INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Index (UIL) No.: 4261.00-00
CASE-MIS No.: TAM-156529-06

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Taxpayer =

=

=

Year One =

Year Two =

Airline =

$ X =

$ X =

X% =

$ X =

$ X =

$ Y =

$Z =

$L =

$M =

$Q =

$N =

$P =

$ X =

$ X =

$ Y =

$ X =

$ X =

ISSUE:

Whether in the circumstances described below the price per frequent flier mile is an amount paid for the right to provide mileage awards for (or other reductions in the cost of) any transportation of persons by air under section 4261 (e)(3) of the Internal Revenue Code (the Code).

CONCLUSION:

In the circumstances described below, the price per frequent flier mile is an amount paid for the right to provide mileage awards for (or other reductions in the cost of) any transportation of persons by air under section 4261 (e)(3) of the Code.

FACTS:

In general, Taxpayer offers two types of products and Customers of Taxpayer earn "points" for certain uses of each product. For , the points can be redeemed in a number of service categories, including airline frequent flier miles. Taxpayer contracts with a number of airlines to purchase frequent flier miles for . For , Taxpayer entered into a agreement with Airline in which the points are to airline frequent flier miles.

Airline is a air carrier that provides air transportation of persons beginning and ending in the United States and transportation between the United States and foreign countries.

In Year One, Taxpayer contracted with Airline for purposes of , specifying an amount paid to Airline per frequent flier mile ( ).

The contract called for Airline to use efforts to the program. It also provided that the parties could engage in joint promotions

). The contract allowed access to each party's for opportunities. Airline could enroll a Taxpayer customer who redeemed points with Airline in its frequent flier program.

For , Taxpayer contracted with Airline to create a , specifying an amount Taxpayer paid per frequent flier mile (

Under the contract, Taxpayer agreed to undertake and of the product.

. The parties agreed to the for the program, but Taxpayer had ultimate decision making authority. Airline agreed to in the and

programs for the , with its own

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In Year One, except for , the price of a frequent flier mile was set at $Z per mile in the contract and the contract.

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In Year Two, Taxpayer renegotiated the and contracts with Airline (New and New contracts, respectively). In the New and New contracts, the parties allocated the price per mile between air transportation and and benefits.

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Thus, this memorandum does not address the excise tax treatment of the New

The New contract provided for a payment of $Q per mile, of which was allocated to the cost of the frequent flier mile and was allocated to

and expenses.

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Taxpayer provided a

However, it is unclear whether takes into account

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LAW AND ANALYSIS:

Section 4261(a) imposes a tax on the amount paid for taxable transportation (as defined by § 4262) of any person by air. "Taxable transportation" generally includes air transportation that begins and ends in the United States.

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 (or other reductions in the cost of) any transportation of persons by air as an amount subject to tax under section 4261(a).

Section 4261(e)(3) was enacted under the Taxpayer Relief Act of 1997, P.L. 105-34, to extend the § 4261(a) tax to certain payments to airlines. According to the Conference Report, Report 105-220, at 555-6, those payments include "(1) payments for frequent flier miles (including other rights to air transportation) purchased by credit card companies, telephone companies, rental car companies, television networks, restaurants and hotels, air carriers and related parties, and other businesses, and (2) amounts received by air carriers (and related parties) pursuant to joint venture credit card or other marketing arrangements."

The General Explanation of Tax Legislation Enacted in 1997, prepared by the Joint Committee on Taxation, JCS-23-97, 230-231, clarified the language of the Conference Report by providing: "… (2) amounts received by airlines (whether paid in cash or in kind) pursuant to joint venture credit card or other air transportation marketing arrangements as compensation for the right to air travel."

Although the Conference Report could be read broadly to include in the tax base all amounts Taxpayer pays Airline under the contract and the New contract, the Blue Book language is reflected in the statutory language: the amounts subject to tax are only those relating to the right to provide mileage awards for, or other reductions in the cost of, any transportation of persons by air, and not "all amounts paid pursuant to a joint venture credit card or other marketing arrangement."

In Rev. Rul. 2002-60, 2002-2 C.B. 641, a domestic air carrier provides air transportation of persons beginning and ending in the United States and transportation between the United States and foreign countries. The air carrier operates a program under which it awards frequent flyer miles to certain purchasers of its air transportation. In addition, the air carrier sells the right to provide mileage awards to other persons. Because the airline's miles are redeemable for transportation beginning and ending in the United States, the revenue ruling holds that the amounts paid for the miles are taxable. Airline's miles are redeemable for transportation beginning and ending in the United States. Thus, the amounts Taxpayer pays Airline for the frequent flier miles are taxable.

In general, all amounts paid to an airline for a ticket for air transportation are part of the tax base, as described in Rev. Rul. 73-508, 1973-2 C.B. 366 (amounts paid for airline security procedures); Rev. Rul. 74-123, 1974-1 C.B. 318 (amounts paid for transportation services rendered in Government-owned aircraft, including both cash and the value of any contribution made by the agency toward providing the service); Rev. Rul. 73-344, 1973-2 C.B. 365 (certain state sales tax imposed on the seller); and Rev. Rul. 72-565, 1972-2 C.B. 578 (amounts paid for layover charges, including pilot expenses for lodging and food) (but see Rev. Rul. 91-61, 1991-2 C.B. 377 (amount paid for Passenger Facility Charge, a federally mandated fee for airport planning, development and construction, is not included in the tax base because of its unique nature and purpose)).

Under §§ 49.4261-2(c), 49.4261-7(i), and 49.4261-8(f) of the Facilities and Service Excise Tax Regulations, if a payment covers charges for nontransportation services as well as for transportation of a person, such as charges for meals, hotel accommodations, etc., the charges for the nontransportation services may be excluded in computing the tax payable for such payment, provided such charges are separable and are shown in the exact amounts thereof in the records pertaining to the transportation charge. If the charges for nontransportation services are not separable, the tax must be computed upon the full amount of the payment. A bundled payment includes amounts for taxable transportation and nontransportation services, such as meals, hotel accommodations, etc.

. Assuming for purposes of this argument that these provisions of

the regulations apply, the contracts do not meet the "shown in the exact amounts" requirement. Further, the regulations do not include marketing and advertising expenses as nontransportation services. Thus, Taxpayer may not rely on the regulations to allocate a portion of the amount paid in the and contracts to and expenses.

Nevertheless, the terms of the and contracts do not reflect a . In contrast,

. Thus, the terms of the and contracts are not consistent with Taxpayer's theory .

Rev. Rul. 2006-52, 2006-43 I.R.B. 761, states that an airline's costs associated with selling tickets are generally necessary to the air transportation the airline provides. Because is on its face a product identified with Airline and a product from which Airline profits, efforts to advertise the are self-promotional in nature. Thus, the $ per mile in the contract is properly included in the tax base.

Whether it is possible to bifurcate a contract expressed exclusively in terms of cents per mile is not under consideration herein.

In the and contracts, the $ per mile is an amount paid for the right to provide mileage awards for (or other reductions in the cost of) any transportation of persons by air.

In the New contract, the $ per mile is an amount paid for the right to provide mileage awards for (or other reductions in the cost of) any transportation of persons by air.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the Taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.