

# Florida Corporate Income Tax – Department of Revenue Cannot Ignore Own Cost of Performance Rule

By: Dan McGinn and French Brown; Dean Mead

On November 28, 2022, Second Judicial Circuit Judge Marsh issued a Final Judgment in Case No. 2021-CA-2158, *Target Enterprise, Inc. v. State of Florida Department of Revenue*. Finding in favor of the Plaintiff, Target Enterprise, Inc. (“TEI”), the court abated the Department of Revenue’s (“DOR”) corporate income tax in full.

DOR proposed adjustments to TEI’s corporate income tax liability for the fiscal years ending in January 31 of 2017-2019. These adjustments were related to the methodology used to attribute the sales of services to TEI’s affiliated company, Target Corporation for the purposes of determining TEI’s Florida sales factor. DOR determined that the service sale receipts should be apportioned to Florida based on the ratio of the retail square footage of Target Corporation retail stores in Florida compared to the square footage of such stores across the entire country.

TEI’s position was that DOR’s own rule, rule 12C-1.0155(2)(l), F.A.C. (the “Cost of Performance Rule”), required that the sales receipts must be attributed to Florida based on the location of the income producing activity directly engaged in by TEI, which in itself is determined by the location of the costs to perform those services. Under the application of the Cost of Performance Rule, the receipts would be attributed to Minnesota, rather than Florida.

The court recognized that the Cost of Performance Rule looks to where the costs were incurred to perform the relevant services. If the greater proportion of the costs were incurred outside Florida, then taxpayer has a numerator of zero, and therefore a Florida sales factor of zero, pursuant to section 220.15, Florida Statutes. If the opposite were true, then the entirety of the receipts would be recorded in the numerator of the sales factor.

DOR attempted to avoid the application of the Cost of Performance Rule by claiming that TEI failed to provide sufficient documentation to apply the rule. Thus, according to DOR, a different methodology could be used based on the equitable authority provided to the department under section 220.44, Florida Statutes. TEI countered this claim by testifying that it’s state-by-state payroll, property, and sales apportionment workpapers were provided to DOR when asked to support the use of the COP rule, and that these documents were made available to DOR both electronically and in-person. Further, TEI testified that the documents are the same documents provided to other state taxing authorities with similar Cost of Performance allocation rules.

The court determined that TEI provided sufficient documentation to DOR to support the use of the Cost of Performance Rule. Only .068% of TEI’s costs of performance were attributable to Florida, whereas nearly 95% were attributable to Minnesota. Therefore, pursuant to the operation of the rule, Target’s sales factor was 0 for the disputed services.

The court further opined on DOR’s position regarding the application of section 220.44, Florida Statutes, to this matter. Recognizing that TEI met its obligations under section 220.21, Florida Statutes, through DOR’s rule applying the statute, rule 12C-1.021(2), F.A.C., to make its any requested records “available for inspection” by DOR, and noting that DOR never questioned these records or made any mention of TEI failing to cooperate with DOR, the court found that the documentation provided was sufficient to support the use of the Cost of Performance Rule. Therefore, the Department was without authority to rely on section 220.44, Florida Statutes, to reconstruct TEI’s sales factor under a different methodology.

Finally, the court noted that even if DOR could have relied on section 220.44, Florida Statutes, that its proposed apportionment methodology was unreasonable as it bore “no relevant relationship” to TEI’s activities in Florida. Specifically, DOR’s proposed methodology was held to conflate Target Corporation’s business activity with TEI’s, which would not accurately capture TEI’s business activity within Florida. Thus, all claims were resolved in favor of TEI.

More recently, on March 1, 2023, Judge Marsh again opined on DOR’s failure to apply the Cost of Performance rule, this time in a matter brought by multiple plaintiffs. In *Billmatrix Corp. et. al v. State of Florida, Department of Revenue*, 2020 CA 000435, Judge Marsh ruled in favor of the Plaintiffs on their motion for summary judgment,<sup>1</sup> finding that the DOR’s assessments against each of the Plaintiffs violated the plain language of rule 12C-1.0155(2)(l), F.A.C., causing DOR to both improperly attribute receipts to Florida in five instances, while failing to properly attribute receipts to Florida in the final instance.

The Court noted that DOR’s auditors attempted to base the sales factor determinations in the audits at issue either based on the location of the ultimate customer or a combination of the location of the customer and the

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location of the taxpayers' transactions and activities. Examining the workpapers and deposition testimony provided by DOR representatives, the Court noted that rather than examining the transactions and activities engaged in by the taxpayer, DOR instead focused on the location, destination, and actions of the taxpayer's customers, thereby contravening the plain language of its own rule. Notably, DOR's own auditor recognized that doing so resulted in the application of a market based methodology rather than the required cost of performance calculation, but carried forward with the assessment nonetheless.

Judge Marsh continued on by recognizing that even if the rule were ambiguous in describing the precise procedure to be followed, the rule still requires the application of the cost of performance method. Interestingly, the Court also found that the DOR's "inconsistent interpretation of its own regulations violates Florida's Taxpayer Bill of Rights", section 213.015, Florida Statutes. Specifically recognizing that section 213.015(21), Florida Statutes, requires the fair and consistent application of tax laws by DOR, Judge Marsh wrote that both DOR's application of its apportionment methodology in a manner that contradicts its own rule, and how DOR's application of its rule differs from taxpayer to taxpayer, are neither fair nor consistent. Recognizing that DOR's own varying internal interpretations of a clear regulation can cause such inconsistencies, the Court found that despite this excuse DOR's failure to apply the correct methodology was nonetheless a violation of the Taxpayer Bill of Rights. As such, the assessments at issue were invalidated and abated in full.

**About the Authors:**

**Daniel McGinn** is an experienced attorney who is proficient in navigating regulatory frameworks to get to his client's desired outcome and devises creative solutions for his client's concerns. Daniel's practice focuses on Florida state and local tax disputes and aiding clients in complying with the operations and policies of Florida's regulatory agencies.

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French Brown offers clients a more than fourteen years of experience practicing law and lobbying in the area of Florida state and local taxation. He began his legal career at the Florida Department of Revenue, where he quickly rose to the position of Deputy Director of Technical Assistance and Dispute Resolution. He specializes in all Florida taxes including sales tax, corporate income tax, motor fuels tax, communications services tax, property tax, and documentary stamp tax. He assists his clients with Florida tax planning and controversies before the Florida Department of Revenue and local Property Appraisers.

French represents some of Florida's largest trade associations and taxpayers before the Florida Legislature, including the Florida Chamber of Commerce, the Florida Retail Federation, and the Florida Realtors. French has directly worked on and advocated for many of the major tax legislation passed in recent years benefiting both companies and taxpayers.

**Endnotes**

- 1 The final judgment in the case is pending a ruling on DOR's motion to dismiss based on an alleged lack of subject matter jurisdiction.

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