

INTERNAL REVENUE SERVICE

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MAR 23 2000

Dear [REDACTED]

Your October 14, 1999, letter to President Clinton was forwarded by the U.S. Department of Transportation, on February 22, 2000, to this office for reply. You inquire in your letter about a bill you received from your telephone company wherein you were charged a 7.5% tax on the frequent flyer miles you earned. You state that other businesses are not passing on to their customers the 7.5% tax on miles earned in their frequent flyer programs. You ask whether the U.S. government can require those companies that pass on the tax to their customers to cease doing so.

As enacted by the Congress, the Taxpayer Relief Act of 1997, added section 4261(e)(3) to the Internal Revenue Code. Under that section, any amount paid for the right to award frequent flyer miles is subject to the 7.5% federal excise tax on air transportation of persons.

Thus, when a business, such as a telephone company, purchases the right to award frequent flyer miles to a customer, it pays the tax to the air carrier selling the miles. The air carrier then pays the tax over to the United States. Because the customer is not paying any amount for the right to award frequent flyer miles, this tax does not apply to the transaction between the customer and the business. The business may show on its invoice to the customer an amount representing the tax that was paid on its purchase of the frequent flyer miles, but the tax, as enacted by the Congress, does not apply to the customer's receipt of the miles as a consequence of the customer's purchase of goods or services. Under these circumstances, no federal excise tax provision prohibits a business from passing its costs of doing business on to customers.

This tax, as well as several other federal excise taxes relating to air transportation, is paid into the Airport and Airway Trust Fund (the Trust Fund). Amounts in the Trust Fund are used to plan, construct, develop, operate, and maintain air traffic control, air navigation, and communications for the airway system. In addition, certain portions of

the budget of the Department of Transportation concerned with air transportation and air safety, including over half of the expenditures of the Federal Aviation Administration, come from the Trust Fund.

I hope the above information is helpful to you.

Sincerely,

Assistant Chief Counsel  
(Passthroughs and Special Industries)

By:

Bernard Weberman  
Assistant to the Chief, Branch 8