OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Mar 22, 1999

CC:DOM:FS:P&SI
TL-N-7376-98

UILC: 4261.01-00

Number: **199926005**
Release Date: 7/2/1999

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Deborah A. Butler
Assistant Chief Counsel CC:DOM:FS

SUBJECT: Air Transportation

This Field Service Advice responds to your memorandum dated February 2, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Taxpayer =

ISSUE(S):

Whether the District should enter into a prototype agreement with the taxpayer providing a mutually acceptable method for allocating the amount paid for a mixed services travel package between amounts paid for taxable air transportation and amounts paid for nontaxable components of the package.

CONCLUSION:

We agree with the concept of a prototype agreement. Such an agreement would eliminate uncertainty in this contentious area. The proposed agreement, however,

appears not to conform to Rev. Rul. 63-155, which addresses the allocation of taxable and nontaxable portions of “package tours.” Even though the allocation used in Rev. Rul. 63-155, is not mandatory in application, the ruling does require the use of a reasonable allocation of transportation costs. The proposal does not appear to achieve a reasonable allocation. Thus, we recommend that the district not approve the agreement as drafted.

FACTS:

The taxpayer, endeavoring to increase its business, either through goodwill or increase receipts, promotes various trip packages to its establishment for identified customers. The junkets may take any of several forms. For premium customers, fully complementary plane flights and hotel stays are available. For other customers, partially complementary (that is, discounted) packages are available and, for the general public, full price packages are available. The packages may be provided directly through the taxpayer or through travel agents. The taxpayer or the agent may charter an aircraft and offer the seats to a group or the public.

Because of the variety of packages offered the taxpayer has had difficulty determining its liability for air transportation tax. The taxpayer and the district propose to enter into an agreement to determine readily the value of the non-air transportation items. A spreadsheet will be used to simplify the tax computations. Under the proposal, the taxpayer will:

1. Record the number of paying passengers and package price for each flight.

2. Record the passenger facility charges (PFC) for all paying passengers.

3. Determine the total amount received (number of paying passenger times cost per passenger less the PFCs).

4. Compute the value of the hotel component by multiplying an agreed-upon per person room rate by the number of paying passengers.

5. Compute the value of the ground transportation component by multiplying an agreed-upon per person amount by the number of paying passengers.

6. Compute the value of the fun books/coupons, etc., component by multiplying an agreed-upon per person amount by the number of paying passengers.

7. Determine other costs per paying passenger.

8. Determine the tax base by subtracting from the total amount received:

A. The total value of single rooms based on (4), above;

B. The total value of double rooms based on (4), above;

C. The total value arrived at for ground transportation and the fun book based on (5) and (6), above.

9. Multiplying the result of 8 by the current FET rate and adding the appropriate segment fees.

10. For charters that are fully complementary, the FET would be calculated based on the amount paid for the charter.

LAW AND ANALYSIS:

Section 4261(a) imposes on amounts paid for taxable transportation of any person a tax equal to 7.5 percent of the amount so paid.

Section 4261(b) imposes a tax on the amount paid for each segment of domestic transportation by air. Currently, the tax is $2.00.

Section 4261(c) imposes a tax of $12.00 on the amount paid for any transportation of any person by air, if such transportation begins or ends in the United States. This tax does not apply to any transportation all of which is taxable under subsection (a).

Section 4262(a) defines the term “taxable transportation” to include 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. The “225 mile zone” means that portion of Canada or Mexico which is not more than 225 miles from the nearest point in the continental United States.

Revenue Ruling 63-155, 1963-2 C.B. 566, addresses a situation in which a hotel provided package tours including “free air transportation.” A flight is advertised as a round-trip 'free flight' to and from the city of X and is sold as part of a 'package tour.' These 'package tours' are sold through the hotel's own ticket offices and through travel and tour agents.

The revenue ruling concludes that in the circumstances under consideration, the payment for the 'package tour' includes an amount paid for taxable transportation. It is immaterial that such transportation also serves as a promotional device to stimulate the normal business activities of the hotel. The revenue ruling holds that the tax imposed by section 4261(a) of the Code applies to that portion of the amount paid for the 'package tour' which is reasonably attributable to taxable transportation. The ruling provides an illustrative method of allocation that is acceptable to the Internal Revenue Service. It provides the following example:

> The tax base may be determined by applying to the total amount paid for the 'package tour' the ratio which (1) the tax-excluded standard transportation charge made by regular certified airlines for a comparable flight within the area bears to (2) such tax-excluded standard transportation charge plus the fair market value of the goods and nontaxable services sold.
>
> In this manner, the tax base may be computed by applying the following formula:
>
> > Standard transportation charge (tax-excluded)/Standard transportation charge (tax-excluded) plus the fair market value of the goods and nontaxable services X Total amount paid for the 'package tour' = TAX BASE
>
> Once the tax base has been computed by an acceptable method, the amount of tax may be determined by applying to the tax base the tax rate in effect at the time the flight begins.

The principle underlying Rev. Rul. 63-155 is that, where an amount is paid for a package including both air transportation and non-air transportation items, the portion of the total amount paid allocable to air transportation (and thus subject to the § 4261 tax) is determined by a calculation of the portion of the total value of all components allocable to the value of the air transportation. The proposed allocation of costs that the District has negotiated does not follow this principle. Rather, it allocates agreed-upon values to the non-air transportation items and any remainder is designated as the amount paid for air transportation. Even though the example in Rev. Rul. 63-155 is only illustrative, the revenue ruling does hold that the tax imposed by section 4261(a) of the Code applies to that portion of the amount paid for the 'package tour' which is reasonably attributable to taxable transportation. In any case where the aggregate of charges for the individual components of the package sold separately differs from the charge for the package, a reasonable allocation must be made between the taxable and nontaxable

components of the package. In the instant case the proposed agreement would allocate full value to the non-air transportation portions of the package and allot the residue to the taxable air transportation portion. This would be a reasonable allocation only if the package cost is identical to the aggregate of the actual charges for the components sold separately. This normally is not the case with most types of package tours. A major selling point usually is the reduced cost of a package compared to the same goods and services purchased separately. As drafted, the agreement results in the determination of an amount paid for air transportation that appears not to reflect the relative value or relative cost of the air transportation in comparison to the other costs. As such the allocation would not reasonable.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We agree in principle with the district's attempt to develop a standard formulaic method of determining the amount of the price of a junket or tour package that is subject to the air transportation tax. However, as you mention in your memorandum dated February 2, 1999, other casinos will learn of and want to use the method agreed upon by the district and the taxpayer. Because of this, we believe that the agreement should be in the form of a Market Segment Understanding (MSU) and should be developed for the industry instead of for one taxpayer. We suggest that the district refer the issue to the Air Transportation Industry Specialization Program for further development and that the ultimate negotiation be completed through the Market Segment Specialization Program. You may wish to discuss the mechanics of the MSSP program with that office's national staff, who may be reach at (202) 401-4494.

If you have any further questions, please call (202) 622-7830.

By: _____

PATRICK PUTZI
Special Counsel
Associate Chief Counsel (Domestic)