# Overview of 2016 Oklahoma Legislative Tax Developments

By Brent Watson, CPA

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**Self-Study Details**
**Interest Area:** Taxation
**Designed for:** CPAs in public accounting and industry tax departments
**Objective:** To provide an overview of Oklahoma's 2016 legislative changes to state and local tax laws
**Level:** Intermediate
**Prerequisite:** None
**Advanced Preparation:** None
**Recommended CPE Credit:** 1 hour
**Note:** CPE credit is available to OSCPA members only.

**MUST BE COMPLETED AND SUBMITTED BY OCTOBER 31, 2016, TO QUALIFY.**

Nearly everyone in Oklahoma is aware of the state's fiscal difficulties that are primarily a result of the precipitous fall in energy prices over the past two years. This price drop is reflected in collection of severance (gross production) taxes, which are based directly on the value of oil and gas extracted. Additionally, as older wells decline or cease production and fewer new wells go online, the decline in volume further reduced the collection of these taxes. Additionally, the decline in prices reduced drilling and production subsequently causing a decline in sales tax collections, forcing companies to lay off workers or go out of business, which resulted in a decline in personal and corporate income taxes. The result has been a record shortfall in state revenues of approximately $1.3 billion.

Significant tax measures have been enacted as part of the budget agreement to bridge the state's budget. This is an overview of some of the more significant tax measures recently enacted.

- **Audit enhancement measures:** The legislature appropriated an additional $4.2 million to the Oklahoma Tax Commission to hire additional auditors and to enhance technology to increase enforcement of sales, income and gross production taxes[1]. The OTC immediately began hiring auditors. Now taxpayers are now experiencing a significant increase in audit activity. Unfortunately, no increased pay was provided to attract and retain skilled and experienced auditors.

- **Sales tax measures:** Legislation titled "The Oklahoma Retail Protection Act of 2016" expanded the reach of sales tax nexus by amending 68 O.S. 2011, Section 1352 to include an augmented definition of doing business in the state, which now includes more actions performed by a related party[2]. These types of nexus factors are commonly referred to as "affiliate nexus." The OTC's initiative precludes assessment of uncollected sales and use tax together with the penalty or interest for sales made during the period the retailer was not registered in Oklahoma, provided the sellers voluntarily register for sales tax prior to May 1, 2017[3]. Additionally, a requirement was added for vendors who lack nexus in the state but who sell in the state to issue letters to Oklahoma customers providing a total of the their sales to that party accompanied with a statement that the resident is required to remit use tax on those purchases[4]. Such a requirement being placed on taxpayers who lack nexus is facially in conflict with the U.S. Constitution's Commerce Clause as illustrated in the 1992 Quill case[5].

  In a separate matter, the period for claiming a refund of sales and use taxes is reduced to two years from the date that the tax was paid for refunds claimed after Aug. 26, 2016[6]. This provision may be the most controversial of all in many respects. A few years ago, Kansas passed a similar limitation, and it was repealed shortly afterward due to the outcry from the business community. This law results in unequal treatment where underpaid taxes can be assessed for up to three years from the date of the invoice, but a refund of overpaid taxes can only be requested for two years.

  This law has resulted in many unanswered questions concerning how underpayments and overpayments should be netted in ongoing audits. Some auditors are refusing to net overpaid taxes paid to vendors for purchases against underpaid tax on purchases. The rule governing statute of limitation waivers seems to clearly indicate that if a waiver is in place, the period for filing a refund claim is extended until the final date of the agreement[7].

- **Personal income tax measures**: Two provisions to increase collections of personal income taxes were included in the budget package. First, the itemized deduction of state income taxes was eliminated by requiring taxable income to be increased by the amount of state and local sales or income tax deducted under Internal Revenue Code (IRC) Section 164. For tax years beginning in 2016, state taxes paid will be added back to reduce federal itemized deductions allowed for Oklahoma income taxes[8]. Second, the refundable aspect of the state's earned income tax credit was repealed effective for tax years beginning after Dec. 31, 2015[9]. The net effect of these measures will more than offset the tax savings attributable to the rate reduction that became effective Jan. 1, 2016 to decrease the maximum rate from 5.25 percent to 5 percent, and will result in increased state income tax liabilities for most taxpayers.

- **Reduction of gross production tax credits for low production oil and gas wells:** The tax credit for economically at-risk oil and gas leases, which are defined as producing less than 10 barrels of oil or 60 MCF (60,000 cubic feet) of gas per day, or which have a net profit of less than the amount of gross production tax remitted. The deadline for filing these credits has been significantly shortened. For all calendar years preceding 2016, should have been filed by July 1, 2016[10]. For calendar years beginning with 2016, claims must be filed by July 1 of the next calendar year. Additionally, a state-wide maximum of credits allowed per year will be set at $12,500,000[11]. Credits granted will be adjusted proportionally so that the maximum state-wide credit allowed is not exceeded. For comparison, total refunds to be paid for the year fiscal year ended June 30, 2016, had been estimated to total $158 million.

- **Reduction of Business income tax credits:** Four provisions to reduce the cost of business tax credits were enacted, including:
    1. Investment/New Jobs Credit for Manufacturers—For tax years beginning on or after Jan. 1, 2016, and ending on or before Dec. 31, 2018, the total amount of the corporate income tax credit for investment/new jobs is limited to $25 million per year[12]. The OTC must annually calculate and publish a percentage by which the credits will be reduced so the total amount of credits does not exceed the $25 million limit.
    2. Child Care Services Credit—Effective for tax years beginning after Dec. 31, 2015, the credit for qualified expenditures by child care providers has sunset[13]. Previously, 68 O.S. 2011, Section 2357.27 allowed a credit of 20 percent of certain eligible expenditures.
    3. Railroad Modernization Credit—This bill reduces a corporate income tax credit for qualified railroad modernization expenditures of an eligible taxpayer's qualified railroad reconstruction or replacement expenditures[14]. While the writing of the statute is somewhat vague, it appears the credit rate is reduced from 50 percent to 37.5 percent for claims occurring after Jan. 1, 2016.
    4. Construction of Energy Efficient Residential Property Credit—The corporate income tax credit for the construction of energy efficient residential property (of 2,000 square feet or less) is limited to the time period beginning on or after Jan. 1, 2006, and ending on July 1, 2016[15].

Fiscal Impact Statement for S.B. 1579, Oklahoma House and Senate, May 4, 2016.
[2]H.B. 2531, Laws 2016 (enacted on May 17, 2016). Note that section 7 of this legislation repeals the following sales tax statutes: OKLA. STAT. tit. 68, §§ 1354.1 (Intent of legislature – Sales tax); 1354.2 (Out-of-state vendors – Tax on sales within state); 1354.3 (Mail order or catalog out-of-state vendors – Tax on sales within state); 1354.4 (Solicitation permit – Fee); 1354.5 (Collection of sales or use tax by certain out-of-state vendors); and 1354.6 (Collection of sales or use tax – Reciprocal agreements).
[3]OKLA. STAT. tit. 68, § 1407.2.B.2.
[4]H.B. 2531, adding OKLA. STAT. tit. 68, § 1406.2.A.
[5]Quill Corp. v. North Dakota, 504 U.S. 298 (1992)
[6]House Bill 3205
[7]OKLA. STAT. tit. 68, § 223.A.
[8]S.B. 1606, Laws 2016 (enacted on May 24, 2016), adding OKLA. STAT. tit. 68, § 2358.E.24.
[9]S.B. 1604, Laws 2016 (enacted on May 27, 2016), amending OKLA. STAT. tit. 68, § 2357.43.
[10]OKLA. STAT. tit. 68, § 1001.3a.C.
[11]OKLA. STAT. tit. 68, § 1001.3a.D.
[12]S.B. 1582, Laws 2016 (enacted on May 24, 2016), amending OKLA. STAT. tit. 68, § 2357.4; *Letter Ruling 16-018*, Oklahoma Tax Commission, June 6, 2016.
[13]S.B. 1605, Laws 2016 (enacted on May 24, 2016), amending OKLA. STAT. tit. 68, § 2357.27.
[14]H.B. 3204, Laws 2016 (enacted on May 24, 2016), amending OKLA. STAT. tit. 68, § 2357.104.
[15]S.B. 1603, Laws 2016 (enacted on May 27, 2016), amending OKLA. STAT. tit. 68, § 2357.46.

## CPE Self-Study Section

Earn one hour of CPE credit by reading the preceding CPE article and completing the provided self-study exam. Mail in the completed exam by Oct. 31, 2016, to the OSCPA CPE Department for grading. If you receive a score of 70% or higher, you will be issued a certificate for one hour of CPE credit, dated as of when the test arrives in the OSCPA office. If you score below a 70%, you will be notified of your score and may be allowed to retake the exam. The answers for this exam will be printed in the next issue of the CPAFOCUS.

Overview of 2016 Oklahoma Legislative Tax Developments—CPE Questions

1. Which of the following is not true regarding the changes made to the new law to expand sales tax nexus?
   a. This law is clearly allowable under current U.S. constitutional law and nexus cases.
   b. Immunity from collection of uncollected sales taxes plus penalty and interest is provided for certain sellers who voluntarily register for sales tax prior to May 1, 2017.
   c. The law seeks to force out-of-state sellers to provide lists of in-state customers to the OTC.
   d. The law seeks to force out-of-state sellers to notify in-state customers of their total annual purchases and their use tax liabilities

2. Which of the following is true regarding the change to the statute of limitations for sales tax refunds?
   a. The period for claiming the refunds is reduced to two years from the date that the tax was paid for all sales tax refunds claimed after Aug. 26, 2016.
   b. The limitation of the statute of limitations for refunds causes disparate treatments for sales tax overpayments and underpayments.
   c. The statute regarding waivers of the statute of limitations seems to clearly indicate that if a waiver is in place, the period for filing a refund claim is extended until the final date of the agreement.
   d. All of the above statements are true.

3. Which of the statements is true regarding changes to personal income taxes?
   a. The deduction for state income taxes is eliminated for tax years beginning after 2015.
   b. The refundable aspect of the state's earned income tax deduction is repealed for tax years beginning after 2015.
   c. The maximum income tax rate is reduced to 5% for tax years beginning after 2015.
   d. All of the above statements are true.

4. Which of the following is <u>not true</u> regarding the changes made to the law pertaining to the tax credit for "economically at risk" oil and gas leases?
   a. Economically at risk oil and gas leases includes oil wells producing less than 10 barrels of oil per day
   b. Economically at risk oil and gas leases includes gas wells producing less than 60 MCF of gas per day.
   c. For all calendar years preceding 2016, claims would have had to be filed no later than July 1, 2016
   d. A state-wide maximum of credits allowed per year will be set at $12,500,000, and credits not paid for the year claimed can be carried forward for 5 years.

5. Which of the following is <u>not true</u> regarding the changes made to the laws for business income tax credits:
   a. The credit for investments or new jobs for manufacturers is limited for years ending before Jan. 1, 2019.
   b. The total credit allowed for investments or new jobs for manufacturers is limited to $25 million annually.
   c. Credits for the manufacturer's credit will be paid on a "first come, first served" basis until the maximum payout is reached.
   d. The credit for railroad modernization has been reduced by 25%.

Participant Evaluation
Please use the following scale to complete the below evaluation: 5=strongly agree; 4=agree; 3=neutral; 2=disagree; 1=strongly disagree

1. The stated learning objectives were adequately met. (add bubbles for rating)
2. The author conveyed a strong knowledge of the subject matter. (add bubbles for rating)
3. The article was timely and relevant. (add bubbles for rating)
4. The article and exam were well-suited to my background, education and experience. (add bubbles for rating)

My overall rating for the self-study program is: __excellent _very good __average __fair __poor

It took me ____ hours and ____ minutes to read the article and complete the exam.

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Answers from last issue: 1) D; 2) C; 3) B; 4) E; 5) D