

Service BB =
Service CC =
Service DD =
Service EE =
Service FF =
Service GG =
Service HH =
Service II =
Service JJ =
Service KK =
Service LL =
Service MM =
Age # =
X Miles =

Dear _____ :

This document replies to a letter ruling request dated March 30, 2009, submitted on your behalf by your authorized representative, regarding the application of § 4261 of the Internal Revenue Code (the "Code") to fees charged for certain products and services ("Services") you offer in connection with the transportation of persons by air. Taxpayer requests a ruling regarding the taxability under § 4261 of the Code of the fees charged for these Services, as described herein.

Facts

Taxpayer is a commercial airline in the business of providing, among other things, the transportation of persons by air. Taxpayer charges fees for a variety of Services that it provides in addition to basic air transportation. These fees are paid to Taxpayer by its customers in cash or by the redemption of frequent flyer miles.

The Services Taxpayer provides are described as follows:

Service A provides customers with assistance in making travel plans, purchasing tickets, and requesting seat assignments, either in person or on the telephone (as opposed to on Taxpayer's website).

Service B allows customers to apply the fare paid for an unused non-refundable ticket (on which § 4261 tax was paid) to a new ticket.

Service C provides customers who are standing by for an alternate flight on the same day of their ticketed travel with a confirmed seat ahead of routine stand-by customers.

Service D allows customers to be placed on the stand-by list for an alternate flight.

Service E provides customers the option of purchasing food and alcoholic beverages while in-flight.

Service F provides customers the option of purchasing headsets to be used for in-flight entertainment.

Service G provides customers with baggage handling for checked luggage, including overweight and oversized baggage.

Service H provides customers with confirmed upgrades, paid for at the time of check-in at the automated kiosks, on certain flights.

Service I provides customers with access to its premium airport lounges on an annual basis.

Service J provides customers with access to its premium airport lounges on a daily basis.

Service K allows customers to purchase non-refundable gift cards that can only be applied to the purchase of future air transportation. The gift cards are not issued in the exact amount of the fare, do not state an itinerary, and do not themselves entitle the bearer to air transportation.

Service L is a fuel surcharge added at the time a customer purchases tickets for transportation by air.

Service M provides custodial service to children traveling without an adult, including transfer of custody from an adult (such as a parent) to a gate agent, a personalized safety briefing onboard the aircraft and further in-flight attention as necessary, arranging for airport transportation to a connecting flight, help picking up the child's baggage, and ensuring the child's safety from the moment of check-in until a responsible adult picks up the child at his ultimate destination. Service M is mandatory for unaccompanied minors under Age # and optional for unaccompanied minors Age # and older.

Service N allows customers who are members of Taxpayer's frequent flyer program ("Members") to purchase frequent flyer miles ("Miles") to be credited to their frequent flyer account ("Account").

Service O allows Members to purchase Miles to be credited to another Member's Account.

Service P allows Members to purchase “bonus” Miles (i.e., double or triple miles) on certain flights to be credited to the Member’s Account. Currently, this service is occasionally offered to members free of charge on a limited-time basis. However, Taxpayer is preparing to offer Service P for a fee.

Service Q allows Members to transfer Miles in their Account to the Account of another Member.

Service R allows Members to restore expired Miles to their Account.

Service S allows Members, through a third party, to convert the value of their Miles into the currency of a loyalty program unaffiliated with Taxpayer.

Service T imposes a fee for certain activities related to a Member’s Account and is described by Taxpayer as solely related to the maintenance of the Member’s Account. The fee for Service T applies to Services N, O, P, Q, R and S, and is the same amount regardless of the tax treatment of such services.

Service U allows the Miles of a deceased Member to be transferred to the Account(s) of one or more Members.

Service V allows divorced Members to transfer Miles to the Account(s) of one or more Members.

Service W allows Members to proactively extend the expiration date of fewer than X Miles in the Member’s Account.

Service X allows Members to proactively extend the expiration date of X Miles or more in the Member’s Account.

Service Y provides Members with a retroactive extension of the Miles in the Member’s Account in certain circumstances.

Service Z provides Members with expedited processing of Mile redemptions for the purchase of air transportation. The fee is charged at the time of ticketing.

Service AA allows Members who have already redeemed Miles for free air transportation to change their ticket. Taxpayer provides Members with the option of applying the Miles from the unused, issued ticket to a new ticket.

Service BB allows Members who have already redeemed Miles for free air transportation to cancel their ticket and reinstate the Miles from the unused, issued ticket to the Member’s Account.

Service CC allows Members to redeem Miles for the purchase of air transportation on Taxpayer's website. At the time this letter ruling request was issued, Taxpayer was not charging a fee for Service CC. Taxpayer is, however, contemplating implementation of a fee for this service. The fee would be charged at the time of ticketing.

Service DD allows Members to purchase, at check-in or in advance, the ability to upgrade to a higher class of service by making a monetary payment.

Service EE allows Members to purchase, at check-in or in advance, the ability to upgrade to a higher class of service by both redeeming Miles and making a monetary payment.

Service FF provides Members with elite status ("Elite Members") the ability to upgrade, free of charge, to a higher class of service. Service FF is available to Elite Members on an annual basis.

Service GG allows Elite Members to maintain their status for the following year if the Elite Member otherwise fails to fully qualify for such status.

Service HH allows Members to obtain elite status in an expedited period of time by meeting certain requirements.

Service II provides Members with a printout of their Account details.

Service JJ provides details and records of a Member's Account to an outside third party.

Service KK provides Members with password protection for Account inquiries made by telephone.

Service LL provides Members with personalized luggage tags.

Service MM is a fuel surcharge added at the time a customer acquires tickets by redeeming Miles for transportation by air.

Law & Analysis

Section 4261(a) imposes a tax on the amount paid for taxable transportation of any person by air. Section 4261(d) provides that the person paying for the taxable transportation (the customer) is liable for the tax and § 4291 provides that the person providing the taxable transportation (Taxpayer) is required to collect and remit the tax to the government.

Section 4261(e)(3)(A) further provides that 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 shall be treated for purposes of § 4261(a) as an amount paid for taxable transportation.

To determine the tax base on which § 4261 is imposed, § 49.4261-2(a) of the Facilities and Services Excise Tax Regulations (the regulations) provides that the tax is measured by the total amount paid.

The concept of an “amount paid” for taxable transportation is addressed in guidance published by the Internal Revenue Service (“IRS”). Rev. Rul. 72-245, 1972-1 C.B. 347, holds that where an airline furnishes an employee the use of its international air travel facilities entirely free of charge, there is no amount paid for transportation within the meaning of § 4261(c). Although § 4261(c) is not at issue in this case, further IRS guidance is consistent with this ruling.

Rev. Rul. 84-12, 1984-1 C.B. 211, for example, holds that the § 4261(a) tax does not apply to free bonus tickets issued by an airline company to customers who have already satisfied all requirements to qualify for the bonus; however, the tax applies to any amount the customer subsequently pays because of not fully qualifying for the free bonus ticket. Rev. Rul. 84-12 reasons that if no amount is paid, the tax does not apply. If payment is made at a reduced rate, however, then the reduced amount is an amount paid for air transportation within the meaning of § 4261(a), because the amount subject to tax is the actual amount paid for taxable transportation.

Thus, to the extent Taxpayer provides a Service for free, there is no amount paid. Also, if Taxpayer does not charge a fee to certain customers with elite status (such as those with a large number of Miles, as designated by Taxpayer), no amount is paid by those customers, even if an amount is required to be paid by other customers. Similarly, there is no amount paid with respect to any Service paid for by the customer entirely with the redemption of Miles.

Regarding customer purchases of Miles, amounts paid for mileage awards that can be redeemed for taxable transportation are not subject to tax to the extent the miles are awarded in connection with the purchase of taxable transportation. See Rev. Rul. 2002-60, 2002-2 C.B. 641. Because the Miles in this case can all be redeemed for taxable transportation, amounts paid for Miles that are not in connection with the purchase of taxable transportation (such as Services N and O) are subject to tax. Likewise, amounts paid to earn “bonus” Miles on certain flights (such as Service P, if offered for a fee) are subject to tax.

The “amount paid” is part of the § 4261(a) tax base if it is paid for taxable transportation. “Taxable transportation” is defined in § 4262(a)(1) to mean transportation by air which begins in the United States or in the 225-mile zone and ends in the United States or in the 225-mile zone.

Existing IRS guidance provides a general framework for determining whether a certain service qualifies as taxable transportation. Rev. Rul. 2006-52, 2006-2 C.B. 761, for example, states that an airline's costs associated with selling tickets are generally necessary to the air transportation the airline provides. Therefore, all amounts paid to an airline for a ticket for air transportation are generally part of the tax base. The regulations and other IRS published guidance, however, specifically exclude (or include) amounts paid for certain types of services.

Section 49.4261-8 provides examples of payments for services not subject to the § 4261(a) tax. As relevant herein, § 49.4261-8(f)(1) provides that the § 4261 tax does not apply to charges for transportation of baggage, including incidental charges such as excess value, storage, transfer, parcel checking, special delivery, etc.

Section 49.4261-8(f)(4) provides that the tax does not apply to charges for admissions, guides, meals, hotel accommodations, and other nontransportation services, for example, where such items are included in a lump sum payment for an all-expense tour. However, if a payment covers charges for both transportation and nontransportation services, § 49.4261-2 (c) provides that the nontransportation charges must be separable and shown in the exact amounts thereof in the records pertaining to the transportation charge, or the tax is computed upon the full amount of the payment.

Although the regulations do not define nontransportation services, the examples in § 49.4261-8(f)(4) generally relate to meals, entertainment and hotel accommodations. Therefore, an amount paid for any Service that falls into one of these categories (such as Service E) is not included in the tax base, provided it meets the recordkeeping requirements of § 49.4261-2 (c). Also, amounts paid for baggage services (such as Service G) are not subject to the tax because of § 42.4261-8(f)(1).

Section 49.4261-7, on the other hand, provides examples of payments for services that are subject to the § 4261(a) tax. As relevant herein, § 49.4261-7(c) provides that amounts paid as additional charges for changing the class of accommodations, destination, or route, extending the time limit of a ticket, as "extra fare," or for exclusive occupancy of a section, etc., are subject to tax. Thus, any Service that meets this provision (such as Services H and DD) is included in the tax base.

For Services that are not addressed by the regulations, IRS published guidance limits the tax base to amounts paid for mandatory charges; in essence, amounts that must be paid to get on the airplane. Rev. Rul. 73-508, 1973-2 C.B. 366, for example, holds that a security charge is part of the amount paid for taxable transportation because it is required to be paid as a condition to receiving air transportation.

An amount paid to access Taxpayer's premium airport lounges is not required to be paid as a condition to receiving air transportation (even though the customer generally must be a ticketed passenger with a valid boarding pass to access lounges located

behind airport security). Thus, an amount paid for this type of service (such as Service I or J), is not paid for taxable transportation and not subject to the § 4261(a) tax.

Similarly, an amount paid for a gift certificate is not required to be paid as a condition to receiving air transportation. Rev. Rul. 56-157, 1956-1 C.B. 523, considers the application of § 4261 to the amount paid for travel gift certificates. The ruling holds that the amount paid for the purchase of the gift certificate is not an amount paid for transportation, and thus not subject to tax under § 4261, because the gift certificate was nothing more than an obligation to pay upon demand a sum certain in money to the holder thereof. Accordingly, the ruling determined that the tax was imposed when the gift certificate was used for the purchase of transportation. In this case, the gift certificates are distinguished from those in Rev. Rul. 56-157 because they cannot be redeemed for cash, but must be used to purchase a ticket. The amount paid for the gift certificate, however, is not required to be paid as a condition to receiving air transportation. In fact, the gift certificate does not allow the bearer to board an airplane but can only be used to purchase a ticket. Therefore, the purchase price of a gift certificate (such as Service K) is not an amount paid for taxable transportation. Rather, consistent with Rev. Rul. 56-157, the tax is imposed when the gift certificate is used for the purchase of transportation.

Rev. Rul. 80-31, 1980-1 C.B. 251, provides further guidance on whether an amount is paid for taxable transportation. The ruling considers the application of § 4261 to a service charge added by an airline to the price of a ticket for the administrative costs involved in the use of that ticket by another person in another city. The ticket in question could have been purchased without the service charge in the other city. The ruling concludes that the service charge is not an amount paid for taxable transportation because the service is optional, not reasonably necessary to the air transportation itself, and bears a reasonable relation to the cost of providing the service.

Therefore, 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. This ruling does not address whether fees for the Services are reasonable because such factor is not necessary to reach a conclusion on the facts provided herein.

At the time this letter ruling request was issued, Taxpayer was not charging a fee for Service CC (allowing Members to redeem Miles for the purchase of air transportation on Taxpayer's website). If Taxpayer charges a fee for Service CC, the service is no longer optional because a Member must pay for each redemption, regardless of method (e.g., on Taxpayer's website, in person or on the telephone). Therefore, if Taxpayer charges a fee for Service CC, it is an amount paid for taxable transportation.

An amount paid for Service M (providing custodial service to children traveling without an adult) is paid as a condition to the unaccompanied minor under Age # receiving the

air transportation because the child cannot board the airplane unless the fee has been paid. Therefore, the charge relating to a minor under Age # is an amount paid for taxable transportation. A Service M charge for an unaccompanied minor Age # or older, however, is optional; thus, the charge relating to a minor Age # or older is not an amount paid for taxable transportation.

Conclusions

Amounts paid for Services A, B, C, D, M (for minors Age # and over), Z, and AA are not taxable because the services are optional, like the service offered in Rev. Rul. 80-31.

Amounts paid for Services E and F are not taxable because they are nontransportation services described in § 49.4261-8(f)(4).

Amounts paid for Service G are not taxable because this service is baggage service described in § 49.4261-8(f)(1).

Amounts paid for Services H and DD are taxable because these services are additional charges for changing the class of accommodations described in § 42.4261-7(c).

Amounts paid for Services I, J, K, Q, R, S, T, U, V, W, X, Y, BB, GG, HH, II, JJ, KK, and LL are not taxable because the amounts are not paid as a condition to receiving air transportation, as described in Rev. Rul. 73-508, and thus are not paid for taxable transportation under § 4261(a).

Amounts paid for Services L, M (for minors under Age #), and MM are taxable because the amounts are paid as a condition to receiving air transportation, as described in Rev. Rul. 73-508, and mandatory, as distinguished from the service offered in Rev. Rul. 80-31.

Amounts paid for Services N, O, and P are taxable because the Miles can be redeemed for taxable transportation but are not awarded in connection with the purchase of taxable transportation, as described in Notice 2002-63.

Amounts paid for Service EE are taxable to the extent paid in cash and not in Miles, because this service is an additional charge for changing the class of accommodations described in § 42.4261-7(c).

Because there is no amount paid for Service CC, no tax applies. If Taxpayer charges a fee for Service CC, however, the amount is paid as a condition to receiving air transportation, as described in Rev. Rul. 73-508, and mandatory, as distinguished from the service offered in Rev. Rul. 80-31.

Because there is no amount paid for Service FF, no tax applies.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Stephanie N. Bland
Senior Technician Reviewer, Branch 7
(Passthroughs & Special Industries)

cc: