BANK OF AMERICA CORPORATION, as successor by merger to NationsBank Corporation, et al., Plaintiffs, v. FLORIDA DEPARTMENT OF REVENUE, Defendant.

Case Information:

Docket/Court: 01-CA-2782, Florida 2nd Circuit Court

Date Issued: 03/12/2004

Tax Type(s): Corporate Income Tax

OPINION

SUMMARY FINAL JUDGMENT

This case having come before the Court on the cross motions for summary judgment filed by both the Plaintiffs and the Defendant, and the Court having considered the motions and responses thereto, the arguments of counsel, and being otherwise fully advised in the premises, finds as follows:

Plaintiffs filed this action pursuant to section 72.011(1), Fla. Stat. (2003), to appeal a final agency action by the Florida Department of Revenue (the "Department") assessing corporate income tax and interest against Plaintiffs in the amount of $4,044,487.46, including interest through September 21, 2001 for the period of 1993 through 1995. In an audit of Plaintiffs, the Department disallowed Plaintiffs' use of net operating loss ("NOL") carryforwards in 1993 and 1994 based upon Florida Administrative Code Rule and 12C-1.013(14)(j) and (k) (the "Florida SRLY Rule"). The Plaintiffs protested the assessment, but the Department denied the protest. The Plaintiffs then requested that the Department reconsider the denial of the protest, but the Department refused to alter the assessment. Plaintiffs thereby exhausted their administrative remedies before the Department.

The court asked the parties to prepare briefs addressing whether the exhaustion of administrative remedies doctrine precluded an exercise of circuit court jurisdiction. The court noted that the complaint challenged an assessment of corporate income tax on the premise that Florida Administrative Code Rules and 12C-1.013(14)(j) and (k)**(FN 1)** exceeded delegated legislative authority and violated a number of federal and state constitutional provisions. In response to the Court's request, the parties both noted that Section 72.011(1)(a), Florida Statutes, provides taxpayers challenging an assessment of tax under chapter 220 the option of filing an action in circuit court or a petition in the Florida Division of Administrative Hearings (DOAH). The only jurisdictional prerequisite attached to filing an action in circuit court is the plaintiffs' fulfilling the financial responsibility requirements of section 72.011(3)(b), Florida Statutes, to wit: paying the amount of the assessment into the court registry, posting a bond for the amount of the assessment or obtaining a waiver from DOR's executive director. The plaintiffs complied with the jurisdictional requirements of section 72.011(3)(b), Florida Statutes. Since Section 72.011(1)(a), Florida Statutes, provides aggrieved taxpayers an option of proceeding in either circuit court or DCAH, Bank of America's decision to proceed in circuit court permits this Court to exercise jurisdiction over the claims asserted.

B. Disposition of Defendant's Objection and Motion to Strike the Affidavit of Arthur J. England, Jr.

On September 19, 2003, Bank of America filed a memorandum of law supporting its motion for summary judgment and submitted the affidavit of former Florida Supreme Court Chief Justice Arthur J. England, Jr. DOR filed its response to Plaintiffs' motion for summary judgment; it also filed an objection to the affidavit of Arthur J. England, Jr. and a motion to strike it. On November 14, 2003, Bank of America filed the "Additional Affidavit" of Mr. England. Other than these affidavits, the parties have stipulated to all facts arguably pertinent to resolution of this matter.

Arthur England is presented as an expert witness. An expert's opinion, however, "is admissible only if it can be applied to evidence at trial." s. 90.702, Fla. Stat. (2003). Statutory construction is a question of law. University of Florida, Board of Trustees v. M Sanal, MD, 837 So.2d 512, 513 (Fla. 1st DCA 2003), citing Dixon v. City of Jacksonville, 774 So.2d 763, 765 (Fla. 1st DCA 2000). The interpretation of an administrative rule is also a question of law. Advance Barricades & Signing, Inc. v. State Department of Transportation, 632 So.2d 704, 705 (Fla. 1st DCA 1994) and M.K. v. School Board of Brevard County, 708 So.2d 340, 342 (Fla. 5th DCA 1998). However, expert testimony is not admissible on a question of law. Lee County v. Barnett Banks, Inc., 711 So.2d 34 (Fla. 2nd DCA 1997). "Statutory construction is a legal determination to be made by the trial judge, with the assistance of counsels' legal arguments, not by way of 'expert opinion.'" Id. "[T]he interpretation of a statute is a question of law to be determined solely by the court, not by expert witnesses." T.J.R. Holding Co., Inc. v. Alachua County, 617 So.2d 798, 800 (Fla. 1st DCA 1993). Mr. England's opinions regarding the proper interpretation of Rule 12C-1.013(14)(j) and the various Florida statutes at issue are therefore outside the scope of expert testimony. The Department's motion to strike is granted.

11. DISPOSITION OF THE MOTIONS FOR SUMMARY JUDGMENT

A. Facts

The parties have filed a compendium of stipulated facts. See Stipulation of Facts, filed July 2, 2003. The court, having reviewed the stipulation and noting that the stipulation comprises "the minimum set of facts on which summary judgment may be granted," accepts the stipulation as the facts upon which summary judgment will rest. No other facts will be relied upon by the Court in the resolution of the motions for summary judgment. The facts will not be repeated here.

The issues to be resolved by the Court are as follows:

1. Whether Rule 12C-1.013(14)(j) implements section 220.131(4), Florida Statutes, in accordance with delegated legislative authority;

2. Whether DOR's promulgation of Rule 12C-1.013(14)(j) preserves the "balance of power" between the legislature and the executive under Articles III and IV, respectively, of the Florida Constitution;

3. Whether Rule 12C-1.013(14)(j) affords equal protection of the laws under the United States Constitution, Amendment 14 and under Article I, Section 22, of the Florida Constitution, Article I, Section 2;

4. Whether Rule 12C-1.013(14)(j) provides due process protections under the Fourteenth Amendment to the United States Constitution, and under Article I, Section 9,, of the Florida Constitution; and

5. Whether Rule 12C-1.013(14)(j) is consistent with Article I, Section 8 of the United States Constitution (i.e., the "commerce clause").

C. Analysis

Rule 12C-1.013(14)(j) is the Florida separate return limitation year (SRLY) rule. The rule specifies the extent to which affiliated groups of corporations **(FN 2)** filing Florida consolidated income tax returns may use the net operating loss (NOL) **(FN 3)** carryovers **(FN 4)** of the groups' constituent members to reduce the income on which the group pays Florida income tax. Rule 12C-1.013(14)(j) is modeled on its federal counterpart, 26 C.F.R. 1.1502-1 and 1.15021(c)

A corporation subject to federal income tax files an income tax return. IRC s. 6012(a)(2). An affiliated group of corporations is afforded the privilege of filing a federal consolidated income tax return "in lieu of separate returns." IRC s. 1501. An affiliated group of corporations is not required to file a federal consolidated income tax return; each of the corporations in the affiliated group may file separate returns. A corporation that does business in Florida must pay state income tax. ss. 220.02(1) and 220.11(1), Florida Statutes. A corporation that does business in Florida either files an income tax return on its own pursuant to Section 220.22(a), or files as part of an affiliated group under Section 220.131(1), Florida Statutes.

For an affiliated group of corporations to file a Florida consolidated income tax return, the identical affiliated group must have filed a federal consolidated income tax return and Section 220.131(1)(b) and (c). However, the fact that an affiliated group files a federal consolidated return does not compel that affiliated group to file a Florida consolidated income tax return. An affiliated group of corporations can file a federal consolidated income tax return while the constituent members of that group file separate Florida income tax returns. This case turns on the last point.

The Federal SRLY Rule

The affiliated group filing a consolidated federal income tax return may deduct from its gross income the NOL that one of its members sustained in a separate return year. 26 C.F.R. 1.1502-21(b)(1). A separate return year is "a taxable year of a corporation for which it files a separate return." 26 C.F.R. 1.1502-1(e). The availability of the NOL a corporation sustains in a separate return year depends on whether the corporation was a member of the affiliated group during the separate return year.

If an affiliated group filing a federal consolidated return would use the NOL that one of its members sustained in a year in which that member was not a member of the affiliated group, the affiliated group may use that NOL only to the extent that the member contributes taxable income to the affiliated group in the year in question.**(FN 5)** The year in which the corporation was not a member of the affiliated group is a *separate return limitation year*. The limitation does not apply if the member contributing the loss was a member of the affiliated group *on each day of the year in which that member sustained the NOL* despite that member's having filed a separate return that year. 26 C.F.R. 1.1502-1(i)(2)(ii). Under these circumstances, the NOL can be used fully in the year in question.

The Florida SRLY Rule

The Florida SRLY is slightly different:

Where members of a federal affiliated group have not elected... to file a Florida consolidated return, SRLY concepts will be applied. SRLY concepts are applicable when a NOL carryover exists from a prior taxable year for which a Florida consolidated return was not filed and Florida corporate income tax returns were not filed for all members. The NOL carryover deduction from a subsidiary included in a consolidated NOL deduction is limited to that subsidiary's taxable income included in the consolidated taxable income for that year. Where all members of the federal affiliated group filed Florida corporate income tax returns for all years from which a NOL carryover is available, SRLY concepts will not be imposed.

Fla. Admin. Code R. 12C-1.013(14)(j).

DOR defends its rule on the premise of nexus. A state's taxing power depends on the taxpayer's nexus**(FN 6)** with the state. National Bellas Hess v. Department of Revenue of the State of Illinois, 386 U.S. 753, 756, 87 S. Ct. 1389, 1391 (1967) and Adventure Communications, Inc. v. Kentucky Registry of Election Finance, 191 F. 3d 429, 436-437 (4th Cir. 1999). The single corporation paying Florida income tax, regardless of the corporation's state of incorporation, domicile or residence, necessarily has a nexus with Florida. See s. 220.01(1), Fla. Stat., and Miller Bros. Co. v. State of Maryland, 347 U.S. 340, 345-346, 74 S. Ct. 535, 539 (1954) and Tyler Pipe Industries, Inc., v. Washington State Department of Revenue, 483 U.S. 232, 250, 107 S. Ct. 2810, 2821 (1987). In the case of an affiliated group that files a Florida consolidated return, only the parent need have nexus with Florida: "[A]ny corporation subject to tax under this code [that is, having nexus with Florida] which corporation is the parent company of an affiliated group of corporations may elect... to consolidate its taxable income with that of all other members of the group regardless of whether such member is subject to tax under this code." s. 220.131(1), Fla. Stat. Thus, a corporation that has no nexus with Florida but is a member of a federal affiliated group need not submit to Florida's taxing authority.

The federal government is not constrained by nexus. A corporation pays tax on its taxable income, which is derived from its gross income; that is, "all income from whatever source." See IRC Sections 11(a), 63(a) and 61(a). Florida's income tax pertains to income earned or received in Florida. s. 220.11(1), Fla. Stat. DOR argues that the rule uses nexus to make the state taxing system symmetrical with the federal taxing system. Further, it asserts that nexus is the proper means to equate the state and federal taxing systems because the states' taxing power is subject to limitations that do not apply to the federal government. F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico, 458 U.S. 354, 363, 102 S. Ct. 3128, 3134 (1982). "While States have considerable discretion in formulating their income tax laws, that power must be exercised within the limits of the Federal Constitution." Lunding v. New York Tax Appeals Tribunal, 522 U.S. 287, 314, 118 S. Ct. 766, 782 (1998).

2. Disposition of the Issues

a. Rule 12C-1.013(14)(j) and Delegated Legislative Authority

Section 220.51(3) authorizes DOR to promulgate "[r]egulations relating to consolidated reporting for affiliated groups of corporations, in order to provide for an equitable and just administration of this code with respect to multicorporate taxpayers." Section 220.43(1) instructs taxpayers to take their deductions in the same manner and amount as reflected in their federal income tax return "[t]o the extent not inconsistent with the provisions" of the Florida corporate income tax code and DOR regulations.

Section 220.02(3) specifies the legislature's intent to utilize federal income tax concepts "to the greatest extent possible." Section 220.13(1)(b)(1)(a) authorizes Florida taxpayers to use the NOL "deduction allowable for federal income tax purposes under s. 172 of the Internal Revenue Code for the taxable year." Section 220.131(4) instructs the affiliated group of taxpayers to compute its taxable income "in the same manner and under the same procedures... as required for... federal income tax purposes in accordance with s. 1502 of the Internal Revenue Code."

Bank of America argues that sections 220.02(3), 220.13(1)(b)(1) a and 220.131(4) preclude DOR from writing rules that affect the NOL a taxpayer calculates for federal purposes, and that the cited statutes authorize a Florida taxpayer to use the amount of the NOL the taxpayer used for federal purposes. In response, DOR claims that the legislature, at section 220.51(3), vested in DOR the same authority Congress vested in the United States Department of Treasury to prescribe regulations for affiliated groups filing consolidated returns. Both the federal and state SRLY rules are therefore creatures of administrative law; neither was specifically created in statutes.

DOR further argues that section 220.43(1) establishes the primacy of Florida statutes and rules; that is, that federal law applies *unless* superceded by a state statute or rule. DOR asserts that Rule 12C-1.013(140)(j) supercedes the application of federal principles. DOR bases its argument on Tafflin v. Levitt, 493 U.S. 455, 458, 110 S. Ct. 792, 795 (1990), which held that the state's sovereignty operates concurrently with "that of the Federal Government, subject to the limitations imposed by the Supremacy Clause," and Oregon Waste Systems, Inc. v. Department of Environmental Quality of the State of Oregon, 511 U.S. 93, 108, 114 S. Ct. 1345, 1354-1355 (1994), which found that states have broad discretion to configure their tax systems as they deem appropriate.

It is interesting to note that DOR's argument is consistent with the comments Arthur England made in his 1972 law review article:

Neither the adoption of federal tax concepts for Florida nor the statutory effort to parallel federal tax procedures was able to avoid all deviation from federal corporate income taxation. The Florida legislature, new to the business of taxing income, soon discovered that states lack the ability to tax income on exactly the same basis as the federal government. Principal among the considerations that preclude wholesale adoption of federal taxable income are questions of [among others]... federal constitutional dictates of the commerce clause.

England, *Corporate Income Taxation in Florida: Background, Scope, and Analysis, An Introduction to Florida Corporate Income Taxation*, Fla. State U. L. Rev., 11 (1972), (hereafter, *FSU Tax Symposium*). Mr. England went on to observe that "[a] second area in which Florida departed from federal taxation involves the privilege of filing consolidated returns for an affiliated group of corporations.... [T]he subject matter is highly technical." Id. at 12. He therefore concluded that "[m]any aspects of Florida consolidation have not been resolved in the statute. The legislature intentionally left many specifics of consolidation for treatment in regulations to be promulgated by the

Department of Revenue, just as Congress left virtually all of aspects of federal consolidation to interpretation by the Treasury Department." Id. at 13.

In Florida, the extent to which a rule implements, interprets or prescribes law may not, accordingly, exceed the authority provided by the statute. As the Administrative Procedures Act provides, "[a]n invalid exercise of delegated legislative authority means an action which goes beyond the powers... delegated by the Legislature." s. 120.52(8), Fla. Stat., (1991).

Section 213.06(1) provides DOR a general grant of rulemaking authority.**(FN 7)** Section 220.51(3), Florida Statutes, specifically authorizes DOR to promulgate rules pertaining to affiliated groups and consolidated returns. "[A]gency rules and regulations, duly promulgated under authority of law, have the effect of law," State v. Jenkins, 469 So.2d 733, 734 (Fla. 1985), citing Florida Livestock Board v. Gladden, 76 So.2d 291, 293 (Fla. 1954), and "will be sustained as long as they are reasonably related to the purpose of the enabling legislation and are not arbitrary or capricious." Joseph v. Henderson, 834 So.2d 373, 375 (Fla. 2nd DCA 2003). A rule validly implements delegated legislative authority when the rule is rationally related to the statute the rule implements. The rational relationship a rule bears to the statute the rule implements is analyzed in accordance with the rational relationship test to which statutes are analyzed under the equal protection clause. Florida League of Cities, 603 So.2d at 1367-1368.

The Plaintiffs assert that the decision in Department of Revenue v. American Telephone and Telegraph Company, 431 So.2d 1025 (Fla. 1st DCA 1983), governs this case and requires a ruling in in favor of the Plaintiff. DOR asserts that AT&T is distinguishable.

AT&T dealt with the IRC section 243 deduction which authorizes a corporation to deduct from its gross income the dividends it receives from its subsidiaries. The amount of the deduction depends on whether the parent and the subsidiary form an affiliated group; that is, whether the parent owns at least 80 percent of the subsidiary. The taxpayer in AT&T was an affiliated group of 23 corporations that filed federal consolidated returns in 1972, 1973 and 1974. Two of the subsidiary corporations, Southern Bell and Western Electric, did business in Florida in 1972, 1973 and 1974; AT&T, the parent, and the two Florida nexus subsidiaries each filed separate Florida returns. AT&T took the 100 percent deduction on its Florida separate return. DOR allowed the 100 percent deduction with respect to the dividends paid by the Florida nexus subsidiaries, Southern Bell and Western Electric, but allowed only 85 percent of the deduction with respect to the 21 other subsidiaries. DOR limited the deduction because the affiliated group could not, under the filing law at that time, file a Florida consolidated income tax return. DOR took the position that there could be no affiliated group for Florida tax purposes unless that affiliated group filed a Florida consolidated income tax return; in short, DOR defined "affiliated group" different from the federal definition. The court rejected this argument. The court noted that Florida had adopted the federal definition without reservation, and therefore held that DOR could not predicate the availability of a deduction on an agency definition inconsistent with the statutory definition.

The AT&T case dealt with membership in an affiliated group of corporations. DOR in this case does not deny an affiliated group. The availability of the NOL deduction is not based on a corporation's membership in an affiliated group; the availability of the NOL deduction is based on the affiliated group's nexus with Florida. When the affiliated group includes corporations that have no nexus with Florida, the requisite nexus is created only by filing a consolidated return.

Lastly, the court in AT&T cited section 220.02(3), pertaining to the use of federal principles, and the England law review article for the "piggyback" principle. The taxpayer in this case argues that the "piggyback" principle applies to the entire federal income tax code. Mr. England's law review article, however, does not support this point. As Mr. England noted in his law review article: "By far the most significant aspect of this federal 'piggyback' for Florida was the adoption of the federal tax concept of 'income.'" England, *FSU Tax Symposium* at 10. That the piggyback principle addresses the definition of income is consistent with the holding in AT&T:

We conclude that the clear intent of the legislature, as expressed in chapter 220, is that taxable income for Florida tax purposes is the amount for which a corporation would be liable for federal tax purposes if the corporation is a member of an affiliated group of corporations, as defined by the Internal Revenue Code.

AT&T, 431 So.2d at 1030-1031. "The amount" the court references is line 30 of the federal income tax return. Line 30 of the federal income tax return is IRC section 63 which follows from IRC section 61, "Gross income defined."

This case does not involve the federal taxable income of line 30 on the federal return; it involves the Florida adjustments made to the federal taxable income. Accordingly, the court concludes that the AT&T case is distinguishable and does not control the result in this case. Further, having carefully considered Rule 12C-1.013(14)(j) and the relevant authorities, the Court must find that the rule is indeed reasonably related to the purpose of the enabling legislation, and is not arbitrary and capricious.

b. Rule 12C-1.013(14)(j) and the "Balance of Power" between the Legislature and Executive under Articles III and IV of the Florida Constitution

The Florida Constitution, Article 2, section 3, divides the power of state government into three branches: legislative, executive and judicial. The Constitution prohibits one branch from exercising the power of another branch. The Court has considered the arguments advanced by Plaintiffs that the rule in question somehow offends the separation of powers, and concludes that this rather vaguely asserted ground is without merit. The Court also notes that the issues of valid and invalid exercises of delegated legislative authority, a concept often tied to a separation of powers argument, is dealt with elsewhere in this summary final judgment.

c. Rule 12C-1.013(14)(j) and Equal Protection under the Fourteenth Amendment to the United States Constitution and under Article I, Section 2 of the Florida Constitution

The Fourteenth Amendment to the United States Constitution prohibits a state from denying "any person within its jurisdiction the equal protection of the laws." The Fourteenth Amendment's guarantee of equal protection applies to state taxation. Barbieri v. Hartsdale Post Office, 863 F. Supp. 152, 153 (S.D.N.Y. 1994) citing Allegheny Pittsburgh Coal Company v. County Commission of Webster County, West Virginia, 488 U.S. 336, 109 S. Ct. 633 (1989). A corporation is a 'person' within the meaning of the Fourteenth Amendment. Metropolitan Life Insurance Company v. Ward, 470 U.S. 869, 881, n. 9, 105 S. Ct. 1676, 1683, n. 9 (1985).

"[S]tate tax classifications require only a rational basis to satisfy the Equal Protection Clause" because "in taxation

even more than in other fields, legislatures possess the greatest freedom in classification." General Motors Corporation v. Tracy, 519 U.S. 278, 311, 117 S.Ct. 811, 830 (1997). The rational relationship standard is "especially deferential in the context of classifications made by complex tax laws." Nordlinger v. Hahn, 505 U.S. 1, 11, 112 S.Ct 2326, 2332 (1992).

A tax is a burden imposed by the sovereign for the support of government and the administration of the law. Collier County v. State, 733 So.2d 1012, 1018 (Fla. 1999). Deductions, which reduce that burden, are matters of legislative grace construed against the taxpayer. Strange v. Commissioner of Internal Revenue, 270 F. 3d 786, 787 (9th Cir. 2001). Rule 12C-1.013(14)0), like its federal counterpart, imposes conditions on the availability of the NOL deduction to prevent tax avoidance. Those conditions entail classifying taxpayers in three respects: (1) according to their membership in an affiliated group, a classification consistent with federal principles; (2) according to their nexus with Florida, a classification peculiar to state principles and (3) according to the return they file. Each element is entirely within the taxpayer's control.

"Rules are entitled to a presumption of constitutional validity and should be interpreted, if possible, in a manner that preserves their validity." Injured Workers Association of Florida v. Department of Labor and Employment Security, 630 So.2d 1189, 1191 (Fla. 1st DCA 1994). The taxpayer bears the burden to "negative every conceivable basis which might support" the classification. Fitzgerald v. Racing Association of Central Iowa, _____ U.S. _____, _____, 123 S. Ct. 2156, 2160 (2003), citing Madden v. Kentucky, 309 U.S. 83, 88, 60 S. Ct. 406, 408 (1940). The challenger's burden to demonstrate an invalid exercise of delegated legislative authority 'is a stringent one indeed.'" Charity v. Florida State University, 680 So.2d 463, 466 (Fla. 1st DCA 1996). The taxpayer does not meet its burden by raising doubt that the Florida Legislature envisioned a unique SRLY rule, leaving to DOR the administrative details of promulgation. Rather, the taxpayer meets its burden by proving that the Florida Legislature prohibited any deviation from federal principles; that Rule 12C-1.013(14)(j) could not reasonably have evolved from section 220.131.

Bank of America has not met its burden. Section 220.131(4) instructs taxpayers to begin their Florida tax computations with federal figures. Section 220.131(5) then directs that taxpayers apportion their income. Florida apportionment necessarily entails adjusting the federal figures, particularly with respect to NOLS and Section 220.131(1)(b) and (2). Rule 12C-1.013(14)(j) protects the state's revenue source by conditioning the availability of a deduction on a particular corporation's nexus with the state of Florida, which is hardly an irrational exercise of executive power.

"In the absence of a fundamental right or a protected class, equal protection demands only that a distinction which results in unequal treatment bear some rational relationship to a legitimate state purpose." Duncan v. Moore, 754 So.2d 708, 712 (Fla. 2000). The rational basis test imposes on the party challenging the regulation the burden "to show that there is no conceivable factual predicate which would rationally support the classification." Hudson v. State, 825 So.2d 460, 468 (Fla. 1st, DCA 2002). The burden is "very heavy" on one attempting to overturn a tax classification. R.R. Donnelley & Sons Company v. Fuchs, 670 So.2d 113, 116 (Fla. 1st DCA 1996). The rational basis standard is "particularly deferential concerning classifications made in complicated tax matters." Renish v. Clark, 765 So.2d 197, 204-205 (Fla. 1st DCA 2000) referencing Nordlinger, 505 U.S. at 11, 112 S.Ct. at 2326. A classification that is "reasonably related to the subject and purpose of the regulation will be upheld even if another or no classification might appear more reasonable." Hobby v. State, 761 So.2d 1234, 1237 (Fla. 2nd DCA 2000).

Rule 12C-1.013(14)(j) prevents an affiliated group of corporations from reducing its consolidated Florida income by using the NOLs of constituent members which sustained those NOLs at a time when either the affiliated group had no nexus with Florida or other members of the group with nexus with Florida separated themselves from the loss corporations by filing separate Florida returns. Preventing the reduction of the state tax base is a legitimate state purpose. Basing the legitimacy of a reduction of the state tax base on a nexus with the state is a rational means to accomplish that end. Rule 12C-1.013(14)(j) does not violate Florida's constitutional guarantee of equal protection.

In light of the above, Rule 12C-1.013(14)0) does not violate the equal protection guarantee under either the Fourteenth Amendment to the United States Constitution or under Article I, Section 2 of the Florida Constitution.

e. Rule 12C-1.013(14)(j) and Due Process under the United States Constitution, Amendment 14 and Article I, Section 9 of the Florida Constitution

The Fourteenth Amendment to the United States Constitution prohibits a state from taking a person's property "without due process of law." The Fourteenth Amendment's guarantee of due process applies to state tax. Barbieri, 863 F. Supp. at 153, citing Allegheny Pittsburgh Coal Company v. West Virginia, 488 U.S. 336, 109 S. Ct. 633. This case concerns the substantive, as opposed to the procedural, aspect of due process,**(FN 8)**

A state tax conforms to due process requirements if: (1) there is a minimal connection between the interstate activities and the taxing state, and (2) there is a rational relationship between the income attributed to the state and the intrastate values of the enterprise. Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425, 436-437, 100 S. Ct. 1223, 1231 (1980). The relationship at issue is between a deduction generated by a Florida-nexus corporation and other corporations that would use that deduction. In regard to the two *Mobil Oil* criteria:

(1) Minimal Connection. Minimal connection is analogous to nexus. A state may tax a foreign corporation in a manner consistent with due process if the "foreign corporation purposefully avails itself of the benefits of an economic market in the forum State," and thereby creates minimum contacts with the forum state, Id. "The simple but controlling question is whether the state has given anything for which it can ask return. The substantial privilege of carrying on business in [the state] clearly supports the tax." State of Wisconsin v. J.C. Penney Co., 311 U.S. at 444-445, 61 S. Ct. at 250 (1940).

In this case, 220 corporations had no nexus with Florida before 1993. Notwithstanding, 10 Florida nexus corporations were availing themselves of the economic market in, and paying tax to, Florida in and before 1992 but, by virtue of their having filed separate returns during those years, are denied the use of the NOL. Mathematical precision is not required under the deferential standard applied in due process challenges to economic legislation. Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California, 508 U.S. 602, 639, 113 S.Ct. 2264, 2288 (1993). Were the NOLs at issue to be made available to these 10 Florida nexus corporations, that availability would benefit it to Florida corporations to the detriment of foreign corporations, and such a result would be likely to violate the commerce clause; and

(2) Rational Relationship. The rational relationship test that applies to substantive due process challenges is "virtually

identical" to the rational relationship test that applies to equal protection challenges. Norfolk Federation of Business Districts v. Department of Housing and Urban Development, 932 F. Supp. 730, 738, n. 5. As is set forth above, that test is easily met: the regulation is sustained if there is any conceivable basis to justify it. Id. at 738. The person challenging the tax must "negative every conceivable basis which might support it." Id. at 739 citing Madden v. Commonwealth of Kentucky, 309 U.S. 83, 88, 60 S.Ct. 406, 408 (1940). Thus, a government regulation withstands a substantive due process challenge if the regulation is rationally related “to a legitimate governmental purpose, unless the regulation implicates a fundamental right or an inherently suspect classification.” Hooks v. Clark County School District, 228 F. 3d 1036, 1041 (9th Cir. 2000). This case involves neither a fundamental right**(FN 9)** nor a suspect classification. This case involves a tax deduction. "'[A]n income tax deduction is a matter of legislative grace and the... burden of clearly showing the right to the claimed deduction is on the taxpayer.'" Indopco v. Commissioner of Internal Revenue, 503 U.S. 79, 84, 112 S.Ct. 1039, 1043 (1992) (citation omitted). "[T]he taxpayer must satisfy the specific statutory requirements claimed to reduce a tax liability." Ekman v. Commissioner of Internal Revenue, 184 F.3d 522, 525 (6th Cir. 1999).

The Bank of America affiliated group does not satisfy the requirements of the Florida deduction. The non-Florida nexus corporations had no relationship with the State of Florida when the NOLs arose. The Florida nexus corporations that were affiliated with the Florida loss corporations when the losses arose are denied use of the deduction as a consequence of the parent's decision not to file a Florida consolidated return. Extending the deduction to the Florida nexus corporations would provide a current benefit based on past nexus; that is, extending the deduction to the Florida nexus corporations would discriminate against non-nexus corporations because they were non-nexus corporations. The rule would violate the commerce clause if the taxpayer's theory is correct. The unavailability of the deduction follows from the taxpayers' filing choice, not from an arbitrary or capricious act of state government. That choice engenders economic consequences:

[W]hile a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not [citations omitted], and may not enjoy the benefit of some other route he might have chosen to follow but did not.

Commissioner of Internal Revenue v. National Alfalfa Dehydrating and Milling Company, 417 U.S. 134, 149, 94 S. Ct. 2129, 2137 (1974).

"A tax will not constitute a deprivation of property under the Due Process Clause [Fifth Amendment] unless it is so arbitrary as to be confiscatory." Swisher International, Inc. v. United States, 178 F. Supp. 2d 1354, (CIT 2001). Rule 12C-1.013(14)(j) does not eradicate the NOLs, and does not deny the NOLs to the corporation that sustained them. Furthermore, Rule 12C-1.013(14)(j) does not shorten the longevity of the NOLs. Pursuant to section 220.13(1)(b)(1)(a), NOLs may, in accordance with IRC section 172(b)(1)(ii), be carded forward 20 years.

Rule 12C-1.013(14)(j) is rationally related to a legitimate government purpose. The government has a legitimate interest in protecting its source of revenue. Rule 12C-1.013(14)(j) prevents taxpayers from reducing their state tax obligation by using a deduction unconnected to the taxpayer in time or by the circumstance of filing separate returns. Rule 12C-013(14)(j) does not, on its face, deny these taxpayers due process under either the State or Federal constitutions.

g. Rule 12C-1.013(14)(j) and the Commerce Clause, United States Constitution Article 1, Section 8, Clause 3

The commerce clause reserves to Congress the power to "regulate Commerce... among the several States." U.S. Const. art. I, s. 8, cl. 3. The commerce clause is an express grant of power. The commerce clause implicitly contains a negative command: the "dormant" commerce clause which "prohibits state taxation or regulation that discriminates against or unduly burdens interstate commerce." National Business Aviation Association, Inc. v. City of Naples Airport Authority, 162 F.Supp.2d 1343, 1348 (M.D. Fla. 2001), citing General Motors Corporation v, Tracy, 519 U.S. 278, 287, 117 S. Ct. 811, 818 (1997).

State tax affecting interstate commerce is subject to the four tests specified in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079 (1977).

*(1) Substantial Nexus.***(FN 10) "**The requisite 'nexus' is supplied if the corporation avails itself of the 'substantial privilege of carrying on business' within the State." Mobil Oil, 445 U.S. at 437, 100 S. Ct. at 1231. In this case, the loss corporations that sustained the NOLs have a nexus with Florida and their future use of the NOLs is not denied. The corporations that are denied use of the NOLs either did not have a nexus with Florida when the NOL was sustained or, by virtue of their not filing consolidated Florida returns, did not merge their economic data with the NOL corporations to affect the NOL. In short, Rule 12C-1.013(14)(j) passes the commerce clause nexus requirement because the NOLs are not denied to those with a nexus to Florida and the activity that generated the NOL.

(2) Fair Apportionment. Florida employs at section 220.15, Florida Statutes, the three factor apportionment formula that has been approved by the United States Supreme Court. See Amerada Hess Corporation v. Director, Division of Taxation, New Jersey Department of the Treasury, 490 U.S. 66, 74, 109 S. Ct. 1617, 1622 (1989), citing Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 170, 103 S. Ct. 2933, 2942 (1983). The NOLs at issue in this case have already been apportioned and belong exclusively to the 15 Florida nexus corporations that generated them. Amerada Hess Corporation v. Director, Division of Taxation, New Jersey Department of the Treasury , 490 U.S. 66, 109 S. Ct. 1617 (1989), The NOL deducts past losses from current gross income. The establishment of the Florida NOL has already passed through the apportionment formula. It is not apportioned further for Florida tax purposes. The amount of NOLs is not at issue in this case; their availability is not, therefore, an issue of fair apportionment.

(3) Discrimination Against Interstate Commerce. "A State may not 'impose a tax which discriminates against interstate commerce... by providing a direct commercial advantage to local business.'" Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175, 197, 115 S. Ct. 1331, 1334 (1995) (citation omitted). Rule 12C-1.013(14)(j) does not discriminate against interstate commerce. The NOLs are as unavailable to out-of-state corporations as they are to Florida-nexus corporations. The availability is determined by membership in an affiliated group and the contemporaneous filing of a Florida consolidated return, creating nexus where none had previously existed.

Rule 12C-1.013(14)(j) does not apply SRLY where all members of an affiliated group filing a consolidated return filed Florida separate returns when the NOL arose. All members of the group were subject to Florida tax like all corporations are subject to federal tax at all times; in that situation there is no corporation occupying a position similar

to an out-of-state corporation.

(4) Fair Relation to Services Provided by the State. "The Commerce Clause demands a fair relation between a tax and the benefits conferred upon the taxpayer by the State." Jefferson Lines, 514 U.S. at 199, 115 S. Ct. at 1345. This fair relation test contemplates a taxpayer receiving from a state services such as police, fire and the benefits of a civilized society. Amerada-Hess, 490 U.S. at 79, 109 S. Ct. at 1625. Here, the NOLs, having been apportioned, reflect a share of income that had received the benefit of Florida's civil services.

Rule 12C-1.013(14)(j) complies with the four tests the Supreme Court in *Complete Auto Transit* specified for conformity to the dormant commerce clause. Rule 12C-1.013(14)(j) does not discriminate against interstate commerce, and does not violate the commerce clause.

D. Conclusion

Rule 12C-1.013(14)(j) is a valid exercise of delegated legislative authority, and does not intrude, in a constitutional sense, on the powers reserved to the Legislative branch. Further, the rule does not violate the equal protection provisions of the state or federal constitutions, and does not deprive the taxpayers of due process. Finally, the rule is consistent with the commerce clause of the United States Constitution, in that it does not discriminate against or burden interstate commerce. It is therefore

ORDERED AND ADJUDGED that Defendant's motion for summary judgment is GRANTED; Plaintiffs' motion for summary judgment is therefore DENIED. Summary final judgment is therefore entered for the Defendant, and Plaintiff shall go hence without day. Since Plaintiffs have not prevailed in this action, Plaintiffs owe the assessment, tax plus interest, that was the subject of this action, and the Court will reserve jurisdiction to enter any further orders necessary in support of the judgment rendered herewith.

DONE and ORDERED in Chambers at Tallahassee, Leon County, Florida this 12 day of March, 2004.

/s/

JANET E. FERRIS
Circuit Judge

Copies to:

Peter O. Larsen, Esq.

Charles Catanzaro, Assistant Attorney General

FOOTNOTES:

FN 1. Florida Administrative Code Rule 12C-1.013(14)(k) is a practical example of how subparagraph (j) works. The validity of subparagraph (k) rests on the validity of subparagraph (j). References to subparagraph (j) will, throughout this opinion, necessarily include subparagraph (k).

FN 2. An affiliated group of corporations is, generally, a group of corporations in which one corporation owns 80 percent of the voting stock and 80 percent of the total value of stock of subsidiary corporations. See 26 USC S. 1504(a) Title 26 of the United States Code is the Internal Revenue Code; it will be cited as IRC.

FN 3. A net operating loss is the excess of federal deductions over gross income. IRC s. 172(c).

FN 4. A NOL can be carried forward and used as a deduction over the 20 years following the year in which the NOL arose. IRC s. 172(b)(1)(A)(ii). Under the federal system, NOLs may be carried back and applied over the two years preceding the year in which the loss arose. IRC s. 172(b)(1)(A)(i). Florida allows NOL carryovers but does not allow NOL carrybacks. s. 220.13(1)(b), Fla. Stat. References in this opinion to NOLs necessarily means NOL carryovers.

FN 5. See 26 C.F.R. ss. 1.1502-1(f)(2)(ii), 1.1502-1(e) and 1.1502-21(e).

FN 6. Nexus is an issue involving taxpayers foreign to the taxing jurisdiction: "net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same." Northwestern States Portland Cement Company v. State of Minnesota, 358 U.S. 450, 452, 79 S. Ct. 357, 359 (1959).

FN 7. See section 213.05, Florida Statutes, which vests in DOR the control and administration of, among other revenue laws, Chapter 220, Florida Statutes, the income tax code.

FN 8. See Glaspy v. Malicoat, 134 F. Supp.2d 890, 894 (W.D. Mich. 2001). The procedural component governs the procedures relating to the deprivation of life, liberty or property. Id. The substantive component relates to the government action itself. Id.

FN 9. "Corporations do not have fundamental rights." Norfolk Federation of Business Districts v. Department of Housing and Urban Development, 932 F. Supp. 730, 738 (E.D. Va. 1996).

FN 10. "The nexus required for commerce clause purposes is different from the nexus requirement for due process purposes. Quill Corporation, 504 U.S. at 312, 112 S. Ct. at 1913. Due process nexus, discussed above, is concerned with the extent of the taxpayer's connection with the taxing state. Id. Commerce clause nexus is concerned with the structure and effect "of state regulation on the national economy," id., it is a "means for limiting state burdens on interstate commerce," id., 504 U.S. at 313, 112 S. Ct. at 1913.