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## Recent Decision To Impact Application Of The Federal Telecommunications Excise Tax

BY MARTHA BUYER  
DAILY RECORD COLUMNIST

Each month when I sit down to prepare this column, I wonder what subject in telecommunications law will be most interesting to the readers. And some months, I have to be honest, I really have to do some serious searching.

However, this month, there's been so much going on, that it was difficult to choose one issue over the others. After some thought about the nature of the calls I've been receiving from clients in the last four weeks, I've decided to raise the issues of the recent Office Max case and how that decision could impact the bottom line of most large businesses.

As you may be aware, the Internal Revenue Service has recently been dealt a blow in the form of the clarification of the definition of how the Federal Telecommunications Excise Tax is to be applied to end-user telephone bills. In a case brought by Office Max, Inc. (*Office Max, Inc. v. U.S.*, Case No. 1:03CV961, N.D. Ohio, Feb. 13, 2004.), the taxpayer successfully claimed that the precise definition and description of the tax requires that only certain telecommunications services be subject to the 3 percent tax, which has historically been applied at this rate on all toll services including not only interLATA (generally speaking between area codes), but international and local toll calls as well.

More precisely, any voice call that isn't truly local is subject to the tax. Since the tax was initially conceived to cover long distance services (although first enacted during the Spanish-American war for transportation companies, it was redefined in the tax code in 1965 to correspond with the distance bands associated with the long distance services that AT&T, the only kid in town, was providing), the tax has been as high as 15 percent, although for the last 21 years, it has held steady at 3 percent.

The crux of the argument involves the definition of "toll telephone service" which is derived from 26 USC Section 4251(b)(1) (IRS Code). It reads as follows:

The term "toll telephone service" means: (1) a telephonic quality communication for which (A) there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication, and (B) the charge is paid within the United States.

Since most voice calls are no longer billed at rates which vary with the distance (it doesn't cost more to call California from New York than it does to call Pennsylvania), this definition, which is the amount that is subject to the 3 percent tax, excludes calls that are billed under postalized rates.

Further, since the word "and" is clearly used within the statute (and there has been some argument about this), in order for toll traffic to qualify for taxation under the statute, as has recently been held by the U.S. District Court in the Northern District of Ohio, both conditions must apply. Since both do not apply (calls may be priced based upon elapsed transmission time, but distance is no longer a factor in the fees charged), toll traffic that has tradi-

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tionally been subject to this additional 3 percent fee may now be exempt.

It is important to note that private line, T1 or other dedicated services, as well as traditional data services that are not considered "dial-up" are not subject to this tax. Further, calls to Mexico are billed based upon distance, so will remain subject to the tax. Finally, the bills for the affected services must be paid within the United States in order to be subject to the tax.

While the IRS has not accepted this decision (and, in fact, an earlier decision involving the American Bankers Insurance Group went the other way), it has quietly, over the past almost 20 years, been settling refund claims made under this theory.

The difference is that now, rather than settling for the 39 percent it has traditionally offered to consultants and other knowledgeable insiders raised in the past 20 years, the most recent court decision requires a full refund.

It is important to note that while the tax has been assessed to the end user by the carrier, any refunds claimed by the end user must be requested directly from the IRS. In addition, it is important to note that carriers have not been directed at this time to stop collecting the tax from end users.

For entities that wish to contest the fee and apply for refunds, there is a multi-step process. The first (and most tedious) step requires that the end user make precise calculations to determine the amount of federal excise tax it has paid during the past three years on postalized long distance service (this three year time period reflects the statute of limitations).

Once this amount has been identified (with sufficient backup documentation to support the refund amount requested), a formal request for refund must be made to the IRS. According to Steve Rosen, a partner at Levine Blaszak, Block & Boothby, LLP ([www.lb3law.com](http://www.lb3law.com)) in Washington who briefed, and won, the case, "a rounded number, even at the time of preliminary filing, is sometimes rejected by the IRS — the taxpayer is best off by doing his or her homework thoroughly before."

After receiving such a request, the IRS has three options. It can process the refund, deny it, or do nothing. If the Service formally denies the refund, or if it does not respond to the taxpayer within six months of the filing, the taxpayer has the option of suing. This is the action that Office Max, Inc. took. This year, other large end users have also filed suit against the IRS with the expectation that they too will receive refunds.

Because it is anticipated that the IRS will take action to credit those end-users who have paid the FET in part, or simply disallow such credits altogether, end users are encouraged to take action as soon as possible.

*Martha Buyer is an attorney concentrating in the practice of telecommunications law. Her clients range from Fortune 500 companies to small family-owned businesses where she has provided a range of telecommunications consulting and legal services, primarily geared to support corporate end-users working with carriers and equipment providers. Buyer can be contacted at [martha@marthabuyer.com](mailto:martha@marthabuyer.com).*