TULSA CHAPTER OF OSCPA

Oklahoma Tax Issues

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A. INDIAN RESERVATION TAX BREAKS THROUGH 2017

Generates an employment credit of $4,000 per qualified employee annually (Form 8845) and faster depreciation. Worthwhile to point out a few items here:

1. **The IRS Has a Precise Map Available**—Map describes the qualified areas.

2. **The 1993 Base for Form 8845 Credit**--Has been a problem for many companies. Difficulty in determining the1993 base is not a very good reason to by-pass claiming the credit. If you can obtain a valid statistical sample, you should be able to develop a reasonable 1993 base.

3. **Compensation Limit (Currently $45,000)**--Under IRC Section 45A, this is described as an "annual rate." So if someone was employed for only six months and made $25,000 during that period, that would take them above the $45,000 annual rate, so they would not qualify. With regard to overtime, we have argued with the IRS on this point, and still believe that overtime does not count toward the $45,000 wage limit since it is not part of the "annual rate."

4. **Extender Legislation Still Alive in Congress**

B. PROVISIONS OF OKLAHOMA LAW

1. **Capital Gain Deduction**—This has been a confusing mess since its initial enactment in 2004. We have the CDR saga, which dealt with the Oklahoma Supreme Court rendering an opinion that CDR did not satisfy the definition of an "Oklahoma company" for purposes of the Oklahoma capital gain deduction. The case ended with the Oklahoma Tax Commission (OTC) settling with CDR, despite having a 5-4 win in the Oklahoma Supreme Court (Docket No. 109.886, 4/22/14). Although this action was criticized by some observers, it was a very prudent move on the part of the OTC, since CDR had a very impressive brief ready to file with the U.S. Supreme Court. The basic problem for the OTC is a 9-0 decision in 1996 by the U.S. Supreme Court, Fulton Corp. v. Faulkner, (116 S.Ct. 848) where the Court held that a tax break related to North Carolina's

intangible tax for ownership of stock of corporations paying North Carolina's income tax violated the Commerce Clause. Oklahoma's capital gain benefit for entities headquartered in Oklahoma does not appear to align with the Fulton decision. Notwithstanding the conflict with the Fulton case, the Supreme Court in May 2019 declined to review Baskins v. OTC (Case No. 18-807).

The attorney for CDR and Baskins, Thomas Ferguson, has another case in progress. Consequently, taxpayers who sold shares of non-Oklahoma companies may wish to consider filing refund claims. Note that the statute of limitations for 2016 Oklahoma Form 511 runs out April 15, 2020. Unlike federal law, Oklahoma law does not take extensions into account.

2. **Sales Tax Issue When Buying or Selling Business**--Oklahoma has a fairly unique rule for sales tax applicable to the sale of a business. First, unlike other states, Oklahoma has no blanket exemption for occasional and isolated sales such as the sale of a business. Second, in order to qualify for the manufacturer exemption, the buyer needs to file for a manufacturer exemption prior to closing. It is possible to get a temporary certificate. The date of application is accepted as cutoff date by the OTC.

3. **Avoiding the Franchise Tax**--See attached article from 2002.

4. **Form 506—Oklahoma Manufacturer's Tax Credit**--This is 5% of your manufacturing property additions or $2,500 for each new manufacturing job, claimed on Form 506. Double credit for "Enterprise Zone" areas. Oklahoma Department of Commerce (www.commerce.ok.gov) has a website with maps based on census tracts. Best to actually check with them because maps are sometimes unclear and areas are subject to change (405-815-5120).

   a. The credit is subject to a limitation for years 2016 forward. For 2018, the limitation was 97.6% of the credit otherwise available. Note that the credit is doubled if you are in an enterprise zone, so it will usually pay you to check with the Oklahoma Department of Commerce to see if your location is in the "enterprise zone." There are some maps available, but they are hard to read and sometimes not up-to-date. A simple email to the Department of Commerce will get you a response that tells you whether or not your location is in the enterprise zone. A manufacturer qualifies for the credit by filing a registration form with the OTC. In the past, the OTC has frequently disallowed manufacturing status based on some very arbitrary criteria. If you have a manufacturing operation, it would be worthwhile to make a careful submission, and to follow up with a protest if manufacturer status is denied.

   b. The OTC has done some flip flopping with regard to lessors who lease manufacturing property to a qualified Oklahoma manufacturer. The current interpretation apparently is that the lessor does not qualify for the credit because the lessor is in the business of leasing rather than manufacturing. For other purposes under the Internal Revenue Code, the lessee's business is taken into consideration in classifying the property for depreciation purposes, so that the OTC's position is

somewhat dubious. An interpretation from some years earlier was that the lessor could claim the credit so long as the property would qualify in the hands of the lessee. This would apply for example if the lessee was taking an investment credit rather than a jobs credit and was not claiming a quality jobs payment. It is fairly common for a manufacturer to lease real estate from a related party. Note that the manufacturing facility does qualify for the credit based on the square footage utilized for manufacturing versus office or storage.

c. If the manufacturer is a partnership, it may be possible for the partnership to allocate the (Form 506) tax credit amongst partners so as to maximize the benefit. This is particularly true if there are of out-of-state partners who might derive no benefit whatsoever by utilizing the Form 506 credit to reduce their Oklahoma income tax. Oklahoma has a unique taxation scheme with regard to out-of-state income. Other states provide a credit for tax on out-of-state income whereas Oklahoma provides an exclusion with a salary exception.

d. Note manufacturers also get a sales tax exemption for electricity or gas used in manufacturing.

5. **Out-of-State Income**

a. Probably the strangest feature of Oklahoma income tax is that, unlike other states, out-of-state income is excluded (except for wages). Other states allow a proportionate credit for state tax paid on out-of-state income, but all of the income is included in your tax return (Oklahoma handles income for personal services this way). If you are a resident of Arkansas, Missouri, Louisiana, etc. and have income from a rental property in a non-tax state like Florida or Texas, you nevertheless pay your income tax on the Florida/Texas income.

b. Delaware Holding Companies
The Delaware Holding Company (DHC) is an old device. Also referred to as a passive investment company (PIC). The tax haven state doesn't have to be Delaware, it could be Nevada or elsewhere. Although commonly used to shelter income from a securities portfolio, much more can be involved. Example: Corporation about to sell stock for large gain, fully taxable in the selling corporation's state. Selling corporation sets up Delaware or Nevada holding company and transfers the stock to the holding company. Stock is then sold by the Delaware or Nevada holding company and is exempt from tax in Delaware or Nevada.

Notwithstanding the legal location of the holding company, a taxing state may argue that business and investment decisions are made by personnel in the taxing state where books and records are kept and most of the corporation's activities are performed. This gives the corporation a domicile in the taxing state. Oklahoma was successful with this argument in *Chestnut Securities Co. v. Oklahoma Tax Commission*, 125 F.2d 571 (CA-10, 1942), and Texas was successful in *Lawrence Industries, Inc. v. Sharp*, 890 S.W. 2d 886 (1994). Both of these cases are good

examples of how not to utilize a DHC.

6. **Apportionment**

   a. Oklahoma uses a standard three-factor apportionment formula based on 1/3 wages, 1/3 property and 1/3 sales, with a throwback provision for sales which are not subject to income tax in a destination state. So there is then a question of whether sales destined for another country should be "thrown back" and treated as Oklahoma sales. The form refers to sales not subject to tax in another state or country, but the statute itself at Section 2358 A.5.c.(1) says "...the taxpayer is not doing business in the state of the destination of the shipment." There was legislation proposed to change to a single factor (sales), which did not move but could re-appear.

   b. Wage Factor—Most states determine wages where the employee is based. So an employee based in Arkansas would have Arkansas wages even if he spent time in Oklahoma developing sales. Oklahoma's payroll factor is based on time spent in Oklahoma under Rule 710:50-17-71(3)(E).

7. **Foreign Exclusion Form 2555 for IRS**
   More liberal 550 days out of U.S.A. in 2 years under 68 O.S. Section 2353(4)

8. **Oklahoma Inventors Assistance**
   Income tax break for a product developed and manufactured in Oklahoma, which is patented or has a patent pending. Exclude from income 65% of the cost of depreciable property utilized directly to manufacture the product, up to $500,000. This is in addition to depreciation. 74 O.S. Section 5064.7A
   Register with OCAST to qualify. Easy 1 page form: www.ocast.ok.gov .

9. **Gamblers—No Itemized Deduction After 2017**
   To shift some of the gambling deduction from Schedule A to page 1, consider the "Session method" per IRS Chief Counsel Advice AM 2008-11 and Shollenberger TC Memo 2009-306.

   As an example, let's say the taxpayer has 50 sessions to account for. Of the 50 sessions, 30 are a net loss and the net loss (say $30,000) is then reported on Schedule A limited to the income on Schedule 1. The other 20 sessions produce net income of $30,000 which is reported on Schedule 1, line 21. So net income is zero, but $30,000 on Schedule 1 included in AGI and $30,000 as an itemized deduction on Schedule A.

   Proposed HB 2667 passed the House and would have allowed an Oklahoma gambling loss deduction, but was opposed by Gov. Stitt, possibly as a negotiating item.

10. **QBI—Section 199A 20% Deduction**
    So far, the Oklahoma Tax Commission has stuck with the dubious opinion that the 20% deduction for federal income tax is not allowable for personal Oklahoma income tax on Form 511. Their opinion is on their website-Q/A #29 re individual tax. There is an excellent and very thorough analysis by Tulsa tax attorney Mike Miers to the contrary on the OSCPA website (Evolve). To take the deduction in opposition to the OTC opinion, put the federal amount on line 14 of Form 511-A, show Code 99, and add an explanation such as federal deduction under Section 199A. There will certainly be some future litigation of this issue. Watch out for this and file an amended return for 2018 not later than April, 15,2022 (3 year Statute from original due date). The OTC will have a huge paperwork problem with this issue.

11. **HB 2665—Oklahoma State Tax Work-Around**
    Oklahoma Form 586 Election to pay tax at Pass Through Entity (PTE) level. Not clear if the IRS will approve this.

12. **New Oklahoma First-Time Home Buyer Deduction in 2020**
    S.B. 961 signed into law April 26, 2019 and effective in 2020. Deduct $5,000 per year ($10,000 on a joint return), and up to $50,000 total for deposits to a "home buyer savings account" at an Oklahoma financial institution. A first-time home buyer is one who has never purchased a single-family residence in Oklahoma.

13. **Property Tax**
    Useful and fairly easy Freeport exemption for inventory "not detained more than nine months" per Article X of the Oklahoma Constitution. Use Form 901-F. Note that the form has an inventory turnover calculation and there is no exemption if you have more than a nine-month turn. Nine months is an extraordinarily long turn. If you buy and sell out-of-state (destination test), your exemption is the lesser of the out-of-state purchase percentage of sales percentage. You might want to check your supplier or customer inventory turns to boost your exclusion. See article in CPAFocus Jan./Feb. 2004.

Avoiding Oklahoma Franchise Tax

By Rick Kells, CPA, JD, LLM

Richard "Rick" Kells was a partner with the law firm of Hartzog Conger Cason & Neville, P.C. He was past president of the Oklahoma City Tax Lawyers Group, past chairman of the OBA Tax Section and past Chairman of the Oklahoma Society of CPAs' Taxation Committee. Kells served on the Board of Directors for the OSCPA. He was a fellow of the American College of Trust and Estate Counsel and was listed in The Best Lawyers in America in Tax Law and Trusts & Estates Law. The OSCPA Taxation Committee created the Rick Kells Outstanding Tax Professional Award (http://www.oscpa.com/Content/60958.aspx) in his honor. This article appeared in the May/June 2002 issue of **CPA*FOCUS*.**

Any corporation conducting business in Oklahoma, whether a C corporation or a S corporation, is subject to Oklahoma franchise tax. Limited liability companies (LLCs) are not subject to Oklahoma franchise tax. Therefore, when creating a new entity for a business, it is usually preferable to organize as a LLC rather than a corporation. A LLC can, if it wishes, elect to be taxed for Federal income tax purposes as an association taxable as a corporation. Further, a new LLC electing corporate treatment can, if it qualifies, elect S corporation status. If the corporate election is not made, the LLC will be taxed as a partnership for Federal income tax purposes - or if a one-member LLC - as a disregarded entity. Regardless of how a LLC is taxed for Federal income tax purposes, it is not subject to Oklahoma franchise tax.

Effective Nov. 1, 2001, Oklahoma law permits a corporation to convert to a LLC by simply filing Articles of Conversion with the Secretary of State. Articles of Organization for the LLC must also be filed. If the LLC wants to continue to be taxed as a corporation it would simply make such an election by filing Form 8832 with the IRS. The conversion from a corporation to a LLC electing corporate treatment should be non-taxable as a mere change in form under Section 368(a)(1)(F). Therefore, if a S corporation converts to a LLC and elects corporate treatment by filing Form 8832, it will continue to be taxed as a S corporation and no new S election is necessary.

Before Nov. 1, 2001, such conversion of a corporation was usually accomplished by creating a new LLC, immediately merging the corporation into the LLC and electing corporate tax treatment. This was accorded the same tax treatment as outlined above. The new law allows for a one-step conversion, rather than the prior two-step process of creation of a LLC and merger.

An operating agreement for the LLC should be entered into by the owners before the conversion. If S corporation status is desired, it must be carefully drafted to avoid more than one class of stock. The conversion should not affect the validity of existing contracts. Further, for income tax purposes, the LLC would use the same tax identification number. Rev. Rul. 95-37. On its next tax return, it would simply reflect the change in name to a LLC.

With a parent and a subsidiary, both the parent and the subsidiary could file Articles of Conversion and Articles of Organization. If the subsidiary did not make the election to be taxed as a corporation and was wholly owned, it would be considered a disregarded entity or division of the parent. In that case, the subsidiary's conversion to a LLC would be considered a liquidation of the subsidiary which is usually tax free under IRC Section 332. Another advantage of using non-electing LLCs as subsidiaries is to avoid the complexities of the Federal consolidated return rules.

The Federal income tax treatment will apply automatically for Oklahoma income tax purposes, but not for Oklahoma sales tax purposes. However, sales tax exemptions are available that should apply to a conversion.

Current tax reform proposals call for repeal of the franchise tax. Since the franchise tax is paid in advance through June 30, corporations which are considering a conversion to a LLC may want to wait until May or June. If, at that time, it appears the franchise tax will not be repealed, a conversion can be made before July 1, 2002.

Attachment to 2018 Income Tax Return

Safe Harbor Method for Determining a Wagering Gain or Loss from Slot Machine Play

Per Notic 2015-21 - "Session Method"

Per T/P Summary	
lost	739555
won	652160
net loss	-87395

Taxpayer Name: Taxpayer, John

Taxpayer SSN: 123-45-6789

		Checksum-->	$0.00	-$292,334.44	<-Total losses - included "in session" losses			
		Total per W-2G Forms->	652160.4	739555	<-Losses per T/P			
		$61,340.00	$652,160.40	$1,031,889.44	$511,647.00	$193,257.96	-$379,729.04	$91,501.96

Session Start: Date & Time Start	Session End: Date & Time End	Funds at start of Session-Funds In	Session W-2G wins	Session Losses	Funds purchased	Funds at end of Session-Funds out	Net Session Win/Loss	Greater of net Win/Loss or zero
1/3/18 3:00 PM	1/3/18 11:59 PM	$1,300.00	$2,560.00	$6,010.00	$2,150.00	$0.00	-$3,450.00	$0.00
1/4/18 3:00 PM	1/4/18 11:59 PM	$0.00	$2,760.00	$3,835.00	$1,075.00	$0.00	-$1,075.00	$0.00
1/8/18 3:00 PM	1/8/18 11:59 PM	$1,500.00	$3,130.00	$6,780.00	$2,150.00	$0.00	-$3,650.00	$0.00
1/12/18 3:00 PM	1/12/18 11:59 PM	$0.00	$8,500.00	$11,509.00	$3,009.00	$0.00	-$3,009.00	$0.00
1/26/18 3:00 PM	1/26/18 11:59 PM	$1,200.00	$11,315.00	$17,115.00	$4,600.00	$0.00	-$5,800.00	$0.00
2/2/18 3:00 PM	2/2/18 11:59 PM	$1,000.00	$11,835.00	$26,306.00	$13,471.00	$0.00	-$14,471.00	$0.00
2/3/18 3:00 PM	2/3/18 11:59 PM	$0.00	$1,200.00	$1,200.00	$0.00	$0.00	$0.00	$0.00
2/18/18 3:00 PM	2/18/18 11:59 PM	$900.00	$8,435.00	$10,606.00	$3,153.00	$1,882.00	-$2,171.00	$0.00
3/3/18 3:00 PM	3/3/18 11:59 PM	$0.00	$0.00	$7,525.00	$7,525.00	$0.00	-$7,525.00	$0.00
3/8/18 3:00 PM	3/8/18 11:59 PM	$700.00	$6,925.00	$7,625.00	$0.00	$0.00	-$700.00	$0.00
3/11/18 3:00 PM	3/11/18 11:59 PM	$0.00	$0.00	$7,774.00	$7,774.00	$0.00	-$7,774.00	$0.00
3/18/18 3:00 PM	3/18/18 11:59 PM	$0.00	$0.00	$5,087.00	$5,087.00	$0.00	-$5,087.00	$0.00
3/28/18 3:00 PM	3/28/18 11:59 PM	$2,000.00	$4,325.00	$8,628.00	$2,303.00	$0.00	-$4,303.00	$0.00
3/31/18 3:00 PM	3/31/18 11:59 PM	$500.00	$6,400.00	$13,134.00	$6,234.00	$0.00	-$6,734.00	$0.00
4/5/18 3:00 PM	4/5/18 11:59 PM	$0.00	$5,810.00	$5,810.00	$0.00	$0.00	$0.00	$0.00
4/13/18 3:00 PM	4/13/18 11:59 PM	$500.00	$1,500.00	$5,009.00	$3,009.00	$0.00	-$3,509.00	$0.00
4/18/18 3:00 PM	4/18/18 11:59 PM	$0.00	$0.00	$4,765.00	$4,765.00	$0.00	-$4,765.00	$0.00
4/21/18 3:00 PM	4/21/18 11:59 PM	$0.00	$0.00	$10,030.00	$10,030.00	$0.00	-$10,030.00	$0.00
4/22/18 3:00 PM	4/22/18 11:59 PM	$0.00	$0.00	$4,407.00	$4,407.00	$0.00	-$4,407.00	$0.00
4/25/18 3:00 PM	4/25/18 11:59 PM	$1,000.00	$2,710.00	$4,713.00	$1,003.00	$0.00	-$2,003.00	$0.00
5/1/18 3:00 PM	5/1/18 11:59 PM	$0.00	$4,400.00	$5,403.00	$1,003.00	$0.00	-$1,003.00	$0.00
5/3/18 3:00 PM	5/3/18 11:59 PM	$0.00	$2,700.00	$7,753.00	$5,053.00	$0.00	-$5,053.00	$0.00
5/5/18 3:00 PM	5/5/18 11:59 PM	$3,000.00	$26,296.00	$15,376.00	$4,688.00	$18,608.00	$10,920.00	$10,920.00
5/6/18 3:00 PM	5/6/18 11:59 PM	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
5/7/18 3:00 PM	5/7/18 11:59 PM	$0.00	$0.00	$3,225.00	$3,225.00	$0.00	-$3,225.00	$0.00
5/8/18 3:00 PM	5/8/18 11:59 PM	$800.00	$3,200.00	$6,614.00	$2,614.00	$0.00	-$3,414.00	$0.00
5/10/18 3:00 PM	5/10/18 11:59 PM	$1,000.00	$1,800.00	$4,411.00	$1,611.00	$0.00	-$2,611.00	$0.00
5/16/18 3:00 PM	5/16/18 11:59 PM	$1,000.00	$4,264.00	$6,300.00	$2,150.00	$1,114.00	-$2,036.00	$0.00
5/19/18 3:00 PM	5/19/18 11:59 PM	$2,000.00	$3,396.00	$8,621.00	$3,225.00	$0.00	-$5,225.00	$0.00
5/22/18 3:00 PM	5/22/18 11:59 PM	$0.00	$0.00	$4,443.00	$4,443.00	$0.00	-$4,443.00	$0.00
5/24/18 3:00 PM	5/24/18 11:59 PM	$0.00	$2,250.00	$7,015.00	$4,765.00	$0.00	-$4,765.00	$0.00
5/25/18 3:00 PM	5/25/18 11:59 PM	$500.00	$4,300.00	$7,950.00	$3,150.00	$0.00	-$3,650.00	$0.00
5/27/18 3:00 PM	5/27/18 11:59 PM	$0.00	$0.00	$3,225.00	$3,225.00	$0.00	-$3,225.00	$0.00
6/1/18 3:00 PM	6/1/18 11:59 PM	$0.00	$7,300.00	$9,922.00	$4,956.00	$2,334.00	-$2,622.00	$0.00
6/4/18 3:00 PM	6/4/18 11:59 PM	$0.00	$5,982.00	$9,518.00	$4,759.00	$1,223.00	-$3,536.00	$0.00