No. 13-1269

IN THE
Supreme Court of the United States

WORLDCOM, INC.,
Petitioner,
v.

INTERNAL REVENUE SERVICE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF TAX FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*[1]

[1] Pursuant to Supreme Court Rule 37.6, counsel for *Amicus* represents that it authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *Amicus* or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel for *Amicus* represents both that all parties were provided notice of *Amicus*'s intention to file this brief at least 10 days before its due date and that all parties have consented to the filing of this brief. Petitioner has filed a letter with the clerk of the Court granting blanket consent to the filing

Tax Foundation submits this brief as *amicus curiae* in support of Petitioner in the above-captioned matter.

The Tax Foundation is a non-partisan, non-profit research organization founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., we seek to make information about government finance more accessible to the general public. Our analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability. The Tax Foundation's Center for Legal Reform furthers these goals by educating the legal community about economics and principled tax policy.

This Court's decision will provide guidance on the application of a statute that affects taxpayer certainty over which types of communications services are taxable. Because *Amicus* has testified and written extensively on taxpayer protections and because this Court's decision may resolve a significant dispute over the interpretation of the governing statute, *Amicus* has an institutional interest in this Court's ruling.

SUMMARY OF ARGUMENT

This Court's guidance is needed to prevent the Internal Revenue Service from reviving a tax that was bad policy to begin with, was never intended to be a permanent tax, and was naturally dying off as technological changes rendered the tax inapplicable to many new telephone services. Originally the telephone excise tax covered local telephone service, toll telephone service, and teletypewriter exchange service, but today only local telephone service is taxed.

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of *amicus* briefs; written consent of respondent to the filing of this brief is being submitted contemporaneously with this brief.

Teletypewriter exchange service is a largely obsolete technology that is not generally offered today. In addition, changes in the way long-distance service is sold has rendered most long-distance services being offered today exempt from the telephone excise tax. Several courts of appeals have ruled that the tax on long-distance service applies only to long-distance service that is based on both time and distance. However, long-distance providers today price long-distance calls on the basis of a set number of minutes per month rather than on the basis of elapsed time and distance of the call. As a result, most long-distance telephone calls are exempt from the statute.

Many telephone service providers do not charge for separate long-distance phone service at all, instead bundling both long-distance and local telephone service together with a set number of minutes that can be used on any calls within the country. As a result, the telephone excise tax does not apply to most of these bundled services. Throughout the past five decades since the telephone excise tax was last updated, technology has radically changed. For example, the tax is inapplicable to many popular services, like VoIP, long-distance calls, and bundled services. In 2006, when the IRS conceded that the tax does not apply to long-distance service, it also conceded that the tax does not apply to these bundled services. I.R.S. Notice 2006-50, 2006-1 C.B. 1141, *Communications Excise Tax; Toll Telephone Service* (June 19, 2006). In addition, the Treasury Department also announced that it would issue refunds for those who improperly paid the tax on long-distance service. In the following eight years, Congress has not updated the tax to ensure that it applies to any of these services.

Today, the tax is mostly collected on local telephone service. However, even this service is undergoing changes that make it difficult to know which services are taxable. While it is possible that the lack of updates to the statute is simply a result of partisan gridlock, it also represents an acknowledgment that the tax is outdated and should not apply to many new technologies absent explicit Congressional authorization. The Federal Circuit specifically noted in *Comcation* that the lack of updates to the telephone excise tax by Congress could have been intentional. ("Undoubtedly, there are times that Congress, in exercising its taxing powers, fails to keep pace with technological evolution. Indeed, that failure might be purposeful." *Comcation, Inc. v. U.S.*, 78 Fed.Cl. 61, 76 (Fed. Cl. 2007). Therefore, if Congress does not act to update the statute to apply to newer technologies, courts should continue a narrow construction of the scope of services explicitly subject to tax under the Act.

The Second Circuit's ruling that the telephone excise tax is applicable to a data-only service that is not capable of sending or receiving voice calls stands in direct conflict with the Federal Circuit's decision in *USA Choice*. *See USA Choice Internet Servs., LLC v. United States*, 522 F.3d 1332 (Fed. Cir. 2008). If the Second Circuit's decision is allowed to stand it will create a guessing game for taxpayers as to which services are taxable in that jurisdiction. While this specific type of dial-up internet service has largely declined in usage, approximately 3 percent of Americans still use dial-up internet.

As a result of this decision, it would be difficult, if not impossible, for these taxpayers to know whether their service would be taxable. The answer, according

to the Second Circuit, depends on very technical details of the system and can include system details upstream that the taxpayer has no control over. Perhaps more importantly, this decision creates a guessing game as to whether broadband services could be taxable if a component upstream connects to a local telephone network. Therefore, allowing the Second Circuit's decision to stand in conflict with the Federal Circuit would create substantial uncertainty for taxpayers.

ARGUMENT

I. THIS COURT'S GUIDANCE IS NEEDED TO RESOLVE A CIRCUIT SPLIT OVER THE APPLICATION OF A TAX THAT WAS NEVER INTENDED TO BE PERMANENT AND HAS ALWAYS BEEN RECOGNIZED AS BAD TAX POLICY.

The telephone excise tax has been recognized by members of Congress and the Treasury Department as a bad tax many times, yet it continues to exist over 100 years after first being enacted. In 1965, Congress decided that the tax had run its course and should be abolished. Congress enacted a law that required the tax to be reduced by one percentage point each year until it was fully repealed in 1969. However, the rising costs of the Vietnam War led President Lyndon Johnson to ask Congress to reverse course and keep the excise tax around as an emergency war funding measure. In 1966, Congress reenacted the legislation on a temporary basis. This was the last time that Congress made any substantive changes to the telephone excise tax.

Congress then continued to renew this "temporary" tax repeatedly throughout the 1960s, 1970s, and

1980s until it was made permanent by the Revenue Reconciliation Act of 1990. *See* U.S. Department of the Treasury, Office of Tax Analysis, *Report to Congress on Communications Services Not Subject to Federal Excise Tax*, at 11, Aug. 1987. Congress acted to make the tax permanent despite the fact that the Treasury Department recommended that the tax be repealed. A report issued by Treasury in 1987 recommended that the tax be allowed to expire because "the tax causes economic distortions and inequities among households." *Id*. The report also concluded that "there is no policy rationale for retaining the communications excise tax in the federal tax system." *Id*.

In 2006, after losing a series of court cases, the Treasury Department concluded that it would no longer collect the tax on long-distance telephone services. *See* Press Release, Treasury Department, *Treasury Announces End to Long-Distance Telephone Excise Tax* (May 25, 2006. In addition, Treasury announced that it would provide refunds to taxpayers who paid the tax between 2003 and 2006. The court cases, and Treasury's decision, were based on the fact that the courts held that for the telephone excise tax to apply to long-distance service, the long-distance calls had to be based on both time and distance. *See e.g. Officemax, Inc. v. U.S.*, 428 F.3d 583 (6th Cir. 2005), *Nat'l Railroad Passenger Corp. v. U.S.*, 431 F.3d 374 (Fed. Cir. 2005). Since most service providers began offering long-distance service based on a set amount of minutes, rather than based on both time and distance as stated in the statute, the courts held that the telephone excise tax did not apply to most long-distance telephone services being offered.

Treasury conceded the argument and decided not to litigate the cases any further. After these decisions,

Treasury again recommended to Congress that the telephone excise tax be repealed. Treasury recommended that in addition to the long-distance telephone tax, that the local telephone services excise tax should also be repealed, calling it "antiquated." Press Release, Treasury Department, *Treasury Announces End to Long-Distance Telephone Excise Tax* (May 25, 2006).

If the tax was considered antiquated by the Treasury in 2006, it has only grown more antiquated in the last eight years. As Americans phone habits change and shift away from landlines and toward bundled wireless service, the telephone excise tax becomes even more of a vestige of a bygone era. If Congress continues to choose not to repeal or modify the tax, this Court's guidance is needed to at least prevent the IRS from expanding the tax beyond the reach of what would have been contemplated under the statute.

II. THIS COURT'S GUIDANCE IS NEEDED TO PREVENT THE INTERNAL REVENUE SERVICE FROM REVIVING AND EXPANDING A TAX THAT WAS NATURALLY BECOMING OBSOLETE AS A RESULT OF TECHNOLOGICAL CHANGES.

The telephone excise tax has not kept pace with a changing world. Many of its provisions have been ruled inapplicable to current technology and the older technology to which it once applied is now obsolete. As a result, most of the statute's provisions are vestiges of a bygone era and are not applied by the IRS in practice today. For example, both §4252(b), which levies a tax on long-distance telephone service, and §4252(c), which levies a tax on teletypewriter exchange service, have either been held to be inapplicable to current

technology or have been rendered moot because the technology to which it once applied is now obsolete. Therefore, if Congress does not act to update the statute to apply to newer technologies, courts should continue a narrow construction of the scope of services explicitly subject to tax under the Act.

Section 4252(b) defines long distance telephone service, in part, as: (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. 26 U.S.C. §4252(b). A series of court decisions held that this meant that for the statute to apply the long-distance charges had to be based on both time and distance. *See e.g. Officemax, Inc. v. U.S.*, 428 F.3d 583 (6th Cir. 2005), *Nat'l Railroad Passenger Corp. v. U.S.*, 431 F.3d 374 (Fed. Cir. 2005). The courts noted that most long-distance services being offered today do not charge based on time and distance, and thus the telephone excise tax was inapplicable to most long-distance services currently being offered. *Id.*

Section 4252(c) defines teletypewriter exchange service as the access from a teletypewriter or other data station to the teletypewriter exchange system of which such station is a part, and the privilege of intercommunication by such station with substantially all persons having teletypewriter or other data stations constituting a part of the same teletypewriter exchange system, to which the subscriber is entitled upon payment of a charge or charges (whether such charge or charges are determined as a flat periodic amount, on the basis of distance and elapsed transmission time, or in some other manner). 26 U.S.C. §4252(c).

A teletypewriter is a now largely obsolete electromechanical typewriter that allows users to communicate typed messages from one terminal to another. These exchanges and teletypewriters have been almost completely replaced among individual users by computers. As a result of the technology being mostly obsolete today this subsection has largely been rendered moot. Most individuals use computers to transmit data to another individual, and those transmissions are generally outside the scope of this tax. Congress has never intervened to modify the statute to apply this subsection to a comparable technology, giving us one more example of a service once taxed under this statute that has been rendered antiquated by technological changes.

Today, the only subsection of the telephone excise tax still being widely applied is the tax on local telephone services, which is defined in 26 U.S.C. §4252(a). Local telephone service is defined as (1) the access to a local telephone system, and the privilege of telephonic quality communication with substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system, and (2) any facility or service provided in connection with such a service described in subparagraph (1). 26 U.S.C. §4252(a).

However, even this subsection is losing its applicability to the type of local telephone services that most individuals use today. Many users are foregoing landlines and are choosing to exclusively have wireless bundled services in their homes. These services allow a user to purchase a set number of telephone minutes, text messages, and data services. Because local service is not billed separately from long-distance service the telephone excise tax is not collected on

these services. I.R.S. Notice 2006-50, 2006-1 C.B. 1141, *Communications Excise Tax; Toll Telephone Service* (June 19, 2006). This change in how users purchase telephone service is quickly rendering §4252(a) obsolete, but the Second Circuit's decision to tax a data-only service that is not capable of making voice calls injects uncertainty into the equation.

The Second Circuit's decision threatens to revive a once dying tax by leaving it an open question whether the local telephone service tax encompasses certain newer technologies not contemplated at the time of the tax's enactment. For example, prior to the Second Circuit's decision, it would have been unquestioned that broadband services do not fall within the scope of the telephone excise tax because data is transmitted through cable service rather than a local telephone network. However, if the Second Circuit's decision is allowed to stand, it will leave substantial uncertainty as to whether broadband service is taxable if an input into the broadband system connects to a local telephone system. Under the Second Circuit's reasoning the broadband service could be taxable if an input to the broadband system connects to a local telephone system even if the broadband service purchased by the cable company has no capability to transmit voice calls. Since over 70 percent of homes currently have broadband service this creates widespread uncertainty that requires this Court's guidance to resolve.

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests that this Court grant the petition for certiorari.

Respectfully submitted,

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