No. __-____

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

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether, contrary to the Federal Circuit's decision in *USA Choice Internet Services, LLC v. United States*, 522 F.3d 1332 (Fed. Cir. 2008), the Internal Revenue Service can tax as "local telephone service" under 26 U.S.C. § 4251 the purchase of data services that do not enable the purchaser to make or receive telephone calls.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, petitioner WorldCom, Inc. states the following:

Verizon Business Global LLC ("Verizon Business") is successor in interest to MCI Inc., formerly known as WorldCom, Inc., and certain of its affiliates. Verizon Business is a wholly owned subsidiary of Verizon Communications Inc., a publicly traded Delaware corporation. Verizon Communications Inc. has no parent company, and no publicly held company owns 10% or more of its stock.

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Petitioner WorldCom, Inc. respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

INTRODUCTION

The decision below creates a conflict with the Federal Circuit, disregards this Court's long-established tax-law principles, and creates widespread uncertainty about the taxability of data services that hundreds of millions of Americans use today. This Court should grant certiorari to resolve that conflict and clarify the scope of a 1960s tax statute for the 21st century.

Congress first imposed an excise tax on telephone service more than a century ago, to finance the Spanish-American War. Although Congress revisited the tax over the decades to finance other wars, Congress last substantively modified the tax in 1965. In the nearly 50 years since then, communications technology and the communications marketplace have changed in dramatic and far-reaching ways, and the objects of the tax have all but withered away. The tax no longer applies to the vast majority of long-distance and local telephone services because of changes in the way those services are sold (in flat-rated, all-you-can-eat bundles); nor does it apply to newer Voice over Internet Protocol ("VoIP") services.

In the case below, the Internal Revenue Service ("IRS") sought to revitalize this tax. The IRS abandoned its historical position that the 1965-era tax on local telephone service applies only to services that enable local voice calling. Instead, the IRS proffered the novel argument that the tax applies to a data-only service that is used to access the Internet and that cannot be used to make or receive a single local

voice call. The Second Circuit accepted the findings of both the bankruptcy court and the district court that the service at issue is data-only and cannot be used to make or receive local voice calls. Moreover, the court recognized that the IRS's litigating position conflicted with its prior published interpretation of the telephone excise tax in Revenue Ruling 79-245.[1] The Second Circuit nonetheless reversed the lower courts and found that the data service is taxable as local telephone service because a component of the service provider's network used as an input to the data-only service that petitioner purchased could be used — as part of an entirely different service that petitioner did not buy — to make or receive local voice calls.

That decision — which denies WorldCom a refund of more than $25 million for improperly collected taxes and has led the government to claim that WorldCom owes back taxes and interest of more than $26 million — conflicts with the Federal Circuit's decision in *USA Choice Internet Services, LLC v. United States*, 522 F.3d 1332 (Fed. Cir. 2008). Under the rule applied in *USA Choice*, a service that the purchaser uses solely for data transmissions is taxable as local telephone service if, but only if, the purchaser could also use that service to complete local telephone calls. In rejecting the Federal Circuit's rule — which is the same rule the IRS itself had long applied — the Second Circuit adopted a rule that conflicts with core principles of tax law that tax liability follows from what the taxpayer actually did, not from what the taxpayer might have done.

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[1] Rev. Rul. 79-245, 1979-2 C.B. 380, 1979 WL 51191 (Jan. 1, 1979).

The ramifications of this decision reach far beyond this case. Taxpayers may file refund suits in either federal district court or the Court of Federal Claims, which is bound by decisions of the Federal Circuit. Therefore, the Second Circuit's divergence from the Federal Circuit creates heightened incentives for taxpayer forum-shopping. Moreover, by allowing the IRS to redefine a 50-year-old telephone tax statute broadly enough to apply to data-only services, the Second Circuit's decision threatens to disrupt the marketplace for services that vast numbers of consumers use today — and that have never before been subject to the tax.

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-37a) is reported at 723 F.3d 346 ("*WorldCom V*"). The opinion and order of the district court (App. 38a-53a) is not reported (but is available at 2011 WL 6434007) ("*WorldCom IV*"). The opinion of the bankruptcy court (App. 54a-70a) is reported at 449 B.R. 655 ("*WorldCom III*").

JURISDICTION

The court of appeals entered its judgment on July 22, 2013. A petition for rehearing was denied on November 19, 2013. App. 71a. On January 13, 2014, Justice Ginsburg extended the time for filing a petition for a writ of certiorari to and including April 18, 2014. App. 76a. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant provisions of the Internal Revenue Code of 1986, as amended ("Code"), 26 U.S.C. §§ 4251 and 4252, are reproduced at App. 72a-75a.

STATEMENT

1.*a.* Congress first enacted an excise tax on long-distance telephone service in 1898, to "curb the federal deficit caused by the Spanish-American War." *OfficeMax, Inc. v. United States*, 428 F.3d 583, 585 (6th Cir. 2005) (citing Act of June 13, 1898, ch. 448, § 25, 30 Stat. 448, 460).[2] Congress repealed the tax in 1902.[3]

To finance World War I and post-war infrastructure costs, Congress again imposed a tax on long-distance telephone service from 1914 to 1924.[4] In 1932, Congress reinstituted a tax on long-distance telephone service, this time to raise funds as the Great Depression wore on.[5] Just before World War II, Congress extended the tax to cover "general" (*i.e.*, local) telephone service.[6] Congress did not repeal the tax after World War II ended. Instead, in 1958, Congress reorganized the statute to tax six communications services: "general" (*i.e.*, local) telephone service, "toll" (*i.e.*, long-distance) telephone service, teletypewriter exchange service, telegraph service,

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[2] *See* Louis Alan Talley, *The Federal Excise Tax on Telephone Service: A History* 1 (Cong. Res. Serv., updated Jan. 4, 2001) ("Talley"), *available at* http://www.law.umaryland.edu/marshall/crsreports/crsdocuments/RL30553_01042001.pdf.

[3] *See* Act of Apr. 12, 1902, ch. 500, § 7, 32 Stat. 96, 97.

[4] *See* Talley at 1-3; Act of Oct. 22, 1914, ch. 331, § 22, 38 Stat. 745, 761; Revenue Act of 1917, ch. 63, § 500(e), 40 Stat. 300, 315; Revenue Act of 1918, ch. 18, § 500(f), 40 Stat. 1057, 1102 (1919); Revenue Act of 1921, ch. 136, § 500(a), 42 Stat. 227, 284; Revenue Act of 1924, ch. 234, § 1100, 43 Stat. 253, 352.

[5] *See* Revenue Act of 1932, ch. 209, § 701, 47 Stat. 169, 270; Talley at 3.

[6] *See* Revenue Act of 1941, ch. 412, § 548, 55 Stat. 687, 714; Talley at 4.

wire mileage service, and wire and equipment service.[7]

b. In 1965, recognizing that the excise tax on telephone service "is undesirable as a permanent feature of our excise tax system,"[8] Congress passed the Excise Tax Reduction Act of 1965. Pub. L. No. 89-44, 79 Stat. 136 ("1965 Act"). The 1965 Act overhauled the statutory definitions, cut the number of taxable services to three — local, toll, and teletypewriter exchange — and provided for the gradual phase-out of the tax altogether by 1969. *See id.* § 302, 79 Stat. 145-48.

Given that the "first purpose of the 1965 Act was to phase-out the excise tax on communication services" before the decade was out, *Trans-Lux Corp. v. United States*, 696 F.2d 963, 966 (Fed. Cir. 1982), the 1965 Congress "had no reason to ensure that the statute covered all future service," *National R.R. Passenger Corp. v. United States*, 431 F.3d 374, 377 (D.C. Cir. 2005). Instead, Congress defined local, toll, and teletypewriter exchange services in terms that reflected services available in the marketplace in 1965. As the IRS has explained, the statutory definitions of local and toll telephone services "describe[] the local and long distance telephone service[s] sold under the 1965 Federal Communications Commission rules." Advance Notice of Proposed Rulemaking, Excise Taxes; Communications Services, 69 Fed. Reg. 40,345, 40,345 (July 2, 2004); *see*, *e.g.*, *American Bankers Ins. Group v. United States*, 408 F.3d 1328, 1333

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[7] *See* Excise Tax Technical Changes Act of 1958, Pub. L. No. 85-859, § 133(a), 72 Stat. 1275, 1289-92.

[8] S. Rep. No. 89-324, at 34 (1965); H.R. Rep. No. 89-433, at 29 (1965).

(11th Cir. 2005) ("In defining taxable 'toll telephone service,' . . . Congress . . . sought to define the method of service provided by AT&T, the company, at the time of enactment, holding a monopoly on all long-distance telephone services.").

Due first to the costs of financing the Vietnam conflict, and later due to large budget deficits, Congress decided to extend the tax and, in 1990, made it permanent at a rate of 3% of the amount paid for the taxable telephone service. *See* Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, tit. XI, § 11217, 104 Stat. 1388, 1388-400, 1388-437. Congress, however, never updated the statute to keep pace with the many, substantial changes over the past five decades in communications technology and the services offered in the marketplace.

c. Today, the telephone excise tax applies to only "limited services." 2001 JCT Report[9] at 506. Teletypewriter exchange service — an "early form of data exchange that connected printers to a network for the purpose of sending text-based messages" — is "obsolete," having been displaced by fax machines, e-mail, and other methods of sending text messages that are not subject to the tax. *WorldCom V*, App. 16a.

Most long-distance services are outside the ambit of the tax as well. In a series of decisions in 2005 and 2006, numerous courts of appeals held that long-

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[9] Staff of Jt. Comm. on Taxation, 107th Cong., *Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986 – Volume II: Recommendations of the Staff of the Joint Committee on Taxation To Simplify the Federal Tax System* (Jt. Comm. Print Apr. 2001) ("2001 JCT Report"), *available at* http://www.jct.gov/s-3-01vol2.pdf.

distance services sold today — which are billed on a time-only (rather than time-and-distance) basis, or (more recently) through a flat monthly charge for an unlimited bundle of local and long-distance services — do not satisfy the statutory definition of "toll telephone service," which requires that pricing be based on both time and distance. *See Fortis, Inc. v. United States*, 447 F.3d 190, 191 (2d Cir. 2006) (per curiam); *Reese Bros., Inc. v. United States*, 447 F.3d 229, 234 (3d Cir. 2006); *OfficeMax*, 428 F.3d at 590-91; *American Bankers Ins. Group*, 408 F.3d at 1333; *Nat'l R.R. Passenger*, 431 F.3d at 379; *cf.* Staff of Jt. Comm. on Taxation, 109th Cong., *Options To Improve Tax Compliance and Reform Tax Expenditures* 372 (Jt. Comm. Print. Jan. 2005) (noting that "long distance calling plans may be purchased now by paying a fixed monthly fee for a limited (or even an unlimited) number of minutes usable nationwide," and "both local and long distance telephone services may be bundled together or with nontaxable services, including data (e.g., text messaging, or wireless internet)"), *available at* http://www.jct.gov/s-2-05.pdf. In 2006, the IRS acceded to those decisions, announcing that not only long-distance service, but also bundles of long-distance and local services and VoIP service, are not subject to the telephone excise tax. *See* 2006 Excise Tax Notice[10] §§ 3-4.

Today, consumers overwhelmingly are purchasing wireless services, VoIP services, and wireline services that bundle local and long-distance, all of which are

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[10] I.R.S. Notice 2006-50, 2006-1 C.B. 1141, *Communications Excise Tax; Toll Telephone Service* (June 19, 2006) ("2006 Excise Tax Notice"), *available at* http://www.irs.gov/irb/2006-25_IRB/ar09.html.

not subject to the telephone excise tax.[11] In addition, hundreds of millions of consumers are purchasing broadband services that have never been subject to the tax.[12] With the growth of the Internet and the advent and widespread adoption of cloud computing, such data services are continuing to proliferate.

d. The IRS has long understood the federal excise tax on local telephone service to apply only to voice-capable services and not to data-only services. The statutory definition of "local telephone service" in the telephone excise tax statute requires, among other things, that the service afford the "privilege of telephonic quality communication with substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system." 26 U.S.C. § 4252(a)(1). In Revenue Ruling 79-245, the IRS interpreted this element of the definition to mean that, to be taxable, a service must allow the purchaser to "plug[] in a regular telephone" and receive "telephonic (voice) quality communication." Rev. Rul. 79-245, 1979 WL 51191, at *2. Thus, the

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[11] *See*, *e.g.*, Centers for Disease Control & Prevention, *Wireless Substitution: Early Release of Estimates From the National Health Interview Survey, January–June 2013*, at 1 (rel. Dec. 2013) (reporting that, as of 2013, nearly 40% of American households had only wireless telephones), *available at* http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201312.pdf; Indus. Analysis & Tech. Div., FCC, *Local Telephone Competition: Status as of December 31, 2012*, at 2 (Nov. 2013) (charting growth in VoIP and wireless subscriptions and decline in landline subscriptions), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-324413A1.pdf.

[12] *See* Indus. Analysis & Tech. Div., FCC, *Internet Access Services: Status as of December 30, 2012*, at 17, tbl. 1 (Dec. 2013), *available at* http://transition.fcc.gov/Daily_Releases/Daily_Business/2013/db1224/DOC-324884A1.pdf.

IRS ruled, local telephone lines that a business used for a data processing and transmission service were taxable because the business could have "plugg[ed] in a regular telephone set" to those lines, even though it chose not to do so. *Id.* But modems the business leased to operate the data service were not taxable because "the type of telephone signal produced by . . . modems is usable only for nonvoice data transmission." *Id.*

In a series of private letter rulings, the IRS adhered to the conclusion in Revenue Ruling 79-245 that "telephonic quality communication" means "voice communication" or involves a service "capable of carrying such voice communication." I.R.S. Priv. Ltr. Rul. 94-12-018, 1993 WL 604384 (Mar. 25, 1994). A computer message service was not a taxable local telephone service because it required use of a modem to transmit or receive messages, and thus was "usable only for non-voice data transmission." I.R.S. Priv. Ltr. Rul. 91-15-055, 1991 WL 778396 (Apr. 12, 1991) (following Revenue Ruling 79-245). A credit card verification service was likewise not taxable, because — even though "initial access" to the service "beg[an] on a voice quality line" — the "only information transmitted to" the customer was "in non-voice form." I.R.S. Priv. Ltr. Rul. 96-50-008, 1996 WL 715840 (Dec. 13, 1996). And an e-mail service accessed from the "public telephone network" was not taxable, because it could transmit "data only," not "voice quality messages." I.R.S. Priv. Ltr. Rul. 92-15-059, 1992 WL 801394 (Apr. 10, 1992); *accord* I.R.S. Priv. Ltr. Rul. 89-50-011, 1989 WL 597200 (Dec. 15, 1989).

2. In the late 1990s, WorldCom began to purchase a service from a variety of local telephone

companies, called "central-office-based remote access" or "COBRA." *See WorldCom V*, App. 3a-5a. The COBRA service provided WorldCom with a "high-speed data stream" that aggregated the Internet communications of numerous individual users of dial-up Internet services. *Id.* at 4a, 5a.[13] WorldCom transmitted the data it received through the COBRA service to dial-up ISPs that routed the data to the Internet.

The service worked as follows: first, an ISP customer's dial-up call traveled from the caller's modem over the caller's telephone line to the local telephone company's switch. *See id.* at 3a-4a. The COBRA service began at that point, with the telephone company transporting that call (and other dial-up calls) within its own network over high-capacity telephone lines, called primary rate interface ("PRI") lines, to a telephone-company-owned network access server that converted the calls to packets of data in a format suitable for transmission over the Internet. *See id.* at 4a. The telephone company sent the aggregated stream of data packets to WorldCom, over a high-speed data line connected to the egress port of the telephone company's network access server. *See id.* WorldCom transmitted the data packets that it received via the COBRA service over its network to its ISP customers, which routed the packets to the Internet. *See id.*

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[13] At that time, consumers typically accessed the "network of interconnected computers that make up the Internet" through "'dial-up' connections provided over local telephone facilities." *NCTA v. Brand X Internet Servs.*, 545 U.S. 967, 974 (2005). "Dial-up" consumers access the Internet by making calls with the modems inside their computers over telephone lines owned by local telephone companies. *Id.* Internet service providers ("ISPs") in turn link these calls to the Internet. *Id.*

WorldCom could not make or receive a voice telephone call using the COBRA service. *See id.* at 5a. Although PRI lines can be configured to carry a regular voice communication signal — they can be plugged into a "switch that allows for voice communication over PRI lines" — the PRI lines used as an input to the COBRA service were not so configured. *Id.* Instead, they were plugged into the telephone companies' network access servers, which converted signals into data packets, so that "it was no longer possible to transmit a traditional voice communication" over the PRI lines. *Id.* Nor could WorldCom "reconfigure the PRI lines, which, along with the other COBRA equipment, were controlled by the local telephone companies." *Id.*

3. After WorldCom filed for bankruptcy protection under Chapter 11 in 2002, the IRS filed a proof of claim in the bankruptcy proceeding seeking nearly $16.3 million in unpaid telephone excise tax allegedly due on WorldCom's post-petition purchases of COBRA service in the early 2000s. *See In re WorldCom, Inc.*, 371 B.R. 19, 24-25 (Bankr. S.D.N.Y. 2007) ("*WorldCom I*"), *rev'd*, Nos. 02-13533 et al., 2009 WL 2432370 (S.D.N.Y. Aug. 7, 2009) ("*WorldCom II*"). WorldCom objected to the claim and moved for a refund of more than $38 million — later reduced to about $25 million — in excise taxes that local telephone companies had previously improperly collected from WorldCom, and remitted to the IRS, for purchases of COBRA service. *Id.* at 25.[14] WorldCom

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[14] The telephone excise tax statute deputizes service providers to collect the tax on the government's behalf. *See* 26 U.S.C. § 4291 ("[E]very person receiving any payment for facilities or services on which a tax is imposed upon the payor thereof under this chapter shall collect the amount of the tax from the person

argued that the COBRA service it had purchased was not a taxable "communications service[]" within the meaning of Code § 4251. The IRS contended that the service satisfied the statutory definition of a "local telephone service." *See* 26 U.S.C. § 4252(a).

The bankruptcy court ruled for WorldCom. *See WorldCom III*, App. 62a-63a, 68a-70a. The court concluded that the COBRA service WorldCom purchased was not a taxable local telephone service because it does not provide "'the privilege of telephonic quality communication.'" *Id.* at 63a-64a (quoting 26 U.S.C. § 4252(a)). Telephonic quality communication, the court noted, "'requires a communication channel over which it is possible to have a two-way conversation with the use of telephones.'" *Id.* at 64a (quoting *USA Choice*, 522 F.3d at 1341 n.2, and citing Revenue Ruling 79-245). The court found that COBRA service did not provide WorldCom with such communications because WorldCom could not have "plugg[ed] a telephone" — or "any equipment" — into the service to make or receive voice calls. *Id.* at 60a.

The IRS appealed to the district court, which affirmed the bankruptcy court's decision. Noting that "it is clear that Congress intended to tax what the average person would understand as a local telephone service" — whether or not the purchaser chose to use the service "for a voice call" — the court found it "key" that WorldCom had purchased from

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making such payment."). In practice, the purchaser pays the tax to its service provider, "who is required to collect the tax and return and pay over the tax" to the government. 26 C.F.R. § 49.4251-2(c); *see also id.* §§ 40.6011(a)-1 through 40.6302(c)-3 (rules governing tax returns and deposits that service providers must make).

the telephone companies "a high-speed data stream" that, the IRS conceded, "is not a telephonic quality communication." *WorldCom IV*, App. 43a, 47a. The court reiterated that WorldCom could be taxed only on the "services purchased, not potential reconfigurations or capabilities" of the components used to provide the services purchased. *Id.* at 47a. The court also found it significant, in considering whether COBRA was a *local* telephone service, that COBRA was an "intermediate service" that "enables end user communication with the Internet," rather than with WorldCom. *Id.* at 48a.[15]

4. The Second Circuit reversed. The court accepted the finding — made by both lower courts — that COBRA service cannot be used to make or receive local (or any other) voice calls. *See WorldCom V*, App. 5a. It also accepted the finding that COBRA was just one piece of the broader communication stream flowing between a dial-up ISP customer and the content of the World Wide Web. *See id.* at 33a. But the court nevertheless concluded that the COBRA service is taxable as a local telephone service.

The Second Circuit based its ruling on the capabilities not of the COBRA service, but of one of the communications channels the provider used as an

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[15] The rules of the Federal Communications Commission ("FCC") applying the Communications Act of 1934 similarly do not treat dial-up ISP calls as "local" calls. Instead, the FCC views dial-up ISP calls as "analogous" to "long distance call[s]" that connect "the dial-up customer and the global" Internet. *E.g.*, Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 16 FCC Rcd 9151, ¶¶ 58-60 (2001), *remanded on other grounds*, *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002).

input to the COBRA service. The court found that a service provides the "privilege of telephonic quality communication," 26 U.S.C. § 4252(a)(1), if a "channel" used in the service has "the technological capacity . . . to transmit voice signals" — that is, if it is a "channel that could also carry an ordinary telephone call." *WorldCom V*, App. 15a-16a. That interpretation led the court to conclude that the COBRA service offers "telephonic quality communication." *Id.* at 17a. The court found that the PRI lines the local telephone company sellers used to carry dial-up ISP calls to their network access servers are channels over which voice communication can occur, even though those PRI lines are "only a *portion* of" the integrated, finished COBRA service WorldCom purchased. *Id.* at 22a-23a. The court thus found it immaterial that WorldCom had no capability to plug a telephone in to the COBRA service (or to the PRI lines used as an input to that service) to receive a voice call. It was enough for the court that "COBRA relied on" PRI lines. *Id.* at 28a.

The Second Circuit recognized that the IRS had previously reached a contrary conclusion. As the court noted, in Revenue Ruling 79-245, the IRS had found a service used solely for data transmissions taxable "because the business could choose to plug a regular telephone instead of a modem into the port for the service." *Id.* at 19a. The court recognized that Revenue Ruling 79-245 "undercut[] the position" the IRS took in this case, because the IRS concluded there that a service — like COBRA — that enables "computer-to-computer communications over telephone wires" and is "usable only for nonvoice data transmission" is not taxable. *Id.* at 18a-19a & n.8 (internal quotation marks omitted). Yet the court

refused to hold the IRS to its position in Revenue Ruling 79-245, on the ground that the ruling was not entitled to *Chevron* deference and did not qualify for *Skidmore* deference. *See id.* at 19a-21a.

The Second Circuit also supported its decision based on its conclusion that its holding avoided "a strange result," where "companies that used their own network access servers to convert a phone signal to a data stream . . . would have to pay the tax" on the services they bought from local telephone companies, but "companies that relied on the local telephone compan[ies] to convert the signals for them, like WorldCom, would not." *Id.* at 30a.

The Second Circuit found that COBRA satisfied the remaining elements of the definition of "local telephone service" — which are "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," 26 U.S.C. § 4252(a) — and ruled that COBRA service was subject to the telephone excise tax. *See WorldCom V*, App. 10a-12a, 33a-35a. The effect of the court's ruling was to foreclose WorldCom's claim for a tax refund of $25 million. In addition, the government now claims in proceedings on remand before the bankruptcy court that WorldCom owes more than $26 million in back taxes and interest.

REASONS FOR GRANTING THE PETITION

I. THE DECISION BELOW CREATES A SIGNIFICANT CONFLICT WITH THE FEDERAL CIRCUIT

The Second Circuit's holding conflicts directly with the Federal Circuit's decision in *USA Choice Internet Services, LLC v. United States*, 522 F.3d 1332 (Fed. Cir. 2008), which held that a service actually used for receiving dial-up ISP data communications was taxable as local telephone service only because the purchaser could have used that service, as sold, to receive local voice telephone calls. The conflict is particularly consequential because it invites forum-shopping by taxpayers across the country. Certiorari is necessary to resolve the split and to bring uniformity to this area of the tax law.

A. USA Choice was an ISP that provided dial-up Internet access to residential and business customers throughout Pennsylvania. *See* 522 F.3d at 1334. As part of its service, USA Choice maintained "network access servers equipped with modems" and housed in facilities called Points of Presence ("POPs"). *Id.* These POPs were linked to local telephone companies by high-capacity digital lines — chiefly PRI lines — that USA Choice purchased from the local telephone companies. *Id.* at 1335.

This arrangement allowed USA Choice's customers to access the Internet by dialing a local telephone number. Such a call would travel from the customer's computer modem, to the local telephone company's facilities, and over a PRI line to USA Choice's POP. *Id.* at 1334. USA Choice then used its own network access servers to "provide[] a connection to the Internet through its network." *Id.* at 1334-35.

The local telephone companies selling the PRI lines to USA Choice collected telephone excise tax on the service and remitted the tax to the IRS. USA Choice sued for and won a refund in the Court of Federal Claims. That court relied on USA Choice's inability to make or receive a voice telephone call through the PRI lines as USA Choice had configured them; USA Choice's "servers could only 'communicate' with subscribers who used a modem." *Id.* at 1340. The lower court reasoned that modem-based communication could not constitute "local telephone service." *USA Choice Internet Serv., LLC v. United States*, 73 Fed. Cl. 780, 794 (2006).

The Federal Circuit reversed the lower court's decision because it found that the "inherent capabilities of the communication services [that USA Choice] purchased" allowed USA Choice to receive voice telephone calls. *USA Choice*, 522 F.3d at 1341. The Federal Circuit explained that it was only "USA Choice's decision to connect these [PRI] lines to modems . . . rather than to telephones" that prevented USA Choice from receiving voice calls over the PRI lines. *Id.* The Federal Circuit found that those "self-imposed limitations . . . did not fundamentally alter the nature of the services" that USA Choice purchased and "had the 'privilege' to use." *Id.* (internal quotation marks omitted).

In the Federal Circuit, whether a service is taxable as a local telephone service therefore turns on whether the "inherent capabilities of the communication services . . . purchased" give the purchaser the "privilege" of using telephones to complete local voice calls, irrespective of whether the purchaser chooses to use that functionality. *Id.*

B. Had this case been in the Federal Circuit, the court, applying *USA Choice*, would have found that COBRA is not a taxable local telephone service because it cannot be used with telephones to place or receive local voice calls. Unlike the service at issue in *USA Choice*, the limitations of COBRA service did not arise because of anything WorldCom chose to do in using the service it purchased. Instead, those limitations were inherent in how the telephone companies that sold COBRA configured the service and offered it for sale to customers, including WorldCom. *See WorldCom V*, App. 5a; *WorldCom III*, App. 60a-61a (holding that WorldCom could not have "plugg[ed] a telephone" — or "any equipment" — into COBRA service to make or receive voice calls).[16] Even though certain *components* that the local telephone companies used as inputs to the COBRA service were capable of transmitting voice calls, the finished *service* that the telephone companies sold and that WorldCom purchased had no such capability and could not be used to complete voice calls.[17] In order to have the capability of placing or receiving

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[16] The bankruptcy court found — rejecting an argument made by the government — that WorldCom could not have used the data stream it received over the COBRA service to carry voice communications using a VoIP service. *See WorldCom III*, App. 62a-63a. The government did not contest that finding in the Second Circuit. *See WorldCom V*, App. 5a-6a n.5. And, even if COBRA could have been used to carry VoIP traffic, that would not have subjected the service to taxability. The IRS stated, in its 2006 notice conceding the non-taxability of long-distance and bundled telephone services, that VoIP is not taxable under the federal statute. *See* 2006 Excise Tax Notice.

[17] Moreover, the contracts pursuant to which WorldCom purchased COBRA service contained prohibitions on making technological modifications to the service to enable the transmission of voice calls. *See WorldCom III*, App. 61a-62a.

local voice calls, WorldCom would have needed to buy a *different* service from the local telephone companies.

The Second Circuit reached the opposite result because it adopted a rule that is directly at odds with the rule of *USA Choice*. Disregarding the Federal Circuit's focus on the "inherent capabilities of the communication services [that the taxpayer] purchased," *USA Choice*, 522 F.3d at 1341, the Second Circuit instead based its decision on the capabilities of a "communications channel" (PRI lines) used as a *component* of the finished service offered for sale. The Second Circuit held that the telephone excise tax applies to COBRA because the service employed "PRI lines that afforded telephonic quality communication" when used as components of different services sold to other customers. *WorldCom V*, App. 27a-28a. As the Second Circuit acknowledged, its rule (and the government's position in this litigation) also conflicted with Revenue Ruling 79-245. The IRS in that ruling, like the Federal Circuit in *USA Choice*, had held that a service used for data transmission is taxable only when the purchaser could have chosen "to plug a regular telephone instead of a modem into the port for the service." *Id.* at 19a. The court, however, did not hold the IRS to its announced interpretation. Instead, it adopted the position the IRS asserted in this litigation and in so doing created a square conflict with the rule the Federal Circuit applied in *USA Choice*.

C. The need to resolve this conflict is pronounced because a split with the Federal Circuit encourages taxpayer forum-shopping, especially where, as here, a significant tax issue is at stake. The Code permits taxpayers seeking refunds of excise taxes to file suit

either in federal district court or in the Court of Federal Claims, which is bound by decisions of the Federal Circuit. *See* 26 U.S.C. § 7422. "The taxpayer is not supposed to derive an advantage by choosing one forum over another." *Miller v. United States*, 38 F.3d 473, 476 (9th Cir. 1994), *abrogated on other grounds by Omohundro v. United States*, 300 F.3d 1065 (9th Cir. 2002) (per curiam); *accord Galuska v. Commissioner*, 5 F.3d 195, 196 n.1 (7th Cir. 1993). This conflict, if left unresolved, will permit taxpayers to do just that.

The Court has previously intervened to resolve a split between a regional circuit and the then-Court of Claims threatening the uniform and "proper administration of the internal revenue laws." *Bulova Watch Co. v. United States*, 365 U.S. 753, 754 (1961). In *Bulova Watch*, the Court granted certiorari to resolve a conflict between the Ninth Circuit and the Court of Claims about whether computation of interest on a judgment that the taxpayer had overpaid was governed by the Code provision on computing refund interest or the general federal statute on computing judgment interest. *Id.* The Court should grant certiorari here to resolve a split that invites similarly "anomalous, nonuniform and discriminatory" tax treatment, *id.* at 757, by creating incentives for taxpayers to forum-shop.

II. THE DECISION BELOW CONFLICTS WITH THIS COURT'S LONG-ESTABLISHED TAX PRECEDENTS

In adopting a rule that conflicts with the Federal Circuit's rule in *USA Choice*, the Second Circuit looked past the service that WorldCom actually purchased, focused instead on the capabilities of one component the local telephone companies used as an input to that service, and held that the capabilities of that component (when used as an input to *different* services) subjected the finished service that WorldCom purchased to the telephone excise tax. The Second Circuit's rule thus departs from two basic principles of tax law that this Court has endorsed for many decades. First, taxes are assessed on the basis of actual transactions, not hypothetical ones. Second, tax law permits tax-reducing transactions that have economic substance.

A. For four decades, this Court has held that a "transaction is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred." *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 148 (1974). Since *National Alfalfa*, the Court has repeatedly rejected attempts to base tax treatment on a hypothetical transaction rather than a transaction as it occurred. In *Central Tablet Manufacturing Co. v. United States*, 417 U.S. 673 (1974), the Court refused to declare a liquidating corporation's fire insurance proceeds tax-free despite the possibility that an enterprising corporation could have structured the timing of its liquidation to avoid tax on any gains. *See id.* at 690 ("Tax consequences follow what has taken place, not what might have taken place."). And in *Don E. Williams Co. v. Com-*

missioner, 429 U.S. 569 (1977), the Court held the taxpayer to the tax consequences of its contribution of a promissory demand note to a trust and declined to "indulge in speculating how the transaction might have been recast with a different tax result." *Id.* at 580. The IRS has no more right to ignore the reality of a transaction than the taxpayer does. As the Court explained in *Boulware v. United States*, 552 U.S. 421 (2008), *National Alfalfa* is just one side of a "two-way street." *Id.* at 429 n.7.

B. This Court has also long recognized that taxpayers often have a choice of how to structure their transactions and have the "right" to select the structure that "decrease[s] the amount of what otherwise would be his taxes, or altogether avoid[s] them, by means which the law permits." *Gregory v. Helvering*, 293 U.S. 465, 469 (1935). Applying this principle, the Court in *United States v. Consumer Life Insurance Co.*, 430 U.S. 725 (1977), honored the taxpayer's chosen transaction, which qualified the taxpayer for more favorable tax treatment, because the chosen form "served valid and substantial nontax purposes." *Id.* at 739 (holding that "even a 'major motive' to reduce taxes will not vitiate an otherwise substantial transaction"). Similarly, in *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978), the Court held that the government must honor the structure of "a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features." *Id.* at 583-84; *see also Helvering v. Minnesota Tea Co.*, 296 U.S. 378, 385 (1935) (endorsing transaction structure taxpayer had

chosen); *John Kelley Co. v. Commissioner*, 326 U.S. 521, 525 (1946) (same).

C. The Federal Circuit's decision in *USA Choice* honors these settled tax principles, while the Second Circuit's decision disregards them.

First, the Second Circuit held that the IRS could tax WorldCom based not on the transaction WorldCom chose (buying a finished service that integrated transport and processing of dial-up ISP calls) but instead on a transaction it could have chosen (buying PRI lines, which were one component of the integrated COBRA service). That ruling conflicts directly with this Court's instruction, in *National Alfalfa* and elsewhere, that tax consequences follow from "what actually occurred," not from "what might have occurred." *National Alfalfa*, 417 U.S. at 148. The Federal Circuit, by contrast, correctly focused on the "inherent capabilities of the communication services [that the taxpayer] purchased," not on the capabilities of components of that service or other services that the taxpayer could have purchased. *USA Choice*, 522 F.3d at 1341.

Second, the Second Circuit expressed concern over what it termed the "strange result" if the telephone excise tax applied to ISPs (such as USA Choice) that purchased PRI lines from local telephone companies but did not apply to companies (such as WorldCom) that purchased a finished, data-only service that integrated PRI lines and network access servers. *WorldCom V*, App. 30a.[18] But this Court's settled tax

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[18] The Second Circuit reasoned that the result was strange because it would make taxability "hinge on what equipment the local telephone company provided, not the nature of the service." *WorldCom V*, App. 30a. But it is the equipment the local telephone company provides — and the way it configures that equipment — that controls the "nature of the service" provided.

precedents make clear that taxpayers are free to use different means to achieve the same substantive result (here, facilitating dial-up access to the Internet), even if those different means produce different tax consequences. Courts are not permitted to ignore the differences where, as here, a transaction has economic substance. As the lower courts found, and the IRS did not dispute, WorldCom purchased the integrated COBRA service — rather than managing the data aggregation, processing, and conversion process itself — based on its determination that it was more "efficien[t] and productiv[e]" to pay the local telephone companies to perform those tasks. *WorldCom I*, 371 B.R. at 24. That way, WorldCom "could reduce the number of ingress lines from the [central office] to the hub that [it was] required to purchase from the [telephone company], as well as reducing the costs associated with adding capacity and capabilities to the aggregation system." *Id.* The Second Circuit had no basis to disregard the manner in which WorldCom chose to serve its ISP customers.

Had the Second Circuit actually focused on the nature of the service — as the Federal Circuit did in *USA Choice* — it would have recognized that, while USA Choice bought a service to which it could have connected either modems (as it did) or telephones, WorldCom bought an integrated, finished service that only provided a data stream and could *not* be used with telephones. Those two services have fundamentally different natures.

III. THIS CASE PRESENTS A QUESTION OF SUBSTANTIAL IMPORTANCE

The Second Circuit's unprecedented (and incorrect) interpretation of the federal telephone excise tax statute raises issues of substantial importance. As explained above, the decision creates a direct conflict with the Federal Circuit that opens the door for taxpayer forum-shopping. *See supra* Part I.C. But the Second Circuit's decision has consequences requiring this Court's review for at least two further reasons as well. First, it generates costly uncertainty about the applicability to 21st-century data services of a tax whose definition "has not been updated since the Mad Men era." *WorldCom V*, App. 32a. Second, the court's willingness to disregard both established tax principles and the IRS's longstanding interpretation of the statute undermines the fair and predictable administration of the tax laws, threatening taxpayer confidence and productive economic investment.

A. The Decision Below Creates Significant Uncertainty For Communications Service Providers And Their Customers

The decision below is of great significance for the companies that provide modern-day communications services and the consumers who purchase them. Prior to the Second Circuit's decision, the federal telephone excise tax was fading organically into obsolescence. Its provisions, "enacted before development of most modern technology," had grown outmoded. 2001 JCT Report at 504-05. With the advent of fax machines and e-mail, "teletypewriter exchange service" has become defunct. Five circuit courts have held, and the IRS has agreed, that the tax on "toll telephone service" does not apply to most (if not all) long-distance services commercially available today

(including bundles of long-distance and local services and VoIP service). Although "local-only" services are still sold today, such services are on the wane, as consumers switch in ever greater numbers to wireless services, VoIP services, and wireline services that bundle local and long-distance.[19]

The Second Circuit's decision creates considerable uncertainty about the applicability of this 1965-era tax to communications services not contemplated (or even invented) 50 years ago, such as broadband and other data services, which vast numbers of consumers use today. According to the Second Circuit, a data-only service provides the "privilege of telephonic quality communication" and is taxable if inputs to that finished service could transmit voice telephone calls when those inputs are used as part of different services. Under that construction, it is unclear what data services an IRS directed to identify new sources of revenue will find meet that standard, suddenly subjecting those services to a 3% tax.

Uncertainty about the applicability of the telephone excise tax to data services will impose real costs on vast numbers of consumers. Hundreds of millions of Americans who use broadband services face the possibility of new and unanticipated tax burdens. *See* Pew Research Internet Project, *Broadband Technology Fact Sheet* (according to a survey completed in September 2013, 70% of Americans have broadband connections at home), *available at* http://www.pewinternet.org/fact-sheets/broadband-technology-fact-sheet/ (last visited Apr. 10, 2014). These consumers have a statutory duty to pay the telephone excise tax on any service to which it

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[19] *See supra* note 11.

applies, whether their service providers bill for it or not. If a consumer fails to pay a tax billed — or if the service provider fails to bill its consumer for a tax incurred — the IRS has the right to proceed against the taxpayer (*i.e.*, the consumer) itself to collect the tax. *See* 26 C.F.R. § 49.4291-1. And consumers would also be liable for interest — compounded daily — for any amount by which they underpay. *See* 26 U.S.C. §§ 6601(a), 6622.

That uncertainty will also subject service providers across the country to heightened economic risk. Providers, which must collect the tax in the first instance and remit it to the government, will "have to decide what services are taxable" after a decision that has further "blurr[ed]" the "lines between taxable and nontaxable services." 2001 JCT Report at 505. If some providers choose to tax a service whose taxability is in question, they risk losing customers to competitors that have chosen not to add a 3% tax to the price of their service. *See id.* ("Competitive issues arise when service providers treat charges for similar services differently."). If providers choose not to tax the service, they run the risk of significant financial sanctions and litigation with the IRS over their failure to collect the tax.[20] The costs of making

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[20] *See* 26 U.S.C. § 6672(a) (willful failure to collect the tax gives rise to a "penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over"); *see*, *e.g.*, *Brinskele v. United States*, 88 Fed. Cl. 334 (2009) (upholding assessment of penalty under § 6672 against provider responsible for collecting excise tax on taxable telephone service), *aff'd*, 397 F. App'x 662 (Fed. Cir. 2010) (per curiam); *Air Tour Acquisition Corp. v. United States*, 781 F. Supp. 669, 672-75 (D. Haw. 1991) (addressing IRS's claim that Code § 4291 and Code § 7501 — which requires persons "required to collect" and pay over tax to hold it "in trust for the United States" — give the

these decisions and assessing additional taxes — potentially on a large number of previously untaxed communications services — will raise compliance costs that already far exceed those in other industries. *See*, *e.g.*, Council On State Taxation, *2004 Telecommunications Tax Study* 4-5, 11 (Mar. 9, 2005) (finding that telecom businesses file more than six times the number of tax returns annually (47,921 returns) than are required of general businesses (7,501 returns each year)), *available at* http://www.cost.org/WorkArea/DownloadAsset.aspx?id=75397.

The decision below also creates uncertainty about the breadth of "local telephone service" under the many state and local tax laws that follow the 1965 Act's statutory definitions. A number of state and local taxes on communications services define "local telephone service" in language materially similar to that in Code § 4252.[21] Many other localities have incorporated the definitions of § 4252 wholesale into their tax laws.[22] There is no way of reliably predicting which jurisdictions will follow the Second Circuit's interpretation of "local telephone service" and

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IRS a cause of action against service providers for failure to collect excise taxes).

[21] *See*, *e.g.*, Ala. Code § 40-21-80(a)(11); Cal. Rev. & Tax. Code § 41015; Sarasota County, Fla. Code of Ordinances Pt. II, Ch. 114, Art. V, § 114-162 (Apr. 12, 2000), *available at* http://library.municode.com/index.aspx?clientId=11511; New Orleans, La. Code of Ordinances Pt. II, Ch. 150, Art. VI, Div. 1, § 150-441 (Mar. 19, 1998) (subsection (9)(c)(1) for definition of "[s]ale of services"), *available at* http://library.municode.com/index.aspx?clientId=10040.

[22] *See*, *e.g.*, Vienna, Va. Code of Ordinances Pt. II, Ch. 6, Art. 2, § 6-13 (Apr. 21, 2003), *available at* https://library.municode.com/HTML/14916/book.html.

which will not, compounding the uncertainty created by the decision below.

B. The Decision Below Undermines The Uniform And Predictable Administration Of The Tax Laws

The Second Circuit's willingness to cast aside the capabilities of the service WorldCom actually purchased — contrary to the IRS's longstanding interpretation of the telephone excise tax statute — undermines the effective administration of the tax laws. Effective "tax administration requires predictability." *Oklahoma Tax Comm'n v. Chikasaw Nation*, 515 U.S. 450, 459-60 (1995); see also *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 549 (1979) (recognizing the "not inconsiderable advantage of enhancing certainty and predictability" in tax administration). If the government can tax consumers on services they never bought, based on a statutory interpretation offered in litigation that conflicts with the IRS's own stated view, none of these values is served.

Permitting taxation of a service based on services it somewhat resembles (but is not) erodes taxpayers' confidence that the tax laws will be applied in a uniform and predictable fashion. The Code "creates numerous tax differences between economically equivalent transactions." Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. Chi. L. Rev. 859, 869 (1982) (reviewing Boris I. Bittker, *Federal Taxation of Income, Estates and Gifts* (1981)). "The very decision to incorporate a business often entails a choice between two economically equivalent ways of pursuing a profit." *Id.* Just as it would create "unacceptable indeterminacy" if taxpayers could receive tax treatment based on the "least costly

alternative to the form [they actually] used," Robert Thornton Smith, *Substance and Form: A Taxpayer's Right To Assert the Priority of Substance*, 44 Tax Law. 137, 142 (1990), it will shatter predictability if the government can assess tax based on the *most* "costly" alternative. As this Court has explained, to avoid "burden and uncertainty," "[t]here must be a fixed and indisputable mode of ascertaining a . . . tax." *Founders Gen. Corp. v. Hoey*, 300 U.S. 268, 275 (1937) (internal quotation marks omitted). The Second Circuit's holding leaves none.

Similarly, if the IRS can litigate cases at odds with its prior, well-established revenue rulings, taxpayers are left with no assurance that such rulings — issued to delimit "taxpayers' rights and obligations," and to "bind[] the IRS, excise tax collectors, and taxpayers"[23] — will be followed in any given case. That error is worsened here by the IRS's failure even to acknowledge its departure from "rules that are still on the books," let alone provide a "reasoned explanation" for its change of heart. *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009); *see WorldCom V*, App. 18a-19a n.8 (noting that the IRS cited Revenue Ruling 79-245, but did "not at all discuss the portion of the revenue ruling that undercuts the position it takes here"). Allowing the IRS to take any litigating position it chooses — turning a blind eye to inconsistent policies and prior rulings on which taxpayers have relied — undercuts the values

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[23] *Cohen v. United States*, 578 F.3d 1, 6-9 (2009) (addressing analogous IRS notices), *vacated in part on other grounds on reh'g en banc*, 650 F.3d 717 (D.C. Cir. 2011); *see also WorldCom V*, App. 20a-21a (acknowledging that "a revenue ruling is the 'official IRS position on application of tax law to specific facts'") (citation omitted).

of regularity and predictability on which the effective administration of the tax laws depends.

The issue is not, as the Second Circuit suggested, one of the level of deference owed to revenue rulings. *See WorldCom V*, App. 20a-21a (finding that revenue rulings are eligible for *Skidmore*, not *Chevron*, deference). Instead, the issue is whether the IRS may retreat from binding revenue rulings for litigating purposes. This Court has long considered such "agency litigating positions" to be suspect. *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212 (1988) (noting that Congress has not delegated to "appellate counsel the responsibility for elaborating and enforcing statutory commands") (internal quotation marks omitted). And courts of appeals have regularly refused to permit agencies, after changing position on the meaning of a statute or regulation, to penalize entities for not having complied in the past with the agency's newly announced view.[24]

These problems are far from academic. Lack of confidence in the predictable application of the tax laws discourages taxpayers from engaging in economically desirable business activity.[25] As this

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[24] *See*, *e.g.*, *Beaver Plant Operations, Inc. v. Herman*, 223 F.3d 25, 30-32 (1st Cir. 2000) (vacating Occupational Safety and Health Review Commission citation because business lacked adequate notice of agency's newly announced interpretation of Occupational Safety and Health Administration safety standard); *United States v. Chrysler Corp.*, 158 F.3d 1350, 1354-57 (D.C. Cir. 1998) (reversing National Highway Traffic Safety Administration recall of two Chrysler models where recall was based on newly announced interpretation of safety standard that conflicted with past agency guidance).

[25] *See* Testimony of Chairman Alan Greenspan Before the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) ("Just as price stability facilitates economic decision-

Court recently noted, "[p]redictability is valuable to corporations making business and investment decisions." *Hertz Corp. v. Friend*, 559 U.S. 77, 94 (2010). The Court should intervene here to restore predictability to the application of the tax laws in the Second Circuit.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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April 18, 2014

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making . . . , some semblance of predictability in the tax code also would facilitate better forward-looking economic decision-making by households and businesses."), *available at* http://www.federalreserve.gov/Boarddocs/Testimony/2005/20050303/default.htm.

APPENDIX

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 12-803

IN RE WORLDCOM, INC.,
Debtor.

INTERNAL REVENUE SERVICE,
Appellant,
v.

WORLDCOM, INC.,
Debtor-Appellee.

Argued: Jan. 11, 2013

Decided: July 22, 2013

Before: KEARSE, KATZMANN, Circuit Judges, and RAKOFF, District Judge.*

KATZMANN, Circuit Judge:

This case calls on us to decide if the bankrupt telecommunications company WorldCom must pay federal excise taxes on the purchase of a telecommunications service that connected people using dial-up modems to the Internet. Appellant, the Internal Revenue Service ("IRS"), appeals from a judgment of the United States District Court for the Southern

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* The Honorable Jed S. Rakoff, of the United States District Court for the Southern District of New York, sitting by designation.

District of New York (Forrest, *J.*), which upheld the decision of the Bankruptcy Court (Gonzalez, *C.J.*) to grant the objection of the reorganized debtors ("Debtors")[1] to the IRS's proof of claim for taxes owed and the Debtors' refund motion for the taxes WorldCom had already paid.

In the late 1990s, WorldCom purchased a service from local telephone companies called "central-office-based remote access," or "COBRA," that gave people the ability to use their modems to connect to WorldCom's network (and the Internet) over their regular telephone line. The tax code adds a three-percent excise tax to the purchase of a "local telephone service." 26 U.S.C. § 4251. A "local telephone service" is any service that provides "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." *Id.* § 4252(a). On appeal, the IRS contends that the district and bankruptcy courts erred in concluding that COBRA was not taxable as a local telephone service.

For the reasons set forth below, we hold that WorldCom purchased a "local telephone service" when it paid for COBRA services, and that World-

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[1] Although the caption names WorldCom, Inc. as the formal debtor-appellee, this adversary proceeding involves several of the debtors in the jointly administered bankruptcy. The principal debtor changed its name from WorldCom, Inc. to MCI Inc. and is currently operating as Verizon Business Global LLC. The subsidiary debtors are principally UUNet Technologies, Inc. and MCI WorldCom Network Services Inc. For convenience, we refer to the relevant debtors as the "Debtors," following the convention of the parties and the district court. For readability, we refer to the transactions at issue as purchased by "WorldCom."

Com must therefore pay federal communication excise taxes on those transactions. Accordingly, we reverse the judgment of the district court and remand the case for further proceedings consistent with this Opinion.

BACKGROUND

I. Factual Background

The following background is drawn from the bankruptcy court's factual findings, adopted by the district court and unchallenged by either party on appeal:[2]

In the late 1990s, WorldCom, originally a long-distance telephone service provider, began building a massive Internet network to provide data services. As part of building that network, WorldCom purchased a now-obsolete telecommunications service known as "central-office-based remote access," or "COBRA" from local telephone companies. COBRA allowed local telephone subscribers to connect to the Internet using a dial-up modem.[3]

In order to connect to the Internet through COBRA, a subscriber's modem would call the COBRA access number over the subscriber's normal telephone line (the public switched telephone network or "PSTN" line). After dialing the COBRA number, the modem signal traveled over the PSTN,

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[2] The parties accuse each other of waiving various arguments by not challenging the bankruptcy court's factual findings. But neither party actually challenges the facts as found by the bankruptcy court, only the legal import of those factual findings on taxability.

[3] We provide here only the factual background that is necessary to resolving the issues present in this appeal. For further background on WorldCom and COBRA, *see In re WorldCom, Inc.* (*WorldCom I*), 371 B.R. 19, 23-24 (Bankr. S.D.N.Y. 2007).

the same network on which traditional telephone calls travel. The signal then passed through a switch at the local telephone company's central office that routed the signal over the telephone company's COBRA-specific high-capacity telephone lines, known as "primary rate interface" or "PRI" lines. The PRI lines carried the signal to a network access server, which converted the phone signal to an Internet-appropriate format (TCP/IP) using digital signal process ("DSP") cards. The network access server sent this TCP/IP data signal to a router through another PRI line contained within the network access server, and the router then transmitted the signal, along with other aggregated dial-up data signals, to WorldCom's network on a high-speed data line through the egress of the network access server. The system also worked in reverse and could convert a data signal from the Internet to a phone signal that could be carried through the local telephone lines back to the user's modem. COBRA provided local telephone customers with a two-way connection to the Internet.[4]

WorldCom plugged the output Internet data stream from the local telephone company's network access server into its own network, and sold access to the stream to Internet Service Providers ("ISPs"), like AOL, which in turn sold access to the Internet to people with dial-up modems. The PRI lines and all aspects of the network access server up through the egress port where WorldCom plugged in its network were considered COBRA equipment and were used by the local telephone companies as part of providing COBRA service to WorldCom. WorldCom paid the

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[4] For diagrams depicting COBRA and its related processes, *see* App'x 536 & 538.

local telephone companies a monthly fee for access to COBRA.

The parties agree that the COBRA system was theoretically capable of transmitting an ordinary telephone call. The PRI lines that carried a modem signal to the network access server could also carry a regular voice communication signal. Instead of connecting to the network access server, those PRI lines could have plugged into a "PBX," which is a switch that allows for voice communication over PRI lines. The COBRA-specific PRI lines, however, did not include a PBX switch. As purchased by WorldCom, COBRA was not set up for voice communication.

WorldCom also could not reconfigure the PRI lines, which, along with the other COBRA equipment, were controlled by the local telephone companies. It could access COBRA only remotely to disable a modem if it was malfunctioning or make limited software changes. Accordingly, within the system provided by the COBRA service, once the network access server converted a telephone signal from a modem into Internet-friendly TCP/IP packets (the high-speed data stream), it was no longer possible to transmit a traditional voice communication. A WorldCom employee's husband could not use COBRA to call his wife's office and ask her whether she wanted to get lunch.[5]

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[5] Before the bankruptcy court, the IRS argued that COBRA could transmit "voice over Internet protocol," or "VoIP." The bankruptcy court, however, concluded that the COBRA contract did not permit VoIP that would require the telephone company to convert the telephone signal into an Internet signal, that the COBRA service as configured could not carry VoIP signals, and that, with respect to computer-to-computer VoIP (*e.g.*, Skype), the technology then in use was too slow to transmit VoIP.

II. Procedural History

WorldCom filed its Chapter 11 bankruptcy petition on July 21, 2002, and the bankruptcy court confirmed the reorganization plan on October 31, 2003. *In re WorldCom, Inc. (WorldCom I)*, 371 B.R. 19, 24-25 (Bankr. S.D.N.Y. 2007). After the court confirmed the plan, the IRS filed a proof of claim requesting that the Debtors pay $16,276,440.81 in excise taxes on WorldCom's purchase of COBRA services. *WorldCom I*, 371 B.R. at 25. The Debtors objected to the IRS's claim and additionally moved for a refund of the $38,297,513 in excise taxes WorldCom had already paid on COBRA.

The bankruptcy court (Gonzalez, *J.*) held an evidentiary hearing on February 1, 2006. By opinion dated June 1, 2007, the bankruptcy court ruled in favor of the Debtors, granting both the refund motion and their objection to the IRS's proof of claim. *WorldCom I*, 371 B.R. at 32. The IRS appealed *WorldCom I* to the district court. On August 7, 2009, the district court (Jones, *J.*) concluded that the bankruptcy court erred in ruling that section 4252(a) required WorldCom to have the privilege to both initiate and receive telephonic quality communication. *In re WorldCom, Inc. (WorldCom II)*, No. 07 Civ. 7417, 2009 WL 2432370, at *3-4 (S.D.N.Y. Aug. 7, 2009) (holding that as long as two-way communication occurred, it was irrelevant which party initiated the call) (citing *USA Choice Internet Servs., LLC v. United States (USA Choice II)*, 522 F.3d 1332, 1338-39 (Fed. Cir. 2008)). Accordingly, the district court reversed and remanded to the bankruptcy court for

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Accordingly, the bankruptcy court concluded that COBRA could not transmit telephonic quality communication through VoIP. The IRS does not challenge this factual finding on appeal.

further factual findings on whether COBRA was a "local telephone service."

On remand, the parties submitted additional proposed findings of fact and conclusions of law, and on June 15, 2011, the bankruptcy court again ruled in favor of the Debtors. *In re WorldCom, Inc. (WorldCom III)*, 449 B.R. 655 (Bankr. S.D.N.Y. 2011). The bankruptcy court concluded that the only service WorldCom had purchased was the ability to plug into the high-speed Internet data stream provided by the local telephone companies, *i.e.*, the egress from the network access server. Because that data stream could not support "telephonic quality communication," which, in the bankruptcy court's interpretation, meant regular phone calls, and because WorldCom could not reconfigure COBRA to provide it with telephonic quality communication, the bankruptcy court concluded that WorldCom had not purchased a "local telephone service" as defined by the statute. The court distinguished WorldCom's purchase of COBRA services from other cases finding that similar Internet services were taxable. *See USA Choice II*, 522 F.3d at 1341; *Comcation, Inc. v. United States*, 78 Fed.Cl. 61, 65 (2007). In those cases, the taxpayer purchased a service that provided it with the raw telephone signals, which the company itself converted to an Internet signal. According to the bankruptcy court, because the companies in those cases had access to the telephone lines, they were provided with signals capable of "telephonic quality communication."

The IRS again appealed to the district court. On December 22, 2011, the district court (Forrest, *J.*) affirmed the judgment of the bankruptcy court. *In re WorldCom, Inc. (WorldCom IV)*, No. 11 Civ. 5463,

2011 WL 6434007 (S.D.N.Y. Dec. 22, 2011). The district court emphasized that WorldCom itself did not connect dial-up users to the Internet and characterized COBRA as simply an "intermediate" step in the Internet-connection process. *Id.* at *5-7. According to the court, this was another reason to distinguish COBRA from the services at issue in *Comcation* and *USA Choice II*, where the ISP plaintiffs connected subscribers to the Internet directly. The district court then evaluated whether this "intermediate" step "c[ould] constitute a stand alone 'local telephone service'" for purposes of section 4252(a). *Id.* at *5. After retracing the process of how the COBRA service operated in practice, the district court concluded that the "nanosecond" of time that the modem signal spent traversing the PRI lines before being converted into an Internet data stream by the network access server was "[s]urely not" "what Congress meant to tax as a 'local telephone service.'" *Id.* at *7.

The district court further concluded that COBRA did not provide the ability to communicate with "substantially all persons" who are part of "such [asserted] telephone system" as required by statute. *Id.* at *7 (brackets in original). The court determined that COBRA was distinct from the local telephone system, and because it "[wa]s a self-contained service" within the telephone company's facility, there was no way for any "person" to access the telephonic quality communication that the COBRA PRI lines could theoretically support. *Id.* Even though COBRA interfaced with the normal local telephone network—which the court delineated as a separate "service"—people who used their modems to connect to the Internet through COBRA could not communicate with the COBRA system, nor could WorldCom communicate with

them. The court entered judgment in favor of the Debtors on December 28, 2011. This appeal followed.

DISCUSSION

Because neither party disputes the bankruptcy court's factual findings or the district court's adoption of those findings, we address only the legal conclusions of the district court. Our review of those conclusions is *de novo*. *In re CBI Holding Co.*, 529 F.3d 432, 449 (2d Cir. 2008). Federal tax assessments are presumed to be correct and constitute prima facie evidence of liability. *See Welch v. Helvering*, 290 U.S. 111, 115, 54 S.Ct. 8, 78 L.Ed. 212 (1933); *United States v. McCombs*, 30 F.3d 310, 318 (2d Cir. 1994). The taxpayer bears the burden to prove that the assessment was incorrect. *McCombs*, 30 F.3d at 318. This burden applies within bankruptcy proceedings. *Raleigh v. Ill. Dep't of Revenue*, 530 U.S. 15, 26, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000).

I. Local Telephone Service

Federal law imposes a three-percent excise tax on amounts paid for three kinds of "communications services": "local telephone service"; "toll telephone service"; and "teletypewriter exchange service." 26 U.S.C. § 4251. The IRS contends that COBRA is a local telephone service, which the statute defines 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 a service described in paragraph (1).

Id. § 4252(a).

Whether COBRA constitutes a "local telephone service" is a question of statutory interpretation. In interpreting any statute, we start with its text, *Auburn Hous. Auth. v. Martinez*, 277 F.3d 138, 143 (2d Cir. 2002), giving the language its ordinary meaning, *Taniguchi v. Kan Pac. Saipan, Ltd.*, — U.S. —, 132 S.Ct. 1997, 2002, 182 L.Ed.2d 903 (2012). Section 4252(a)(1) sets forth two requirements for a local telephone service, both of which must be satisfied: (a) "access to a local telephone system"; and (b) "the privilege of telephonic quality communication" with "substantially all" of the people who are part of that system. We address each element in turn.

A. Access to a local telephone system

We begin with the element of "access to a local telephone system." Although we have not previously addressed the proper interpretation of section 4252(a), the Federal Circuit has confronted its scope. After reviewing ordinary definitions of "access," the Federal Circuit found that "general dictionary definitions of 'access' provide little insight" into what is covered by the tax. *USA Choice II*, 522 F.3d at 1337. But the court noted it had previously interpreted "access" in the context of access to a teletypewriter exchange system under section 4252(c) of the statute, where it held that "the 'technological meaning of the word access . . . in the communications field in general . . . mean[s] the interface or connection between . . . the central exchange and the [customer terminal].'" *Id.* (quoting *Trans-Lux Corp. v. United States*, 696 F.2d 963, 965 (Fed. Cir. 1982)) (alterations and brackets in *Trans-Lux*). Based on this interpretation of the closely related teletypewriter exchange service definition, the Federal Circuit concluded that "'access' simply means connectivity." *Id.*

The Federal Circuit's definition of access was adopted by the district court in this case, *see WorldCom II*, 2009 WL 2432370, at *3, and is undisputed by the parties. We agree. "Access to a local telephone system" simply means a service that provides a connection to a local telephone system.

We must still determine, however, what level of connectivity is sufficient to provide "access." Several of our sister circuits have noted that because section 4252(a) speaks of "access to a local telephone system," Congress intended that the service provide a direct connection to a specific local system. *See*, *e.g.*, *OfficeMax, Inc. v. United States*, 428 F.3d 583, 599-600 (6th Cir. 2005). We agree that "access" in the context of the purchase of a local telephone service is limited to direct connectivity to a specific local telephone system. Interpreting "access" to cover indirect connections would mean, for example, that a toll or long-distance telephone service, which provides indirect access to every local telephone system, would also be considered a local telephone service. This would collapse the separate definitions of "local telephone service" and "toll telephone service" under the statute. *See id.* (noting that contrary interpretation would "blur[] the line between" sections 4252(a) and 4252(b)); *accord Reese Bros., Inc. v. United States*, 447 F.3d 229, 240-41 (3d Cir. 2006); *Am. Bankers Ins. Grp. v. United States*, 408 F.3d 1328, 1338 (11th Cir. 2005) (noting that a contrary interpretation would make "the entire United States . . . part of one 'local telephone system'" (other internal quotation marks omitted)); *Am. Online, Inc. v. United States*, 64 Fed. Cl. 571, 582 (2005). Similarly, the *USA Choice II* court suggested that a service like Vonage, whose Voice over Internet Protocol ("VoIP") technology

"uses the internet to transmit telephone signals, rather than using the traditional public switched telephone network," does not provide direct "access" to a local telephone system. *USA Choice II*, 522 F.3d at 1343 (citing *Verizon Servs. Corp. v. Vonage Holdings Corp.*, 503 F.3d 1295, 1298 (Fed. Cir. 2007)).

With this understanding of "access" in mind, we conclude that COBRA provided WorldCom with access to a local telephone system. The connection between a dial-up user and WorldCom through COBRA began with a local telephone customer's ordinary PSTN line. When the subscriber dialed the COBRA number, the telephone company routed the signal from the subscriber's modem and PSTN line to COBRA's PRI lines, which connected to WorldCom's network through the telephone company's network access server. Thus, COBRA provided direct "connectivity" to a local telephone system. Moreover, the record demonstrates that COBRA was a service provided by *individual* local telephone companies. WorldCom contracted separately with each local telephone company, like BellSouth, to gain access to that company's local telephone system. COBRA did not transform the "entire United States [into] . . . one 'local telephone system.'" *Am. Bankers Ins. Grp.*, 408 F.3d at 1338. The access element is satisfied.

B. The privilege of telephonic quality communication

With access defined, we turn to the second—and more hotly contested—element of local telephone service: whether COBRA provided WorldCom with "the privilege of telephonic quality communication with substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system." 26 U.S.C. § 4252(a)(1). The IRS contends that COBRA did so by connecting dial-

up users to WorldCom's network through modems and telephonic PRI lines, just like the similar dial-up Internet services that were found taxable by the Federal Circuit in *USA Choice II* and the Court of Federal Claims in *Comcation*. The Debtors respond that, unlike the services at issue in *USA Choice II* and *Comcation*, WorldCom had access only to the Internet data stream from the telephone company's network access server. Without the ability to use or reconfigure COBRA to talk to the dial-up users on the phone, they argue, COBRA did not provide "the privilege of telephonic quality communication."

We must therefore define "telephonic quality communication." Starting with "telephonic," dictionaries contemporaneous to the enactment of the last substantive revision to the relevant statutory provision define "telephonic" as "[o]f, pertaining to, of the nature of, or conveyed by a telephone." 2 The Compact Edition of the Oxford English Dictionary 3252 (1971); *accord* Webster's New Collegiate Dictionary 873 (1961) (adjective form of "telephone," defined as, *inter alia*, "[t]o send or communicate by telephone"); *see also Taniguchi*, 132 S.Ct. at 2002-03 & n. 2 (interpreting "ordinary meaning" of statutory term with reference to contemporaneous dictionaries).

Next, because section 4252 uses the term "telephonic *quality* communication," 26 U.S.C. § 4252(a)(1) (emphasis added), we must determine how "quality" modifies "telephonic." Like the statute's use of the word "access," general dictionary definitions of "quality" shed little light on Congress's intent. *See USA Choice II*, 522 F.3d at 1337. Quality can mean: an attribute, property, special feature, or characteristic; nature, kind, or character; the degree or grade of excellence; or a particular class, kind, or grade of

anything, as determined by its quality. 2 The Compact Edition of the Oxford English Dictionary 2383; Webster's New Collegiate Dictionary 691. The meaning of the word depends on context and connotation.

However, "[a] provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because the same terminology is used elsewhere in a context that makes its meaning clear." *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988). Here, comparing the definition of "local telephone service" to the related provision of section 4252 defining "toll [long-distance] telephone service" shows that we must give meaning to the word "quality" independent of "telephonic." Section 4252(b) sets forth two alternative definitions of toll telephone service, one that uses the term "telephonic quality communication," and another that refers to a service that provides the customer with the "privilege of an unlimited number of telephonic communications," unmodified by the word quality. *Compare* 26 U.S.C. § 4252(b)(1) (defining toll telephone service as, in relevant part, "a telephonic *quality* communication" (emphasis added)), *with id.* § 4252(b)(2) (alternatively defining toll telephone service as "service which entitles the subscriber . . . to the privilege of an unlimited number of *telephonic communications*" (emphasis added)).[6] Because Congress has distinguished between a service that pro-

[6] Congress enacted these two definitions of toll telephone service in 1965 to reflect the two ways that AT & T—the country's only long-distance telephone provider at the time—billed customers for long distance service. *OfficeMax*, 428 F.3d at 590; *see also* H.R.Rep. No. 89-433, at 30 (1965); S.Rep. No. 89-324, at 35 (1965).

vides the privilege of "telephonic communications" and "telephonic quality communication," we cannot treat "telephonic quality" as equivalent to "telephonic." *See Duncan v. Walker*, 533 U.S. 167, 174, 121 S.Ct. 2120, 150 L.Ed.2d 251 (2001) ("We are . . . reluctant to treat statutory terms as surplusage in any setting." (internal quotation marks and brackets omitted)).

If we define "quality" in the context of "telephonic quality communication" as meaning an "attribute, property, or characteristic," we would make "quality" redundant with "telephonic." Saying that a communication that has the "property" or "characteristic" of being telephonic is no different from simply calling a communication telephonic. *See also* 2 The Compact Edition of the Oxford English Dictionary 3252 (defining "telephonic" in part with "of the nature of"). On the other hand, applying the alternate dictionary definitions of "quality" as meaning "the degree or grade of excellence" or "a particular class, kind or grade of anything, as determined by its quality," gives meaning to "quality" by broadening the scope of telephonic communications to those communications in the same "class, kind or grade" as a communication by telephone.

We therefore conclude that quality, as used in this statute, refers to the technological capacity of the channel to transmit voice signals, regardless of whether or not the channel is used for voice communication. If the "grade" of the communication is one that is of the same level as a telephonic communication, then the communication is telephonic quality. In other words, a telephonic quality communication is a communication that is carried over a communi-

cation channel that could also carry an ordinary telephone call.[7]

Our interpretation not only gives substance to the word "quality," but is also supported by another provision of section 4252. "The meaning of a particular section in a statute can be understood in context with and by reference to the whole statutory scheme, by appreciating how sections relate to one another. In other words, the preferred meaning of a statutory provision is one that is consonant with the rest of the statute." *Auburn*, 277 F.3d at 144 (citing *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997)). In addition to taxing local and toll telephone services, the tax code also imposes the communications excise tax on "teletypewriter exchange service." 26 U.S.C. § 4251. Teletypewriter exchange services—now, like COBRA, obsolete—did not provide voice communication; they were an early form of data exchange that connected printers to a network for the purpose of sending text-based messages. *See* 28 The New Encyclopedia Britannica 475 (15th ed. 2002); *see also* 26 U.S.C. § 4252(c) (defining as "access from a teletypewriter or other data station").

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[7] This definition also appears to be in accord with industry usage of the term "telephonic quality." *See Taniguchi*, 132 S.Ct. at 2005 (relying on "technical" definition as supporting "ordinary" statutory interpretation). In *USA Choice I*, the Court of Federal Claims noted that "[w]hen using the term 'telephonic quality,' the government's expert used 'what [he] believe[d] would be the industry understood definition[, that is] a communication channel over which it [i]s possible to have a two-way conversation with the use of telephones.'" *USA Choice Internet Serv., LLC v. United States (USA Choice I)*, 73 Fed.Cl. 780, 783 n.7 (2006) (all but first brackets in original), *aff'd*, 522 F.3d at 1341 n.2; *accord WorldCom III*, 449 B.R. at 661 & n.9.

After defining what a "teletypewriter exchange service" is, section 4252(c) notes that "[t]he term 'teletypewriter exchange service' does not include any service which is 'local telephone service' as defined in subsection (a)." 26 U.S.C. § 4252(c). By adding this provision to the definition of teletypewriter exchange service, it is clear that Congress envisioned the possibility that a text-based teletypewriter service could also qualify as a local telephone service, even absent the provision of any voice communication. Otherwise, there would be no need to clarify that a service cannot be treated as both a "teletypewriter exchange service" and "local telephone service." To hold that "telephonic quality communication" means only voice communication would render this provision surplusage.

From this, we conclude that a data communication transmitted by a modem is a telephonic quality communication. In this case, both the government's witness and the Debtors' witness agreed that modems transmit data from a computer over telephone lines using the "the same exact [frequency] range" as the human voice, J. App'x 493; *accord id.* at 506. The Debtors' expert also agreed that a modem connection "requires a telephonic quality grade telephone line." *Id.* at 496. Indeed, both the district court and bankruptcy court found that the parties agreed that up until the modem signal reached the network access server there existed "telephonic quality communication." *WorldCom IV*, 2011 WL 6434007, at *6; *WorldCom III*, 449 B.R. at 658. Similarly, the Federal Circuit in *USA Choice II* noted that "a successful connection between one of USA Choice's server modems and another subscriber's modem required telephonic quality." *USA Choice II*, 522 F.3d at 1341. And in

Comcation, the Court of Federal Claims explained that, "once a call was established [to Comcation's network] on the PRI lines, two-way, telephonic-quality communication occurred," because information from the subscriber and the Internet "flowed back and forth over these [PRI] lines." *Comcation*, 78 Fed.Cl. at 66 (rejecting argument that ISP did not have "privilege" to "communicate with" local telephone customers because ISP could not initiate calls).

We recognize, however, that there is one authority that may be contrary to our interpretation. In a revenue ruling from 1979, the IRS was asked to evaluate whether a data processing and transmission service that used modems and local telephone lines was taxable, and whether the equipment provided to the business in connection with that service was likewise taxable. *See* Rev. Rul. 79-245, 1979-2 C.B. 380. Although the IRS found that the service could be taxed as a "local telephone service" under section 4252(a)(1), it determined that the modems and computer equipment provided to the business were not taxable as facilities provided in connection with that service under section 4252(a)(2). *Id.* The IRS concluded that because "the type of telephone signal produced by . . . modems is usable only for nonvoice data transmission to other computer station," and because "only a relatively few stations in [the local] telephone system are used in this computer service," "a modem is not a facility provided in connection with the privilege of telephonic quality communication with substantially all persons having stations in the local system." *Id.*[8]

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[8] Although we acknowledge this potential conflict, the IRS cites Revenue Ruling 79-245 in this case only to point out that the communications service there was deemed taxable. *See*

It is not clear whether the IRS reached this conclusion primarily because the service provided access to only a limited number of stations, or because "nonvoice data transmission" was not of telephonic quality. In the end, the IRS found the service taxable because the business could choose to plug a regular telephone instead of a modem into the port for the service, thereby affording it the privilege of telephonic quality communication, "even though [it] may not be exercised." *Id.*; *accord USA Choice II*, 522 F.3d at 1341-42. Although not altogether certain, the strong implication of the IRS's reasoning, however, is that computer-to-computer communications over telephone wires are not "telephonic quality communication." *See WorldCom III*, 449 B.R. at 661 (interpreting Revenue Ruling 79-245 as "equating telephonic quality communication with voice communication" (emphasis omitted)).

We do not think this revenue ruling overcomes the text of the statute. The deference owed to IRS revenue rulings is presently an unsettled area of law. *See United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 220, 121 S.Ct. 1433, 149 L.Ed.2d 401 (2001) (declining to decide whether revenue rulings are entitled to *Chevron* deference). Prior to the Supreme Court's opinion in *United States v. Mead Corp.*, 533 U.S. 218, 121 S.Ct. 2164, 150 L.Ed.2d 292

Appellant's Reply Br. 15. It does not at all discuss the portion of the revenue ruling that undercuts the position it takes here. The IRS simply assumes the definition given to telephonic quality by the Federal Circuit in *USA Choice II* is correct and urges us to adopt it. *See* Appellant's Br. 29-30. For their part, the Debtors never discuss Revenue Ruling 79-245. Nevertheless, because statutory interpretation is a "holistic endeavor," we address the potentially contrary authority here. *See United Sav. Ass'n of Tex.*, 484 U.S. at 371, 108 S.Ct. 626.

(2001), we afforded "great deference" to IRS revenue rulings, and explained that they are "presumed to have the force of legal precedent unless unreasonable or inconsistent with the provisions of the Internal Revenue Code." *Weisbart v. U.S. Dep't of Treasury*, 222 F.3d 93, 98 (2d Cir. 2000) (internal quotation marks omitted). We have recognized, however, that this standard was potentially undermined by the Supreme Court's holding in *Mead* that administrative rulings are not entitled to deference unless they carry the "force of law." *See Reimels v. Comm'r*, 436 F.3d 344, 347 n.2 (2d Cir. 2006); *see also Fortis, Inc. v. United States*, 420 F. Supp. 2d 166, 178-79 (S.D.N.Y. 2004). We now hold, consistent with every other circuit to have addressed the issue since *Mead*, that revenue rulings are not entitled to *Chevron* deference. *See*, *e.g.*, *Kornman & Assocs., Inc. v. United States*, 527 F.3d 443, 454 & n.9 (5th Cir. 2008); *Aeroquip-Vickers, Inc. v. Comm'r*, 347 F.3d 173, 181 (6th Cir. 2003); *Omohundro v. United States*, 300 F.3d 1065, 1067-68 (9th Cir. 2002); *Del Commercial Props., Inc. v. Comm'r*, 251 F.3d 210, 214 (D.C. Cir. 2001).

"[A]dministrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority." *Mead*, 533 U.S. at 226-27, 121 S.Ct. 2164. But, "[u]nlike treasury regulations, the IRS does not invoke its authority to make rules with the force of law when promulgating revenue rulings." *Kornman*, 527 F.3d at 454 (citing 26 C.F.R. § 601.601(d)(2)(v)(d)). Even though a revenue ruling

is the "official IRS position on application of tax law to specific facts," *Weisbart*, 222 F.3d at 98 (internal quotation marks omitted), the Supreme Court has made clear that official agency interpretations lacking the force of law are not entitled to *Chevron* deference. *See Mead*, 533 U.S. at 233-34, 121 S.Ct. 2164 (holding tariff rulings are not entitled to *Chevron* deference); *Christensen v. Harris Cnty.*, 529 U.S. 576, 587, 120 S.Ct. 1655, 146 L.Ed.2d 621 (2000) (holding agency opinion letters are not entitled to *Chevron* deference). As we previously implied in *Reimels*, *Weisbart* has been abrogated by *Mead*.

Although not entitled to *Chevron* deference, particular revenue rulings may be given deference to the extent that they are persuasive—in other words, we will afford them *Skidmore* deference. *See Mead*, 533 U.S. at 234-35, 121 S.Ct. 2164 (citing *Skidmore v. Swift & Co.*, 323 U.S. 134, 139-40, 65 S.Ct. 161, 89 L.Ed. 124 (1944)); *accord WorldCom I*, 371 B.R. at 30-32 (rejecting *Chevron* deference and evaluating whether revenue rulings are entitled to deference under *Skidmore*). "The weight [accorded to an administrative] judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Mead*, 533 U.S. at 228, 121 S.Ct. 2164 (quoting *Skidmore*, 323 U.S. at 140, 65 S.Ct. 161). As relevant here, we do not defer to Revenue Ruling 79-245 under *Skidmore* because we do not find it persuasive.

The IRS's one-page legal analysis makes no effort to interpret the word "quality." Nor does it attempt to square "telephonic quality communication" in the

local telephone service definition with either "telephonic communications" in the toll telephone service definition or the teletypewriter definition's exclusivity rule. The ruling "contains no analysis of text or legislative history or any other relevant interpretive guidance." *Fed. Nat'l Mortg. Ass'n v. United States*, 379 F.3d 1303, 1308 (Fed. Cir. 2004). Similarly, the ruling "neither elucidates nor invokes support for its conclusion" that modems do not qualify as conveying telephonic quality communication. *Id.* By contrast, other courts that have squarely addressed the issue of whether dial-up Internet services similar to COBRA are taxable have concluded that modems do engage in telephonic quality communication by communicating over telephone lines. *See USA Choice II*, 522 F.3d at 1334, 1341; *Comcation*, 78 Fed.Cl. at 64. We therefore give Revenue Ruling 79-245 no weight, in accord with our sister circuits that have declined to defer to similarly cursory revenue rulings. *See Fed. Nat'l Mortg. Ass'n*, 379 F.3d at 1308-09; *O'Shaughnessy v. Comm'r*, 332 F.3d 1125, 1130-31 (8th Cir. 2003).[9]

To be of telephonic quality a communication must use "a communication channel over which it is possi-

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[9] We likewise reject any potential argument that we should defer to Revenue Ruling 79–245 pursuant to the "legislative re-enactment doctrine," which presumes that Congress is "aware of an administrative or judicial interpretation of a statute and . . . adopt[s] that interpretation when it re-enacts a statute without change." *Lorillard v. Pons*, 434 U.S. 575, 580, 98 S.Ct. 866, 55 L.Ed.2d 40 (1978) (citations omitted). There is no evidence that this particular revenue ruling has been "fully brought to the attention of the public and the Congress," in a way that justifies invoking the doctrine. *Am. Bankers Ins. Grp.*, 408 F.3d at 1335-36 (holding doctrine not applicable to revenue ruling on long-distance phone calls in interpreting communications excise tax).

ble to have a two-way conversation with the use of telephones," *USA Choice II*, 522 F.3d at 1341 n.2 (alteration omitted). The local telephone and PRI lines used by modems are such a channel. Therefore, data communication through a modem over telephone lines is "telephonic quality communication."

Now that we have defined the "privilege of telephonic quality communication," we must decide if COBRA provides it. The IRS argues that by routing a dial-up user's modem signal over PRI lines that were capable of carrying a phone call, COBRA provided WorldCom with the privilege of telephonic quality communication. But the Debtors claim that because COBRA transformed that modem signal into an Internet-compatible, non-voice quality TCP/IP data stream within the network access server, and because WorldCom had access to only the data stream, COBRA did not provide the privilege of telephonic quality communication. The Debtors contend that "all [the] requirements [of section 4252(a)] . . . must extend through the *entirety* of the connection. It is not sufficient that a portion of the path contains one of these elements." Appellee's Br. 24 (emphasis added).

Despite the certainty of the Debtors' assertion, they cite no portion of the statute, nor any relevant case law, that supports such an interpretation. The plain language of section 4252(a)'s phrase "the privilege of telephonic quality communication" does not answer whether the service purchased has to provide the privilege of telephonic quality communication throughout the *entirety* of the service's system, or if it is sufficient if only a *portion* of the system provides that privilege. We have fallen into a statutory crevice. To fill it, we look beyond the plain text of the

statute. *In re Boodrow*, 126 F.3d 43, 49 (2d Cir. 1997) ("'[T]he text is only the starting point,' especially when the language is ambiguous." (quoting *Kelly v. Robinson*, 479 U.S. 36, 43, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986))).

But before we do so, we address the government's contention that we do not need to look beyond the plain text because COBRA is clearly taxable when section 4252(a) is read in conjunction with another provision of the communications excise tax statute, section 4254(a). Section 4254(a) sets out the general rule for calculating the excise tax, which is that "[i]f a bill is rendered the taxpayer for local telephone service or toll telephone service[,] . . . the amount on which the tax with respect to such services shall be based shall be the sum of all charges for such services included in the bill." 26 U.S.C. § 4254(a). Because the modem connection between the dial-up users and the network access server is of "telephonic quality" and has been previously held to be taxable by *USA Choice II* and *Comcation*, the IRS argues that COBRA simply provides the same "service" plus a network access server, and that the whole charge is therefore taxable.

We disagree for several reasons. First, we think the IRS misreads the applicability of *USA Choice II* and *Comcation*. The IRS contends that because those courts found similar services taxable, we can shoe-horn COBRA into that finding as providing a little "more." But this mistakes the holdings of *USA Choice II* and *Comcation* for agreement with the IRS's reasoning. Those courts did not address the issue of whether the "service" changes when the customer does not have access to the PRI lines. *See USA Choice II*, 522 F.3d at 1341 ("USA Choice's decision

to connect these lines to modems in its network servers rather than to telephones through equipment such as a multiplexor or PBX[—]though perfectly understandable for a commercial ISP—resulted in self-imposed limits that did not fundamentally alter the nature of the services that USA Choice had the privilege to use." (internal quotation marks, citation, and brackets omitted)). Looking, as we must, at the text, it would be entirely circular to use section 4254(a)'s explanation of how to calculate the tax assessed on a local telephone service to define what a local telephone service is. The IRS's argument works only if we already assume that the section of COBRA that uses PRI lines is a taxable "local telephone service," and therefore fails.

Although the plain text of the statute does not answer whether a service must provide "telephonic quality communication" throughout the entirety of the system in order to be taxable, "Congress passes legislation with specific purposes in mind. When the ordinary tools of statutory construction permit us to do so, we must attempt to discover those purposes. . . ." *N.Y.C. Health & Hosps. Corp. v. Perales*, 954 F.2d 854, 862 (2d Cir. 1992). Keeping in mind that "[s]tatutory construction . . . is a holistic endeavor," *United Sav. Ass'n of Tex.*, 484 U.S. at 371, 108 S.Ct. 626, we may "look at legislative history to determine the intent of Congress," *Auburn*, 277 F.3d at 143-44.

The history of the communications excise tax is long and turbulent. Congress first imposed a tax on the purchase of communications services shortly after the Spanish-American War, twenty years after the invention of the telephone. *See OfficeMax*, 428 F.3d at 585-86 (tracing legislative iterations of the tax). Although initially designed as a temporary tax

passed to finance the deficit caused by the War, Congress repeatedly reenacted and extended the tax, adjusting the scope of its coverage and changing the rates applicable to various services, before making the tax permanent at its current rate of three percent in 1990 for all services covered. *Id.* (noting that attempt to repeal the tax in 2000 was vetoed by President Clinton).

The most recent substantive change to the definitions of taxable services occurred in 1965, when Congress enacted the Excise Tax Reduction Act of 1965, Pub. L. No. 89-44 § 302, 79 Stat. 136, 145. *See Am. Online*, 64 Fed.Cl. at 578. As is most relevant here, the 1965 Act enacted the current definitions of local telephone service, toll telephone service, and teletypewriter exchange service. *See Trans-Lux Corp.*, 696 F.2d at 967. The definitions were "likely . . . updated and modified in order to reflect and to meet the changing technology and market conditions of the industry . . . [,] in order 'to make it clear that it is the service as such which is being taxed and not merely the equipment being supplied.'" *Id.* (quoting H.R.Rep. No. 89-433, at 30 (1965); S.Rep. No. 89-324, at 35 (1965)).[10] This history suggests that Congress intended to tax any communication service as a "local telephone service" so long as it connected a customer

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[10] The prior version of the statute, enacted in 1958, defined "general telephone service" as "any telephone or radio telephone service furnished in connection with any fixed or mobile telephone or radio telephone station which may be connected (directly or indirectly) to an exchange operated by a person engaged in the business of furnishing communication service." Excise Tax Technical Changes Act of 1958, Pub. L. No. 85-859 § 133, 72 Stat. 1275, 1290. The 1965 amendments broadened this definition to "telephonic quality communication," unmooring the statute from any particular equipment configuration.

to a local telephone system and allowed that customer to use the telephone lines to communicate with the subscribers to that system, regardless of whether the service also used non-telephonic equipment to accomplish that communication.

Although the bankruptcy and district courts acknowledged this congressional purpose, they misapplied it when evaluating the service that COBRA provided. By focusing solely on the part of the COBRA system that WorldCom connected to and had control over—the data stream that came out of the egress to the network access server—the bankruptcy and district courts did not apprehend the scope of the service the local telephone companies sold to WorldCom. The COBRA service was not just a "data stream," sitting on a shelf to be picked up by any telecom shopper looking for Internet access. Such a conclusion gives too much emphasis to the equipment used by the local telephone companies—the network access server—and ignores the system as a whole.

What COBRA provided, as made clear by the bankruptcy court's factual findings, was a communication *pathway* between local telephone customers and WorldCom's network. COBRA allowed WorldCom to connect dial-up modem users to the Internet through those users' regular telephone lines. And in order to connect them to the Internet, the part of that pathway that used modems required telephonic quality communication.

That WorldCom connected its equipment to the COBRA system only after the local telephone company converted the modem signals to a high-speed data stream does not change the fact that the service relied on modem signals being carried over PRI lines

that afforded telephonic quality communication. Without PRI lines there would be no COBRA service and nothing for WorldCom to resell to the ISPs. As other courts have noted, the statutory definition of local telephone service shows that Congress intended to tax those users who rely on the traditional telephone system for whatever reason. *See USA Choice II*, 522 F.3d at 1341 (noting the tax applies to customers who use their phone lines, regardless of whether to make phone calls or to plug in a fax machine). Accordingly, because COBRA relied on telephonic quality PRI lines to allow WorldCom's network to communicate with dial-up subscribers, COBRA provided WorldCom with the "privilege of telephonic quality communication."

The Debtors, relying on the same legislative history from 1965 that emphasizes the "shift [of] the focus of the tax to the services rather than the equipment being provided." *USA Choice II*, 522 F.3d at 1339; *see* H.R.Rep. No. 89-433, at 30, argue that the PRI lines were merely part of the local telephone company's COBRA equipment and not part of the actual service provided to WorldCom. We disagree. First, the bankruptcy court found that one of the "COBRA system['s] . . . three basic components" was routing "dial-up connections . . . from [the telephone company's central office] switches to the COBRA system through ingress Primary Rate Interface ('PRI') lines." *WorldCom I*, 371 B.R. at 24. Indeed, on remand from the district court, the Debtors' proposed findings of fact stated that the PRI lines were "used by the [telephone companies] as part of their provision of COBRA service." J. App'x 1391-92; *see also WorldCom III*, 449 B.R. at 662 (referring to PRI lines as "part of the COBRA service"). Second, the Debtors'

expert witness and employee, John Anderson, testified that the PRI lines were a component of the COBRA service purchased by WorldCom. Third, WorldCom's contracts with local telephone companies listed the PRI lines as part of the COBRA service.

To give a more intuitive example (though perhaps dated for some), consider a fax machine. Fax machines transmit data signals over ordinary telephone lines. When a person pushes "start" on a fax machine, the machine scans the piece of paper, converts the image into a signal, and transmits it over a telephone line to the number dialed. The fax machine on the other end of the call receives the signal, converts the signal back into the image originally scanned, and prints a copy. Given that we have defined "telephonic quality" as meaning any communication that relies on a telephonic-grade connection, a fax connection is of telephonic quality. But the connection over the telephone lines is not the only thing the fax machine relies on to communicate. To finish the communication, the fax machine converts the signal into a printed image. The piece of paper printed is certainly not of "telephonic quality."

Accepting the Debtors' argument that the connection must remain of telephonic quality through the entirety of the connection, a service that connects fax machines over the local telephone system would not be taxable. We would have to conclude that only the printer/scanner part of the fax machine that the customer uses is the "service," and that the telephone lines used by the machines are merely "equipment." But if that is the case, what, other than an ordinary telephone call, could be taxable as a telephonic quality communication? Such an interpretation would

bring us back to treating "telephonic quality communication" in sections 4252(a)(1) and (b)(1) as equivalent to "telephonic communications" in subsection (b)(2). We do not think that Congress intended the taxability of a "local telephone service" to turn on whether a service that allows a customer to communicate using a telephonic quality connection adds additional services or equipment beyond that connection.

Moreover, to hold that COBRA did not provide the privilege of telephonic quality communication would create a strange result where telecommunication companies that used their own network access servers to convert a phone signal to a data stream, like USA Choice and Comcation, would have to pay the tax, but companies that relied on the local telephone company to convert the signals for them, like WorldCom, would not. This appears at odds with the statute's intent for two reasons. First, whether a service is taxable would hinge on what equipment the local telephone company provided, not the nature of the service. *See* S.Rep. No. 89-324, at 35; H.R.Rep. No. 89-433, at 30.

Second, when Congress enacted the 1965 Act it added the "private communications service" exemption to the tax to avoid such a discrepancy in another context. *See* 26 U.S.C. § 4252(d). As the Federal Circuit explained:

> Congress enacted the private communication services exemption in order to correct the competitive imbalance that had developed between telephone company-furnished services and subscriber-owned equipment. Under the 1958 Excise Tax Technical Changes Act, a subscriber to the telephone company's Centrex or PBX

> systems (communication systems that allowed both intrapremise and interpremise communication) was subjected to the federal excise tax on his entire payment to the telephone company for service and equipment. But if the subscriber purchased its intercom equipment outright from a communications equipment manufacturer, the equipment was free of the federal excise tax. Because the telephone companies were losing business to companies that provided telephone and microwave equipment that could be purchased and operated by the users themselves, Congress created an exemption to the excise tax on local telephone service.

Trans-Lux Corp., 696 F.2d at 967 (citations omitted); *accord W. Elec. Co. v. United States*, 215 Ct.Cl. 100, 564 F.2d 53, 57 (1977) (en banc); H.R.Rep. No. 89-433, at 30-31 (noting inequity of taxing intercom services where telephone company owned equipment but not taxing substantially identical service where subscriber owned equipment). The Debtors' argument would create a similar inequity here, despite the identical purpose and function of the systems, regardless of ownership.

The Debtors also urge us to rely on the canon of statutory interpretation that any doubt as to taxability should be resolved in favor of the taxpayer. That canon's validity has been called into question by both the Supreme Court and this Court. *White v. United States*, 305 U.S. 281, 292, 59 S.Ct. 179, 83 L.Ed. 172 (1938) ("We are not impressed by the argument that, as the question here decided is doubtful, all doubts should be resolved in favor of the taxpayer."); *Wolder v. Comm'r*, 493 F.2d 608, 611 n.4 (2d Cir. 1974). Because the other traditional tools of statutory inter-

pretation lead us to conclude that COBRA is taxable, we decline to rely on the canon here. *See Chickasaw Nation v. United States*, 534 U.S. 84, 94, 122 S.Ct. 528, 151 L.Ed.2d 474 (2001) ("[C]anons are not mandatory rules. They are guides that need not be conclusive." (internal quotation marks omitted)).

It is somewhat odd to fit Internet technology into a statutory definition that has not been updated since the Mad Men era. Although Congress frequently revised the communications excise tax in the first half of the twentieth century to account for changing technology, the 1965 Act was intended to be the last iteration of the tax before it was phased out entirely by 1969. *See Am. Bankers Ins. Grp.*, 408 F.3d at 1333. In light of this history, courts have refused to rewrite the definition of "toll telephone service" to account for changes in how telephone companies charge for long distance service. *See*, *e.g.*, *id.* ("[I]f the statutory language no longer fits the infrastructure of the industry, the IRS needs to ask for congressional action to bring the statute in line with today's reality. It cannot create an ambiguity that does not exist or misinterpret the plain meaning of statutory language to bend an old law toward a new direction." (quoting *Am. Online*, 64 Fed.Cl. at 578)).

But although congressional clarity would make our inquiry easier, we cannot simply say the statute is "too old" and decline to apply it to this newer technology. The reasoning in *American Bankers* does not foreclose us from using the purpose of the statute to resolve an ambiguity; it simply cautions us not create one where the language is clear. Unlike the toll telephone service cases, there is an ambiguity in the definition of "local telephone service" that we must address. And in interpreting Congress's

purpose at the time the statute was passed, we find that the "privilege of telephonic quality communication" element of local telephone service covers any service that makes use of the traditional telephone network for communication, regardless of the form of the communication or whether the service also uses non-telephonic technology to accomplish that communication. COBRA provided this privilege.

C. Communication with substantially all persons constituting a part of such local telephone system

The district court also found in the alternative that because COBRA was merely an "intermediate" step in connecting to the Internet, WorldCom could not use COBRA to communicate with "substantially all persons" in the local telephone system. *See* 26 U.S.C. § 4252(a)(1) (requiring "the privilege of telephonic quality communication with substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system"). The COBRA system, in the district court's view, was its own cocooned network, set off from the local telephone system that the dial-up subscribers used. *See WorldCom IV*, 2011 WL 6434007, at *7 (holding the only communication within COBRA was "with and between the equipment within the [telephone company's] switch and [the network access server]"). We disagree with the district court's interpretation of this element of section 4252(a) and its application to COBRA.

The portion of the statute that requires communication with "substantially all persons" in a local telephone system is part of the "privilege" element of the definition—meaning that it focuses on the capacity of the purchaser to communicate with "substantially all persons," not whether the purchaser actually does so.

See USA Choice II, 522 F.3d at 1341-42 (holding ISP's decision to impose a password requirement for connecting to its servers did not deprive it of the privilege to communicate with "substantially all persons" in the local telephone system). The district court reasoned that because WorldCom's network was only an intermediate step to the Internet that connected dial-up users to ISPs, WorldCom could not "communicate" with the dial-up users "as an intermediary sitting between any relationship of the end users and the [local telephone companies] and ISPs." *WorldCom IV*, 2011 WL 6434007, at *7. The district court relied on the fact that in *USA Choice II*, "the suit was between the ISP and the I.R.S. The ISP was not playing simply an intermediary role as the Debtors are here." *Id.* at *5 n.3. According to the district court, WorldCom's intermediary role is "a critical distinguishing factor between the COBRA service and the services at issue in [*USA Choice II* and *Comcation*]." *Id.* at *5.

But this ignores that WorldCom *chose* to resell the COBRA data stream to the ISPs. *See WorldCom I*, 371 B.R. at 23-24 & n.1 (describing various WorldCom Internet networks, and explaining that WorldCom used COBRA to resell access to smaller regional ISPs). The Debtors cite nothing that prevented WorldCom from acting as an ISP. The district court's reasoning falls apart for substantially the same reasons as did the arguments in *USA Choice II* and *Comcation*: it "ignore[s] evidence that these . . . restrictions relate solely to . . . self-imposed limitations." *USA Choice II*, 522 F.3d at 1341; *accord Comcation*, 78 Fed.Cl. at 65.

The district court also characterized COBRA as a self-contained service, and concluded that "[t]here is

no way for 'substantially all persons' within this service to access whatever telephonic quality communication the [COBRA] PRI lines support." *WorldCom IV*, 2011 WL 6434007, at *7. But this reasoning conflates the term "local telephone *service*" under section 4252(a) with the elements of section 4252(a), specifically "access" to a "local telephone *system*" and communication with "substantially all persons" in that "local telephone *system*." COBRA provided "the privilege of telephonic quality communication with substantially all persons" in the local telephone system because all of the local telephone company's customers could call the COBRA number and could communicate with WorldCom's network through the use of a modem. Because COBRA connected WorldCom to the local telephone system, it provided WorldCom with "access" to that system. And because it allowed any dial-up user within that system to call the COBRA number and communicate with WorldCom's network, it also provided the privilege of telephonic quality communication with "substantially all persons" within that local telephone system. This is all the statute requires; the "local telephone service" and the "local telephone system" do not have to be one and the same.

II. Private Communications Service

Finally, although not addressed by either the bankruptcy or district courts, the Debtors argue that we can affirm the judgment on the alternative ground that COBRA was exempt from taxation as a "private communication service" pursuant to 26 U.S.C. § 4252(d)(1). *See ACEquip Ltd. v. Am. Eng'g Corp.*, 315 F.3d 151, 155 (2d Cir. 2003) (noting that we may affirm on any ground appearing in the

record). A private communication service is defined in relevant part as:

> (1) the communication service furnished to a subscriber which entitles the subscriber—
>
> (A) to exclusive or priority use of any communication channel or groups of channels, . . . regardless of whether such channel, groups of channels, or intercommunication system may be connected through switching with a [local telephone service],
>
> . . . except that such term does not include any communication service unless a separate charge is made for such service.

26 U.S.C. § 4252(d). The Debtors contend that WorldCom had exclusive use of the data stream leading from the network access server to WorldCom's network. WorldCom paid separately for COBRA service; this payment was not comingled with any other service. Therefore, according to the Debtors, WorldCom purchased a private communication service akin to an exclusive intercom system, which the Court of Claims has held to be non-taxable. *See W. Elec. Co.*, 564 F.2d at 66.

This argument is meritless. First, we do not think that COBRA constitutes a distinct "communications service" that is separate from the local telephone system. *See USA Choice II*, 522 F.3d at 1344 (holding exception "requires that the system at issue provide a 'communication service' beyond that of mere local telephone service, not just connectivity to the local telephone system *itself*," and finding that PRI lines are not a service separate from the local telephone system); *accord Comcation*, 78 Fed.Cl. at 73-75; *see also* H.R.Rep. No. 89-433, at 31 ("Centrex systems—where the switching equipment is generally on the

premises of the local exchange rather than on that of the subscriber—generally do not . . . provide for a charge which is separate and distinct from that for the local telephone service."); *accord* S.Rep. No. 89-324, at 35. Second, even assuming COBRA were a separate communications service, the Debtors cannot show that WorldCom was entitled to "exclusive or priority" use of the channel. Anyone connected to the public telephone network could dial in to utilize COBRA's dedicated PRI lines (and connect to the Internet). *See USA Choice II*, 522 F.3d at 1346. *But see id.* at 1347-48 (Dyk, J., concurring in part and dissenting in part) (arguing that USA Choice did have exclusive or priority use, but agreeing that service was not a distinct "communication service"). The exception does not apply.

CONCLUSION

Accordingly, the judgment of the district court is **REVERSED**, and the case is **REMANDED** for further proceedings consistent with this Opinion.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Chapter 11
Case No. 02-13533 (AJG)

IN RE WORLDCOM, INC., ET AL.,
Reorganized Debtors.

11 Civ. 5463 (KBF)

INTERNAL REVENUE SERVICE,
Appellant,
v.

WORLDCOM, INC., ET AL.,
Appellees.

[filed December 22, 2011]

OPINION & ORDER

KATHERINE B. FORREST, District Judge.

The United States Internal Revenue Service (the "I.R.S.") appeals from an order of the Bankruptcy Court, *In re Worldcom, Inc.*, 449 B.R. 655 (Bankr. S.D.N.Y. 2011) ("*Worldcom III*"), which (i) granted Debtors'[1] objection to a proof of claim filed by the

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[1] Due to the history of name changes of the principal debtor in this bankruptcy—*i.e.*, WorldCom Inc., MCI Inc., and currently Verizon Business Global LLC—and the various subsidiary debtors whose actions are at issue in this appeal—principally, UUNet Technologies Inc. and MCI WorldCom Network Services

I.R.S. relating to unpaid telecommunications excise taxes with respect to the Debtors' purchase of Central Office Based Remote Access ("COBRA") service, and (ii) determined in Debtors' favor a refund motion for approximately $38 million in previously paid excise taxes for the same service. As the I.R.S. states, "[T]he issue behind both the debtors' objection to the I.R.S. payment request and their refund motion is the same: whether the federal communications excise tax applies to COBRA services." Brief of the Appellant ("I.R.S. Br.") at 7.

The outcome of this appeal depends entirely on whether the COBRA service as purchased by the Debtors constituted a "local telephone service" as defined in 26 U.S.C. § 4252(a). If it did, then Debtors purchased such a service, are liable for excise taxes claimed, and are not entitled to a refund of taxes previously paid. If, on the other hand, the COBRA service does not meet the statutory definition, then Debtors are entitled to the refund and owe nothing more.

The determination of whether or not the COBRA service meets the statutory definition is surprisingly complicated on what is now an agreed factual record. *See* I.R.S. Br. at 7 n.5 ("The government is not challenging findings of fact in this appeal"). The determinative issue comes down to a judicial finding as to whether, when the undisputed facts are laid against the statutory definition of "local telephone service," they meet or fall short of what Congress intended. As set forth below, they fall short. Accordingly, the judgment of the Bankruptcy Court is AFFIRMED.

Inc., *see* Brief of the Appellant ("I.R.S. Br.") at 1 n.1—the Court refers to the various debtors as the "Debtors."

BACKGROUND

This matter has been between this Court and the Bankruptcy Court for almost five years. The technology underlying this proceeding has been superceded by other ways of accessing the Internet. *See*, *e.g.*, *Worldcom III*, 449 B.R. at 658; *see also* Hr'g Tr. at 66:25-67:20 (Bankr. S.D.N.Y. Feb. 1, 2006) (Testimony of Debtors' Expert, John Anderson). The issue in this appeal does not, therefore, have prospective application to how a "local telephone service" would be defined with respect to today's most utilized technologies for Internet connection.

During the time that this matter has been between the Bankruptcy Court and this Court, there have been a number of opinions that have extensively described the technology at issue and the procedural posture of this case. *See*, *e.g.*, *In re Worldcom, Inc.*, 371 B.R. 19 (Bankr. S.D.N.Y. 2007) ("*Worldcom I*"); *In re Worldcom, Inc.*, No. 07 Civ. 7414, 2009 WL 2432370 (S.D.N.Y. Aug. 7, 2009) ("*Worldcom II*"). The Court assumes familiarity with those opinions.

In *WorldCom II*, this Court remanded the action to the Bankruptcy Court for two additional findings of fact that would assist it in determining whether the COBRA service met the statutory definition of a "local telephone service." 2009 WL 2432370, at *2. The factual questions this Court posed were: (1) whether the COBRA services purchased by the Debtors afforded "access" to a "local telephone system"; and (2) whether that system as purchased provided for "two-way" or "full-duplex" "telephonic quality communication." *Id.* at *4. In connection with those factual issues, this Court identified two factual disputes that needed to be resolved: (a) the nature and function of the Primary Rate Interface

("PRI") circuits and services in relation to COBRA (and whether these PRI's enabled "access" via a connection to a PBX line); and (b) whether the COBRA service could transmit Voice Over Internet Protocol ("VoIP") communication in a manner that would be considered "telephonic quality communication." *Id.*

Upon remand, on December 13, 2010, the parties submitted Proposed Findings of Fact and Conclusions of Law to the Bankruptcy Court. On June 15, 2011, the Bankruptcy Court found the COBRA system as purchased by the Debtors did not provide "access" to a local telephone service, but only provided access to high-speed data stream which was not capable of telephonic quality communication. *Worldcom III*, 449 B.R. at 659. As discussed below, the Bankruptcy Court focused on the fact that the Debtors only purchased the output of the COBRA service—that is, the high-speed data stream that emerged from the COBRA system at its "point of egress." *Id.* The Bankruptcy Court also found that the "speed of service that COBRA could maintain would result in communication being garbled and unintelligible when converted from data to voice. Therefore the COBRA service could not provide telephonic quality communication for computer to computer VoIP." *Id.* at 660. The Bankruptcy Court granted the Debtors' motion and the relief requested in Debtors' refund motion. *Id.* at 663. The I.R.S. now appeals that ruling.

Because the I.R.S. is "not "challenging any findings of fact in this appeal," I.R.S. Br. at 7 n.5, this Court's ruling is based upon the facts set forth in the Bankruptcy Court's June 15, 2011 decision.

DISCUSSION

A. *STANDARD OF REVIEW*

The standard of review applicable to matters within core bankruptcy jurisdiction is governed by the Federal Rules of Bankruptcy Procedure. On appeal, the court "may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings." Fed. R. Bankr. P. 8013.

While normally a district court would review a bankruptcy judge's findings of fact for clear error, *id.*; *see also Solow v. Kalikow* ("*In re Kalikow*"), 602 F.3d 82, 91 (2d Cir. 2010) ("[f]indings of fact are reviewed for clear error"), that is unnecessary here since the I.R.S. has conceded that it is not disputing any factual findings. *See* I.R.S. Br. at 7 n.5.

The issue before this Court, therefore, is how application of the undisputed facts measure against a straightforward reading of the relevant statute and legal principles. Legal conclusions of the Bankruptcy Court are "reviewed de novo." *In re Kalikow*, 602 F.3d at 91.

This Court is also mindful of the principle that "if doubt exists as to the construction of a tax statute, the doubt should be resolved in favor of the taxpayer." *Xerox v. United States*, 41 F.3d 647, 658 (Fed. Cir. 1994). But, as in *USA Choice Internet Services, LLC v. United States* ("*USA Choice II*"), 522 F.3d 1332 (Fed. Cir. 2008), "'doubts which may arise upon a cursory examination of [the statutory provisions at issue] disappear when they are read, as they must be, with every other material part of the statute, and in the light of their legislative history.'" *Id.* at 1343 (quoting *White v. United States*, 305 U.S. 281, 292 (1938)).

B. *LOCAL TELEPHONE SERVICE*

The statutory definition of a "local telephone service" comprises a number of interrelated elements relevant to this appeal: (1) "access" to a "local telephone system," and (2) the "privilege" of "telephonic quality communication" with "substantially all persons having telephone or radio telephone stations constituting a part of such local telephone system." 26 U.S.C. § 4252. On the face of the statute, it is clear that Congress intended to tax what the average person would understand as a local telephone service. Whether that service was being used for a voice call has been found irrelevant. *See*, *e.g.*, *USA Choice II*, 522 F.3d at 1341.

The two-part statutory definition of "local telephone service" breaks down into the following subquestions: what is the meaning of the word "access"?; whether the "privilege" of telephonic quality communication must amount to what could in fact be accomplished with what the Debtors purchased (or, alternatively, whether that "privilege" could be potential or theoretical but not necessarily practically available to the Debtors); whether the service as purchased by the Debtors is capable of "telephonic quality communication"; and, lastly, whether that "telephonic quality communication" can occur with "substantially all persons" who "hav[e] telephone or radio telephone stations constituting the local telephone system." *See* 26 U.S.C. § 4252; *Worldcom III*, 449 B.R. at 661.

This Court accepts that as a matter of law, the word "access" as used in 26 U.S.C. § 4252 is synonymous with "connectivity." *USA Choice II*, 522 F.3d at 1337; *Worldcom II*, 2009 WL 2432370, at *3. The record is clear that the COBRA service derives from, and is dependent upon, the provision of local tele-

phone service that is operated by the local exchange carriers ("LECs"). But that is a different question from whether the COBRA service itself constitutes a "local telephone service" such that Debtors can and should be liable for excise taxes thereon. *See Worldcom III*, 449 B.R. at 658.

C. *THE COBRA PROCESS*

To understand the current dispute, it is useful to emphasize that the COBRA service is only one part of a three-part process that together constitute an Internet access service that ultimately connected end users with dial-up connections to the Internet. The LECS, the Debtors with their purchase of COBRA service from the LECs, and the Internet Service Providers ("ISPs") all played roles in this Internet service offering that had three distinguishable parts. The COBRA service that the Debtors purchased was the middle or intermediary piece of the overall Internet service that sat between end users, their LEC, and the ISPs. *See*, *e.g.*, *Worldcom II*, 449 B.R. at 658; I.R.S. Br. at 4; App. Br. at 8.

A brief review of the overall Internet service into which COBRA fits assists greatly in crystallizing the key issues. The starting point, or "step one," for the particular dial-up service was for an end user to use a modem to establish a dial-up connection to his or her LEC's telephone service. *Worldcom II*, 449 B.R. at 658. The Debtors had no contractual or physical relationship with the end users, their modems, or the LECs at this stage. The modem passed the data onto the telephone lines that carried it to the LEC's facilities, I.R.S. Br. at 4—and the Debtors played no role in that passage of data. The parties do not dispute that at that stage there was a "path" for telephonic quality communication "all the way from the dial up users' modem to [] the NAS." *Worldcom III*, 499 B.R.

at 658. The term "path" is apparently used in an attempt to accept the fact that the physical lines that connect the end users' modems into the COBRA system are capable of telephonic quality communication, but to distinguish that "path" leading into COBRA from what occurs within COBRA itself. *See*, *e.g.*, *Worldcom III*, 449 B.R. at 658; I.R.S. Br at 5; App. Br. at 10.

The COBRA service comes into play in the second step of providing the dial-up Internet service: the data initiated via a modem connection by the end user is passed along a LEC's telephone lines into the LEC's central office or "switch." *Worldcom III*, 449 B.R. at 658. "After passing through the LEC Switch, the data traveled along a PRI line . . . ." *Id.* The COBRA service "starts" when the data crosses the threshold (as it were) into the LEC's central office. Debtors did not have physical control of the data as it passed into the central office or as it passes along the PRI lines. *Id.* at 659.[2] The data continued along the LECs PRI lines and then passed into and was collected within the LEC's network access server ("NAS"). *Id.* at 658. The NAS contained several digital signal process ("DSP") cards that aggregated and converted the data from the type of data that left the dial-up users' modem into TCP/IP packets. The NAS then transmitted the TCP/IP packets to a high-speed router via a PRI, located within the NAS. *Id.* The NAS essentially transformed the data from low-speed into a high-speed data stream. *Id.*

The PRI lines within the LEC central office "can plug into a PBX, which is a switch permitting traditional telephone voice communication. The service

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[2] There is no factual claim that the COBRA service starts prior to that time.

purchased by the debtors did not include a PBX connection to the PRI lines." *Id.* In the absence of a PBX, such as the COBRA service as configured here, there was no possibility of voice telephone communication. *Id.* With the addition of equipment, the PRI lines were therefore theoretically capable of transmitting a telephonic quality communication. *Id.* at 659.

D. *THE PRIVILEGE OF TELEPHONIC QUALITY COMMUNICATION*

The parties expend a great deal of effort arguing whether the "privilege" of telephonic quality communication has been met by virtue of two facts: (1) the data communication initiated by the modem connection has now traveled along the PRI lines and that communication, to a point, is a "telephonic quality communication" (there is ample evidence in the record to support this); and (2) the PRI lines are capable of "telephonic quality communication" by voice "if" they were connected to a Private Branch Exchange ("PBX"). *See id.* at 658-59. It is undisputed that Debtors did not purchase a service that was connected to any PBX. *Id.* at 658; I.R.S. Br. at 5. The significance of the absence of actual connection to a PBX is hotly contested.

The Bankruptcy Court found that "the Debtors did not have access to any COBRA equipment that would have enabled telephonic quality communication if altered." *World Com III*, 449 B.R. at 659. That finding is taken as dispositive of the ultimate issue of whether the COBRA service met the statutory definition of "local telephone service." *Id.* at 661. The Bankruptcy Court did not find significant the fact that when the data crosses into the central office of the LEC, travels along a PRI line and before it

enters the NAS, it is traveling along a "path" that is of telephonic quality. *See* I.R.S. Br. at 5.

The premise of the I.R.S.'s argument on appeal is that this finding of the Bankruptcy Court was error. The I.R.S. has, however, not considered other factors that irrespective of that finding, still result in a judgment for Debtors. As discussed below, even if this Court accepts that Debtors did purchase a "pathway" consisting of telephonic quality communication, that purchase is not enough to persuade the Court to find that the COBRA service meets all necessary elements of the statutory definition of a "local telephone service."

First, the discussion of whether the theoretical connection to the PBX lines meant that the Debtors had the "privilege" of telephonic quality communication ignores that this Court previously determined that all the Debtors can be responsible for are the services purchased, not potential reconfigurations or capabilities. *Worldcom II*, 2009 WL 2432370, at *4. That is "law of the case" that this Court sees no compelling reason to alter. That, alone, however, is not necessary to the disposition of this matter.

Second, and key for purposes of this appeal, is that what the Debtors purchased from the LECs was in fact the "NAS output": a high-speed data stream. *See Worldcom III*, 449 B.R. at 659. Nothing in the record suggests that the Debtors had any interest whatsoever in purchasing anything short of the high-speed data stream. Only a high-speed data stream would fulfill the Debtors business of providing that stream to ISPs who in turn pass it into the Internet. The parties agree such high-speed data stream emerging from the NAS is not a telephonic quality communication. I.R.S. Br. at 12; App. Br. at 10. Viewed through dissection of the constituent parts of

what dial-up users ultimately received, the Debtors have at most a momentary and intermediary participation in the process. The entirety of their participation is derivative of the more direct actions of the ISPs and LECs.

In the third and final step of the process, the ISP then connects the now-high-speed data stream to the Internet. The reverse of that process occurs in order for end users to receive information from the Internet. Understood in this way, it is easier to see that what the Debtors are purchasing is a service, or the high-speed data stream output of that service, that is sandwiched in the middle of an overall, three-stage process that enables end user communication with the Internet. *See Worldcom III*, 449 B.R. at 659; I.R.S. Br. at 3-4 ("Debtors then sold access to that data stream to Internet service providers, which in turn sold internet access to dial up users."). The COBRA service is quite clearly an intermediate service—and not a standalone service—that assists in, but is not independently sufficient for, communication over the Internet.

The fact that the Debtors have only an intermediary role in providing Internet service is a critical distinguishing factor between the COBRA service and the services at issue in the cases the I.R.S. places heavy reliance upon—*i.e.*, *USA Choice II* and *Comcation, Inc. v. United States*, 78 Fed. Cl. 61 (2007). In both of those cases, the taxpayer was purchasing the entirety of what was needed to connect an end user to the Internet, not just purchasing one piece of a multi-step process.[3] *USA Choice II*, 522

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[3] In *USA Choice II*, the suit was between the ISP and the I.R.S. The ISP was not playing simply an intermediary role as the Debtors are here.

F.3d at 1334; *Comcation, Inc.*, 78 Fed. Cl. at 65. When the COBRA service is put into proper context, the determinative question of whether this intermediate piece of dial-up Internet service can constitute a stand alone "local telephone service" pursuant to 26 I.R.S. § 4252 takes on new meaning.[4]

E. *SHOULD DEBTORS PAY AN EXCISE TAX?*

If this Court were to find that the Debtors should pay the excise tax at issue, given the nature of the COBRA service as now described, should the Debtors' responsibility for payment of the excise tax be assessed on the basis of what they purchased—which was the high-speed data stream output of the COBRA service—or should they be taxed on the totality of the COBRA service itself? That is, were the Debtors buying all of the processing that resulted in the high-speed data stream that came out of the NAS, or were they purchasing only the output itself (and the right to put a high-speed data stream back into the NAS to head in the other direction when the process was reversed)—and does it matter?

The Debtors and the Bankruptcy Court focus on the moment of purchase—that is, the fact that what Debtors purchased is available only at the "point of egress" of the COBRA service. *See Worldcom III*, 449 B.R. at 659; App. Br. at 9. Essentially, without so

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[4] The parties do not articulate the issue in this way or this clearly—instead, they spar over concepts of whether "access" or connectivity to a telephone service occurs, and whether it must occur within the COBRA service to meet the 26 U.S.C. § 4252 definition, *see* I.R.S. Br. at 14-16; App. Br. at 20-22, and over whether there is ever a telephonic quality communication and if so, whether the necessary portion of COBRA in which the NAS takes in a signal of one speed and spits out a signal of another speed must mean that there was telephonic quality communication, *see* I.R.S. Br. at 15; App. Br. at 9.

stating, the Debtors are arguing that they should be taxed on the output and not how the output came into being. The I.R.S.'s position assumes—and contends—the opposite: that the Debtors should be taxed on what has to occur within the COBRA service in order for the high-speed data output to be created in the first place. I.R.S. Br. at 15-16. The parties' arguments are ships passing in the night.

The I.R.S.'s focus on the processing that enabled the COBRA service to create a high-speed data stream results in two potential points of "telephonic quality communication." The first point has really nothing to do with the Debtors—*i.e.*, when the end user's modem establishes a connection along the LEC's telephone lines in order to get to the LEC's central office where the COBRA service processing begins. *See* I.R.S. Br. at 5. As stated above, the Debtors have nothing to do with that portion of the process. While that point of the process is a necessary antecedent to what enables the COBRA service to have a signal to process into a high-speed data stream, it is not a service itself purchased by the Debtors.

The second point of potentially "telephonic quality communication" is when the data that is sent up the LEC's telephone lines crosses the threshold and travels within the LEC's central office. At that point, the data travels along PRI lines on the way into the NAS. *Worldcom III*, 449 B.R. at 659; I.R.S. Br. at 5. It is still possible that if that line were tapped into with a PBX line, a voice communication could occur. *Worldcom III*, 449 B.R. at 659. There is no dispute that what is travelling along the PRI lines is potentially of telephonic quality, but it is also not disputed that the COBRA service does not have PBX lines. That issue, however, is of little moment.

As stated above, it is accepted that until the signal passes into the NAS, there is "telephonic quality communication." The Bankruptcy Court found that while so called PRI lines could plug into a PBX, which is a switch permitting traditional telephone voice communication, the service purchased by the Debtors did not include a PBX connection to the PRI lines. *Worldcom III*, 449 B.R. at 659. In addition, the Debtors' contracts did not permit them to access the PRI line to reconfigure it to permit traditional telephone voice communication. *Id.* at 655, 659, 660.

The question thus becomes whether the period of time when the LEC takes the data into its central office, passes it along its PRI lines and into the NAS, is enough to transform this intermediate COBRA service into a standalone "local telephone service"? The answer to that question must be "no."

Why that cannot be is easily understood by reference to an example: let us assume that the data that travels into the LEC central office is only on a PRI line for a nanosecond before it enters the NAS and is aggregated and transformed into a high-speed data signal that the parties agree is no longer a telephonic quality communication. Assume that this nanosecond on the PRI lines provides the only theoretical moment of telephonic quality communication within the COBRA service. Is that what Congress meant to tax as a "local telephone service"? Surely not.

But there is another point that becomes clear when the COBRA service is properly understood as an intermediate step in providing an Internet service to end users. Once the data has "crossed the threshold" into the central office, what the COBRA service cannot and does not do, is communicate with "substantially all persons" who are part of "such [asserted]

telephone system," as the statute requires. *See* 26 I.R.S. § 4252. Even if the PRI lines within the COBRA service are taken into account, there is simply no way that as an intermediary sitting between any relationship of the end users and the LECs and ISPs, COBRA provides such far reaching communication capability. The LECs can communicate with substantially all of their customers and vice versa with a telephonic quality communication, but the COBRA service, and end users whose data is traveling independent of them, cannot. The COBRA service allows for communication with and between the equipment within the LEC's switch and NAS. The COBRA service's inability to communicate with "substantially all persons" in the telephone system (and vice versa) means that the COBRA service cannot meet the statutory definition of "local telephone service." *See Comcation, Inc.*, 78 Fed. Cl. at 64 ("the term 'privilege' connotes that the user of such service must have the right to use equipment to communicate with substantially all persons participating in the local telephone system").

The I.R.S. urges that the fact that the signal travels over the PRI lines (in the Court's example, if only for a nanosecond) means that there is the potential for "substantially all persons" to access those PRI lines. But that is nonsensical in the context of the COBRA service. The COBRA service is a self-contained service within the LEC facility. There is no way for "substantially all persons" within this service to access whatever telephonic quality communication the PRI lines support. If the COBRA service has "telephonic quality communication" for a nanosecond, then that makes the point even more starkly. The service that the Debtors purchased is, then, only a service which interfaces with another

service (the LEC's actual telephone system) that can and does provide telephonic quality communication to "substantially all persons" in the telephone system. But that is one step too removed.

The law of statutory construction is clear: courts should give statutes their plain meaning. *USA Choice II*, 522 F.3d at 1336; *Hawkins v. United States*, 469 F.3d 993, 1000 (Fed. Cir. 2006). The Court finds, then, that to be a "local telephone service," the service must have the ability to communicate a "telephonic quality communication" to "substantially all persons" using the system. Here, the merely intermediary service purchased by the Debtors does not. Indeed, not a single end user could use the COBRA service for real "telephonic quality communication." Accordingly, the Bankruptcy Court correctly granted Debtors' objection to an IRS request for tax payment and granted Debtors' refund motion.

CONCLUSION

For the foregoing reasons, the Bankruptcy Court's judgment is AFFIRMED.

The appeal is dismissed, and the Clerk of Court shall close this case.

SO ORDERED.

Dated: New York, New York
December 22, 2011

/s/ KATHERINE B. FORREST

KATHERINE B. FORREST
United States District Judge

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

No. 02-13533 (AJG)

IN RE WORLDCOM, INC., ET AL.,
Reorganized Debtors.

June 15, 2011

OPINION, FOLLOWING REMAND FROM THE DISTRICT COURT, REGARDING ADDITIONAL FINDINGS OF FACT AND CONCLUSIONS OF LAW WITH RESPECT TO THE REORGANIZED DEBTORS' (I) OBJECTION TO PROOF OF CLAIM NO. 38365, AND (II) MOTION FOR A DETERMINATION OF REFUND RIGHTS PURSUANT TO SECTION 505(a)(1) OF THE BANKRUPTCY CODE

ARTHUR J. GONZALEZ, Chief Judge.

This matter is before the Court on remand from the District Court for certain additional determinations and findings of fact concerning a dispute between, on one side, Verizon Business Global LLC, successor in interest to MCI, Inc., together with certain of its affiliates as reorganized debtors in the above captioned bankruptcy case (collectively, the "Debtors"), and, on the other side, the Internal Revenue Service (the "IRS"). In that regard, the parties currently have motions before the Court seeking entry of their respective proposed findings of fact and conclusions of law. The parties' underlying dispute concerns the Debtors' liability for the telecommunications excise tax under 26 U.S.C. § 4251 *et seq.* (the "Excise Tax")

with respect to central office based remote access ("COBRA") services that the Debtors purchased from various Local Exchange Carriers (the "LECs").[1]

Prior to issuing *WorldCom I*, the Court had before it (i) a proof of claim filed by the IRS for certain amounts it alleged were due as Excise Tax; (ii) the Reorganized Debtors' objection (the "Claim Objection") to that proof of claim; and (iii) the Reorganized Debtors' motion (the "Refund Motion") seeking a refund of amounts that had already been paid to the IRS representing Excise Tax. On June 1, 2007, this Court issued its opinion granting both the Claim Objection and the Refund Motion, *WorldCom I*, 371 B.R. 19, and orders (the "Orders") to that effect were subsequently entered. The Orders were appealed to the District Court of the Southern District of New York, which issued its opinion reversing this Court's Orders and remanding the case for further consideration. *See Worldcom II*, Slip Op., 2009 WL 2432370.

In its opinion, the District Court noted that this Court had relied primarily upon a Court of Federal Claims opinion in *USA Choice Internet Service, LLC v. U.S.*, 73 Fed.Cl. 780 (2006), when this Court reasoned that "section 4252(a) requires that the taxpayer have the privilege to both initiate and receive telephonic quality communication. *WorldCom I*, 371 B.R. at 28."[2] *Worldcom II*, 2009 WL 2432370 at *2.

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[1] The detailed factual allegations relevant to this matter are set forth in the opinions issued by both this Court, *In re WorldCom, Inc.* ("*WorldCom I*"), 371 B.R. 19 (Bkrtcy. S.D.N.Y. 2007), and the District Court on appeal, *In re Worldcom, Inc.* ("*WorldCom II*"), No. 07-7414, 08-3070, 2009 WL 2432370 (S.D.N.Y. 2009), and familiarity with those facts is presumed.

[2] As a result of this Court's determination, the resolution of certain factual disputes between the parties was not required for the disposition of the case.

Prior to the District Court issuing its ruling, however, the decision of the Federal Court of Claims on that point had been reversed by the Federal Circuit Court in *USA Choice Internet Services, Inc. v. U.S.*, 522 F.3d 1332 (Fed. Cir. 2008). The District Court issued a ruling agreeing with the Federal Circuit Court's interpretation of section 4252(a), and for that reason reversed this Court's orders and remanded the case for further consideration.

Specifically, the District Court requested that this Court "determine whether the COBRA service purchased by Debtors afforded 'access' to a 'local telephone system' as well as 'two-way' or 'full duplex' 'telephonic quality communication.'" The District Court further referenced "at least two principal factual issues that must be resolved" to make such determination. The first factual issue referenced was that

> the parties dispute the nature and function of Primary Rate Interface ("PRI") circuits and services in relation to the COBRA service. (More specifically, the parties dispute in the first place whether PRI lines are included in the COBRA service purchased by Debtors. They also dispute whether the data stream produced through the COBRA service could be utilized by telephone equipment such as a Private Branch Exchange ("PBX") to enable communication by telephone between the Debtors and a party connected to the local telephone system. They also dispute whether, even if the data stream may be so utilized, it is within the power of the Debtors to plug in such a PBX.)

Worldcom II, Slip Op., 2009 WL 2432370 at *4. Citing this Court's decision, the District Court indi-

cated that a second factual issue requiring resolution was the parties dispute whether the COBRA service can transmit VoIP communication. *Worldcom II*, Slip Op., 2009 WL 2432370 at *4 (citing *WorldCom I*, 371 B.R. at 28.). The District Court further noted that "these issues go to both prongs of section 4252(a) and require factual findings from the Bankruptcy Court." *Id.*[3]

In remanding for these limited factual findings, the District Court also noted that it agreed with certain determinations reached by this Court. Specifically, the District Court noted that it agreed with this Court's reasoning that

> the capability of COBRA service must be assessed as purchased, not in relation to possible configurations . . . the Debtors only have the privileges that they purchased. *WorldCom*, 371 B.R. at 29. Neither self-imposed limitations nor unpurchased hypothetical configurations need be considered in determining whether the COBRA system purchased by Debtors afforded connectivity to a "local telephone system" and "two-way" "telephonic quality communication." The Court need only determine what was purchased and what uses of those purchases the Debtors may make of their own volition and without having to

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[3] The District Court also referenced certain factual findings that would be required to decide a separate dispute between the parties "concerning COBRA's potential qualification as a 'private communication service' and concomitant exclusion from taxation under section 4252(a)." *Worldcom*, 2009 WL 2432370 at *5. However, the way in which this matter had been resolved does not require a determination of the "private communication service" issue and, therefore, obviates the need to determine those additional factual issues.

seek permission or additional purchases of the LECs or any other party.

Worldcom II, Slip Op., 2009 WL 2432370 at *4.

In light of the District Court's ruling, thereafter, the Debtors filed a motion seeking additional findings of fact and conclusions of law, accompanying the motion with proposed findings and conclusions. The IRS responded by filing a motion seeking entry of its own proposed findings of fact and conclusions of law, and opposing entry of the Debtors proposal. The parties contend that the factual record that was developed before this Court at the evidentiary hearing conducted prior to the issuance of *WorldCom I* has sufficient elements to make any additional findings and conclusions required by the District Court. A hearing on these motions was heard on March 30, 2011.

ADDITIONAL FINDINGS OF FACT[4]

COBRA is a service technology that allows persons using dial-up modems (the "Dial-Up Users") to access the Internet. LECs sold COBRA service, whereby the LECs would aggregate Dial-Up Users' data into transmission control protocol/Internet protocol ("TCP/IP") packets, which are suitable for transmission over the Internet. With COBRA service, the Debtors plugged the output TCP/IP high speed data stream into their network, and sold access to the stream to ISPs, who in turn sold access to Dial-Up Users.

A Dial-Up User would make a telephone call using a modem (through a separately purchased local telephone service) to a telephone number associated with

[4] These findings of fact are derived from the parties' submissions.

COBRA. The modem data traveled through the public switched telephone network (the "PSTN"), the same network on which traditional telephone calls travel. After traveling from the Dial-Up User using the PSTN, the data passed through a switch at the LECs' central office (the "LEC Switch").

After passing through the LEC Switch, the data traveled along a PRI to the LECs Network Access Server (the "NAS"). The NAS contained several digital signal process "DSP" cards that aggregated and converted the data from the Dial-Up User's modem into TCP/IP packets. The NAS then transmitted the TCP/IP packets to a high speed router or a frame relay line card via a PRI, both located within the NAS. The TCP/IP packets then traveled on a high speed data line through the egress port of the NAS.

The PRI lines, the DSP cards, and all aspects of the NAS up until the Debtors plugged into the egress port, were COBRA equipment, and thus used by the LECs as part of their provision of COBRA service.

The parties agree that there was a path for telephonic quality communications all the way from the Dial-Up Users modem to the DSP card[5] contained in the NAS. The parties further agree that A PRI can plug into a PBX, which is a switch permitting traditional telephone voice communication. The service purchased by the Debtors did not include a PBX connection to the PRI lines. Further, the Debtors contracts did not permit them to access the PRI line to reconfigure it in any way.

The Debtors did not own any of the COBRA equipment. The equipment, including the NAS, all

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[5] The parties interchangeably refer to the DSP card as the modem for the NAS.

DSP cards, and all PRI lines remained with the LECs at their central offices. The demarcation point between the LECs' equipment and the Debtors' network lay at the egress point of the back of the NAS. The COBRA equipment was behind the LECs locked doors so that the Debtors could not physically access it. The Debtors only had electronic remote access to the COBRA service components. This electronic remote access allowed the Debtors to disable a modem if it was malfunctioning or make limited software changes.

The high speed data stream that resulted from COBRA service was not capable of providing the Debtors with telephonic quality communication. The Debtors could not have obtained a dial tone by plugging a telephone and a telephone jack into the stream. The Debtors were unable to plug in any equipment into the data stream that would have allowed them to have telephonic quality communications.

The PRI lines were capable of transmitting a telephonic quality communication. The capability of a telephonic quality communication existed from the Dial-Up User's modem, through the LEC Switch, to the PRI, but once the path reached the DSPs within the NAS, the DSPs converted the data into TCP/IP packets and, from that point on, COBRA service was not capable of transmitting a telephonic quality communication. Because the Debtors did not purchase access to the COBRA equipment or to the LECs' central offices, the Debtors could not access the COBRA service at any point where it was capable of transmitting telephonic quality communications.

The Debtors did not purchase the ability to alter COBRA service. The Debtors did not purchase the

ability to plug in a PBX, which is a switch that would permit telephone voice communication. Therefore, the Debtors could not have used a PBX or similar telephone equipment to enable telephonic quality communications within the COBRA service. The Debtors did not have access to any COBRA equipment that would have enabled telephonic quality communication if altered.

Voice over Internet Protocol ("VoIP") is a technology that allows regular voice signals to be converted to packets that are designed to travel on the TCP/IP network. There are two ways to enable VoIP communication: (i) a VoIP gateway, whereby voice TCP/IP packets travel to an LECs' central office, and are converted by the LECs' modems into voice data that can travel on the PSTN to any local telephone number; and (ii) computer to computer VoIP, whereby users convert their voice data into TCP/IP packets on their computer using a VoIP service such as Skype before it is sent over the Internet like any other TCP/IP packet.[6] These two types of VoIP require different equipment.

The COBRA services cannot distinguish between a computer-to-computer VoIP packet carrying a packetized voice transmission and any other non-voice packet coming out of a dial-up user's computer.

The relevant contracts between the Debtors and various LECs (the "COBRA Contracts") prohibited

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[6] Thus, in VoIP gateway, a user send a traditional voice call into the gateway, which converts it to VoIP Internet packets. Whereas, in computer-to-computer VoIP, the conversion from voice to IP packets takes place on the Dial-Up User's own computer, and these packets generated by the computer are similar to any other voice or non-voice packets that travel over the Internet.

the Debtors from adding any VoIP capability without renegotiating with the LECs. One such agreement read:

> Should [the Debtors] wish to directly use the COBRA Services to directly provide any one-way or two-way voice telephony communications, whether local or long distance ("VoIP"), [the Debtors] and Vendor shall negotiate terms, conditions, and rate structures that are applicable to VoIP prior to [the Debtors] utilizing the COBRA Services to directly provide VoIP.

The parties agree that the Debtors could not have used gateway VoIP with COBRA service. A VoIP gateway requires that an LEC utilize certain DSP cards in the NAS that are capable of converting incoming VoIP packets into voice data that can travel over telephone lines. COBRA service, as configured pursuant to the COBRA Contracts, did not use any DSP cards that were capable of serving as a VoIP gateway.

The parties agree that the Debtors did not have any access to the DSP cards, which were inside the NAS, in the LECs' central offices. The parties further agree that the Debtors did not have the contractual right to enable a VoIP gateway.

Prior to the Debtors commencing to decommission the COBRA service, computer to computer VoIP was not possible with COBRA service because the technology then available with the COBRA service was too slow to enable it. Based upon the testimony, the speed of service that COBRA could maintain would result in the communication being garbled and unintelligible when converted from data to voice. Therefore, the COBRA service could not provide

telephonic quality communication for computer to computer VoIP.[7]

The Debtors paid for COBRA on a bundled, monthly per port basis. The price of the port includes all access to the PSTN. The monthly charge that the Debtors paid for COBRA services (i) excluded the egress circuits that connected COBRA to the Debtors' network; (ii) did not vary with the volume carried by each port; (iii) did not vary with the content of the packet—whether representations of voice or data—sent over COBRA; and (iv) would not have varied if VoIP packets were sent over COBRA.

However, as previously noted, under the COBRA Contracts, the Debtors did not have the right to utilize the COBRA services to directly provide VoIP service or request that the provider reconfigure the system to allow for such service unless the terms, conditions, and rate structures applicable to VoIP service were first renegotiated.

Conclusions of Law

Pursuant to the Internal Revenue Code (the "IRC"), a three percent excise tax is imposed on "communications services," including "local telephone service." *USA Choice*, 522 F.3d at 1335 (citing 26 U.S.C. § 4251(a)(1) & (b)(1)(A)).[8] Section 4252(a) of the IRC defines "local telephone service" is defined as

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[7] Telephonic quality requires "a communication channel over which it [i]s possible to have a two-way conversation with the use of telephones." *USA Choice Internet Services, LLC v. United States*, 522 F.3d 1332, 1341 n.2 (Fed. Cir. 2008) (*quoting*, *USA Choice Internet Serv., LLC v. United States*, 73 Fed.Cl. 780, 783 & n.7 (2006)).

[8] In relevant part, 26 U.S.C. § 4251 provides

(a) Tax imposed.—

> (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 a service described in paragraph (1).

26 U.S.C. § 4252(a). Section 4252 further provides that "local telephone service" does not include "toll telephone service" or a "private communication service" as defined in the subsections (b) and (d) of section 4252.

The expert witnesses in this case defined telephonic quality communication as the quality of communication necessary to and present in a voice telephone call. It appears that "'telephonic quality' requires a communication channel over which it is possible to have a two-way conversation with the use of telephones." *USA Choice*, 522 F.3d at 1341 n.2 (citing *USA Choice*, 73 Fed.Cl. at 794 & n.24); *see also* IRS Rev. Rul. 79-245, 1979-2 C.B. 380 (1979) (equating

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> (1) In general.—There is hereby imposed on amounts paid for communications services a tax equal to the applicable percentage of amounts so paid.
>
> (2) Payment of tax.—The tax imposed by this section shall be paid by the person paying for such services.
>
> (b) Definitions.—For purposes of subsection (a)—
>
> (1) Communications services.—The term "communications services" means—
>
> (A) local telephone service;
>
> (B) toll telephone service; and
>
> (C) teletypewriter exchange service.

telephonic quality communication with *voice* communication).[9]

In this case, the Debtors only purchased access to a high speed data stream that resulted from the COBRA service the LECs provided. As configured,

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[9] In its 2007 decision, the *Comcation* court made the observation that "any distinction between voice and data communications has long become outdated in the face of [VoIP] technology, which allows the routing of realtime, two-way voice communications over the Internet or any other packetized communications network", *Comcation*, 78 Fed.Cl. at 72 n.18 (citing *See Vonage Holdings Corp. v. FCC*, 489 F.3d 1232, 2007 WL 1574611 (D.C. Cir. Jun. 1, 2007)). The *Comcation* court's observation that the absence of voice communication was irrelevant was premised upon availability of technological advances by that time that were capable of voice communication. However, as evident from the expert testimony adduced at trial in the instant matter, during the period in which the COBRA services were provided here, there was a clear dispute as to whether that service had the capability to transmit a viable VoIP communication. Therefore, preserving the previously applied requirement for "voice" communication to the instant matter is appropriate. Nor does the fact that the statute does not use the term "voice" dictate otherwise. The statute requires the privilege of "telephonic quality" communication. The reference to "telephonic quality" was added in 1965 and, as often noted, that term was not defined. The lack of a definition was likely the consequence of the common perception, at that time, that telephone quality had to be capable of comprehendible voice communication.

To be clear, the Court is not relying on the fact that ISPs could not have been contemplated when the statute was enacted to preclude its application to this more recent technology. Rather, the Court is analyzing the language used in the statute, in the context of the common understanding of the terms employed at the time of its enactment, to conclude that the tax was meant to be imposed on services that were capable of voice quality communication. Inasmuch as the Court finds that the configuration of the COBRA services purchased here was not capable of any viable voice quality communication, the tax does not apply.

the Debtors were able to access only the high speed data stream. That data stream was incapable of providing the Debtors with telephonic quality communication. The limitations on the configuration was inherent to the right purchased, not self-imposed by the Debtors in how they directed the counterparty to configure the access. Thus, the configuration was dictated by the rights the Debtors purchased. Therefore, the Debtors did not purchase access to a local telephone system or the privilege of telephonic quality communications with persons constituting a local telephone system.

The Debtors may only be taxed on services actually purchased, not hypothetical configurations that they could have purchased from the LECs. The COBRA service as purchased by the Debtors was not a local telephone service. The Debtors may not be taxed for services if they would be required to negotiate new terms, conditions and rate structures from the LECs in order to access those services. Although certain telephonic quality services may have been technologically possible if a different configuration had been purchased, the Debtors contractual arrangement did not permit for such configuration. Any such configuration would have required additional negotiation concerning the terms, conditions and rate structures contained in the COBRA Contracts.

Thus, although it might have been possible to enable voice communications by plugging telephone equipment such as a PBX into the PRI circuit, the Debtors did not purchase the ability to do so, and could not do so because they lacked physical access to the PRI lines. Therefore, the Debtors did not purchase the privilege of telephonic quality communica-

tions by virtue of the PRI being part of the COBRA service.

The Debtors did not purchase gateway VoIP communication capability for COBRA service. Under the COBRA Contracts, the Debtors would have had to renegotiate the terms, conditions, and rate structure, if they wished to add gateway VoIP capability. Thus, the Debtors did not purchase the privilege of telephonic quality communication by way of a VoIP gateway communication.

The Debtors purchased COBRA service, including the DSP cards, as configured within the NAS. The DSP cards used did not have the capacity to be used as a VoIP gateway, meaning the service the Debtors purchased did not have the ability to be used as a VoIP gateway. Therefore, the Debtors did not have access to a local telephone system or the privilege of telephonic quality communications with substantially all persons constituting that local telephone system by way of a VoIP gateway.

The Debtors would have needed permission and access to the LECs' central offices if they wished to enable a VoIP gateway because they would have needed to change the DSP cards. The Debtors did not purchase the ability to make any such alterations. Further, without renegotiating the terms and rates of the COBRA Contracts, the Debtors could not direct the LECs to reconfigure the COBRA system to allow for VoIP gateway. Therefore, the Debtors did not have access to a local telephone system or the privilege of telephonic quality communication with substantially all persons constituting that local telephone system through use of a VoIP gateway.

Further, computer-to-computer VoIP over the COBRA services purchased would have been too

garbled and unintelligible for telephonic quality communication. Based upon the testimony of the expert witnesses, the configuration of the COBRA system could not have supported the speeds necessary to allow for computer to computer VoIP communication with the technology available during the period prior to the Debtors commencing to decommission the services. At a minimum, even if such technology were available at that time, there is no indication that the COBRA system services purchased by the Debtor were configured with the necessary technology to allow for such computer-to-computer VoIP communication. Thus, VoIP service was not technologically feasible. Therefore, the putative VoIP capability does not provide a separate basis for applying the excise tax to the COBRA services purchased by the Debtors.

The COBRA services purchased by the Debtors is legally distinguishable from the services described in *Comdata Network, Inc. v. United States*, 21 Cl.Ct. 128 (1990), *USA Choice Internet Services, LLC v. United States*, 522 F.3d 1332 (Fed. Cir. 2008), and Revenue Ruling 79-245, 1979-2 C.B. 380, wherein taxpayers received data streams or services that, when they reached the taxpayers, were capable of telephonic quality communication. By contract, COBRA service was not capable of telephonic quality communication at its egress point. COBRA service's limitations are inherent as purchased by the Debtors, whereas the limitations in the cited cases were self-imposed by the taxpayers.[10]

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[10] In the cited cases, the limitation in the service was a "product of how plaintiff itself decided to configure those lines." *See Comcation*, 78 Fed.Cl. at 65. In our case, it was not the Debtors decision to configure the system that way. Rather, it

The COBRA system configuration did not result from the Debtors' self-imposed limitations. Instead, the configuration was a function of the services actually purchased, which services were inherently incapable of being used more expansively. *See Comcation*, 78 Fed.Cl. at 65 (noting that "section 4252(a) distinguishes between, on the one hand, inherent limitations associated either with the capacity of equipment or the contractual right to use it, and, on the other, those voluntarily associated with the way a given taxpayer chooses to use a particular service"). If the Debtors desired a configuration that would provide them with the privilege of telephonic quality communication, they were required to renegotiate the terms and rates of their agreements for such capability with the COBRA service. The inherent limitations of the configuration of the system were associated with the Debtors' contractual rights to use the system. It was an inherent limitation of the services purchased. Thus, the Debtors carried their burden to show that the system was not appropriately configured to provide them with the privilege of telephonic quality communication.

The Debtors were physically, contractually, and technologically incapable of altering COBRA service to obtain access to telephonic quality communication. Several alterations to the LECs' equipment-alterations which the Debtors' contracts, as negotiated, did not permit-would have been required to allow for voice quality communication. Moreover, the

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was a limitation imposed by the contractual agreement, *i.e.*, it was dictated by the rights purchased. The Debtors could neither alter the configuration nor direct the provider to reconfigure the system without renegotiating the terms, conditions and rate structure.

Debtors did not have access to the LECs COBRA equipment to unilaterally reconfigure such equipment to enable voice communication with the local telephone system.

Therefore, the COBRA services purchased by the Debtors are not subject to the § 4251 excise tax because they did not provide the Debtors with access to the local telephone system and the privilege of telephonic quality communication.

Because the Debtors met their burden of production and persuasion in challenging the validity of the federal excise tax, as applied to COBRA service, the Objection is granted, and the Court grants the relief requested in the Refund Motion as set forth in the Stipulation and Order.

An order consistent with these findings of fact and conclusions of law will be entered contemporaneously herewith.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, 40 Foley Square, in the City of New York, on the 19th day of November, two thousand thirteen,

In Re: WorldCom, Inc.
Debtor.

********** **ORDER**

Internal Revenue Service, Docket No: 12-803
Appellant,

v.

WorldCom, Inc.,
Debtor – Appellee.

[filed November 19, 2013]

Appellee WorldCom, Inc., filed a petition for panel rehearing, or, in the alternative, for rehearing *en banc*. The panel that determined the appeal has considered the request for panel rehearing, and the active members of the Court have considered the request for rehearing *en banc*.

IT IS HEREBY ORDERED that the petition is denied.

FOR THE COURT:
Catherine O'Hagan Wolfe, Clerk
/s/ CATHERINE O'HAGAN WOLFE

STATUTORY PROVISIONS INVOLVED

1. Section 4251 of the Internal Revenue Code, 26 U.S.C. § 4251, provides:

26 U.S.C. § 4251. Imposition of tax

(a) Tax imposed.—

(1) In general.—There is hereby imposed on amounts paid for communications services a tax equal to the applicable percentage of amounts so paid.

(2) Payment of tax.—The tax imposed by this section shall be paid by the person paying for such services.

(b) Definitions.—For purposes of subsection (a)—

(1) Communications services.—The term "communications services" means—

(A) local telephone service;

(B) toll telephone service; and

(C) teletypewriter exchange service.

(2) Applicable percentage.—The term "applicable percentage" means 3 percent.

(c) Special rule.—For purposes of subsections (a) and (b), in the case of communications services rendered before November 1 of a calendar year for which a bill has not been rendered before the close of such year, a bill shall be treated as having been first rendered on December 31 of such year.

(d) Treatment of prepaid telephone cards.—

(1) In general.—For purposes of this subchapter, in the case of communications services acquired by means of a prepaid telephone card—

(A) the face amount of such card shall be treated as the amount paid for such communications services, and

(B) that amount shall be treated as paid when the card is transferred by any telecommunications carrier to any person who is not such a carrier.

(2) Determination of face amount in absence of specified dollar amount.—In the case of any prepaid telephone card which entitles the user other than to a specified dollar amount of use, the face amount shall be determined under regulations prescribed by the Secretary.

(3) Prepaid telephone card.—For purposes of this subsection, the term "prepaid telephone card" means any card or any other similar arrangement which permits its holder to obtain communications services and pay for such services in advance.

2. Section 4252 of the Internal Revenue Code, 26 U.S.C. § 4252, provides:

26 U.S.C. § 4252. Definitions

(a) Local telephone service.—For purposes of this subchapter, the term "local telephone service" means—

(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 a service described in paragraph (1).

The term "local telephone service" does not include any service which is a "toll telephone service" or a "private communication service" as defined in subsections (b) and (d).

(b) Toll telephone service.—For purposes of this subchapter, 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, and

(2) a service which entitles the subscriber, upon payment of a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time), to the privilege of an unlimited number of telephonic communications to or from all or a substantial portion of the persons having telephone or radio telephone stations in a specified area which is outside the local telephone system area in which the station provided with this service is located.

(c) Teletypewriter exchange service.—For purposes of this subchapter, the term "teletypewriter exchange service" means 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). The term "teletypewriter exchange service" does not include any service which is "local telephone service" as defined in subsection (a).

(d) Private communication service.—For purposes of this subchapter, the term "private communication service" means—

(1) the communication service furnished to a subscriber which entitles the subscriber—

(A) to exclusive or priority use of any communication channel or groups of channels, or

(B) to the use of an intercommunication system for the subscriber's stations,

regardless of whether such channel, groups of channels, or intercommunication system may be connected through switching with a service described in subsection (a), (b), or (c),

(2) switching capacity, extension lines and stations, or other associated services which are provided in connection with, and are necessary or unique to the use of, channels or systems described in paragraph (1), and

(3) the channel mileage which connects a telephone station located outside a local telephone system area with a central office in such local telephone system,

except that such term does not include any communication service unless a separate charge is made for such service.

Supreme Court of the United States
Office of the Clerk
Washington, DC 20543-0001

SCOTT S. HARRIS
Clerk of the Court
(202) 479-3011

January 13, 2014

Mr. Scott H. Angstreich
Kellogg, Huber, Hansen, Todd,
Evans & Figel, P.L.L.C.
1615 M Street, N.W., Suite 400
Washington, DC 20036

Re: WorldCom, Inc.
v. Internal Revenue Service
Application No. 13A732

Dear Mr. Angstreich:

The application for an extension of time within which to file a petition for a writ of certiorari in the above-entitled case has been presented to Justice Ginsburg, who on January 13, 2014, extended the time to and including April 18, 2014.

This letter has been sent to those designated on the attached notification list.

Sincerely,

Scott S. Harris, Clerk
by /s/ ERIK FOSSUM
Erik Fossum
Case Analyst

[attached notification list omitted]