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Opportunity to File Claims for Refund Regarding Overpaid Federal Excise Taxes on Toll Telephone Service

Early in 2004, two federal district courts issued contrary opinions concerning application of the three percent IRC §4252 excise tax on long distance telephone service. *Office Max, Inc. v. United States*, 2004 TNT 53-14, (N.D. OH), and *American Bankers Insurance Group, Inc. v. United States*, 2004 TNT 158-12, (S.D. FL). *Office Max* was decided for the taxpayer and *ABIG* for the government. While some may have thought Office Max to be an anomaly, three recent taxpayer victories[1] have made clear an opportunity for tax refund claims in amounts up to $6 million.[2]

The Statute:

Section 4251 of the Code imposes a three percent excise tax on amounts paid for "communications services," which includes "toll telephone service." "Toll telephone service" is defined in Section 4252(b)(1) and (2) as follows:

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.

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 stations in a specified area which is outside the local telephone system area in which the station provided with this service is located. (Key words *italicized*.)

This statutory language was enacted in 1965 when AT&T held a monopoly over nationwide long distance telephone service and offered, in the above statutory context (1) Toll Telephone Service and (2) WATS service. AT&T participated with Treasury in the drafting of these statutory definitions. "The first type [of toll service offered by AT&T] involved calls that were billed per call according to tolls which were calculated based on both the elapsed transmission time and the mileage band that corresponded to the actual distance of the telephone transmission." See *ABIG* at 18.

With the evolution of telephone industry technology, it has recently become the case that long distance telephone service is not billed on a "distance and elapsed transmission time" basis. Instead, most "modern" long distance billing formats rely exclusively only on "elapsed time." *Office Max*, BNA at K-13.

The Legal Question:

The question put to the district courts was whether the "*and*" in the Section 4252(b)(1) phrase — *a toll charge which varies in amount with the* ***distance and elapsed transmission time*** *of each individual communication* — means only "and," or whether it can also mean "or." Four of these district courts have now held that the statutory language is unambiguous on its face and that the "and" does not also mean "or." Significantly, in *Office Max*, the district court followed the precedent that "statutes imposing a tax are construed liberally in favor of the taxpayer."[3]

Despite the pro-taxpayer opinions, this issue was not addressed in the recent American Jobs Creation Act of 2004. Consequently, we expect the

1 *Fortis Inc. v. United States*, 2004 USLW 2085528 (S.D. N.Y. Sept. 16, 2004); *National Railroad Passenger Corp. v. United States*, 2004 USLW 2098849 (D.D.C. Sept. 20, 2004); and *Reese Brothers, Inc. v. United States*, 2004 TNT 225-19 (W.D. PA Nov. 30, 2004).
2 Taxpayer claims for refund of which we are aware range from a few hundred thousand dollars to $6 million.
3 *The Limited, Inc. v. Commissioner*, 286 F.3d 334, 332 (6th Cir. 2002).

IRS will continue to litigate this issue intensely, perhaps all the way to the Supreme Court, should a conflict among the Circuits result in these cases. Our view is that the four taxpayer victories should not be ignored and that every affected taxpayer should promptly prepare and file Claims for Refund for all open quarters. Telephone technology has changed but the relevant statutory language has not. Unlike interpretations of the Constitution in some circles, tax code jurisprudence has never adopted a "living, breathing instrument" approach to the tax law. An amendment to Section 4252 may surely be in order to protect the fisc, but that will not cure the IRS's current problem, or bar timely filed refund claims for pre-2005 tax quarters.

What should a taxpayer do?

Depending on a taxpayer's circumstances, there are substantial dollars involved. As previously noted, we know of taxpayer refund claims ranging from a few hundred thousand dollars to over $6 million. To preserve the right to refunds for past quarters, a taxpayer with significant Section 4251 excise tax payments for long distance service should promptly file Claims for Refund for all open quarters. Since these taxes are paid quarterly, and a Quarterly Federal Excise Tax Return filed, the statutory period for filing claims for refund — generally, three years — also expires quarterly.

Winston & Strawn's tax lawyers are familiar with this issue and the requirements for preparing and filing timely Claims for Refund for toll telephone excise taxes. We invite you to contact any of the following for more information:

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