Opinion
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SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

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SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION

U. S. SPRINT COMMUNICATIONS COMPANY, et al.

Petitioners,

v.

DISTRICT OF COLUMBIA

Respondent.

C.A. 8599-87
Tax Docket 4011-87

App. No. 87-1353

AMERICAN TELEPHONE & TELEGRAPH COMPANY, et al.

Plaintiffs,

v.

DISTRICT OF COLUMBIA, et al.

Defendants.

C.A. 10080-87

App. No. 87-1354

O R D E R

This matter came before the Court on a hearing of the Plaintiff-carriers' claims that the District of Columbia's Gross Receipts Tax Amendment Act of 1987 (the Act) and a companion emergency Bill, the Gross Receipts Tax Amendment Emergency Act of 1987, was unconstitutional. Upon a review of the pleadings, arguments of counsel and directive from the District of Columbia Court of Appeals,[1/]

1/ Remand from D. C. Court of Appeals on October 6, 1988 directing the Trial Court to file a more detailed "Findings of Fact" or, in the alternative, a ruling on the merits.

the Court makes the following ruling of the merits:

Background and Parties

Since the divestiture of AT&T, the telecommunications industry has undergone unprecedented changes and long distance subscribers and their access mechanism were not immune from these changes. The typical telephone subscriber is a customer of a local telephone company which in turn is part of a regional company created in the breakup of AT&T, part of a national holding company (such as U.S. Sprint, formerly GTE), or an independent company. It is the local company which handles all dialed calls within its local service area and, in some States, handles all toll calls in a wider market area. In most States, including the District of Columbia, the local or regional telephone company has competition for some or all of the intrastate toll calls from one point in its system to another. Undisputably, the long distance industry is a powerful industry. In 1986 alone, it was a $60 billion industry with some of the larger players spending tens of millions of dollars in marketing and advertising aimed at securing customers throughout the Nation.[2/]

On July 14, 1987, the Council of the District of Columbia (hereinafter the "Council") adopted the Gross Receipts Tax Amendment Act of 1987 (the Act) and a

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2/ See generally U.S. Department of Justice, The Geodesic Network: 1987 Report on Competition in the Telephone Industry ("DOJ Study"), at 3.5 and 3.4.

companion emergency Bill, the Gross Receipts Tax Amendment Emergency Act of 1987. Pursuant to the Council's emergency powers, the Emergency Act became effective immediately for a period of 90 days, expiring on October 1, 1987. See, D.C. Code § 1-229(a) (1981). The Emergency Act made the tax retroactive to July 1, 1986 without any payment being due before October 30, 1987. The permanent Act became effective October 1, 1987. By its terms, the Act imposed a tax at the rate of 6.7 percent on the gross receipts of telecommunication companies engaged in the provision of toll telecommunication services.

Plaintiffs (the carriers) are "telecommunication companies" and offer "toll telecommunication services" within the definition of § 6(5)(B)(V) of the 1902 District Appropriation Act, as amended by the Gross Receipts Tax Amendment Act of 1987, D.C. Code § 47-2501 (Supp. 1988). Each of these carriers is subject to the tax in question.

In No. 4011-87, Plaintiff-carriers are as follows: U.S. Sprint Communications Company is a joint venture under the partnership laws of New York. TMC Long Distance of Washington Incorporated is a corporation organized under the laws of the District of Columbia. Starnet International Inc. is a corporation organized under the laws of the State of Oregon. Intervenor Allnet Communication Services, Inc. is a corporation organized under the laws of the State of Illinois. Intervenor Cable & Wireless Communications, Inc. is a corporation organized

under the laws of the District of Columbia. Intervenor Mid-Atlantic Telecommunications, Inc. is a corporation organized under the laws of the Commonwealth of Virginia. Intervenor Long Distance Service of Washington, Inc. is a corporation organized under the laws of the State of Delaware. Intervenor RealCom Communications Corporation is a corporation organized under the laws of the State of Delaware. In C.A. No. 10080-87, Plaintiff-carriers are American Telephone & Telegraph Company and AT&T Communications of Washington, D.C., corporations organized under the laws of the State of New York.

The Defendants (the District or District defendants) are Marion S. Barry, Jr., Harold L. Thomas, and the District of Columbia. Marion S. Barry, Jr. is the Mayor of the District of Columbia and is sued in his official capacity. Harold L. Thomas is the Director, Department of Finance and Revenue (Acting Director at the commencement of this litigation), and is sued in his official capacity. The District of Columbia is a body corporate for municipal purposes which may sue and be sued under its Congressional charter.

FACTS

1. The purpose of the Act is to restore to the District of Columbia's tax base those revenues from long distance telephone calls which were lost as a result of the AT&T divestiture which became effective on January 1, 1984.

2. Prior to the divestiture, C&P Telephone Company and AT&T provided nearly all long distance telephone service to and from the District. C&P billed for this service and through an arrangement with AT&T (called the division of revenues), retained a portion of the income for itself which it included in its revenues subject to tax by the District. In addition, C&P, beginning in the 1970's, provided network access services to other unaffiliated long distance carriers such as MCI Telecommunications, Inc., and U.S. Sprint Communications Company (formerly GTE and U.S. Tel. Co.). The unaffiliated companies in turn paid C&P for the use of the equipment that allowed them to service their customers. Prior to the divestiture, C&P did not pay the gross receipts tax on these revenues contending that these revenues were not derived from the sale of public utility services within the meaning of the existing utility statute.

3. After divestiture, AT&T became an unaffiliated carrier like MCI and U.S. Sprint. Rather than rely on the old division of revenues, AT&T, like its competitors, paid to C&P access charges for use of the local equipment. Consistent with its earlier treatment of the access charges from MCI and U.S. Sprint, C&P excluded these revenues from those subject to tax by the District.

The record and the testimony here indicate that in 1984, as a result of divestiture, the Department of Finance and Revenue sent letters and assessments to AT&T, Sprint,

and the other large carriers stating that they were subject to the District's then existing tax on utilities. D.C. Code § 47-2501 (1981). Although the Department ultimately withdrew the assessments, it did so having decided that access charges paid to C&P were taxable. In subsequent communications with, at least, AT&T, the Department indicated that if the C&P assessment failed, it might again look to long distance carriers to make up any revenue loss.

Once assessed, C&P paid the tax, interest and penalty due, and sought an administrative refund. When that was denied, it brought suit requesting that the Court refund the taxes paid on revenues derived from access charges. It contended that these revenues were not derived from the sale of public utility services within the meaning of the statute and, as such, were not includable in the revenues subject to the utility tax.

In July 1985, the Superior Court of the District of Columbia, Tax Division, agreed with C&P and ordered the District to refund the gross receipt taxes C&P paid on these revenues. The District of Columbia Court of Appeals in District of Columbia v. C&P Telephone Co., 516 A.2d 181 (D.C. 1986) affirmed this Court's decision holding that the revenues from the network "access charges" were not taxable because the services C&P provides to other utility companies are not public utility services. The District, with passage of the Act, sought to correct the problem

presented by the C&P challenge and to recover the resulting loss in revenues. However, the new legislation chose to impose a tax on the gross receipts of the carriers that were selling long distance services in the District. The District estimated that the exclusion of "access charges" had resulted in a revenue loss of approximately $8.9 million annually. A District witness (Mr. Cook) testified that taxing the long distance carriers would yield the District approximately $18.5 million per year. He further estimated that the retroactive portion of the tax would bring in a one-time payment of approximately $20 million.

4. The Act was introduced in the Spring of 1987 or one month after the District's request for an en banc hearing in the C&P case was denied by the Court of Appeals. About the time of the bill's introduction, the Department of Finance and Revenue, on April 7, 9, and 28, held informal discussions with industry representatives. AT&T, U.S. Sprint and Cable Wireless, each carriers here, were in attendance at least one or more of these sessions. Both of the District witnesses (Mr. Lund and Mr. Many) and the AT&T witness (Ms. Schultz) agreed that the "origination or destination and billed" test for determining whether the revenue from telephone calls would be taxed was put forth by the industry. The industry, however, advocated a sales tax and advanced this test to avoid multiple taxation in that context.

Mr. Cook, the District's witness, testified that gross receipts and sales taxes are essentially identical in that they are both paid on gross revenues. Except in those cases in which the customer is exempt from the sales tax (which accounts for many entities within a Nation's Capitol, i.e., the District of Columbia), it is the same revenues that are taxed. In the case of the sales tax, the customer pays the tax which is calculated on the amount it is paying the carrier for long distance services. In the case of gross receipts tax, the company, rather than the customer, is paying the tax on revenues it receives from the customer. Given the exemption factor, the District's use of a sales tax would fall far short in addressing the loss revenue.

Hearings were held in May and several companies (including AT&T, U.S. Sprint and Cable Wireless) were active and vocal participants in those hearings. Further, roundtable discussions were held by Council staff and Department of Finance and Revenue personnel. The industry representatives expressed a strong preference for a sales tax rather than a gross receipts tax by raising concerns of the potential multiple taxation and/or the difficulty in compliance under a gross receipts tax that carried no apportionment. The smaller telecommunications companies did not attend these roundtables to express their concerns over compliance, as they are now expressing in this litigation.

5. The tax is levied on all carriers' receipts from toll telecommunications services that

> "... originate from or terminate on telecommunication equipment located in the District and for which a toll charge or periodic charge is billed to an apparatus, telephone, or account in the District, to a customer location in the District, or to a person residing in the District, without regard to where the bill for the service is physically received ..." Act, Section 6(5)(B) (i)(1), codified at D.C. Code § 47-2501 (1988 Supp.).

The Act exempts from gross receipts tax so called "access charges" designating such charges as "sale for resale" transactions in recognition of the C&P decision that telecommunications providers are "public utilities" when they purchase services and commodities from each other. The Act also allows a credit for amounts already paid on the personal property tax, and exempts each carrier from that tax in the future as well as the sales tax for equipment used in the generation of revenues taxable under this legislation.

The tax rate is 6.7 percent of the gross receipts, and the prospective portions are to be paid on a monthly basis. The tax is due by the 20th day of each calendar month for the preceding month. The retroactive portions were to be paid in two equal installments on or before November 1, 1987, and January 11, 1988.

The gross receipts tax is a self-assessment tax. The first payment was due on the prospective portion of the

tax by October 20, 1987, and on the retroactive portion of the tax by November 1, 1987. Although some of the carriers filed the requisite affidavits, none fully prepaid the tax before instituting this litigation.

6. The carriers are telecommunications companies doing business in the District of Columbia. The testimony made clear that the carriers differ widely, both as to their relative positions in the industry and their technological capabilities in terms of their compliance with the District's tax.

7. Undisputed testimony indicated that AT&T, U.S. Sprint, along with MCI (which is not a party here), are facility based carriers using their own equipment to service customers nation wide. Together they supply long distance service to 90 percent of the customers nationwide, with AT&T having approximately 70 to 80 percent and the others with approximately 10 percent of the market. These carriers were aware of the Department's 1984 post-divestiture efforts, participated in many of the 1987 discussions, and maintained that a sales tax approach as opposed to a gross receipts tax would be their preference.

U.S. Sprint, the other large carrier in this litigation, chose not to call any witnesses to testify. It did put forth documents in evidence to show that it filed a tariff with the FCC but contended that it would be unable to pass on the cost of the retroactive portion of the tax to its customers. It also contended in its pleadings that

for some of its calls, it could not determine origination. The District's witnesses (Mr. Lund and Mr. Many) stated that after the Act's adoption but before payments were due, Sprint wrote to the Department of Finance and Revenue explaining its peculiar compliance problems. The Department replied (as was the practice with other carriers) that it would consider returns based on recognized sampling techniques or some other documented method. Subsequent to that correspondence, Sprint filed notarized letters in place of the gross receipts tax return devised by the Department. While these notarized letters indicated the proposed tax owed, Sprint never paid the tax. When the assessments were issued in November, the Department had added a penalty since Sprint's reported figures in each letter indicated that it received exactly the same revenues for each month.

8. The Act was adopted by the D. C. Council on the premise that the telecommunication companies had the option of passing along the tax on their gross receipts to their customers. In its report accompanying the Bill, the Committee stated:

> "The Federal Communications Commission ("FCC") permits these toll telecommunication service companies to recover the gross receipts taxes paid by making a separate charge to customers on their bills in jurisdictions where a gross receipts tax is imposed (SEE In the Matter of AT&T Communications Tariffs 1 and 2, MEMORANDUM OPINION AND ORDER, Adopted May 29, 1986; Released May 30, 1986) [60 R.R.2d 468, 480-82].

> "While such a recovery is permitted, it is important to note that the affected companies have the option of absorbing all or a part of the gross receipts tax."

Report at 7 (emphasis added).

9. The remaining telecommunications industry (considerably smaller in size), or approximately 10 percent of the market, is divided among a large number of regional carriers. These resellers offer their customers long distance services that they purchase in bulk from AT&T, MCI and U.S. Sprint. Allnet and Cable and Wireless also service areas other than the Washington Metropolitan area. Like the other carriers they were familiar with the District's post-divestiture exploration of tax alternatives and attended the various discussions while the Act was being developed. Allnet's witness, Elizabeth Ragan, testified that the company was experiencing some compliance difficulty due to an earlier merger of companies with incompatible record keeping. She acknowledges that the District had offered sampling as a calculation technique but that, to date, the company had made no attempt to comply. Cable and Wireless, through its witness James Burdge, enumerated a number of compliance difficulties. Notwithstanding these compliance difficulties, some attempt had been made to comply with an estimated payment of the tax. The remaining regional carriers, Mid-Atlantic Telecommunications, RealCom Communications Corporation,

Long Distance Service of Washington, Inc., TMC Long Distance of Washington and Starnet are also smaller resellers. None of these carriers were invited to participate in the roundtable discussions regarding the tax. Each first learned of the tax when the Department circulated materials to all companies that paid access charges to C&P. Representatives of TMC and Starnet testified at trial. Martin Huddock, for TMC, indicated that his company was small, that his only customers were in the District, and that only about 10 percent of the company's calls originate in the District. He indicated that he would have difficulty identifying the District calls from other calls within the D.C. Local Access Transport Areas (LATA) because of his technological capabilities. He admitted that since he knew the percentage of minutes by jurisdiction and the percentage of revenues by jurisdiction that he might be able to estimate, by some rough approximation, the amount of the tax due to the District. Mr. Moreland, for Starnet, testified that his company has paid gross receipt taxes in twenty states. Starnet had not filed the District's return nor paid the District's tax, primarily because of its technological limitations and the uniqueness of the D.C. LATA configuration which, as indicated, embraces part of the States of Maryland and Virginia.

10. The District called Fred J. Kelsey, whom the Court qualified as an expert witness, to explain such

technical areas as Feature Group or access options, FCC relationships to these new carriers, and retroactive rate making. He was also asked to give some general background on the telecommunication's industry.

Mr. Kelsey first explained that despite divestiture, AT&T continues to have 75 to 80 percent of the market and together with the other facility carriers (MCI and U.S. Sprint) has all but approximately 10 percent of the market. This percentage is changing every day as the market continues to be competitively price sensitive.

Mr. Kelsey also explained that Feature Group A (FGA) was the earliest available technology and the most primitive form of access options. This group required the caller to dial a seven digit number to access a switch, receive a dial tone before dialing a six digit number (personal identification number or PINS), and then the area code and the intended long distance number. He agreed that in these calls the carrier did not know where in the D. C. LATA the call originated. Indeed, he too noted that the D.C. LATA is unique in itself. Unlike other States, which have LATAs within their own state boundaries, D.C. embraces portions of Virginia and Maryland. Thus, the potential for multi-taxation is very apparent. Mr. Kelsey explained, however, that since the quality of the service was poor and the inconvenience of calling so many numbers was unattractive, this group service was being replaced by an equal access service which would help to supply the carrier with the origination data needed in determining the tax liability.

Mr. Kelsey explained that Feature Group B (FGB), the trunk side connection with fewer numbers to dial, was a somewhat better quality access service. However, he testified it too was being phased out. He noted that like FGA, the carrier was not supplied the caller's origination point though at the time of the call that information, he suggested, might be available through C&P. Whether or not such information has been retained is another issue.

Mr. Kelsey explained that Feature Group C (FGC) entails dialing number 1-800, and the number then is dedicated solely to AT&T, which presented none of the problems of A and B. He explained that Feature Group D (FGD), equal access, was a quality service mandated by the Divestiture to be eventually made available nationwide; and that Feature Group D presented none of the problems associated with Feature Groups A and B. He explained that C&P was ahead of schedule in upgrading its switches to accommodate this service in which the dialing of 1 would access one's pre-selected carriers and that, currently, approximately 90 percent of the 202 area code was equipped with equal access.

Mr. Kelsey also testified that in his opinion the carriers would have no difficulty in passing on prospectively the cost of this tax. He explained that the FCC, to date, has chosen not to regulate any carrier other than AT&T; but even as to AT&T, it was his opinion that the

FCC would permit it, as a new cost, to be factored into any of its new proposed rates.

CONCLUSIONS OF LAW

The Act, In Imposing A Retroactive Tax Upon Gross Receipts Is Unconstitutional

It is well settled that states may enact tax statutes that operate retroactively if they are consistent with the Constitution. Scallop Corp. v. Tully, 546 F. Supp. 745, 751 (N.D.N.Y. 1982) aff'd, 705 F.2d 645 (1983). Due Process is violated only if a statute seeks to achieve its purpose in an "arbitrary and irrational way". Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976); Duke Power Co. v. Carolina Enviromental Study Group, Inc., 438 U.S. 59 (1978). Judicial scrutiny of a statute must therefore include an assessment of the rationality of retroactive effects as a means to achieve the legislative purpose. Nachman Corp. v. Pension Ben. Guaranty Corp., 592 F.2d 947, 958 (7th Cir. 1979).

However, the issue of whether a gross receipts sales tax on telecommunications may be constitutionally applied retroactively by a state, without violating the Due Process Clause, has never been narrowly and directly addressed. As to the Court's duty to distinguish between permissible and impermissible retroactive tax legislation, "the lower courts are in conflict and the Court's prior cases fail to furnish adequate guidance." Van Emmerik v. Janklow, Governor of South Dakota, 454 U.S. 1131, 1134 (1982).

It has generally been held, however, that before a tax statute's retroactive application is declared "so harsh and oppressive as to trangress the constitutional limitation", it is necessary to inquire into the "nature of the tax and the circumstances in which it is laid". Welch v. Henry, 305 U.S. 134, 147 (1938). See Sidney v. Commissioner of Internal Revenue, 273 F.2d 928, 932 (2nd Cir. 1960) (Welch test pertinent to analysis of retroactive tax statute); First National Bank in Dallas v. U.S., 420 F.2d 725, 730 (Cl. Ct. 1970) (court guided by criteria delineated in Welch).

In U.S. v. Hemme, 476 U.S. 558 (1986), the Court in expanding on Welch added that where a statute, without notice, gives a more oppressive and different legal effect to conduct undertaken before enactment of the legislation, such retroactive legislation should be determined unconstitutional. Hemme, supra at 569. Thus, a threshold inquiry of this Court must be whether Plaintiff-carriers received proper notice of the retroactive application of the tax.

In 1984, the District demanded payment from the major Plaintiff-carriers under the then-existing statute providing for taxation of "utility" services. Carriers responded that they were not subject to the tax under existing law and the District withdrew their demands that same year, pending outcome of the C&P litigation over access charges. There is no evidence that such demands were also made to the smaller

Plaintiff-carriers. Bill 7-186, introduced April 7, 1987, did not provide fair notice of the ultimate contents of the Act as enacted on July 17, 1987, which required the imposition of a gross receipts tax. Structurally, the original bill merely amended the existing gross receipt tax law by eliminating the phrase "public utility" before the phrase "commodities and services", defining "telephone company" more broadly, and then exempting access charges. Plaintiffs further argue that as a result of the roundtable discussions, while the bill was pending in the Council, they believed they had persuaded the Department, hence the Council, in adopting a sales tax instead of a gross receipts tax. Their actual notice therefore came from the Bill's actual passage containing a gross receipts tax and, more specifically, its retroactive application.

The Department argues that no notice of this tax is required by due process because such action would "unfairly make the public interest subservient to the private interest". The Department further states that assuming *arguendo* that due process does require advance notice of the tax, such notice was provided by the public roundtable discussions of the tax prior to its enactment, relying on *U.S. v. Darusmont*, 449 U.S. 292 (1981). This Court finds this argument to be without merit because in *Darusmont*, *supra*, the proposed amendments to increase the rate of a minimum tax under The Tax Reform Act of 1976, had been under public discussion for almost a year before its enactment.

Further, the final federal Tax Reform Act reflected a compromise between the House and Senate and, therefore, both bills provided notice of the impending changes. Id. at 299. The instant case concerns a local Washington, D.C. law. Such local "state" laws are not accompanied by the easily accessable publications commonly associated with federal Congressional actions. Moreover, this Court has held as early as 1962 that C&P revenues from access services, provided to long distance carriers other than AT&T, were not subject to tax. Chesapeake and Potomac Telephone Co. v. District of Columbia, No. 1756 (D.C. Tax Ct, July 17, 1962) aff'd in part, 117 U.S. App. D.C. 21, 325 F.2d 217 (1963). Therefore, carriers had ample basis to believe that their revenues would not be subject to gross receipt taxes. It is apparent that the Department, through the Council, wanted to most expeditiously deal with the District's substantial revenue loss. (The C&P decision required the refund of some $14.7 million in gross receipts taxes, plus the Department's inability to collect tax charges of approximately $8.9 million for July 1, 1985 through June 30, 1986.) In their zeal, the Council failed to provide adequate notice of the Acts' approach and, more importantly, the retroactive applications of the tax.

The Court next considers whether the statutes retroactively gave a more oppressive and different legal effect to the conduct undertaken by Plaintiff-carriers before enactment of the legislation. Hemme, supra at 569.

The Second Circuit has stated that retroactive tax legislation will not be unconstitutional, "if it is no more burdensome than the taxpayer should have expected it to be when he did the thing which created the tax liability." Wilgard Reality, 127 F.2d 514, 517 (1942). Since Plaintiff-carriers had no adequate prior notice of the retroactive gross receipts tax, the tax is more burdensome than contemplated. The Acts' retroactivity, without warning, denied Plaintiffs an opportunity, prior to the Act's effective date, to decide whether to reconstruct their respective business in the District of Columbia or to withdraw from the District of Columbia so as to avoid incurrence of the tax between July 1, 1986, and the effective date of the Act. Plaintiff-carriers are worse off than they would have been without enactment of the Act because if Plaintiffs had known of the tax during the retroactive period, they could have recovered against their customers under the then-existing tariff. As noted earlier herein, the Report of the Committee on Finance and Revenue on Bill 7-186, dated June 29, 1987, p. 7 (Report) observed:

> The Federal Communications Commission ("FCC") permits these toll telecommunication service companies to recover the gross receipts taxes paid by making a separate charge to customers on their bills in the jurisdiction where a gross receipts tax is imposed ...
>
> While such a recovery is permitted, it is important to note that the affected

> companies have the option of absorbing all or part of the gross receipts tax.

Plaintiffs argue that this Court should not apply a substantive due process inquiry to determine whether the retroactive tax was imposed by the legislature in an "arbitrary and irrational" way, since cases utilizing such an analysis concern pension plan litigation and are not tax decisions, see Pension Benefit Guaranty Corp. v. R.A. Gray & Co., 467 U.S. 717 (1984). This Court, however, considers Scallop Corp. v. Tully, 546 F.Supp. 745 (N.D.N.Y. 1982), aff'd, 705 F.2d 645 (1982), to provide some persuasive guidance. There, a New York statute sought to collect a two percent tax on gross receipts of oil companies. The oil companies claimed that such a tax was unconstitutional because it imposed tax liability during a period when the oil companies were prevented from including the cost of the tax in the sale price of their products. Id. However, Scallop was ultimately determined on federal preemption, Supremacy Clause and jurisdictional grounds. Scallop, supra.

This Court determines that the equities are on the side of Plaintiff-carriers. The lack of adequate notice and the arbitrary and irrational way of computing the tax renders the Act unconstitutional.

The Act, Insofar As It Fails To Apportion Taxable Gross Revenues Between The Two Jurisdictions Necessarily Involved In An Interstate Or International Telephone Call,

Subjects The Taxpayer To Double Taxation In Violation Of The Commerce Clause of the United States Constitution.

All toll communications carried into or out of the District are calls originating or terminating in another State or in a foreign country and thus are calls in interstate or foreign commerce. Each of the toll calls, the receipts for which the D. C. tax applies, is a call in interstate or foreign commerce as defined in Section 3(e) ("interstate communication") and (f) ("foreign communication") of the Communications Act of 1934, 47 U.S.C. § 153(e) and (f). All of the Plaintiffs handle calls that originate in the District and terminate in one or more foreign countries.

Plaintiffs claim that the Act violates the Commerce Clause, Art. I, Sec. 8, cl. 3. An unapportioned tax on gross receipts is constitutionally suspect because of the risk such taxes create for multiple taxation on the same activity. Tyler Pipe Industries v. Washington Department of Revenue, 483 U.S. ___, 107 S.Ct. 664 (1987). The Supreme Court has laid down a four-part test of state[3/] taxation of interstate commerce.

In Complete Auto Transit v. Brady, 430 U.S. 274, 287 (1977), the Court ruled that a state tax does not offend the Commerce Clause if it is applied to an activity with

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3/ The D. C. Court of Appeals has also said that the District may not propound legislation that unduly burdens interstate commerce. Smith v. D. C., 439 A.2d 53, 58 n. 5 (1981).

(1) a "substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to services provided by the State." 430 U.S. at 279. But in Complete Auto, those criteria were merely identified, and not contested or applied leaving open many questions of application and interpretation. In D. H. Holmes Co. v. McNamara, 108 S.Ct. 1619 (1988), the Chief Justice wrote for a unanimous Court that "Complete Auto abandoned the abstract notion that interstate commerce 'itself' cannot be taxed by the States." Id. at 1623. The Court in turn analyzed the validity of the tax under the Commerce Clause on the basis of the Complete Auto criteria.

Plaintiffs maintain that the tax fails the second test of the four-part test of Complete Auto in that it is not apportioned. To those calls to which the Act applies, it subjects one hundred percent of the revenues to the 6.7 percent rate. Central Greyhound Lines v. Mealey, 334 U.S. 653, 662-63 (1948), teaches that the originating or terminating jurisdiction may not tax the entire transaction. See Japan Line v. Los Angeles, 441 U.S. 434, 447 (1979) ("The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full.") The District's tax has no credit for taxes paid elsewhere, thus double taxation would in fact occur. But, in any event, the precedent of recent decisions in the Supreme Court is that this

Court need not confirm the facial discrimination by an examination of the tax burdens imposed by other states. Tyler Pipe Industries v. Washington Department of Revenue, 483 U.S. ___, 107 S.Ct. 664, quoting Armco v. Hardesty, 467 U.S. 638, 644-45 (1984). (Reply at 8-15).

In this regard, the statutory framework adopted by the tax in question stands in marked contrast to the framework which existed prior to divestiture. C&P, prior to the divestiture, was taxed on its share of long distance revenues apportioned to the corporation under the Division of Revenue, which were attributable to the services provided by C&P in the District. Under the present scheme, the District makes no effort to apportion the gross revenues and to tax only that portion of each such revenue from each phone call attributable to activities within the District. The District attempts to tax the entire revenue stream from each phone call it taxes. This effort was intentional on the part of the District because of its concern that little revenue would otherwise be apportioned to it for it to tax.

In addition, the tax burden imposed on the whole transaction is not "fairly related" to the District as required by the fourth test of Complete Auto Transit, supra. The tax falls so heavily on revenues from out-of-jurisdiction activities that it fails the disproportion test.

The apportionment issue was addressed in Holmes, supra, and the Court had no doubt that the apportionment test was satisfied. This was so because, it observed, "the

Louisiana taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other States." Id. at 1623.

Most jurisdictions employ some sort of formula to apportion (for purposes of their gross receipts or similar tax among the jurisdictions involved) the revenue from the long distance or interstate telecommunications service which is subject to the tax and then apply such a tax only to the portion of such revenue which is properly apportionable to activities within its borders. Usually, this apportionment is determined by reference to a ratio which compares the extent to which some index of measurement (such as wire mileage or value of personal property) is present in the taxing jurisdiction vs. the extent of the index generally. In the absence of such apportionment, the same revenue from the same transaction can be subject to taxation by two or more states. This cannot happen if each state taxes only that revenue fairly apportionable to an area within their own boundaries. The bill to impose the tax (as originally proposed by the Mayor) required that the District promulgate regulations providing for apportionment of gross receipts. Because the relevant officials of the District's Department of Finance and Revenue had no experience in apportioning the receipts from toll telecommunications service for purposes of applying the proposed tax, they asked to meet with the major industry representatives to discuss the issue.

At these roundtable meetings, industry representatives proposed that the tax be drawn as a sales tax on the sale of toll communication services with the tax defined by reference to the origination and billing of the call. A standard, used to define what sales are subject to a sales tax, is not the same as a formula intended to apportion gross receipts subject to a gross receipts tax. The industry representatives did not propose that such a standard would be an appropriate formula for apportioning gross receipts for purposes of such a gross receipts tax. District officials were concerned, however, that if a formula were employed to apportion receipts for purposes of the proposed gross receipts tax, very little of such receipts would be apportioned to the District and subject to the District's tax.

The Act and regulations do not apportion the revenues of each subject call between the District of Columbia and the other state or foreign country in which the call originated or terminated. The Act taxes subject calls on an "all or nothing" basis, i.e., it taxes 100 percent of the price of each subject call. Built into the carrier's price for each call is the cost of access on the originating end, the cost of inter-LATA transmission, and the cost of access on the terminating end. By virtue of the interstate nature of the subject calls, only one of the access costs is incurred within the District of Columbia, and only a small segment of the inter-LATA carriage.

The Department of Finance and Revenue recognized from the outset that some apportionment mechanism was required and the bill as originally drafted provided that the Mayor should prescribe such a formula by regulation. (Sec. 2[c] of Bill 7-186 appended to Council Secretary's referral memo, dated Apr. 7, 1987.) The District subsequently adopted the origination and billing language which had been suggested by the industry with respect to a sales tax. Neither the Act nor the regulations provide for an appropriate credit for taxes paid to other jurisdictions on a call subject to the District of Columbia's gross receipts tax. Without any credit provision, the inevitable result is double taxation.

The gross receipts taxes of Illinois,[4/] Virginia[5/] and Maryland,[6/] Connecticut,[7/] Maine,[8/] Vermont,[9/] and West Virginia[10/] present apportionment problems when laid alongside the District's "all or nothing" tax. Wisconsin[11/] and Oklahoma[12/] have taxes on access charges which would be a second, unapportioned tax burdening those calls originating or terminating in the District and billed to an account in the District. Washington taxes interstate services itself.[13/] The City of Los Angeles levies a gross receipts tax of ten percent on all interstate calls

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4/ Ill. Rev. Stat. 1985, Ch. 120, ¶ 2004 (1987 Supp.) (Exhibits 5, Tab 4). This is the statute under challenge in Goldberg v. Johnson, 117 Ill.2d 493, 512 N.E. 2d 1262 (1987), *cert. granted*, 56 U.S.L.W. 3556 (1988) (Nos. 87-826, 87-1101).

originating within its city limits including calls terminating in the District of Columbia and billed to an account, etc., in the District. L.A. Mun. Ord. Nos. 162586 and 162418 (1987). Plaintiffs urged that such calls originating in Los Angeles and terminating and billed in the District would be doubly taxed at an aggregated rate of 16.7 percent. Such calls, it maintains, are quite common.

Double taxation results under the Act because the District seeks to tax 100 percent of the revenue from the subject calls, where other taxing jurisdictions tax that portion of the revenue from such calls that is apportionable to them.

In its haste to address its revenue loss following the C&P decision, the District omitted this key credit provision. Moreover, the decision not to utilize a sales tax as opposed to gross sales should have warranted closer

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(footnote continued from previous page)

5/ 8A Code Va. 1950, § 58.1-2623 (1987 Supp.).

6/ Md. Ann. Code, Art. 81, § 130, Md. Tax Rep. (CCH) ¶¶ 92502, 92503 (September, 1987).

7/ Conn. Gen. Stat. Ann. § 12-255 (1983 and Supp. 1987).

8/ 36 Me. R.S.A. § 2691 (1964 and Supp. 1987).

9/ 32 Vt. Stat. Ann. § 8521 (1981 and Supp. 1986).

10/ W.Va. Code § 11-13B (1987).

11/ Wisc. Stat. Ann. § 76.38 (1957 and Supp. 1987).

12/ 68 Okla. Stat. Ann. § 1354 (Supp. 1987).

13/ Rev. Code Wash. §§ 82.04.050, 82.04.065, 82.04.250 (Supp. 1987).

scrutiny in light of unique Federal payments to the District, due to the presence of so many entities which are exempt from District of Columbia sales taxes.

The Cost of Compliance Under the Act Is So Disproportionate as to Violate The Due Process Clause

Plaintiff-carriers maintain that the accounting for subject calls is extremely complicated. There are millions of toll calls each year in and out of the District. Some are billed to parties in the District, and some are billed to parties at the other end of the call. Some are billed to third numbers at neither end of the call. Conversely, some calls that neither originate nor terminate in the District are billed to numbers in the District, i.e., third-party calls and credit card calls. Taking into account toll fraud, subsequent bill adjustments and bad debts requires that multiple records be consulted as to each call or account, thereby making the computation of actual gross revenues subject to the tax onerous and expensive. Moreover, as to the retroactive portions of the tax, computer systems and installations on which some of the billings of Plaintiff-carriers were done have since been abandoned, and are no longer operational.

The accounting of Plaintiff-carriers is further complicated by the fact that the non-AT&T carriers cannot identify the geographical locations from which all calls originate. Each of the Plaintiff-carriers serves the Washington, D. C. LATA from a single point of presence.

The LATA includes 2.1 million access lines in 35 exchanges in the District of Columbia, Suburban Maryland, and Northern Virginia. U.S. v. Western Electric Co., 569 F.Supp. 990, 1024 n. 176 (D.D.C. 1983). These boundaries of the LATA were expressly approved by Judge Harold H. Greene. Id. at 1024-25.

Although C&P Telephone Company is required by the consent decree in U.S. v. Western Electric Co., 552 F.Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. U.S., 460 U.S. 1001 (1983), and by U.S. v. Western Electric Co., 569 F.Supp. 1057, 1063 (D.D.C. 1983), to provide "equal access" to the non-AT&T toll carriers, there will always be many calls over the Plaintiff-carriers' long distance services that are not identifiable by calling location, i.e., calls over the FGA and FGB facilities, the calls received over In-WATS (or "1-800") facilities (also known as travel card calls), and the calls from mobile telephones. The actual percentage of C&P customers having "equal access" is in fact considerably less than the so-called percentage conversion. It is noted, for example, that the jurisdictional origin of about half of TMC's traffic outbound from its D.C. switch is still not identifiable. In July, 1986, the origin of about half of Intervenor Cable & Wireless' traffic was geographically indeterminate, and as much as 30 percent of CWCI's traffic is still of indeterminate geographic origin. Allnet has approximately 30 percent non-equal-access origination. The other

Plaintiff-carriers have substantial proportions of geographically indeterminate traffic. Even after C&P's eventual 100 percent conversion to equal access, there will still remain a relatively small market for FGA, FGB, and In-WATS calling because of its flexibility and convenience to the customer and because of the billing features offered by the use of authorization codes. Thus, the accounting problems presented by the District's gross receipts tax are uniquely peculiar to the structure of the tax and to the multi-jurisdictional geography of the Washington, D. C. LATA. No other State's tax is so structured. In addition, no other gross receipts tax involves a LATA with predominantly out-of-state traffic. No other gross receipts tax involves such intractable computational problems.

Neither the Act nor the regulations provide a definition or formula for determining gross receipts subject to the tax. While the Act does not permit or contemplate estimations, the District's tax forms do not provide for estimates but requires the subject revenues to be submitted under oath. As of yet, the Department of Finance and Revenue has not proposed any rule that would allow companies to estimate the amount of tax due on their tax returns. Moreover, it is somewhat of an anomaly to have taxes based on estimates, particularly since the FCC would not accept estimated rates from carriers.

The monetary demands of the District placed on some of the Plaintiff-carriers seem somewhat arbitrary. In the case of Plaintiff-U.S. Sprint, for example, the District simply multiplied by a factor of 1.2 the estimates of gross receipts arguably subject to the tax, as reported by affidavit pursuant to 9 DCMR §§ 3501, 3502, 3503, 34 D.C. Register 6143, 6149-50 (1987). For Plaintiff-TMC, the District apparently multiplied TMC's total gross receipts for the relevant period by a factor of three, although only 10 percent of TMC's customers are located in the District of Columbia. The gross revenues attributed to the other Plaintiff-carriers were arbitrarily fixed without any indication as to how the rates were set.

It is this Court's determination that the Act's failure to apportion accompanied by its burden of compliance creates an irreparable injury to all Plaintiff-carriers. The Act's vagueness as to estimating and sampling further compounds the injury. It is these very compliance problems that preclude any adequate remedy at law, *i.e.*, the proper payment of taxes and appropriate affidavits before bringing suit.

Congress May Delegate to the Government of the District of Columbia the Authority to Enact Legislation Imposing New Taxes for the Purpose of Raising Revenues

The Court finds no merit in the carriers' contention that Congress may not delegate to the District of Columbia the authority to adopt a new tax. It is well settled that

Congress may, and has, delegate to the Council of the District of Columbia full legislative authority that includes the power to adopt new tax measures. District of Columbia v. John R. Thompson Co., 346 U.S. 100 (1953); Self-Government and Governmental Reorganization Act, Pub.L. 93-1988, Title II, § 302, D.C. Code § 1-204, which grants the District the power to legislate on "all rightful subjects of legislation."

The Court finds that the carriers are mistaken when they assert that, while Congress may have given the District such broad powers, these do not include revenue measures which must be initiated in the House of Representatives. Art. 1, § 7, Cl. 1. Plaintiff-carriers are mistaken because such a requirement is imposed on Congress when it considers federal revenue measures and is not a limitation on Congress' power to delegate to the District local legislative authority. It is only true that should Congress adopt a tax for the District, it may be constrained by the requirement that such legislation must begin in the House. Miller v. Robert, 202 U.S. 429 (D.C. 1906); and Twin City National Bank v. Nebeker, 3 App. D.C. 190, 199, aff'd 167 U.S. 196 (1894). Just as the Revenue Raising Clause is not a limitation on Congress when it delegates power to the territories, including the power to tax, it is not a limitation here. Texaco Puerto Rico, Inc. v. Descarles, 304 F.2d 194 (1942).

Further, the Court rejects the notion that in adopting the Act, the District violated D.C. Code § 1-233(a)(3) (1981) which in relevant part provides that "the Council shall have no authority to ... enact any act ... which is not restricted in its application exclusively in and to the District." The Act applies only to revenues from calls that originate or terminate and are billed to someone in the District.

The problems with respect to compliance and the potential double taxation, as stated within, are treated separately from the authority the District has in enacting such a tax.

The Act Does Not Violate Plaintiffs' Constitutional Rights Insofar As It Grants Personal Property and Sales Tax Exemptions to Local Companies Which Is Not Enjoyed By Out-of-State Competitors

Under the Act, certain telecommunications companies engaged in the provision of interstate toll telephone service are afforded exemptions from and/or credits against, the payment of sales use, and personal property taxes. The District places a gross receipts tax on revenues generated from toll calls that originate or terminate in the District and are billed to a caller in the District. The law also permits an exemption from payment of the personal property tax and sales tax for equipment located <u>in the District</u> and used in the generation of these revenues. Just as the revenues are locally generated, the exemption is local. Just as large interstate sellers of

all kinds of products move their corporate headquarters to take advantage of various tax provisions, any one of these carriers could move to the District to take advantage of the incentive provided here. As indicated earlier, a number of States have similar credit provisions that do not appear to be under attack. This Court sees no Constitutional violation as to this incentive provision in the Act, since the provision does not appear to be designed to specifically discriminate in favor of local companies to the detriment of out of state companies. The end result of this provision of the Act that may credit and/or exempt taxes from carriers with a larger portion (up to a certain maximum) of their personal property in the District, pay less tax than companies that have a smaller proportion of personal property in the District, even when the revenue of the two companies is the same. While this may not encourage the open competition envisioned by Judge Greene in his divestiture decision, it also does not appear to be on its face unconstitutional.

CONCLUSION

Having reviewed the total record, having listened to the parties' witnesses and having examined the parties' authorities, this Court concludes that while portions of the Act have been determined to be Constitutional, those portions declared unconstitutional cannot be altered or changed by judicial decision.

WHEREFORE, it is this 14th day of November, 1988,

ORDERED: Plaintiff-carriers' request for declaratory judgment is hereby GRANTED.

JUDGE IRALINE G. BARNES

Copies to:

Clerk of the Court
D. C. Court of Appeals

Charles L. Reischel, Esquire
Deputy Corporation Counsel
Appellate Division

Richard Aguglia, Esquire
Deputy Corporation Counsel
Community Development Division

William Malone, Esquire
1901 L Street, N. W. (36)

John C. Wood, Esq.
1150 Connecticut Avenue, N.W., Suite 900 (36)

Paul M. Tendler, Esquire
1090 Vermont Avenue, N. W., Suite 1200 (5)

John Noble, Esquire
P. O. Box 1310
Rockville, MD 20850

Patrick E. McMahon, Esquire
2330 Shawnee Mission Parkway
Shawnee Mission, KS 66205

Deborah J. Harwood, Esquire
P.O. Box 33535
Vancouver, WA 98668

Mitchell F. Brecher, Esquire
1990 M Street, N. W., Suite 500 (36)

Andrew D. Lipman, Esquire
3000 K Street, N.W., Suite 300 (7)

Susan L. Launer, Esquire
1777 F Street, N. W. (6)

Joseph M. Gensheimer, Esquire
529 - 14th Street, N.W., Suite 1155 (45)

Harold L. Thomas, Director
Dept. Finance & Revenue
R. Stanfield
11/14/88