

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

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to: Barbara Fiebich
Director, Specialty Exam Policy and Quality

cc: Kellie McCann
Excise Tax Policy Manager

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

subject: Mileage Awards Programs and Travel on a Foreign Airline

This Chief Counsel Advice responds to your request for assistance dated June 17, 2015. This advice may not be used or cited as precedent.

ISSUE

Whether, in the situations described below, the tax imposed by § 4261 (air transportation excise tax) of the Internal Revenue Code (Code) applies to amounts paid by a foreign airline (FA) to a domestic airline (DA) that issues mileage awards (referred to herein as frequent flyer miles) to its customers in connection with an international flight operated by FA.

FACTS

DA is a common carrier that provides regularly scheduled, ticketed domestic and international air travel. DA operates a mileage awards program that provides or sells frequent flyer miles to its customers and to certain other entities.

FA is a common carrier that provides regularly scheduled, ticketed international air travel; FA does not provide air transportation that begins and ends within the United States. FA operates its own mileage awards program.

DA and FA entered into a code sharing agreement¹ and reciprocal mileage awards agreement, as further described below.

Situation 1

Passenger purchases an international flight from DA but the flight is operated by FA. DA remits the entire ticket fare (less the amount representing the § 4261(c) tax) to FA. After the flight is over, DA determines that Passenger accrued frequent flyer miles in DA's mileage awards program in connection with the international flight operated by FA. DA awards frequent flyer miles to Passenger, and then invoices FA an amount representing the monetary value of the frequent flyer miles it awarded to Passenger, plus 7.5% of that amount, representing the air transportation excise tax pursuant to § 4261(e)(3)(A).

Situation 2

Situation 2 is the same as *Situation 1* except that the flight is operated by DA. Passenger pays DA an amount for the international flight. Like in *Situation 1*, the amount paid does not include the air transportation excise tax, but does include the § 4261(c) tax on the use of international travel facilities. After the flight, DA determines that Passenger accrued frequent flyer miles in DA's mileage awards program in connection with the international flight and awards frequent flyer miles to Passenger. Neither Passenger nor anyone else pays § 4261(a) tax on the frequent flyer miles.

LAW

Section 4261(a) imposes a tax on the amount paid for taxable transportation (as defined in § 4262) of any person by air and § 4261(b) (domestic segment tax) imposes a tax on the amount paid for each segment of taxable transportation. The § 4261(a) tax is a percentage of the amount paid, and the domestic segment tax is a fixed dollar amount for each segment. "Taxable transportation" generally includes air transportation that begins and ends in the United States.

Section 4261(c) generally imposes a tax on the amount paid for any transportation of any person by air whether within or without the United States, if such transportation begins or ends in the United States and is not entirely taxable under § 4261(a).

Section 4261(d) generally provides that the taxes imposed by § 4261 are paid by the person making the payment subject to the tax. Section 4291 generally provides that any person receiving any payment for taxable air transportation must collect the amount of the tax from the person making the payment. The collector is generally required by the regulations to make deposits, file returns, and pay over the tax to the government.

¹ Code sharing is a marketing practice in which two or more airlines agree to share, for marketing purposes, the same two-letter code used to identify carriers in the computer reservation systems used by travel agents.

Section 4261(e)(3)(A) treats any amount paid (and the value of any other benefit provided) to an air carrier for the right to provide mileage awards for any transportation of persons by air as an amount paid for taxable transportation that is taxable under § 4261(a).

Rev. Rul. 55-534, 1955-2 C.B. 665, provides that where the transportation of persons involves the services of two or more carriers, the tax applies only to the payments made by, or on behalf of, the passengers for the complete transportation service. The tax does not apply to payments made by the carriers between themselves in settlement of their charges for their respective services, even though the payments made to the initial carrier by or for the passengers may have been exempt from the tax. The initial carrier should in such cases furnish to the other carrier or carriers a certification that (a) the tax has been collected with respect to the amounts paid by or for the passengers for the complete transportation service, or (b) the payments made by or for the passengers were exempt from the tax. Such a certification by the initial carrier constitutes authority to the other carrier or carriers not to collect the tax.

Notice 2002-63, 2002-2 C.B. 644, provides the following rules applicable to frequent flyer miles:

(1) Amounts paid for frequent flyer miles that cannot be redeemed for taxable transportation beginning and ending in the United States are not subject to tax. For purposes of this rule, frequent flyer miles issued by a foreign air carrier are considered to be usable only on that foreign air carrier and thus not redeemable for taxable transportation beginning and ending in the United States. Therefore, amounts paid to a foreign air carrier for frequent flyer miles are not subject to tax.

(2) Amounts paid by an air carrier to a domestic air carrier for frequent flyer miles that can be redeemed for taxable transportation are not subject to tax to the extent those miles will be awarded in connection with the purchase of taxable transportation.

(3) Amounts paid by an air carrier to a domestic air carrier for frequent flyer miles that can be redeemed for taxable transportation are subject to tax to the extent those miles will not be awarded in connection with the purchase of taxable transportation.

Rev. Rul. 2002-60, 2002-2 C.B. 641, illustrates the application of Notice 2002-63 when a foreign air carrier purchases frequent flyer miles from a domestic air carrier, and distinguishes Rev. Rul. 55-534, concluding that Rev. Rul. 55-534 does not hold that all payments between air carriers are exempt from the tax imposed by § 4261.

More specifically, Rev. Rul. 2002-60 describes a transaction between W, a domestic air carrier, and Z, a foreign air carrier. W sells the right to award W's miles awards to Z. Instead of paying for the miles with money, Z provides W with frequent flyer miles for transportation on Z's flights. Because Z is a foreign air carrier, none of the frequent flyer

miles will be provided to its customers in connection with the purchase of taxable transportation. Therefore, the ruling holds that entire value of the frequent flyer miles transferred by Z is subject to tax under § 4261(a).

In Rev. Rul. 84-12, 1984-1 C.B. 211, an airline company instituted a program for frequent travelers entitling them to free round-trip tickets for amassing sufficient mileage. Travelers who enroll in the airline's program prior to a certain date are entitled to a "free" bonus round-trip ticket without prior accrual of mileage. The traveler must then accumulate the requisite amount of mileage by a certain date. If the traveler does not accrue the requisite mileage, the traveler is billed for the bonus ticket. The ruling holds that the tax imposed by § 4261 does not apply in the case of free bonus tickets issued by an air carrier to its customers who have already satisfied all requirements to qualify for the bonus. The Service reasoned that for purposes of the tax, the amount subject to tax is the actual amount paid for air transportation, and where no amount is paid, the tax does not apply.

ANALYSIS & CONCLUSION

In *Situation 1*, FA paid an amount to DA for frequent flyer miles in DA's mileage awards program, redeemable by Passenger for taxable transportation in connection with a flight that was not taxable transportation.

Rev. Rul. 55-534 addresses a situation in which an amount was paid by an air carrier to another air carrier to transport its passengers because, due to mechanical problems, the first air carrier was unable to complete the transportation service for which its passengers had paid. The revenue ruling, which concludes that the tax does not apply to amounts paid by the first air carrier to the second carrier, does not stand for the broad proposition that all payments between air carriers are exempt from the § 4261 tax, and has no applicability to *Situation 1*. See generally Rev. Rul. 2002-60.

Rather, *Situation 1* falls squarely into rule (3) of Notice 2002-63: Amounts paid by an air carrier to a domestic air carrier for frequent flyer miles that can be redeemed for taxable transportation are subject to tax to the extent those miles will not be awarded in connection with the purchase of taxable transportation. Based on the foregoing, we conclude that in *Situation 1*, air transportation excise tax is imposed on the frequent flyer miles that DA awards to Passenger in connection with the international flight. Thus, DA correctly collects the air transportation excise tax when it invoices FA for those frequent flyer miles.

In *Situation 2*, Passenger purchases transportation from DA that is not subject to the air transportation excise tax. Neither Passenger nor any other party pays an amount for the frequent flyer miles. Because there is no "amount paid" for the frequent flyer miles, the rule in Rev. Rul. 84-12 applies to this case. As a result, the air transportation excise tax does not apply.

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