No. 13-1269

IN THE

Supreme Court of the United States

WORLDCOM, INC.,

Petitioner,

v.

INTERNAL REVENUE SERVICE,

Respondent.

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

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BRIEF FOR THE UNITED STATES TELECOM ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF THE *AMICUS CURIAE*[1]

The United States Telecom Association ("USTelecom") is the premier trade association representing service providers and suppliers for the telecommunications industry. USTelecom's member companies offer a wide range of services across communications platforms, including voice, video and data over local exchange, long distance, wireless, Internet, and cable. The FCC has identified increased availability of these broadband services as critical to the growth of the U.S. economy, with FCC Chairman Wheeler recently stating that "[o]ur prosperity is a function, among other things, of the quality of our broadband networks." http://www.fcc.gov/document/chairman-tom-wheeler-remarks-ncta (Apr. 30, 2014). *See also* http://www.whitehouse.gov/blog/2010/02/17/americas-2020-broadband-vision (Feb. 17, 2010) (then-FCC-Chairman Genachowski stating that "even modest increases in broadband adoption can yield hundreds of thousands of new jobs").

The members of USTelecom range from large, publicly traded companies to small rural cooperatives, spanning all seven continents and more than 225 countries. Collectively, they repre-

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[1] Pursuant to Rule 37.6, *amicus* states that no counsel for a party authored this brief in whole or in part, and no person or entity, other than *amicus* and its counsel, made a monetary contribution to the preparation or submission of the brief. Pursuant to Rule 37.2(a), counsel for *amicus* states that all parties were provided notice of *amicus*'s intention to file this brief at least 10 days before its due date. As reflected in letters filed with the Clerk, all parties have consented to the filing of this brief.

sent hundreds of billions of dollars in investment and employ millions of workers.

Members of USTelecom provide customers with communications services, some of which are subject to the communications excise tax of 26 U.S.C. § 4251. Although the customers are liable for the tax, the service provider must collect the tax and remit it to the IRS. When the applicability of the tax to particular services is clouded by uncertainty, the provider's determination can expose it to risks of litigation if the customer or the IRS disagrees. Because USTelecom believes that the Second Circuit's erroneous decision threatens significantly to increase the level of uncertainty surrounding the taxability of different kinds of services, USTelecom has a strong interest in the outcome of this case. Accordingly, it filed an amicus brief in the court of appeals in support of a petition for rehearing en banc, and it has a strong interest in having this Court grant certiorari and restore clarity to this area of the law.

REASONS FOR GRANTING THE PETITION

A. The System for Collection and Payment of the Federal Communications Excise Tax Puts a Premium on Clarity in the Rules Governing the Applicability of the Tax

Section 4251(a)(2) of the Internal Revenue Code (26 U.S.C.) provides that the excise tax on communications services "shall be paid by the person paying for such services." But it is not the customer's responsibility to calculate and remit the tax. Code section 4291 places that responsibility on the service provider, stating that "every person

receiving any payment for facilities or services on which a tax is imposed upon the payor thereof [for communications or air transportation services] shall collect the amount of the tax from the person making such payment." Thus, the customer pays the tax not to the IRS but to the service provider, "who is required to collect the tax and return and pay over the tax." Treas. Reg. (26 C.F.R.) § 49.4251-2(c); *see also* 26 C.F.R. §§ 40.6011(a)-1 through 40.6302(c)-3 (rules governing tax returns and deposits that must be made by service providers).

As a practical matter, the service provider collects the tax by billing the customer for the tax when it bills for the service. It thus falls on the service provider in the first instance to calculate the tax and, more importantly, to determine whether a particular service is subject to the communications excise tax at all. When the applicability of the tax is clear, the service provider's collection responsibility is just another administrative task. But when applicability is unclear, the service provider can find itself embroiled in disputes with the IRS or with its customers.

Because the obligation to collect the communications excise tax arises from a statutory mandate, telecommunications companies that provide services subject to the communications excise tax fall within the ambit of Code section 6672(a). This section, most commonly applied to employers' income tax withholding obligations, imposes a penalty in the full amount of the tax liability upon persons required to collect and pay over federal taxes who willfully fail to do so.

Generally, section 6672 has not been invoked against communications service providers, which is unsurprising given that the tax has not been updated since 1965 to keep up with changes in the marketplace and thus has not been broadly applicable in recent years. Section 6672 could be invoked in the future, however, if the IRS seeks to use the Second Circuit's reasoning in this case to argue for broader applicability of the excise tax to other emerging communications services not contemplated in 1965.

In addition, the IRS has previously taken the position that section 4291 (as well as Code section 7501) creates a cause of action for the government against service providers for failure to collect the excise taxes contained in Chapter 33 of the Code, which include the communications excise tax. Although a district court has rejected that position, it also found that the IRS's position was "substantially justified." *See Air Tour Acquisition Corp. v. United States*, 781 F. Supp. 669, 672-75 (D. Haw. 1991). Thus, if communications service providers in the future do not collect excise taxes that the IRS believes should be collected, they expose themselves to the risk of litigation with the IRS seeking to impose liability for those amounts either directly or pursuant to the penalty regime of section 6672.

Conversely, if service providers collect an excise tax that customers believe is not owed, they run the risk that the customers will sue them to recover those amounts. Customers subjected to both communications and air transportation excise tax collection under section 4291 have followed this approach in the past. *See, e.g.*, *Sigmon v. Southwest Airlines Co.*, 110 F.3d 1200 (7th Cir.

1997); *Kaucky v. Southwest Airlines Co.*, 109 F.3d 349 (7th Cir. 1997); *Econ, Inc. v. Illinois Bell Tel. Co.*, 351 F. Supp. 1087 (N.D. Ill. 1972). Although the courts generally have held that these suits cannot be maintained if the service provider was exercising "colorable authority" (*see, e.g.*, *Kaucky*, 109 F.3d at 352), uncertainty over the scope of the tax increases the risk of such suits, including possible disputes over the existence of "colorable authority." Further, even if no litigation ensues, the Code obligates service providers to refund overcollections to customers upon "proper application" (26 U.S.C. § 6415(c)), thereby exposing service providers to an additional administrative headache when they collect excise taxes of uncertain applicability. Thus, when there is doubt concerning the applicability of the communications excise tax, service providers can be caught between a rock and a hard place, exposed to potential litigation no matter which way they resolve the uncertainty.

In addition to litigation risks, increased uncertainty in the applicability of the communications excise tax creates other difficulties in the industry and tax administration. The telecommunications industry is competitive, and the judgments of individual service providers about whether to collect the tax could affect customers' choice among competing providers by increasing the price of the services of the providers that collect the tax. That possibility, in turn, could influence providers' determinations of whether the tax is applicable to a particular service.

Recent history has shown that it is not easy to unring the bell when the communications excise

tax is collected, but later determined to be inapplicable. Several circuits ruled in the mid-2000s that the tax does not apply to long-distance service where the rate charged does not vary with time and distance. Although long-distance service was billed in that way in 1965 — when Congress last substantively amended the statute — long-distance providers have for decades charged rates that vary only with time or, more recently, have charged flat rates for unlimited long-distance plans. Despite the marketplace changes, however, service providers continued to collect the tax, meaning that they had been improperly collecting the tax for years on standard long-distance plans that had millions of subscribers. *See Reese Bros., Inc. v. United States*, 447 F.3d 229, 234 (3d Cir. 2006) (citing cases).

Apparently recognizing that standard refund procedures would not adequately provide long-distance-service customers with relief from that mistake, the IRS promulgated a special procedure for refunding these illegally exacted excise taxes. *See* Notice 2006-50, 2006-1 C.B. 1141. That refund process, however, proved to be "confusing and dysfunctional" and a "procedural boondoggle." *In re Long-Distance Tel. Serv. Fed. Excise Tax Refund Litig.*, No. 12-5380, 2014 U.S. App. LEXIS 8724, at *31-33 (D.C. Cir. May 9, 2014) (Brown, J., concurring in part and dissenting in part). The excise tax refund problem spawned an explosion of (eventually consolidated) multi-district litigation that yielded three district court decisions and three court of appeals decisions (one by the en banc

court). *See generally id.* at *1-7.[2] Ultimately, the IRS's special refund procedure was vacated prospectively in 2012 for failure to comply with the APA, and the matter was remanded to the agency. *See id.* at *6-7. The IRS has done nothing in response and, indeed, has indicated that it has no plans to come up with a substitute. *Id.* at *7-8.

In sum, for several reasons it is highly desirable to maximize clarity in the rules governing the applicability of the communications excise tax so that service providers can correctly apply the tax at the outset.

B. The Second Circuit's Departure from Settled Practice, Coupled with Its Determination to Look Beyond the Statutory Text and to Consider Whether Affirmance Would Produce a "Strange Result," Creates Uncertainty

1. The Second Circuit's decision injects considerable uncertainty into the scope of the communications excise tax that did not previously exist. First, until now it has been commonly understood that "local telephone service" does not encompass communications services that are "usable only for nonvoice data transmission." *See* Rev. Rul. 79-245, 1979-2 C.B. 380, 381. The Federal Circuit's decision in *USA Choice Internet Servs., LLC v.*

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[2] Although that litigation has proceeded against the United States, several service providers originally were named as defendants and were ensnared in the litigation for several months until their motion to dismiss was granted. *See Gurrola v. United States*, No. 2:06-cv-03425-SVW-E (C.D. Cal. filed June 5, 2006).

United States, 522 F.3d 1332 (Fed. Cir. 2008), was consistent with that understanding because the customer purchased a service that could have been used for voice transmissions simply by plugging in a telephone at either end. Indeed, because a single PRI circuit could carry 23 simultaneous voice calls, the PRI service purchased by USAChoice was frequently used at the time by call centers and other customers with high inbound voice call volumes. *See id.* at 1335; Annabel Z. Dodd, *The Essential Guide to Telecommunications* 255 (3d ed. 2002) ("Large call centers use PRI ISDN to receive the telephone number of the person calling.").

The taxpayer's argument in *USA Choice* thus was that taxability depends on how the customer chooses to use the service, not on the inherent capability of the purchased service. The Federal Circuit correctly rejected that argument, explaining that the service was not used for voice communications simply because of the customer's "own self-imposed limitations" in connecting the lines to modems rather than telephones. 522 F.3d at 1341; *see also* Pet. App. 29a (noting that a service can provide the privilege of "telephonic quality communication" even if the customer chooses to connect the lines to a fax machine instead of a telephone); *id.* at 30a (taxability is not affected when a customer "adds additional services or equipment *beyond that connection*" established between the service provider and the customer) (emphasis added).

Here, however, the COBRA service purchased by WorldCom was not capable of voice transmission, even if telephones were connected at both ends of the service, and therefore the Second Cir-

cuit's decision extends the communications excise tax beyond previously recognized boundaries. *See* Pet. App. 5a ("COBRA was not set up for voice communication"). Moreover, the network access server embedded within the COBRA system would drop a call if it came from a telephone; thus, any attempt by a local telephone system subscriber to send a voice communication to WorldCom over the COBRA system would be halted before any signal could reach WorldCom. *See id.* at 60a. In *USA Choice*, this feature of the network access server did not affect the taxability determination because the network access server was owned by the customer and located beyond the connection with the telephone company. Therefore, a "telephonic quality connection was established even where authentication ultimately failed and USA Choice consequently disconnected the call." 522 F.3d at 1341. By contrast, the COBRA service did not enable any such connection to WorldCom.

2. Second, in going beyond the statutory text and relying on its speculation about whether Congress would have wanted to tax COBRA service, the Second Circuit's rationale significantly broadens the uncertainty over the applicability of the tax beyond the uncertainty triggered by the holding alone. As noted, the fact that the COBRA service was not capable of completing a telephone call to WorldCom from a local telephone subscriber places the COBRA service on the opposite side of the taxability line from the service provided in *USA Choice* — according to the criteria set forth in the statute. The Second Circuit, however, looked beyond those criteria.

The Second Circuit asserted that failing to treat COBRA as "local telephone service" "would create a strange result" by taxing companies like USA Choice "that used their own network access servers to convert a phone signal to a data stream" while not taxing companies "that relied on the local telephone company to convert the signals for them." Pet. App. 30a. To support its view that Congress would have objected to this distinction, the Second Circuit pointed to the reasons why Congress enacted the "private communications service" (PCS) exception in 1965. *Id.* at 30a-31a.[3]

This kind of reasoning severely undermines the goal of clarity in administration of the excise tax, making it extremely difficult for service providers to determine when to collect the tax when communications services are not unequivocally covered by the statutory text. Even if the Second Circuit's analogy had merit (and in fact it was flawed because the situation that triggered enactment of the PCS exception involved services that offered the same functionality), the Second Circuit's approach was improper. The court's role requires it to apply the statute *as enacted*, not to speculate about what Congress might have wanted

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[3] The Second Circuit also made the puzzling statement that finding COBRA to be nontaxable would make taxability "hinge on what equipment the local telephone company provided, not the nature of the service." Pet. App. 30a. But it is precisely the differences in the functionality of the *service* provided (whether the service is capable of transmitting a voice communication) that justifies — indeed, requires — treating COBRA service differently from the service in *USA Choice* under the terms of the statute.

to do if faced with a situation it did not contemplate. In the excise tax area, the courts have consistently followed this approach, which furthers clarity, even if leads to different outcomes based on what some might view as minor factual differences. *See. e.g.*, *Iselin v. United States*, 270 U.S. 245, 251 (1926) ("[w]hat the Government asks is not a construction of a statute, but, in effect, an enlargement of it by the court . . . [which] transcends the judicial function"); *Florida Power & Light Co. v. United States*, 375 F.3d 1119, 1123-24 (Fed. Cir. 2004) (imposition of the heavy vehicle use tax can turn on minor factual differences, and objections to the "undesirable" policy effects "are more appropriately addressed to Congress").

The recent long-distance-service excise tax cases are prominent examples of courts declining to speculate about Congress's wishes. The courts ruled that the statute did not impose the tax on long-distance service whose cost did not vary with distance, although the government argued that Congress generally wanted to tax long-distance service and would not have wanted taxability to turn on such an apparently insignificant distinction. The courts uniformly rejected that argument. *See, e.g.*, *Nat'l R.R. Passenger Corp. v. United States*, 431 F.3d 374, 377-78 (D.C. Cir. 2005); *OfficeMax, Inc. v. United States*, 428 F.3d 583, 593 (6th Cir. 2005).

In sum, the Second Circuit's determination that the excise tax should be extended to a communications service incapable of voice transmission and its asserted justification that doing so was necessary to avoid a "strange result" both inject troublesome uncertainty into the scope

of the tax that will create problems for its administration. Service providers cannot reasonably anticipate with accuracy when a court will conclude that it should depart from the apparent dictates of the statutory text on the ground that the text would produce a "strange result" that Congress would not desire.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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MAY 2014