State of Florida

Department of Revenue

Tallahassee, Florida 32399-0100

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Gentlemen:

The enclosed memorandum states a proposed administrative construction currently being considered by the Department with respect to taxable services purchased by members of affiliated groups as such groups are defined in s. 212.02(2), F.S. The major constitutional and statutory legal issues are stated, followed by a discussion of legal authority for opposing sides of the issues. Authorities for both sides of the legal issues are discussed separately in an effort to present such issues objectively. Finally, alternative administrative positions are analyzed in terms of hazards of litigation and revenue impact associated with each alternative. The facts to be assumed for the purposes of the enclosed memorandum are stated on page one thereof.

As consultants to the Department of Revenue, please review the enclosed memorandum and provide me with your written opinion on the following matters:

1. The proper construction of the conjunction "and" contained in the following phrase from s. 212.02(2), F.S.

   ... to define its affiliated group in a manner which excludes any member who has no tax nexus in this state and any member whose business activities are unrelated to the business activities of other members of the group. (e.s.)

2. Whether Chapter 212, F.S., requires that the group which must aggregate their property, payroll and sales in determining the apportionment formula and for which the apportionable purchases are aggregated in determining the apportionable tax base must be the same group as the affiliated group for which the exemption of intercompany transactions pursuant to s. 212.0592(1), F.S., is allowed.

3. Is it constitutional to require an affirmative act by an affiliate having no nexus with Florida in order for such an affiliate to exclude itself from the affiliated group pursuant to s. 212.02(2), F.S.?
4. Does the internal consistency requirement imposed by the due process and commerce clauses, require either a broad or a narrow construction of the definition of "local market" in s. 212.0591(9)(b)3., F.S. Please suggest a definition of "local market".

5. Does a correct construction of s. 212.0593(1), F.S., authorize the Department to delay any refund or credit to affiliates which are located totally in this state until the time of the supplementary return? (The refund or credit would be the difference between the tax on 100% of the cost price and tax which would result if the group's aggregate nongeographically specific purchases were apportioned.)

6. Are the hazards of litigation in part 5 of the memorandum correctly stated and all inclusive or are other hazards perceived by you?

7. Are there any other relevant matters contained in the memorandum that may be a misstatement or an improper interpretation of Chapter 212, F.S. or related case law?

Your earliest response will be greatly appreciated.

Sincerely,

Randy Miller
Executive Director

RM/sh
Enclosure
MEMORANDUM

TO: MR. RANDY MILLER, EXECUTIVE DIRECTOR

FROM: DANIEL MANRY, BUREAU CHIEF, TAX INFORMATION AND ASSISTANCE

RE: AFFILIATED GROUPS: COLLECTION AND REMITTANCE; APPORTIONMENT

THIS MEMORANDUM IS PREPARED IN ANTICIPATION OF IMPENDING LITIGATION. IT CONTAINS MENTAL IMPRESSIONS AND WORK PRODUCT OF COUNSEL. THIS MEMORANDUM IS NOT SUBJECT TO DISCOVERY OR TO THE PUBLIC RECORDS LAW.

1. Purpose and Executive Summary

(a) Purpose

This memorandum was precipitated by several requests for technical assistance advisements and other written, as well as verbal, inquiries from taxpayers and tax practitioners. The issues raised in such requests and inquiries were collected and addressed herein.

The memorandum first states a proposed administrative construction of Chapter 212, F.S., as it relates to taxable services purchased by members of affiliated groups as such groups are defined in s. 212.02(2), F.S. The major constitutional and statutory legal issues are then stated, followed by a discussion of legal authority for opposing sides of the issues. Authorities for both sides of the legal issues are discussed separately in an effort to present such issues objectively. Finally, alternative administrative positions are analyzed in terms of hazards of litigation and revenue impact associated with each alternative.

For the purposes of this memorandum, the following facts are assumed. Affiliated group E is comprised of a parent, P, and four subsidiaries, corporations A-D. Corporation A is a non-Florida corporation having no tax nexus with Florida, but is includable, within the meaning of s. 212.02(2), F.S. because its business activity is related to that of the other members of the affiliated group other than corporation D. Corporation D has no tax nexus with this state and its business activity is unrelated to that of the other affiliates. Corporations B and C have tax nexus with this state as well as related business activity. Corporation A buys a non-geographically specific service outside of Florida (no cost of performance is in Florida),
which under the rules of construction in s. 212.0591(9)(b)4 may be presumed to be enjoyed in Florida. The seller of the service has no tax nexus with Florida.

(b) Executive Summary

An affiliated group is defined in s. 212.02(2), F.S., for two purposes under Chapter 212. One purpose is to exempt intercompany transactions between members of an affiliated group from sales and use taxes pursuant to s. 212.0592(5), F.S. The other purpose is to include purchases of nongeographically specific services by all of the members of the affiliated group in the apportionable tax base for purposes of determining in s. 212.0591(9)(b)4, F.S., where the economic benefit of such services is enjoyed. Members may be excluded from the affiliated group for both statutory purposes if the member has neither tax nexus with this state nor business activity related to that of the affiliated group. All other affiliates are statutorily presumed to be economically related for purposes of determining exemptions and the locus of benefit of nongeographically specific services purchased by all of the members of the affiliated group.

The legal obligation to collect and remit both sales and use taxes due on the sale or use of services in this state is generally imposed on dealers by s. 212.059(3)(a), F.S. An exception to a dealer's duty to collect and remit tax due is provided in s. 212.059(3)(b), F.S., if the purchaser, among other things, has tax nexus with this state. If the purchaser has no tax nexus with this state, the legal obligation to collect and remit any tax due remains on dealers by virtue of the general rule in s. 212.059(3)(a), F.S. Dealers include those dealers that merely use services in this state pursuant to s. 212.06(2)(k), F.S. An affiliate that is a dealer, within the meaning of any of the provisions of s. 212.06, F.S., and which enjoys the benefit of nongeographically specific services purchased by its non-Florida affiliate outside of this state is obligated to collect and remit the use tax due pursuant to s. 212.059(3)(a), F.S.

The sales and use tax due is determined by first allocating geographically specific services in their entirety to real or tangible personal property or to a local market. By expanding the definition of services that can be specifically allocated and by liberally construing a local market, the department minimizes the burden imposed on interstate commerce by the requirement to apportion nongeographically specific services.

The amount of tax due on nongeographically specific services is determined by a formulary apportionment method prescribed in s. 212.0591(9)(b)4, F.S. The apportionable portion of the monthly tax
liability of a multistate affiliate having tax nexus with this state is determined by multiplying the cost price of nongeographically specific services purchased everywhere by all of the members of the group during the reporting period (hereinafter "apportionable tax base") by a fraction. The numerator of the fraction is the sum of the property, payroll, and double weighted sales of the reporting affiliate for the most recent supplementary returns. The denominator of the fraction is the sum of the property, payroll, and double weighted sales for all of the members of the affiliated group for the most recently filed supplementary return. Prior to filing the first supplementary return, the property, payroll and sales used for apportionment are based on the most recently filed federal income tax return. The apportionable tax base is the actual apportionable tax base for the economic unit during the reporting period.

Two elections are provided administratively by the department for the purpose of remitting sales and use taxes on an estimated basis. Both elections must be consistent with such elections made by sibling affiliates. The first election is made for the purpose of estimating the monthly tax liability of the reporting affiliate for each of the 12 months preceding the first supplementary return. If the first election is properly made in a timely manner, the monthly tax liability of the reporting affiliate may be estimated by multiplying the appropriate apportionment fraction by the apportionable tax base derived from the most recently filed federal tax return and remitting one-twelfth of the product each month. The second election is made for the purpose of estimating the monthly tax liability of the reporting affiliate for each of the 12 months succeeding each supplementary return. If the second election is properly made in a timely manner, the monthly tax liability of the reporting affiliate may be estimated by multiplying the appropriate apportionment fraction by the apportionable tax base derived from the most recently filed supplementary return and remitting one-twelfth of the product each month. If the sum of the estimated payments made pursuant to either election is less than 90 percent of the combined tax liability determined to be due on the supplementary return, applicable penalties and interest will be imposed.

On the supplementary return, the combined sales and use tax liability of each affiliate having tax nexus with this state for the supplementary return period is determined in the following manner. The aggregate apportionable tax base for the period covered by the supplementary return is multiplied by a fraction. The numerator is the property, payroll and double weighted sales of the reporting affiliate during the supplementary return period. The denominator is the property, payroll, and double weighted sales for all of the members of the affiliated group during the supplementary return period. The combined tax liability thus determined for each affiliate is compared to the sum of tax payments by that affiliate during
the supplementary return period. Any excess of combined sales and use tax liability over tax payments is a deficiency owed by the affiliate. Any excess of monthly payments of sales and use tax over combined sales and use tax liability will be refunded to the affiliate subject to audit.

Affiliates having tax nexus with this state, may unanimously consent to designate one of their members as the "tax affiliate." Designation of a tax affiliate shall be effective only upon written approval by the department. The tax affiliate will prepare the supplementary return on behalf of all of the members of the taxpaying group by comparing combined tax liability and payments on an aggregate basis as described above. Deficiencies owed by the group will be the joint and several liability of each member represented by the tax affiliate. Accurate refunds properly made to the tax affiliate will absolve the state from further liability to the separate members.

Upon the prior written consent of the department, the tax affiliate also may report and remit the monthly tax liability of the taxpaying group on one monthly return in lieu of separate returns for each member. The separate monthly returns filed by the tax affiliate will be reconciled with the combined tax liability on the supplementary return. The monthly sales tax liability of an affiliate wholly in this state, however, will be 100 percent of the tax due at the time of the transaction because such an affiliate is precluded under s. 212.0593(1) from obtaining and presenting an exempt purchase permit. Sales tax apportioned by such an affiliate on the supplementary return must be evidenced to the satisfaction of the department including sales invoices. Use tax will be remitted monthly by an affiliate wholly in this state by the formulary apportionment method described herein. An affiliate located wholly outside of this state may avoid any monthly sales tax liability by obtaining and presenting an exempt purchase permit pursuant to s. 212.0593(2), F.S. A multistate purchaser, either with or without nexus, that fails to present an exempt purchase permit must pay 100 percent of the tax due at the time of the transaction and obtain a refund by a separate application for refund rather than by a supplementary return.

Members of an unaffiliated group will apportion tax liability in the same manner as that to be utilized for affiliates, except that unaffiliated members will use only their own property, payroll and sales to determine the apportionment fraction. The apportionable tax base will include only the purchases of the separate unaffiliated member. A refund will be available, pursuant to ss. 212.0591(9)(b)6, and 212.0593(3), F.S., to the extent that the unaffiliated member proves to the satisfaction of the department that the benefit of a nongeographically specific service was enjoyed outside this state.
2. Proposed Administrative Construction

2.01 Obligation of Collection and Remittance by Member Without Tax Nexus

A member of an affiliated group having no tax nexus with this state is not obligated to remit use tax on a service purchased outside of this state from a service provider without Florida tax nexus. Neither is a seller having no tax nexus with this state required to collect and remit any use tax due on the sale of services outside of this state. A seller having tax nexus with this state that sells services outside of this state is required to collect and remit use tax, whether or not the purchaser has tax nexus with this state, only if the services directly relate to real or tangible personal property in this state or are represented by tangible personal property forwarded to this state within the meaning of s. 212.059(3)(b), F.S. A sale of interstate or international transportation services is deemed to be a sale in this state, even though actually sold outside of this state, if the point of origin or destination is in this state. In such a case, the seller must collect and remit a tax on one half of the cost or sales price pursuant to s. 212.059(5)(b), F.S. Finally, an advertiser who purchases advertising in a sale outside this state for use inside this state must self accrue and remit the use tax due in all events pursuant to s. 212.0595(6), F.S.

2.02 Obligation of Collection and Remittance by Member With Tax Nexus

(a) Imposition of the Tax: Economic Benefit

A use tax is due on the use of a service in this state when the sale is outside of this state, pursuant to s. 212.059(2), F.S. For the purpose of determining where the economic benefit of a service is enjoyed, an affiliated group is treated as a single economic unit, and is considered to be the purchaser in accordance with s. 212.0591(9)(b)4, F.S. For the same purpose, therefore, all of the included members of the affiliated group are included within the single economic unit, i.e., the purchaser. A taxable service purchased in a sale outside of this state by a member of an affiliated group having no tax nexus with this state is subject to the use tax imposed by s. 212.059(2), F.S., to the extent that the benefit of the service is enjoyed by one or more other members of the economic unit that are doing business in this state within the meaning of s. 212.0591(9)(b)4, F.S.

(b) Obligation to Remit: Legal Liability

The obligation to remit any use tax due under s. 212.059, F.S., generally is imposed by s. 212.059(3)(a), F.S., on "dealers" as that term is
defined in s. 212.06, F.S. An exception to the duty of dealers to collect and remit any use tax due on the taxable sale of services outside of this state is provided in s. 212.059(3)(b), F.S., if, among other things, the purchaser has tax nexus with this state. If the purchaser does not have tax nexus with this state, the obligation to collect and remit any use tax due on the taxable sale of services outside of this state remains on the dealer. If any of the business activities conducted in this state by members of the economic unit that have tax nexus with this state qualify as an activity performed by a dealer, then the duty to collect and remit any use tax due on the sale of taxable services outside this state is imposed by s. 212.059(3)(a), F.S., on the members of the affiliated group that are dealers in this state.

2.03 Amount Remitted

The amount of sales and use tax that must be remitted by a member of an affiliated group that is a dealer in this state is based upon that part of the cost price of all services purchased by the purchaser represented by the portion of the benefit of services enjoyed in this state. Statutory presumptions (referred to in s. 212.059(4)(d), F.S., as allocation and apportionment) are established in s. 212.0591(9), F.S., for the purpose of determining where the benefit of a service is enjoyed. When the purchaser is a business, presumptions prescribed in s. 212.0591(9)(b) must be used for the purpose of determining the locus of the benefit of a service. As a threshold test, s. 212.059(9)(b)1-3, F.S., presumes that the benefit of services directly relating to real property, tangible personal property with a business situs, or to a local market is enjoyed where such property or local market is located. Such geographically specific services are allocated in their entirety to the location of the property or local market to which such services directly relate.

The services that are not allocated under the foregoing presumptions are nongeographically specific. Nongeographically specific services are allocated pursuant to Part IV of Chapter 214, as modified by s. 220.15, F.S. The apportionable tax base and the denominator of the apportionment fraction are the same for all of the members of the affiliated group.

3. Considering An Affiliated Group As A Single Economic Unit, and Apportioning The Sales And Use Tax Liability Of Affiliates Having Nexus With This State Based On The Combined Purchases Of The Group Is An Administrative Construction That Is Both Constitutional And Statutorily Valid

3.01 Affiliated Group As An Economic Unit
Legislative intent to treat the affiliated group as a single economic unit, (i.e., the purchaser,) for purposes of determining where the economic benefit of a taxable service is enjoyed presumes that ownership, operation, and use of the business activities of each member are integrated with, dependent upon, or contribute to a flow of benefit and use among the members of the group.¹ No statutory presumption arises in s. 212.02(2), F.S., however, unless the stock ownership of a group of corporations satisfies the requisite 80 percent test for affiliation established in s. 1504 of the Internal Revenue Code of 1986 (IRC). The legislature increased the traditional stock ownership test for single economic units from 50 to 80 percent, thereby reducing the number and size of groups statutorily presumed to be a single economic unit.²

The flow of benefit and use among members of an affiliated group is considered to be an essential economic reality in establishing and maintaining the market position and exploitation of a state economy by the group through its members.³ The simple but controlling question is whether the state has given anything economically for which it can ask something in return.⁴ If the answer is yes, then tax revenues generally should increase proportionately with the increase in exploitation of state markets.

3.02 Doing Business and Nexus Distinguished

Considering an affiliated group as a single economic unit, under s. 212.0591(9)(b)4, F.S., establishes an important legislative distinction. The economic business activities of all of the members of an affiliated group are considered in s. 212.0591(9)(b)4, F.S., as the business activities of a single economic unit for the sole purpose of determining the value of economic benefit to the members of the affiliated group that have tax nexus with this state. The affiliated group is not treated as a single legal unit for the purpose of determining whether all of the members of the affiliated group have tax nexus with this state. The legislature, therefore, intended the department to determine the sales and use tax base of the remitter by viewing the remitter as part of a single economic unit. The apportionment formulas prescribed in s. 212.0591(9)(b)4, F.S., must be applied by the remitter to the entire economic unit to determine the amount of both sales and use taxes that must be remitted pursuant to s. 212.0593(1), F.S. Legal liability for self accruing and remitting such taxes is not imposed on all of the members of the affiliated group. In this manner, the legislature intended to accurately reflect the value of the economic benefit that forms the sales and use tax base for members of an affiliated group that have tax nexus with this state.

The legislative distinction between an economic concept of doing business in this state and a legal concept of tax nexus is evident from the
difference in language used to describe the two concepts in ss. 212.059(9)(b)4 and 212.059(3), F.S. For example, the legislature uses the phrase "doing business in this state" in s. 212.059(9)(b)4, F.S., when describing the aggregate economic activity of the affiliated group that is to be considered for purposes of determining the economic benefit on which the sales and use tax is based in s. 212.059, F.S. Conversely, the legislature uses the phrase "nexus for tax purposes" in s. 212.059(3)(b), F.S., when it intends to create a legal obligation to accrue and remit the use tax imposed by s. 212.059(2), F.S. The legislature was acutely aware that the purpose of s. 212.059(9), F.S., is to determine economic benefit, rather than to impose a legal obligation. The legal obligation to self accrue and remit the use tax due on such an economic benefit is imposed on members of an affiliated group that have tax "nexus" with this state, pursuant to s. 212.059(3)(b). A multistate purchaser having tax nexus with this state that wishes to avoid sales tax at the time of a sale inside this state may self accrue and remit any sales tax due if such a purchaser obtains an exempt purchase permit (Form DR-11T) pursuant to s. 212.0593(1), F.S.

3.03 Dealers With Nexus Defined

If a multistate purchaser does not have tax nexus with this state, the legal obligation to collect and remit both sales and use taxes remains on dealers pursuant to s. 212.059(3)(a), F.S. In Scrip.to, Inc. v. Carson, 362 U.S. 207 (1960), the Supreme Court upheld the right of a state like Florida to require dealers in another state to collect and remit a use tax due Florida. The Court based its decision on a finding that such dealers had nexus with Florida. Removing any doubt as to the continued viability of its decision in Scrip.to, the Supreme Court in Tyler Pipe Industries, Inc. v. Washington State Department of Revenue, 55 LW 4978, 4983 (June 23, 1987), reaffirmed the propriety of its decision in Scrip.to. In addition the Court stated that its decision in National Geographic Society v. California Equalization Board, 430 U.S. 551 (1977), attributing the nexus of a subsidiary to a parent, was not limited to situations in which agency is present.

Dealers are defined in s. 212.06, F.S., as persons who conduct business activities described in that section. The term "dealer," in s. 212.06(2)(k), F.S., includes any person who purchases, uses, or consumes a service that is taxable by Part I, Chapter 212, F.S. Activities described in s. 212.06, F.S., as dealer activities include a variety of activities that may or may not constitute the requisite nexus needed to obtain in-personam jurisdiction for the purpose of establishing that a tax is due. Authority of the state to enforce collection of the tax due is provided in ss. 212.10 and 212.12, F.S. Absent in-personam jurisdiction, the state
generally may not enforce the collection of tax due solely on the basis on in-rem jurisdiction.

Nexus with this state, for tax purposes, may be established either by the business activities of an affiliate in this state or by intercompany transactions carried on directly with an affiliate that is doing business in this state. The business activities of an affiliate are determined by the property, payroll, and sales in this state. Business activities of subsidiaries are attributed to their parents for the same reasons that the business activities of subcontractors are attributed to out-of-state manufacturers in order to establish nexus with the manufacturer. It is uncertain whether the business activities of a subsidiary can be attributed beyond its immediate parent to second tier parents or to siblings that have no intercompany transactions directly with an affiliate having tax nexus with a state. The business activities of a parent may not be attributable to its subsidiaries because the subsidiary does not control the parent legally, even though a mutual economic benefit and dependency may exist between the two companies.

3.04 Formulary Apportionment

In order to accurately reflect the value of the economic benefit enjoyed by affiliates with tax nexus in this state from the flow of benefit and use of services purchased by the economic unit, the cost price of services purchased by all of the members of the group must be considered for purposes of s. 212.0591(9), F.S. It would be impossible to value such a flow of benefit and use by separate accounting. While each transaction may be separately accounted for by invoice, such separate accounting fails to accurately reflect the flow of economic benefit attributable to noneconomically specific services purchased by all of the members of the economic unit. The inadequacy of separate accounting to accurately reflect the locus of the benefit of services shared by all of the members of an affiliated group justifies the use of formulary apportionment.

Formulary apportionment historically has been applied for the purpose of attributing income to its geographic source among the various states. Income of an affiliated group is not economically specific because it is produced by the combined efforts of all of the members of a single economic unit. Apportionment accurately reflects the source of noneconomically specific income by attributing such income to the benefits derived from geographically specific expenses incurred for property, payroll, and receipts from sales. For the same reasons, formulary apportionment accurately reflects the destination of the benefit of noneconomically specific services by attributing that benefit to geographically specific expenses incurred for property, payroll, and receipts from sales.
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Formulary apportionment for the purpose of attributing income of an affiliated group to its geographic source among the various states, has been consistently upheld by the Supreme Court as a constitutional method of accurately reflecting income if the particular apportionment formula is fair under the Due Process and Commerce clauses.¹³ An apportionment formula is fair if it is both internally and externally consistent.¹⁴ A formula has internal consistency if it is such that, if applied by every jurisdiction, it would result in no more than all of the income of a unitary business being taxed by multiple taxing states.¹⁵ The same formula has external consistency if the factors or factors used in the apportionment formula actually reflect a reasonable sense of how income is generated.¹⁶

(a) Internal Consistency: Multiple Taxation

Formulary apportionment of the value of interstate transactions is mandated by the Supreme Court if apportionment is necessary to achieve internal consistency of a tax imposed on such a transaction. In Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434 (1939), for example the Court held unconstitutional a gross receipts tax imposed by the state of Washington on the entire volume of interstate commerce. More recently, in National Can Corporation v. Washington Department of Revenue, 55 LW 4979 (June 23, 1987), the Supreme Court also held that a gross receipts tax imposed by the State of Washington (in the form of a merchandizing tax) was unconstitutional because it was not apportioned in order to eliminate the risk of multiple taxation. Thus, the failure of a state to apportion transaction taxes, such as gross receipts taxes, is not fair under the Due Process and Commerce clauses, because the absence of apportionment results in internal inconsistency.

Sales and use taxes, like gross receipts taxes, are transaction taxes,¹⁷ and no fundamental distinction between different types of transaction taxes suggests that it is internally consistent to apportion one type of transaction tax while not apportioning a different type of transaction tax. If the value of a nongeographically specific service is not apportioned, the full value of the economic benefit of such a service may be taxable by more than one state if the transaction involves interstate commerce. The same transaction, moreover, would be taxed only once if it involves only intrastate commerce. Even without statutory authority in s. 212.0591(9)(b), F.S., it is well within the proper exercise of administrative discretion to require formulary apportionment.¹⁸

The Florida legislature clearly agreed with the Supreme Court mandate to apportion transaction taxes in order to satisfy internal consistency requirements imposed by the Due Process and Commerce clauses. In s. 212.0591(9)(b)4, F.S., for example, the legislature expressly required
apportionment of nongeographically specific services purchased by multistate purchasers. This statutory requirement of apportionment is intended legislatively to be used for the purpose of determining value where the economic benefit of a nongeographically specific service is enjoyed. By apportioning the value of such services, the legislature gives effect to the exemption in s. 212.0592(1), F.S., for services used outside of this state, as well as the limited scope of the use tax in s. 212.059(2), F.S., which is limited to services used in this state.

It is clear that the Florida legislature required apportionment for legitimate state purposes, and that such a requirement is consistent with judicial mandates of the Supreme Court. It is also clear that the legislature prescribed the method of apportionment that it determined to be fair. In s. 212.0591(9)(b)4, F.S., for example, the legislature required use of the apportionment formulas set forth in Part IV of Chapter 214 as modified by s. 220.15(4), F.S.

The legislative reference in s. 212.0591(9)(b)4, F.S., to Chapters 214 and 220, F.S., restricts the apportionment formula to be used, for purposes of sales and use taxes, to the property, payroll, and double weighted sales formula used in apportioning state corporate income tax. The legislative reference, however, does not restrict the apportionable tax base, for sales and use tax purposes, to purchases by members of an affiliated group having tax nexus with this state. Such a restriction would define the group entitled to exemptions for intercompany transactions to be larger than the group which provides the tax base. Such a result would frustrate the legislative purpose of the exemption and have an economic result that is absurd. It is presume that the legislature intends its enactments to be construed in a manner that avoids absurd results. Therefore, the legislative reference to Chapter 214 is reasonably construed as referring only to the formula to be used and not as permitting the apportionable tax base to affiliates that could be required to file a consolidated return.

The legislature expressly provided in s. 212.0592(5), F.S., that nothing in s. 212.0592(5), F.S., was to be construed as requiring affiliated groups to file a consolidated return under Chapter 220, F.S., in order to retain the exemptions for intercompany transactions. The prohibition against requiring a consolidated return, like the legislative reference to Chapter 214, F.S., cannot reasonably be construed as defining the group entitled to exemptions for intercompany transactions to be larger than the definition of the group which provides the apportionable tax base. Permitting affiliates other than those included in the state consolidated return to receive exemptions while restricting the apportionable tax base to consolidated members may provide an exemption to more affiliates than those included in the apportionable tax base.
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Any result that allows an exemption to all affiliates while restricting the apportionable tax base to affiliates having tax nexus with this state would frustrate the legislative purpose of the exemption and have an economic result that is absurd. It is presumed that the legislature intends its enactments to be construed in a manner that avoids absurd results. Therefore, the legislative reference to Chapter 214 and the prohibition against requiring consolidated returns are reasonably construed as not limiting the apportionable tax base to affiliates that could be required to file a consolidated return.

(b) External Consistency: Accurate Method of Apportionment

The apportionment formula utilized in Chapter 214, F.S., is a three factor formula based on property, payroll, and a double weighted sales factor. Use of the property, payroll and sales of an affiliate is widely accepted as resulting in the fairest representation of business activity carried on by an affiliate in a particular state. Not only has the three factor formula been widely approved, it has been characterized by the Supreme Court in Container Corp. of America v. Franchise Tax Board as the benchmark against which other apportionment formulas are judged.

The underlying economic realities that make formulary apportionment appropriate to accurately reflect nongeographically specific income are also appropriate to accurately reflect the value of the benefit from nongeographical specific services. Net income, for example, is arrived at by subtracting deductible expenses from gross income. A subtraction is allowed because each such expense is considered to benefit the business purpose of producing income. Formulary apportionment assumes that the economic benefit to income that is not geographically specific is attributable to the benefit enjoyed from expenses incurred for property and payroll. Similarly, formulary apportionment assumes that the economic benefit of nongeographically specific services is partially enjoyed in proportion to the economic burden of expenses incurred for property and payroll.

Formulary apportionment also attributes the source of nongeographically specific income to the economic benefit attributable to gross receipts from sales because with no sales there generally will be no income to apportion. For the same reasons, formulary apportionment attributes the economic benefit from nongeographically specific services to sales that are necessary in establishing and maintaining the market position required to exploit a particular state's economy. The economy of this state and the nation is shifting from a manufacturing to service economy. Double weighting the sales factor accurately reflects this economic shift as well as the economics peculiar to this state.
It has been asserted that apportionment accurately reflects income because income is earned over time. Apportionment is not applicable to transaction taxes, so the argument goes, because a transaction is a single isolated event occurring in a moment in time. This argument may have application to tangible personal property and geographically specific services because the benefit of such transactions tends to have a situs. Services that are not geographically specific, however, tend to be those for which the benefit is enjoyed over a period of time. It is this time element which the contribution of income and the enjoyment of the benefit of services have in common.

c. Internal and External Consistency As Applied

Formulary apportionment also must be applied fairly in order to have internal and external consistency. Absent manipulation by the administrative agency in determining the factors to be utilized in the apportionment formula, the three factor formula has been consistently sustained by the Supreme Court. Assertedly, internal consistency would be absent if the department refused to permit out of state affiliates to obtain exempt purchase permits for use when buying services sold in this state. This would require both instate and out-of-state affiliates to pay sales tax on 100 percent of the value of services sold in this at the time of the transaction and wait until filing the supplementary return at the end of the year before getting a refund for the portion of tax on the services used outside of this state. Since the reporting period for sales and use taxes is monthly, refunds allegedly should be available in the same intervals as the payment of tax. Delaying refunds for periods longer than intervals for paying the tax arguably is an abuse of administrative discretion which taxes 100 percent of an interstate transaction. This administratively deprives the tax of its internal consistency during the period between the time of payment and refund. It allegedly results in an undue burden on interstate commerce because it denies the remitter operating cash needed for normal business cycles and fails to take into account the time value of the money.

Many states alleviate or eliminate potential multiple taxation solely by tax credits without apportionment. For example, the District of Columbia and all but three states with sales and use taxes provide a credit against their own use taxes for sales taxes paid to another state. Florida provides such a credit in ss. 212. and s. 212.0593(2), F.S. The Supreme Court in *National Can Corporation v. Washington State Department of Revenue*, 55 LW 4978, (June 23, 1987) determined that such a credit mechanism is a constitutionally valid means of maintaining internal consistency. Such a credit mechanism is no less constitutional in s. 212.0593(2), F.S., which merely delays the credit until the remitter's actual tax liability can be determined in the supplementary return using current year's apportionment.
Administrative refusal to provide the exempt purchase permit contemplated in s. 212.0593(2), F.S., while not unconstitutional, may disregard the express legislative language of that statute which requires a business without tax nexus to obtain such permits and absolves the seller who accepts such permits from further liability. Both classes of taxpayers may have a valid statutory action against the department even though the credit concept is itself constitutional.

3.05 Administrative Burden on Interstate Commerce

The administrative burden imposed on interstate commerce by apportionment is not so great that formulary apportionment for sales and use taxes violates the commerce clause under National Bellas Hess. It is true that combined or consolidated reporting involves a special computation for the single purpose of determining state tax liability. It is also true that much of the information needed to compute combined income is not available to members of an affiliated group that do not file consolidated returns for purposes of federal income tax. Such administrative difficulties, however, have not been viewed by the Supreme Court as an unreasonable burden on interstate commerce when imposed by states requiring combined formulary apportionment for purposes of state income tax. Neither is it reasonable to view such administrative requirements as unconstitutional when required in combined formulary apportionment for purposes of sales and use taxes.

3.06 Combined and Consolidated Returns Distinguished

(a) Legislative Intent

Legislative intent to accurately reflect economic benefit based on the purchases by the entire affiliated group in order to determine sales and use taxes due from corporations having tax nexus with this state is also evident when the definition of an affiliated group in s. 212.02(2), F.S., is read in concert with the reporting requirements in s. 212.059(4)(d), F.S. Each multistate purchaser that self accrues the tax due on its purchases of services is required by s. 212.059(4)(d), F.S., to file an annual supplementary return summarizing its purchases and sales of services for its prior fiscal year. The type of "annual supplementary return" contemplated by the legislature is not specified. Arguably, it could have been either a consolidated return or a combined return.

No precedent can be found for the type of supplementary return to be used by members of an affiliated group for purposes of reporting sales and use taxes owed to a state. Two types of returns are used by members of an affiliated group for the purpose of reporting state income tax. Combined returns are filed only by those affiliates having nexus with the taxing
state, but the tax due is determined by aggregating the income of all of the members of the affiliated group. The legal obligation to remit the tax due is restricted to the affiliates filing the return.\textsuperscript{31}

Like combined returns, consolidated returns are required to be filed only by affiliates having nexus with the taxing state. The tax due in a consolidated return, however, is determined by aggregating the income of the consolidated members.\textsuperscript{32} Similarly, the legal obligation to remit the tax due is shared by all of the consolidated members. Unlike combined returns, the income of affiliates without nexus cannot be required to be included in the consolidated return by the taxing state.\textsuperscript{33}

Combined returns aggregate the income of all of the members of an affiliated group and consolidated returns aggregate only the income of the consolidated members. The difference in the value between non-geographic services apportioned either on a combined or consolidated basis is the proportion of the value of the economic benefit enjoyed by affiliates with tax nexus in the state attributable to the flow of benefit and use of services purchased by the economic unit.

If the legislature intended a consolidated return to be used in s. 212.059(4)(d), F.S., for the purpose of remitting the tax due on the benefit of services purchased by an affiliated group and enjoyed in this state, the legislature would not have defined the affiliated group to include members that have no tax nexus with this state. Further, the legislature would not have required an affirmative act in the form of an election by affiliates having no tax nexus with this state in order for such affiliates to preserve their constitutional rights, under the due process clause, against being included in a consolidated return. Such a legislative requirement would have been constitutionally infirm, and it is assumed that the legislature intends its enactments to be construed in a manner that is constitutionally valid.\textsuperscript{34} In fact, the legislature expressly said so in s. 212.0591(2), F.S. Moreover, the legislature expressly stated in s. 212.0592(5), F.S., exempting intercompany sales, that nothing was to be construed as requiring the filing of a consolidated return for state income tax purposes.

The only person required to file a supplementary return in s. 212.059(4)(d), F.S., is a purchaser that self accrues tax due. The purchaser is defined as the affiliated group for purposes of obtaining exemptions and determining the sales and use tax base. For all other purposes including the filing of returns in s. 212.059(4)(d), F.S., the purchaser is each separate corporate entity. The only combined returns can be filed by separate corporate entities. Consolidated returns are single returns filed by all of the consolidated affiliates, each of which has joint and several tax liability.
The group from which the apportionable income tax base is derived in either consolidated or combined reporting is also the group from which the denominator in the apportionment formula is derived. Symmetry between the base and the denominator is required to accurately reflect income or benefit. Reflecting income or benefit without symmetry between the apportionable tax base and the denominator results in economic distortion.

Symmetry between the group entitled to exemptions for intercompany transactions and the group providing the apportionable tax base must also be maintained in order to avoid distortion of the legislative purpose of exemptions for intercompany transactions, as well as economic reality. Failure to maintain such symmetry would permit exemptions for transactions between consolidated and unconsolidated affiliates as well as transactions between all unconsolidated affiliates in determining the value of the benefit of services purchased by the single economic unit. The apportionable tax base, however, would include only those purchases outside the group made by consolidated affiliates from unaffiliated companies. Transactions between unconsolidated affiliates and those between unconsolidated affiliates and unaffiliated members would not be included in the apportionable tax base. Thus, an exemption would be provided for more members than those included in the apportionable tax base. Such a result would be economically and legislatively absurd, and it is presumed that the legislature intends that its enactments will be construed to avoid absurd results. Therefore, the legislative reference to Chapter 214 is reasonably construed as defining the apportionment formula to be used rather than limiting the apportionable tax base to affiliates that could be required to file a consolidated return.

The legislative grant of outright exemptions from the taxability of services sold between members of an affiliated group is inconsistent with consolidated return treatment for intercompany sales. In Treas. Regs. s. 1.1502-13(b), gain or loss from intercompany sales of services between affiliates is recognized if such services pertain to ordinary business operations. Even gain or loss on capitalized services is merely deferred rather than exempt as provided in s. 212.0592(5), P.S.

(b) Combined Reporting

The value of the economic benefit of services that are not allocated as geographically specific is apportioned to this state to the extent the purchaser is doing business in this state. The extent of business done in this state by a purchaser is determined by utilizing apportionment formulas set forth in part IV of Chapter 214, as modified by s. 220.15, P.S. Generally, the formulaic apportionment methods prescribed in s. 212.0591(9)(b)4, P.S., require a purchaser that is an affiliated group to
determine the locus of the benefit of nongeographically specific services by multiplying the aggregate cost price of all such services purchased everywhere by all members of the affiliated group, as an economic unit, by a fraction. The numerator (payroll, property, and double weighted sales in this state) is the aggregate amount of numerators of all included members which have tax nexus with this state. The denominator is the aggregate amount of denominators (payroll, property, and double weighted sales "everywhere") of all included members of the affiliated group comprising the economic unit.

There are two methods for apportioning income for the purpose of combined reporting. The first method is referred to for purposes of this memorandum as the California method. The other method is referred to as the Oregon method. In both methods, apportionment fractions are first determined for each member of the group based on its property, payroll and sales factors. In California, however, the apportionment fractions of each affiliate having tax nexus with the state are combined and applied to the total combined income of the group in order to determine California combined income. The California combined income may be divided among the various members having tax nexus by a second apportionment or the entire combined tax assessed on the separate return of one member. The other California members file returns and pay the minimum tax which is deducted from the combined tax liability. In Oregon, conversely, the tax liability of each affiliate having nexus with the taxing state is determined by multiplying the apportionment fraction of each member by the aggregate income of the entire group.37

3.07 "Election Out" In s. 212.02(2), F.S. Consistent With Presumptions of Economic Benefit In s. 212.0591(9)(b)

Combined reporting is consistent with the fact that the related business activity of each member of an affiliated group took priority in the legislative process over each affiliate's nexus. The relationship of the business activity of each affiliate to the enterprise of the economic unit, not jurisdiction over each member, was of concern to the legislature because the legislature considered all of the members of the affiliated group to be the purchaser when determining the sales and use tax base in s. 212.0591(9)(b)4, F.S.

The cost price of purchases everywhere by a group of corporations not defined as an affiliated group, within the meaning of s. 212.02(2), F.S., includes the cost price of only those purchases made by individual members having tax nexus with this state. The business of such a group is not legislatively presumed to be so controlled that the group can be considered as a single economic unit. Therefore, nongeographically specific services
purchased everywhere by all of the members of the unaffiliated group are not aggregated. In comparison, the cost price of purchases everywhere by an affiliated group includes the cost price of purchases by every member of the group because the affiliated group is considered in s. 212.059(9)(b)4, F.S., to be a single economic unit for purposes of determining the locus of the economic benefit. The difference in the amount determined by applying separate apportionment formulas for affiliated and unaffiliated groups is the value attributable to the flow of economic benefit and use of services purchased by all of the members of the affiliated group, to the extent that such value is enjoyed by affiliates having tax nexus with this state.

The right to initially determine whether the economic business activity of affiliates having no tax nexus with this state is related to that of the single economic unit is granted legislatively to the members of an affiliated group by way of statutory election in s. 212.02(2), F.S. If the election is not made for any reason, the legislature establishes the benefit tests in s. 212.0591(9)(b), F.S., merely as presumptions which can be overcome by the taxpayer on a case-by-case basis. The statutory presumption is that an affiliated group made up of members that do not elect out of the group is considered to be a single economic unit for purposes of determining the tax base under s. 212.0591(9)(b)4, F.S., because an affiliate with neither tax nexus nor related business activity can elect out initially. If an affiliate has tax nexus with this state, however, the statutory presumption is that its business activity is related to that of the other members. If that presumption is inaccurate, the legislature provided the taxpayer with the statutory means for discretionary administrative relief in s. 212.0591(9)(b)6, F.S.

4. Considering An Affiliated Group As A Single Economic Unit, And Apportioning The Sales And Use Tax Liability Of Affiliates Having Nexus With This State Based On The Combined Purchases Of The Group Is An Administrative Construction That Is Both Unconstitutional And Invalid.

4.01 Formulary Apportionment Has No Internal Consistency as Applied

The exemption in s. 212.0592(1), F.S. for services used outside of this state and the apportionment requirement in s. 212.0591(9)(b), F.S., together give Chapter 212 internal consistency. The effect of those two sections is to tax only that portion of the total value of economic benefit of services that are used inside this state. The remaining value is available to other taxing states. If one of those taxing states attempted to tax the unapportioned value of the same transaction the constitutional infirmity would be in the taxing scheme of the state that taxed the transaction on an unapportioned basis.
Chapter 212, F.S., would have no internal consistency either in the absence of the exemption provided in s. 212.0592(1), F.S., or as applied if the department administered the law in a manner that effectively eliminated the exemption in s. 212.0592(1), F.S. For example, the department might tax 100 percent of all sales in this state and either ignore the exemption in s. 212.02(2), F.S., for services used outside this state, or refuse to allow the use of exempt purchase permits required by the legislature in s. 212.0593, F.S. Such an application by the department would jeopardize the internal consistency of the statute and disregard the clear intent of the state legislature.

4.02 Formulary Apportionment Has No External Consistency Whenever It Is Applied to Sales and Use Taxes

Formulary apportionment is not fair when applied to sales and use taxes because its application to such taxes is not externally consistent. The underlying economic realities that justify treating an affiliated group as a single economic unit for purposes of income taxation are inapposite for purposes of sales and use taxes. Sales and use taxes, unlike income taxes, are transaction taxes imposed on a single isolated event. Unlike the transactions of employees that contribute to income over an entire taxable year, transactions subject to sales and use taxes occur at a given moment and in a given state. Therefore, the need to apportion the tax among various states in order to accurately reflect the transactions is not present for sales and use taxes. If a state in which the transaction did not take place attempted to impose an apportioned tax on the same transaction, such action would amount to an unconstitutional expansion of its taxing jurisdiction through the use of the state’s apportionment formula.41

4.03 Formulary Apportionment Of Sales and Use Taxes Has No External Consistency As Applied

Determination of the factors to be used in formulary apportionment must be administratively fair. Administrative manipulation that results in discrepancies between the denominations and apportional tax base would fail to accurately reflect the economic benefit of services used in a particular state. For the same reason, administrative computation of the factors in a manner that is different for in-state and out-of-state members may be invalid due to the lack of external consistency as applied by the department.

4.04 Administrative Burden: National Bellas Hess and the Commerce Clause

The administrative burden on interstate commerce created by apportionment requirements also may violate the commerce clause. In
National Bellas Hess v. Department of Revenue, 386 US 753 (1967), the
Supreme Court held that administrative requirements which imposed burdens
and impediments upon the free conduct of interstate commerce were
unconstitutional if such requirements had the effect of entangling
interstate business in a virtual welter of complicated obligations to local
jurisdictions. If apportionment is required for sales and use taxes, then
an unconstitutional burden will be placed on interstate commerce because
most of the financial information required for the apportionment formula is
not available to members of an affiliated group that does not file
consolidated returns.

4.05 Formulary Apportionment Limited to Distinct Entities

If a court determines that subparagraph (b) of s. 212.0591, F.S., is
valid and that formulary apportionment applies to sales and use taxes, then
the application of such apportionment is restricted to formal lines
recognizing each separate corporate entity as the purchaser required to
report in s. 212.059(4)(d), F.S. A state revenue department decision to
respect separate corporate existence is itself not unconstitutional,
Westinghouse Electric Corp. v. Commissioner of Revenue, 398 N.W. 2d 530
(Minn. 1986).

There is no precedent for and it is not appropriate to utilize combined
or consolidated methods of reporting for sales and use tax. The utility of
such methods is to consider as a single economic unit a group of separate
entities solely for the determination of the applicable income to the taxing
state.

The Oregon Supreme Court, in its Coca-Cola decision stated that the
authority to apportion contained in that state's income tax statutes
inherently includes the authority to require combination of all related
separate legal entities when an affiliated group acts in concert as a single
economic unit. The rationale of this decision is suspect. Logic expressed
in mathematical terms, does not require or permit alteration of the dividend
before application of the divisor. Redetermination of the dividend is a
process not inherent or properly includable in the process of division.

Moreover, the construction placed upon Oregon's apportionment statute
in Coca-Cola is in direct conflict with the legislative intent expressed by
its scivenors. The Oregon statute (UDITPA) proscribing apportionment was
UDITPA in haec verba. There is ample authority in various state court
decisions addressing various other uniform acts drafted by the national
conference of commissioners on uniform state laws to require the
construction of any such uniform act in a manner consistent with the
contemporaneous comments, notes and similar utterances of the NCCUSL. The
transcripts of the meetings of the Committee on the whole which drafted UDITPA expressly state that the exclusive purpose of that suggested uniform act was to provide a uniform system for dividing the income of a corporation in a manner which, if adopted by all states which taxed a portion of that income, would result in not more than 100 percent of such income being taxed. These transcripts also disclose that the NCCUSL expressly excluded questions of determining the pre-apportionment tax base, stating that determination of the tax base was left to the discretion of each state.

Florida's fundamental apportionment provisions in Chapter 214, F.S., "track" UDITPA. Redetermination of the tax base to be apportioned is beyond the scope of these provisions. This concept is validated by the Florida legislature's subsequent and separate enactment of s. 220.135, F.S., (and its subsequent repeal) to provide express statutory authority to aggregate the net incomes of the various separate legal entities which comprised an economic unit for purposes of Chapter 220, F.S. Unquestionably, the legislature considered that the apportionment provisions of part IV of Chapter 214, F.S., as modified by s. 220.15, F.S., do not provide authority to mandate such aggregation. If authority to mandate aggregation of the results of business activities of all legal entities for income tax purposes cannot be derived from the apportionment statutes cited above, then authority to mandate aggregation for sales and use tax purposes cannot be derived from the identical provisions.

Respecting separate legal entity as the reporting unit is consistent with the difference in legislative intent for ss. 212.059(4)(d) and 212.0591(9)(b), F.S. For example, s. 212.0591(9)(b) is legislatively intended for the sole purpose of determining where the benefit of a service is enjoyed. For that purpose, the affiliated group is the economic unit or purchaser. In comparison, the purchaser is defined in s. 212.059(4)(d) as a purchaser that self accrues. The validity of this distinction in legislative intent is not altered even if the department authorizes a single composite supplementary annual return which aggregates in a single return, the separately stated and identified filing requirements of each separate purchaser which self accrues. Since the members in an affiliated group without tax nexus could have been included in the economic unit, the identity of the purchaser required in s. 212.059(4)(d), F.S. for reporting purposes is not the same as the economic unit defined for purposes of determining where the benefit of a service is enjoyed.

4.06 Formulary Apportionment Limited To Consolidated Affiliates

If the court validates some form of formulary apportionment which includes more than one separate corporate legal entity in a single computation, then each of the included legal entities must have separate tax
nexus with the state. The requirement in s. 212.02(2), F.S., to elect out of the affiliated group is legislatively intended for two purposes. A member of an affiliated group is entitled to make the election for the purposes of availing itself of the exemption pursuant to s. 212.0592(1), F.S., and to determine the economic unit that will be considered to be the purchaser pursuant to s. 212.0591(9)(b), F.S. Clearly, the legislature intended to require only affiliates which have both related activities and tax nexus to be included in the economic unit because the legislature permitted the election out by two classes of affiliates. Those that lacked tax nexus and those that lacked related business activities. Requiring only affiliates with tax nexus to be included in the apportionable tax base is consistent with consolidated reporting.

Since the affiliated group is comprised only of those members having tax nexus with this state, members not having tax nexus are never doing business in and out of this state within the meaning of s. 212.0591(9)(b)4, F.S. Accordingly, such purchases are neither allocable nor subject to apportionment.

5. Hazards of Litigation and Revenue Impact

A case can be made that the infamous conjunction in s. 212.02(2), F.S., is properly construed in either the conjunctive or disjunctive. Regardless of the probability of success on the merits of either side of the issue, concerns over hazards of litigation and revenue impact should be considered before the infamous conjunction is finally construed.

5.01 Hazards of Litigation

Hazards of litigation are most harmful to the department if litigation is lost based on the unconstitutionality of the administrative construction adopted by the department. Hazards of litigation are less harmful to the department, but more harmful to the state, if litigation is lost based on the facial unconstitutionality of the statute. The hazards of litigation are least harmful to both the department and the state if litigation is lost for reasons other than the unconstitutionality of either the statute or its application by the department. In any event, hazards of litigation are discussed herein based on the assumption that the department may lose any one of the five alternative litigating positions available to it.

(a) Conjunction in the Conjunctive and Consolidated Returns

It is clear that the department cannot construe the infamous conjunction in the conjunctive and require consolidated returns. A state cannot require a member of an affiliated group that has no tax nexus with
the state to be included in a consolidated return because the joint and several tax liability based on such a return is imposed on each of the members of the consolidated group. Neither can a state use an apportionment formula to expand its taxing jurisdiction. Accordingly, the court may find that the statute is facially unconstitutional. If the court construed legislative intent as requiring combined returns, in order to preserve the statute, it would be difficult for the court to avoid finding that the statute is facially constitutional but unconstitutional as applied by the department.

(b) Conjunction in the Disjunctive and Consolidated Returns

In order to avert the foregoing result, the department may decide to interpret the infamous conjunction in the disjunctive and require consolidated returns. However, it is also a basic tenet of federal due process that a person cannot be required by a state to exercise an affirmative act in order to preserve certain constitutional rights enjoyed under the Constitution of the United States. An adversary seeking to avoid liability for self accruing and remitting any tax due on a transaction may assert that the administrative requirement to file consolidated returns is a valid statutory construction but that such a statutory requirement is facially unconstitutional. The court may hold that the statute is constitutional because the legislature intended to require combined reporting in order to preserve the statute. In that event, administratively requiring members of an affiliated group that do not have tax nexus with this state to make an election to be excluded from the consolidated group in s. 212.02(2), F.S., in order to avoid state jurisdiction, may be interpreted by the court as an unconstitutional application by the department of an otherwise constitutional statutory requirement.

The fact that the department applied the requirement for consolidated returns in a constitutional manner, so that only affiliates having tax nexus with this state were required to consolidate, would be no defense against affiliates asserting facial invalidity of the statute, regardless of how it was applied by the department, in order to avoid the obligation to self accrue and remit the tax. The department could not reverse its administrative position by asserting combined reporting during litigation in order to preserve the statute against constitutional attack concerning facial validity.

(c) Conjunction in the Disjunctive and Combined Reporting

Alternatively, if the department construes the infamous conjunction in the disjunctive but requires combined reporting, in order to avoid any constitutional infirmity, a taxpayer seeking to avoid the obligation to
collect and remit the tax due may take the position that combined reporting is not applicable to transactional taxes. The probability of success on the merits would be enhanced for the taxpayer because combined reporting is inconsistent with permitting affiliates with related business activities to be excluded from the economic unit.

The purpose of combined reporting is to accurately reflect value attributable to the flow of benefit among all of the members of an affiliated group comprising a single economic unit. Permitting the election out of part of the economic unit (members with related business activity but which lack tax nexus) does not more accurately reflect the value of economic benefit but reflects that value less accurately. Economic distortion occurs if the aggregate value of the flow of economic benefit and use among all of the members of the affiliate group is reduced by eliminating economically related members in order to equate the economic unit with legal principles of tax nexus.

An administrative position that achieves economic distortion creates two mutually exclusive hazards of litigation for the department. First it may enhance the probability that a court would find that consolidated reporting was contemplated. Alternatively, the court may find that combined reporting was contemplated by the legislature. If so, the court may determine that the infamous conjunction is construed in the conjunctive. The application by the department then would be subject to judicial sanctions as an unconstitutional application of an otherwise valid constitutional statute.

(d) Conjunction in the Conjunctive and Combined Reporting

Construing the conjunction in the conjunctive enhances the ability of the department to sustain the requirement of a combined return because such a construction is consistent with economic reality and due process guidelines for combined reporting. If the department loses because the court finds that combined reporting does not apply to transaction taxes, the harm to the department is no greater than if the department had administratively required consolidated reporting initially.

The advantage to the department of this litigating position is that the court can invalidate combined reporting as an inappropriate method of formulary apportionment without the necessity of addressing the constitutionality of the state requiring consolidated reporting unless an affiliate elects out pursuant to s. 212.02(2), F.S. The court would have the latitude of deciding the case on grounds other than the unconstitutionality of either the statute or its application by the department.
If the court wished to invalidate combined reporting but preserve the apportionment requirement in s. 212.0591(9)(b)4, F.S. for sales and use taxes, the court could: prescribe methods of apportionment other than combined apportionment, without addressing the consolidated return; or impose consolidated reporting under conditions prescribed by the court. In any event, the department then has judicial direction for its administrative position. If consolidated reporting is administratively applied by the department without such judicial direction, the likelihood is much greater that a reviewing court will be required to address the constitutionality of either the statute or its application by the department in order to decide the case.

(e) The Commerce Clause and National Bellas Hess

A compromise construction may be available to the department if tax research projections predict that tax revenue losses generated by the compromise alternative will be tolerable. Under the compromise alternative, the department would construe the infamous conjunction in the disjunctive but require combined reporting. The administrative purpose for permitting affiliates with related business activity to elect out of the group, although inconsistent with combined reporting, may be justified as an effort by the department to minimize the administrative burden on interstate commerce created by complex apportionment and reporting requirements. Such an administrative construction is consistent with the judicial guidelines provided in National Bellas Hess, even though that case does not apply to the sale of services. The administrative burden on interstate commerce could also be minimized by an expansive administrative definition of local market, thereby reducing apportionable purchases. However, a liberal definition of local market may trigger unacceptable tax revenue losses for multistate groups that do not apportion the purchases of all of the members of the group. Such a definition also may trigger litigation from purchasers that have 100 percent of their services allocated to Florida as a result of the expansive definition of local market.

An administrative construction in deference to the commerce clause may or may not enhance the probability of success on the merits if such a construction is litigated. However, such a construction may reduce the probability of litigation because it would permit members of an affiliated group to define the economic unit in a manner most suitable to each affiliate by minimizing both the tax burden to the affiliate as well as tax revenues to the state.

5.02 Revenue Impact

In determining which administrative construction to adopt, the department must look to the Florida Supreme Court advisory opinion because
that opinion is intended for the express purpose of providing guidance to the state executive branch in administering the new sales and use tax on services. In its opinion, the Florida Supreme Court expressly recognized (at pages 1 and 22 at footnote 11) that the new tax bill was intended solely for the purpose of raising revenues. The assumptions supporting the revenue projections required of the governor in the legislative process should be implemented to the fullest extent possible in administering the new tax.

Relevant tax research, committee tapes, and fiscal notes indicate that the following assumptions were made in making revenue projections required of the governor. If sales in this state involving members of an affiliated group were taxed at 100 percent, revenue to the state would be approximately $122,000,000. If such sales were apportioned construing the infamous conjunction in the conjunctive, revenue loss to the state would approximate $72,000,000. Using the disjunctive, revenue losses would substantially exceed remaining $50,000,000.

The same revenue impact estimates apply to any administrative alternatives for construing the conjunction. For example, administratively construing the infamous conjunction in the disjunctive, regardless of whether consolidated or combined reporting is used, will exacerbate the loss of tax revenues by permitting affiliated groups to either: combine or consolidate as a taxpayer, if combination or consolidation reduces their Florida tax burden; or report by separate accounting for each affiliate if separate accounting reduces the state tax burden. The only affiliated groups that would be required to combine or consolidate would be those groups consisting of members that have related business activity and tax nexus with this state.

If the disjunctive is used and consolidated reporting permitted, affiliated groups will consistently define the group so that it is as large as possible. In this way, exemptions for intercompany transactions will be enjoyed by all affiliates including transactions between consolidated and unconsolidated affiliates. Moreover, the purchases of unconsolidated affiliates from unaffiliated corporations will be excluded from the apportionable consolidated tax base.

Florida is the fourth most populous state and is steadily increasing in population. Presumably, the number of affiliates doing business in this state as members of a single economic unit will increase in proportion to the size of the market.

The department must follow the Florida Supreme Court opinion for the purpose of administering the new tax law in a constitutional manner that enhances tax revenues. Construing the conjunction in the conjunctive and
requiring combined reporting is the only position that: can be asserted consistently as both an administrative and litigating position without subjecting the new statute to taxpayer attacks based on facial unconstitutionality; and give effect to the assumptions utilized by the governor in making revenue projections required in the legislative process.

DM/jl

2. Cf. Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 103 S.Ct. 2933, 2943 (1983) (discussing "potential for control" as the threshold test for combined reporting) See also authorities cited in n. 38 infra. Various state tests for stock ownership are compared in Hellerstein, State Taxation at para. 8.12[2], 469 supra n. 1.


5. See, e.g., s. 212.059(3)(a), F.S., which imposes the legal obligation to collect and remit both sales and use taxes on "dealers." Western Acceptance Co. v. Department of Revenue, 472 So.2d 497 (1 DCA FL 1985). (The requirement that the dealer have nexus is imposed as a judicial condition of enforcement of the legal obligation.)


7. Western Acceptance Co., 472 So.2d at 502.


10. J. Hellerstein, Tax Developments, at 981 supra n. 4.

11. J. Hellerstein, Tax Developments, at 977 supra n. 4.


15. Id.


19. Petersburg v. Siebold, 48 So.2d 291 (Fla. 1950); Haworth v. Chapman, 152 So.2d 663 (Fla. 1934); Sharet v. Hotel Corp. of America, 144 So.2d 813, (Fla. 1962). See also W. Hellerstein, Legal Study at 8 and 9.

20. Container Corp. of America, 463 U.S. at 170.

21. IRC s. 63 [All references to IRC are to the Internal Revenue Code of 1986.]

22. IRC s. 161

23. Butler Brothers, 315 U.S. at 509.

24. Deleted.

25. J. Hellerstein, Tax Developments, at 978, supra at n. 4


29. 386 U.S. 753 (1967)
30. Id.
32. Id.
33. Id.
34. Chatlos v. Overstreet, 124 So. 2d 1 (Fla. 1960).
35. Pierce & Peacock, 14 Fla. St. U.L. Rev., 479 (1986); W. Hellerstein, Legal Study at 93, supra at n.
36. Petersburg v. Siebold, 48 So. 2d 291 (Fla. 1950). See also cases cited in n. 19 supra.
37. E. Rudolph, State Taxation of Interstate Business, at 197, supra at n. 18.
38. Compare Container Corp. of America #463 U.S. at 169 with F.W. Woolworth #458 U.S. at 362 (requiring actual control instead of potential control). See also J. Hellerstein, State Taxation at 469 and 470, supra n. 1.
40. Id.
42. See n. 35 supra.