

IRS Hot Topics

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Recent developments in air transportation excise tax

The air transportation excise tax provisions found in Internal Revenue Code section 4261 expired at midnight on July 22, 2011. At that time, the percentage tax, international facilities tax and domestic segment tax ceased to apply to airline ticket purchases and travel. On Friday, August 5, 2011, the Senate, using unanimous consent procedures passed, and the President signed, House Bill 2553, The Airport and Airway Extension Act of 2011, Part IV ("the Bill"), retroactively extending the air transportation excise taxes. The Bill seamlessly extended the air transportation excise as though it never lapsed. The primary effect to air travelers and ticket purchasers is that anticipated refunds will not be available. In addition, the statements of members of Congress immediately after passage reveal the intention to forgo retroactive enforcement against ticket purchasers and airlines for tax not paid or collected between July 23, 2011 and midnight Monday, August 8, 2011.

Taxes

Section 4261(a) imposes a 7.5% excise tax on amounts paid for taxable transportation of any person by air (the "percentage tax"). Taxable transportation is generally defined by section 4262(a) as transportation by air that begins and ends in the U.S. (or areas of Canada and Mexico within 225 miles from the continental U.S.). The percentage tax not only applies to amounts paid directly for transportation, such as standard ticket purchases, but also to purchases of frequent flyer miles redeemable for taxable transportation. Thus, companies involved in the various types of reward programs featuring points or miles redeemable for airline tickets may also be subject to this tax, as are individuals who make direct purchases of frequent flyer miles.

Section 4261(b)(1) imposes an additional amount of \$3.70 (adjusted



annually for inflation) per domestic segment of taxable transportation in 2011 (the "domestic segment tax"). Section 4261(c) imposes an excise tax amount of \$16.30 (adjusted annually for inflation) for use of international travel facilities, where the transportation does not both begin and end in the U.S. The taxes under section 4261 are collected taxes, meaning that the person liable for the tax, the purchaser of the ticket, is the person making the payment for the taxable transportation. Pursuant to section 4291, the person receiving the payment, generally the airline or in certain instances the travel agent, is the person that collects the tax, files the Form 720 quarterly excise tax return and remits payment to the IRS.

Retroactivity

Prior to the Bill, the section 4261 taxes applied to amounts paid for transportation between October 7, 1997 and July 22, 2011, as well as amounts paid during such period but for transportation beginning after such period. Under section 4261(j)(2), taxpayers are entitled to a refund if, as of the date the transportation begins, the section 4261 taxes would not have applied if the transportation was paid for on that date.

Though not signed by the President until August 5, 2011, the Bill, as written, is effective as of July 23, 2011, the date of expiration of the prior law. By this retroactive operation, the excise tax provisions apply without interruption

through September 16, 2011. In a letter released by the four ranking members of the Congressional tax writing committees, they have requested the Commissioner of Internal Revenue to exercise his discretion not to enforce the tax retroactively against the airlines, who are liable as collectors of the tax under section 4291, and also against taxable air transportation purchasers upon whom the section 4261 is imposed. Senators Baucus and Hatch, along with Representatives Camp and Levin, also requested in their letter that the IRS give the airlines a three-day period from the date the Bill was signed to restart their tax collection processes, in other words, August 8, 2011.

Observations

Taxpayers expecting a refund, either from the airlines or the IRS, of section 4261 taxes for tickets purchased while the tax was in place for flights taken while the tax "lapsed" will not be receiving the expected refunds. Ordinarily, the airline refunds the tax to the purchaser of taxable travel and the airline claims a refund or credit in accordance with section 6415. The Commissioner addressed this on August 5, 2011, by stating, "[a]s a result of the bill Congress passed today, passengers who purchased tickets prior to July 23 and traveled between July 23 and the date of enactment of today's legislation are not entitled to a refund of the airline ticket excise tax." This seems consistent with the fact that the

re-enactment was retroactive to July 23; those passengers who paid the tax will not benefit.

It appears that the purchasers of air transportation that are going to benefit are those who purchased tickets between July 23, 2011 and midnight August 8, 2011, regardless of when the transportation will occur. Those persons bought the tickets tax free. The four ranking members of the tax writing committees made it clear their intention is that the IRS will not seek retroactive enforcement to impose taxes on those purchasers. Commissioner Shulman, in recognition of this Congressional charge, stated, "the IRS intends to provide relief for passengers and airlines with respect to ticket taxes that were not paid or collected because of the lapse."

Based on IRS statements to date, the airlines that raised ticket prices during

the "lapse" will not be required to remit any uncollected air transportation excise tax out of their own fares.

Passengers and frequent flier mile purchasers should also not expect any attempt by the IRS to impose tax on fares and miles purchased tax free during the "lapse."

The matter that is not getting significant attention yet is that the extension runs only through September 16, 2011. When the Houses of Congress return in early September, we are expecting the air transportation excise taxes to again become a point of contention and focus. Both the latest Senate and House versions of the bills became politicized, so the next extension could prove as challenging as the last.

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