## Section 4261.—Imposition of Tax

*26 CFR 49.4261–1: Imposition of Tax; in general.*

This revenue ruling illustrates the application of Notice 2002–63, 2002–40 I.R.B. 644, when a foreign air carrier purchases mileage awards from a domestic air carrier. In addition, the revenue ruling distinguishes Rev. Rul. 55–534, 1955–2 C.B. 665, concluding that Rev. Rul. 55–534 does not hold that all payments between air carriers are exempt from the tax imposed by § 4261 of the Internal Revenue Code. See Rev. Rul. 2002–60, on this page.

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This notice provides rules relating to the air transportation tax imposed by § 4261(a) of the Internal Revenue Code on amounts paid for the right to provide mileage awards. The notice supersedes Notice 2001–6, 2001–1 C.B. 327. See Notice 2002–63, page 644.

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**Mileage awards.** This ruling illustrates the application of Notice 2002–63, 2002–40 I.R.B. 644, when a foreign air carrier purchases mileage awards from a domestic air carrier. In addition, the revenue ruling distinguishes Rev. Rul. 55–534, 1955–2 C.B. 665, concluding that Rev. Rul. 55–534 does not hold that all payments between air carriers are exempt from the tax imposed by section 4261 of the Code.

## Rev. Rul. 2002–60

Notice 2002–63, 2002–40 I.R.B. 644, provides rules relating to the tax imposed by § 4261 of the Internal Revenue Code on any amount paid (and the value of any other benefit provided) for the right to provide mileage awards for, or other reductions in the cost of, any transportation of persons by air. The notice provides an exception from the tax for amounts paid for mileage awards that cannot be redeemed for taxable transportation beginning and ending in the United States and rules for determining the tax on amounts paid by an air carrier to a domestic air carrier for mileage awards. Under these rules, amounts paid for mileage awards 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 and are subject to tax to the extent they will not be awarded in connection with the purchase of taxable transportation. The situation described below illustrates the application of Notice 2002–63 when a foreign air carrier purchases mileage awards from a domestic air carrier.

FACTS

*W*, 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. *W* operates a program under which it awards frequent flyer miles to certain purchasers of its air transportation. In addition, *W* sells the right to provide mileage awards to other persons. *W*'s miles are redeemable for taxable transportation beginning and ending in the United States.

*Z*, a foreign air carrier, purchases from *W* the right to award *W*'s miles. *Z* will award *W*'s miles in connection with the purchase of air transportation provided by *Z*. Instead of paying for *W*'s miles with money, *Z* provides *W* with mileage awards for transportation on *Z*'s flights.

ANALYSIS

*Z*'s transfer of mileage awards to *W* is a payment for the right to provide mileage awards. Making the payment with mileage awards, rather than with money, does not affect the tax consequences of a payment for the right to provide mileage awards. Because *W*'s miles are redeemable for transportation beginning and ending in the United States, the exception in Notice 2002–63(1) is not applicable. However, *Z* is an air carrier, and the rules in Notice 2002–63(2) and (3) require a determination of the extent to which the mileage awards purchased by *Z* will be awarded in connection with taxable transportation. Because *Z* is a foreign carrier none of the mileage awards will be provided to its customers in connection with the purchase of taxable transportation. Therefore, the entire value of the mileage awards transferred by *Z* is subject to tax under § 4261(a).

Rev. Rul. 55–534, 1955–2 C.B. 665, 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 and obtained transportation on the second air carrier for the passengers. 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. It has no applicability to payments for the right to provide mileage awards.

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 55–534 is distinguished.

DRAFTING INFORMATION

The principal author of this revenue ruling is Patrick S. Kirwan of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Kirwan at (202) 622–3130 (not a toll-free call).

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