FLORIDA
DEPARTMENT OF REVENUE

Executive Director
Lisa Vickers

TAX: Corporate Income Tax
TAA NUMBER : 11C1-001
ISSUE : Request for Permission to use an Alternative Method of Apportionment
STATUTE CITES: SS. 220.03, 220.15, and 220.152, F.S.
RULE CITES: Rules 12C-1.015, 12C-1.0152, 12C-1.0153, 12C-1.0154, and 12C-1.0155, F. A. C.

QUESTION: May the taxpayer be granted permission to use an alternative method of apportionment in computing its Florida corporate income tax liability?

ANSWER: The parent company was not granted permission to use an alternative method of apportionment in computing its Florida corporate income tax liability.

February 2, 2011

XXX
XXX
XXX

Re: Technical Assistance Advisement 11C1-001
Request to Use Alternative Apportionment
Requestor: XXX (hereinafter referred to as "the taxpayer")
FEIN: XXX
Sections 220.03, 220.15, and 220.152, Florida Statutes (F.S.)
Rules 12C-1.015, 12C-1.0152, 12C-1.0153, 12C-1.0154, and 12C-1.0155, Florida Administrative Code (F.A.C.)

Dear XXX:

Your letter of XXX, requests permission to use an alternative apportionment method for Florida corporate income tax purposes. This response to your request constitutes a Technical Assistance Advisement under Chapter 12-11, Florida Administrative Code, and is issued to you under authority of s. 213.22, Florida Statutes.

FACTS SUPPLIED BY TAXPAYER

The taxpayer is a XXX corporation that is a wholly owned subsidiary of a XXX parent corporation. The taxpayer is in the business of investing in foreign partnerships that invest in United States partnership interests. Specifically, the taxpayer invests in XXX partnerships that in turn invest in real estate partnerships in the United States, and receives schedule K-1's from the partnerships in which it invests. However, because of the number of tiers existing in the partnerships, the taxpayer does not receive the property, payroll, and sales amounts for the middle and lower tiered partnerships in which it invests that are necessary to properly compute its Florida apportionment factor. Therefore, for Florida corporate income tax purposes, the taxpayer allocates all of the income from the partners

LEGAL AUTHORITY

Section 220.03(1)(s), F.S., states:

> "Partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, including a limited partnership; and the term "partner" includes a member having a capital or a profits interest in a partnership.

Section 220.15, F.S., states in part:

> (1) Except as provided in ss. 220.151 and 220.152, adjusted federal income as defined in s. 220.13 shall be apportioned to this state by taxpayers doing business within and without this state by multiplying it by an apportionment fraction composed of a sales factor representing 50 percent of the fraction, a property factor representing 25 percent of the fraction, and a payroll factor representing 25 percent of the fraction. If any factor described in subsection (2), subsection (4), or subsection (5) has a denominator that is zero or is determined by the department to be insignificant, the relative weights of the other factors in the denominator of the apportionment fraction shall be as follows: . . .

Section 220.152, F.S., states:

> **Apportionment; other methods.** --If the apportionment methods of ss. 220.15 and 220.151 do not fairly represent the extent of a taxpayer's tax base attributable to this state, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's tax base, if reasonable:
>
> (1) Separate accounting;
>
> (2) The exclusion of any one or more factors;
>
> (3) The inclusion of one or more additional factors which will fairly represent the taxpayer's tax base attributable to this state; or
>
> (4) The employment of any other method which will produce an equitable apportionment.

Rule 12C-1.015(10), F.A.C., states:

> **The amounts of the property, payroll, and sales of a partnership are attributable to the partners or members of the joint venture. A corporation that is a partner in a partnership must add its share of the property, payroll, and sales to its own apportionment factors, regardless of whether the partnerships are Florida partnerships.** Form F-1065 is used in part to distribute to each partner subject to the tax its share of the apportionment factors of the partnership or joint venture. (Emphasis Supplied)

Rule 12C-1.0152, F.A.C., states in part:

> (1)(a) A departure from the applicable method of apportionment required under the provisions of ss. 220.15 or 220.151, F.S., shall be permitted only where the method does not accurately and fairly reflect business activity in Florida. An alternative method may not be

> invoked, either by the Department of Revenue or the taxpayer, merely because it reaches a different apportionment percentage than the regularly applicable formula. However, if the applicable formula will lead to a grossly distorted result in a particular case, a fair and accurate alternative method is appropriate (see Norfolk and Western Railway Co. v. Missouri State Tax Commission, 390 U.S. 317, 88 S. Ct. 995, 19 L. Ed. 2d 1201 (1968), which is incorporated by reference in Rule 12C-1.0511, F.A.C.).
>
> (b) A taxpayer seeking to utilize an alternative apportionment method must show by clear and cogent evidence that the regularly applicable formula would result in taxation of extraterritorial values (see Butler Bros. v. McColgan, 315 U.S. 501, 62 S. Ct. 701, 86 L. Ed. 991 (1942), which is incorporated by reference in Rule 12C-1.0511, F.A.C.). This can be shown only if the regularly applicable formula is demonstrated to operate unreasonably and arbitrarily in apportioning to Florida a percentage of income which is out of all proportion to the business transacted in Florida and does not accurately and fairly reflect business activity in Florida (see Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123, 51 S. Ct. 385, 75 L. Ed 879 (1931), which is incorporated by reference in Rule 12C-1.0511, F.A.C.).
>
> (2) The party seeking to use an alternative formula must prove that the alternative formula fairly and accurately apportions income to Florida based upon business activity in this state.
>
> (3) A departure from the regularly applicable apportionment method will be authorized only in limited and specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce a result that is incongruous with the results of previous tax years under the regularly applicable apportionment method….

Rule 12C-1.0153(9), F.A.C., states the following in regard to the property factor:

> A portion of a partnership's real and tangible personal property, both owned or rented and used during the tax year in the regular course of such trade or business, is included in the denominator of a taxpayer's property factor to the extent of the taxpayer's interest in the partnership. The value of such property located in Florida is also included in the numerator of the property factor. The value of property that is rented or leased by the taxpayer to the partnership or vice versa is, with respect to the taxpayer, excluded from the property factor of the partnership or eliminated to the extent of the taxpayer's interest in the partnership in order to avoid duplication. For purposes of inclusion in the Florida property factor, partnership property is allocated to each partner based on their interest in the partnership, or as designated in the partnership agreement.

Rule 12C-1.0154(6), F.A.C., states the following in regard to the payroll factor:

> Compensation paid to employees of a partnership is included in the denominator of the taxpayer's payroll factor to the extent of the taxpayer's interest in the partnership. The amount paid to employees in Florida is also included in the numerator of the payroll factor to the extent of the taxpayer's interest in the partnership. Partnership payroll should be allocated to each partner based on each partner's interest in the partnership, or as designated in the partnership agreement, for inclusion in the Florida payroll factor.

Rule 12C-1.0155(4), F.A.C., states:

Sales of a partnership are included in the denominator of a taxpayer's sales factor to the extent of the taxpayer's interest in the partnership. The amount of sales in Florida is also included in the numerator of the sales factor to the extent of the taxpayer's interest in the partnership. Partnership sales should be allocated to each partner based on each partner's interest in the partnership, or as designated in the partnership agreement, for inclusion in the Florida sales factor.

ISSUE PRESENTED

1. Whether the taxpayer's sales, payroll, and property factors of the apportionment formula should include the taxpayer's interest in various partnerships.

2. Whether the taxpayer may use an alternative apportionment method.

DISCUSSION AND ANALYSIS

The Florida statutes and rules are clear that the activities of a partnership flow through the partnership to its partners. In its letter dated XXX, the taxpayer states that the partnerships it invests in contain multiple layers of ownership, and the lower tiered and middle tiered partnerships do not report apportionment information to the top tiered partnership because they are not required to do so in the states where they are located. Therefore, the upper tiered partnerships do not have any way to report the apportionment information from the middle and lower tiered partnerships to the corporate partner (in this case the taxpayer).

For federal income tax purposes, partnerships generally have no formal federal filing requirement other than information returns, and because a partnership is a conduit, items of partnership income, expense, gain, or loss pass through to the partners and are given tax effect at the partner level. For state income tax apportionment purposes, a particular state's approach in this area dictates the flow-through of partnership tax attributes up to the corporate partner.

Florida's approach conforms to the federal concept of the flow-through of partnership tax attributes up to the corporate partner. The apportionment rule, Rule 12C-1.015(10), F.A.C., governs the corporate income tax treatment of corporations that invest in partnerships. This rule provides that a corporation that is a partner in a partnership must add its share of the partnership's property, payroll, and sales to its own apportionment factor. Based on the foregoing, the partnerships' property, payroll, and sales should be combined with the taxpayer's property, payroll, and sales, for purposes of determining the taxpayer's apportionment factor as provided by Rule 12C-1.0153(9), F.A.C., Rule 12C-1.0154(6), F.A.C., and Rule 12C-1.0155(4), F.A.C.

The taxpayer asserts that the tiered partnerships do not provide the taxpayer with their respective apportionment factors. Therefore, the taxpayer does not have the required apportionment information to correctly apportion its income in accordance with Rule 12C-1.015(10), F.A.C. However, the Florida statutes and rules are clear that the activities of a partnership flow through the partnership to its partners. Therefore, the activities of the partnership are attributable to the partners and, contrary to the statement in the taxpayer's letter, are unitary to the partners.

As a result of the taxpayer's lack of information on the tiered partnerships, it has requested to use its allocation methodology or some other method as an alternative apportionment under section 220.152,

F.S.. In Florida, alternative apportionment is very rare. The Florida Supreme Court recognized this fact in *Roger Dean Enterprises v. State, Department of Revenue,* 387 So. 2d 358 (Fla. 1980).

> There is a very strong presumption in favor of normal three-factor apportionment and against the applicability of relief provisions. . . . The relief provision should be used where the statute reaches arbitrary or unreasonable results so that its application could be attacked successfully on constitutional grounds. Departures from the basic formula should be avoided except where reasonableness requires.

Id. at 363.

Rule 12C-1.0152, F.A.C., provides for an adjustment to the apportionment formula if the standard formula leads to a grossly distorted result. This rule references two court cases.

In *Norfolk*, supra, the U.S. Supreme Court found the application of the apportionment formula unconstitutional where the taxing state imposed an ad valorem property tax on the railroad rolling stock, using the familiar single-factor mileage formula apportionment basis. The taxpayer presented evidence showing the actual inventory of rolling stock in Missouri on tax day was less than half (approximately $7,600,000 versus assessed value of $19,981,000) the value assessed using Missouri's apportionment formula. The taxpayer further demonstrated that its calculation of the tax-day value was representative of the value of rolling stock located within the state throughout the year and in the preceding year. The Supreme Court in *Norfolk,* at page 329, noted that it is not necessary for a state to demonstrate that its use of the mileage formula yields an exact measure of value. However, the Supreme Court further stated that:

> [w]hen a taxpayer comes forward with strong evidence tending to prove that the mileage formula will yield a grossly distorted result in its particular case, the State is obliged to counter that evidence or to make the accommodations necessary to assure that its taxing power is confined to its constitutional limits. If it fails to do so and if the record shows that the taxpayer has sustained the burden of proof to show that the tax is so excessive as to burden interstate commerce, the taxpayer must prevail.

In the *Hans Rees'* case, supra, North Carolina tried to apportion income of a manufacturing concern using a formula based on the ratio of the value of the taxpayer's real and tangible personal property located in North Carolina over the value of its real and tangible property located everywhere times its entire income. The taxpayer was able to show that such a one-factor (property) apportionment formula "operated unreasonably and arbitrarily" in attributing income to the state that was "out of all proportion" to the taxpayer's activities in the state. The Court concluded that proof the formula produced a tax on 83% of the taxpayer's income when only 17% of that income actually had its source in the State would be enough to invalidate the assessment under the Due Process Clause. *See Moorman Manufacturing*. The type of distortion present in *Hans Rees'* is largely remedied today by use of a three-factor apportionment formula. The three factors now generally used by states to apportion the income of most businesses (like the taxpayer in *Hans Rees'*) to their state are sales, property, and payroll.

Rule 12C-1.0152, F.A.C., and the cited case law require the taxpayer to show by clear and cogent evidence that the apportionment formula results in taxation of extraterritorial values. The taxpayer must demonstrate that the apportionment formula operates unreasonably and arbitrarily in apportioning income to Florida, that it is out of all proportion to the business transacted in Florida, and that it does not accurately and fairly reflect business activity in Florida.

While section 220.152, F.S., authorizes a taxpayer to petition the Department to use an alternative apportionment method if the methods of sections 220.15 and 220.151, F.S., do not fairly represent the taxpayer's tax base attributable to Florida, the taxpayer is also required to show that use of the apportionment method provided by section 220.15, F.S., causes its tax base attributable to Florida to be unfairly represented. Here, the taxpayer states that it does not have sufficient information to compute its Florida standard apportionment factor. However, this lack of information makes it difficult to determine whether Florida's standard apportionment results in the taxation of income to Florida. Therefore, the Department cannot approve an alternative apportionment method at this time.

CONCLUSION

Based on the discussion above, Florida law requires the taxpayer to include its share of the partnership's property, payroll, and sales, for purposes of determining the taxpayer's apportionment factor. Additionally, as the taxpayer has failed to show that use of the apportionment method provided by section 220.15, F.S., causes its tax base attributable to Florida to be unreasonably and arbitrarily represented, the taxpayer is required to use the apportionment method provided by section 220.15, F.S., in apportioning its income to 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 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 s. 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,

Suzanne C. Paul
Technical Assistance and
Dispute Resolution

SCP/tlg
Control No.: 86118