

JURISDICTION: OKLAHOMA TAX COMMISSION DECISION
CITE: 87-08-13-03 / PRECEDENTIAL
ID: P-85-277
DATE: AUGUST 13, 1987
DISPOSITION: DENIED
TAX TYPE: INCOME
APPEAL: NO APPEAL TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above styled cause comes on for consideration pursuant to assignment regularly made to ADMINISTRATIVE LAW JUDGE, by the Oklahoma Tax Commission. A hearing was held, at which hearing Protestant was represented by CPA, Certified Public Accountant. The Income Tax Division of the Oklahoma Tax Commission appeared by OTC ATTORNEY, of the General Counsel's Office of the Oklahoma Tax Commission.

Opening statements were made and exhibits, not itemized herein, were received into evidence. Closing arguments were made and the case was submitted for a decision.

STATEMENT OF FACTS

By agreement prior to the hearing, the parties adopted a Stipulation of Facts, approved and executed by the General Counsel's Office and Protestant, CORPORATION, concerning the procedure leading up to the hearing, the facts as to the management and operation of Protestant's corporation, and the conduct of business upon which the disputed assessment of income tax is based.

The Stipulation of Facts, admitted as Joint Exhibit No. 1, with additional exhibits attached thereto and incorporated therein by reference, is hereby incorporated in these Findings of Fact and Conclusions of Law, and is, by reference, made a part hereof. However, for the convenience of the reader, a brief summary of the salient facts is made.

The Protestant, CORPORATION, is a corporation organized and existing under the laws of the State of Texas, having its principal location of business and commercial domicile in CITY, Texas. Protestant is duly qualified to do business in the State of Oklahoma.

Protestant is a bus or transportation company and is affiliated to some extent as franchisee with the FRANCHISOR. Its Franchise consists of Interstate 40 between CITY, Oklahoma and CITY, Texas and between CITY, Texas and CITY, Kansas.

Protestant's principal business activity is Inter-city Transportation and its principal product or service is bus passenger and express. Approximately forty percent (40%) of the Protestant's gross revenue is derived from passenger and express fares, however, it also derives revenue from private bus charters, package tours, bus rental paid by other franchise companies and from bus repair work to buses owned by other franchise companies.

During the years 1981 through 1983, Protestant operated partly within and partly without the State of Oklahoma and reported its income and expenses for tax purposes as a nonunitary business enterprise. The method used by Protestant for allocating its expenses to the State of Oklahoma was based on a formula by which gross expense was multiplied by a fraction derived from dividing Oklahoma income by gross income.

An office audit of Protestant's Oklahoma income tax returns for the years 1981, 1982 and 1983 was conducted by the Income Tax Division, and Protestant's reported income was adjusted by the Income Tax Division by adding back certain items of income not reported, which the Income Tax Division asserted should have been allocated to the State of Oklahoma in the same manner as Protestant's expenses were allocated to Oklahoma. Protestant protested the assessment and in its protest indicated that it believed Oklahoma operating income was properly identified, that is, income generated by sales of passenger tickets in Oklahoma, and that it was improper to include interest income and rents and gains earned on property located in the State of Texas since Protestant had no assets located in the State of Oklahoma.

Thereafter, upon the request of the Income Tax Division, a consent fixing the period of limitations for the assessment of the Oklahoma income tax return filed for the year 1981 was executed by Protestant and the Income Tax Division and Protestant filed its 1984 Oklahoma income tax return. The 1984 income tax return was filed in the same manner as the 1981, 1982, and 1983 income tax returns had been filed.

Upon review of the office audit and assessment and based upon the Income Tax Division's determination that Protestant as a transportation concern was a unitary business, the Income Tax Division adjusted the Protestant's reported income by apportioning such income to the State of Oklahoma using the three-factor apportionment formula and issued a revised assessment for the years 1981, 1982, 1983 and 1984. The numbers or amounts used to determine each of the three factors were provided by the representative of the Protestant.

Protestant protested the revised assessment, basing its objection on its belief that the United States Constitution prevents states from taxing income derived from transactions made outside the state. Protestant further alleged that allocation of income by indirect methods using the three-factor formula did not reasonably reflect the net income actually attributable to the taxing state.

An informal meeting was held between the representatives of the Protestant and the Income Tax Division at which meeting additional information was introduced by the Protestant which caused the Income Tax Division to adjust its audit and issue a second revised assessment. Thereafter, the Protestant paid under protest the amount of the additional income tax assessed for the years 1981, 1982, 1983 and 1984. Further, the amount of the assessment for the year 1981 was reduced by the Income Tax Division after being notified of a mathematical error in the calculations by the Protestant.

CONTENTIONS OF PROTESTANT

Protestant alleges in its first assignment of error that the value of the “rolling stock” should be reduced for purposes of calculating the property factor in the apportionment formula by the value of eight times the rental income of the rolling stock Protestant had no control over nor was operating during the audit period but had leased to another.

Protestant alleges in its second assignment of error that the method employed by the Division in calculating the sales factor in the apportionment formula allocates an excessive portion of its total income to the State of Oklahoma. Protestant further alleges that the formula used to calculate the sales factor has no relationship to sales.

CONTENTIONS OF THE DIVISION

First, the Income Tax Division contends that Section 2358(A)(5)(a) precludes Protestant from reducing the value of its rolling stock for purposes of computing the property factor of the three-factor formula by the value of eight times the rental income of the rolling stock Protestant leased to another and had no use of or control over.

Second, the Income Tax Division contends that, under Section 2358(A)(5)(C), Protestant may not use a percentage other than that which is statutorily prescribed in determining the sales or revenue factor of the three-factor formula. Further, the statutorily prescribed percentage is not allocating an excessive portion of net income to Oklahoma but is simply allocating its fair and just share of revenue from interstate transportation.

ISSUES

I. Whether, in calculating the property factor in the apportionment formula under 68 O.S. 1981, § 2358(A)(5)(a), it is proper to reduce the value of rolling stock by the value of eight times the rental income of the rolling stock if the owner thereof leases the property to another and does not have any use or control of the property.

II. Whether, in calculating the sales factor in the apportionment formula under 68 O.S. 1981, §2358 (A) (5) (c) (3), it is proper to allocate a portion of revenue to the State of Oklahoma based on interstate mileage traveled in Oklahoma as a percentage of total interstate mileage traveled.

APPLICABLE LAW

This action arises under the Oklahoma Income Tax Act, 68 O.S. 1981, § 2351 et seq., and the Oklahoma Tax Commission has jurisdiction under Section 207 of the Uniform Tax Procedure Code, 68 O.S. 1981, §§ 201-246.

Section 2358(A)(5)(a) of Title 68 provides:

§2358. Adjustments to arrive at Oklahoma taxable income and Oklahoma adjusted gross income.

A. Taxable income and, where use of adjusted gross income is necessary, i.e., required by this act, adjusted gross income shall be adjusted as follows to arrive at Oklahoma taxable income and Oklahoma adjusted gross income:

...

5. The net income or loss remaining after the separate allocation in paragraph 4 above, being that which is derived from a unitary business enterprise, shall be apportioned to this state on the basis of the arithmetical average of three factors consisting of property, payroll and sales or gross revenue enumerated below as a, b and c. Net income or loss as used in this paragraph includes that derived from patent or copyright royalties, purchase relating to or arising from a business activity, the income from which is apportioned under this subsection, including the sale or other disposition of such property and any other property used in the unitary enterprise. Deductions used in computing such net income or loss shall not include taxes based on or measured by income.

a. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property everywhere owned or rented and used during the tax period.

(1) Property, the income from which is separately allocated in subsection A, paragraph 4, above, shall not be included in determining [SIC] this fraction. The numerator of the fraction shall include a portion of the investment in transportation and other equipment having no fixed situs, such as rolling stock, buses, trucks, and trailers, including machinery and equipment carried thereon, airplanes, salesmen's automobiles, and other similar equipment, in the proportion that miles traveled in Oklahoma by such equipment bears to total miles traveled.

(2) Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate received by the taxpayer from subrentals [SIC].

(3) The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the Tax Commission may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

...

Protestant’s suggestion that the value of its “rolling stock” should be reduced by the value of eight times the rental income of the rolling stock it did not control or use but leased to another, ignores Section 2358(A)(5)(a)(1). Section 2358(A)(5)(a)(1) specifically requires that a portion of the investment in transportation and other equipment having no fixed situs be included in the numerator of the property factor fraction. This “portion” includes not only the investment in transportation and other equipment which Protestant has immediate control or use, but also the transportation and other equipment owned by Protestant but which it has no use or control over because it has leased such transportation and other equipment to another. The statute is clear on its face, and the Income Tax Division may not create an exception in the statute where none exists.

Section 2358(A)(5)(c) provides in pertinent part:

c. The sales factor is a fraction, the numerator of which is the total sales or gross revenue of the taxpayer in this state during the tax period, and the denominator of which is the total sales or gross revenue of the taxpayer everywhere during the tax period. Sales as used in this subsection does not include sales or gross revenue which are separately allocated in paragraph 4 above.

...

(3) In the case of an airline, truck or bus enterprise or freight car, tank car, refrigerator car or other railroad equipment enterprise, the numerator of the fraction shall include a portion of revenue from interstate transportation in the proportion that interstate mileage traveled in Oklahoma bears to total interstate mileage traveled.

Protestant’s assertion that the factors to be included in the numerator and denominator should include only those sales which relate to miles traveled by passengers is similar to its argument in its first assignment of error. The argument must fail, however, since the formula is statutorily prescribed and there is no provision in the statute to modify the plain language of the statute.

Protestant’s assertion is based on the theory that the state should only tax those miles used by its buses which involve the transportation of fare-paying passengers. The express intent of the controlling statute, however, is to allocate a portion of the revenues received without regard to whether a fare-paying passenger is aboard the bus. Such a conclusion is necessary since the legislature would have created a statutory exemption for non-fare-paying miles traveled in Oklahoma had that been its intent. See Kasishke’s Estate v. Oklahoma Tax Commission, 541 P.2d 848 (Okl. 1975).

CONCLUSIONS OF LAW

In view of the above and foregoing findings of fact and conclusions of law applicable thereto, the undersigned Administrative Law Judge concludes as follows:

(1) The Oklahoma Tax Commission has jurisdiction in this matter under 68 O.S. 1981, § 207.

(2) This protest is governed by 68 O.S. 1981, § 2358(A) of the Oklahoma Income Tax Act.

(3) The Oklahoma Tax Commission has authority to enforce the provisions of the Oklahoma Income Tax Act and to enforce reasonable rules and regulations consistent with the intent of the Legislature as expressed in the relevant statutes, 68 O.S. 1981, § 203.

(4) Section 2358(A)(5)(a)(1) requires the inclusion of the transportation and other equipment owned by Protestant but which it has no use of or control over because it has leased such transportation and other equipment to another.

(5) Section 2358(A)(5)(c) does not provide an exemption for non-fare-paying passenger miles traveled in Oklahoma as a factor in determining the proportion of interstate miles traveled in Oklahoma to total interstate mileage traveled.

(6) The revised assessments are correct and proper, are in accordance with the statutes as cited and that additional income tax and interest is due and owing by Protestant to the State of Oklahoma in the following amount, to-wit:

For 1981, additional income tax in the amount of Five Thousand Three Hundred Twenty-Five Dollars (\$5,325.00) and interest in the amount of Three Thousand Eight Hundred Thirty-Five Dollars (\$3,835.00), for a total aggregate amount of Nine Thousand One Hundred Sixty Dollars (\$9,160.00).

For 1982, additional income tax in the amount of Six Thousand Eight Hundred Seventy-Eight Dollars (\$6,878.00) and interest in the amount of Four Thousand Four Hundred Thirty-Six Dollars (\$4,436.00), for a total aggregate amount of Eleven Thousand Three Hundred Fourteen Dollars (\$11,314.00).

For 1983, additional income tax in the amount of Six Thousand Two Hundred Forty-Three Dollars (\$6,243.00) and interest in the amount of Two Thousand Nine Hundred Nineteen Dollars (\$2,919.00), for a total aggregate amount of Nine Thousand One Hundred Sixty-Two Dollars (\$9,162.00).

For 1984, additional income tax in the amount of Six Thousand One Hundred Twelve Dollars (\$6,112.00) and interest in the amount of One Thousand Seven Hundred Fifty-Seven Dollars (\$1,757.00), for a total aggregate amount of Seven Thousand Eight Hundred Sixty-Nine Dollars (\$7,869.00).

DISPOSITION

It is the ORDER of the OKLAHOMA TAX COMMISSION, based upon the specific facts and circumstances of this case, that the protest of PROTESTANT be denied.

OKLAHOMA TAX COMMISSION

Deemed precedential by Tax Commission Order No. 87-10-01-03.