**JURISDICTION:** **OKLAHOMA TAX COMMISSION**
**CITE:** **2018-09-20-04 / NON-PRECEDENTIAL**
**ID:** **P-14-011-H, P-15-063-H**
**DATE:** **SEPTEMBER 20, 2018**
**DISPOSITION:** **DENIED**
**TAX TYPE:** **CORPORATE INCOME**
**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 Post Remand Findings of Fact, Conclusions of Law and Recommendation made and entered by the Administrative Law Judge on the 21st day of September, 2018, appended hereto, together herewith shall constitute the Order of the Commission.

SO ORDERED

## POST REMAND

## FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

**NOW** on this 21st day of September 2018, the above-styled and numbered causes come on for consideration under assignment regularly made by the Oklahoma Tax Commission to ALJ, Administrative Law Judge. PROTESTANT ("Protestant") appears through ATTORNEY 1, and ATTORNEY 2, FIRM. The Compliance Division ("Division"), Oklahoma Tax Commission, appears through DGC, Deputy General Counsel, and AGC, Assistant General Counsel, Office of General Counsel, Oklahoma Tax Commission.

## PROCEDURAL HISTORY

On February 5, 2014 and June 8, 2015, the protest files, respectively, were 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*

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

*Law Judges*.[2] The Court Clerk mailed the Introductory Letters to the Protestant that ALJ, Administrative Law Judge ("ALJ") had been assigned to each matter, and docketed as Case Numbers P-14-011-H and P-15-063-H.

On November 2, 2015, the parties filed a Joint Motion to Consolidate Cases. On November 2, 2015, the ALJ granted the Motion consolidating the captioned cases. On November 3, 2016, the parties filed Joint Stipulation of Facts and Issues, with Joint Exhibits 1 through 26.

On January 4, 2017, the parties filed an Agreed Supplement to Joint Stipulation of Facts and Issues, with Joint Exhibits 27 through 41. On January 24, 2017, the Protestant filed its Brief-In-Chief, with Protestant's Exhibits 48 through 59. On February 9, 2017, the Division filed its Response Brief. On February 16, 2017, the Protestant filed its Reply Brief, with attachments. On March 14, 2017, the parties filed Second Agreed Supplement to Joint Stipulation of Facts and Issues, with Joint Exhibits 42 through 45.

On March 15, 2017, at 9:30 a.m. the ALJ convened a closed hearing.[3] The Protestant called MANAGER, Senior Tax Manager, who testified about Protestant's nexus-creating activities in Oklahoma, including the activities and the relationships of Protestant, PARTNER LLC, and SUBSIDIARY LLC. The Protestant identified and offered a hard copy of a Power Point Presentation of MANAGER, dated March 15, 2017, which the ALJ admitted into evidence as ALJ Exhibit 1. The Division called ADMINISTRATOR, Administrator, Compliance Division, Oklahoma Tax Commission, who testified concerning her training and experience, the

[2] OKLA. ADMIN. CODE §§ 710:1-5-20 through 710:1-5-49.

[3] The Protestant, through ATTORNEY 1, invoked confidentiality. *See* OKLA. STAT. ANN. tit. 68, § 205 (West Supp. 2018). Tr. at 5

conduct of the audit, the decisions made regarding the liabilities of the Protestant, which are under protest, and as custodian of the Division's records.

On May 31, 2017, the ALJ advised the parties to submit Proposed Findings of Fact and Conclusions of Law by August 14, 2017. On August 14, 2017, the parties filed Agreed Correction to the Joint Stipulation of Facts and Issues, and their respective Proposed Findings of Fact and Conclusions of Law. On August 22, 2017, the ALJ acknowledged receipt of the August 14, 2018 filings, closed the record, and submitted this matter for decision.

On May 11, 2018, the ALJ issued Findings, Conclusions, and Recommendations. On July 24, 2018, the Commissioners issued Commission Order No. 2018-07-24-06 remanding these matters with instructions.

## JOINT STIPULATION OF FACTS AND ISSUES

On November 3, 2016, the parties filed Joint Stipulation of Facts and Issues, with Joint Exhibits 1 through 26:

## STATEMENT OF ISSUES

1. Whether Protestant has nexus with the State of Oklahoma under OKLA. ADMIN. CODE § 710:50-17-3.

2. If Protestant does have nexus, what are the correct apportionment factors for the tax years at issue under 68 O.S.§ 2358(A)(5), including whether Protestant may include payroll, property, and sales of its subsidiary company, SUBSIDIARY LLC, in calculating its apportionment factors.

3. Whether the adjustment of Protestant's distributable taxable partnership income from PARTNER LLC and the corresponding adjustment of the Net Operating Loss Deductions was proper. Protestant has raised the specific issue of whether the Division correctly applied existing precedent specifically, Commission Orders Nos. 92-10-21-002 and 91-02-19-018 in allocating partnership income.

4. Whether Protestant's interest income/loss for tax years 2006 and 2007 is interest income derived from unitary business operations which should be apportioned to Oklahoma pursuant to 68 O.S. § 2358(A)(5).

## STATEMENT OF FACTS

**2004 Tax Year**

1. On or about September 18, 2014, Protestant filed an amended Oklahoma corporate income tax return for tax year 2004.

2. On its amended 2004 return, Protestant stated the following:

   a. Protestant had an Oklahoma apportionment factor of 2.2595% on line 5 of the Schedule B;
   b. Protestant reported total payroll within Oklahoma to be $OMITTED and total payroll within and without Oklahoma (less officers' salaries) to be $OMITTED which resulted in a 3.3893% payroll factor;
   c. Protestant reported total sales within Oklahoma to be $OMITTED and total sales within and without Oklahoma to be $OMITTED, which resulted in a 3.3893% sales factor;
   d. Protestant did not claim an Oklahoma Net Operating Loss Deduction;
   e. Protestant claimed $OMITTED in separately allocable partnership income from PARTNER LLC on line 6(a) of Schedule B; and,
   f. Protestant reported its Oklahoma taxable income as –$OMITTED on line 9 of Schedule B;

3. By letter dated March 17, 2015, the Division made the following adjustments to Protestant's 2004 amended return:

   a. Protestant's Oklahoma Apportionment factor was adjusted to 0.00%; and,
   b. Protestant's return was adjusted to reflect a Net Operation Loss Deduction of [$OMITTED];

4. By letter dated May 13, 2015, Protestant timely protested the adjustments to the 2004 tax year, along with the 2005, 2006, and 2007 years.

**2005 Tax Year**

5. On or about September 18, 2014, Protestant filed an amended Oklahoma corporate income tax return for tax year 2005.

6. On its amended 2005 return, Protestant stated the following;

   a. Protestant had an Oklahoma apportionment factor of 1.8283% on line 5 of the Schedule B;
   b. Protestant reported total payroll within Oklahoma to be $OMITTED and total payroll within and without Oklahoma (less officers' salaries) to be $OMITTED which resulted in a 2.7425% payroll factor;
   c. Protestant reported total sales within Oklahoma to be $OMITTED and total sales within and without Oklahoma to be $OMITTED which resulted in a 2.7425 % sales factor;
   d. Protestant reported its Oklahoma taxable income as –$OMITTED on line 9 of Schedule B;
   e. Protestant did not claim an Oklahoma Net Operating Loss Deduction; and,
   f. Protestant claimed $OMITTED in separately allocable partnership income from PARTNER LLC on line 6(a) of Schedule B;

7. By letter dated March 17, 2015, the Division made the following adjustments to Protestant's 2005 amended return:

   a. Protestant's Oklahoma Apportionment factor was adjusted to 0.00%; and,
   b. Protestant's Net Operating Loss Deduction was initially adjusted to [$OMITTED] in a previous December 2013 audit and this number was revised back to $0.00;

8. By letter dated May 13, 2015, Protestant timely protested the adjustments to the 2005 tax year, along with the 2004, 2006, and 2007 years.

**2006 Tax Year**

9. Protestant's originally filed 2006 Oklahoma tax return included a statement which said the following:

> PROTESTANT is filing the Oklahoma Corporation Income Tax Return Form 512, as it is a 94% partner in PARTNER LLC. Apportionment factors are derived from 94% of the business of PARTNER LLC.
>
> PROTESTANT is a Holding Company; it has no employees or gross receipts and carries no inventory or depreciable assets on its own books.

10. In May 2013, Protestant filed an amended Oklahoma corporate income tax return for tax year 2006. On or about September 18, 2014, Protestant filed a second amended Oklahoma corporate income tax return for tax year 2006.

11. On its second amended 2006 return, Protestant stated the following:

    a. Protestant had an Oklahoma apportionment factor of 1.4515% on line 5 of the Schedule B;
    b. Protestant reported total payroll within Oklahoma to be $OMITTED and total payroll within and without Oklahoma (less officers' salaries) to be $OMITTED which resulted in a 2.1773% payroll factor;
    c. Protestant reported total sales within Oklahoma to be $OMITTED and total sales within and without Oklahoma to be $OMITTED which resulted in a 2.1773% sales factor;
    d. Protestant reported its Oklahoma taxable income as $0.00 on line 9 of Schedule B;
    e. Protestant claimed an Oklahoma Net Operating Loss Deduction of [$OMITTED]; and,
    f. Protestant claimed $OMITTED in separately allocable partnership income from PARTNER LLC on line 6(b) of Schedule B;

12. By letter dated March 30, 2015, the Division made the following adjustments to Protestant's second amended 2006 return:

a. Protestant's Oklahoma Apportionment factor was adjusted to 0.00%;
b. Protestant's partnership income from PARTNER LLC was adjusted from $OMITTED to $OMITTED to reflect changes made in an audit of PARTNER LLC;
c. Protestant's interest income of [$OMITTED] was adjusted to be apportioned to Oklahoma rather than allocated to the domiciliary situs of Protestant; and,
d. Protestant's Net Operating Loss Deduction was adjusted to $OMITTED;

13. By letter dated May 13, 2015, Protestant timely protested the adjustments to the 2006 tax year, along with the 2004, 2005, and 2007 years.

**2007 Tax Year**

14. Protestant's originally filed 2007 Oklahoma tax return included a statement which said the following:

> PROTESTANT is filing the Oklahoma Corporation Income Tax Return Form 512, as it is a 94% partner in PARTNER LLC. Apportionment factors are derived from 94% of the business of PARTNER LLC.
>
> PROTESTANT is a Holding Company; it has no employees or gross receipts and carries no inventory or depreciable assets on its own books.

15. On or about May 14, 2013, Protestant filed an amended Oklahoma corporate income tax return for tax year 2007.

16. On its amended 2007 return, Protestant stated the following:

a. Protestant had an Oklahoma apportionment factor of 2.0180% on line 6 of the Schedule B Apportionment Formula;
b. Protestant reported total payroll within Oklahoma to be $OMITTED and total payroll within and without Oklahoma (less officers' salaries) to be $OMITTED which resulted in a 2.9290% payroll factor;

c. Protestant reported total sales within Oklahoma to be $OMITTED and total sales within and without Oklahoma to be $OMITTED which resulted in a 3.1250% sales factor;
d. Protestant claimed $OMITTED in separately allocable partnership income from PARTNER LLC on line 6(b) of Schedule B;
e. Protestant claimed an Oklahoma Net Operating Loss Deduction of [$OMITTED]; and,
f. Protestant reported its Oklahoma taxable income as "None" on line 30 of Schedule A;

17. By letter dated April 1, 2015, the Division made the following adjustments to Protestant's amended 2007 return:

a. Protestant's Oklahoma Apportionment factor was adjusted to 0.00%; and,
b. Protestant's partnership income from PARTNER LLC was adjusted to $OMITTED to reflect changes made in an audit of PARTNER LLC and this income was allocated;
c. Protestant's interest income of [$OMITTED] was adjusted to be apportioned to Oklahoma rather than allocated to the domiciliary situs of Protestant; and,
d. Protestant's Net Operating Loss Deduction was adjusted to [$OMITTED];

18. By letter dated May 13, 2015, Protestant timely protested the adjustments to the 2007 tax year, along with the 2004, 2005, and 2006 years.

**2009 Tax Year**

19. On or about February 28, 2011, Protestant filed its original 2009 corporate income tax return.

20. On its original 2009 return, Protestant stated the following:

a. Protestant had an Oklahoma apportionment factor of 1.2210% on line 6 of the Schedule B Apportionment Formula;
b. Protestant reported no payroll within or without Oklahoma on line 2(c) of the Apportionment formula which resulted in a 0.00% payroll factor;
c. Protestant reported total sales within Oklahoma to be $OMITTED and total sales within and without Oklahoma to be $OMITTED which resulted in a 3.6630% sales factor;

d. Protestant reported its Oklahoma taxable income as $0.00 on line 30 of Schedule A;
e. Protestant claimed an Oklahoma Net Operating Loss Deduction of [$OMITTED]; and,
f. Protestant claimed $OMITTED in separately allocable partnership income from PARTNER LLC on line 6(b) of Schedule B;
g. Protestant's included a statement which said the following:

> PROTESTANT is filing the Oklahoma Corporation Income Tax Return Form 512, as it is a 94% partner in PARTNER LLC.
>
> PROTESTANT is a Holding Company; it has no employees or gross receipts and carries no inventory or depreciable assets on its own books.

21. On or about May 14, 2013, Protestant filed an amended Oklahoma corporate income tax return for tax year 2009.

22. On its amended 2009 return, Protestant stated the following:

a. Protestant had an Oklahoma apportionment factor of 2.4161% on line 6 of the Schedule B Apportionment Formula;
b. Protestant reported total payroll within Oklahoma to be $OMITTED and total payroll within and without Oklahoma (less officers' salaries) to be $OMITTED which resulted in a 3.5854% payroll factor;
c. Protestant reported total sales within Oklahoma to be $OMITTED and total sales within and without Oklahoma to be $OMITTED, which resulted in a 3.6630% sales factor;
d. Protestant claimed $OMITTED in separately allocable partnership income from PARTNER LLC on line 6(b) of Schedule B;
e. Protestant claimed an Oklahoma Net Operating Loss Deduction of [$OMITTED]; and,
f. Protestant reported its Oklahoma taxable income as "None" on line 30 of Schedule A;

23. By letter dated November 6, 2013, the Division made the following adjustments to Protestant's amended 2009 return:

a. The Division adjusted Protestant's reported apportionment factor to 0.00%;

b. Protestant's NOL was denied based on Protestant's failure to make a written election in prior returns to forego the required 2 year carryback per 68 O.S. § 2358(A)(3);
c. Protestant's distributable Oklahoma taxable income from PARTNER LLC was adjusted to reflect changes made during an audit of the PARTNER LLC tax return for this year;

24. By letter dated January 2, 2014, Protestant timely protested the adjustments to the 2009 amended return.

**2010 Tax Year**

25. On or about February 21, 2012, Protestant filed its original 2010 corporate income tax return.

26. On its original 2010 return, Protestant stated the following:

a. Protestant had an Oklahoma apportionment factor of 3.9360% on line 6 of the Schedule B Apportionment Formula;
b. Protestant reported no payroll within or without Oklahoma on line 2(c) of the Apportionment formula which resulted in a 0.00% payroll factor;
c. Protestant reported total sales within Oklahoma to be $OMITTED and total sales within and without Oklahoma to be $OMITTED which resulted in a 3.9360% sales factor;
d. Protestant reported its Oklahoma taxable income as $0.00 on line 30 of Schedule A;
e. Protestant claimed an Oklahoma Net Operating Loss Deduction of [$OMITTED]; and,
f. Protestant claimed $OMITTED in separately allocable partnership income from PARTNER LLC on Line 6(b) of Schedule B;
g. Protestant included a statement which said the following:

> PROTESTANT is filing the Oklahoma Corporation Income Tax Return Form 512, as it is a 94% partner in PARTNER LLC.
>
> PROTESTANT is a Holding Company; it has no employees or gross receipts and carries no inventory or depreciable assets on its own books.

27. On or about May 14, 2013, Protestant filed an amended Oklahoma corporate income tax return for tax year 2010.

28. On its amended 2010 return, Protestant stated the following:

a. Protestant had an Oklahoma apportionment factor of 2.6085% on line 6 of the Schedule B Apportionment Formula;
b. Protestant reported total payroll within Oklahoma to be $OMITTED and total payroll within and without Oklahoma (less officers' salaries) to be $OMITTED which resulted in a 3.8895% payroll factor;
c. Protestant reported total sales within Oklahoma to be $OMITTED and total sales within and without Oklahoma to be $OMITTED, which resulted in a 3.9360% sales factor;
d. Protestant claimed $OMITTED in separately allocable partnership income from PARTNER LLC on line 6(b) of Schedule B;
e. Protestant claimed an Oklahoma Net Operating Loss Deduction of [$OMITTED];
f. Protestant reported its Oklahoma taxable income as "None" on line 30 of Schedule A;

29. By letter dated November 6, 2013, the Division made the following adjustments to Protestant's 2010 amended return:

a. The Division adjusted Protestant's reported apportionment factor to 0.00%;
b. Protestant's NOL was denied based on Protestant's failure to make a written election in prior returns to forego the required 2 year carryback per 68 O.S. § 2358(A)(3);

30. By letter dated January 2, 2014, Protestant timely protested the adjustments to the 2010 amended return.

**Additional Information**

31. By letter dated November 12, 2015, Protestant sent a supplemental protest letter for the 2004, 2005, 2006, 2007, 2009, and 2010 tax years.

32. The Protestant's protest is properly before the Administrative Law Judge.

## AGREED SUPPLEMENT TO JOINT STIPULATION OF FACTS AND ISSUES

On January 4, 2017, the parties filed an Agreed Supplement to Joint Stipulation of Facts and Issues:

## STATEMENT OF FACTS

1. Protestant is the sole owner of SUBSIDIARY LLC.

2. SUBSIDIARY LLC is treated for federal and Oklahoma purposes as a single member LLC, that has not elected to be treated as an entity separate from its parent under US Treas. Reg. Secs. 301.7701-1 through 301.7701.3.

## AGREED CORRECTION TO THE JOINT STIPULATION OF FACTS AND ISSUES

On August 14, 2017, the parties filed Agreed Correction to the *Joint Stipulation of Facts and Issues* filed with the Court on November 3, 2016. The parties agree that the following amendments are necessary to correct and clarify the jointly stipulated facts:

1. All Net Operating Loss Deduction amounts listed in the stipulated facts should be positive numbers;

2. All interest income amounts listed in the stipulated facts should be positive numbers; and,

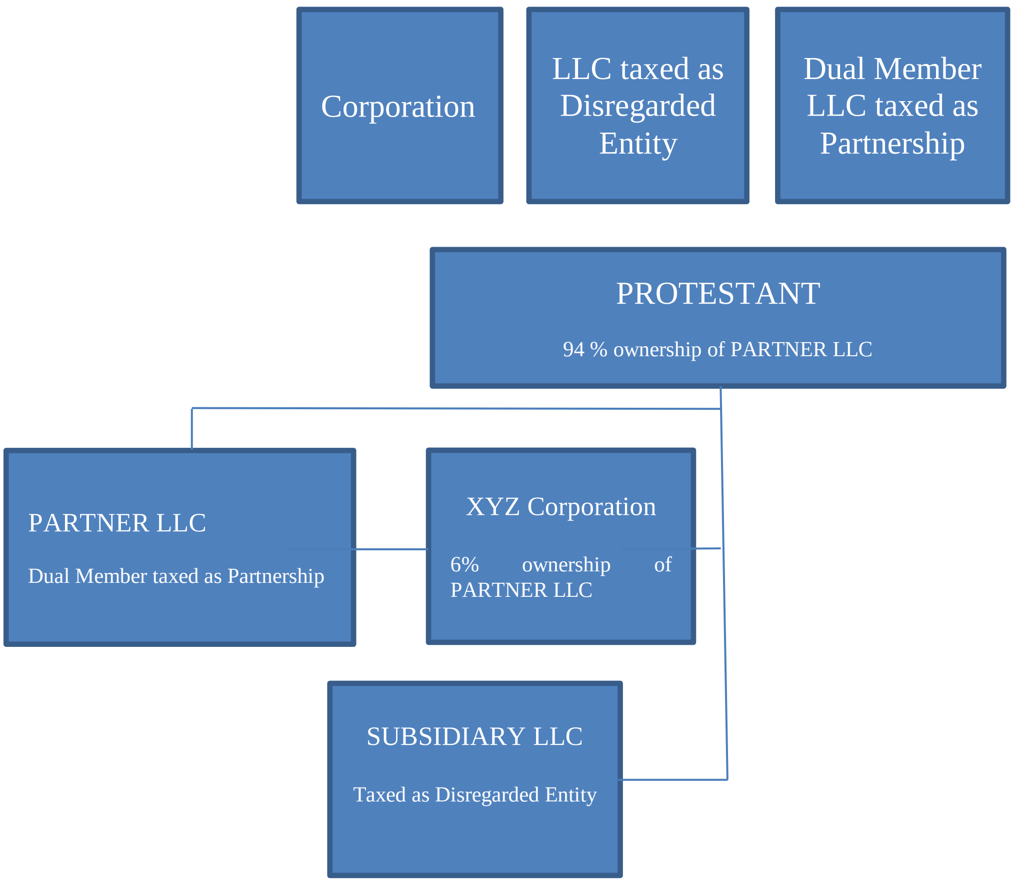
3. Protestant's interest income from the second amended 2006 return was listed in the stipulations as –$OMITTED and should be corrected to $OMITTED.

## ADDITIONAL FINDINGS OF FACT

Upon review of the file and records, including the record of the proceedings, the exhibits received into evidence, the ALJ finds:

1. Protestant's Simplified Structure[4] is:

**Legend**




2. Protestant does not have its own employees acting on its behalf in Oklahoma.

3. Protestant has no withholding account or a sales tax account with the Oklahoma Tax Commission for the 2004, 2005, 2006, 2007, 2009, and 2010 tax years.

[4] *See* ALJ Exhibit 1.

4. PARTNER LLC leased employees from SUBSIDIARY LLC, under an Employee Leasing Agreement.

5. PARTNER LLC reported payroll for the employees it leased from SUBSIDIARY LLC as an expense on its federal partnership returns. Under the Employee Leasing Agreement SUBSIDIARY LLC charged PARTNER LLC for the expenses of the employees plus an additional amount equal to two percent (2%) of the expenses.

6. The Division adjusted the Protestant's Amended Returns for the 2006 and 2007 Tax Years to include Protestant's interest income in apportionable income. Protestant did not provide statements or other documentation with the returns indicating the source of the income.[5]

## CONCLUSIONS OF LAW

1. The Legislature vested the Oklahoma Tax Commission with jurisdiction over the parties and subject matter of this proceeding.[6]

2. The Oklahoma Income Tax Act[7] ("Act") imposes an income tax upon the Oklahoma taxable income of every corporation doing business in Oklahoma or deriving income from sources within the state.[8]

3. Any term used in the Act shall have the same meaning as when used in a comparable context in the Internal Revenue Code, unless a different meaning is clearly required. For all taxable periods covered by the Act, the tax status and all elections of all taxpayers shall be the

[5] Testimony of Administrator. Tr. at 38-39.

[6] OKLA. STAT. ANN. tit. 68, § 221(C) (West 2014).

[7] OKLA. STAT. ANN. tit. 68, § 2351 *et seq.* (West 2017).

[8] OKLA. STAT. tit. 68, § 2355(D) (West 2007).

same for all purposes material hereto as they are for federal income tax purposes except when the Act specifically provides otherwise.[9]

4. The beginning point of determining Oklahoma Taxable Income is Federal Taxable Income.[10]

5. Under the Act, net income from unitary, multistate business operations is apportioned to Oklahoma based on the arithmetical average of three factors consisting of property, payroll and sales or gross revenue.[11]

6. The taxable income of any taxpayer shall be adjusted to arrive at Oklahoma taxable income for corporations and Oklahoma adjusted gross income for individuals, as follows:

> 4. Items of the following nature shall be allocated as indicated. Allowable deductions attributable to items separately allocable in subparagraphs a, b and c of this paragraph, whether or not such items of income were actually received, shall be allocated on the same basis as those items:
>
> a. Income from real and tangible personal property, such as rents, oil and mining production or royalties, and gains or losses, from sales of such property, shall be allocated in accordance with the situs of such property;
>
> b. Income from intangible personal property, such as interest, dividends, patent or copyright royalties, and gains or losses from sales of such property, shall be allocated in accordance with the domiciliary situs of the taxpayer, except that:
>
> 1. where such property has acquired a nonunitary business or commercial situs

[9] OKLA. STAT. tit. 68, § 2353(3) (West 2017).

[10] *See* OKLA. STAT. tit. 68, § 2353(12) (West 2017).

[11] OKLA. STAT. ANN. tit. 68, § 2358(A)(5) (West 2017).

> apart from the domicile of the taxpayer such income shall be allocated in accordance with such business or commercial situs; interest income from investments held to generate working capital for a unitary business enterprise shall be included in apportionable income; …
>
> …
>
> 3. income from such property which is required to be allocated pursuant to the provisions of paragraph 5 of this subsection shall be allocated as herein provided;
>
> c. Net income or loss from a business activity which is not required to be allocated pursuant to the provisions of paragraph 5 of this subsection shall be allocated as herein provided.[12]

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.[13]

8. Any corporation that has "nexus" with the State of Oklahoma is subject to Oklahoma Corporate income taxes.[14]

9. "Unitary income" means income derived from the conduct of each separate business in more than one state, all the factors of which are essential to determining the ultimate gain derived from the business enterprise as a whole, and not from its component parts which are too closely connected and necessary to each other to justify division or separate allocation. Each

[12] OKLA. STAT. ANN. tit. 68, § 2358(A)(4)(a) through (c) (West 2017).

[13] OKLA. STAT. ANN. tit. 75, § 250 *et seq.* (West 2018).

[14] *See* OKLA. ADMIN. CODE § 710:50-17-1(b) and (3) (June 25, 2006).

corporation must calculate its own Oklahoma Taxable Income/Loss separately, even when included in a Consolidated Return.[15]

10. A business that operates in more than one state is a "unitary business" for income tax purposes when operations conducted in one state benefit and are benefited by operations in one or more other states where the various aspects are so interdependent and of such mutual benefit that they are considered to form one integral business.[16]

11. The term "partnership" includes a syndicate, group, pool, joint venture or other unincorporated organization, through or by means of which any business, financial operation or venture is carried on, and which is not a trust or estate or classed as a corporation within the provisions of this article; and the term "partner" includes a member of such syndicate, group, pool, joint venture or organization.[17]

12. Partnership income or loss shall be separately allocated.[18] The Oklahoma distributive share of partnership income as determined under 68 O.S. § 2358 and 68 O.S. § 2362 shall be allocated to Oklahoma.[19]

13. The term "Limited Liability Company" means an organization other than a corporation or partnership, which is organized pursuant to Section 2000 *et seq.* of Title 18 of the Oklahoma Statutes. Except as otherwise specifically provided, for all purposes under Title 68 of

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[15] OKLA. ADMIN. CODE § 710:50-17-70.

[16] *See Matter of Income Tax Protest of Griffin Television, Inc.*, 1994 OK 35, 877 P.2d 588. *See also Matter of Income Tax Protest of Ashland Exploration, Inc.*, 1988 OK 23, 751 P.2d 1070.

[17] OKLA. STAT. ANN. tit. 68, § 202(i) (West 2014).

[18] *See* OKLA. ADMIN. CODE § 710:50-17-51(15)(A) (July 11, 2010). *See also* OKLA. STAT. ANN. tit. 68, § 2358(A)(4) (West 2017).

[19] *See* OKLA. ADMIN. CODE § 710:50-17-51(15)(B) (West 2017).

the Oklahoma Statutes, a domestic limited liability company shall be treated the same and taxed as a domestic partnership and a foreign limited liability company shall be treated the same and taxed as a foreign partnership, provided that such domestic or foreign limited liability companies are classified as partnerships for federal income tax purposes.[20]

14. A taxpayer's income tax liability is determined under the law in effect when the income is received.[21]

15. In all proceedings before the Tax Commission, the taxpayer has the burden of proof.[22]

16. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect and in what respects.[23]

**DISCUSSION**
**ISSUE ONE**

The Protestant is a Holding Company, and has no employees or gross receipts and carries no inventory or depreciable assets on its own books. The Protestant shares the location of PARTNER LLC's headquarters in California. The Protestant has previously reported zero (0) Property, Sales, and Payroll resulting in a zero (0) apportionment factor under § 2358. The Protestant's purpose in Amending its Returns for the 2004, 2005, 2006, 2007, 2009, and 2010

[20] OKLA. STAT. ANN. tit. 68, § 202(j) (West 2014).

[21] *See Affiliated Management Corp. v. Oklahoma Tax Commission*, 1977 OK 183, 570 P.2d 335. *See also Wootten v. Oklahoma Tax Com'n*, 1935 OK 54, 40 P.2d 672.

[22] *See* OKLA. ADMIN. CODE § 710:1-5-47 (June 25, 1999). *See also* OKLA. ADMIN. CODE § 710:1-5-77(b) (June 25, 1999).

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

Tax Years was to combine the apportionment factors of PARTNER LLC and SUBSIDIARY LLC with its zero (0) apportionment factors (Aggregate Approach).

The Protestant contends that it is deriving Oklahoma source income from PARTNER LLC, through the employee leasing arrangement between PARTNER LLC and SUBSIDIARY LLC.

From the ALJ's reading of the record, the parties do not dispute that the Protestant has nexus with the State of Oklahoma under § 710:50-17-3. The issue concerns Protestant's methodology for calculating its Oklahoma Taxable Income using the apportionment factors of PARTNER LLC and SUBSIDIARY LLC (Aggregate Approach).

**CONCLUSION ISSUE ONE**

Protestant has shown it has nexus with the State of Oklahoma, through SUBSIDIARY LLC's leasing of its employees in this state to PARTNER LLC, and the resulting income derived in this state from the leasing arrangement.

**ISSUE TWO**

The Protestant asserts that through its own activities and those of its disregarded single member LLC, SUBSIDIARY LLC, Protestant maintains Oklahoma corporate income tax nexus due to its status as a disregarded entity. The Protestant treats SUBSIDIARY LLC as a division combining the activities of SUBSIDIARY LLC with and into the operations of Protestant for federal and Oklahoma income tax purposes.

This treatment is entirely distinct from a parent/regarded subsidiary corporation arrangement. For federal and Oklahoma income tax purposes, Protestant and SUBSIDIARY LLC are one company. The parties stipulated that SUBSIDIARY LLC is treated for federal and

Oklahoma purposes as a single member LLC, which has not elected to be treated as an entity separate from its parent under US Treas. Reg. Secs. 301.7701-1 through 301.7701.3

The Division acknowledges that the Protestant owns a 100% interest in SUBSIDIARY LLC, but argues that SUBSIDIARY LLC is a separate entity and Protestant may not combine the apportionment factors of SUBSIDIARY LLC with its zero (0) apportionment factor.

An entity, which derives income from sources within the state, has an Oklahoma income tax filing requirement and will be subject to Oklahoma income tax. Protestant does not have the scope for apportionment factors based upon its own business activities in Oklahoma.

As a disregarded entity, SUBSIDIARY LLC's apportionment factors are allowed to Protestant. The question is what are those factors? Protestant argues that it should be allowed to combine both the payroll factor of SUBSIDIARY LLC and a sales factor based upon the receipts SUBSIDIARY LLC receives from leasing employees to PARTNER LLC. The Division argues that payroll should be attributed to the corporation for whom employees perform their services.

The payroll factor is a fraction, the numerator of which is the total compensation for services rendered in the state, and the denominator of which is the total compensation for services rendered everywhere. 68 O.S. § 2358(A)(5)(b). Compensation only includes those paid-for services related to the unitary business. *Id.* Here, the services rendered in this state related to the unitary business were rendered to PARTNER LLC. "Rendered" is defined as "to do (a service) for another."[24] No services were rendered to SUBSIDIARY LLC in this state. Therefore, SUBSIDIARY LLC's payroll factor in Oklahoma is zero (0).

The sales factor is a fraction, the numerator of which is the total sales or gross revenue of the taxpayer in this state, and the denominator of which is the total sales or gross revenue of the

[24] WEBSTER'S NINTH COLLEGIATE DICTIONARY (1987), 997.

taxpayer everywhere. 68 O.S. § 2358(A)(5)(c). Receipts for performing services are included in the numerator if the receipts derive from customers within Oklahoma or are otherwise attributable to this state's market place. OKLA. ADMIN. CODE § 710:50-17-71(1)(A)(ii). The sales factor does not include sales or gross revenue separately allocated under § 2358(A)(4). 68 O.S. § 2358(A)(5)(c).

Protestant's unitary business is the manufacturing of computer hard disc drives for customers throughout the world. Protestant is not in the unitary business of leasing employees. Net income or loss from a business, which is not a part of business carried on within or without the state of a unitary character, is separately allocated. § 2358(A)(4)(c). SUBSIDIARY LLC's Oklahoma sales factor is zero (0).

## CONCLUSION ISSUE TWO

As a single member LLC that has not elected to be treated as an entity separate from its parent, Protestant may utilize SUBSIDIARY LLC's apportionment factors, if it had any. SUBSIDIARY LLC, however, does not have either a payroll factor or sales factor. Consequently, Protestant's combined apportionment factors are zero (0).

## ISSUE THREE

The Protestant contends that PARTNER LLC and the Protestant are "unitary with each other" (Aggregate Approach), so PARTNER LLC's apportionment factors can be combined with the Protestant's apportionment factor of zero (0).[25] The Protestant asserts this position because PARTNER LLC is taxed as a partnership, and that each partner handles its share of a partnership's operations, so the Protestant recognizes its share of PARTNER LLC's activities for corporate income tax purposes. The Protestant asserts its position is directly analogous with the

[25] Tr. at 23.

corporate taxpayer in Commission Order No. 91-02-19-018, because the income Protestant receives from PARTNER LLC is specifically related to the Protestant's unitary business enterprise. To support its position that the Protestant is unitary with PARTNER LLC, the Protestant's Senior Tax Manager testified that other states, which could have consolidated, combined, or separate filing, had not challenged the Protestant's unitary status (Aggregate Approach).[26]

Protestant's position rests upon a misunderstanding of the statutory provisions, which apply in calculating Oklahoma taxable income. States such as Oklahoma that require each individual entity to file a separate tax return are separate reporting states, in contrast to those states that require all related entities to file one combined tax return, referred to as combined reporting states. *See* OKLA. ADMIN. CODE § 710:50-17-50.

In OTC Order No. 91-02-19-018, the Tax Commission determined that § 2363 does not control the taxability of the income from the partnership, but simply directs which portion the partner must report to the State of Oklahoma. The taxability of the income, gains, losses or deductions is controlled by § 2358 and/or § 2362. The Oklahoma part of partnership income, gains, losses or deductions are determined under § 2358. In OTC (Precedential) Order No. 92-10-21-002, the Tax Commission determined that under § 2362(1)(d), the income and gain received by taxpayers from a partnership are includable in Oklahoma taxable income and are subject to Oklahoma income tax. This treatment of the income and gain follows the decision in Commission Order No. 91-02-19-018 wherein it was determined that taxpayer's (a unitary business enterprise) Oklahoma distributive share of income from a partnership, to which

[26] Tr. at 9.

taxpayer was a partner, was apportionable to Oklahoma rather than allocable to taxpayer's domiciliary situs.

In Commission Order No. 91-02-19-018, the income from the joint ventures was apportioned once at the corporate level due to the fact the joint ventures had no separate filing requirement. Here, Protestant is attempting to apportion the income from PARTNER LLC twice, once at the partnership level and then once again at the corporate level. PARTNER LLC used the three (3)-factor formula to determine Protestant's Oklahoma distributable share of its income. Now, Protestant wants to use PARTNER LLC's three (3)–factor formula a second time to apportion Protestant's distributive share of the partnership income. There is no provision in the Act permitting Protestant to use a second three (3)-factor formula to apportion some of that income away from Oklahoma.

Protestant's Aggregate Approach is not applicable in Oklahoma. *See* OKLA. ADMIN. CODE §§ 710:50-17-50 and 710:50-17-70. PARTNER LLC is a separate and distinct unitary business, whose apportionment factors are determined by Section 2358(A)(5).

**CONCLUSION ISSUE THREE**

The Division's adjustment of Protestant's distributable taxable partnership income from PARTNER LLC and the corresponding adjustment of the Net Operating Loss Deductions were proper, and the Division correctly applied existing precedent.

**ISSUE FOUR**

On Issue Three, the ALJ concluded that PARTNER LLC is a separate and distinct unitary business, whose apportionment factors are determined by § 2358(A)(5). This conclusion supports the Division's treatment of interest income/loss on the Protestant's Amended Returns for the 2006 and 2007 Tax Years.

**CONCLUSION ISSUE FOUR**

The Division's adjustment to the Protestant's interest income/loss for tax years 2006 and 2007 was correct.

## RECOMMENDATIONS

The ALJ recommends denying the protest as more fully set forth.

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).