CASE STUDY

Sales Sourcing & Apportionment Study Saves Telecom Company Over $1M Annually in CA Income Tax

AT A GLANCE

Challenge

A national telecommunications company supplying cell phones to low-income customers located mainly in California apportioned most of its sales to that state. This resulted in significant state taxes, but it was unclear whether these tax calculations were correct.

Solution

The company is reimbursed for the services via a federal government program. Armanino SALT experts conducted a deep dive into the case law, closely examining the intent and execution of the statute under which the company receives payment to determine proper sales apportionment and tax liability.

Result

The company was able to drop their apportionment in California from 93% to 4.5% . They lowered their tax liability by over $1M annually, gained compliance and now have a model to correctly apportion future sales.

Client Challenge

A national telecommunications company offers wireless services and provides flexible, affordable options to low-income customers. The company is reimbursed for these services by the U.S. government through a voucher submission process.

In apportioning their income, the company was using the physical location of the phone users as their determining factor. Given that the bulk of their users are in Southern California, 93% of income had been apportioned to California, leading to a high state income tax liability.

The Tax Issue

According to the Communications Act of 1934 , which governs the federal reimbursement program, economically disadvantaged households can have up to one phone. With landline phones on the decline, cell phones have become the new standard. The company is certified as a phone provider by the California Public Utilities Commission (CPUC) and by other states, allowing them to administer cell phones under the Act .

The concept of revenue sourcing can be difficult to ascertain, as many find it to be somewhat subjective in how it's determined. Depending on the state, revenue sourcing can be based on where the service is performed or where the customer is located.

As a result, the telecom company found itself in a gray area. The wireless phone customers don't pay the company for the phones. The company doesn't bill the phone users, and payments are made by the CPUC as reimbursements from a federal mandated program. The question then becomes, who benefits? Who is the customer? The company engaged Armanino's state and local tax (SALT) experts to unravel this.

> After the SALT team completed the sales sourcing study, the company's apportionment in California dropped from 93% to 4.5%, resulting in annual California tax savings of over $1 million.

Solution

Armanino's SALT team worked closely with the company to:

- Conduct a sales sourcing review to determine proper apportionment by state, reviewing California case laws and regulations for guidance
- Provide consulting and documentation pertaining to the issue, revealing that previous filings were incorrect

To properly conduct the sales sourcing study, the SALT experts analyzed the Communications Act of 1934 in its intent and application. They found that under the law, the CPUC is not the customer, and the customer is determined by who benefits from the use of the phone. By clarifying this, the SALT experts determined that the apportionment must be applied based on the number of cell towers in California over the number of all cell towers in the U.S. This new method yielded a 4.5% California apportionment factor.

Results

After the SALT team completed the sales sourcing study, the company's apportionment in California dropped from 93% to 4.5%, resulting in annual California tax savings of over $1 million. Armanino now handles the company's tax compliance annually, helping the business maintain compliance and apply the unique apportionment rules to accurately determine their tax liability in California and other states.

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