

CONCLUSION

The Protestants have met their burden of proof, by preponderance of the evidence, that the Division's disallowance of the Deduction was incorrect, and in what respects.

RECOMMENDATIONS

The ALJ recommends granting the protest, based upon the facts and circumstances set forth.

ERRATA SHEET

NOW on this _____ day of July 2016, the above-styled and captioned matter comes on for consideration of errors appearing in the *Findings, Conclusions and Recommendations* issued June 30, 2016. The ALJ finds the following errors, as follows, to-wit:

Page 4: On February 9, 2016, the ALJ closed the record and this matter submitted for decision on February 8, 2016.

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[68] *See* OTC Order No. 2013-01-15-04 (January 15, 2013). (Citations omitted.)

[69] *See* Note 34, *supra.*

[70] *See* Note 56, *supra.*

[71] *See* Note 34, *supra.*

Page 7: 15. On December 30, 2013, the Certificate of Ownership merging PETROLEUM COMPANY into HOLDING COMPANY, and changing the name of the surviving corporation into "PETROLEUM COMPANY[,"] was filed with the Secretary of State of Delaware.

Page 9: Upon review of the file and records, including the record of the proceedings, the exhibits received into evidence, the briefs, Stipulations, and Protestant's May 2, 2016 Status Report, the undersigned finds:

25. The Operating Company was merged with and into the Holding Company on December 30, 2013, with the name of the surviving corporation being changed to "PETROLEUM COMPANY" (*i.e.*, the name previously used by the Operating Company). Subsequent to such merger, the surviving corporation filed its Certificate of Qualification with the Oklahoma Secretary of State on January 9, 2014.**[**13**]**

Page 10: Footnote 14 should read OKLA. STAT. ANN. tit. 68, § 207 (West 2014).

Page 14: (3) **Sale of real or tangible personal property by pass-through entities.** Net capital gains earned by member, partner, or shareholder of a pass-through entity as a result of the sale of real or tangible personal property located within Oklahoma, and included in the a {sic} taxpayer's federal taxable income is excludable, provided that the taxpayer has been a member of the pass-through entity for an uninterrupted period of five (5) years and that the pass-through entity has held the asset for not less than five (5) uninterrupted years prior to the date of the transaction that created the capital gain.

Page 16: In *CDR*,[34] the Supreme Court of Oklahoma held that the "…[D]eduction for capital gains for taxpayers that were headquartered in Oklahoma for three years prior to the sale that triggered the gains does not violate Dormant Commerce Clause."

Page 17: The issue is "Whether the merger of LLC into HOLDING COMPANY was a mere change in the form of legal organization of the same company, and if so, whether the Protestants are entitled to "tack" the headquarters periods of LLC (May 21, 2007 to December 11, 2011) and HOLDING COMPANY (December 11, 2011 to December 30, 2013) to meet the requirement of Section 2358(F)(2)(c), which states as follows,[40] to-wit:

> "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,

Page 20: …The federal holding period provisions have no bearing on ***where*** an entity's headquarters is located, nor the length of time during which that headquarters is located in a particular state. (Emphasis original.)

Page 21: The parent company then filed for an investment credit based upon its hiring of "new workers" from the engineering firm.

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 2014) and OKLA. STAT. ANN. tit. 75, § 302 (West 2002).