

Part III - Administrative, Procedural, and Miscellaneous

REQUEST FOR COMMENTS REGARDING THE EXCISE TAX ON AMOUNTS PAID FOR THE RIGHT TO PROVIDE MILEAGE AWARDS

Notice 2015-76

**SECTION 1. PURPOSE**

The Treasury Department and the Internal Revenue Service (IRS) are considering exercising their authority under § 4261(e)(3)(C) of the Internal Revenue Code (Code) to prescribe rules to exclude from the tax imposed by § 4261(a) certain amounts attributable to mileage awards (sometimes referred to as “frequent flyer miles”) that are redeemed other than for the taxable transportation of persons by air (referred to in this notice as “other than for taxable air transportation”), such as, but not limited to, redemptions for international air transportation, restaurant gift cards, magazine and newspaper subscriptions, free hotel nights, and items from the airline’s shopping catalog. This notice invites public comments on issues that should be addressed in guidance relating to § 4261(e)(3).

**SECTION 2. BACKGROUND**

Section 4261(a) of the Code imposes a tax on the amount paid for the taxable transportation of any person.

Section 4262(a) defines “taxable transportation” to generally include transportation by air that begins and ends in the United States.

Section 4261(d) provides that the tax is paid by the person making the payment subject to tax, and § 4291 provides that the tax is collected by the person receiving the payment.

Section 4261(e)(3)(A) provides that for purposes of § 4261(a) any amount paid (and the value of any other benefit provided) to an air carrier (or any related person) for the right to provide mileage awards

for (or other reductions in the cost of) any transportation of persons by air is treated as an amount paid for taxable transportation.

Section 4261(e)(3)(C) provides that the Secretary may prescribe rules that exclude amounts attributable to mileage awards that are used other than for the transportation of persons by air from the tax imposed by § 4261(a).

Congress enacted § 4261(e) as part of the Taxpayer Relief Act of 1997 (Public Law 105-34, 111 Stat. 788). The General Explanation of Tax Legislation Enacted in 1997 (General Explanation), prepared by the Joint Committee on Taxation, JCS-23-97 at 230-231, explains that § 4261(e)(3)(C) authorizes the Treasury Department to develop regulations excluding from the § 4261(a) tax base a portion of otherwise taxable payments, if any, with respect to awarded frequent flyer miles “if the Treasury determines that a portion properly can be allocated (traced) to frequent flyer miles that are used by consumers for purposes other than air transportation.” General Explanation at 231. The General Explanation further states that as part of any rulemaking process it undertakes, the Treasury Department is authorized to review airline mileage awards programs and other information from all available sources, including industry and third-party data, in determining whether frequent flyer miles can be adequately traced to support allocations based on the ultimate use of the frequent flyer miles. The General Explanation also states that Congress intended that any adjustment to the tax base will be prescribed only if the Treasury Department finds a consistent pattern of non-air transportation usage of frequent flyer miles by consumers at levels indicating that significant mileage awarded pursuant to payments taxable under § 4261(e)(3) are being used for purposes other than for taxable air transportation.

The Treasury Department and the IRS have not prescribed an allocation method that taxpayers (for example, credit card companies) and collectors (typically airlines' mileage awards programs) can use to exclude from the taxes imposed by § 4261(a) amounts attributable to mileage awards that are used other than for taxable air transportation. As a result, taxpayers currently must pay tax on all frequent flyer miles purchased from an airline mileage awards program and then file a claim for credit or refund for tax paid on those frequent flyer miles that were ultimately redeemed other than for taxable air transportation .

The Treasury Department and the IRS are considering a possible methodology, described in Section 3 of this Notice, that would allow a reduction in a taxpayer's § 4261(a) tax base for amounts paid for mileage awards based on historical redemption data.

### **SECTION 3. POSSIBLE METHODOLOGY FOR DETERMINING REDUCTION IN SECTION 4261(a) TAX BASE**

The Treasury Department and the IRS are considering an elective safe harbor methodology that a collector could use to reduce a taxpayer's § 4261(a) tax base on purchased frequent flyer miles. Under the methodology, for each 12 month period beginning on April 1 and ending on March 31 (the "Election Year"), the tax base for frequent flyer miles purchased from a particular airline mileage awards program would be reduced based on redemption data from that airline mileage awards program for the calendar year immediately preceding the calendar year in which the Election Year begins (the "Base Period").

The methodology would be based on the following data from the Base Period:

- Total number of frequent flyer miles redeemed under that program.
- Number of frequent flyer miles under that program redeemed for taxable air transportation.
- Number of frequent flyer miles redeemed under that program other than for taxable air transportation.

More specifically, for each specific airline mileage awards program (that is, on a per airline mileage awards program basis), a collector may reduce the tax base upon which the tax imposed by § 4261(a) is calculated by applying the following ratio:

- i) The number of frequent flyer miles under that program that the airline data shows were redeemed during the Base Period other than for taxable air transportation; over
- ii) The total number of frequent flyer miles under that program that the airline data shows were redeemed during the Base Period.

The collector will multiply the amount paid for the right to provide frequent flyer miles under the program by the ratio determined above (the "Exclusion Ratio") and will reduce the § 4261(a) tax base on the purchased frequent flyer miles by this amount. The Exclusion Ratio would apply for the entire Election Year.

Example. The following example illustrates this methodology:

On April 1, 2015, Company buys 5,000,000 frequent flyer miles from Airline X's only mileage award program for \$.01 per frequent flyer mile (for a total cost of \$50,000). Under current law, if the § 4261(a) tax is calculated on the gross purchase of the frequent flyer miles, the tax due on the purchase will be \$3,750 ( $\$50,000 \times 7.5\%$ ).

For the applicable Base Period (that is, January 1, 2014, through December 31, 2014), Airline X data indicates that frequent flyer miles were redeemed as noted in the table below:

Year	Total Frequent Flyer Miles Redeemed	Frequent Flyer Miles Redeemed for Taxable Air Transportation	Frequent Flyer Miles Redeemed for Non-Taxable Purposes
1/1/2014 - 12/31/2014	100,000,000	70,000,000	30,000,000

Following the methodology described above, Airline X may reduce Company's tax base on the purchased frequent flyer miles as follows:

- Frequent flyer miles redeemed other than for taxable air transportation in the Base Period divided by total frequent flyer miles redeemed in that period:  $30,000,000 \div 100,000,000 = 30\%$ .
- Exclusion Ratio calculated in the previous step applied to the frequent flyer miles purchased on April 1, 2015:  $30\% \times \$50,000$  amount paid for frequent flyer miles = § 4261(a) tax base reduction of \$15,000. This results in a § 4261(a) tax base of \$35,000 ( $\$50,000$  less \$15,000).

Therefore, under this methodology, the tax due on the April 1, 2015, purchase is \$2,625 ( $\$35,000 \times 7.5\%$ ).

#### **SECTION 4. POSSIBLE PROCEDURES FOR A COLLECTOR ADOPTING AN EXCLUSION RATIO FOR A PROGRAM FOR A YEAR**

4.01 The collector would file a new form (to be designated by the IRS at a future date) reporting the Exclusion Ratio to the IRS by February 1 following the close of the Base Period. The collector's filing of the form by February 1 constitutes an election to use the safe harbor methodology. The election would be irrevocable for all frequent flyer miles purchased from the collector during the Election Year beginning on April 1 following the close of the Base Period.

4.02 The collector would provide notification of the adoption of the use of an Exclusion Ratio and specify the ratio itself in program literature available to taxpayers by February 1.

4.03 The collector would be required to use the Exclusion Ratio reported by the collector in its February 1 filing for the entire Election Year.

4.04 A taxpayer that purchased frequent flyer miles offered by the collector would be deemed to have elected application of the safe harbor methodology. The collector would be required to reference this deemed election in program literature available to taxpayers.

4.05 A taxpayer would not subsequently be able to obtain a credit or refund for a portion of the tax paid if the percentage of frequent flyer miles ultimately redeemed other than for taxable air transportation ends up being higher than the percentage calculated under the safe harbor methodology, nor would the taxpayer be assessed additional § 4261(a) tax if the percentage ends up being lower.

## **SECTION 5. POSSIBLE PROCEDURES FOR FILING FORM 720 APPLYING AN EXCLUSION RATIO**

A box would be added to Part I, *Communications and Air Transportation Taxes*, line *IRS no. 26*, of Form 720, *Quarterly Federal Excise Tax Return*, in which the collector would report the Exclusion Ratio.

## **SECTION 6. REQUEST FOR COMMENTS**

The Treasury Department and the IRS request comments on issues that should be addressed in guidance relating to § 4261(e)(3). Specifically, the Treasury Department and the IRS request comments addressing the following:

- Whether the methodology in Section 3 of this notice, if adopted, is workable for taxpayers, airlines, and other potential stakeholders.
- Whether the methodology in Section 3 of this notice, if adopted, should be adopted as a rule of general applicability instead of as a safe harbor provision.
- Whether the methodology in Section 3 of this notice should be modified to take into account a longer or shorter period of historical data.
- Whether airlines (or airline mileage awards programs) are willing to share historical data with taxpayers so that taxpayers can verify the tax base upon which the § 4261(a) tax is applied when a taxpayer purchases frequent flyer miles.

- Whether in lieu of the methodology in Section 3 of this notice, the Treasury Department and the IRS should provide an allocation percentage that can be applied on an airline industry-wide basis, which the Treasury Department and the IRS would calculate using industry-provided data.
- How often an industry-wide allocation percentage, if adopted, should be updated to reflect current industry data and what is the best method for the Treasury Department and the IRS to collect the necessary data.
- Whether the Treasury Department and the IRS should adopt a methodology that is not described in this notice and recommendations for alternative methodologies.
- Whether the Treasury Department and the IRS should provide a mechanism for collectors to make adjustments to the Exclusion Ratio to correct computational and typographical errors after the collector reports the Exclusion Ratio to the IRS, and how such a mechanism should work.
- Whether the procedures in Sections 4 and 5 of this notice would be workable from the collector and the taxpayer's perspectives.
- How to address overpayments and underpayments of tax resulting from errors in the Exclusion Ratio, including whether the collector should be responsible for such underpayments.

DATE: Comments must be submitted by **[INSERT DATE 120 DAYS FROM DATE OF**

**PUBLICATION]**.

ADDRESSES: Comments, identified by Notice 2015-76, may be sent by one of the following

methods:

- Mail:

Internal Revenue Service  
CC:PA:LPD:PR (Notice 2015-76)  
Room 5203  
P.O. Box 7604  
Ben Franklin Station  
Washington, DC 20044

- Hand or courier delivery:

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Courier's Desk  
Internal Revenue Service  
1111 Constitution Ave., N.W.  
Washington, DC 20224  
Attn: CC:PA:LPD:PR  
(Notice 2015-76)

- Electronic:

Taxpayers may submit comments electronically to [Notice.Comments@irs.counsel.treas.gov](mailto:Notice.Comments@irs.counsel.treas.gov). Please include "Notice 2015-76" in the subject line of any electronic communications.

All submissions will be available for public inspection and copying in room 1621, 1111

Constitution Avenue, NW, Washington, DC, from 9 a.m. to 4 p.m.

#### **SECTION 7. NO EFFECT ON OTHER DOCUMENTS**

This notice does not affect any other documents.

#### **SECTION 8. NO RELIANCE BY COLLECTORS OR TAXPAYERS**

Unless and until the Treasury Department and the IRS issue regulatory or other administrative guidance under § 4261(e)(3)(C) that adopts the methodology in Section 3 of this notice, the methodology in Section 3 of this notice does not apply for purposes of calculating the tax due under § 4261(a), and neither excise tax collectors nor taxpayers may rely on that method or this notice.

#### **SECTION 9. DRAFTING INFORMATION**

The principal author of this notice is Michael H. Beker of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, please contact Mr. Beker at (202) 317-6855 (not a toll-free call).