

**FHH Telecom Law  
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**IRS Straight-arms Court,  
Keeps On Collecting Taxes**

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In May a federal circuit court – the 11<sup>th</sup> Circuit covering Alabama, Georgia and Florida – ruled that the IRS could not impose an excise tax on certain long distance calls. Most people assumed that the IRS would obey the court and stop imposing the tax. However, to everyone's surprise, the IRS released a notice declaring that it was aware of the court's decision but it would keep collecting the tax anyhow. At the beginning of November, another federal circuit court – the 6<sup>th</sup> Circuit covering Michigan, Ohio, Tennessee and Kentucky – also decided that the IRS was wrong. What the IRS will do now is anyone's guess.

At the turn of the century, not last century but the one before, Congress was looking for ways to fund the Spanish-American War. To pay for the war Congress created the telecommunications excise tax. The tax survives today even though Spain and America have been allies for decades. Congress tinkered with the tax over the years and in 1958 decided that the tax would apply to local, toll and teletypewriter service. In defining toll service, Congress specified that such service would be taxed if its cost varied by time and distance. At that time, and for years to come, this definition seemed appropriate as the charges for calls were billed based upon where and when you placed the call. Most calls from Boston to California were more expensive than calls from Chicago to Detroit.

However, along came Candice Bergen and Sprint's dime-a-minute plan. Every other long distance provider followed suit. Today, most callers pay a flat rate for long distance calls. Consumers in Seattle pay the same to call Miami as they do to call Portland, Oregon. The concept of paying more because the other phone is farther away has all but vanished. The tax nevertheless remains on the books and the IRS must collect a tax on calls that vary by time *and* distance. However, the IRS insists that long distance calls should be taxed if they vary by time *or* distance. That little conjunctive here means a difference of hundreds of millions of dollars in taxes. After a few years, several organizations were tired of paying the IRS and sued them.

The IRS fought the lawsuits and usually lost on its interpretation. Most recently, the IRS lost at the federal appeals court level – the last stop before the U.S. Supreme Court. In May, the U.S. Court of Appeals for the 11<sup>th</sup> Circuit decided that the IRS was wrong. The Tax Code is clear: a charge must vary based upon the time and distance of the call. The IRS had its day in court and lost. However, the IRS decided that it would ignore the Circuit Court's decision. A few months later, a notice was released by the IRS which announced that it still would be collecting the taxes. The IRS noted that an appeals court elsewhere in the country was considering the same issue and that it would keep taxing.

Consumers were told that if they thought the tax was wrong, they should pay the tax anyhow and then file for a refund of the taxes just paid. The IRS also told consumers that after they filed for the refunds, the IRS had no intention of processing the refund requests.

The IRS based its collection fervor, which many decried as flatly illegal, on the fact that there were similar cases elsewhere in the nation. Indeed, at the time that the IRS issued its surprising decision, the 6<sup>th</sup> Circuit was considering a case in which Office Max sued the IRS for collecting the tax. At the beginning of November, the 6<sup>th</sup> Circuit issued an opinion agreeing with Office Max, the 11<sup>th</sup> Circuit and many other courts that the IRS was wrong. The 6<sup>th</sup> Circuit began its order with the observation that it is tempting to “make a crack about the demise of the rule of law.” However, the court went on and took 20 pages to analyze the claims made by the IRS and why the IRS may have decided as it did. Nonetheless, this court also ruled against the IRS.

What remains to be seen is how the IRS will react to the fact that two circuit courts have ruled against it. The nation is divided into 13 circuit courts. We expect that the IRS position will be challenged in these other circuits as well. Eventually, either the Supreme Court will decide the matter once and for all, or the crescendo of losses will force the IRS to relent. In the meantime, telecom carriers are required by the IRS to continue collecting the tax (even in the circuits where it has lost), and aggrieved customers must file a claim for a refund. Stay tuned.