Florida Department of Revenue
Technical Assistance and Dispute Resolution

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QUESTION: How should the taxpayer source its income from different types of services it provides?

ANSWER: The taxpayer should source its income from different types of services it provides to the location of the customer to which the services are provided, on a market basis.

September 27, 2018

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XXX

Re: Technical Assistance Advisement 18C1-011
Request for Sales Sourcing Guidance
Section 220.15, F.S.
Rule 12C-1.0155, F.A.C.
XXX ("the taxpayer")
FEIN: XXX

Dear XXX:

This is in response to your request dated XXX, for a Technical Assistance Advisement ("TAA") pursuant to s. 213.22, F.S., and Rule Chapter 12-11, F.A.C., regarding guidance on the sourcing of sales. An examination of your letter has established that you have complied with the statutory and regulatory requirements for issuance of a TAA. Therefore, the Department is hereby granting your request for a TAA.

FACTS SUPPLIED BY TAXPAYER

The taxpayer is headquartered in XXX. The taxpayer files its federal and Florida corporate income tax returns on a consolidated basis. The taxpayer and its affiliate offer XXX.

The taxpayer also has a XXX, for use by XXX.

The taxpayer also provides XXX.

ISSUE

The taxpayer is requesting guidance on the proper sourcing of income for the types of services it offers, for Florida corporate income tax purposes.

LAW

Section 220.15(5)(a), 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:

> (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.
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> (l) 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.

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ANALYSIS

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 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.

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."

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

[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.

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:

> . . . 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

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[4] Id. at 1116.
[5] Id.
[6] Id.
[7] Id. at 1117.
[8] Id.

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.

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

[9] Id.
[10] No. 2009AP445 (App. Ct. IV 2009), 788 N.W.2d 383 (Wis. Ct. App. 2010)
[11] Id. at ¶ 30
[12] Id.

> 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 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 Appeals 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

[13] Id. at ¶34.
[14] Id. at ¶35.
[15] Wis. Tax Rptr (CCH) ¶203-149 (WTAC 1990)

> 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.

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

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[16] Id. at ¶18.
[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.

"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.

The taxpayer is entitled to receive income from XXX. Such XXX is associated with a specific location in a specific state, in which the XXX, or other issue which gave rise to the XXX occurred. Therefore, the income producing activity which generates income for the taxpayer and its affiliate is XXX associated with such XXX. To the extent that the XXX, for which the XXX is located or resides in Florida, such income should appear in both the numerator and the denominator of the Florida sales factor computed in the taxpayer's Florida corporate income tax return.

The taxpayer also has a XXX. In this instance, the taxpayer receives income from XXX at the specific location XXX. If a XXX from the taxpayer's XXX is XXX in Florida, such income should appear in both the numerator and the denominator of the Florida sales factor computed in the taxpayer's Florida corporate income tax return.

The taxpayer also provides XXX, through its affiliates. The affiliates are typically engaged by XXX. The affiliates involved in this activity also XXX. Again, this activity is provided to XXX at specific locations in specific states, and income derived from it should appear in both the numerator and the denominator of the Florida sales factor computed in the taxpayer's Florida corporate income tax return, when the XXX with which the income is associated is located in Florida, or when the XXX originates or occurs in Florida.

While the letter requesting this TAA references Rule 12C-1.0155(2)(e), F.A.C., that rule paragraph addresses taxpayers that provide "personal services." Section 448(d)(2)(A), I.R.C., defines "personal services" as involving "the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, ..." As the taxpayer and its affiliates are hired by parties that XXX, to provide XXX to them, but the taxpayer and its affiliates do not provide XXX themselves, the taxpayer and its affiliates do not provide "personal services." Therefore, that rule does not apply to the taxpayer and its affiliates.

Additionally, the TAA's referenced in this TAA request that were previously issued by the Department were issued to other taxpayers based on their specific facts and circumstances, do not appear to reflect the activities of this taxpayer, and do not apply to this taxpayer.

[21] 716 (2nd Pocket Edition 2001)

CONCLUSION

The income the taxpayer and its affiliate receive from XXX should appear in both the numerator and the denominator of the Florida sales factor computed in the taxpayer's Florida corporate income tax return, when the XXX is located or resides in Florida.

The income the taxpayer receives from XXX should appear in both the numerator and the denominator of the Florida sales factor computed in the taxpayer's Florida corporate income tax return, when a XXX from the taxpayer's XXX located in Florida.

The income the taxpayer and its affiliates receive from providing XXX should appear in both the numerator and the denominator of the Florida sales factor computed in the taxpayer's Florida corporate income tax return, when the XXX with which the income is associated is located in Florida, or when the XXX originates or occurs in Florida.

This response constitutes a Technical Assistance Advisement under s. 213.22, F.S., which is binding on the Department only under the facts and circumstances described in the request for this advice as specified in s. 213.22, F.S. Our response is predicated on those facts and the specific situation summarized above. You are advised that subsequent statutory or administrative rule changes, or judicial interpretations of the statutes or rules, upon which this advice is based, may subject similar future transactions to a different treatment than expressed in this response.

You are further advised that this response, your request and related documents are public records under Chapter 119, F.S., which are subject to disclosure to the public under the conditions of s. 213.22, F.S. Your name, address, and any other details, which might lead to identification of the taxpayer, must be deleted before disclosure. In an effort to protect the confidentiality of such information, we request you provide the undersigned with an edited copy of your request for Technical Assistance Advisement, backup material and response within fifteen days of the date of this advisement.

Sincerely,

Suzanne C. Paul

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cc: XXXX
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AMS No.: 7000018513