

BEFORE THE INTERNAL REVENUE SERVICE

In the Matter of

Excise Taxes; Communication Services

IRS 2004-61

COMMENTS OF THE VOICE ON THE NET COALITION (“VON COALITION”)

The Voice on the Net Coalition (“VON Coalition”)¹ files these comments in the above captioned proceeding, in which the IRS seeks to “solicit information from the public on how present technology should be treated within the description of telephonic or telephonic quality communication in the definitions of local and toll telephone service under section 4252 [of Title 26 of the U.S. Code].”² The VON Coalition believes that any taxation of Voice over IP (“VoIP”) services would exceed the scope of Congress’s statutory delegation, and would constitute poor public policy. The IRS should not automatically tax talking when new and different technologies like the Internet allow people to communicate in entirely new and different ways. Consequently, VON urges the IRS to abstain from extending the telephone excise tax – also known as the Spanish-American War Tax – to VoIP services. This “tax on talking,” originally meant to fund the Spanish-American War, has served our country and should be given an honorable discharge, not another tour of duty.

DISCUSSION

For more than a century, the Federal Government has imposed an excise tax – or “luxury tax” – on telecommunications, currently equal to 3% of telecommunications revenues. In the first instance, this tax was levied as a temporary measure to help pay for the 1898 Spanish-American War. Although the War lasted just under six months and its debt was settled long ago, this excise tax remains in effect. When President William McKinley first signed the tax into law in 1898, he could hardly have contemplated the Internet, let alone the taxation of this innovative

¹ The VON Coalition consists of companies that are developing and offering voice products and services for use on the Internet and IP networks, including AT&T, BMX, Callipso, Convedia, Covad, IceNet, iBasis, Intel, Intrado, Level 3, MCI, Microsoft, PointOne, pulver.com, Skype, SmartNet, Teleglobe, Texas Instruments, US DataNet, VocalData, and Voiceglo. Largely through the efforts of VON Coalition members, packet-switched voice services are emerging as an exciting new technology benefiting consumers throughout the world. Since its inception, the VON Coalition has consistently advocated that federal and state regulators maintain current policies of refraining from extending legacy regulations and taxes to Internet services. More information about the VON Coalition can be obtained at <http://www.von.org>.

² *Excise Taxes; Communications Services*, IRS Announcement 2004-61, 69 Fed. Reg. 40345 (July 1, 2004).

medium. In fact, at the time the tax was imposed, only 2,000 phone lines were operational in America.³

The telephone tax has done its job, and if anything should be repealed, rather than extended to novel services like VoIP. Congressional actions support this view. In 2000, both the House and Senate voted overwhelmingly to eliminate the excise tax completely.⁵ President Bush has also supported the elimination of the excise tax.⁶ Given the overwhelming opposition to the tax generally, it should certainly not be imposed on Internet communications.

Any extension of this century-old tax to emerging Internet services like VoIP would move the nation in the wrong direction from a public policy standpoint. Historically, excise taxes have often been imposed to discourage certain negative behaviors; thus, “sin taxes” have been levied on cigarettes and alcohol.⁷ VoIP, though, should be encouraged, not discouraged. Over the last two decades, similar Internet innovations like e-mail, the World-Wide-Web, and e-commerce have unleashed powerful transformations that have changed almost every aspect of our lives, grown our economy, and increased our standard of living. The VON Coalition believes that with the right public policies, VoIP can make talking more affordable, while providing a force for increased competition, a platform for innovation, incentives for broadband deployment, and a vehicle for continued economic growth. Any taxation of VoIP, however, might stifle this innovation and leave VoIP’s potential unrealized.

I. VOIP SERVICES ARE BEYOND THE SCOPE OF SECTION 4252

A. VoIP is fundamentally different from traditional telephony

The development of the Internet and VoIP is having a profound and beneficial impact on the United States and the world in a way unimaginable in 1898. The use of VoIP is drastically reducing the cost of communications and creating a foundation and demand for broadband communications that have much greater capacity and functionality than that offered by traditional telephony. Traditional telephone networks require that each pair of users maintain a continuous connection, regardless of the amount of information sent through that path. By contrast, VoIP services digitize the information, and utilize the Internet to optimize the use of

³ See *Information Technology Association Fact Sheet on Spanish-American War Tax* at <http://www.ita.org/taxfinance/fedexctx.htm> (last visited Sep. 27, 2004)

⁵ See H.R. 4516, 106th Cong. §1003 (2000) (vetoed by President Clinton). See Robert J. Wagman, *Excising the Excise Tax*, (June 1, 2001) at <http://www.smallbusinesscomputing.com/biztools/article.php/685301> (noting that the bill was eventually vetoed by Bill Clinton because of his opposition to other measures included in the final text)..

⁶ *Id.*

⁷ J. Fred Giertz, *Excise Taxes*, THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY (1999).

transmission resources by dividing voice and data into packets that can then be routed in the most efficient manner possible. As the cost of computer processing continues to decrease and the demand for communications bandwidth by consumers grows, VoIP will increasingly offer a more economical and robust means of voice communication. However, at present it is obvious that VoIP cannot be regulated using decades-old statutes; not only is VoIP much more complex than traditional telephony, but its continued development is likely to be rapid and unpredictable.⁸ As such, it is clear that any extension of Section 4252, which is tailored to traditional telephony, would be unwarranted.

B. Congress has not authorized the taxation of VoIP

Although administrative agencies, including the IRS, often have broad discretion to shape regulatory policy, they are ultimately constrained by the scope of the substantive authority delegated to them by Congressional statute.⁹ The agency may not legitimately enlarge this scope; agency rules which do so are invalid. This basic rule is particularly relevant in the context of taxation. The Framers abhorred the excesses of executive taxation, and consequently they specifically lodged the power to tax with Congress, and further mandated that all revenue bills originate in the People's House of Representatives.¹⁰

As an initial matter, the excise tax does not apply to VoIP under the plain terms of Section 4252(b)(1), which defines a taxable "toll telephone service" as a "telephonic quality communication" for which "there is a toll charge which varies in amount with the distance and elapsed transmission time of each individual communication[.]"¹¹ As the District Court of the District of Columbia recently affirmed, this definition requires that the toll charge be based on both distance *and* elapsed transmission time.¹² Since VoIP service charges generally do not vary as a function of distance or elapsed time (most provide unlimited local and domestic long distance calling, for a flat fee), VoIP is outside of the scope of Section 4252. As such, the IRS clearly lacks the statutory authority to impose the excise tax on VoIP.

Moreover, it is apparent that Congress intended to tax only traditional telephone services. At the time of Section 4252's amendment in 1965, Congress could not have envisioned the emergence of the Internet and VoIP services. As Section 4252's legislative history unquestionably demonstrates, Congress's intent was to impose a sharply limited and temporary tax on traditional telephony alone. Both the House and Senate Reports establish that Congress was actually motivated by the desire to phase out the excise tax and had no intention of

⁸ See Separate Statement of Chairman Michael K. Powell, *IP-Enabled Services Notice of Proposed Rulemaking*, WC Docket No. 04-36 (Feb. 12, 2004) ("Our starting point – and our most important finding – is the recognition that all IP-enabled services exist in a dynamic, fast-changing environment that is peculiarly ill-suited to the century old telephone model of regulation.").

⁹ See *Chevron v. Natural Resources Defense Counsel*, 467 U.S. 837, 842 (1984) ("If the intent of Congress is clear, that is the end of the matter.").

¹⁰ U.S. CONST., Art. I, sec. 7, 8.

¹¹ 26 U.S.C. §4252(b)(1).

¹² *Nat'l R.R. Passenger Corp. v. U.S.*, No. 03-431 (RMC) (D.D.C., Sept. 20, 2004).

expanding its application.¹³ The Reports also show that the Section's language was broadened only to clarify that traditional telephone *service*, as well as *equipment*, was taxable. In no event, though, did Congress intend to broaden the scope of the tax beyond traditional telephony, or to delegate authority to the IRS to do so.

II. TAXATION WOULD UNDERMINE THE BENEFITS OF VOIP SERVICES

The growth of IP-enabled services like VoIP has been propelled in part by the U.S. Government's "hands-off" regulatory approach. Since the introduction of VoIP services, the federal government, including the FCC, has consistently declined to regulate.¹⁴ An important component of this "hands-off" approach has been the absence of any taxation of VoIP services. In addition to the potential harm that the extension of the excise tax could have on nascent VoIP services in the present, such an extension could have a dramatic and adverse impact on the technological development of VoIP in the future. No tax could properly account for the variety of network configurations or service offerings that are collectively known as VoIP, or ensure a competitively-neutral impact on the evolution of VoIP technologies; an imperfect tax would necessarily favor some technologies over others. As a result, companies might try to design services to avoid taxation, instead of to maximize consumer welfare.

III. THE IRS SHOULD DEFER TO THE JUDGMENT OF CONGRESS AND THE FCC

A. Congress has not determined that VoIP taxation is appropriate

Although it has had ample opportunity to do so, Congress has not modified Section 4252 in order to authorize the IRS to tax VoIP services. Rather, recent Congressional actions demonstrate that Congress is actively debating whether this step is appropriate,¹⁵ while its past actions have supported the repeal of the excise tax completely.¹⁷ As such, any unilateral effort by the IRS to tax VoIP would be highly questionable, and should be avoided. As a legislative body with virtually plenary authority over VoIP, Congress is better suited to craft a unified and comprehensive regulatory policy that effectively balances competing interests and priorities.

¹³ See CONF. REP. 89-525, 1965 U.S.C.C.A.N. 1752, 1761 (June 16, 1965) (noting the phased reduction plan for excise taxes on telephone services); S. REP. 89-324, 1965 U.S.C.C.A.N. 1690, 1725 (June 14, 1965) ("The definitions of local telephone service . . . , toll telephone service, and teletypewriter exchanges service have been updated and modified to make it clear that it is the service as such which is being taxed and not merely the equipment supplied.").

¹⁴ See Jason Oxman, *The FCC and the Unregulation of the Internet* (FCC OPP Working Paper No. 31, July 1999).

¹⁵ Both the House and the Senate are debating the reenactment of the Internet Tax Freedom Act, and attempting to reconcile their disparate views on complex questions of law and policy.

¹⁷ See *supra* n. 4.

B. The IRS should defer to the ongoing efforts of the FCC

While the IRS is expert in many areas, it has not been charged with the substantive management of highly complex communications technologies. Rather, Congress has delegated the regulation of communications services and technologies to the Federal Communications Commission. The FCC not only maintains a staff of experts who are well-versed in the particular issues raised by the introduction of VoIP across multiple contexts, but also benefits from years of experience studying VoIP and Internet-related issues. The FCC has expressed time and time again that old statutes cannot simply be imported and applied to new technologies; rather, a full record which examines the implications of the new technologies must be developed and carefully scrutinized.¹⁸ Currently, the FCC is engaged in a rulemaking that specifically addresses this very task with respect to the many flavors of VoIP, and is analyzing whether VoIP should be treated as an information service or a telecommunications service, as those terms are defined in the Communications Act.¹⁹ The IRS should defer to the FCC and wait to take action in this proceeding until the FCC has finished its comprehensive review of VoIP.

IV. VOIP TAXATION IS IMPRACTICAL

As a policy matter, no tax should be levied if it cannot be easily collected. Substantial government resources are likely to be wasted, and offsetting revenues are likely to be unacceptably low. Technically, an excise tax on VoIP would be extremely difficult to collect. Unlike traditional telephony, VoIP services utilize an indeterminate array of constantly shifting nodes and communications channels, which rarely (if ever) keep records of the type or destination of information they siphon. Moreover, VoIP transmissions are indistinguishable from other forms of data transfer. Once voice communications are digitized, they “look” like pure data (e.g. e-mail), and as such any attempt to isolate and tax VoIP would likely prove futile.

¹⁸ *Federal-State Joint Board on Universal Service, Report to Congress*, 13 FCC Rcd 11501 at ¶ 90 (1998) (“*Report to Congress*”).

¹⁹ *In the Matter of IP-Enabled Services*, Notice of Proposed Rulemaking, WC-Docket 04-36 (released March 10, 2004).

CONCLUSION

For the reasons outlined above, VON urges the IRS to refrain from any attempt to extend the excise tax to VoIP services.

Respectfully submitted,

THE VON COALITION



Bruce D. Jacobs

Glenn S. Richards

Shaw Pittman LLP

2300 N Street, N.W.

Washington, D.C. 20037-1128

Telephone: (202) 663-8000

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