IN THE CIRCUIT COURT OF THE SECOND JUDICIAL CIRCUIT
IN AND FOR LEON COUNTY, FLORIDA

MICROSOFT CORPORATION

Plaintiff,

vs. CASE NO.: 2024 CA 000213

STATE OF FLORIDA, DEPARTMENT OF REVENUE,

Defendant.

_____/

COMPLAINT

Plaintiff Microsoft Corporation ("Microsoft" or "Plaintiff"), by and through its undersigned counsel and pursuant to chapters 72, 212, and 213, Florida Statutes, files this Complaint for relief against the State of Florida, Department of Revenue ("Department" or "Defendant"), and alleges as follows:

THE PARTIES

1. Microsoft is a corporation duly incorporated and existing under the laws of the State of Washington, and is qualified to conduct, and is conducting, business in the State of Florida.

2. At all times relevant, Microsoft's headquarters were located in Redmond, Washington.

3. The Department is an agency of the State of Florida. The Department is the state agency responsible for, among other items, the administration of Florida's corporate income tax, imposed by chapter 220, Florida Statutes.

JURISDICTION AND VENUE

4. Microsoft brings this action to contest the legality of an assessment issued by the Department against Microsoft for corporate income taxes and interest made pursuant to chapter 220, Florida Statutes.

5. This Complaint is timely-filed and any and all jurisdictional requirements under section 72.011, Florida Statutes, have been met.

6. With respect to the jurisdictional security requirement in section 72.011(3)(b), Florida Statutes, Microsoft requested that the Department waive the security requirement. Upon review of Microsoft's request, the Department waived the jurisdictional security requirement in section 72.011(3)(b), Florida Statutes, by letter dated January 29, 2024. A copy of the Department's letter to Microsoft waiving the security requirement is attached hereto as **Exhibit A**.

7. Pursuant to section 284.30, Florida Statutes, a copy of this Complaint, which requests attorney fees, is being simultaneously served on the Department of Financial Services.

8. All conditions precedent to the filing of this Complaint have been satisfied.

9. Venue is proper in this Court pursuant to section 72.011(4)(b), Florida Statutes.

FACTUAL BACKGROUND

10. Pursuant to chapter 72, Florida Statutes, Plaintiff brings this action to invalidate and set aside a disputed corporate income tax assessment issued by the Department for the tax years ending June 30, 2017 ("FY17"), June 30, 2018 ("FY18") and June 30, 2019 ("FY19") (the "Tax Years at Issue").

A. Microsoft's Business

11. Microsoft is engaged in the business of developing, licensing, and distributing computer software, and providing computer software and software-related services.

12. In connection with this business, Microsoft has created and protects numerous copyrights, patents, and trademarks with respect to software.

13. Microsoft also designs and sells hardware, including PCs, tablets and gaming and entertainment consoles.

14. Microsoft's revenue is derived from several revenue streams.

15. Microsoft derives revenue from sales of tangible personal property, software licensing, and the licensing of various intangible rights.

16. Microsoft also derives revenue from the sale of various digital products.

17. In addition, Microsoft also derives revenue from the provision of various services, including consulting services, advertising services, marketing services, support services, and other consumption services, such as Azure – Microsoft's comprehensive cloud service.

18. Microsoft has business operations within the United States as well as in numerous jurisdictions outside of the United States, which allows the company to stay competitive in local markets across the world.

19. The greatest proportion of Microsoft's activities, and the direct costs related to its activities and offerings take place in Redmond, Washington and Reno, Nevada. These activities include Microsoft's research and development, sales and marketing, technical support, legal, administrative, management, and finance activities. Thus, the greatest proportion of Microsoft's activities and direct costs related to its gross receipts take place outside of Florida.

B. The Department's Audit, Notice of Proposed Assessment, and Notice of Decision

20. For the Tax Years at Issue, Microsoft timely filed corporate income tax returns in Florida. In December 2021, Microsoft filed an amended return for FY18. Microsoft's original

returns for the Years at Issue, as amended, are collectively referred to herein as the "Florida Returns."

21. The Department initiated a routine corporate income tax audit of Microsoft for the Years at Issue. At the conclusion of the audit, the Department made certain adjustments to Microsoft's Florida Returns.

22. In particular, the Department made adjustments to Microsoft's Florida sales factor numerator, asserting that Microsoft should have reported sales from certain of its revenue streams utilizing a market-sourcing methodology rather than a costs of performance sourcing methodology as used by Microsoft on its Florida Returns.

23. The Department also made an adjustment to Microsoft's sales factor denominator to exclude receipts related to Microsoft's Internal Revenue Code section 481 adjustment, including deferred revenue.

24. The Department also made an adjustment to add back the amount of Texas Margin Tax that Microsoft paid to Texas for the Years at Issue.

25. The Department also made other adjustments, including adjustments to Microsoft's net operating loss carryover and Microsoft's Florida payroll factor.

26. On February 3, 2022, the Department issued a Notice of Proposed Assessment for the Years at Issue (the "NOPA"). A copy of the NOPA is attached hereto as **Exhibit B**. The NOPA assessed Microsoft corporate income tax and interest through February 3, 2022 in the following amounts:

Filing Period	Tax	Interest	Total
FY18	$4,055,401	$1,122,147	$5,177,548
FY19	$2,430,735	$458,342	$2,889,077
Total	$6,486,136	$1,580,489	$8,066,625

27. On April 4, 2022, Microsoft timely filed a written protest with the Department contesting the Notice and requesting an informal conference.

28. On December 7, 2023, the Department issued a Notice of Decision denying Microsoft's protest and upholding the Department's audit adjustments and the NOPA in full. A copy of the Notice of Decision is attached hereto as **Exhibit C**.

29. In the Notice of Decision, the Department stated that Florida law "directs" receipts from the provision of services "to be sourced to Florida and included in the numerator of the sales factor when the services are rendered to customers located in Florida." Notice of Decision at 9.

30. In the Notice of Decision, the Department concluded that Microsoft's receipts "derived from sales of its products and services should be sourced to the location of the customer to whom those products and services are provided, using a market sourcing methodology." Notice of Decision at 15.

31. Pursuant to section 72.011(2), Florida Statutes, and chapter 12-6, Florida Administrative Code, the Department's assessment is final as of the date of the Notice of Decision, i.e., December 7, 2023.

32. In accordance with the procedure set forth in section 72.011, Florida Statutes, Microsoft has timely filed this action pursuant to section 72.011 within sixty (60) days from the date that the proposed assessment became a final assessment. *See* § 72.011(2), Fla. Stat.; Fla. Admin. Code Ann. ch. 12-6.

FLORIDA LAW AND THE CORPORATE INCOME TAX

33. Article VII, section 1, Florida Constitution, states that "[n]o tax shall be levied except in pursuance of law."

34. In Florida, it is a long established rule that tax laws are to be construed strongly in favor of the taxpayer and against the government. *See New Sea Escape Cruises v. Dep't of Revenue*, 823 So. 2d 161, 163 (Fla. 4th DCA 2002); *Dep't of Bus. & Pro. Regul. v. WJA Realty P'ship*, 679 So. 2d 302, 306 (Fla. 3d DCA 1996).

35. Florida imposes corporate income tax on a corporation based on the corporation's income derived from, or attributable to, sources within Florida. § 220.15, Fla. Stat.

36. Corporations engaging in business within Florida and at least one other state must apportion their federal adjusted gross income utilizing Florida's apportionment formula in order to calculate the portion of their income that is properly attributed to Florida. § 220.15(1), Fla. Stat.

37. The applicable Florida apportionment formula consists of a property factor, a payroll factor, and a double-weighted sales factor. § 220.15(1), Fla. Stat.

38. The numerator of the Florida sales factor is the total sales of the taxpayer within Florida, and the denominator of the sales factor is the total sales of the taxpayer everywhere. § 220.15(5), Fla. Stat.

39. The Florida Legislature has authorized the Department to promulgate rules to administer and enforce Florida's Income Tax Code. *See* § 220.51, Fla. Stat. Pursuant to such authorization, the Department promulgated Rule 12C-1.0155, Florida Administrative Code, which details the process for determining a corporation's sales factor, as provided in section 220.15(1), Florida Statutes. *See* Order Granting Plaintiff's Motion for Summary Judgment at 4, *Billmatrix Corp. v. Dep't of Revenue*, No. 2020-CA-000435 (Fla. 2d Cir. Ct. Mar. 1, 2023).

40. According to the rule, "other sales," i.e., those sales that are not sourced under other provisions in Rule 12C-1.0155(2), Florida Administrative Code, are sourced to Florida in accordance with Rule 12C-1.0155(2)(l), Florida Administrative Code, i.e., the costs of

performance rule (the "COP Rule"). These "other sales" include the sale of services, except personal services. Under the COP Rule, sales are attributed to Florida if the income producing activity responsible for generating the sales revenue is performed by the taxpayer in Florida. If the income producing activity is performed within and outside Florida, the COP Rule states that the sales will be attributed to Florida only if the greater proportion of the income producing activity is performed in Florida, based on costs of performance. For purposes of the COP Rule, the "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profits. *See Billmatrix Corp.*, No. 2020-CA-000435 at 9, *Target Enter., Inc. v. Dep't of Revenue*, No. 2021-CA-002158, 2022 Fla. Cir. LEXIS 2986, at *6-7 (Fla. 2d Cir. Ct. Nov. 28, 2022).

COUNT I

THE DEPARTMENT INCORRECTLY CALCULATED MICROSOFT'S SALES FACTOR NUMERATOR

41. Each and every allegation set forth in paragraphs 1 through 40 of this Complaint is realleged and incorporated herein by reference.

42. Microsoft was required to apportion its federal adjusted gross income to Florida under section 220.15, Florida Statutes, because it was engaged in business both within and outside of Florida.

43. Microsoft was required to apportion its federal adjusted gross income to Florida in accordance with the three factor apportionment formula in section 220.15(1), Florida Statutes.

44. For purposes of calculating its sales factor for Florida corporate income tax purposes, Microsoft was required to use the COP Rule for sourcing the receipts it derived from services.

45. For purposes of calculating its sales factor for Florida corporate income tax purposes, Microsoft was required to use the COP Rule for sourcing the receipts it derived from "other sales," i.e., those sales that are not sourced under other provisions in Rule 12C-1.0155(2), Florida Administrative Code.

46. In the NOPA and in the Notice of Decision, the Department determined that Microsoft should have sourced all of its receipts, including its receipts from services and "other sales," using a "market sourcing" methodology, and not the COP Rule.

47. This Court has twice rejected the Department's application of "market sourcing" to source receipts from services, finding it inconsistent with the text of the COP Rule. *See Billmatrix Corp.*, No. 2020-CA-000435; *Target Enter., Inc.*, No. 2021-CA-002158, 2022 Fla. Cir. LEXIS 2986. This Court explained in *Billmatrix*: "The plain language of the COP Rule unambiguously directs that the income from Plaintiffs' sales be determined through use of the cost of performance method." *Id.* at 12. This Court further explained: "In contrast to the plain language of the COP Rule, the Department's audits detail varying interpretations of the COP Rule, each of which contradicts the rule's plain language, and instead imposes a market-based approach." *Id* at 13. "The Department's focus on the 'location,' 'destination,' or 'actions' of customers contradicts the plain language of the rule and must be rejected." *Id.* at 16.

48. The Department's NOPA and Notice of Decision incorrectly applied the provisions of Florida law in arriving at the proposed tax due from Microsoft.

49. As a result, the NOPA and Notice of Decision are incorrect, improper and contrary to Florida law, and must be abated.

COUNT II

THE DEPARTMENT INCORRECTLY CALCULATED MICROSOFT'S SALES FACTOR DENOMINATOR

50. Each and every allegation set forth in paragraphs 1 through 49 of this Complaint is realleged and incorporated herein by reference.

51. For purposes of calculating the Florida sales factor, "sales" means "all gross receipts of the taxpayer except interest, dividends, rents, royalties, and gross receipts from the sale, exchange, maturity, redemption, or other disposition of securities." § 220.15(5)(a), Fla. Stat.; Fla. Admin. Code Ann. r. 12C-1.0155(1) (stating "sales" means "all gross receipts received by the taxpayer from transactions and activities in the regular course of its trade or business."). The definition of "sales" does not exclude amounts of income determined under Internal Revenue Code section 481.

52. The Department incorrectly calculated Microsoft's sales factor denominator by excluding receipts related to Microsoft's section 481 adjustment, including deferred revenue.

53. Microsoft's receipts related to its section 481 adjustment, including deferred revenue, meet the definition of "sales" and must therefore be included in the calculation of Microsoft's sales factor denominator pursuant to Florida law. *See* § 220.15(5)(a), Fla. Stat.; Fla. Admin. Code Ann. r. 12C-1.0155(1).

54. The Department incorrectly applied the provisions of Florida law in arriving at the proposed tax due from Microsoft.

55. As a result, the NOPA and Notice of Decision are incorrect, improper, and contrary to Florida law, and must be abated.

COUNT III

THE DEPARTMENT'S ASSESSMENT VIOLATES THE UNITED STATES CONSTITUTION

56. Each and every allegation set forth in paragraphs 1 through 55 of this Complaint is realleged and incorporated herein by reference.

57. Under the Commerce Clause of the United States Constitution, a state may not tax income earned in the course of activities that are unrelated to the activities taking place within the state.

58. To satisfy the Commerce Clause, a tax must apply to an activity that has sufficient nexus with the state, must not discriminate against interstate commerce, must be fairly apportioned, and must be fairly related to services the state provides. *See Complete Auto Transit, Inc. v. Brady*, 420 U.S. 274, 278-79 (1977).

59. The Department's NOPA and Notice of Decision has sourced receipts to Florida based on activities that are unrelated to Microsoft's business activities taking place within Florida. Such a method is arbitrary, capricious, unreasonable, and constitutes unfair apportionment under the Commerce Clause as it is not based on the activity between Microsoft and Florida.

60. The Department's adjustments have resulted in an excessive amount of income being attributable to Microsoft's business activities in Florida. As a result, the amount of income attributed to Florida is out of all appropriate proportion to Microsoft's business transacted in Florida, does not fairly represent the extent of Microsoft's business activities in Florida, results in an unfair and disproportionate amount of income being assigned to Florida and, thus, violates the Due Process and Commerce Clauses of the U.S. Constitution.

COUNT IV

THE DEPARTMENT INCORRECTLY ADDED BACK THE TEXAS MARGIN TAX IN CALCULATING MICROSOFT'S NET INCOME SUBJECT TO TAX

61. Each and every allegation set forth in paragraphs 1 through 60 of this Complaint is realleged and incorporated herein by reference.

62. Under section 220.11, Florida Statutes, every taxpayer conducting business or earning or receiving income in Florida must pay a tax imposed on the taxpayer's net income for the taxable year.

63. "Net income" is defined as a taxpayer's adjusted federal income, or that share of its adjusted federal income for such year which is apportioned to Florida. § 220.12, Fla. Stat.

64. "Adjusted federal income" is defined to mean a taxpayer's taxable income as properly reportable for federal income tax purposes, as adjusted under the Florida Income Tax Code. *See* § 220.13(1), Fla. Stat.

65. One adjustment required to compute "adjusted federal income" is an addition for "[t]he amount of any tax upon or measured by income, excluding taxes based on gross receipts or revenues, paid or accrued as a liability to the District of Columbia or any state of the United States which is deductible from gross income in the computation of taxable income for the taxable year." § 220.13(1)(a)(1)a., Fla. Stat.

66. The Texas Margin Tax is not a tax upon or measured by income and is, therefore, not required to be added back under section 220.13(1)(a), Florida Statutes. *Graphic Packaging Corp. v. Hegar*, 471 S.W.3d 138, 147 (Tex. App. 2015) ("the franchise tax is not 'a tax imposed or measured by net income'"), *aff'd on other grounds* 538 S.W.3d 89 (Tex. 2017); *see Comcast Corp. v. Dep't of Revenue*, 24 OTR 250, 319 (Or. Tax Nov. 25, 2020). The margins tax is imposed on a taxpayer's "taxable margin," which begins with total revenue. *Comcast Corp.*, 24 OTR 250

at 315 (quoting *Graphic Packaging Corp. v. Hegar*, 538 S.W.3d 89 (Tex. 2017). From total revenue, the taxpayer is permitted a deduction for the greater of: (1) 30% of total revenue, (2) $1 million, (3) specified costs of goods sold, or (4) specified compensation. *See* Tex. Tax Code § 171.101(a).

67. Although the Texas Margin Tax is not an income tax, in the NOPA and in the Notice of Decision, the Department nevertheless determined that Microsoft was required to add back the Texas Margin Tax.

68. The Department's NOPA and Notice of Decision incorrectly applied the provisions of Florida law in arriving at the proposed tax due from Microsoft.

RELIEF REQUESTED

WHEREFORE, Plaintiff, Microsoft Corporation, respectfully requests that this Court enter judgment against the Department and in favor of Microsoft, and that this Court issue an Order:

A. Invalidating the NOPA and Notice of Decision or, in the alternative, enter an order invalidating the portion of the NOPA and Notice of Decision determined to be erroneous, unjust, unlawful, and contrary to the laws of the State of Florida;

B. Awarding Plaintiff and ordering judgment against Defendant for attorney fees and expenses of litigation to which Plaintiff may be entitled under the laws of the State of Florida pursuant to sections 213.015 and 57.105, Florida Statutes; and

C. Awarding such other and further relief as this Court may deem just and appropriate.

* * *

Respectfully submitted this 5th day of February, 2024.

EVERSHEDS SUTHERLAND (US) LLP

By: _____

Jonathan A. Feldman
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Atlanta, GA 30309
Telephone: (404) 853-8189
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JonathanFeldman@eversheds-sutherland.com

Attorney for Plaintiff,
MICROSOFT CORPORATION

EXHIBIT A

Florida Department of Revenue
Office of General Counsel

Jim Zingale
Executive Director

5050 West Tennessee Street, Tallahassee, FL 32399

floridarevenue.com

January 29, 2024

Mr. Jonathan A. Feldman, Esq.
Eversheds Sutherland (US) LLP
999 Peachtree Street, NE, Suite 2300
Atlanta, GA 30309

Re: Microsoft Corporation
FEI#: 91-1144442
Bond Waiver Request
Audit# 200289019
Tax years ending 06/30/17 – 06/30/19
Tax Type: Corporate Income Tax

Dear Mr. Feldman:

I am in receipt of your letter requesting a waiver of the provisions of s. 72.011(3)(b), F.S., on behalf of Microsoft Corporation. Ms. Isabel Nogues, an Assistant General Counsel with the Department, has reviewed the publicly available financial information of Microsoft Corporation. Based on that review and Isabel's recommendation, the Department is willing to waive the requirements of s. 72.011(3)(b), F.S., with respect to an action by Microsoft Corporation.

A copy of this letter should be attached to your complaint that is filed with the circuit court.

Should you have any questions, please give Isabel or me a call.

Sincerely,

Mark S. Hamilton
General Counsel

EXHIBIT B

FLORIDA

NOTICE OF PROPOSED ASSESSMENT

02/03/2022

C/O TAX DEPARTMENT
MICROSOFT CORPORATION
1 MICROSOFT WAY
REDMOND WA 98052-8300

Audit Number : 200289019
Business Partner : 848053
Tax : Corporate Income Tax
ID Number : 91-1144442
Audit Period : 06/30/2017, 06/30/2018, 06/30/2019

The *Notice of Proposed Assessment* ("Notice") identifies the deficiency resulting from an audit of your books and records for the audit period indicated. The Department has previously provided you with schedules of the various transactions supporting the basis for the proposed assessment.

Assessment Authority: Chapter 220, F.S.

Tax		$	6,486,136.00
Penalty		$	.00
Penalty - Fraud		$	.00
Penalty - Other		$	.00
Interest Through	02/03/2022	$	1,580,488.52
Total Deficiency		$	8,066,624.52
Less: Payment(s)		$	.00
Less: Offset(s)		$	.00
Balance Due		$	8,066,624.52

Plus additional daily interest at $1,243.92 per day from 02/04/2022, through the payment date. See Page 2, "Addendum to Notice of Proposed Assessment" for explanation of interest rates (if applicable).

If you do not agree with the proposed assessment, you may request a review through one of the following:

- ♦ informal protest
- ♦ administrative hearing
- ♦ judicial proceeding

The enclosed brochure provides you with the procedures for requesting a review.

If you file an **informal written protest**, you must file it with the Department no later than 04/04/2022, unless you request and receive an extension prior to this date. If you fail to file an informal written protest, the proposed assessment will become a FINAL ASSESSMENT on 04/04/2022.

If you request an **administrative hearing** or **judicial proceeding**, you must file your request no later than 06/03/2022 or 60 days from the date the assessment becomes a Final Assessment. Florida Statutes mandate this time limit and the Department cannot extend it. You must file the petition for an administrative hearing with the Department of Revenue. For judicial proceedings, you must file a complaint with the appropriate Clerk of the Court.

If a balance is due and you agree with the proposed assessment, please pay the balance due within 60 days from the notice date. Please return your payment in the enclosed envelope and include the NOPA remittance coupon.

The amount shown on this notice may not include: credits, payments, notices of tax action, delinquency notices or other billings previously issued by the Department.

NOTE: If you are protected by Federal Bankruptcy Law, you are not required to pay except as provided by Title 11 United States Code (U.S. Bankruptcy Code).

Refer questions and correspondence to:

Compliance Standards Process
P.O. BOX 5139
Tallahassee, FL 32314-5139
Phone: (850) 617-8565 Fax: (850) 245-5981

FLORIDA DEPARTMENT OF REVENUE

Addendum to Notice of Proposed Assessment
Schedule of Tax, Penalty and/or interest

C/O TAX DEPARTMENT
MICROSOFT CORPORATION
1 MICROSOFT WAY
REDMOND WA 98052-8300

Audit Number : 200289019
Business Partner : 848053
Tax : Corporate Income Tax
ID Number : 91-1144442
Audit Period : 06/30/2017, 06/30/2018, 06/30/2019

I. 12% Interest Rate		II. Market Interest		III. Combined Liability			
Applied Period		Applied Period		Combined Applied Period			
Tax $	Interest Through 02/03/2022 $	Tax $	Interest Through 02/03/2022 $	Tax $	Penalties $	Interest Through 02/03/2022 $	Total $
0.00	1,569,293.27	6,486,136.00	11,195.25	6,486,136.00	0.00	1,580,488.52	8,066,624.52
					Less Payments		(0.00)
					Offsets		0.00
					Balance Due		8,066,624.52

I. Twelve (12) Percent Interest Rate: For taxes due on or before December 31, 1999, an interest rate of 12% per annum applies, except for Corporate Income and Emergency Excise Taxes. The additional daily interest amount for this portion of the liability is $0.00

II. Market Interest Rate: For taxes due on or after January 1, 2000, a floating interest rate applies. This rate will be updated January 1 and July 1 of each year. The additional daily interest amount for this portion of the liability is $1,243.92. Current and prior interest rates are posted on our Internet site at: **www.floridarevenue.com** or you can contact Taxpayer Services at 850-488-6800 and select Information on Taxes from the option menu.

III. Combined Liability: This column combines columns I and II and represents the total tax, penalties and interest assessed. The combined daily interest amount is $1,243.92. Please include additional interest accrued from 02/04/2022 through the date your payment is postmarked.

Refer questions and correspondence to:

Compliance Standards Process
Florida Department of Revenue
P.O. BOX 5139
Tallahassee, FL 32314-5139
Phone: (850) 617-8565 Fax: (850) 245-5981

FLORIDA
DEPARTMENT OF REVENUE

Enforcement Remittance Coupon
NOPA Remittance Coupon

C/O TAX DEPARTMENT
MICROSOFT CORPORATION
1 MICROSOFT WAY
REDMOND WA 98052-8300

Business Partner	: 848053
Service Notification	: 200289019
Period	: 06/30/2017 - 06/30/2019
Tax Type	: Corporate Income Tax

To ensure proper credit, please detach and include the preprinted remittance coupon below when submitting payments.

The amount of interest owed has been calculated through the Interest Through date shown on the NOPA. When submitting your payment, please remember to include the additional interest amount accrued since that date.

To calculate the additional interest amount, multiply the number of days since the Interest through date times the daily interest amount. The daily interest amount is also shown on the NOPA.

You can pay bills online for many taxes using your credit card or the ACH-Debit method at www.floridarevenue.com.

DR-839
N.10/03

Detach For processing

NOPA Remittance Coupon

Service Center: Los Angeles	Check Number:
Business Partner: 848053	Tax Type: Corporate Income Tax
Audit Number 200289019	Remittance Total:

Make check or money order payable to:
Florida Department of Revenue
5050 West Tennessee Street
Tallahassee, Florida 32399-0100

C/O TAX DEPARTMENT
MICROSOFT CORPORATION
1 MICROSOFT WAY
REDMOND WA 98052-8300

0600 0 20190630 0002005059 4 6200289019 0000 1

FLORIDA
Executive
Director
Jim Zingale

Tax Audit Satisfaction Survey

The Florida Department of Revenue invites you to complete the online ***Tax Audit Satisfaction Survey*** to help the Department identify ways to improve service to taxpayers. This survey is an opportunity to provide feedback on your recent tax audit experience. Your input is important to us. To access the survey, place the following web address in your browser's access bar:

https://fdor-audit.questionpro.com

When you open the survey, you will be asked to enter the three numbers listed below. This information will enable you to complete and submit the survey.

Business Partner Number:	848053
Notification Number:	200289019
Respondent Code:	44

As you complete the survey, you will be asked to provide the following information:

Tax Audited:	Corporate Income Tax
Service Center:	Los Angeles Service Center

If you need technical assistance accessing the survey, please email Douglas Charity at douglas.charity@floridarevenue.com.

Thank you.

EXHIBIT C

Florida Department of Revenue
Technical Assistance and Dispute Resolution

Jim Zingale
Executive Director

5050 West Tennessee Street, Tallahassee, FL 32399

floridarevenue.com

December 7, 2023

Mr. Ted W. Friedman
Eversheds Sutherland (US), LLP
1114 Avenue of the Americas, 40th Floor
New York, NY 10036

TedFriedman@eversheds-sutherland.com

Re: Notice of Decision
Microsoft Corporation
BPN: 0000848053
Audit #: 200289019
Corporate Income Tax
Period: 06/30/2017 - 06/30/2019

Proposed Assessment Amount:		$	8,066,624.52
Sustained Amount:		$	8,066,624.52
Balance Due:	*	$	9,078,639.44

* Includes payments and updated interest through December 06, 2023. Interest continues to accrue at $ 1,954.73 per day until the postmark date of payment. Daily interest is subject to change every January 1 and July 1.

Dear Mr. Friedman:

This is the Department's response to the protest letter postmarked April 04, 2022, filed against the referenced assessment. The letter of protest, the case file, and other available information have been carefully reviewed. This reply constitutes the issuance of our Notice of Decision, pursuant to the provisions of Rule 12-6.003, Florida Administrative Code (F.A.C.). It represents our position based on applicable law to the issues under protest.

ISSUE

Whether the taxpayer should apportion the income it derives from software licensing fees; sales of digital content and products offered through gaming platforms and its online store; platforms as a service; sales of consumption services; and sales of cloud subscription services; using a market sourcing methodology or a costs of performance sourcing methodology, for purposes of Florida corporate income tax.

FACTS

The taxpayer is in the business of developing, licensing, creating, and distributing computer software and related services. It holds numerous software-related copyrights, patents, and trademarks.

The taxpayer derives income from:

1. Licensing fees paid by other equipment manufacturers (OEM) who sell the taxpayer's software with their machines;

2. The sale of digital content and products offered through gaming and other platforms, and the taxpayer's online store;

3. The sale of consumption services classified as "platforms as a service," and providing users a cloud platform that includes, computing, networking, storage, and analytic services;

4. The sale of services, which includes "software as a service," and other services;

5. The sale of cloud subscription services that provide computing, networking, and support services to consumers; and

6. The sale of tangible personal property and software licensing.

The taxpayer filed its Florida corporate income tax returns for the audit period using a costs of performance sourcing methodology for income it receives for the business activities listed above, and reported a Florida sales factor of zero. When the Department audited the taxpayer's Florida corporate income tax returns for the tax years ended June 30, 2017, June 30, 2018, and June 30, 2019, it was determined that the taxpayer's income should have been apportioned using a market sourcing methodology, and the sales factor was adjusted to reflect market sourcing of income.

Additionally, the Department also increased the taxpayer's state tax addition to add back the Texas Margin Tax, adjusted the numerator of its sales factor related to "OEM Licensing Revenue," adjusted its net operating loss carryover, and it's Florida payroll factor.

The taxpayer is protesting the Department's audit adjustments.

TAXPAYER ARGUMENT

The protest letter dated April 4, 2022, states that, based on Florida's statutes and rules, and several court decisions, the taxpayer was correct in sourcing its income to Florida using a costs of performance methodology, as its activities and direct costs occur and are incurred in Redmond, Washington, and Reno, Nevada.

Additionally, in the telephone conference with the taxpayer on July 27, 2023, the taxpayer stated that its situation is identical to those of Billmatrix Corporation, and Target Enterprise, Inc., and that the rulings in Billmatrix Corp., et. al v. Florida Department of Revenue, Circuit Court, 2nd Dist., Leon County, No. 2020-CA-000435 (3/1/23); and Target Enterprise, Inc., v. Department of Revenue, Fla. Cir. Ct (2nd), No. 2021-CA-002158, (11/28/22), apply equally to this taxpayer.

LAW

Section 220.02, F.S., states in part:

> (1) It is the intent of the Legislature in enacting this code to impose a tax upon all corporations, organizations, associations, and other artificial entities which derive from this state or from any other jurisdiction permanent and inherent attributes not inherent in or available to natural persons, such as perpetual life, transferable ownership represented by shares or certificates, and limited liability for all owners. . . .
>
> ***

Section 220.15(5), F.S. states in part:

> (5) The sales factor is a fraction the numerator of which is the total sales of the taxpayer in this state during the taxable year or period and the denominator of which is the total sales of the taxpayer everywhere during the taxable year or period.
> (a) As used in this subsection, the term "sales" means all gross receipts of the taxpayer except interest, dividends, rents, royalties, and gross receipts from the sale, exchange, maturity, redemption, or other disposition of securities. However:
> 1. Rental income is included in the term if a significant portion of the taxpayer's business consists of leasing or renting real or tangible personal property; and
> 2. Royalty income is included in the term if a significant portion of the taxpayer's business consists of dealing in or with the production, exploration, or development of minerals.
>
> ***

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-1.013(15)(d) and (f), F.A.C., state:

> (d) A Florida addition or subtraction under Section 220.13(1), F.S., never creates an NOL or increases the amount of a federal NOL. However, adjustments to federal taxable income such as the adjustment for long-term contracts and the adjustment for Election B required under the provisions of Section 220.03(5)(c), F.S., impact the net operating loss and therefore, the carryover for Florida purposes. While a Florida addition or subtraction may never increase the amount of the net operating loss carryover over the federal amount, an adjustment may increase or decrease the net operating loss carryover for Florida purposes.
>
> * * *
>
> (f) Only the excess of Florida additions over Florida subtractions will dilute the amount of net operating loss carryover available to the following tax year. Example: A corporation's taxable income for 1991 was $(200,000). The taxpayer was required pursuant to Section 220.13(1)(a)2., F.S., to addback $100,000 exempt interest. A subtraction of $50,000 was provided by Section 220.13(1)(b)2.b., F.S., for the gross-up of income required by s. 78, I.R.C. The net operating loss carryover will be diluted for Florida tax purposes only by the excess of Florida additions over Florida subtractions. The net operating loss carryover to 1992 will be calculated as $(200,000) – ($100,000 – $50,000). Therefore, the net operating loss carryover available for Florida tax purposes will be $150,000.
>
> * * *

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

(1)(a) A departure from the applicable method of apportionment required under the provisions of section 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 Florida.
(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.
(4) A taxpayer must petition the Department for a departure from the required apportionment method by filing, on or before the due date for filing of the return for the taxable year, with extension, either: a written request for a technical assistance advisement under section 213.22, F.S., and rule chapter 12-11, F.A.C.; or, a petition for a declaratory statement under section 120.565, F.S.
(a) The taxpayer must file the request or petition with Technical Assistance and Dispute Resolution, P.O. Box 7443, Tallahassee, Florida 32314-7443.
(b) The taxpayer's request or petition must include a summary of the evidence to support the taxpayer's contention that the applicable apportionment formula results in taxation of extraterritorial values and to demonstrate that the regular formula operates to unreasonably and arbitrarily attribute income to Florida far out of proportion to the business transacted in Florida. The taxpayer must also furnish evidence that the use of an alternative method fairly and accurately apportions income to Florida.

Rule 12C-1.0155, F.A.C., states in part:

(1) For the purposes of the sales factor, the term "sales" means all gross receipts received by the taxpayer from transactions and activities in the regular course of its trade or business.

* * *

(h) Sales of services. In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency, the performance of equipment service contracts, or research and development contracts, "sales" includes the gross receipts from the performance of such services including fees, commissions, and similar items.

* * *

(2) Florida sales. The numerator of the sales factor includes gross receipts attributed to Florida which were derived by the taxpayer from transactions and activities in the regular course of its trade or business. All interest income, service charges, carrying charges, or time-price differential charges incident to such gross receipts shall be included, regardless of the place where the account records are maintained or the location of the contract or other evidence of indebtedness.

* * *

(h) Computer related sales.
1. Hardware delivered in Florida constitutes Florida sales.
2. Canned software programs are Florida sales if delivered to a customer in Florida.
3. Customized software programs are Florida sales when the customization of the programs is done in Florida. That is, when technical advice to customize a program is rendered on site in Florida, the sale will be considered a Florida sale.
4. Licensing fees for software are Florida sales to the extent the software is used in Florida.
5. Interactive networks.
a. Where there are charges to Florida customers for direct access to a data base, these charges are considered Florida sales. These charges include, but are not limited to, fees to access the network, fees based on the number of information requests made, time charges for connection to the data base and lines, and information retrieval from the data base.
b. Where there are charges by a corporation located in Florida to Florida customers for access to third party data bases, all charges will be considered Florida sales, regardless of where the third-party data bases are located.
c. Where a foreign (out-of-state) corporation charges Florida customers for access to third party data bases, all charges will be considered Florida sales except for charges directly related to the retrieval of information from the third-party data base.

d. When a P.C. or mainframe is physically located in Florida, a corporation will have a "Florida customer" for purposes of this subparagraph.

* * *

(*l*) Other Sales in Florida. Gross receipts from other sales shall be attributed to Florida if the income producing activity which gave rise to the receipts is performed wholly within Florida. Also, gross receipts shall be attributed to Florida if the income producing activity is performed within and without Florida but the greater proportion of the income producing activity is performed in Florida, based on costs of performance. The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profits. Where independent contractors are used to complete a contract, the term "income producing activity" will include amounts paid to the independent contractors.

* * *

DISCUSSION

Subsection 220.02(1), F.S., provides that it is the intent of the Florida Legislature to impose a corporate income tax on every taxpayer in each taxable year, for the privilege of conducting business, deriving income, or being incorporated in this state. Subsection 220.15(5), F.S., defines the sales factor as a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year or period and the denominator of which is the total sales of the taxpayer everywhere during the taxable year or period. Rule 12C-1.0155, F.A.C., describes how the receipts from different types of sales activities are computed, and then provides information on the computation of the Florida portion of those receipts. Rule 12C-1.0155(2), F.A.C., provides that the numerator of the sales factor includes gross receipts attributed to Florida which were derived by a taxpayer from transactions and activities in the regular course of its trade or business. In this case, the taxpayer's business activities include both service activities and the sale of tangible personal property.

The apportionment factor provides a measure of a taxpayer's business activity in the states in which it does business and serves as a means of attributing income to the states from which the income was derived. Florida bases its sales apportionment on where the sales transaction takes place rather than where contracts are approved, where data is processed or stored, where payment is made, or where the customer's headquarters is located.

The taxpayer has applied Rule 12C-1.0155(2)(*l*), F.A.C., which addresses "Other Sales in Florida," to source the income from *all* its business activities using a costs of performance methodology, even when there are rules specifically directing a different sourcing method. Further, this application of the rule ignores the fact that the taxpayer also sells tangible personal property, at least some of which is, presumably, sold to customers located in Florida. There is no doubt that

Chapter 220, F.S., requires sales of tangible personal property to be sourced to Florida when the customer to which such property is sold is located in Florida. Furthermore, Rule 12C-1.0155(2)(h), F.A.C., entitled "Computer related sales," addresses the proper sourcing of income for many of the taxpayer's lines of business. Therefore, it is unclear why the taxpayer would apply a costs of performance sourcing methodology to its sales of tangible personal property, and it would not be reasonable to expect the taxpayer's sales factor for the tax years included in the audit period, to be zero.

Software Licensing Fees:

Rule 12C-1.0155(2)(h)4., F.A.C, directs that fees derived from licensing of software should be sourced to the location of the software user, and it would be expected that at least *some* of the software licenses for which the taxpayer receives payment apply to software used in Florida. Therefore, it is unclear why the taxpayer would apply a costs of performance sourcing methodology to fees it receives for licensing software, and again, it would not be reasonable to expect the taxpayer's sales factor for the tax years included in the audit period to be zero.

Similarly, software licensing fees paid to the taxpayer by OEM's would be sourced to the location of the OEM that purchased the licenses.

Sales of Digital Content, Products Offered through Platforms, and Cloud Subscription Services:

The taxpayer also derives income from the sale of digital content and products offered through platforms such as Xbox Live and the taxpayer's online store. Again, the taxpayer is selling software and licensing its use, and Rule 12C-1.0155(2)(h), F.A.C., directs that these sales be sourced to Florida when the customer to whom they are sold is located in Florida. It is not reasonable to expect that *none* of the purchasers of these products are located in Florida, or that the taxpayer's sales factor for the years included in the audit period should be zero.

The services referred to as "platforms as a service" and "cloud subscription services" in the protest letter are, in essence, interactive networks, the income from which Rule 12C-1.0155(2)(h)5., F.A.C., directs is to be sourced to Florida when the customer using the service is located in Florida. Again, it is not reasonable to expect that *none* of the purchasers of these services are located in Florida, or that the taxpayer's sales factor for the years included in the audit period should be zero.

As Rule 12C-1.0155(2)(h), F.A.C., addresses the sourcing of income for the types of products and services discussed above, there is no reason to apply Rule 12C-1.0155(2)(*l*), F.A.C., which addresses "Other Sales in Florida."

Premier and Microsoft Consulting Services:

With regard to the "Premier and Microsoft Consulting Services," which include "software as a service" and "consulting service elements," it is unclear whether these services rise to a level that would allow them to be apportioned using a costs of performance methodology. However, Rule 12C-1.0155(1)(h), F.A.C., which addresses "Sales of Services," states that income received for providing services includes the gross receipts from the performance of such services and, to the extent that those services are provided to customers located in Florida, Rule 12C-1.0155(2), F.A.C., directs that the income is to be sourced to Florida and included in the numerator of the sales factor.

Pursuant to Rule 12C-1.0155(2)(*l*), F.A.C., sales are attributed to Florida if the income producing activity which gave rise to the receipt is performed wholly within Florida. "Income producing activity" is defined in Rule 12C-1.0155(2)(*l*), F.A.C., as "the transactions and activity directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profits."

However, as the income the taxpayer derives from the "Premier and Microsoft Consulting Services," which include "software as a service" and "consulting service elements," is clearly derived from the sale of services, it would appear that the provisions of Rule 12C-1.0155(1)(h), F.A.C., which addresses "Sales of Services," and Rule 12C-1.0155(2), F.A.C., which directs that such income is to be sourced to Florida and included in the numerator of the sales factor when the services are rendered to customers located in Florida, are on point and are more appropriately applied to the taxpayer's services income than Rule 12C-1.0155(2)(*l*), F.A.C., which addresses "Other Sales in Florida."

Furthermore, there have been a number of legal decisions on the subject of sourcing income under the costs of performance methodology, which determined that the services income addressed therein should be sourced to the location of the customer to whom the service was provided. The following two cases illustrate Florida's position on the interpretation of Rule 12C-1.0155(2)(*l*), F.A.C. In Heller Western v. Arizona Department of Revenue[1], Heller Western[2] borrowed money from its Illinois parent in order to lend money to Arizona businesses. Any loan over one million dollars had to be approved by its parent in Illinois and its headquarters in California. The California office also monitored the progress of loans made in Arizona and paid the interest expense on the loans from the parent company to Heller Western in Arizona. Prior to 1978, Heller Western sourced the interest earned from loans to Arizona customers[3] to Arizona. After 1978, Heller Western sourced the interest earned from loans to Arizona customers outside Arizona. Heller Western argued that pursuant to A.C.A.R.R. R15-2-135-8(b)(5)(j)(1978) (an Arizona rule similar to Rule 12C-1.0155(2)(*l*), F.A.C.), borrowing money from its parent was part of its income producing activity in Arizona, and that since more than fifty

[1] 775 P.2d 1113 (Ariz. Sup. Ct. 1989).
[2] Heller Western is a branch of a California corporation. The California corporation is a subsidiary of a corporation domiciled in Illinois.
[3] Customer is used interchangeably with consumer.

percent of the costs associated with the borrowing occurred outside of Arizona, the income earned from lending money in Arizona should not be sourced to Arizona. The Arizona Department of Revenue ("Arizona") disagreed and argued that the interest earned from loans to Arizona consumers should be sourced to Arizona because "only the activities of the Arizona branch office immediately resulted in generating income from the Arizona loans. Thus only those activities qualify as 'income producing activity.'"[4]

The Arizona Supreme Court ruled in favor of Arizona and stated, "[w]e believe that the term, 'income producing activity,' in our regulation contemplates only direct sales payment activity by the consumer, which in this case occurred in Arizona."[5] This position was further elaborated by the Court:

> . . . Further, those activities are uniformly local to the situs of the *consumer*.... For example, payments for interstate transportation of freight are allocated to the state where the freight is delivered, not purchased, because that is where the consumer is. However, payments for interstate transportation of people on a common carrier are allocated to the state where the ticket is purchased, not the traveler's destination, again because that is where the consumer is. Finally, payments resulting from business generated by interstate telephone calls are allocated to the state where the customer placed or received the call; whether the seller called the consumer or the consumer called the seller, it is the consumer's situs that is determinative. . . [6]

The Court states that sourcing sales made to Arizona consumers to Arizona was a "logical conclusion."[7] The Court compares the interest earned from loans to a retailer selling goods and states:

> Heller Western can no more argue that its receipts from Arizona loan consumers should not be taxed due to its out-of-state involvement in procuring its 'inventory' than a retailer who is engaged in extensive dealings out of state to buy his merchandise could argue that he should not be taxed on the goods he sells to consumers here.[8]

The Arizona Supreme Court held that based on the "consumer location orientation...'income producing activity' contemplates direct solicitation, negotiation, and sales activities with consumers in this state."[9] As a result, all sales were sourced to Arizona, regardless of where most of the costs of performance occurred.

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

In Ameritech Publishing, Inc. v. Wisconsin Department of Revenue[10], Ameritech was in the business of selling advertising for placement in telephone directories. The advertising services at issue were sold entirely within Wisconsin. However, the vast majority of the costs of performance of the advertising services occurred outside Wisconsin. The final product, a telephone book containing the advertisements, was delivered to Wisconsin via common carrier. Ameritech initially sourced the sales of these services to Wisconsin. However, it later filed amended returns seeking refunds arguing that the sale of its services should not be sourced to Wisconsin pursuant to WIS. STAT. s. 71.25(9)(d) ((1999) similar to Rule 12C-1.0155(2)(l), F.A.C.) because the majority of the costs of performance occurred outside Wisconsin, and the telephone books were delivered to Wisconsin via common carrier.

The Wisconsin Department of Revenue ("Wisconsin") disagreed and argued that Ameritech's income producing activity occurred within Wisconsin for several reasons. First, Wisconsin argued that Ameritech had significant sales for the four years at issue and if Ameritech's argument was accepted, Ameritech would pay no tax in one of the years and receive a refund of two million dollars for two of the years. Second, Wisconsin argued that Ameritech's position was unreasonable because large amounts of the income producing activity would not be sourced to Wisconsin, where the advertising occurred. Wisconsin also argued that the Tax Appeals Commission's finding that Ameritech's income producing activity was "furnishing its customers access to a Wisconsin audience was reasonable...."[11] Finally, Wisconsin argued that Ameritech's position that solicitation and advertising production were the income producing activities was "belied by the fact that these activities were not specified in the contract," and that not all of its customers used these services.[12]

The Wisconsin Court of Appeals ruled in favor of Wisconsin and upheld the Tax Appeals Commission's finding that the:

> . . .'[I]ncome-producing activity' associated with [Ameritech]'s service from 1994 to 1997 was, at bottom, the provision of access to a Wisconsin audience. Advertisers paid [Ameritech] to reach Wisconsin consumers through this familiar and well-established advertising medium. It is undisputed that, in the course of providing this service, [Ameritech] employees working in offices outside of Wisconsin executed tasks related to the sale and production of the ads. But [Ameritech]'s customers did not pay primarily for [Ameritech] to service their accounts, design their advertisements, or send their ad copy with the completed directory to the printer. They paid for the broad access [Ameritech] could provide to a Wisconsin audience.[13]

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[10] No. 2009AP445 (App. Ct. IV 2009), 788 N.W.2d 383 (Wis. Ct. App. 2010)
[11] Id. at ¶ 30
[12] Id.
[13] Id. at ¶34.

The Wisconsin Court of Appeals also agreed that the income producing activity occurred in Wisconsin, not in the other states in which a majority of the costs of performance occurred and stated:

> Moreover, the Commission reasonably concluded that this service of providing access to Wisconsin consumers is income-producing activity performed within the state of Wisconsin under WIS. STAT. § 71.25(9)(d). During the relevant period, API acted as a gatekeeper for its advertisers to the Wisconsin market; API's customers paid a monthly toll to reach that market via a venerable advertising medium. API's income was dependent primarily upon its status as a telephone directory publisher, and its ability to offer advertisers access to a pool of local consumers (Wisconsin consumers in this case) through this medium. Thus, regardless which state API's sales persons and advertising production staff was located, API's primary service of providing access to a Wisconsin audience was performed in the state of Wisconsin.[14]

The Wisconsin Court of Appeal stated that the Tax Appeals Commission reasonably relied on The Hearst Corporation v. DOR[15] in order to determine the income producing activity. In Hearst, WISN-TV was a television broadcaster located in Wisconsin. WISN-TV generated revenue from local and national advertisements. The administration of the local advertisements occurred within Wisconsin, while the administration of the national advertisements occurred outside Wisconsin. WISN-TV argued that the income producing activity in regard to national advertisement was performed outside Wisconsin since all the costs of performance occurred outside Wisconsin. The Tax Appeals Commission in Hearst ruled that the income producing activity was the broadcasting of the national advertisement in Wisconsin, despite the fact that the costs of performance of the advertisement occurred outside Wisconsin. The Tax Appeals Commission reasoned that:

> "[T]he network and national advertising revenues are based upon the showing or broadcasting thereof. Without broadcasting there is no income." The Commission further found that "advertisers choose spots based upon the demographic profile of the audience viewing the particular programming during which the spots occur or are available, and that the advertisers are buying the spots due to the programming and its demographic makeup." In its findings of fact, the Commission concluded "the income producing activity is the actual broadcasting of the programming desired by the advertiser and the commercial spots during that programming and, thus, is in Wisconsin."[16]

In both Heller Western and Ameritech, the majority of the taxpayer's costs of performance occurred outside the state in which their customers resided and where the income producing activity actually occurred. The taxpayers in both cases argued that sales should be sourced to

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

the state in which the majority of the costs of performance occurred instead of where the customer was located and where the income producing activity occurred. However, the courts in the two cases held that the income producing activities were the actual sale of services to its customers, as opposed to the costs of performing those services. The courts in both cases sourced the taxpayer's gross receipts from the sale of services to the market state, the state in which the customer resided, reasoning that the direct sale to the customer at the customer's domicile is where the income producing activity occurred. In analyzing the income producing activity, the most important factor to determine is where the customer is located.

The background of the adoption of the sales apportionment factor for the Florida corporate income tax is also helpful for this analysis. When the adoption of the corporate income tax was being debated by the Florida legislature in 1971, there were two options available to measure the receipts for the sales apportionment factor: the pure destination test, also known as the market state test, or the combined destination and origin test.[17] The pure destination test sources the goods sold to the market state or the state where the goods are consumed. The combined destination and origin test assigns the sales to the state from which the goods were shipped if the taxpayer was not doing business in the state of the purchase or if the purchaser was the federal government.

The Florida legislature adopted the pure destination test and assigned fifty percent of the apportionment factor to the sales factor.[18] Florida deviated from weighting the three apportionment factors equally because Florida is a consumer state. Had the legislature adopted equal weighting for the three factors, foreign corporations that do not relocate personnel and property to Florida, would pay proportionately less tax on their income than local corporations that have significant payroll and property factors assigned to Florida.[19] When analyzing each portion of the receipts, a determination must be made as to the final destination of the product or service being sold.

The term "income producing activity" is defined as "the transactions *and* activity directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profits."[20] The word "and" signifies that both transactions and activities must exist in order for any activity to be considered the income producing activity. The word "transaction" is used several times in the Florida Statutes and Rules, but is not defined. Black's Law Dictionary[21] defines "transaction" as:

1. The act or an instance of conducting business or other dealings.
2. Something performed or carried out; a business agreement or exchange.
3. Any activity involving two or more persons.

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

This taxpayer's "Premier and Microsoft Consulting Services" do not appear to rise to the level that would allow them to be sourced using a costs of performance sourcing method and the income from providing them should be sourced to the location of the taxpayer's customer, as provided by Rule 12C-1.0155(1)(h), F.A.C., and Rule 12C-1.0155(2), F.A.C., rather than using the costs of performance method addressed in Rule 12C-1.0155(2)(*l*), F.A.C.

Additional Issues Raised in the Protest:

The taxpayer has cited an Oregon court ruling saying that the Texas Margin Tax is not a tax based on income. However, the Department has considered this matter and determined that it *is* a tax based on income. Therefore, until there is a controlling ruling on the issue, the Department may consider other state's rulings, but reserves the right to disagree with them.

The adjustment of the taxpayer's sales factor related to "OEM Licensing Revenue" is addressed previously in this notice.

The adjustment to the taxpayer's net operating loss carryover resulted from applying the provisions of Rules 12-1.013(15)(d) and (f), F.A.C., which do not allow subtractions to exceed additions to create or increase a federal net operating loss. The adjustment was necessary to bring the taxpayer's net operating loss computation into compliance with Florida's corporate income tax statutes and rules.

The audit adjustment to the taxpayer's Florida payroll factor is based on the use of the taxpayer's Florida reemployment tax filings, and reconciles the amounts reported for that tax to the taxpayer's Florida corporate income tax payroll factor. This is an acceptable method of computing a taxpayer's Florida payroll factor.

It appears that the taxpayer is attempting to challenge the Department's rules in its protest letter. However, the Department's informal protest process is not the proper forum for that action.

Additionally, the protest letter requests alternative apportionment if the Department disagrees with the taxpayer's position. Alternative apportionment must be requested in the form of a Technical Assistance Advisement or Declaratory Statement, as addressed in s. 220.152, F.S., and Rule 12C-1.0152, F.A.C., and may be granted on a prospective basis only. Alternative apportionment cannot be granted retroactively.

CONCLUSION

Based on Florida's statutes, rules, and the discussion presented above, income the taxpayer derived from sales of its products and services should be sourced to the location of the customer to whom those products and services are provided, using a market sourcing methodology. While the taxpayer has stated that its business activities mirror, identically, those of Billmatrix Corporation and Target Enterprise, Inc., there are sufficient distinctions

between the taxpayer's operations and those of the other two entities to determine that the rulings in the Billmatrix Corporation and Target Enterprise, Inc., court decisions do not apply to this taxpayer. Accordingly, the audit assessment is sustained.

Enclosed for your convenience is an audit remittance coupon. Payment, including interest to the postmark date of payment, should be returned in the enclosed envelope, along with the audit remittance coupon. The check should reflect the audit number.

TAXPAYER APPEAL RIGHTS

This Notice of Decision constitutes the final position of the Department unless a Petition for Reconsideration is filed on a timely basis, in which event the Notice of Reconsideration will be the Department's final position. The requirements for a Petition for Reconsideration are set forth below.

Pursuant to Section 72.011(2), F.S., and Rule Chapter 12-6, F.A.C., the assessment is final as of the date of this Notice of Decision unless you file a written Petition for Reconsideration postmarked within thirty (30) days of the date of this Notice of Decision and addressed to Technical Assistance and Dispute Resolution, Post Office Box 7443, Tallahassee, FL 32314-7443. The Petition for Reconsideration must contain new facts or arguments; otherwise, it is subject to dismissal.

Absent a timely-filed Petition for Reconsideration, the assessment reflected in the Notice of Decision is final, and you have three alternatives for further review:

1) Pursuant to Section 72.011, F.S., and Rule Chapter 12-6, F.A.C., you may contest the assessment in circuit court by filing a complaint with the clerk of the court. THE COMPLAINT MUST BE RECEIVED BY THE CLERK OF THE CIRCUIT COURT WITHIN SIXTY (60) DAYS OF THE DATE OF THIS NOTICE OF DECISION. Section 72.011(3), F.S., provides that no circuit court action may be brought unless you pay to the Department the amount of taxes, penalties, and accrued interest assessed by the Department that are uncontested and tender or post a bond for the remaining disputed amounts unless a waiver is granted, as provided in that section. Failure to pay the uncontested amounts will result in the dismissal of the action and imposition of an additional penalty in the amount of twenty-five percent (25%) of the tax assessed. The requirements of Chapter 72, F.S., are jurisdictional;

2) Pursuant to Sections 72.011, 120.569, 120.57, and 120.80(14), F.S., and Rule Chapter 12-6, F.A.C., you may contest the assessment in an administrative forum by filing a petition for a Chapter 120 administrative hearing with the Department of Revenue, Office of General Counsel, Post Office Box 6668, Tallahassee, FL 32314-6668. THE PETITION MUST BE RECEIVED BY THE DEPARTMENT WITHIN SIXTY (60) DAYS OF THE DATE OF THIS NOTICE OF DECISION. The petition should conform to the requirements of the Uniform Rules promulgated pursuant to Section 120.54(5), F.S. Section 120.80(14), F.S., provides that before you file a petition under Chapter 120, F.S., you must pay to the Department the amount of taxes, penalties, and accrued

interest that are not being contested. Failure to pay those amounts will result in the dismissal of the petition and imposition of an additional penalty in the amount of twenty-five percent (25%) of the tax assessed. Mediation pursuant to Section 120.573, F.S., is not available. The requirements of Section 72.011(2) and (3)(a), F.S., are jurisdictional for any action contesting an assessment or refund denial under Chapter 120, F.S.; OR

3) Pursuant to Section 120.68, F.S., you may contest the assessment in the appropriate district court of appeal by filing a Notice of Appeal meeting the requirements of Rule 9.110, Florida Rules of Appellate Procedure, with i) the Clerk of the Department of Revenue, Office of General Counsel, Post Office Box 6668, Tallahassee, FL 32314-6668 and ii) with the clerk of the appropriate district court of appeal, accompanied by the applicable filing fee. THE NOTICE OF APPEAL MUST BE FILED WITH BOTH THE DISTRICT COURT OF APPEAL AND THE DEPARTMENT OF REVENUE WITHIN THIRTY (30) DAYS OF THE DATE OF THIS NOTICE OF DECISION.

Should you have any further questions concerning this matter, please do not hesitate to contact me.

Sincerely,

Suzanne Haines

Suzanne P. Haines
Tax Conferee
Technical Assistance & Dispute Resolution
(850) 717-6794

Enclosure: Audit Remittance Coupon

NOTICE UNDER THE AMERICANS WITH DISABILITIES ACT

Persons needing an accommodation to participate in any proceeding before the Technical Assistance and Dispute Resolution Office should contact that office at 850-617-8346, or you may also call via the Florida Relay System at 800-955-8770, at least five working days before such proceeding.

Florida Department of Revenue
Technical Assistance and Dispute Resolution

Jim Zingale
Executive Director

5050 West Tennessee Street, Tallahassee, FL 32399

floridarevenue.com

TADR Satisfaction Survey

The Florida Department of Revenue invites you to complete the online TADR Satisfaction Survey to help us identify ways to improve our service to taxpayers. The survey is an opportunity to provide feedback on your recent experience with the Department's office of Technical Assistance and Dispute Resolution (TADR). To access the survey, place the following address in your browser's access bar:

https://tadr.questionpro.com

When you open the survey, you'll be asked to enter the following information. This information will enable you to complete and submit the survey.

Notification number: 200289019

Respondent code: 44

Tax type: Corporate Income Tax

Correspondence type: Informal Protest

If you need technical assistance accessing the survey, please email Douglas Charity at douglas.charity@floridarevenue.com.

Thank you.

FLORIDA
DEPARTMENT OF REVENUE
Executive Director
Jim Zingale

DR-839
N. 05/04

Audit Remittance Coupon

December 6, 2023

C/O TED W FRIEDMAN
MICROSOFT CORPORATION
1114 AVE AMERICAS FL 40
NEW YORK NY 10036-7703

Business Partner: 848053
Audit Number : 200289019
Audit Period : 06/30/2017, 06/30/2018, 06/30/2019
Tax Type : Corporate Income Tax

To ensure proper credit, please detach and include the preprinted remittance coupon below when submitting payments.

If additional interest is applicable, please refer to the additional interest instructions on the enclosed correspondence.

You can pay bills online for many taxes using your credit card or the ACH-Debit method at www.myflorida.com/dor.

DR-839
N. 05/04

Detach For Processing

Audit Remittance Coupon

Service Center
Los Angeles Service Center
Business Partner
848053
Audit Number
200289019

Make check or money order payable to:
Florida Department of Revenue
5050 West Tennessee Street
Tallahassee, Florida 32399-0100

Check Number
Tax Type
Corporate Income Tax
Remittance Total
.

C/O TED W FRIEDMAN
MICROSOFT CORPORATION
1114 AVE AMERICAS FL 40
NEW YORK NY 10036-7703

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