

JURISDICTION: OKLAHOMA TAX COMMISSION
CITE: 2019-04-23-06/ NON-PRECEDENTIAL
ID: P-16-273-K
DATE: APRIL 23, 2019
DISPOSITION: DENIED
TAX TYPE: 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 Findings of Fact, Conclusions of Law and Recommendation made and entered by the Administrative Law Judge on the 14th day of February, 2019, appended hereto, together herewith shall constitute the Order of the Commission.

SO ORDERED

FINDINGS OF FACT, CONCLUSIONS OF LAW AND RECOMMENDATION

NOW on this 14th day of February, 2019, the above styled and numbered cause comes on for decision under assignment regularly made by the Oklahoma Tax Commission to ALJ, Administrative Law Judge. Protestants, TAXPAYER and SPOUSE are represented by ATTORNEY 1 and ATTORNEY 2, Attorneys at Law, FIRM. The Account Maintenance Division of the Oklahoma Tax Commission ("Division") is represented by DGC, Deputy General Counsel and AGC, Assistant General Counsel, Office of General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

The Division disallowed the investment/new jobs credits claimed by Protestants on their 2013 and 2014 Oklahoma Resident Income Tax Returns, and by letters dated October 12, 2016, proposed the assessment of additional taxes of \$59,239.00 and \$2,320.00, respectively. Protestant timely protested the disallowance of the credits for the 2013 and 2014 tax years.

On December 28, 2016, the protest and records of the Division were referred to the Office of the Administrative Law Judges to initiate proceedings under the Uniform Tax

Procedure Code¹ and the Rules of Practice and Procedure before the Office of the Administrative Law Judges².

A pre-hearing teleconference was scheduled for February 16, 2017. The conference was considered held upon receipt of a *Status Report* filed February 16, 2017, and the parties were directed to file a status report. Several additional status reports were filed as instructed.

By *Status Report* filed May 16, 2018, the parties advised they were prepared to proceed with the protest and would submit a joint proposed scheduling order. The *Joint Proposed Scheduling Order* was filed June 13, 2018, which proposed procedure and dates were adopted as the *Scheduling Order* of the Court, inclusive of the scheduling of a hearing for December 13, 2018.

A *Joint Stipulation of Facts, Issues and Exhibits* filed November 2, 2018. The *Brief of the Account Maintenance Division* and Protestant's *Pre-Trial Brief* were filed December 6, 2018.

A closed hearing was held as scheduled.³ As a preliminary matter, the *Joint Stipulation of Facts, Issues and Exhibits (Joint Stipulation)*, and Joint Exhibits 1 through 23 were admitted into evidence. Protestant, TAXPAYER testified regarding the purchase of COMPANY. AUDITOR, Auditor III testified regarding the audit, the documentation requested to support the credits and the reason for the disallowance of the credits. Upon conclusion of closing statements, the record closed and the protest submitted for decision.⁴

FINDINGS OF FACT

Upon review of the file and records, including the digital recording of the hearing, the *Joint Stipulation*, Joint Exhibits and the pleadings of the parties, the undersigned finds:

A. The parties stipulate to the following:⁵

¹ 68 O.S. 2011, § 201 et seq., as amended.

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

³ Confidentiality was invoked. 68 O.S. 2011, § 205.

⁴ OAC, 710:1-5-39(a).

⁵ References to the Joint Exhibits in support of the statements are omitted.

PROCEDURAL FACTS

1. Protestants filed their 2012 Oklahoma income tax return (“2012 Return”) on October 13, 2013.
2. Protestants’ 2012 Form 511CR, included as part of the 2012 Return, listed \$37,615.00 in available Oklahoma Investment/New Jobs credits.
3. Protestants claimed the Oklahoma investment/new jobs credit in the amount of \$37,615.00 on line 17 of the 2012 Return.
4. Protestants filed their 2013 Oklahoma income tax return (“2013 Return”) on or about October 15, 2014.
5. Protestants’ 2013 Form 511CR, included as part of the 2013 Return, listed \$102,796.00 in available Oklahoma Investment/New Jobs credits.
6. Protestants claimed the Oklahoma investment/new jobs credit in the amount of \$69,217.00 on line 17 of the 2013 Return.
7. Protestants filed their 2014 Oklahoma income tax return (“2014 Return”) on or about October 12, 2015.
8. Protestants’ 2014 Form 511CR, included as part of the 2014 Return, listed \$33,579.00 in available Oklahoma Investment/New Jobs credits.
9. Protestants claimed the Oklahoma investment/new jobs credit in the amount of \$33,579.00 on line 17 of the 2014 Return.
10. Protestants filed their 2015 Oklahoma income tax return (“2015 Return”) on October 17, 2016.
11. In a letter dated October 12, 2016, the Division issued a proposed assessment against Protestants for \$59,239.00 in additional tax due for the 2013 tax year (“2013 Assessment Letter”).
12. The 2013 Assessment Letter disallowed investment/new jobs credits in the amount of \$69,217.00.
13. In a letter dated October 12, 2016, the Division issued a proposed assessment against Protestants for \$2,320.00 in additional tax due for the 2014 tax year (“2014 Assessment Letter”).
14. The 2014 Assessment Letter disallowed investment/new jobs credits in the amount of \$33,579.00.
15. The 2014 Assessment Letter adjusted Protestants line 35, amount carried forward, from \$21,237.00 to \$0.00.
16. In a letter dated December 8, 2016, the Division issued a proposed adjustment to Protestants for 2015 Return (“2015 Adjustment Letter”).

17. The 2015 Adjustment Letter resulted in \$343.64 in underpayment of estimated tax interest due for the 2015 tax year.

18. The 2015 Adjustment letter [sic] adjusted the line 33, total payments and credits, for the 2015 tax year from \$49,981.00 to \$28,744.00.

19. By letter dated December 9, 2016, the Protestants protested the disallowance of the credits for the 2013 and 2014 tax years.

GENERAL FACTS

20. The Oklahoma Investment/New Jobs credits (the "Credits") claimed by the Protestants were generated by COMPANY.

21. COMPANY is a subchapter S corporation.

22. The Credits were generated prior to January 1, 2012.

23. LLC ("LLC") owned COMPANY stock during the audit period.⁶

24. The 2006 tax return for COMPANY shows SHAREHOLDER 1 and SHAREHOLDER 2 each owned a 50% interest in COMPANY.

25. The 2007 tax return for COMPANY shows SHAREHOLDER 1 and SHAREHOLDER 2 each owned a 50% interest in COMPANY.

26. The 2008 tax return for COMPANY shows SHAREHOLDER 1 and SHAREHOLDER 2 each owned a 50% interest in COMPANY.

27. The 2009 tax return for COMPANY shows SHAREHOLDER 2 owned 100% of the stock in COMPANY.

28. The 2010 tax return for COMPANY shows SHAREHOLDER 2 owned 100% of the stock in COMPANY.

29. The 2011 tax return for COMPANY shows SHAREHOLDER 2 owned 100% of the stock in COMPANY.

B. Additional findings:

1. Protestants' CPA, CPA informed him a company was available for purchase which had unused tax credits that could offset his income tax liability to State of Oklahoma. Testimony of Protestant.

2. By *Stock Purchase Agreement* dated January 1, 2012, LLC purchased 167 shares of stock in COMPANY from SHAREHOLDER 2

⁶ The Joint Stipulation reference Joint Exhibit 15, p.4 and Joint Exhibit 16, p.4 and note that the Oklahoma Small Business Corporation Income Tax Returns of COMPANY, Form 512-S report LLC had a 50% ownership interest in COMPANY for the 2013 and 2014 tax years.

(“Shareholder”), representing 67% of the outstanding shares for \$18,800.00. Joint Exhibit 19.

3. LLC is a single member limited liability company owned by Protestant (Husband). Testimony of Auditor; Joint Exhibit 17.

4. Another individual purchased the remaining 83 shares of stock in COMPANY. *Id.*

5. Under paragraph 3.5 of the *Stock Purchase Agreement*, Representations and Warranties of the Shareholder, “[t]he Shareholder represents that, to the best of her knowledge, the Corporation has unused Oklahoma investment credits and new jobs credits of approximately \$280,000.” Joint Exhibit 19.

6. The *Stock Purchase Agreement* is unexecuted by LLC and the other individual. *Id.*

7. Protestant does not know when the *Stock Purchase Agreement* was executed by the Shareholder and does not know if he ever signed the agreement. Testimony of Protestant.

8. Protestant requested documentation regarding the *Stock Purchase Agreement* from counsel and nothing was provided. *Id.*

9. Protestant is unaware of any other documentation regarding the condition he would receive the right to use the tax credits or of when the *Stock Purchase Agreement* closed. *Id.*

10. Protestant does not know when he paid for the stock, but maintains that he would not have purchased COMPANY without the letter ruling and assurance the tax credits would transfer to him. *Id.*

11. On February 6, 2012, COUNSEL requested a letter ruling from the Tax Commission on behalf of “our client” regarding “the impact of the transfer of 100% of shares of COMPANY to the new shareholder and, in particular, the

impact of the transfer on the unused investment credits and new jobs credits generated by COMPANY.” Joint Exhibit 21.

12. COUNSEL does not specifically identify “our client” in the request, but states that “[o]ur client is negotiating the purchase from SHAREHOLDER 2 of 100% of the shares of COMPANY.” *Id.*

13. CPA , Protestants’ CPA negotiated the purchase. Testimony of Protestant.

14. The facts as set forth in the letter ruling are:

It is our understanding that COMPANY is a Subchapter S Corporation operating in Oklahoma and that it has unused investment credits and new jobs credits totaling \$280,823. The present shareholder is SHAREHOLDER 2 (SS#).

Our Client is negotiating the purchase from SHAREHOLDER 2 of 100% of the shares of COMPANY. We have been advised that upon the transfer of the S-corporation shares to our client that unused investment credits and new jobs credits will in effect transfer to the new shareholder; that is, those unused credits will flow out from the S-corporation to the new shareholder.

Joint Exhibit 21.

15. The OTC response provides:

Under 68 O.S. § 2357.4 certain entities are entitled to a credit for investments made or the creation of new jobs. These credits, to the extent earned but not used, are allowed to be carried over to subsequent tax years.

Partnerships, LLCs and Subchapter S Corporations (pass-through entities) are typically entitled to pass tax credits to the partners, members or shareholders. Unused credits may be passed to subsequent shareholders of a Subchapter S Corporation.

You also inquired as to any ‘unique reporting requirements pertaining to the transfer of said credits.’ While this is not a transfer of tax credits, rather an allocation credits, OTC Form 569 must be filed reporting the allocation of this tax credit.

Id.

16. The letter ruling contains the typical provisos, “[t]his response

applies only to the circumstances set out in [the] request” and “may be generally relied upon only by the entity to whom it is issued, assuming all pertinent facts have been accurately and completely stated, and * * * there [is] no change in applicable law”; and reservations, “this ruling does not preclude the Oklahoma Tax Commission from conducting an audit or examination * * * of any report or return claiming a credit for the transaction” and “the right to issue any assessment, correction, or adjustment”. *Id.*

17. The letter ruling was issued April 10, 2012. *Id.*

18. COMPANY reported investment/new jobs credits for tax years 2003 through 2006. Joint Exhibits 9, pp. 12-15 and 10, pp. 6-9.

19. None of the Forms 506 report a Manufacturing Sales/Exemption Permit number (“MSEP”). *Id.*

20. The credits reflected on COMPANY’S 2006 and 2007 returns were allocated to the shareholders. Joint Exhibits 9, pp. 8-12 and 10, pp. 12-15.

21. COMPANY’S returns for 2008 through 2011 do not report the generation or allocation of any new credits. Joint Exhibits 11-14.

22. Schedule – OK1 to COMPANY’S 2010 return shows the following computation of the investment/new jobs credit carryforward:

Per OTC Auditor	\$282,850	(From prior to 2009)
Used in 2009	<u>2,027</u>	(By Shareholder)
Net Available	\$280,823	(For carryforward)

Joint Exhibit 13, pp. 5.

23. The Form 569 dated October 14, 2013, and marked received on October 15, 2013, submitted after the filing of Protestants’ 2012 Return on October 13, 2013, purports to allocate \$93,608.00 of investment/new jobs credits to LLC 2 (LLC 2) and \$187,215.00 of investment/new jobs credits to LLC, for a total of \$280,823.00. Joint Exhibit 17; Joint Stipulation, #1.

24. The person/entity named as transferring or allocating the credit is SHAREHOLDER 2. *Id.*

26. The Form 569 was completed incorrectly as it purports to allocate the credits instead of showing the credits were transferred since an individual cannot allocate credits. Testimony of Auditor.

25. A Form 569 dated May 29, 2014, purports to allocate \$46,804.00 of the credit LLC received from SHAREHOLDER 2 to LLC 2. Joint Exhibit 18.

26. The person/entity named as transferring or allocating the credit is Protestant. *Id.*

27. The Form 569 reports that the investment/new jobs credit of \$187,215.00 received by LLC was transferred to LLC on January 1, 2012 by SHAREHOLDER 2. *Id.*

28. No Form 569 showing a transfer or allocation of the credit received by LLC to Protestant has been provided.

29. Protestants' tax returns for the 2013, 2014 and 2015 tax years were adjusted. Testimony of Auditor.

30. The investment/new jobs credit was disallowed on the 2013 and 2014 returns resulting in the assessment of additional income tax for those years. Joint Exhibits 5 and 6; *Id.*

31. An investment/new jobs credit was also claimed by Protestants on their 2012 return, however by the time the audit was completed and the credits disallowed, the three (3) year statute of limitation on assessments had run. Testimony of Auditor.

32. The person or entity generating an investment/new jobs credit must have a MSEP to qualify for the credit. 68 O.S. § 2357.4(A)(1) and (2).

33. Nothing was provided to the Auditor to show COMPANY ever had a MSEP and a search of the records of the Tax Commission found no active

MSEP for COMPANY. Testimony of Auditor.

34. The credits were disallowed because the investment/new jobs credit is not a transferrable credit and the Form 569 shows an individual attempting to transfer the credits to LLC 2 and LLC. Testimony of Auditor.

ISSUES AND CONTENTIONS

The issue presented for decision, as stipulated by the parties is “[w]hether the Division properly disallowed the investment/new jobs credit available under 68 O.S. § 2357.4 as claimed on Protestants’ 2013 and 2014 Oklahoma income tax returns?”

At the hearing, Protestants’ Counsel defined the issue as whether the investment/new jobs credits generated by a company that is sold can be redeemed by the successor company? Protestants contend that regardless of whether the credits are obtained by transfer or allocation, they should be allowed to claim them. Protestants argue that no law prevents the allocation or transfer of investment/new jobs credits between subsequent owners of subchapter S corporations. Protestants further contend that the statute of limitations bars the Division’s disallowance of the credits. In support, Protestants argue that the credits claimed on the 2013 and 2014 returns were carried forward from the 2012 return and Form 569 where the credits were established and to which the use of the Division has not disallowed. In the alternative, Protestants contend that the Tax Commission is estopped from disallowing Protestants’ use of the credits. In support, Protestants argue that they have proven the five elements of estoppel and the public policy or interest to be advanced is assurance of taxpayers in the advice given by the Tax Commission.

At the hearing, the Division defined the issue as whether investment/new jobs credits can be transferred by the former shareholder to the new shareholders? The Division contends that the disallowance of the credits was proper because: (1) the investment/new jobs credit authorized by 68 O.S. § 2357.4 is not a transferrable credit; (2) the credits generated by COMPANY had been allocated to the company’s former shareholders, and were no longer available to be allocated to Protestants; and (3) Protestants have not established the validity of the credits since

they have not shown that COMPANY had an MSEP. To support the first contention, the Division argues that § 2357.4 is devoid of any language authorizing the transfer of the credit and that had the legislature intended to make the credit transferrable, it was competent to do so citing several income tax credit provisions containing language authorizing the transfer of the credit. For the second contention, the Division argues that all items of income, loss, deduction or credit of an S corporation are passed through to the shareholders and are accounted for on the shareholder's return in the taxable year in which the taxable year of the S corporation ends. Regarding Protestants' estoppel argument, the Division asserts that the request for the letter ruling does not identify for whom the request was made, doesn't accurately represent the facts, including that the credits had been allocated to the shareholders and the request and letter ruling were made and issued after the stock was purchased.

CONCLUSIONS OF LAW

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

I. JURISDICTION AND BURDEN OF PROOF

1. Jurisdiction of the parties and subject matter of this proceeding is vested in the Oklahoma Tax Commission. 68 O.S. 2011, § 221(D).
2. The taxpayer has the burden of proof to show the action or proposed action of the Oklahoma Tax Commission is incorrect, and in what respect. *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. If the taxpayer fails to prove a prima facie case, the protest may be denied solely on the grounds of failure to prove sufficient facts which would entitle the taxpayer to the relief requested. *OAC 710:1-5-47; Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission*, 1988 OK 91, 768 P.2d 359, 362, citing *Continental Oil Co. v. Oklahoma State Bd. of Equalization*, 1976 OK 23, 570 P.2d 315, 317.
3. The burden of proof standard is "preponderance of evidence." 2 Am.Jur.2d

Administrative Law § 357. “Preponderance of evidence” means “[e]vidence which is of greater weight or more convincing than the evidence offered in opposition to it; that is, evidence which as a whole shows the fact sought to be proved is more probable than not * * * evidence which is more credible and convincing to the mind * * * that which best accords with reason and probability.” BLACK’S LAW DICTIONARY 1064 (5th ed. 1979). Each element of the claim must be supported by reliable, probative, and substantial evidence of sufficient quality and quantity as to show the existence of the facts supporting the claim are more probable than their nonexistence. 2 Am.Jur.2d *Administrative Law* § 357.

4. An order of the Tax Commission must be supported by substantial evidence. *Dugger v. State ex rel. Oklahoma Tax Commission*, 1992 OK 105, 834 P.2d 964. Likewise, the audit upon which a portion of the record is formed and order issued, must be supported by substantial evidence. Oklahoma Tax Commission Order No. 2003-07-22-09, 2003 WL 2347117.

5. An audit is supported by substantial evidence when an evidentiary foundation for the audit has been established. Usually the evidentiary foundation will be established by the records reviewed by the auditor. Where an evidentiary foundation has been established, the taxpayer must prove the action of the Tax Commission in assessing the tax is incorrect, and in what respect. *OAC* 710:1-5-47; *Enterprise Management Consultants, Inc.*, supra. However, where an evidentiary foundation has not been laid or the records upon which the audit is based establish no basis for assessing a tax, the audit and assessment in the initial instance cannot be sustained as supported by substantial evidence. *Dugger*, supra.

II. SUBCHAPTER S CORPORATIONS

1. A corporation having an election in effect under Subchapter S of the Internal Revenue Code shall not be subject to the Oklahoma income tax on the corporation. *OAC* 710:50-21-1(a). The shareholders of a Subchapter S corporation shall include in their taxable income their distributive share of such corporation’s Federal income, subject to the modifications in 68 O.S. §§ 2358 and 2362. *OAC* 710:50-21-1(b).

2. “Internal Revenue Code” means the United States Internal Revenue Code, 26 U.S.C. § 1 et seq., as the same may be amended or adopted from time to time applicable to the taxable year; and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time applicable to the taxable year. 68 O.S. 2011, § 2353(2). “Any term used in the Oklahoma Income Tax Act shall have the same meaning as when used in a comparable contest in the Internal Revenue Code, unless a different meaning is clearly required.” 68 O.S. 2011, § 2353(3). “For all taxable periods covered by the Oklahoma Income Tax Act, the tax status and all elections of all taxpayers covered by the Oklahoma Income Tax Act shall be the same for all purposes material hereto as they are for federal income tax purposes except when the Oklahoma Income Tax Act specifically provides otherwise”. *Id.*

3. A Subchapter S corporation is a pass-through entity that is generally not subject to income tax. IRC § 1363(a). *See, OAC 710:50-3-54(b)(3)(A).*⁷ All items of income, loss, deduction, or credit the separate treatment of which could affect the liability for tax of any shareholder, and nonseparately computed income or loss are accounted for by the shareholders of the S corporation in the taxable year in which the taxable year of the S corporation ends. IRC § 1366(a).

III. INVESTMENT/NEW JOBS CREDIT

1. “Taxation is an exclusively legislative function that can be exercised only under statutory authority and in the manner specified by statute.” *State, ex rel. Oklahoma Tax Commission v. Texaco Exploration & Production, Inc.*, 2005 OK 52, ¶ 7, 131 P.3d 705, 707. The basis for the Division’s action and Protestants’ protest thereto are governed by the Business credit for investment or increase in full-time employees⁸ and the Oklahoma Income Tax Act

⁷ Providing that “[a] corporation that is treated as an S-Corporation under the Internal Revenue Code” is a “Pass-through entity” for Oklahoma income tax purposes.

⁸ 68 O.S. § 2357.4.

(“Act”)⁹.

2. Oklahoma income tax is imposed on the “Oklahoma taxable income of every resident or nonresident individual”, 68 O.S. 2011, § 2355(B). An individual’s “Oklahoma taxable income” is “‘taxable income’ as reported (or as would have been reported by the taxpayer had a return been filed) to the federal government, and in the event of adjustments thereto by the federal government as finally ascertained under the Internal Revenue Code, adjusted further as hereinafter provided”. 68 O.S. 2011, § 2353(12).

3. A credit against the tax imposed by § 2355 of the Act is authorized for investments in qualified depreciable property placed in service for use in a manufacturing operation, 68 O.S. 2011, § 2357.4(A)(1); or a net increase in the number of full-time-equivalent employees in manufacturing, or processing, including employees engaged in support services, 68 O.S. § 2357.4(A)(2).¹⁰ The credit is conditioned on the manufacturing operation meeting the definition of manufacturing operation under § 1352 of the Oklahoma Sales Tax Code and receiving a manufacturer exemption permit. *Id.*

4. In 1999, the credit provision was amended by the insertion of subsections B to D which provided:

B. Except as otherwise provided in subsection F of Section 3658 of this title, for taxable years beginning after December 31, 1998, there shall be allowed a credit against the tax imposed by Section 2355 of this title for:

1. Investment in qualified depreciable property with a total cost equal to or greater than Forty Million Dollars (\$40,000,000.00) within three (3) years from the date of initial qualifying expenditure and placed in service in this state during those years for use in the manufacture of products described by

⁹ 68 O.S. 2011, § 2351 et seq., as amended.

¹⁰ A taxpayer’s income tax liability is determined under the law in effect when the income is received. *Affiliated Management Corp. v. Oklahoma Tax Commission*, 1977 OK 183, 570 P.2d 335; *Wooten v. Oklahoma Tax Commission*, 1935 OK 54, 170 Okla. 584, 40 P.2d 762. The credits in this matter were generated prior to 2009. Therefore, the provisions of the credit in effect prior to the 2009 amendment of the Section and any material changes thereto are cited. Laws 2009, c. 426, § 9, eff. Jan. 1, 2010.

any Industry Number contained in Division D of Part I of the Standard Industrial Classification (SIC) Manual, latest revision; or

2. A net increase in the number of full-time-equivalent employees in this state engaged in the manufacture of any goods identified by any Industry Number contained in Division D of Part I of the Standard Industrial Classification (SIC) Manual, latest revision, if the total cost of qualified depreciable property placed in service by the business entity within the state equals or exceeds Forty Million Dollars (\$40,000,000.00) within three (3) years from the date of initial qualifying expenditure.

C. The business entity may claim the credit authorized by subsection B of this section for expenditures incurred or for a net increase in the number of full-time-equivalent employees after the business entity provides proof satisfactory to the Oklahoma Tax Commission that the conditions imposed pursuant to paragraph 1 or paragraph 2 of subsection B of this section have been satisfied.

D. If a business entity fails to expend the amount required by paragraph 1 or paragraph 2 of subsection B of this section within the time required, the business entity may not claim the credit authorized by subsection B of this section, but shall be allowed to claim a credit pursuant to subsection A of this section if the requirements of subsection A of this section are met with respect to the investment in qualified depreciable property or net increase in the number of full-time-equivalent employees.

Laws 1999, c. 1, § 21, emerg. eff. Feb 24, 1999.

5. Subsections E and F place additional conditions on qualifying for the credit under either subsections A or B. 68 O.S. Supp. 2006, § 2357.4(E) and (F). Subsections E and F also provide: “[i]f the credit provided in subsections A or B of this section is calculated on the basis of the cost of the qualified property, the credit shall be allowed in each of the four (4) subsequent years (from the year the qualified property is placed in service), 68 O.S. Supp. 2006, § 2357.4(E); and “if based upon an increase in the number of full-time-equivalent employees, shall be allowed in each of the four (4) subsequent years”, 68 O.S. Supp. 2006, § 2357.4(F). Subsection I of Section 2357.4 provides that any credits allowed but not used in any taxable year may be carried over: “[t]o each of the four (4) years following the year of qualification, 68 O.S. Supp. 2006, § 2357.4(I)(1); “[t]o the extent not used in those years in order to each of the fifteen (15) years following the initial five-year period, 68 O.S. Supp. 2006, § 2357.4(I)(1). The ending paragraph of § 2357.4(I) permits the utilization of any credits from qualified depreciable property placed in

service on or after January 1, 2000, to the extent not used , in any tax year after the initial twenty-year period. 68 O.S. Supp. 2006, § 2357.4(I).

IV. REPORTING THE TRANSFER OR ALLOCATION OF A TAX CREDIT

1. The reporting of a transfer or allocation of an income tax credit is generally governed by *OAC 710:50-3-55*, with limited exceptions. *OAC 710:50-3-55(b)*. This rule provides in part:

(c) **Report.** The transfer or allocation of any tax credit, on or after July 1, 2011, shall be reported to the Tax Commission (OTC Form 569) by the entity transferring or allocating the credit. Said form shall be filed on or before the twentieth day of the second month after the tax year in which an act occurs which allows the tax credit to eventually be claimed.

(d) **Transferable credits.** If the credit is transferable, the report shall state:

- (1) Name of the taxpayer and taxpayer identification number to whom the credit is transferred;
- (2) Tax type;
- (3) Amount of credit;
- (4) Statutory or other legal authority which forms the basis for the credit; and
- (5) Any other information the Tax Commission may require.

(e) **Allocable credits.** If the credit is allocated, the report shall state:

- (1) Identity of the shareholder, partner or member of the pass-through entity to whom the credit is allocated;
- (2) Taxpayer identification number of the shareholder, partner or member of the pass-through entity to whom the credit is allocated;
- (3) Whether the shareholder, partner or member of the pass-through entity to whom the credit is allocated is a pass-through entity;
- (4) Tax type;
- (5) Amount of credit;
- (6) Statutory or other legal authority which forms the basis for the credit; and
- (7) Any other information the Tax Commission may require.

(f) **Failure to file report.** If a taxpayer claims a credit on any state tax return that was not previously reported to the Tax Commission, pursuant to this Section, the Tax Commission shall disallow the credit and recompute the applicable tax liability including any penalty and interest; provided, upon the filing of the report, the credit shall be allowed.

OAC 710:50-3-55, emphasis original.

V. STATUTORY CONSTRUCTION AND OPERATION

1. The fundamental rule and primary goal of statutory construction is to ascertain and give effect to legislative intent. *Rogers v. Quiktrip Corp.*, 2010 OK 3, 230 P.3d 853. The starting point for any inquiry into legislative intent is the language of the statute. *Redmond v. Cauthen*, 2009 OK CIV APP 46, 211 P.3d 233. When the words of a statute are plain and unambiguous, no occasion exists to employ rules of construction, and the statute will be accorded its clear and definite meaning. *Id.*

2. Only where the legislative intent cannot be ascertained from a statute's text, as when ambiguity or conflict with other statutes is shown to exist, may rules of statutory construction be invoked. *Rogers, supra*. The test for ambiguity in a statute is whether statutory language is susceptible to more than one reasonable interpretation. *YDF, Inc. v. Schlumar, Inc.*, 2006 OK 32, 136 P.3d 656.

3. In resolving an ambiguity in a statute, courts will look to the relevant legislative scheme to ascertain and give effect to the legislative intent and the public policy underlying that intent. *Wilhoit v. State*, 2009 OK 83, 226 P.3d 682, corrected. In interpreting statutes, courts do not limit their consideration to a single word or phrase in isolation to determine their meaning, but construe together relevant legislative enactments to ascertain and give effect to the legislature's intention and will, and attempt to avoid unnatural and absurd consequences. *Tull v. Commissioners of Dept. of Public Safety*, 2008 OK CIV APP 10, 176 P.3d 1227. It is important in construing the Legislative intent behind a word in a statute to consider the whole act in light of its general purpose and objective, considering relevant portions together to give full force and effect to each. *Estes v. ConocoPhillips Co.*, 2008 OK 21, 184 P.3d 518. The words of a statute will be given their plain and ordinary meaning unless it is contrary to the purpose and intent of the statute when considered as a whole. *Stump v. Check*, 2007 OK 97, 179 P.3d 606. The subject matter and purpose of a statute are material to ascertaining the meaning of a word or phrase used and that language should be construed to be harmonious with the purpose of the act, rather than in a way which will defeat it. *Tull, supra*. Statutes are interpreted to attain that

purpose and end championing the broad public policy purposes underlying them. *Keating v. Edmondson*, 2001 OK 110, ¶ 8, 37 P.3d 882 (citations omitted).

4. Tax statutes are penal. *Williams v. Smith & Nephew, Inc.*, 2009 OK 36, 212 P.3d 484; *Globe Life and Accident Insurance Company v. Oklahoma Tax Commission*, 1996 OK 39, 913 P.2d 1322. Penal statutes are to be strictly construed. *Mid-Continent Pipeline Co. v. Crauthers*, 1954 OK 61, 267 P.2d 568. Strict construction regarding a penal statute is that which refuses to extend the law by implication or equitable consideration and confines its operations to cases clearly within the letter of the statute, as well as within its spirit or reason. *State ex rel. Allen v. Board of Education of Independent School Dist. No. 74 of Muskogee County*, 1952 OK 241, 206 Okla. 699, 246 P.2d 368. Courts cannot enlarge the taxing act's ambit to make its provisions applicable to cases not clearly within the legislature's contemplation or to fill lacunae in the revenue law in a manner that would distort the enactment's plain language. *Globe, supra* at 1327.

5. “Statutes exempting property from taxation are to be strictly construed against the claimant.” *American Airlines, Inc. v. Oklahoma Tax Commission*, 2014 OK 95, ¶ 30, 341 P.3d 56, 64, citing *Blitz U.S.A., Inc. v. Oklahoma Tax Commission*, 2003 OK 50, ¶ 14, 75 P.3d 883, 888. “Claims of exemption must be by express grant.” *Id.*, citing *In re Noble’s Estate*, 1938 OK 324, ¶ 7, 183 Okla. 148, 80 P.2d 243, 245. “An exemption cannot exist by implication and a doubt is fatal to the claim of exemption.” *Id.*, citing *Oklahoma City v. Shields*, 1908 OK 195, ¶ 10, 22 Okla. 265, 100 P. 559

6. “The rule of strict construction comes into play only when the language, after analysis and subjection to the ordinary rules of interpretation, presents ambiguity.” *Colcord v. Granzow*, 1928 OK 211, ¶ 18, 137 Okla. 194, 278 P.2d 654, 660, citing *Ruling Case Law*, Volume 25, p. 1076. “Tax exemptions must be construed sensibly in order to give effect to the governing legislative scheme.” *American Airlines, supra* at ¶ 31, citing *Blitz, supra* at ¶ 16.

VI. EQUITABLE ESTOPPEL

1. In Oklahoma Tax Commission Order No. 2017 05 04 08, the Commission declined an invitation to venture outside Oklahoma and the Tenth Circuit to determine the requirements for estoppel against the government, instead relying on *Malonek v. United States*, 923 F.Supp. 1462 (D. Wyo. 1996), which held at 1467:

In [the Tenth Circuit], the requirements for estoppel against the government are a bit more strict. They include the traditional elements of equitable estoppel, which are: (1) the party to be estopped must know the facts; (2) the party to be estopped must intend that his conduct will be acted upon or must so act that the party asserting the estoppel has the right to believe that it was so intended; (3) the party asserting estoppel must be ignorant of the true facts; and (4) the party asserting estoppel must rely on the other party's conduct to his injury. *Penny v. Giuffrida*, 897 F.2d 1543, 1545-46 (10th Cir. 1990); *Che-Li Shen v. INS*, 749 F.2d 1469, 1473 (10th Cir. 1984). *In addition, a party seeking to estop the government must prove that there was some sort of 'affirmative misconduct' on the part of the government or its agents. Penny*, 897 F.2d at 1546.

The Court found that the failure of the IRS to inform the taxpayers that the statute of limitations had expired indicated that the IRS at most was negligent, perhaps even recklessly negligent, but negligence even reckless negligence, is not affirmative misconduct. *Id.* at 1467-68.

2. “Although the principle is harsh, there is no room for equitable considerations in the administration of tax laws.” *Duncan Medical Services v. Oklahoma Tax Commission*, 1994 OK 91, 911 P.2d 247, 250, citing *Western Auto Supply Company v. Oklahoma Tax Commission*, 1958 OK 144, 328 P.2d 414, 420. General principles of equity may not override statutory requirements for timely filing of tax refund claims. Oklahoma Tax Commission Order No. 2006-03-23-07 (Prec.). See, *Republic Petroleum Corp. v. United States*, 613 F.2d 518, 527 (5th Cir. 1980). The levying of taxes is purely statutory, and tax statutes must be administered as written. *Western Auto*, *supra* at ¶ 15.

3. Estoppel generally does not apply against the state acting in its sovereign capacity because of unauthorized acts of its officers, *State ex rel. Cartwright v. Dunbar*, 1980 OK 15, 618 P.2d 900; or because of mistakes or errors of its employees, *State ex rel. Cartwright v. Tidmore*, 1983 OK 116, 674 P.2d 14; *State ex rel. Oklahoma Tax Commission v. Emery*, 1982

OK CIV APP 13, 645 P.2d 1048. Application of estoppel is not allowed against state, political subdivisions, or agencies, unless the facts and circumstances implicate the interposition of estoppel would further some prevailing principle of public policy or interest. *Tice v. Pennington*, 2001 OK CIV APP 95, 30 P.3d 1164; *Burdick v. Independent School District*, 1985 OK 49, 702 P.2d 48, 26 Ed. Law Rep. 486. Where there is no power to act, a public official cannot bind a government entity even if he or she mistakenly or falsely asserts such authority. *Hiland Dairy Foods Company, LLC v. Oklahoma Tax Commission*, 2006 OK CIV APP 68, ¶ 11, 136 P.3d 1072, citing *Indiana Nat'l Bank v. State Dept. of Human Services*, 1993 OK 101, 857 P.2d 53, 64.

ANALYSIS

1. The investment/new jobs credit authorized by § 2357.4 is not a transferrable credit. The credit expressly provides for the carryover of any credits allowed, but not used in any taxable year. 68 O.S. Supp. 2006, § 2357.4(I). No such language authorizes the transfer of the credit.

Other income tax credit provisions enacted by the legislature authorize the transfer of the credit by express grant. *See, e.g.*, 68 O.S. §§ 2357.7 (Credit for venture capital investment); 2357.11 (Coal credit); 2357.32B (Credit for manufacturers of small wind turbines); 2357.41 (Credit for qualified rehabilitation expenditures); 2357.46 (Credit for construction of energy efficient residential property); and 2357.104 (Credit for qualified railroad reconstruction or replacement expenditures). Legislative silence, when the Legislature is competent to speak, is an indication of intent to not occupy the field. *McSorley v. Hertz Corp.*, 1994 OK 120, 885 P.2d 1343, 1346.

2. Protestants contend that regardless of whether the investment/new jobs credits are obtained by transfer or allocation, no law prevents subsequent shareholders of a subchapter S corporation from utilizing the credits generated by the S corporation. The statutes and rules regarding S corporations provide that all items of income, loss, deduction, or credit are passed

through to the shareholders of the S corporation and accounted for by the shareholders in the taxable year in which the taxable year of the S corporation ends.

COMPANY generated the investment/new jobs credits prior to 2009. Those credits were passed through and accounted for by the shareholder/shareholders of COMPANY in the taxable year in which they were generated. COMPANY had no investment/new jobs credits available to allocate to LLC when LLC became a shareholder of COMPANY. The Form 569 correctly reports SHAREHOLDER 2, the shareholder of COMPANY prior to January 1, 2012, as the person transferring or allocating the credits. However, the Form incorrectly reports an allocation of the credits by SHAREHOLDER 2. An individual cannot allocate a credit. *OAC 710:50-3-55(c) and (e)*.

3. Protestants contend that because the Division did not disallow the credits on the 2012 return where the credits originated, the Division is barred from disallowing the credits on the 2013 and 2014 returns. Protestants have cited no authority for this proposition.

Generally, the equitable defense of laches bars a claim where delay in bringing or prosecuting the claim is unreasonable, and the defendant has been materially prejudiced by the delay. *Osage Nation v. Board of Commissioners of Osage County*, 2017 OK 34, ¶ 33, 394 P.3d 1224, 1236. Laches is a gap-filling doctrine, and where there is a statute of limitations, there is no gap to fill. *SCA Hygiene Products Aktiebolag v. First Quality Baby Products, LLC*, 137 S.Ct. 954, 959, 197 L.Ed.2d 292, 85 USLW 4121 (2017). Laches cannot be invoked to bar legal relief in the face of a statute of limitations. *Id.*, at 961.

With exceptions, the Legislature has enacted a three (3) year statute of limitations on the assessment of any tax levied under any state tax law. 68 O.S. 2011, § 223(A). As such, laches cannot be invoked to bar an assessment made within the three (3) year time period.

4. Protestants contend the Division should be estopped from disallowing the use of the credits citing the letter ruling. Protestants have the burden of proof. *OAC 710:1-5-47*. Protestants have not shown to whom the letter ruling was issued, but the evidence suggests it was issued to Protestants' CPA, not Protestants. Protestants have not overcome their burden of

proving by a preponderance of evidence detrimental reliance on the letter ruling as it was not requested nor issued until after the stock purchase agreement was dated and the credits transferred. Joint Exhibits 18, 19 and 21. Moreover, “all facts [were not] accurately and completely stated” in the request for the letter ruling.

5. The investment/new jobs credit is conditioned on the manufacturing operation having a manufacturer exemption permit in the years qualified depreciable property is placed in service or a net increase in the number of full-time-equivalent employees are engaged in manufacturing, processing or aircraft maintenance or support services. 68 O.S. Supp. 2006, § 2357.4(A)(1) and (2). Protestants have not offered any evidence to show COMPANY had or was ever issued a manufacturer exemption permit.

RECOMMENDATIONS

The protest should be denied. The additional income tax as assessed, inclusive of penalty and accrued and accruing interest, should 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 2014) and OKLA. STAT. ANN. tit. 75, § 302 (West 2002).