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# Amtrak Prevails in Refund Suit Involving the Federal Communications Excise Tax

Tax Controversy Alert

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In *National Passenger Railroad Corp. v. United States* , 431 F.3d 374 (DC Cir. 2005), the U.S. Court of Appeals upheld the DC district court's holding that Amtrak was not liable for the section 4251 communications excise tax imposed on toll telephone services.

Because Amtrak is a common carrier, the Court of Appeals held that Amtrak is exempt from tax, pursuant to section 4253(f), on toll telephone services described in section 4252(b)(2), "meaning that it must pay tax only if its long-distance charges fall within [section 4252](b)(1)." Section 4252(b)(1) defines taxable "toll telephone service" to include a service for which the charge "varies in amount with the distance and elapsed transmission time of each individual communication."

Amtrak argued that section 4252(b)(1) did not describe Amtrak's toll telephone services because that section requires the charge to vary with the "distance and elapsed transmission time" of each call. Because Amtrak was billed on the basis of a flat, per-minute rate for its services, Amtrak's services did not vary by the distance of each call as required by the statute.

The government argued that subsection (b)(1) was ambiguous because Congress sometimes uses "and" disjunctively and that the legislative history indicated that section 4252(b)(1) should be read to include any service for which the charge varies either with distance or elapsed transmission time. Further, the government argued that the statute should be construed broadly to include services such as Amtrak's because in 1965, Congress intended to tax all long-distance charges.

The Court of Appeals concluded that reading "and" conjunctively was consistent with Congress's intent to describe the MTS communications service in place in 1965 when Congress last amended section 4252(b). The charge for MTS service varied by both distance and time. Moreover, even if Congress meant to tax all long-distance charges existing in 1965, the court found that Congress would have "had no reason to ensure that the statute covered all future service, as the 1965 Act phased the tax out by the end of that decade." Even the Revenue Ruling cited by the government in support of its proposed construction of the statute "conceded that charges like Amtrak's do not fall within the statute's language."

Echoing an almost century-old Supreme Court decision, the Court of Appeals stated: "What the government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function." Accordingly, the court held that a service is taxable by virtue of being described in subsection 4252(b)(1) only when the charge for a call varies in amount with both the call's distance and its elapsed transmission time, and because Amtrak's charges did not vary by distance, they were not taxable.

Two other Courts of Appeals have held against the government on this issue. In *OfficeMax v. United States*, 428 F.3d 583 (6th Cir. 2005), the Sixth Circuit found that OfficeMax's long-distance services were not described by section 4252(b)(1) because the language of the statute unambiguously requires, and the legislative history supports, that "and" be read conjunctively. Because OfficeMax, unlike Amtrak, was not an exempt common carrier, the court also had to address whether OfficeMax's services were taxable as toll telephone services described in section 4252(b)(2). The court held that the services, billed on the basis of a flat, per-minute rate, were not described by, and were not taxable under, section 4252(b)(2) since they were not billed as "a periodic charge (determined as a flat amount or upon the basis of total elapsed transmission time) [entitling the subscriber] to the privilege of an unlimited number of [calls]." Similarly, in *American Bankers Ins. Group v. United States* , 408 F.3d 1328 (11th Cir. 2005), the Eleventh Circuit reversed the district court's holding that "and" as used in section 4252(b)(1) could be read as "or." In addition, three other district courts, and the Court of Federal Claims (twice), have held against the government on this issue. The government filed a petition for en banc rehearing in December 2005 in the *OfficeMax* case.

In response to the *American Bankers* decision, the Service issued Notice 2005-79 stating that it will "continue to assess and collect the tax under section 4251 on all taxable communications services, including communications services similar to those at issue in the case," even from taxpayers in the Eleventh Circuit. The Service noted further that taxpayer refund claims would not be processed while there are pending cases in other Circuits. Appeals are pending in the Third and Federal Circuits.

*Editor's note: Miller & Chevalier represented Amtrak in this appeal.*

**Tax Court Finds Times Mirror Mathew Bender Transaction Taxable**

The Tax Court denied tax-free reorganization treatment on the Times Mirror Co., Inc. (TM) transfer of Matthew Bender & Co., Inc. (Bender) to Reed Elsevier (Reed) in *Tribune Co. v. Comm'r,* 125 T.C. No. 8 (2005). In 1998, TM exited the legal publishing business by disposing of its interest in Bender in what TM planned as a non-taxable reverse triangular merger. In 2002, the Service taxed the Bender transaction as a sale of Bender stock for cash.

For the Bender transaction, Reed created two special purpose corporations, MB Parent and MergerSub, and a special purpose LLC, Liberty Bell I, LLC (Liberty Bell), with MB Parent as the sole member. MergerSub borrowed $600 million from a Reed affiliate, and Reed contributed $775 million in cash to MergerSub for all of the MergerSub common stock and MergerSub preferred stock. Reed contributed the MergerSub preferred stock to MB Parent for all of the MB Parent preferred stock (with 80% of the vote). MergerSub then transferred the cash to MB Parent in exchange for all of MB Parent's common stock (with 20% of the vote). When MergerSub merged into Bender (with Bender surviving), four things occurred: (1) all of the MergerSub stock was converted into Bender stock, in the same class and with the same voting rights; (2) TM's Bender stock converted into all of MB Parent's common stock (with 20% of the vote); (3) TM became the non-member manager of Liberty Bell; and (4) MB Parent contributed $1.375 billion in cash to Liberty Bell.

TM then owned all of the common stock in MB Parent, which in turn wholly owned Liberty Bell. Under Liberty Bell's LLC agreement, the manager had complete control over the assets of the LLC and owed fiduciary duties to only the common stockholder of its sole member (i.e., TM). TM retained an indirect, non-controlling interest in Bender through MB Parent's ownership of Bender (formerly MergerSub) preferred stock, and Reed retained an indirect, non-controlling interest in Liberty Bell through ownership of MB Parent preferred stock. The combination of redemption rights and the put and call options ensured TM of eventual undivided ownership of MB Parent.

In a reverse triangular merger under section 368(a)(2)(E), the owners of the target must exchange a controlling amount of stock in the surviving corporation for voting stock in the parent. TM argued that it met all of the judicial and statutory requirements for a tax-free reverse triangular merger. TM exchanged all of its Bender stock for MB Parent's voting common stock, which the parties valued at $1.375 billion. TM claimed the cash in Liberty Bell was not separate consideration because Delaware law restricted Reed's ability to use the cash. TM alternatively argued the exchange of the Bender-stock for MB-parent stock was a B reorganization. TM argued that no one would purchase the MB Parent common stock separately from the management of Liberty Bell; therefore, the Liberty Bell management rights were not boot.

The Service argued that the Bender transaction was a taxable sale of Bender to Reed for $1.375 billion. In the Service's view, the requirements for a tax-free reverse triangular merger were not met because the value of the MB Parent common stock exchanged was worth less than $1.1 billion (80% of $1.375 billion). The Service argued that the requirements for a B reorganization also were not met since the constructive receipt of the management rights for Liberty Bell was impermissible boot.

Sidestepping arguments over TM's fiduciary duties as manager of Liberty Bell, the Tax Court found that the primary consideration received by TM was the management control over the cash in Liberty Bell and that the MB Parent common stock had an objective value of less than $1.1 billion. Because TM did not exchange control of Bender for voting stock of MB Parent, the Court concluded that the Bender transaction could not constitute a reverse triangular merger. The Court found that even though the MB Parent common stock and management of Liberty Bell were likely inseparable, the parties had structured the management of the LLC so that it was separate from the stock ownership and that a separate valuation of this right was appropriate. Because MB Parent common stock was not TM's sole consideration in the transaction, the solely-for-voting-stock requirement for a B reorganization also was not met. Instead, the Court found that the transaction was a taxable sale of Bender stock for $1.375 billion in cash. TM's parent company has indicated it will appeal this decision.

Several aspects of Court's opinion could have implications that extend far beyond this particular transaction. The Court's decision to separately value the management rights could have implications for cash-rich split-offs and other transactions where cash or management rights are an important factor. The Court's expanded concept of boot may also affect prior reorganizations.

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