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IRS Finally Concedes Defeat on Long-Distance Time-Only Phone Charges; Refunds with Interest to Be Granted Back to March 2003

NEWS-FEDERAL, 2006TAXDAY, (May 26, 2006), Item #I.2, IRS Finally Concedes Defeat on Long-Distance Time-Only Phone Charges; Refunds with Interest to Be Granted Back to March 2003 (IR-2006-82; Notice 2006-50; TDNR JS-4287)

Buckling under the combined weight of five federal circuit courts of appeal losses, numerous district court losses, and the outcry of congressional leaders and the communications industry, the IRS has finally conceded that long distance telephone charges that vary only by time elapsed (not by distance) are not taxable under [Code Sec. 4251 LK:NON: IRC-FILE S4251](#). The IRS now says that it will no longer litigate the issue and will instead follow the federal appellate court opinions that rejected its position:

American Bankers Insurance Group, CA-11, [2005-1 ustc ¶70,241 LK:NON: ustclink 2005-1USTCP70241](#);

OfficeMax, Inc., CA-6, [2005-2 ustc ¶70,246 LK:NON: ustclink 2005-2USTCP70246](#);

National Railroad Passenger Corp., CA-D.C., [2005-2 ustc ¶70,247 LK:NON: ustclink 2005-2USTCP70247](#);

Fortis, Inc., CA-2, [2006-1 ustc ¶70,252 LK:NON: ustclink 2005-2USTCP70252](#); and

Reese Brothers, Inc., CA-3, [2006-1 ustc ¶70,253 LK:NON: ustclink 2006-1USTCP70253](#).

In fact, the IRS is going one step further than the courts in that it will no longer collect the three-percent excise tax on *any* long distance services, even those plans that bill based on both elapsed transmission time and distance of the call.

The government, therefore, will stop collecting the federal excise tax on long distance telephone service and will issue credits or refunds of all excise taxes paid on long-distance service billed after February 28, 2003, along with interest.

The key points of the IRS's new policy concerning the communications excise tax are discussed below:

Long distance and bundled service nontaxable. Long distance service is communication with persons outside the local telephone system of the caller. Bundled service is local and long distance service provided under a plan that does not list the local telephone service charge separately. Bundled service includes Voice over Internet Protocol service, prepaid telephone cards, and plans that provide both local and long distance service for either a flat monthly fee or a charge that varies with elapsed transmission time. Both long distance service *and* bundled service are now nontaxable. As a result, taxpayers are no longer required to pay tax under [Code Sec. 4251 LK:NON: IRC-FILE S4251](#) for long distance or bundled service (“nontaxable service”), but collectors should continue to collect and pay over the [Code Sec. 4251 LK:NON: IRC-FILE](#)

S4251 tax on local-only service charges.

Refunds with interest back to March 2003. Collectors or taxpayers may request a refund of tax paid for nontaxable service that was billed to the taxpayers after February 28, 2003, and before August 1, 2006 (the “relevant period”). The IRS will schedule an overassessment under Code Sec. 6407 LK:NON: IRC-FILE S6407 to keep the period of limitations open for these requests.

Effect on collectors. The IRS has directed collectors to stop collecting and paying over nontaxable services billed after July 31, 2006. Collectors should not pay over to the IRS any tax on nontaxable service that is billed after that date. As to amounts of tax paid on nontaxable services billed *before* August 1, 2006, collectors may repay those amounts to taxpayers, but are not obligated to do so. Note, however, that, while collectors are directed to stop collecting tax on services billed after July 31, 2006, collectors are not required to report to the IRS any refusal by their customers to pay any tax on nontaxable service that is billed after May 25, 2006.

Alternative method collectors may adjust the account for the amount of an overpayment as described in Reg. §40.6302(c)-3(b)(2)(ii)(C) LK:NON: GCMLINK S40.6302(C)-3(B)(2)(II)(C). The adjustment should be reflected on Form 720, Quarterly Federal Excise Tax Return, but it may not reduce the tax liability on that form below zero.

Cut-off date for refunds. The IRS will deny all taxpayer requests for refund of tax on nontaxable service that is billed after July 31, 2006. Such requests should instead be directed to the collector.

Particular forms required. Taxpayers may request a credit or refund of tax only on their 2006 federal income tax return, which is the income tax return for calendar year 2006, or the first tax year including December 31, 2006. Those who are not otherwise required to file a federal income tax return must nevertheless file a return to obtain a credit or refund. Concerning the proper way to request a credit or refund, the notice provides specific guidance for individuals, entities, partnerships, S corporations, estates and trusts, tax-exempt organizations, corporations and other nonfiling entities. Generally, the IRS will not process requests for a credit or refund on forms other than those prescribed by the notice.

Certification and recordkeeping. Instructions to the various federal income tax returns will require taxpayers to certify that (1) the taxpayer has not received a credit or refund from the collector, and (2) the taxpayer will not ask the collector for a credit or refund and has withdrawn any request that the taxpayer previously submitted. Except for taxpayers requesting the *safe harbor amount* (see below), the instructions will also require taxpayers to retain records to substantiate their requests.

Safe Harbor Amount. Individual taxpayers can request a safe harbor amount without having any supporting documentation, but qualify to make that request only if they (1) have paid all taxes billed by their service provider after February 28, 2003, and before August 1, 2006, (2) have not received a credit or refund from the service provider, and (3) have not requested a credit or refund from the service provider or have withdrawn any request. The safe harbor amount is still under consideration and will be announced in later guidance. No safe harbor amount is allowed for entities, however, and they can request only the actual amount of tax paid on nontaxable service.

Requests by collectors. A collector may request a refund or credit only if the person that paid over the tax to the government establishes that it repaid the amount to the taxpayer, or if it obtains written consent from the taxpayer allowing the collector to request the credit or refund (see Code Sec. 6415 LK:NON: IRC-FILE S6415). The notice provides separate guidance for regular

method collectors and alternative method collectors.

Interest on credit or refund taxable. Interest on the credit or refund of the tax paid for nontaxable service must be included as income on the taxpayer's income tax return for the tax year in which the interest is received or accrued. Therefore, individuals are generally required to report the interest on their 2007 income tax returns.

Estimated taxes. A credit or refund claimed with respect to the excise tax will not be considered to be a credit against tax for purposes of determining the amount of estimated tax installments to be paid in 2006. For purposes of determining the amount of the required installments of estimated tax for 2007, the income attributable to the excise tax credit or refund may be taken into account on the date the income is paid or credited in the case of a cash method taxpayer and on the date the return making the request is filed in the case of an accrual method taxpayer.

Finally, [Notice 2005-79 LK:NON: RULINK NOTICE2005-79](#), I.R.B. 2005-46, 952, in which the IRS stated that, notwithstanding its Eleventh Circuit loss in *American Bankers Insurance Group*, it would continue to assess and collect the communications excise tax on long distance telephone services, is revoked. [Rev. Rul. 79-404 LK:NON: rulinK REVRUL79-404](#), which concludes that a long distance service charge is taxable even if it varies only with elapsed transmission time, not distance, will be revoked in a later revenue ruling.

By David Becker, Stephen K. Cooper and Dave Hansen, CCH News Staff