

the pinnacle is always small.



## TAXPAYER WINS COST OF PERFORMANCE DISPUTE THROUGH AN OPERATIONAL ANALYSIS

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On May 28, 2010, the Massachusetts Appellate Tax Board (the "Board") addressed a cost of performance issue and ruled in favor of the taxpayer, AT&T. The Board addressed whether receipts from AT&T's interstate and international telecommunications services should be excluded from the numerator of AT&T's sales factor for tax years 1996-1999. The Massachusetts statute provides that receipts from the sales of services be sourced to the Commonwealth if more of the costs of performing the income-producing activity occurred in the Commonwealth than in any other state. A number of states have a similar sourcing rule.

AT&T was headquartered in New Jersey and maintained and monitored its extensive network from New Jersey...a network that allows it to provide telecommunications services to its customers worldwide. The Commissioner of Revenue argued that the cost of performance analysis should be transactional and viewed at a low level, specifically, that the analysis must view each of AT&T's billions of individual "buyer-seller interactions" in a taxable year. The Commissioner asserted that by analyzing at a transactional level, AT&T could not prove that more costs of performing its income-producing activity occurred in a state other than Massachusetts.

AT&T countered the transactional view argument by demonstrating that its income-producing activity must be viewed instead on an operational basis. AT&T's income-producing activity is actually the owning and operating of its one, continuous telecommunications network that provides interstate and international voice and data services to its customers, not each individual telephone call or email "transaction." Specifically, AT&T demonstrated that its network consists of interconnected equipment located in every state and in numerous foreign jurisdictions and how AT&T manages and monitors this massive network from New Jersey. It was therefore no surprise, taking a common sense view, that costs in New Jersey exceeded those in Massachusetts. To prove the common sense view, AT&T undertook an extensive cost accounting study and presented the supporting empirical evidence through a number of experts at the hearing.



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The Board agreed with AT&T's operational analysis and the results of its cost accounting study showing more costs in New Jersey than Massachusetts. This operational view was consistent with prior decisions in Massachusetts interpreting costs of performance in other service industries. See, *Boston Professional Hockey Ass'n, Inc. v. Commissioner of Revenue*, 443 Mass. 276 (2005) and *The Interface Group v. Commissioner of Revenue*, Mass. ATB Findings of Fact and Reports, 2008-1343.

AT&T was represented in this matter by David S. Ruskin and Megan M. Mathias of Horwood Marcus & Berk and Kathleen King Parker of Pierce Atwood.

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## HMB COMMENT

This is one of the few decisions interpreting a state's cost of performance statute/regulation as it applies to the telecommunications industry. The concept of viewing a company's income-producing activity through an operational analysis, as opposed to a micro-level transactional analysis, has significance for service industries well beyond the telecommunications industry. Also significant is that while there are a number of states moving away from this cost of performance methodology to focus instead on the location of benefits received, many states are still employing the same language as in this case, but multi-state service providers are not taking full advantage of the statutory language. If you are a multi-state service provider in a state with this type of COP language, make sure you are properly analyzing your sourcing of receipts.

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