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.

January 13, 2020

XXXXX
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Re: Technical Assistance Advisement 20C1-001
Corporate Income Tax – Sales Factor
Section 220.15(5), Florida Statutes ("F.S.")
Rule 12C-1.0155(1), (2), Florida Administrative Code ("F.A.C.")
XXXXX ("Taxpayer")
FEIN: XXXXX

Dear XXXXX:

This advisement is in response to your request dated July 25, 2019, for a Technical Assistance Advisement ("TAA") pursuant to section 213.22, F.S., and Rule Chapter 12-11, F.A.C., regarding your request for a Technical Assistance Advisement concerning the proper sourcing of sales for Taxpayer.

FACTS SUPPLIED BY TAXPAYER

Taxpayer is headquartered in XXXXX, and is a technology-based corporation that provides a platform for developers to create and sell software applications ("apps"). The platform consists of XXXXX. Taxpayer's XXXXX of the platform are performed primarily in XXXXX.

Taxpayer is seeking guidance regarding the proper treatment of certain revenues for the Florida sales factor. Specifically, how the Taxpayer's User XXXXX Fees (referred to as XXXXX within the

sample contract provided[1]) and XXXXX Fees (referred to as XXXXX within the sample contract provided) should be sourced to Florida.

User XXXXX Fees

Taxpayer charges individuals and/or businesses ("Users") a XXXXX fee in exchange for access to its platform and certain rights and services. Users must create an account to access Taxpayer's platform. The platform provides the XXXXX apps on the platform. Users are also given a limited license to utilize certain intellectual property that Taxpayer grants them access to, and Users must enter into a registration agreement with Taxpayer that governs the use of these resources.

User XXXXX Fees

A User is charged a XXXXX Fee when an end-user/customer of User ("Consumer"): (a) purchases anything from Taxpayer's platform; (b) purchases physical goods or other items from Taxpayer's platform; or (c) purchases anything from a platform other than Taxpayer's platform. Services Taxpayer provides in relation to the XXXXX Fee include:

(1) acting as an intermediary in transactions between Consumers and Users;
(2) collecting payments from Consumers for sales made by Users;
(3) calculating, collecting, and remitting sales and use taxes and withholding taxes to the relevant taxing authorities for sales made via Taxpayer's platform;
(4) calculating and maintaining a refund reserve on behalf of Users to cover potential refund amounts including refunds, rebates, and chargebacks; and
(5) transferring remaining balances from the refund reserve to Users on a monthly basis.

ISSUES PRESENTED

In its letter dated July 25, 2019, Taxpayer requests a Technical Assistance Advisement to provide guidance on how Taxpayer's *User XXXXX Fee* and *XXXXX Fee* revenues should be sourced within and without Florida for purposes of the Florida sales factor.

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.

[1] Taxpayer provided a sample XXXXX

(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.

* * *

(*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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DISCUSSION AND 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.

Sales of tangible personal property are to be included in both the numerator and the denominator of the Florida sales factor when the goods are delivered or shipped by the seller to a purchaser in Florida, regardless of the F.O.B. point, other conditions of the sale, or the ultimate destination of the property. However, when tangible personal property is shipped by common or contract carriers, a destination test is to be used to determine if the sale is a Florida sale or if the sale should be sourced to another state.

In this case, Taxpayer has requested guidance on the sourcing of sales other than 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[2], Heller Western[3] 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[4] 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.'"[5]

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

[2] 775 P.2d 1113 (Ariz. Sup. Ct. 1989).
[3] Heller Western is a branch of a California corporation. The California corporation is a subsidiary of a corporation domiciled in Illinois.
[4] Customer is used interchangeably with consumer.
[5] Id. at 1116.

the consumer, which in this case occurred in Arizona."[6] 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. . . [7]

The Court states that sourcing sales made to Arizona consumers to Arizona was a "logical conclusion."[8] 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.[9]

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."[10] 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[11], 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.
[8] Id. at 1117.
[9] Id.
[10] Id.
[11] 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…."[12] 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.[13]

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.[14]

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

[12] Id. at ¶ 30
[13] Id.
[14] 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.[15]

The Wisconsin Court of Appeals stated that the Tax Appeals Commission reasonably relied on The Hearst Corporation v. DOR[16] 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."[17]

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

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

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.[18] 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.[19] 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.[20] When analyzing each portion of the receipts, a determination must be made as to the final destination of the product or service being sold.

Absent a statutory definition, words should be given their plain and ordinary meaning, and one looks to the dictionary for the plain and ordinary meaning of words. Suddath Van Lines, Inc. v. Department of Environmental Protection, 668 So.2d 209, 212 (Fla. 1st DCA 1996).

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."[21] 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[22] 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.

Under Rule 12C-1.0155(2)(*l*), F.A.C., when the activity producing the sales revenue occurs entirely or predominately in Florida, the receipts from the Florida activity are deemed to be a Florida sale.

User XXXXX Fees

The income producing activity in regard to the User XXXXX Fees is the creation of the User XXXXX. Taxpayer may charge the fee once the XXXXX is created, regardless of whether the User actually uses Taxpayer’s platform. Therefore, if the User XXXXX is created in Florida, the User

[18] England, Arthur. Corporate Income Taxation in Florida: Background, Scope, and Analysis. 1972. p.14–15. Print.
[19] Id. at 15.
[20] Id.
[21] Rule 12C-1.0155(2)(l), F.A.C.
[22] 716 (2nd Pocket Edition 2001)

XXXXX Fee is a Florida sale, the determination of which is based on the User's billing address. This presumption is rebuttable if it can be proven the User created the XXXXX outside of Florida.

User XXXXX Fees

Taxpayer's income producing activity is performing services for Users in exchange for a XXXXX. Taxpayer receives income when a Consumer either pays a fee to access a User's app or purchases goods or services using a User's app or purchases goods or services outside of User's app. If the Consumer's billing address is in Florida, the User XXXXX Fee should be sourced to Florida. This presumption is rebuttable if it can be proven the Consumer used or purchased from the User's app outside of Florida.

CONCLUSION

Given the specific circumstances involved in this case, and based on the representation of Taxpayer, when a User XXXXX is created in Florida ***or*** User XXXXX Fees are generated from a Consumer with a Florida billing address, that income is sourced to Florida. However, Taxpayer is reminded that should the facts provided in its request of July 25, 2019, be determined to be incorrect or changed, the proper sourcing of these revenues could be substantially different from what has been agreed upon in this TAA.

This response constitutes a Technical Assistance Advisement under section 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 section 213.22, F.S. Our response is based on those facts and specific situation summarized above. You are advised that subsequent statutory or administrative rule changes or judicial interpretations of the statutes or rules upon this advice is based may subject future transactions to a different treatment than expressed in this response.

You are further advised that this response, your request and related backup documents are public records under Chapter 119, F.S., and are subject to disclosure to the public under the conditions of section 213.22, F.S. Confidential information must be deleted before public disclosure. In an effort to protect confidentiality, we request you provide the undersigned with an edited copy of your request for Technical Assistance Advisement, the backup material and this response, deleting names, addresses and any other details which might lead to identification of the taxpayer. Your response should be received by the Department within 15 days of the date of this letter.

Sincerely,

Mark McElroy

Mark McElroy
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