STATE OF FLORIDA
DEPARTMENT OF REVENUE

ADP, LLC,	)	
a foreign limited liability company,	)	
	)	
Petitioner,	)	
	)	**CASE NO.**
vs.	)	
	)	
FLORIDA DEPARTMENT OF	)	
REVENUE,	)	
a state agency,	)	
	)	
Respondent.	)	

PETITION FOR FORMAL ADMINISTRATIVE HEARING

Petitioner, ADP, LLC ("ADP"), by and through its undersigned counsel and pursuant to Sections 72.011(1)(a), 120.569, 120.57, and 120.80(14)(b), Florida Statutes, seeks an administrative determination of the invalidity of a corporate income tax assessment issued by Respondent, Florida Department of Revenue ("Department"), and alleges:

Identity of the Parties

1. ADP is a Delaware limited liability company with its principal place of business in New Jersey. ADP's address for purposes of these proceedings is that of its counsel, Hollis L. Hyans, Morrison & Foerster LLP, 250 West 55th Street, New York, New York 10019.

2. The Department is an executive branch agency of the State of Florida lawfully created and organized pursuant to Section 20.21, Florida Statutes. By law, the Department is vested with responsibility for regulating, controlling, and fairly administering the revenue laws of the State of Florida, including specifically the laws relating to the imposition and collection of Florida corporate income tax under Chapter 220, Florida Statutes. Section 213.05, Fla. Stat. The Department's address for purposes of these proceedings is that of its General Counsel, Mark S.

Hamilton, Esquire, Office of the General Counsel, Florida Department of Revenue, 2450 Shumard Oak Boulevard, CCOC 1-2400, Tallahassee, Florida 32399-0100.

Background Allegations

3. ADP brings this action to determine the validity of the Department's assessment of corporate income tax and interest for tax years ended June 30, 2013 through June 30, 2014 (the "Assessment Period"), arising from Audit No. 200220190. The Department issued its assessment in the form of a Notice of Proposed Assessment (the "NOPA").[1]

4. ADP filed an informal written protest of the NOPA, which was ultimately granted in part and denied in part by the issuance of a Notice of Decision dated April 1, 2019. A true and correct copy of the Notice of Decision is attached hereto as Exhibit A.

5. For purposes of Chapter 72 and Section 120.80(14), Florida Statutes, the Department's assessment became final on April 1, 2019, the date of the Notice of Decision. *See* Rule 12-6.003(3)(b), Fla. Admin. Code.

6. This Petition is authorized by Sections 72.011(1)(a) and 120.80(14)(b), Florida Statutes, and is timely filed. Section 72.011(2)(a), Fla. Stat.

7. ADP is substantially affected by the assessment as it is alleged to owe a substantial amount of tax and interest to the Department, and its assets are subject to seizure and sale in order to satisfy the amounts ultimately held to be due.

8. By this Petition, ADP contests all of the tax and interest assessed by the Department and disputes that any such amount is lawfully owed, except for $29,899.54

[1] Effective July 1, 2014, ADP, Inc. converted to a Delaware single-member limited liability company and changed its name to ADP, LLC. For purposes of this Petition for Formal Administrative Hearing, ADP, Inc. and ADP, LLC will be referred to interchangeably as "ADP." Although the Notice of Decision also makes references to "A D Processing, LLC," as far as ADP is aware there is no legal entity with that name.

(comprising $21,721 in tax and $8,178.54 in interest) which has been paid to the Department pursuant to Section 120.80(14)(b)(3), Florida Statutes prior to filing this Petition.

9. ADP has exhausted all legally necessary administrative remedies and has otherwise satisfied all conditions precedent legally required for filing this action.

10. The following allegations are true and correct for all time periods material to the Department's assessment.

Material Facts

11. ADP is comprised of several divisions, including the Employer Services Division, which is engaged in data processing services (including payroll remittance services) and, to a much lesser degree, the licensing of prewritten software, leasing of timeclocks, and sale of supplies.

12. The Employer Services Division earns fee income for providing various human capital management data processing services, including tax services, payroll services, benefits administration, human resources management, and retirement services.

13. The service revenue earned by the Employer Services Division is overwhelmingly generated by transactions and activities that take place at a facility in Georgia where the Employer Services Division performs data processing services for all of the Employer Services Division's customers nationwide. ADP has no data processing services facility in Florida. The activities performed at the Georgia facility directly provide the services from which the Employer Services Division derives its service revenue.

14. The Employer Services Division's direct costs of performing these transactions and activities are primarily incurred outside Florida.

15. On its corporate income tax returns filed with the Department for the Assessment Period, ADP included the Employer Services Division's service revenue in its taxable income. In apportioning its taxable income to Florida, ADP computed its sales factor in accordance with Section 220.15(5)(a) and (b), Florida Statutes, and Rule 12C-1.0155, Florida Administrative Code. Specifically, ADP included the Employer Services Division's service revenue in the denominator of its sales factor but excluded those receipts from the numerator of its sales factor as directed by the Department's "costs of performance" provision in Rule 12C-1.0155(2)(*l*). Under that Rule, the Employer Services Division's service revenue was not attributable to Florida (and thus not includable in the numerator of ADP's sales factor) because the greater proportion of the Employer Services Division's income producing activities that generated its service revenue were not performed in Florida, based on the costs of performing those activities. Rather, the overwhelming majority of the costs of transactions and activities directly engaged in hy the Employer Services Division to generate its service revenue were incurred in locations outside of Florida.

16. The Department's auditor determined that the service revenue of the Employer Services Division should have been reported by using a market-based sourcing methodology, meaning that the Employer Services Division's service revenue should have been sourced to Florida to the extent that the service revenue was earned for providing services to customers located in Florida.

17. The basis for the Department's calculations and legal theories is not entirely clear. The auditor claimed to be unable to determine the correct amount of the Employer Services Division's service revenue to include in ADP's sales factor using a market-based sourcing methodology. According to the narrative in the Notice of Intent, the auditor used "payroll data"

and "match[ed] the sales factor with the payroll factor to simulate a market sourcing approach." No specifics are provided on what "payroll data" was used or how the auditor calculated the sales factor. The Notice of Decision states that while the Department's auditor initially calculated ADP's sales factor using ADP's "payroll information," the auditor also used unspecified data received from ADP to calculate a market-based apportionment, although "a revised Notice of Intent to Make Audit Changes [based on such data] was not issued." The Notice of Decision nonetheless concludes that the "auditor used the Florida sales information provided by the taxpayer" to compute the sales factor. It is unclear based on the Notice of Decision which of these methods was ultimately used to calculate the sustained tax amount in the Notice of Decision. As described in greater detail below, neither of the methods described by the Department is correct, and neither is supported by Florida law.

18. The Notice of Decision is intended to reflect the Department's policy of general applicability that interprets a taxpayer's "income producing activity" to occur where its customer is located, a requirement not supported by the plain language of the Department's own regulation.

19. In the Notice of Decision issued by the Department to ADP, the Department has indicated that Rule 12C-1.0155(1)(h), a provision that does not provide ***any*** guidance regarding how to determine which gross receipts of a taxpayer belong in the numerator and denominator of the taxpayer's sales factor, requires services income to he sourced using a market-based sourcing methodology, and that Rule 12C-1.0155(2)(*l*) does not apply.

20. By this Petition, ADP contests the legality of the Department's entire assessment of corporate income tax and interest, except for the amount identified in paragraph 8 (which relates to calculations of Internal Revenue Code Section 168(k) bonus depreciation).

Statutes and Regulations that Entitle Petitioner to Relief

21. Section 120.569, Florida Statutes, authorizes a person whose substantial interests are determined by an agency to file a petition with the agency challenging that determination.

22. Section 120.57, Florida Statutes, provides for the assignment of an administrative law judge by the Division of Administrative Hearings to conduct a hearing and determine all disputed issues of material fact.

23. Sections 72.011(1) and 120.80(14)(b), Florida Statutes, authorize a taxpayer to file an action under Chapter 120, Florida Statutes, to determine the validity of an assessment issued by the Department under Chapter 220, Florida Statutes.

24. A "taxpayer" for purposes of the Florida Income Tax Code "means any corporation subject to the tax imposed by this code . . . ." § 220.03(1)(z), Fla. Stat.

25. The Florida Income Tax Code requires a taxpayer doing business within and outside Florida to apportion its taxable income to Florida. § 220.15(1), Fla. Stat. That apportionment is achieved by multiplying taxable income by a fraction composed of a sales factor, a property factor, and a payroll factor. *Id.* Each factor is, itself, a fraction, the numerator of which includes the taxpayer's Florida sales, property, or payroll, respectively, and the denominator of which includes the taxpayer's sales, property, or payroll everywhere. § 220.15(2), (4), (5), Fla. Stat.

26. Specifically, "[t]he sales factor is a fraction the numerator of which is the total sales of the taxpayer ***in this state*** during the taxable year or period and the denominator of which is the total sales of the taxpayer everywhere during the taxable year or period." § 220.15(5), Fla. Stat. (emphasis added).

27. The Department has duly promulgated administrative regulations in accordance with the Administrative Procedure Act, Chapter 120, Florida Statutes, which instruct taxpayers on the proper methodology for computing the apportionment fraction required by Section 220.15. *See* Rules 12C-1.0153, 12C-1.0154, and 12C-1.0155, Fla. Admin. Code. Rule 12C-1.0155(2) governs the determination of when particular sales are deemed to occur "in this state" for purposes of Section 220.15(5).

28. Rule 12C-1.0155(1)(h) provides, in pertinent part, that "[i]n the case of a taxpayer engaged in providing services . . . 'sales' includes the gross receipts from the performance of such services including fees, commissions, and similar items." Rule 12C-1.0155(1)(h) does ***not*** provide any instruction as to how to determine which "sales" of a taxpayer must be attributed to Florida for purposes of calculating the sales factor.

29. Rule 12C-1.0155(2) provides, in pertinent part, that the numerator of a taxpayer's sales factor "includes gross receipts ***attributed to Florida*** which were derived by the taxpayer from transactions and activities in the regular course of its trade or business." (Emphasis added). The determination of when gross receipts are "attributed to Florida" is made pursuant to Rule 12C-1.0155(2)(a)-(*l*). The provisions of Rule 12C-1.0155(2)(a)-(k) apply to gross receipts from specified transactions and activities, while Rule 12C-1.0155(2)(*l*) is a catch-all governing "Other Sales in Florida" which are not encompassed within the more specific subparagraphs that precede it.

30. Whether gross receipts from "other sales" are attributable to Florida is determined by applying a "costs of performance" test:

> Other Sales in Florida. Gross receipts from other sales shall be attributed to Florida if the income producing activity which gave rise to the receipts is performed wholly within Florida. Also, ***gross receipts shall be attributed to Florida if the income producing***

> ***activity is performed within and without Florida but the greater proportion of the income producing activity is performed in Florida, based on costs of performance.*** The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profits. Where independent contractors are used to complete a contract, the term "income producing activity" will include amounts paid to the independent contractors.

Rule 12C-1.0155(2)(*l*), Fla. Admin. Code (emphasis added).

31. The Department's same regulation elsewhere defines the term "costs of performance" to mean "direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the taxpayer's trade or business." Rule 12C-1.0155(2)(e)2.b, Fla. Admin. Code.

32. The Due Process Clause, Amend. XIV, § 1, of the United States Constitution, requires that the portion of a multistate taxpayer's income attributed to a state for corporate income tax purposes must be rationally related to the taxpayer's business conducted within that state.

33. The Commerce Clause, Art. I, § 8, cl. 3, of the United States Constitution, requires that the factor or factors used by a state in its formula to apportion a multistate taxpayer's income must reasonably reflect how the income was earned in the state. Under the Commerce Clause, a state may tax only that part of a multistate taxpayer's income that is fairly attributable to its income producing activities in that state.

34. The Administrative Procedure Act defines a "rule" to include "each agency statement of general applicability that implements, interprets, or prescribes law or policy or describes the procedure or practice requirements of an agency and includes any form which

imposes any requirement or solicits any information not specifically required by statute or by an existing rule." § 120.52(16), Fla. Stat.

35. The Administrative Procedure Act provides that "[r]ulemaking is not a matter of agency discretion" and mandates that each agency statement defined as a "rule" in Section 120.52 "***shall be adopted by the rulemaking procedure*** provided by this section as soon as feasible and practicable." § 120.54(1)(a), Fla. Stat. (emphasis added.)

36. An agency statement of general applicability that implements, interprets, or prescribes law or policy, but has not been adopted through the rulemaking procedures in Section 120.54, Florida Statutes, is an invalid exercise of delegated legislative authority and unenforceable. § 120.56(4)(a), (d), Fla. Stat. A tax assessment based on such a non-rule policy is likewise invalid and unenforceable. *E.g.*, *Dep't of Revenue v. Vanjaria Enters., Inc.*, 675 So. 2d 252 (Fla. 5th DCA 1996).

Disputed Issues of Material Fact and Law

37. The following issues of material fact and law are in dispute:

a. Whether the Employer Services Division is doing business both in Florida and outside of Florida, such that its taxable income is subject to apportionment pursuant to Section 220.15, Florida Statutes;

b. Whether Rule 12C-1.0155(1)(h) requires services income to be sourced using a market-based sourcing methodology;

c. Whether the Employer Services Division's service revenue is subject to apportionment according to the more specific sourcing methodologies required by Rule 12C-1.0155(2)(a)-(k);

d. Whether the Employer Services Division's service revenue is subject to apportionment according to the "costs of performance" test required by Rule 12C-1.0155(2)(*l*) for "other sales";

e. Whether the transactions and activities directly engaged in by the Employer Services Division that produced its service revenue were performed wholly within Florida;

f. Whether the greater proportion of transactions and activities directly engaged in by the Employer Services Division that produced its service revenue were performed in Florida, based on the Employer Services Division's costs of performing those transactions and activities;

g. Whether the service revenue received from the Employer Services Division's Florida clients is required by Florida law to he included in the numerator of ADP's sales factor for purposes of apportioning its taxable income under the Florida Income Tax Code;

h. Whether the Department's application of a non-rule, market-based sourcing policy to the Employer Services Division's service revenue fairly reflects the extent of the Employer Services Division's business activity attributable to Florida;

i. Whether the Department's application of a non-rule, market-based sourcing policy to the Employer Services Division's service revenue reflects a reasonable sense of how such service revenue was generated;

j. Whether the Department's assessment, to the extent it double weights the payroll factor and eliminates the sales factor, is rationally related to ADP's business attributable to Florida and reflects a reasonable sense of how ADP's revenue was earned;

k. Whether the Department's assessment, to the extent it relies on unspecified data from ADP, is rationally related to ADP's business attributable to Florida and reflects a reasonable sense of how ADP's revenue was earned.

l. Whether the assessment, to the extent it double weights the payroll factor and eliminates the sales factor, causes the income apportioned to Florida to be out of all appropriate proportion to the business ADP transacted in Florida during the Assessment Period;

m. Whether the assessment, to the extent it relies on unspecified data from ADP, causes the income apportioned to Florida to be out of all appropriate proportion to the business ADP transacted in Florida during the Assessment Period;

n. Whether the Department's assessment subjects more of ADP's revenue to Florida corporate income tax than is fairly attributable to ADP's activities in Florida;

o. Whether the Department is allowed to double weight the payroll factor and eliminate the sales factor, which reflects the activities of all of ADP's business divisions;

p. Whether the Department applied a statement of general applicability prescribing law and policy by interpreting the Employer Services Division's "income producing activity" to occur where its customer is located, a requirement not supported by the plain language of the Department's own regulation;

q. Whether the Department's non-rule, market-based sourcing policy implements, interprets, and prescribes law or policy by dictating how a non-Florida based, multistate taxpayer must source its income under the Florida Income Tax Code, and by imposing procedure or practice requirements regarding the sourcing of such a multistate taxpayer's income;

r. Whether the Department's non-rule, market-based sourcing policy is inconsistent with the Department's "costs of performance" test in Rule 12C-1.0155(2)(*l*) and the Department's definition of "costs of performance" in Rule 12C-1.0155(2)(e)2.b;

s. Whether the Department has generally applied its non-rule, market-based sourcing policy to other non-Florida based, multistate taxpayers whose income is required to be sourced under Rule 12C-1.0155(2)(*l*);

t. Whether the Department failed to adopt its non-rule, market-based sourcing policy in accordance with the rulemaking procedure mandated under the Administrative Procedure Act, Chapter 120, Florida Statutes;

u. Such other issues as may arise during discovery in this proceeding.

Grounds for Relief

38. ADP is entitled to relief from the assessment on the following grounds:

a. The Employer Services Division is doing business both in Florida and outside of Florida, such that its taxable income is subject to apportionment pursuant to Section 220.15, Florida Statutes;

b. Rule 12C-1.0155(1)(h) does not require services income to be sourced using a market-based sourcing methodology because Rule 12C-1.0155(1)(h) does not at all address which of a taxpayer's gross receipts must be attributed to the numerator or denominator of a taxpayer's sales factor;

c. The Employer Services Division's service revenue is not subject to apportionment according to the more specific sourcing methodologies required by Rule 12C-1.0155(2)(a)-(k);

d. The Employer Services Division's service revenue is subject to apportionment according to the "costs of performance" test required by Rule 12C-1.0155(2)(*l*) for "other sales";

e. The transactions and activities directly engaged in by the Employer Services Division that produced its service revenue were not performed wholly within Florida;

f. The greater proportion of transactions and activities directly engaged in by the Employer Services Division that produced its service revenue were not performed in Florida, based on the costs of performing those transactions and activities;

g. The service revenue received from the Employer Services Division's Florida clients is not required by Florida law to be included in the numerator of ADP's sales factor for purposes of apportioning its taxable income under the Florida Income Tax Code;

h. The Department's application of a non-rule, market-based sourcing policy to the Employer Services Division's service revenue does not fairly reflect the extent of the Employer Services Division's business activity attributable to Florida;

i. The Department's application of a non-rule, market-based sourcing policy to the Employer Services Division's service revenue does not reflect a reasonable sense of how the Employer Services Division's service revenue was generated;

j. The Department's assessment, to the extent that it double weights the payroll factor and wholly eliminates ADP's sales factor, is not rationally related to ADP's business attributable to Florida and does not reflect a reasonable sense of how ADP's revenue was earned;

k. The Department's assessment, to the extent that it relies on unspecified data from ADP, is not rationally related to ADP's business attributable to Florida and does not reflect a reasonable sense of how ADP's revenue was earned;

l. To the extent that the Department's assessment double weights the payroll factor and eliminates ADP's sales factor, the income apportioned to Florida in the Department's assessment is out of all appropriate proportion to the business ADP transacted in Florida during the Assessment Period;

m. To the extent that the Department's assessment relies on unspecified data from ADP to calculate the sales factor, the income apportioned to Florida in the Department's assessment is out of all appropriate proportion to the business ADP transacted in Florida during the Assessment Period;

n. The Department's assessment, to the extent that it double weights the payroll factor and wholly eliminates ADP's sales factor, subjects more of ADP's revenue to Florida corporate income tax than is fairly attributable to ADP's activities in Florida;

o. The Department's assessment, to the extent that it relies on unspecified data from ADP to calculate ADP's sales factor, subjects more of ADP's revenue to Florida corporate income tax than is fairly attributable to ADP's activities in Florida;

p. The Department is not allowed to double weight ADP's payroll factor and wholly eliminate ADP's sales factor, which reflects the activities of all of ADP's business divisions;

q. The Department applied a statement of general applicability prescribing law and policy by interpreting the Employer Services Division's "income producing activity" to

occur where its customer is located, a requirement not supported by the plain language of the Department's own regulation;

r. The Department's non-rule, market-based sourcing policy implements, interprets, and prescribes law or policy by dictating how a non-Florida based, multistate taxpayer must source its income under the Florida Income Tax Code, and by imposing procedure or practice requirements regarding the sourcing of such a multistate taxpayer's income;

s. The Department's non-rule, market-based sourcing policy is inconsistent with the Department's "costs of performance" test in Rule 12C-1.0155(2)(*l*) and the Department's definition of "costs of performance" in Rule 12C-1.0155(2)(e)2.b;

t. The Department bas generally applied its non-rule, market-based sourcing policy to other non-Florida based, multistate taxpayers whose income is required to be sourced under Rule 12C-1.0155(2)(*l*);

u. The Department failed to adopt its non-rule, market-based sourcing policy in accordance with the rulemaking procedure mandated under the Administrative Procedure Act, Chapter 120, Florida Statutes; and

v. ADP reserves the right to assert other additional grounds for relief as discovery in this case proceeds.

Relief Requested

WHEREFORE, ADP respectfully requests the following relief:

A. That this Petition be assigned to an administrative law judge of the Division of Administrative Hearings;

B. That a hearing be conducted for the purpose of determining the disputed facts;

C. That a Final Order be entered vacating the assessment in whole or in part (except as it relates to the Internal Revenue Code Section 168(k) bonus depreciation addressed in paragraphs 8 and 20 of this Petition); and

D. That ADP be granted such other relief as may be just and equitable, including taxing costs of this proceeding against the Department.

Filed this 13th day of May 2019.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Petition for Formal Administrative Hearing was furnished by electronic mail to Respondent, Florida Department of Revenue, by and through its Chief Assistant General Counsel, Eric R. Peate, Esquire, Office of the General Counsel, Florida Department of Revenue, 2450 Shumard Oak Boulevard, CCOC 1-2400, Tallahassee, Florida 32399-0100, at eric.peate@floridarevenue.com, this 13th day of May 2019.

Mark E. Holcomb

1596206

Florida Department of Revenue
Technical Assistance and Dispute Resolution

Jim Zingale
Executive Director

5050 West Tennessee Street, Tallahassee, FL 32399

floridarevenue.com

April 1, 2019

Ms. Hollis L. Hyans
Morrison & Foerster LLP
250 West 55th Street
New York, NY 10019-9601

Re: Notice of Decision
A D Processsing, LLC
BPN: 0000910758
Audit #: 200220190
Corporate Income Tax
Period: 06/30/2013 - 06/30/2014

Proposed Assessment Amount:		$	2,874,446.88
Sustained Amount:		$	231,299.47
Balance Due:	*	$	241,871.29

* Includes payments and updated interest through March 28, 2019. Interest continues to accrue at $44.07 per day until the postmark date of payment. Daily interest is subject to change every January 1 and July 1.

Dear Ms. Hyans:

This is the Department's response to the protest letter postmarked September 10, 2018, filed against the referenced assessment. The letter of protest, the case file, and other available information have been carefully reviewed. This reply constitutes the issuance of our Notice of Decision, pursuant to the provisions of Rule 12-6.003, Florida Administrative Code (F.A.C.). It represents our position based on applicable law to the issues under protest.

EXHIBIT A

ISSUE

1. Whether the taxpayer should apportion the income it derives from payroll processing using a market methodology or a costs of performance methodology, for purposes of Florida corporate income tax.

2. Whether the interest income of an entity related to the taxpayer, derived from impounding client funds, should be included in the taxpayer's income.

FACTS

The taxpayer is comprised of several divisions. The Employer Services Division processes payroll for its clients from its data processing facility located in Georgia. In filing its Florida corporate income tax returns for both this audit period and the prior audit period, the taxpayer computed its Florida sales factor using a costs of performance methodology for the receipts derived from payroll processing. Market sourcing was used for the other receipts included in the Florida sales factor. When the Department of Revenue audited the taxpayer for the prior audit period, it was determined that the sales derived from payroll processing should have also been reported using a market methodology. The prior audit assessment was sustained in the Department's Notice of Decision (NOD) dated April 3, 2018, and the Notice of Reconsideration (NOR) dated August 6, 2018.

In the prior audit, the Department's auditor was unable to determine the correct amount of sales to include in the taxpayer's sales factor using a market methodology, from the information available, and reduced the sales factor for each year of that audit period to zero. The property and payroll factors for that audit period were each weighted at 50 percent.

For the audit period addressed in *this* NOD, the Department's auditor was again unable to determine the correct amount of Florida sales to include in the numerator of the taxpayer's sales factor using a market methodology, from the information available, and initially estimated the taxpayer's sales based on the taxpayer's payroll information. However, after receiving an e-mail dated February 7, 2018, from the taxpayer, stating that *if* market sourcing of the taxpayer's receipts was appropriate, the Florida sales factor numerator for each year of the audit period would increase by the amounts provided in the e-mail, information in the audit file shows that the amounts provided by the taxpayer in that e-mail were used to compute the numerators of the Florida sales factor for each year of the audit period, *not* the payroll information that the auditor initially used to compute the sales factor. The audit file further indicates that using the taxpayer's numerator amounts, rather than the auditor's estimate based on payroll information, increased the tax due by $1,774.00. As that additional amount of tax was deemed to be immaterial, a revised Notice of Intent to Make Audit Changes was not issued. However, the tax amount on the Notice of Proposed Assessment dated July 12, 2018, reflects that reduction in tax.

Additionally, an audit adjustment was made to include interest income of a related entity, derived from impounding funds of the taxpayer's clients, in the taxpayer's taxable income.

The taxpayer is protesting the portion of the audit assessment associated with computing the Florida sales factor based on payroll information, and the inclusion of the interest income of the related entity in the taxpayer's taxable income.

TAXPAYER ARGUMENT

The protest letter dated September 7, 2018, states that the taxpayer's income derived from payroll processing was properly sourced outside Florida based on costs of performance, pursuant to Rule 12C-1.0155(2)(*l*), F.A.C. It further states that even if market sourcing was appropriate, the auditor's use of payroll information to estimate the sales factor was not supported by Florida law. Additionally, the protest letter states that the interest income of the entity related to the taxpayer, derived from impounding client funds, should not be included in the taxpayer's income.

These positions were reiterated in the conference held on January 23, 2019.

LAW

Section 220.02, F.S., states in part:

> (1) It is the intent of the Legislature in enacting this code to impose a tax upon all corporations, organizations, associations, and other artificial entities which derive from this state or from any other jurisdiction permanent and inherent attributes not inherent in or available to natural persons, such as perpetual life, transferable ownership represented by shares or certificates, and limited liability for all owners. . . .

Section 220.15(5), F.S., states:

> (5) The sales factor is a fraction the numerator of which is the total sales of the taxpayer in this state during the taxable year or period and the denominator of which is the total sales of the taxpayer everywhere during the taxable year or period.
> (a) As used in this subsection, the term "sales" means all gross receipts of the taxpayer except interest, dividends, rents, royalties, and gross receipts from the sale, exchange, maturity, redemption, or other disposition of securities. However:
> 1. Rental income is included in the term if a significant portion of the taxpayer's business consists of leasing or renting real or tangible personal property; and
> 2. Royalty income is included in the term if a significant portion of the taxpayer's business consists of dealing in or with the production, exploration, or development of minerals.

Rule 12C-1.0155, F.A.C., states in part:

> (1) For the purposes of the sales factor, the term "sales" means all gross receipts received by the taxpayer from transactions and activities in the regular course of its trade or business.
>
> * * *
>
> (h) Sales of services. In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency, the performance of equipment service contracts, or research and development contracts, "sales" includes the gross receipts from the performance of such services including fees, commissions, and similar items.
>
> * * *
>
> (2) Florida sales. The numerator of the sales factor includes gross receipts attributed to Florida which were derived by the taxpayer from transactions and activities in the regular course of its trade or business. All interest income, service charges, carrying charges, or time-price differential charges incident to such gross receipts shall be included, regardless of the place where the account records are maintained or the location of the contract or other evidence of indebtedness.
>
> * * *
>
> (j) Other Sales in Florida. Gross receipts from other sales shall be attributed to Florida if the income producing activity which gave rise to the receipts is performed wholly within Florida. Also, gross receipts shall be attributed to Florida if the income producing activity is performed within and without Florida but the greater proportion of the income producing activity is performed in Florida, based on costs of performance. The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profits. Where independent contractors are used to complete a contract, the term "income producing activity" will include amounts paid to the independent contractors.
>
> * * *

EXHIBIT A

DISCUSSION

As stated in the Department's NOD dated April 3, 2018, and its NOR dated August 6, 2018, for the prior audit, subsection 220.02(1), F.S., provides that it is the intent of the Florida Legislature to impose a corporate income tax on every taxpayer in each taxable year, for the privilege of conducting business, deriving income, or being incorporated in this state. Subsection 220.15(5), F.S., defines the sales factor as a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year or period and the denominator of which is the total sales of the taxpayer everywhere during the taxable year or period. Rule 12C-1.0155, F.A.C., describes how the receipts from different types of sales activities are computed, and then provides information on the computation of the Florida portion of those receipts. Rule 12C-1.0155(2), F.A.C., provides that the numerator of the sales factor includes gross receipts attributed to Florida which were derived by a taxpayer from transactions and activities in the regular course of its trade or business. In this case, the taxpayer's payroll processing activities do not constitute the sale of tangible personal property. Therefore, the discussion below will focus on the sourcing of sales other than tangible personal property, namely the sale of services.

The taxpayer has continued to apply Rule 12C-1.0155(2)(*l*), F.A.C., which addresses "Other Sales in Florida," to source its income from payroll processing activities using a costs of performance methodology. However, as was also stated in the NOD and the NOR for the prior audit, Rule 12C-1.0155(1)(h), F.A.C., which addresses "Sales of Services," states that income received for providing services includes the gross receipts from the performance of such services and, to the extent that those services are provided to customers located in Florida, Rule 12C-1.0155(2), F.A.C., directs that the income is to be sourced to Florida and included in the numerator of the sales factor.

The apportionment factor provides a measure of a taxpayer's business activity in the states in which it does business, and serves as a means of attributing income to the states from which the income was derived. Florida is frequently referred to as a "market state" because its sales apportionment is based on where the sales transaction takes place rather than where contracts are approved, where data is processed or stored, where payment is made, or where the customer's headquarters is located.

The Employer Services Division derives income from processing payroll information submitted to it by its customers. The information is then processed using the taxpayer's proprietary payroll system, and the results are submitted back to the customer.

Pursuant to Rule 12C-1.0155(2)(*l*), F.A.C., sales are attributed to Florida if the income producing activity which gave rise to the receipt is performed wholly within Florida. "Income producing activity" is defined in Rule 12C-1.0155(2)(*l*), F.A.C., as "the transactions and activity directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profits."

However, as the income the taxpayer derives from payroll processing is clearly derived from the sale of a service, it would appear that the provisions of Rule 12C-1.0155(1)(h), F.A.C., which addresses "Sales of Services," and Rule 12C-1.0155(2), F.A.C., which directs that such income is to be sourced to Florida and included in the numerator of the sales factor when the services are rendered to customers located in Florida, are on point and are more appropriately applied to the taxpayer's payroll processing income than Rule 12C-1.0155(2)(*l*), F.A.C., which addresses "Other Sales in Florida."

Furthermore, there have been a number of legal decisions on the subject of sourcing income under the costs of performance methodology, which determined that the services income addressed therein should be sourced to the location of the customer to whom the service was provided. The following two cases illustrate Florida's position on the interpretation of Rule 12C-1.0155(2)(*l*), F.A.C. In Heller Western v. Arizona Department of Revenue[1], Heller Western[2] borrowed money from its Illinois parent in order to lend money to Arizona businesses. Any loan over one million dollars had to be approved by its parent in Illinois and its headquarters in California. The California office also monitored the progress of loans made in Arizona and paid the interest expense on the loans from the parent company to Heller Western in Arizona. Prior to 1978, Heller Western sourced the interest earned from loans to Arizona customers[3] to Arizona. After 1978, Heller Western sourced the interest earned from loans to Arizona customers outside Arizona. Heller Western argued that pursuant to A.C.A.R.R. R15-2-135-8(b)(5)(j)(1978) (an Arizona rule similar to Rule 12C-1.0155(2)(*l*), F.A.C.), borrowing money from its parent was part of its income producing activity in Arizona, and that since more than fifty percent of the costs associated with the borrowing occurred outside of Arizona, the income earned from lending money in Arizona should not be sourced to Arizona. The Arizona Department of Revenue ("Arizona") disagreed and argued that the interest earned from loans to Arizona consumers should be sourced to Arizona because "only the activities of the Arizona branch office immediately resulted in generating income from the Arizona loans. Thus only those activities qualify as 'income producing activity.'"[4]

The Arizona Supreme Court ruled in favor of Arizona and stated, "[w]e believe that the term, 'income producing activity,' in our regulation contemplates only direct sales payment activity by the consumer, which in this case occurred in Arizona."[5] This position was further elaborated by the Court:

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[1] 775 P.2d 1113 (Ariz. Sup. Ct. 1989).

[2] Heller Western is a branch of a California corporation. The California corporation is a subsidiary of a corporation domiciled in Illinois.

[3] Customer is used interchangeably with consumer.

[4] Id. at 1116.

[5] Id.

> . . . Further, those activities are uniformly local to the situs of the *consumer*.... For example, payments for interstate transportation of freight are allocated to the state where the freight is delivered, not purchased, because that is where the consumer is. However, payments for interstate transportation of people on a common carrier are allocated to the state where the ticket is purchased, not the traveler's destination, again because that is where the consumer is. Finally, payments resulting from business generated by interstate telephone calls are allocated to the state where the customer placed or received the call; whether the seller called the consumer or the consumer called the seller, it is the consumer's situs that is determinative. . .[6]

The Court states that sourcing sales made to Arizona consumers to Arizona was a "logical conclusion."[7] The Court compares the interest earned from loans to a retailer selling goods and states:

> Heller Western can no more argue that its receipts from Arizona loan consumers should not be taxed due to its out-of-state involvement in procuring its 'inventory' than a retailer who is engaged in extensive dealings out of state to buy his merchandise could argue that he should not be taxed on the goods he sells to consumers here.[8]

The Arizona Supreme Court held that based on the "consumer location orientation...'income producing activity' contemplates direct solicitation, negotiation, and sales activities with consumers in this state."[9] As a result, all sales were sourced to Arizona, regardless of where most of the costs of performance occurred.

In Ameritech Publishing, Inc. v. Wisconsin Department of Revenue[10], Ameritech was in the business of selling advertising for placement in telephone directories. The advertising services at issue were sold entirely within Wisconsin. However, the vast majority of the costs of performance of the advertising services occurred outside Wisconsin. The final product, a telephone book containing the advertisements, was delivered to Wisconsin via common carrier. Ameritech initially sourced the sales of these services to Wisconsin. However, it later filed amended returns seeking refunds arguing that the sale of its services should not be sourced to Wisconsin pursuant to WIS. STAT. s. 71.25(9)(d) ((1999) similar to Rule 12C-1.0155(2)(l), F.A.C.) because the majority of the costs of performance occurred outside Wisconsin, and the telephone books were delivered to Wisconsin via common carrier.

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[6] Id.
[7] Id. at 1117.
[8] Id.
[9] Id.
[10] No. 2009AP445 (App. Ct. IV 2009), 788 N.W.2d 383 (Wis. Ct. App. 2010)

The Wisconsin Department of Revenue ("Wisconsin") disagreed and argued that Ameritech's income producing activity occurred within Wisconsin for several reasons. First, Wisconsin argued that Ameritech had significant sales for the four years at issue and if Ameritech's argument was accepted, Ameritech would pay no tax in one of the years and receive a refund of two million dollars for two of the years. Second, Wisconsin argued that Ameritech's position was unreasonable because large amounts of the income producing activity would not be sourced to Wisconsin, where the advertising occurred. Wisconsin also argued that the Tax Appeals Commission's finding that Ameritech's income producing activity was "furnishing its customers access to a Wisconsin audience was reasonable...."[11] Finally, Wisconsin argued that Ameritech's position that solicitation and advertising production were the income producing activities was "belied by the fact that these activities were not specified in the contract," and that not all of its customers used these services.[12]

The Wisconsin Court of Appeals ruled in favor of Wisconsin and upheld the Tax Appeals Commission's finding that the:

> . . .'[I]ncome-producing activity' associated with [Ameritech]'s service from 1994 to 1997 was, at bottom, the provision of access to a Wisconsin audience. Advertisers paid [Ameritech] to reach Wisconsin consumers through this familiar and well-established advertising medium. It is undisputed that, in the course of providing this service, [Ameritech] employees working in offices outside of Wisconsin executed tasks related to the sale and production of the ads. But [Ameritech]'s customers did not pay primarily for [Ameritech] to service their accounts, design their advertisements, or send their ad copy with the completed directory to the printer. They paid for the broad access [Ameritech] could provide to a Wisconsin audience.[13]

The Wisconsin Court of Appeals also agreed that the income producing activity occurred in Wisconsin, not in the other states in which a majority of the costs of performance occurred and stated:

> Moreover, the Commission reasonably concluded that this service of providing access to Wisconsin consumers is income-producing activity performed within the state of Wisconsin under WIS. STAT. § 71.25(9)(d). During the relevant period, API acted as a gatekeeper for its advertisers to the Wisconsin market; API's customers paid a monthly toll to reach that market via a venerable advertising medium. API's income was dependent primarily upon its status as a telephone directory publisher, and its ability to offer advertisers access to a pool of local consumers (Wisconsin consumers in this case) through this medium. Thus, regardless which state API's sales persons and

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[11] Id. at ¶ 30
[12] Id.
[13] Id. at ¶34.

> advertising production staff was located, API's primary service of providing access to a Wisconsin audience was performed in the state of Wisconsin.[14]

The Wisconsin Court of Appeal stated that the Tax Appeals Commission reasonably relied on The Hearst Corporation v. DOR[15] in order to determine the income producing activity. In Hearst, WISN-TV was a television broadcaster located in Wisconsin. WISN-TV generated revenue from local and national advertisements. The administration of the local advertisements occurred within Wisconsin, while the administration of the national advertisements occurred outside Wisconsin. WISN-TV argued that the income producing activity in regard to national advertisement was performed outside Wisconsin since all the costs of performance occurred outside Wisconsin. The Tax Appeals Commission in Hearst ruled that the income producing activity was the broadcasting of the national advertisement in Wisconsin, despite the fact that the costs of performance of the advertisement occurred outside Wisconsin. The Tax Appeals Commission reasoned that:

> "[T]he network and national advertising revenues are based upon the showing or broadcasting thereof. Without broadcasting there is no income." The Commission further found that "advertisers choose spots based upon the demographic profile of the audience viewing the particular programming during which the spots occur or are available, and that the advertisers are buying the spots due to the programming and its demographic makeup." In its findings of fact, the Commission concluded "the income producing activity is the actual broadcasting of the programming desired by the advertiser and the commercial spots during that programming and, thus, is in Wisconsin."[16]

In both Heller Western and Ameritech, the majority of the taxpayer's costs of performance occurred outside the state in which their customers resided and where the income producing activity actually occurred. The taxpayers in both cases argued that sales should be sourced to the state in which the majority of the costs of performance occurred instead of where the customer was located and where the income producing activity occurred. However, the courts in the two cases held that the income producing activities were the actual sale of services to its customers, as opposed to the costs of performing those services. The courts in both cases sourced the taxpayer's gross receipts from the sale of services to the market state, the state in which the customer resided, reasoning that the direct sale to the customer at the customer's domicile is where the income producing activity occurred. In analyzing the income producing activity, the most important factor to determine is where the customer is located.

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[14] Id. at ¶35.
[15] Wis. Tax Rptr (CCH) ¶203-149 (WTAC 1990)
[16] Id. at ¶18.

The background of the adoption of the sales apportionment factor for the Florida corporate income tax is also helpful for this analysis. When the adoption of the corporate income tax was being debated by the Florida legislature in 1971, there were two options available to measure the receipts for the sales apportionment factor: the pure destination test, also known as the market state test, or the combined destination and origin test.[17] The pure destination test sources the goods sold to the market state or the state where the goods are consumed. The combined destination and origin test assigns the sales to the state from which the goods were shipped if the taxpayer was not doing business in the state of the purchase or if the purchaser was the federal government.

The Florida legislature adopted the pure destination test and assigned fifty percent of the apportionment factor to the sales factor.[18] Florida deviated from weighting the three apportionment factors equally because Florida is a consumer state. Had the legislature adopted equal weighting for the three factors, foreign corporations that do not relocate personnel and property to Florida, would pay proportionately less tax on their income than local corporations that have significant payroll and property factors assigned to Florida.[19] When analyzing each portion of the receipts, a determination must be made as to the final destination of the product or service being sold.

The term "income producing activity" is defined as "the transactions *and* activity directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profits."[20] The word "and" signifies that both transactions and activities must exist in order for any activity to be considered the income producing activity. The word "transaction" is used several times in the Florida Statutes and Rules, but is not defined. Black's Law Dictionary[21] defines "transaction" as:

1. The act or an instance of conducting business or other dealings.
2. Something performed or carried out; a business agreement or exchange.
3. Any activity involving two or more persons.

As was further stated in the NOD and the NOR for the prior audit, the Employer Services Division derives income from providing a service, processing payroll information submitted to it by its customers. If those customers did not provide the information to the taxpayer, the taxpayer would have nothing to process and, as a result, would derive no income from that activity. Therefore, the income from processing payroll information should be sourced to the location of the taxpayer's customer, as provided by Rule 12C-1.0155(1)(h), F.A.C., and Rule 12C-1.0155(2), F.A.C., rather than using the costs of performance method addressed in Rule 12C-1.0155(2)(*l*), F.A.C.

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[17] England, Arthur. Corporate Income Taxation in Florida: Background, Scope, and Analysis. 1972. p.14–15. Print.
[18] Id. at 15.
[19] Id.
[20] Rule 12C-1.0155(2)(l), F.A.C.
[21] 716 (2nd Pocket Edition 2001)

The Department has the authority to base tax assessments on estimates made using the best information available to it, including estimating the Florida sales factor using payroll information if that is the best information available. However, as stated previously in this NOD, while the Department did not issue a revised Notice of Intent to Make Audit Changes, the Department's audit computed the sales factor for each year of the audit period addressed in this NOD using the amount of Florida sales provided by the taxpayer, on a market basis. Accordingly, the portion of the audit assessment associated with this issue is sustained.

Its clients are required to remit cash to the taxpayer so that it may make payments on their behalf. The taxpayer and its affiliates may impound that cash and invest it until the time it is disbursed. Cash was transferred to a related entity of the taxpayer and invested, earning interest until it was disbursed. The Department's audit included in the income of the taxpayer, interest income of the related entity, derived from impounding the taxpayer's client's funds, based on the provisions of a contract the taxpayer provided to the Department's auditor. The taxpayer provided a copy of a more current contract during the protest. Based on the information in the more recent contract, and additional information provided during this protest, the portion of the audit assessment associated with the inclusion of the related entity's interest income is withdrawn.

The protest letter dated September 7, 2018, states that the Department's Notice of Proposed Assessment violates the Florida and U.S. Constitutions. The Department considers the tax positions it has taken to be wholly consistent with all relevant law and rules, both Florida and Federal and, as the statutory provisions at issue were passed by the Florida Legislature, and the rules in place were properly promulgated, the Department's informal protest process is not the proper forum for challenging Florida's statutes and rules.

CONCLUSION

Based on the discussion presented above, income derived from processing payroll information should be sourced to the location of the taxpayer's customers. As the auditor used the Florida sales information provided by the taxpayer, on a market basis, to compute the Florida sales factor during the audit period, the portion of the audit assessment associated with this issue is sustained.

Based on information provided by the taxpayer during the protest, the portion of the audit assessment associated with the inclusion of the related entity's interest income, derived from the impounding of funds, is withdrawn.

Enclosed for your convenience is an audit remittance coupon. Payment, including interest to the postmark date of payment, should be returned in the enclosed envelope, along with the audit remittance coupon. The check should reflect the audit number.

EXHIBIT A

TAXPAYER APPEAL RIGHTS

This Notice of Decision constitutes the final position of the Department unless a Petition for Reconsideration is filed on a timely basis, in which event the Notice of Reconsideration will be the Department's final position. The requirements for a Petition for Reconsideration are set forth below.

Pursuant to Section 72.011(2), F.S., and Rule Chapter 12-6, F.A.C., the assessment is final as of the date of this Notice of Decision unless you file a written Petition for Reconsideration postmarked within thirty (30) days of the date of this Notice of Decision and addressed to Technical Assistance and Dispute Resolution, Post Office Box 7443, Tallahassee, FL 32314-7443. The Petition for Reconsideration must contain new facts or arguments; otherwise, it is subject to dismissal.

Absent a timely-filed Petition for Reconsideration, the assessment reflected in the Notice of Decision is final, and you have three alternatives for further review:

1) Pursuant to Section 72.011, F.S., and Rule Chapter 12-6, F.A.C., you may contest the assessment in circuit court by filing a complaint with the clerk of the court. THE COMPLAINT MUST BE RECEIVED BY THE CLERK OF THE CIRCUIT COURT WITHIN SIXTY (60) DAYS OF THE DATE OF THIS NOTICE OF DECISION. Section 72.011(3), F.S., provides that no circuit court action may be brought unless you pay to the Department the amount of taxes, penalties, and accrued interest assessed by the Department that are uncontested and tender or post a bond for the remaining disputed amounts unless a waiver is granted, as provided in that section. Failure to pay the uncontested amounts will result in the dismissal of the action and imposition of an additional penalty in the amount of twenty-five percent (25%) of the tax assessed. The requirements of Chapter 72, F.S., are jurisdictional;

2) Pursuant to Sections 72.011, 120.569, 120.57, and 120.80(14), F.S., and Rule Chapter 12-6, F.A.C., you may contest the assessment in an administrative forum by filing a petition for a Chapter 120 administrative hearing with the Department of Revenue, Office of General Counsel, Post Office Box 6668, Tallahassee, FL 32314-6668. THE PETITION MUST BE RECEIVED BY THE DEPARTMENT WITHIN SIXTY (60) DAYS OF THE DATE OF THIS NOTICE OF DECISION. The petition should conform to the requirements of the Uniform Rules promulgated pursuant to Section 120.54(5), F.S. Section 120.80(14), F.S., provides that before you file a petition under Chapter 120, F.S., you must pay to the Department the amount of taxes, penalties, and accrued interest that are not being contested. Failure to pay those amounts will result in the dismissal of the petition and imposition of an additional penalty in the amount of twenty-five percent (25%) of the tax assessed. Mediation pursuant to Section 120.573, F.S., is not available. The requirements of Section 72.011(2) and (3)(a), F.S., are jurisdictional for any action contesting an assessment or refund denial under Chapter 120, F.S.; OR

3) Pursuant to Section 120.68, F.S., you may contest the assessment in the appropriate district court of appeal by filing a Notice of Appeal meeting the requirements of Rule 9.110, Florida Rules of Appellate Procedure, with i) the Clerk of the Department of Revenue, Office of General Counsel, Post Office Box 6668, Tallahassee, FL 32314-6668 and ii) with the clerk of the appropriate district court of appeal, accompanied by the applicable filing fee. THE NOTICE OF APPEAL MUST BE FILED WITH BOTH THE DISTRICT COURT OF APPEAL AND THE DEPARTMENT OF REVENUE WITHIN THIRTY (30) DAYS OF THE DATE OF THIS NOTICE OF DECISION.

Should you have any further questions concerning this matter, please do not hesitate to contact me.

Sincerely,

Suzanne C. Paul

Suzanne C. Paul
Tax Conferee
Technical Assistance & Dispute Resolution
(850) 717-6794

Enclosure: Audit Remittance Coupon

cc: Mr. Brian G. Gallagher
ADP, LLC
1 ADP Boulevard MS 433
Roseland, NJ 07068-1728

NOTICE UNDER THE AMERICANS WITH DISABILITIES ACT

Persons needing an accommodation to participate in any proceeding before the Technical Assistance and Dispute Resolution Office should contact that office at 850-617-8346, or you may also call via the Florida Relay System at 800-955-8770, at least five working days before such proceeding.

FLORIDA

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Audit Remittance Coupon

03/28/2019

C/O HOLLIS L HYANS
A D PROCESSING, LLC
250 W 55TH ST
NEW YORK NY 10019-9710

Business Partner: 910758
Audit Number: 200220190
Audit Period: 06/30/13-06/30/14
Tax type: Corporate Income Tax

To ensure proper credit, please detach and include the preprinted remittance coupon below when submitting payments.

If additional interest is applicable, please refer to the additional interest instructions on the enclosed correspondence.

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New York Service Center
Business Partner:
910758
Audit Number:
200220190

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Florida Department of Revenue
Technical Assistance & Dispute Resolution
Post Office Box 5800
Tallahassee, FL 32314-5800

Check Number:
Tax Type:
Corporate Income Tax
Remittance Total:

C/O HOLLIS L HYANS
A D PROCESSING, LLC
250 W 55TH ST
NEW YORK NY 10019-9710

0600 0 20140630 0002005059 9 6200220190 0000 0

EXHIBIT A