No. 13-1269

IN THE
# Supreme Court of the United States

WORLDCOM, INC.,
*Petitioner*,

v.

INTERNAL REVENUE SERVICE,
*Respondent.*

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

## BRIEF OF BROADBAND TAX INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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*Amicus Curiae* respectfully requests that this Court grant the Petition for a Writ of Certiorari and overturn the United States Court of Appeals for the Second Circuit's holding that Petitioner, WorldCom, Inc. ("WorldCom"), purchased "local telephone services" that are subject to the federal excise tax ("FET") on telecommunications services. The Second Circuit's decision, if left in place, creates substantial uncertainty for the broadband industry and could disrupt the broadband marketplace.

## INTEREST OF *AMICUS CURIAE*[1]

The Broadband Tax Institute ("BTI") is a non-profit corporation formed in 1986 to facilitate cooperation among its members on tax issues and developments affecting the cable and telecommunications industries. BTI is currently composed of approximately 250 industry members and associate consultants and includes the majority of the nation's largest communications companies responsible for the collection and remittance of the FET on telecommunications.

BTI's members sell an array of broadband data services that have never been subject to the FET on local telephone service. The opinion of the United States Court of Appeals for the Second Circuit in this

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus* represents that it authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *amicus* or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel for *amicus* represents both that all parties were provided notice of *amicus'* intention to file this brief at least ten days before its due date and that all parties have consented to the filing of this brief. Written consent of Petitioner and Respondent to the filing of this brief is being submitted contemporaneously with this brief.

case potentially upends the long-standing interpretation of both the Internal Revenue Service ("IRS") and the communications industry in the majority of jurisdictions that data services, like those at issue in this case, are not subject to the FET.

If not overturned, the Second Circuit's decision could provide the IRS with a basis to subject BTI's members and their customers to FET on purchases of broadband data services. The Second Circuit's decision thus creates substantial uncertainty by forcing sellers of broadband data services to guess which services are subject to the FET as "local telephone services."[2] Further, it could lead some broadband customers to pay more tax than others, potentially retarding broadband access.

In light of the harmful consequences the decision will likely have for BTI's members and their customers, BTI respectfully requests that the Court grant WorldCom's Petition for a Writ of Certiorari.

## SUMMARY OF ARGUMENT

The Second Circuit's decision abandons the long-standing interpretation by the IRS that data services are not subject to the FET. The decision calls into question the taxability of Internet access and related broadband data services and effectively extends the

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[2] The FET also applies to long distance, or "toll," telephone services charged based on both the time of the call and the distance the call traveled. As telecommunications companies began to bundle local and long distance services and charged only based on time, sellers and consumers of telecommunications services were uncertain as to whether the FET applied to their services. This uncertainty produced countless lawsuits, which ultimately resulted in the IRS refunding excise taxes to millions of telecommunications customers throughout the country.

scope of the FET on "local telephone services" to services that are neither local nor capable of carrying voice communications.

If left in place, the Second Circuit's decision could potentially increase the costs of Internet access and data services to Internet access providers and consumers. Furthermore, the Second Circuit's decision leaves broadband providers guessing whether to collect FET from their customers. As a result, some broadband providers may charge FET on broadband data services while others may not.

The determination that the FET applies to central-office-based-remote-access ("COBRA") service purchased by WorldCom conflicts with the Federal Circuit's decision in *USA Choice Internet Services, LLC v. United States*. 522 F.3d 1332 (Fed. Cir. 2005). The Federal Circuit held that data services that cannot carry voice communications, through no limitation of the taxpayer, are not subject to the FET as "local telephone service."

The Second Circuit's decision is difficult to reconcile with cases in five circuits, including the Second Circuit. *OfficeMax, Inc. v. United States*, 428 F.3d 583 (6th Cir. 2005); *Nat'l R.R. Passenger Corp. v. United States*, 431 F.3d 374 (D.C. Cir. 2008); *Am. Bankers Ins. Group v. United States*, 408 F.3d 1328 (11th Cir. 2005); *Reese Bros. v. United States*, 447 F.3d 229 (3d Cir. 2006); *Fortis, Inc. v. United States*, 447 F.3d 190 (2d Cir. 2006). These cases held that services are not local for FET purposes merely because the services incorporate local telecommunications components. The COBRA services purchased by WorldCom, like the long distance services at issue in those cases, cannot be local telephone services, as they extend beyond a

limited geographic area. WorldCom incorporates the COBRA services into Internet access services to allow users to connect to the Internet, a global network.

*Amicus* respectfully requests that the Court grant WorldCom's Petition for a Writ of Certiorari and reverse the decision of the Second Circuit.

## ARGUMENT

### I. The Second Circuit's decision could stifle the growth and availability of broadband services throughout the United States.

The Second Circuit's decision, if not reversed, will negatively affect access to broadband services, which is a key driver to the wealth and prosperity of the United States. Continued expansion and growth of broadband services remains integral to economic growth and remains a Congressional mandate for the Federal Communications Commission ("FCC"). Telecommunications Act of 1996 § 706, 47 U.S.C. § 1302; *In the Matter of Inquiry Concerning the Deployment of Advanced Telecomms. Capability to All Ams. in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecomms. Act of 1996, as Amended by the Broadband Data Improvement Act*, GN Docket No. 11-121, F.C.C. 12-90, para. 1 (2012). The Second Circuit's decision could increase the cost of purchasing and providing broadband and other data services and, consequently, inhibit the expansion of these services throughout the United States.

Indeed, broadband data services have expanded exponentially throughout the United States in the past decade. One of the key drivers of this expansion has been that broadband data services have

remained largely exempt from federal and state taxes. Congress has preempted state and local taxation of Internet access services for decades, Internet Tax Freedom Act § 1102, 47 U.S.C. § 151, and the IRS adhered to the view that the FET did not apply to data services. Now, for the first time in the long history of the tax, an appellate court has provided the IRS with what the IRS may view as newfound authority to impose the FET on vital data services components of the Internet.

The continued availability of broadband services, in part, depends on the costs associated with the use of broadband. While the majority of the United States has *access* to broadband services, smaller percentages of Americans have broadband services at home. As of September 2013, seventy percent of adults nationwide used broadband at home. Only fifty-two percent of those with income below $30,000 used broadband at home. Pew Research Internet Project, Broadband Technology Fact Sheet (Sept. 2013), *available at* http://www.pewinternet.org/fact-sheets/broadband-technology-fact-sheet/. Conversely, at higher income levels, home broadband use is significantly more prominent, with ninety-one percent of adults with income at or above $75,000 using broadband at home. *Id.* The disparity in home broadband use among different income levels evidences the impact that the costs of broadband deployment and access have on actual broadband use by consumers.

Increased costs associated with the provision of broadband services, such as by extending the FET to broadband services, will further impede access to broadband and data services for lower-income consumers. The Second Circuit's decision will have

such an effect by extending the scope of the FET to data services and providing the IRS with impetus to apply the FET to broadband services. Applying the FET to broadband services will increase costs to broadband customers in two ways. First, some customers must pay the FET on broadband services if the broadband provider determines it should collect FET from customers. Second, for broadband providers that must themselves pay FET on the inputs because they cannot pass the tax through to customers, the broadband providers will likely increase their broadband rates to effectively recover the tax. These increased costs will hamper the continued expansion and availability of broadband services, and Americans falling within lower income brackets will remain underserved.

## II. The Second Circuit's decision creates substantial uncertainty for broadband providers regarding the FET treatment of data services.

The Second Circuit's decision will change the landscape for broadband providers, and such providers will face difficult and conflicting determinations as to whether they must collect FET on their services. Consequently, broadband providers will face increased litigation resulting from such uneven results.

As a result of the Second Circuit's decision, broadband providers, and providers of data services generally, will be forced to guess whether their services are subject to the FET as "local telephone services." This uncertainty will arise whenever a broadband provider incorporates into its data services a local telecommunications component. Broadband providers will inevitably apply the Second Circuit's decision inconsistently, and such

inconsistency within the industry and among the same services will be detrimental to the businesses of those broadband providers that collect FET from customers.

The Second Circuit's decision creates a burdensome test for broadband providers in determining whether broadband and data services are subject to the FET. A broadband provider whose services leverage local telecommunications components must determine whether those components are theoretically capable of carrying voice communications. Even if the components purchased from the local telecommunications company could not carry voice communications as configured for a broadband provider, the dispositive issue under the rule the Second Circuit adopted is whether such components could, in some other instance or hypothetical configuration, carry voice communications. *See In re WorldCom, Inc.*, 723 F.3d 346 (2d Cir. 2013).

The determination as to whether services are subject to FET will be fact-specific for each provider and will lead to incongruous FET treatment of the same data services throughout the United States. The focus of these determinations will be on the inherent capabilities of each component of the data services, depending largely on the technology of each local provider nationwide. If the local component is theoretically capable of carrying a voice communication in one of numerous circumstances, even if not configured for the broadband provider for such use, the broadband provider must still collect FET from its customers, at least in the Second Circuit. Such a rule makes no sense and is inconsistent with the clear language of the statute. Moreover, five earlier Circuit Court opinions

analyzing the FET have refused to expand the interpretation of "local telephone service." *OfficeMax, Inc. v. United States*, 428 F.3d 583 (6th Cir. 2005); *Nat'l R.R. Passenger Corp. v. United States*, 431 F.3d 374 (D.C. Cir. 2008); *Am. Bankers Ins. Group v. United States*, 408 F.3d 1328 (11th Cir. 2005); *Reese Bros. v. United States*, 447 F.3d 229 (3d Cir. 2006); *Fortis, Inc. v. United States*, 447 F.3d 190 (2d Cir. 2006).

The application of the Second Circuit's test will result in broadband providers reaching different determinations as to whether they must collect the FET from customers. Each provider must guess whether there is any feasible instance in which the local infrastructure utilized in its data services could, instead, carry a voice communication. The Second Circuit's test could lead to varying FET consequences for the same broadband provider within different jurisdictions throughout the United States, as the taxability of the provider's services will depend on the infrastructure of differing local telecommunications providers. Likewise, two broadband providers that offer the same data service to customers could have differing FET treatment depending on the contracts they negotiate with local telecommunications providers, or depending on the capabilities of the local telecommunications providers' different infrastructures. The market will, inevitably, favor broadband providers that negotiate more favorable contracts with local telecommunications companies and do not collect FET on their data services.

Furthermore, broadband providers that collect FET on their services will face increased litigation on three fronts: (1) customers seeking refunds of FET

paid to the broadband providers; (2) broadband providers seeking refunds of FET collected from customers and paid to the IRS;[3] and (3) broadband providers seeking refunds of FET paid by the providers for components they input into their services. Long distance providers faced a similar result following litigation regarding the treatment of long distance telecommunications for FET purposes. After the determinations of five circuits that modern long distance services are not subject to the FET, either as toll telephone service or local telephone service, long distance providers faced class action lawsuits filed by consumers, consumers filed class action lawsuits against the IRS, and long distance providers filed lawsuits against the IRS. *See, e.g., In re Long-Distance Tel. Serv. Fed. Excise Tax Refund Litig.*, No. 12-5380, slip. op. (D.C. Cir. May 9, 2014) [hereinafter *FET Refund Litigation II*], *aff'g*, 901 F. Supp. 2d 1 (D.D.C. 2012), *remand from sub nom. Cohen v. United States.*, 650 F.3d 717 (D.C. Cir. 2011), *reh'g* 578 F.3d 1 (D.C. Cir. 2009), *rev'g sub nom. In re Long-Distance Tel. Serv. Fed. Excise Tax Refund Litig.*, 539 F. Supp. 2d 281 (D.D.C. 2008) [hereinafter *FET Refund Litigation I*]; *Matthew v. RCN Corp.*, No. 12 Civ. 0185 JMF, 2012 WL 5834917 (S.D.N.Y. Nov. 14, 2012); *RadioShack Corp. v. U.S.*, 105 Fed. Cl. 617 (2012).

Taxpayers, however, have seen little success in receiving FET refunds from the IRS. Illustratively, customers seeking refunds from the IRS of FET collected by long distance providers never received

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[3] Internal Revenue Code § 6415 enables a collector of FET to seek a refund from the IRS of the tax collected from customers if the collector can show that it has repaid such amounts to its customers. 26 U.S.C. § 6415(a).

refunds because of the IRS's failure to properly adopt and correct its notice establishing the refund claim procedures. *See FET Refund Litigation II*, slip. op. at 8 (affirming the district court decision that the IRS improperly adopted Notice 2006-50, relating to FET refund claims, without notice and comment in violation of the Administrative Procedure Act, and that the taxpayers did not have a remedy for the IRS's failure to correct such errors, despite the lower court's remand for such purpose). Due to the nature of the FET being paid by a collector and the lack of procedures for recoupment of taxes improperly paid to the IRS resulting from their improper expansive interpretation, taxpayers have lost the ability to receive refunds of the taxes. As Judge Brown stated in *FET Refund Litigation II*, "when the [IRS] says a workable refund scheme exists under the current legal and regulatory regime, its contention is, at best, unreasonable, and, at worst, dishonest." *FET Refund Litigation II*, slip. op. at 10 (Brown, J., dissenting). Broadband and other data services providers, as well as their customers, will likely face the same result due to the uncertainty created by the Second Circuit's decision.

Finally, the Second Circuit's decision creates uncertainty for taxpayers by conflicting with the long-recognized understanding that taxpayers may rely on revenue rulings to the extent that the revenue rulings relate to the taxpayers' issues. *See*, e.g., *Estate of Rapp v. Comm'r*, 140 F. 3d 1211, 1217 (9th Cir. 1998) (explaining that when a taxpayer invokes a published revenue ruling that addresses the issue in its case, the revenue ruling is dispositive to the issue). By failing to give the appropriate

weight to Rev. Rul. 79-245,[4] which applied to WorldCom's issue, the Second Circuit leaves taxpayers second-guessing whether they can rely on the IRS's stated position and interpretation of the Internal Revenue Code.

## III. The Second Circuit's decision conflicts with the Federal Circuit's decision in *USA Choice*.

The Second Circuit's decision conflicts with the Federal Circuit's decision in *USA Choice Internet Services, LLC v. United States.* 522 F.3d 1332 (Fed. Cir. 2005). The decision improperly extends the scope of the FET to services that are not actually capable of, or configured for, telephonic communications.

In *USA Choice*, the Federal Circuit determined that a dial-up Internet service provider had purchased a "local telephone service" for FET purposes because the lines carrying its Internet access services were capable of telephonic communications, even though the taxpayer chose not to use them for such communications. *Id.* at 1341. The court distinguished between taxpayer-imposed limitations and local-telecommunications-company-imposed limitations on the use of communications infrastructure for telephonic communications. *Id.* The court determined that, where it was the taxpayer that limited the use of services it purchased to data communications, the services the taxpayer purchased could still be subject to FET. *Id.* The court found the FET applied to the services the

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[4] In Rev. Rul. 79-245, the IRS stated that a service is not subject to the FET if the taxpayer cannot connect a regular telephone to the service and engage in telephonic communications with others. 1979-2 C.B. 380, 1979 WL 51191 (Jan. 1, 1979).

taxpayer bought as an input to its Internet access services because the taxpayer could have received a telephone call over the service it purchased from the local telecommunications company, but instead chose not to use the service for that purpose. *Id.* at 1334-35 & 1341.

The Second Circuit's decision conflicts with the holding in *USA Choice* by looking to the theoretical capabilities of the local infrastructure the telephone companies used to create the COBRA service, rather than the actual capabilities of the service as configured and sold to customers, including WorldCom. In so doing, the Second Circuit's decision extends the scope of the FET to data services that are not capable of "telephonic quality communications."

When properly applying the Federal Circuit's holding in *USA Choice*, the result must be that the FET does not apply to COBRA service. The services WorldCom purchased are very different from the services purchased in *USA Choice*. As purchased, the taxpayer in *USA Choice* could use the service for telephonic quality communications and "answer" a call. Conversely, WorldCom received signals that the local telecommunications company previously converted to digital signals that could not be used to carry telephonic quality communications or "answer" a call. *In re WorldCom, Inc.*, 723 F.3d 346, 350 (2d Cir. 2013). The Second Circuit, however, disregarded the uncontested findings that (1) the local telecommunications company's network access server converted the digital signals, and not WorldCom; and (2) that the network access server could not carry telephonic communications because the server's "switch" did not carry such a capability. *Id.* at 349-

50. Specifically, because the PRI lines used as an input to the COBRA service did not switch through a Private Branch Exchange ("PBX") prior to reaching WorldCom, but instead switched through the local telecommunications company's network access server, WorldCom did not receive a signal that could carry telephonic quality communications. *Id.* at 350.

The Federal Circuit in *USA Choice* sought to limit the scope of the FET on data services, such as Internet access services, to only those services where a taxpayer purchases a local telephone service but chooses not to use the service for that purpose. The Second Circuit's decision, instead, threatens to extend the FET to all communications services that involve local telecommunications components, without exception, even where such components could not carry telephonic quality communications when incorporated into a finished Internet access or data service. Given the wide array of available infrastructure for carrying data communications, the IRS may seek to use this decision to improperly expand the FET to data and Internet access services.

## IV. The Second Circuit's decision is at odds with the long-recognized understanding of "local telephone service."

By treating the COBRA services WorldCom purchased as local telephone services, the Second Circuit's decision conflicts with the long-recognized understanding of "local telephone services" and telecommunications services generally. The IRS seeks to expand the FET on local telephone services to services without a limited geographic scope, which five circuits previously rejected in the context of long distance telecommunications.

Internet access services are not and cannot be "local telephone service," as they are neither local nor qualify as telecommunications services. This Court and the FCC have long recognized that Internet access services, whether broadband or dial-up, do not qualify as telecommunications services. *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967 (2005). In *Brand X*, this Court upheld the FCC's determination that, for purposes of the Telecommunications Act, Internet access services that incorporate broadband inputs as part of a finished Internet access service are not "pure" telecommunications services. Rather, Internet access services are "enhanced" services, in that they require computer processing to convey data. As such, local telecommunications services, when integrated into a finished data service and not used for voice communications, are not telecommunications services under the Communications Act.

The Second Circuit and the IRS, by concluding otherwise, ignore the operational reality of the COBRA services—that such services, both as sold to WorldCom and as incorporated into a finished Internet access service, cannot carry voice communications and instead transmit data packets. Rather, the Second Circuit and the IRS seek to apply the FET to these services on the basis that a subscriber's modem must dial and connect through a local telephone network, even though the COBRA service only transmitted to WorldCom a data stream that WorldCom integrated into a finished Internet access service that cannot carry voice communications.

Even if Internet access services are telecommunications services, they are not "local."

The IRS's expansion of the FET on local telephone services to include data and Internet access services is difficult to reconcile with FET cases in five circuits that determined communications services are not local simply because they access local networks throughout the United States. The IRS's current attempt to expand the FET mirrors its previous attempts in those cases to extend the FET on local telephone services to long distance telephone services. Five circuit courts of appeals rejected that expansive interpretation of "local telephone service." *OfficeMax, Inc. v. United States*, 428 F.3d 583 (6th Cir. 2005); *Nat'l R.R. Passenger Corp. v. United States*, 431 F.3d 374 (D.C. Cir. 2005); *Am. Bankers Ins. Group v. United States*, 408 F.3d 1328 (11th Cir. 2005); *Reese Bros. v. United States*, 447 F.3d 229 (3d Cir. 2006); *Fortis, Inc. v. United States*, 447 F.3d 190 (2d Cir. 2006).

These circuits explained that the long distance services were not local for FET purposes simply because the services necessarily involved local components to deliver the services. The FET definition of "local telephone service" contemplates a limited geographic scope and access to a singular local telephone system, not multiple local telephone systems nationwide. *E.g.*, *OfficeMax*, 428 F.3d at 600. The courts stated, "[i]t is hardly a plain or natural reading of the statute to claim that the entire United States is part of one 'local telephone system.'" *Am. Bankers*, 408 F.3d at 1338 (citing *Fortis, Inc. v. United States*, 420 F. Supp. 2d 166 (S.D.N.Y. 2004)). Nevertheless, that is exactly what the Second Circuit did in this case with COBRA service, by treating a service used to access a national data network as though it were local telephone service.

Internet access services are not local telephone services simply because they incorporate local telecommunications components. The Second Circuit found that the COBRA service was a local telephone service because it could be accessed through local telephone networks. However, the purpose and capability of the COBRA service was not to provide a telephone connection between two users of the same local telephone network for voice communication, but rather to transmit data—and only data—to and from the Internet, nationwide and internationally.

If long distance telecommunications, which carry voice communications, are not "local telephone service" simply because they leverage local telecommunications components, then data-only services, which are used for Internet access and not voice communications, cannot be local telephone services for purposes of the FET. Internet access services are communications services that operate on a global network, and the COBRA service was used to reach far more than the limited geographic area covered by local exchange servers. Local telephone service under the FET contemplates access to one local telephone system and not access to all telephone systems covered by the COBRA service. The COBRA service allowed customers to connect to the Internet and communicate data on a global basis. Such services do not actually involve voice communications, but instead transmit data, thereby falling outside the scope of services long-recognized as telecommunications services. It is, therefore, hardly a plain or natural reading to conclude that access to a global data communications network is part of a local telephone system.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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