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**SHUGHART THOMSON & KILROY'S TELECOMMUNICATIONS AND NEW TECHNOLOGIES PRACTICE GROUP TELECOM REPORT**

Shughart Thomson & Kilroy, P.C.'s Telecommunications and New Technologies Practice Group has substantial experience in regulatory and enforcement proceedings before the Federal Communications Commission ("FCC") and state regulatory agencies, and in litigation involving telecommunications matters in the federal and state courts. We present below for your information various recent regulatory and court rulings affecting the telecommunications industry. We are available to assist you in such matters.

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**United States Court of Appeals for Third Circuit Joins Other Federal Circuit Courts in Holding That 3% Federal Communications Excise Tax Does Not Apply to Long Distance Services That Are Priced Based on Fixed, Permanent and Non-Distance Sensitive Rates; United States Treasury Announces Discontinuance of Collection of Federal Excise Tax Effective July 31, 2006**

The United States Court of Appeals for the Third Circuit joined four other U.S. Circuit Court of Appeals in ruling that the three percent (3%) federal excise tax as set forth in 26 U.S.C. §4251(a)(1) does not apply to long distance telephone services that are priced based on fixed permanent, non-distance sensitive rates. The Court rendered its ruling in *Reese Brothers, Inc. v. United States*, Case No. 05-2135, in affirming the United States District Court for the Western District of Pennsylvania's ruling that the excise tax did not apply to long distance charges not based on time and distance. The Third Circuit and the lower court's rulings were grounded upon the plain language and structure of the excise tax statute in §4251(a)(1) of the Internal Revenue Code. Thus, the Third Circuit upheld the District Court's decision that Reese Brothers was entitled to a refund from the IRS totalling approximately \$345,000.

Shortly after the U.S. Court of Appeals for the Third Circuit released its opinion in *Reese Brothers*, the U.S. Department of Treasury announced that it had conceded the legal dispute over federal excise tax and long distance telephone service based on time and distance, and the Department of Justice on behalf of the IRS would no longer pursue litigation on this issue. Furthermore, the Treasury Department announced that the IRS will issue refunds of the federal excise tax on long distance service not based on time and distance for the past three (3) years. Taxpayers will be able to apply for refunds on their 2006 tax forms, to be filed in the year 2007.

With respect to tax refunds, the Department of Treasury's announcement stated that no immediate action is required by taxpayers, refunds will be part of the 2006 tax returns to be filed in 2007, refund claims will cover all excise taxes paid on long distance service over the last three years not based on time and distance. In addition, interest will be paid on refunds.

Refunds will not include taxes paid on local telephone exchange service to which the federal excise tax applies, or to long distance service based on time and distance.

Despite the announcement, taxpayers who have paid a substantial amount of federal excise tax for which they are entitled a refund, still have the option of filing a request for refund rather than wait to obtain a fund through the filing of their 2006 tax return in 2007.

Please let us know if you have any questions about obtaining a refund for the three percent (3%) federal excise tax on long distance service not based on time and distance.

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### **FCC Orders That Broadband and VoIP Providers Must Comply with the Communications Assistance for Law Enforcement Act (“CALEA”)**

The FCC has concluded that facilities-based broadband internet access and interconnect VoIP providers are covered by CALEA, and that they must make their facilities accessible to law enforcement agencies, on May 14, 2007. Additionally, the FCC has clarified that the May 14, 2007, compliance date will apply to all facilities-based broadband internet access and interconnect VoIP providers, thereby eliminating any possible confusion about the applicability of the deadline, avoiding any adverse effect on competition, and preventing migration of criminal activity onto networks with delayed compliance dates.

The FCC has also allowing telecommunications carriers the option of using Trusted Third Parties (“TTPs”) to assist in meeting their CALEA obligations and providing law enforcement agencies the electronic surveillance information those agencies require in acceptable format. TTPs provide a variety of services for CALEA compliance to carriers, including processing requests for intercepts, conducting electronic surveillance, and delivering relevant information to law enforcement agencies. If a carrier chooses to use a TTP, the carrier remains responsible for ensuring the timely delivery of call-identifying information, and call content information to a law enforcement agency, and for protecting subscriber privacy as required by CALEA.

The FCC has also restricted the availability of compliance extensions under Section 107(c) of CALEA, to equipment, facilities and services deployed prior to October 25, 1998. The FCC specifically determined that Section 107(c) only provides limited relief from compliance requirements. In other words, the FCC will not grant broad extensions of time to comply with the May 14, 2007, deadline.

The FCC also ruled that it may, in addition to the law enforcement remedies available through the courts, take separate enforcement action under Section 229(a) of the Communications Act against carriers that fail to comply with CALEA. Such enforcement actions may include imposition of forfeitures and penalties, revocation of authority to provide domestic and international telecommunications services, refusal to renew radio licenses and revocation of radio licenses.

The FCC also declined to adopt a national surcharge to recover a carrier’s cost for compliance with CALEA, finding that such a surcharge would increase the administrative burden placed upon carriers and provide them with little incentive to minimize their costs for CALEA compliance.

Finally, the FCC requires all carriers providing facilities-based broadband internet access and interconnect VoIP service to submit interim reports to the FCC to ensure that they will be compliant by May 14, 2007, and also requires all facilities-based broadband internet access and interconnect VoIP providers to CALE A obligations were previously applied to come into compliance with system security requirements in the FCC's rules within ninety (90) days of May 12, 2006, or by August 10, 2006.

Please let us know if you have any questions about this FCC action.

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### **FCC Modifies Advance Wireless Services ("AWS") Auction Schedule and Moves Start Date to August 9, 2006**

The FCC has revised its scheduled requirements for the FCC's first auction of radio spectrum licenses for Advanced Wireless Services ("AWS"). The auction will include 1,122 AWS licenses in the 1710-1755 MHz broadband and 2110-2155 MHz broadband.

The FCC originally scheduled the AWS auction on June 29, 2006. The FCC, however, has decided that more time is needed by potential participants in the auction for preparation and planning for the auction, and has moved the start date to August 9, 2006. In addition, the deadline for filing short form applications for the auction has been moved to June 19, 2006. The FCC had previously set May 10, 2006, as the short form deadline.

If you have any questions about the AWS auction, please let us know.

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### **FCC to Consider Imposing Universal Service Charges on Internet-Based Telephone and an Increase in Such Charges on Wireless Services**

The FCC is reviewing a proposal to assess universal service charges on Internet telephone and wireless services in order to soften the blow from a \$350 million shortfall the Universal Service Fund charge will experience in July 2006, when local exchange carriers' DSL broadband revenue becomes exempt from universal service charges. As we advised you in our newsletter for August 2005 (Vol. II, Issue 6), the FCC deregulated DSL services as a result of the Supreme Court's decision in *Brand X, National Cable and Telecommunications Assn., et al. v. Brand X, et al.* (issued June 27, 2005).

Universal service fees are assessed on all landline and wireless long distance telephone services to subsidize telephone services in rural areas, among other things. The current surcharge is 10.9%, which results in a \$7 billion annual fund.

Some wireless carriers now only pay the universal service charge on their total calls that the FCC estimates to be long distance – 28.5% of all calls. Under the proposal which the FCC is considering, the estimated long distance portion of the wireless carrier's long distance service on which universal service charges will be assessed would rise to 37.1% of the total calls.

In addition, Internet phone service providers (that are VoIP service providers current) do not pay universal service charges, because the FCC has not yet determined whether Voice over Internet Protocol is a telecommunications service. Under the proposal which the FCC is considering, such providers would pay tax on 64.9% of calls which the FCC estimates to be long distance. The assessment of universal service charges would narrow the retail cost advantage which VoIP providers have over wire line and wireless telephone carriers for long distance service.

The FCC is expected to consider the proposal at its meeting on June 15, 2006. If the FCC decides to impose universal service charges on VoIP providers, it may mean that the FCC has decided by implication that VoIP services are a telecommunications service or constitute telecommunications as oppose to an information service because of Section 254 of the Communications Act of 1934, as amended, 47 U.S.C. §25. That section provides, in pertinent part, that every telecommunications carrier that provides interstate “telecommunications services” shall contribute...to specific, predictable and sufficient mechanisms established by the FCC to preserve and advance Universal Service. This section further states that “any other providers of interstate ‘telecommunications’ may be required to contribute to Universal Service if the public interest so requires”.

If you have any questions about this proposal, please let us know.

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If you have any questions about this Report or prior Reports, or other recent FCC or state regulatory rulings, or federal or state court decisions affecting telecommunications, or any of our services, please don’t hesitate to contact us.

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