

March 12, 2018

Recent Increase in Internet Tax Freedom Act Class Action Lawsuits Calls for Defensive Strategies

In the past few weeks, there has been a significant increase in the number of deceptive trade practice putative class suits alleging violations of the Internet Tax Freedom Act (“ITFA”). Based on our familiarity with this deceptive trade practice theory based on the ITFA, below is a summary of our current thoughts on the case law related to these claims as well as potential defensive strategies:

Relevant Provisions of the ITFA

Enacted as a temporary moratorium in 1998 and made permanent in 2016, the ITFA prohibits states and their political subdivisions from imposing taxes on internet access. ITFA § 1101(a)(1), codified at 47 U.S.C. § 151, note. However, the ITFA also expressly preserves taxes preexisting its enactment. *Id.* §§ 1101(b), 1104.

The ITFA sets out the following definitions:

- **“Internet access”** is defined as “a service that enables users to connect to the Internet to access content, information, or other services offered over the Internet” and includes the purchase, use or sale of telecommunications by a provider of such a service to the extent those telecommunications are purchased, used or sold to provide the service or to “otherwise enable users to access content, information or other services offered over the Internet.” *id.* § 1105(5);
- **“Tax”** is defined to include “the imposition on a seller of an obligation to collect and to remit to a governmental entity any sales or use tax imposed on a buyer by a governmental entity,” *id.* § 1105(8); and
- **“Tax on internet access”** is defined somewhat circularly as “a tax on Internet access, regardless of whether such tax is imposed on a provider of Internet access or a buyer of Internet access and regardless of the terminology used to describe the tax,” *id.* § 1105(10).

Finally, the ITFA provides the following “accounting rule” in the event that internet access is bundled with other, taxable services: “If charges for Internet access are aggregated with and not separately stated from charges for telecommunications or other charges that are subject to taxation, then the charges for Internet access may be subject to taxation unless the Internet access provider can reasonably identify the charges for Internet access from its books and records kept in the regular course of business.” *Id.* § 1106(a).¹

Relevant Case Law on the ITFA

Although the ITFA previously has not been heavily litigated, there are a handful of key cases from which potential defenses to an ITFA lawsuit may be gleaned:

In re AT&T Mobility Wireless Data Services Sales Tax Litigation

The seminal ITFA class action case—*In re AT&T Mobility Wireless Data Services Sales Tax Litigation*—was also potentially among the largest class action settlements in history. Plaintiffs had filed class action lawsuits against AT&T in federal district courts in nearly every state alleging violations of the ITFA. Plaintiffs alleged that AT&T had charged its customers, as a separate line item in each customer’s bill, for wireless internet data plans for

March 12, 2018

smartphones and laptop computers. AT&T apparently charged sales tax on the entire bill, including the separate line item for wireless internet data, and remitted the taxes collected to the relevant taxing authority.

The United States Judicial Panel on Multidistrict Litigation consolidated all but one of the cases in the Northern District of Illinois. AT&T then settled with the plaintiffs immediately after the consolidation. In the settlement agreement, AT&T primarily agreed to: (1) stop collecting the taxes from its customers; (2) at its sole expense, seek and coordinate refunds from the roughly 2,000 taxing authorities to whom it paid the challenged taxes; (3) pay to the settlement class any “vendor compensation” it received from certain taxing authorities as compensation for collecting the taxes, which amounted to \$2.2 million; and (4) waive its opposition to class certification and pay the expenses related to notifying the settlement class. 789 F. Supp. 2d 935, 943–44, 956 (N.D. Ill. 2011).

As to the refund requests, the settlement administrator was to send settlement checks to the settlement class members only *after* the monies were received from the relevant taxing authority. The total amount of tax refunds at issue was about \$1.15 billion, although due to various statutes of limitations on refunds, the total amount potentially recoverable was about \$950 million. *Id.* at 953.

In considering whether to approve the settlement or whether the plaintiff class members would fare better if they proceeded to trial, the judge noted that AT&T had several potentially meritorious defenses to the case. *Id.* at 961. First, the plaintiffs would have had to “establish that the ITFA permits a private cause of action, even though the statute does not explicitly create one,” which the court considered to be a “potentially significant legal challenge” for the plaintiffs. *Id.* Second, AT&T’s service agreement contained mandatory arbitration provisions, and if the settlement had not been approved, AT&T would likely have succeeded in compelling arbitration. *Id.* at 962. Finally, AT&T would have relied on the “voluntary-payment doctrine to argue that Class Members who voluntarily paid the disclosed tax charge cannot later recover the same.” *Id.* Under the voluntary-payment doctrine, a taxpayer may not recover taxes voluntarily paid, even if the taxing body improperly assessed the taxes absent statutory authorization. *Id.* at 963. After evaluating these and other issues, the judge approved the settlement. *Id.* at 939.

Harris v. Las Vegas Sands L.L.C., et al

Plaintiffs have also attempted to make more creative use of the ITFA. For example, in *Harris v. Las Vegas Sands L.L.C.*, plaintiff filed a class action lawsuit against the Las Vegas Sands and Venetian Casino Resort in California federal court. No. CV 12-10858 DMG FFMX, 2013 WL 5291142, at *1 (C.D. Cal. Aug. 16, 2013). Among other things, the plaintiff alleged that the defendant hotels had violated the ITFA by charging a tax on internet access, apparently by collecting the Clark County transient lodging tax on the resort fee. *Id.* at *7. Clark County generally taxes the total amount of rent received by transient lodging establishments—that is, hotels.

The defendant hotels moved to dismiss the case, arguing that even if Clark County’s transient lodging tax was a tax on internet access, that tax had been in place in 1983 and was therefore exempt under the provision of the ITFA that states that the ITFA does not impair or supersede otherwise permissible taxes that predate its enactment in 1998. *Id.* Ultimately, because the ITFA claim was alleged in conclusory fashion and because plaintiff’s response to the defendant hotels’ argument misinterpreted the ITFA, the court dismissed the claim. *Id.*

Takeaways and Potential Defenses to an ITFA case:

First, as the *AT&T* court observed, the ITFA provides no private cause of action, and implied causes of action are

March 12, 2018

generally disfavored. Additionally, as in *AT&T*, the voluntary payment doctrine may be an available defense, so long as the particular jurisdiction in which the suit is brought recognizes the doctrine.

Second, similar to the *Harris* case, and depending on the facts concerning the particular tax at issue, there may be a good defense that the tax at issue is exempt from the ITFA because it predates the 1998 enactment of the ITFA.

Third, if the charges for internet access at issue are aggregated or bundled with other charges and taxed as a whole (for example, in the case of a hotel resort fee that bundles the charges for various guest services), it may be possible to defend the suit based on the ITFA “accounting rule.” That is, it may be possible to argue that taxes were collected on the entire bundled charge because it was not possible to identify how much of the charge represented the charge for internet access in particular, and the ITFA prohibition therefore does not apply.

Conclusion

While cases such as *AT&T* and *Harris* provide some comfort that good defenses are available to class action lawsuits based on the ITFA, the ITFA is still largely untested in the courts. If you need help evaluating or defending an ITFA matter, please do not hesitate to contact one of the attorneys listed below.

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This document is intended to provide you with general information regarding a recent increase in ITFA class action lawsuits and potential defensive strategies. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorneys listed or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.