

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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date: March 11, 2015

to: Kellie L. McCann
Excise Tax Policy Manager, Small Business/Self Employed

from: Stephanie Bland
Branch Chief, Branch 7
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

subject: Prepaid Air Travel Cards

This Chief Counsel Advice responds to your request for assistance dated December 9, 2014. This advice may not be used or cited as precedent.

ISSUES

1. Whether the tax imposed by § 4261 of the Internal Revenue Code (Code) applies to amounts paid for a prepaid gift card (which is redeemable only for air transportation services) from a commercial air carrier (Airline).
2. Whether the § 4261 tax applies to amounts paid for prepaid flying programs, where fixed hours are sold for a fixed price by sellers for charter air transportation on aircraft owned and operated by third parties.

FACTS

Issue 1

Airline is a commercial air carrier that provides regularly scheduled flights. Purchaser purchases a prepaid gift card denominated in dollars from Airline. The gift card can only be used as payment toward commercial flights provided by Airline. The gift card is not issued in the exact amount of the fare, does not state an itinerary, and does not itself entitle the bearer to air transportation.

All Airline flights originate from within the United States and all destinations are also within the United States. Airline's gift cards cannot be redeemed for cash.

Issue 2

Issue 2 involves three parties:

- Seller – Entity that sells prepaid flight cards for a fixed number of flying hours.
- Operator – Independent third party that owns an aircraft and operates the flights paid for with the prepaid flight cards
- Purchaser – Card purchaser.

Seller sells non-refundable “jet cards” that typically offer a fixed price for 25 hours of flying time on a specific type of aircraft operated by a third party, the Operators. Seller acts as agent for Purchasers by booking charter flights with Operators. Typically, once a charter flight is booked, Operator invoices Seller for the flight, and Seller must remit payment for the flight to Operator within 30 days.

The jet card’s cost to Purchaser includes the § 4261 tax based on the total cost of the 25 hour jet card. The jet card is valid for 12 months from the date Seller receives the funds from the Purchaser, which locks in the hourly rate for one year. If there are any hours remaining after the 12 month period, Purchaser can use them, but will have to pay any difference between the jet card’s rate at the time Purchaser purchased the card and the rate then offered by Seller. The additional cost will be charged to Purchaser’s credit card rather than Purchaser’s jet card. All flights originate from within the United States and all destinations are also within the United States.

Purchaser also has the option to book other aircraft size categories, other than the specific type of aircraft designated by Purchaser’s jet card. When booking an aircraft with a rate higher than the rate specified by Purchaser’s jet card, the difference will be charged to Purchaser’s credit card rather than Purchaser’s jet card. When booking an aircraft with a rate lower than the rate specified by Purchaser’s jet card, the difference is credited to Purchaser for use against any incidental charges for the flight. For all domestic flights, one hour is debited from Purchaser’s jet card account balance for each hour of flying time.

LAW

Section 4261(a) imposes a tax on the amount paid for taxable transportation of any person a tax equal to 7.5 percent of the amount so paid.

Section 4261(d) provides that except as provided in § 4263(a), the taxes imposed by § 4261 are paid by the person making the payment subject to the tax.

Section 4263(a) provides that if the payment upon which the § 4261 tax is imposed is made outside the United States, the person furnishing the initial transportation pursuant to such order must collect the amount of the tax.

Section 4263(c) generally provides that where any tax imposed by § 4261 is not paid at the time payment for transportation is made, then, under regulations prescribed by the Secretary, to the extent that such tax is not collected under any other provision of this subchapter such tax shall be paid by the carrier providing the initial segment of such transportation which begins or ends in the United States.

Section 4263(d) provides that the tax imposed by § 4261 shall apply to any amount paid within the United States for transportation of any person by air unless the taxpayer establishes, pursuant to regulations prescribed by the Secretary, at the time of payment for the transportation, that the transportation is not transportation in respect of which tax is imposed by § 4261.

Section 49.4261-4(a) provides that the tax imposed by § 4261 shall apply to any amount paid within the United States for the transportation of any person, unless the taxpayer establishes in accordance with the provisions of this section that at the time of payment the transportation is not transportation in respect of which tax is imposed by § 4261(a).

Section 49.4261-7(b) provides examples of payments subject to tax.

Rev. Rul. 56-157, 1956 C.B. 523, considers the application of § 4261 to amounts paid for travel gift certificates. Under the facts of the revenue ruling, the recipient of the gift certificate has the right either to use the certificate for the purchase of transportation (receiving in cash any excess in value of the certificate over the cost of the transportation) or to take the entire face value of the certificate in cash without the purchase of any transportation. The revenue ruling holds that since the gift certificates are nothing more than obligations accepted by the issuing agency or carrier to pay a sum certain in money to the designated payee upon demand, the amount paid for the purchase of such a gift certificate is not an amount paid for transportation within the meaning of § 4261. Therefore, the tax on transportation of persons does not apply to the purchase of the gift certificate. Instead, tax is imposed when the gift certificate is used for the purchase of taxable transportation.

Rev. Rul. 73-508, 1973-2 C.B. 366, was issued after the Civil Aeronautics Board authorized the airlines to add a charge to their existing passenger tariffs to cover the expenses involved in certain security procedures. It holds that, since the described security charge is required to be paid as a condition to receiving air transportation, such charge is part of 'the amount paid' for taxable air transportation within the meaning of § 4261(a) and is subject to the tax imposed by that section.

Rev. Rul. 80-31, 1980-1 C.B. 251, holds that an airline agency service charge added to the price of a ticket for taxable transportation to cover administrative costs involving use of the ticket by a different person in a different city is not subject to the tax imposed by § 4261. It further holds that the tax imposed by § 4261 should not apply to a separate charge made by an air carrier or an airline agent for a service not reasonably necessary

to the air transportation itself, provided the service is optional and the charge bears a reasonable relation to the cost of providing the service.

ANALYSIS & CONCLUSION

Section 4261(a) imposes a tax on the amount paid for the taxable transportation of any person. "Taxable transportation" is defined in § 4262(a)(1) to generally include transportation by air that begins and ends in the United States. The flights described in *Issue 1* and *Issue 2* meet the definition of taxable transportation.

Issue 1

In this case, the gift cards are similar to the gift certificates described in Rev. Rul. 56-157, except that the gift cards in this case cannot be redeemed for cash and may only be used to purchase a ticket from Airline. The amount paid for the gift card is not required to be paid as a condition to receiving air transportation. See Rev. Rul. 73-508. The gift card does not allow the bearer to board an airplane and can only be used to purchase a ticket. In essence, the gift card is a cash equivalent.

Based on the foregoing, we conclude that the § 4261 tax does not apply to the purchase of the gift card. Instead, tax attaches when Purchaser uses the gift card to purchase taxable transportation from Airline, and Airline must collect the tax at that time.

Issue 2

Section 49.4261-7 provides examples of payments for services that are subject to the § 4261 tax.

For services that are not addressed by the regulations, IRS published guidance limits the tax base to amounts paid for mandatory charges; in other words, amounts that must be paid to get on the airplane. All amounts paid as a condition to receiving air transportation are subject to tax unless the service is also optional and not reasonably necessary to the air transportation itself. See Rev. Rul. 73-508 and Rev. Rul. 80-31.

In this case, the jet cards entitle Purchaser (or the holder of the jet card) to get on a flight. They are essentially ticket substitutes. Based on the foregoing, we conclude that the § 4261 tax attaches when Purchaser buys a jet card from Seller, and Seller must collect the tax at that time.

Please call Rachel Smith at (202) 317-6855 if you have any further questions.