

TAX BULLETIN

Refunds of Communications Excise Tax Paid on Toll Telephone Service on 2006 Tax Returns

In response to a growing line of taxpayer victories in court cases, the IRS issued a notice earlier this year acquiescing to the position taken by the courts that amounts paid for time-only telephone service are not subject to the Communications Excise tax imposed by §4251 of the Internal Revenue Code.

Background

Section 4251 of the Code imposes a tax on amounts paid for communications services, which include local telephone service, toll telephone service and teletypewriter exchange service. These taxes are to borne by the person paying for the service, and the provider of the service is required to collect the tax and remit it to the government.

The service that is the subject of the court challenges and recent IRS guidance is "toll" telephone service, which is defined by the Code as service for which there is a toll charge that varies in amount with distance and elapsed transmission time. In a 1979 ruling the IRS concluded that the tax applied to telephone service charges that varied only with elapsed transmission time and not with distance. This conclusion was challenged by a number of taxpayers and recent court cases have held in favor of those taxpayers.

New Rules

Under the guidance recently issued by the IRS, bundled services and certain long distance service are considered nontaxable services and will no longer be subject to the excise tax. Bundled services include local and long distance service packages that do not separately state the charge for local service. Long distance service includes telephone service to persons outside the local telephone system of the caller.

Collectors and payers of the tax may request a refund of the tax paid on these nontaxable services during the period after February 28, 2003 and before August 1, 2006. Under the notice, collectors have been directed to cease collecting tax on any nontaxable service after July 31, 2006, and they will be required to certify with the IRS that no nontaxable services were billed after July 31, 2006. They will be able to claim refunds if they can demonstrate that they already refunded the tax to the taxpayers from whom it was collected.

Application for Refund

Claims for refund of taxes paid on nontaxable services between February 28, 2003 and August 1, 2006 can be made only on 2006 federal income tax returns. This is a one-time offer by the IRS and failure to follow the guidance put forth will result in a denial of the refund claim. A new line will be added to all individual, corporate, fiduciary, partnership and exempt organization returns for the 2006 year to report the claim of refund. Additional guidance regarding reporting of the refund will be provided in the instructions to the 2006 tax forms. Refunds to collectors will be made by filing form 720X, Amended Quarterly Federal Excise Tax Return.

With respect to the computation of the refund, individuals will be allowed the option of claiming the actual tax paid or a safe harbor amount (\$30 to \$60 depending on number of exemptions claimed). Taxpayers other than individuals may request only the actual amount of the tax paid on nontaxable service billed during the relevant period. Additionally, taxpayers who deducted the excise tax being refunded as business expenses must increase their 2006 taxable income dollar for dollar by the amount of the credit claimed. If the taxpayer is a pass-through entity, the amount of the credit computed will be allocated to the respective shareholders, partners or beneficiaries as appropriate. We will inform our clients as to the exact procedures to be followed in claiming their refunds in conjunction with preparation of their 2006 tax returns.

If you have any questions regarding specific rules for claiming refunds of these taxes or we can assist you in computing the amount of your claim, please contact your Wolf Financial Group representative.