

# THE DAILY RECORD

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## Recent Federal Excise Tax issues — time is of the essence

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Depending on the circles in which attorneys travel, the Internal Revenue Service's recent action, which invalidated most of the long standing Federal Excise Tax on telecommunications, is either big news or not even a blip on the radar.

However, for anyone advising small, medium and large businesses (including law firms), the IRS's announcement (Notice 2006-50) of a one-time opportunity to receive a refund/credit (many of the details have yet to be released by the IRS) can be as significant, on average, as an entire monthly phone bill. That can be serious money.

What was once a burdensome and expensive process can be much less burdensome and expensive if actions are taken in advance of preparation of the 2006 corporate tax return.

As has been mentioned in previous columns, the Federal Excise Tax was initiated in 1898 to support the Spanish-American War. While it has generated revenue from all "common carriers" (rail, airlines, trucking companies as well as telecommunications companies) since that time, it was only after the IRS had lost 10 court battles (eight at the trial level, two on appeal) that it finally threw in the towel and agreed to return the excise taxes paid by corporate entities (and individuals and partnerships) between March 1, 2003 and July 31, 2006.

While there has been a good deal of conversation about the IRS's recent activity with respect to the Federal Excise Tax, there are many issues that remain unresolved. First, the IRS has not yet issued its final rulings on the requirements for applications for refunds/credits, (I use the phrase "refunds/credits" because it has not yet been determined in what form, or under what circumstances, the return of paid FET will be relayed to taxpayers.)

The best advice to give to clients at this point is to identify, compile and organize billing information from the period of March 1, 2003 through July 31, 2006 so that when the dust settles, those clients — or their worthy consultants — will be able to figure out the proper amounts.

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Secondly, this is a tax issue, not really a telecom issue. Clients interested in pursuing this one-time refund/credit, must work with their tax departments from the outset in order to secure the optimal refund/credit.

Finally, to the extent that the IRS has issued some direction, in many instances the devil has been — and will be — in the details. For this reason, several of the more precise elements of the direction of the IRS follows:

#### 1. Time is of the essence

The IRS has indicated that the application for a refund or credit will be a **one-time offer**, to appear as a line item on a corporate tax return filed for 2006. While many end users do not use a calendar year as a fiscal year, it is anticipated that any fiscal tax year that includes Dec. 31, 2006 will qualify for

the return.

Additionally, while specifics are not yet available, end users/taxpayers are advised to begin identifying and collecting information on Federal Excise Taxes paid beginning March 1, 2003 and running through July 31, 2006. Calculating the precise amount will be both complex and labor intensive, and the sooner a taxpayer can get started, the better it will be.

(I've suggested to clients in those cases where identifying the amount paid will be relatively straightforward, that it's a great summer intern project.)

The IRS, although requiring that taxpayers have and maintain backup documentation on the amount of the refund/credit to be submitted with the return, will nonetheless require justification for the amount of refund claimed.

It is certainly fair to assume that some, if not most, claims for FET refunds will be audited, so documentation should not only be kept, but also isolated and easily located should the IRS come knocking.

While some carriers stopped collecting the FET as soon as the IRS issued its announcement, carriers can continue to collect the tax through the end of July. Any amounts of

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FET that are assessed after July 31 must be taken up with the carrier that billed the amount, not the IRS. Bills should be monitored closely for this reason, among many others.

## **2. Guesstimates won't fly**

Corporations and some business entities will be required to request the specific amount of FET paid during the allotted period to the IRS. Other entities, including individuals, will be eligible for a "safe harbor" amount. It is estimated that this will be somewhere between \$25-\$50 per taxpayer, but this estimate is nothing more than an educated guess.

## **3. Eligible services**

The refund/credit available from the IRS will apply to long distance, "bundled" services that include local and long distance service, and wireless/cellular services, but it will not apply to bills for strictly local services or ancillary equipment associated with local service, including automatic call distribution equipment, amplifier handsets and anything else associated with local service.

## **4. Some special requirements**

A. In order to be eligible for a refund/credit, the taxpayer

must have paid telephone bills from the United States. That is, if the bills are paid out of Canada, then the taxpayer is precluded from receiving the refund/credit.

B. Any amounts that the taxpayer has claimed as a business expense during the March 1, 2003 to July 31, 2006 timeframe are not eligible for refund. As such, these amounts must be added back in order to take advantage of the full FET paid. Additionally, any prior settlement with the IRS for a percentage of FET paid are final. Those taxpayers who settled with the IRS prior to May 26, 2006 may not apply for a full FET refund.

This column provides a brief overview of some of the issues associated with the IRS' determination on the Federal Excise Tax. For more information, please feel free to check the IRS website ([www.irs.gov](http://www.irs.gov)), or contact me or your tax professional.

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