The Taxability of Frequent Flyer Credits Earned by Employees: Why the IRS Has Remained Silent on the Issue

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I. INTRODUCTION

It has been over twenty years since the advent of frequent flyer programs at major airlines. Yet, the Internal Revenue Service ("IRS" or "Service") has left unsettled the controversy surrounding the taxability of credits earned by employees through these programs. This inaction is surprising given the following factors: (1) well-established taxation principles found in code and case law that seem to warrant IRS intervention in this area and (2) the well-known nature of the IRS to tax everything within its powers. Indeed, the IRS has not turned a fully blind eye to this controversial topic; in a 1985 notice of proposed rulemaking regarding the implementation of regulations pertaining to employee fringe benefits, the

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2. See discussion infra. at V.A.4.


4. Note that while some commentators argue that frequent flyer credits should not be includable in gross income because they fall under one of the I.R.C. § 132 exceptions for fringe benefits, this comment does not address that issue. For an in-depth analysis of why these exceptions do not, in fact, apply to the case of frequent flyer credits, see Dominic L. Daher, The Proposed Federal Taxation of Frequent Flyer Miles Received From Employers: Good Tax Policy But Bad Politics, 16 AKRON TAX J. 1, 7 (2001) (stating reasons why frequent flyer miles do not fall under the I.R.C. § 132 exceptions); Lee S. Garsson, Frequent Flyer Bonus Programs: To Tax or Not To Tax—Is This The Only Question?, 52 J. AIR. L. & COMMERCE 973, 973 (1987); Sharon Alice Pouzar, Note, Frequent Flyer Awards as Taxable Income: Time to Pay the Taxman, 5 TEX. WESLEYAN L. REV. 55, 66 (1998). In addition, for

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IRS made the following solicitation:

Comments are also requested relating to the tax treatment of so-called "bonus" programs (such as "frequent flyer" programs) under which a company provides benefits (such as free flights, automobile rentals, and hotel rooms) to their customers on the basis of the amount of business the customer does with the company. The issue of tax treatment arises when, for example, the business that gives rise to the benefits or bonuses is paid for by the customer's employer rather than the customer (i.e. business flights or hotel rooms are paid for by the employer and the company awards the free flight or hotel room to the employee). Comments are requested on the need for special rules relating to the valuation of the benefits, the administrability of either withholding on or reporting the value of such benefits, and the appropriate party to charge with the responsibility for reporting. Comments are specifically requested regarding whether the benefits should be regarded as "wages" subject to withholding.5

Despite the abundance of persuasive commentary that has been contributed in response to this solicitation, the Service has chosen to remain passive on the issue and, consequently, no formal tax treatment of frequent flyer credits earned by employees exists today.6

The purpose of this comment is to explore the different considerations that best explain why the Service has not chosen to tax flyer credits earned in the employee context. Such considerations include various technical difficulties and policy complications. In addition, this examination will embrace the widely accepted concession that credits earned through private activity should not be taxed.

Part II provides an overview of the mechanics of frequent flyer programs and the redemption of credits. Part III outlines pertinent tax principles and provides a framework for the current status of the debate surrounding this controversial issue. Part III supports the proposition that, theoretically, credits earned by employees should be taxed, and Part IV provides an analysis of what is considered the most relevant case on the topic, Charley v. Commissioner.7 In Part V, the focus shifts towards issues

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5. Taxation of Fringe Benefits and Exclusions From Gross Income for Certain Fringe Benefits 50 Fed. Reg. 52,333, 52,334 (proposed Dec. 23, 1985). Note that the proposed regulations offered no treatment for frequent flyer credits, and that the only mention thereof was in the above solicitation.

6. According to Dominic Daher, the Service officially withdrew all plans to tax employer-provided frequent flyer miles in 1988. See Daher, supra note 4, at 18.

7. 91 F.3d 72 (9th Cir. 1996).
surrounding a practical application of the relevant tax principles. Deference to existing commentary in this article is limited to theoretical applications of tax law in this context. While most commentators have chosen to sound an aggressive call to arms in support of the taxation of these credits, Part V explains why the IRS has been correct in taking a position of silence on the matter. In support of this argument, Part V emphasizes the complications inherent in the mechanics of frequent flyer programs, including valuing, monitoring, and timing issues—all of which present difficulties to a tax levy. Part VI then surveys different policy considerations, some that undermine, and some that support, the position of non-action by the IRS, and Part VII provides an historical framework of action by the Service to date. Finally, the comment's conclusion summarizes why a passive approach by the IRS is warranted, and leaves open for discussion the possibility of congressional action on the issue.

II. OVERVIEW OF THE FREQUENT FLYER CREDIT ACCUMULATION AND REDEMPTION PROCESS

The mechanics of frequent flyer programs are relatively simple. An individual usually calls an airline and requests to sign up for that airline's frequent flyer program. The airline representative creates an account for the individual and mails account information as well as information on how to earn and redeem flyer credits. Under current programs, such credits may be earned through a wide variety of commercial activities. These include the purchase of flights, car rentals, cruises, hotel use, bus travel, credit card usage, electronic stock trading, real estate transactions, telephone use, flower purchases, and a multitude of other activities. The standard procedure is for the individual to present his or her frequent flyer membership account number when paying for any of the above-mentioned items. When enough credits have been accumulated for the individual to redeem a flight, that person can usually contact the airline via the Internet, telephone, mail, or in person, to request a voucher or ticket for airline travel.

III. APPLICATION OF TAXATION PRINCIPLES

Section 61(a) of the Internal Revenue Code dictates that gross income

9. See DELTA AIR LINES, INC., supra note 8, at 29.
10. The type of flight redeemable will vary with the amount of credits accumulated. See, id. at 13-16.
11. See id. at 17.
is "all income from whatever source derived."\textsuperscript{12} This has been construed by the courts to mean "accessions to wealth, clearly realized . . . over which the taxpayers have complete dominion."\textsuperscript{13} Indeed, this broad conception has withstood scrutiny in the context of would-be gifts,\textsuperscript{14} punitive damages,\textsuperscript{15} treasure troves,\textsuperscript{16} and even a unique situation involving the use of frequent flyer credits.\textsuperscript{17} This treatment begs the question: If the definition of taxable income has been so broadly conceived, why doesn't the IRS tax frequent flyer credits? In the case of credits earned through the private purchase of flights (i.e., personal travel), the answer is simple—there is no income realized. Rather, the individual is getting the benefit of his or her bargain in an ordinary market transaction. Put another way, the price of an airline ticket can be seen to reflect the value of the flight and the value of any credits accumulated as a result of purchasing the flight.\textsuperscript{18} Some refer to this characterization as a volume discount approach, others call it a mere reflection of market value.\textsuperscript{19} Under either theory, the purchaser uses his or her own money to purchase the tickets, and the credits are accumulated as part of that purchase. Therefore, such an acquisition of credits cannot be described as "income" or an "accession to wealth."

In the employment context, however, something quite different occurs. An employee books a flight using his or her own money, and flyer credits are added to a personal account the individual keeps with the airline to accumulate credits for travel taken with the airline. The employer later reimburses the employee for the expense of the flight, and the employee keeps the credits. What distinguishes this from the case involving personal travel is that here the employee is not getting the benefit of his or her bargain. Rather, he or she is getting the right to retain these credits which

\begin{itemize}
  \item \textsuperscript{12} I.R.C. § 61(a) (2001).
  \item \textsuperscript{13} See Comm'r v. Glenshaw Glass, 348 U.S. 426, 431 (1955) (holding that money received as exemplary damages for fraud or as punitive antitrust recovery constitutes gross income).
  \item \textsuperscript{14} See Comm'r v. Duberstein, 363 U.S. 278, 278 (1960).
  \item \textsuperscript{15} See Glenshaw Glass, 348 U.S. at 426.
  \item \textsuperscript{17} See Charley v. Comm'r, 91 F.3d 72, 72 (9th Cir. 1996). This case is examined in further detail below. For now, it is only important to note that the Ninth Circuit court did not address the issue of whether frequent flyer credits earned as an employee were taxable.
  \item \textsuperscript{18} For example, an individual might ordinarily be willing to pay $375 for a round-trip flight from Philadelphia to Boston. However, given the prospect of gaining 2,000 frequent flyer credits on a reputable airline in addition to the right to travel, the purchaser may be willing to increase the amount of consideration paid for the round-trip ticket from $375 to $400.
  \item \textsuperscript{19} See Jonathan Barry Forman, Income Tax Consequences of Frequent Flyer Programs, 26 Tax Notes 742, 742 (1985) ("Frequent flyer programs are basically just complicated discounts for the purchase of multiple airline tickets.").
\end{itemize}
can later be used to gain travel and other airline benefits. Essentially, the employee is getting something for nothing. However, this something represents a clear accession to wealth and would therefore appear taxable under the principles of federal income taxation established by the Internal Revenue Code and accompanying case law. Nevertheless, neither the IRS nor the judiciary has chosen to take an affirmative stance on this issue. As a result, there exists no legal precedent directly establishing the taxability of these credits. In addition, the IRS has no enforcement policy in place that would call for the assessment of a tax on these benefits. The consequence is that taxpayers who earn these credits, in the course of what appears to be a taxable transaction, are free to continue using them without fear of tax liability.

IV. CHARLEY V. COMMISSIONER

The well-known and somewhat infamous case of Charley v. Commissioner is the closest that either the Tax Court or the federal courts have come to deciding whether employee-earned frequent flyer credits are taxable. Indeed, it is the closest the Service itself has ever come to taking an affirmative stance on the issue. While the case involved a "near miss" of the issue at hand, its precedential value lies in its illustration of the reluctance of the IRS, Tax Court, and federal courts to grapple with the difficult issue involved.

In Charley, the appellant, Dr. Phillip Charley, was the President of a company named Truesdail Laboratories (hereinafter "Truesdail"). In the course of his employment, he was required to fly extensively for the company. When Dr. Charley flew, Truesdail's travel agent, Archer Travel Service, billed Truesdail directly for the cost of the flight. Truesdail, in turn, billed the client for this amount. Truesdail had an unwritten policy that frequent flyer credits earned by employees in connection with such business travel could be kept by the employees and would become their exclusive property.

21. See sources cited and text accompanying supra notes 12-17.
22. In tax litigation, a refund suit may be brought directly in a Federal District Court, and a deficiency suit may be appealed from the Tax Court to a Circuit Court. James J. Freeland et al., Fundamentals of Federal Income Taxation 27-30 (10th ed. 1998).
23. The IRS defended its decision to assert a tax deficiency on appellant Dr. Philip Charley for the monetary benefit he derived from his use of frequent flyer credits. However, the IRS conceded in its Tax Court brief that ""the tax treatment of frequent flyer bonus programs [was] still under consideration."" Charley v. Comm'r, 91 F.3d 72, 75 (9th Cir. 1996).
24. Truesdail provided laboratory testing services, including testing the urine of race horses and investigating the causes of industrial accidents. Id. at 73.
During 1988, Dr. Charley was able to make a monetary gain through the manipulation of frequent flyer credits accumulated in connection with his travel for the company. This gain was accomplished through a five-step transaction. First, a client engaged the services of Truesdail and directed Dr. Charley to travel to a particular site. Second, if Dr. Charley chose to travel by air, Truesdail billed the client for round-trip first class air travel. Third, Dr. Charley instructed Archer Travel Service to arrange for coach service to and from the site, but to bill Truesdail for first class air travel. Fourth, Dr. Charley used his personal frequent flyer credits accumulated largely through prior business travel for Truesdail, to upgrade the coach ticket to first class. Fifth, Dr. Charley then instructed Archer to transfer funds amounting to the difference between the cost of a first class ticket and a coach ticket to his personal travel account. The total value of these funds in 1988 was $3,149.93. Dr. Charley claimed that he had no idea that they constituted taxable income.

The Tax Court held for the IRS, finding that the funds transferred to the taxpayer's personal account constituted gross income.25 The Tax Court stated:

There is no indication in the record that petitioners could not use the accumulated [funds in the account] for personal purposes nor, in fact, redeem the [funds] for cash on demand. There is no showing that Truesdail had any rights, interest, or control over petitioners' personal travel account. Whether we regard this fact situation as a straight "rip-off" by petitioner of his employer or a highly technical "sale" of his frequent flyer [credits](which have zero basis) for the [funds], the fact remains that petitioner was wealthier after the transaction than before. In such circumstances, the accretion of wealth is the receipt of income.26

This opinion is relevant for two reasons. First, it emphasizes the fact that courts intend to treat clear accessions in wealth as "income from whatever source derived."27 Second, while the Tax Court found that there was taxable income, it did not state whether this income was an employee fringe benefit, a constructive dividend, or gain realized from the distribution of property. In fact, it appeared to be completely irrelevant to the Tax Court's holding that frequent flyer credits were involved.28 This omission is particularly conspicuous given that the issue of whether these credits are taxable had already been widely commented on and seemed ripe

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26. Id.
for determination. Based on the combination of these factors, it is clear that the Tax Court must have been unwilling to address the issue of the taxability of frequent flyer credits in the abstract, and thus proffer a solution to the debate.

On appeal, the Ninth Circuit affirmed, finding that the funds in Dr. Charley’s travel account could be classified as compensation derived from his employer, or, alternatively, that the funds could be considered proceeds from the sale or exchange of the taxpayer’s personal frequent flyer credits.\textsuperscript{29} Under the latter approach, the funds would be treated as a gain Dr. Charley made on the disposition of his own frequent flyer credits and taxable under I.R.C. § 61(a)(3).\textsuperscript{30}

Unfortunately, such reasoning did little to clarify the tax consequences, if any, associated with the accumulation or use of frequent flyer credits. Indeed, the Ninth Circuit was careful to sidestep such a conclusion:

[T]he Charleys argue that no taxable event occurred. . . . [They] argue that this case raises the question of whether, in the abstract, frequent flyer [credits] constitute gross income. We disagree and do not reach that issue. . . . The fact that the [funds] were exchanged for frequent flyer [credits] simply is not relevant to the analysis.\textsuperscript{31}

It is worth noting that the Ninth Circuit dismissed the notion that if the funds were treated as compensation to Dr. Charley from his employer, they could be exempt from taxation as gifts\textsuperscript{32} or as a non-taxable employment fringe-benefit.\textsuperscript{33}

One may ask at this point whether, aside from giving peripheral attention to the use of frequent flyer credits, \textit{Charley} has any value for the issue this comment addresses. The answer is a resounding yes. The case clearly demonstrates the reluctance of the IRS, the Tax Court, and the Ninth Circuit to address the taxability of frequent flyer credits. Indeed, each of these parties had the opportunity to do so: the IRS in its brief, and the Tax Court and Ninth Circuit in their decisions—if not as part of their reasoning, then at least as dicta. Instead, each chose to shy away from a topic that was, and continues to be, highly controversial. This leads us to the question of why has the issue been so avoided, and has this been an

\textsuperscript{29} \textit{Charley}, 91 F.3d at 74.

\textsuperscript{30} I.R.C. § 61(a)(3).

\textsuperscript{31} \textit{Charley}, 91 F.3d at 74. By concluding that the funds were taxable as employee compensation or, in the alternative, as a gain on the disposition of property, the Ninth Circuit effectively evaded the question of whether the use of frequent flyer credits could be treated as a taxable event.


\textsuperscript{33} See, e.g., I.R.C. § 132 (2001).
acceptable approach?

V. PROBLEMS INHERENT IN THE TAXATION OF FREQUENT FLYER CREDITS DUE TO COMPLEXITIES IN THE MECHANICS OF FREQUENT FLYER PROGRAMS

There is little doubt that the taxation of frequent flyer credits earned on business travel would result in a tremendous increase in tax revenues by the Federal Government. There are approximately seventy Frequent Flyer Programs today worldwide with over one-hundred million members receiving over ten million awards per year. The possible added tax revenue figure involved with those credits earned through business travel is more than impressive. However, the Service has chosen not to take advantage of this available stream of would-be taxable income. As will be discussed in the remainder of this comment, the reason for such lack of action by the Service can be only a result of practical difficulties involved in such taxation.

First, there is the problem of establishing standards for determining the value of the credits to be taxed. For example, the most widely considered proposals suggest that taxable credits should be measured by either, (1) the cost of a redeemable flight; (2) the after-market resale value of the credits or flights; or (3) the cost of other items that may be purchased with the credits. Secondly, there is the problem of

34. For a myriad of related concerns, see generally Canter et al., How Not To Deal With Frequent Flyer Miles For Tax Purposes, 85 J. TAX'N 319 (1996) (discussing Charley and the conundrum frequent flyer credits pose for tax lawyers, and suggesting various strategies for tax lawyers who must deal with the valuation of frequent flyer miles).


36. See M. Bernard Aidinoff, Frequent Flyer Bonuses: A Tax Compliance Dilemma, 31 TAX NOTES 1345, 1347 (1986) (“Ever since frequent flyer bonus problems were introduced in the early 1980’s, billions of dollars of free travel benefits have been received by passengers in connection with business flights.”); Rosenzweig, supra note 28, at 677, (citing George Guttman, IRS Moves Slowly On Frequent Flier Issue, 38 TAX NOTES 1309 (1988)) (indicating that it was estimated that taxation of frequent flyer miles would have generated tax revenue of $200 million in 1988).

37. Note that the ticket price for a particular flight will vary throughout the year. The amount of credits needed to redeem the flight, however, will be set by the particular program’s guidelines. See, e.g., DELTA AIR LINES, INC., supra note 8, at 13 (describing the Delta frequent flyer program’s guidelines).

38. Note that a secondary market exists for the sale or exchange of these credits before redemption. See, e.g., Tom Belden, Business Travel: How to Propel Yourself Into First Class, PHILA. INQUIRER, Oct. 27, 1997, at E6 (describing how frequent flyer credits may be sold or exchanged rather than redeemed).

39. For example, frequent flyer mile credits may be used towards the redemption of hotel rewards. See, e.g., Hilton Hotels Corporation, Hilton Honors—Earn Both Points and Miles, at http://www.hilton.com/hhonors/points/index.html (last visited Jan. 28, 2002).
monitoring—or, more simply stated, the question of who has the ultimate responsibility for keeping track of these credits. The only reasonable possibilities are the parties involved in the transaction: (1) the taxpayer; (2) the employer; or (3) the third party airline. Finally, there is the problem of timing, i.e., the determination of the point at which these credits constitute taxable income. The two most commonly proposed points in time are: (1) when credits are accumulated and (2) when they are redeemed or used. An examination of these difficulties and the lack of effective solutions available lends support to an argument in favor of the Service’s path of non-action.

A. Valuation Problems

The first complexity with taxing frequent flyer credits is determining the amount to be included in the taxpayer’s gross income. The three most commonly discussed possibilities are listed above. They are, essentially: (1) the fair market value, or cost, of the ticket redeemable (2) the fair market value of the credits in a secondary market; and (3) the value of other items that may be redeemed with the credits. In addition, there have been two other methods proposed for valuing these credits that are worth exploring. The first is based on a specified value per mile or credit, and the second on a percentage of the would-be flight cost.  

1. Fair Market, or Cost, Valuation

The first possibility, the value of a flight that can be redeemed, poses inequitable results if adopted as a uniform standard. For instance, assume that a taxpayer has a frequent flyer account with Delta Airlines, and that enough credits have been received to purchase a flight, round-trip from Boston to Philadelphia. Assume also that the taxpayer goes ahead and purchases this flight. Under this redemption or market valuation theory, the taxpayer will have accumulated added gross income totaling the amount of money it would take to purchase this flight from Delta. However, it is likely that there are other airlines that offer the same flight (Philadelphia to Boston) with comparable amenities (including space,
refreshments, etc.), but at a cheaper price. Nevertheless, under this approach, taxpayers that have redeemed credits with these airlines for the same flight will actually be liable for less taxable income than our taxpayer that flies Delta on business. It would be inaccurate, however, to say that any one of the two has experienced a greater "accession to wealth" than the other. They have all received the same benefit, or increase in wealth, yet one individual would owe a greater amount of tax for it. Essentially, the factors involved in pricing such flights involve considerations so far removed from the taxation of the redemption of these flights, that taxation in this context would produce arbitrary results.

Another problem with the fair market valuation rule is that it may overstate the taxpayer's "accession to wealth."\textsuperscript{42} For example, an individual may choose to redeem a flight for a date that the airline has severely overpriced its tickets, due to an anticipated high volume of travel, or for some other reason. The fact may be that the individual would never pay out-of-pocket anything near the current price of the flight. Therefore, it would be hard to say that the taxpayer's "accession to wealth" is equal to the face value of the ticket redeemed. Indeed, the Tax Court in the 1954 case of \textit{Turner v. Commissioner} reduced tax liability based on this subjective standard.\textsuperscript{43} The Court stated:

Persons desiring to buy round trip first-class tickets . . . similar to those to which the petitioners were entitled, would have had to pay $2,220 for them. The petitioners, however, were not such persons. The winning of the tickets did not provide them with something which they needed in the ordinary course of their lives and for which they would have made an expenditure in any event, but merely gave them an opportunity to enjoy a luxury otherwise beyond their means. Their value to the petitioners was not equal to their retail cost . . . . The problem of arriving at a proper fair figure for this purpose is difficult.\textsuperscript{44}

A theoretical solution to this problem would be to allow taxpayers to determine the value of the tickets themselves, and tax them based on this amount. However, the obvious problem with this approach is that it opens the door for rampant tax evasion. Certainly, given the unfortunate and astounding amount of tax evasion every year, individuals likely would be inclined to lie and drastically undervalue the worth of the credits to

\textsuperscript{42} See Garsson, \textit{supra} note 4, at 989 (indicating that consumers may fly first class only as a result of a bonus program which would render the value of the first-class ticket an inaccurate measure of their accession to wealth).

\textsuperscript{43} Turner \textit{v. Comm'r}, 13 T.C.M. (CCH) 462, 463 (1954) (finding that the face value of a trip won as a prize was not equal to the value realized by taxpayers).

\textsuperscript{44} \textit{Id.}
themselves. This would result in unwanted litigation and related expenses that the Service would want to avoid. Litigation would be complicated by problems of proof involved in trying to determine the real subjective value of the tickets to taxpayers—for example, how is the Service expected to ascertain such value? This subjective standard certainly does not provide a viable solution to the valuation problem.

Sharon Pouzar has offered a theory of valuation that seems to alleviate this problem of subjective valuation and resultant over-taxation. Pouzar argues that restricted or non-restricted frequent flyer tickets should carry no more value than a corresponding restricted or non-restricted ticket available for purchase at the time the free transportation is confirmed. As a result, a value attached to a ticket redeemed through frequent flyer programs will never be more than the face value of the least expensive corresponding ticket available for purchase at the time of redemption. The difficulty with this approach is that, by limiting the standard to only one airline, it does not overcome the possibility of inequitable results. The least expensive corresponding ticket available with one airline will, in many instances, be more expensive than a comparable ticket with another airline. As a result, individuals will accumulate unequal measures of tax liability for what amounts to the same accession to wealth.

The only possible solution to enable Pouzar’s approach to work would be to value the redemption at the amount of the cheapest corresponding ticket amongst all airlines. Nevertheless, not all airlines will offer a flight with the same “accession to wealth” as others. For example, ‘Big Luxury’ airlines will provide a more desirable flight than ‘Bare Necessities’ airlines. To attach the same value to both just because they offer flights to and from the same destination on the same dates would be foolish. In addition, any standards put forth to determine the comparative value of the flights will invite debate, as subjective considerations will necessarily play a role in

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45. Based on IRS figures as of 2000, tax evasion has increased by sixty-seven percent in the last eleven years and represents about 22.5% of the amount of taxes collected. See Fundamental Tax Reform: Hearing before the Comm. on Ways and Means, 106th Cong. 106-115 (2000) (statement of Leo E. Linbeck, Jr., Chairman, Linbeck Corporation, Houston, Texas and Voluntary Chairman, Americans for Fair Taxation, Houston, Texas).

46. See Pouzar, supra note 4, at 75 (outlining Pouzar’s proposed method of valuation).

47. Id. at 76.

48. Id. (illustrating that Pouzar’s method of valuation results in valuing frequent flyer credits at fair market value).

49. This argument is not inconsistent with the earlier “inequitable results” argument. See infra discussion at Part V. There are situations where the face values are different, but the actual flights are comparable, and there are situations where the face values may be the same but the flights are not comparable. In both situations, one individual incurs a tax liability that is not proportionate to his or her accession to wealth. This apparent inconsistency in language only serves to highlight the difficulties inherent in attempting to create a uniform, yet equitable, valuation method based on fair market value.
reaching this type of decision.

2. Secondary Market Valuation

Valuing the frequent flyer credits received by an employee at the resale value of the credits also involves insurmountable complexities. The secondary market is created when an individual cashes in his or her miles for a "flight voucher" and, in turn, sells this voucher. This transaction usually involves a middleman called a coupon broker. Analysis of this valuation method must begin with the assumption that these credits can, in fact, be sold. Once this is established, the amount at which these credits can be sold will also have to be ascertained. This amount, which is likely to be substantially less than the redemption value of the credits, would be the amount a taxpayer would be required to include in his or her gross income.

The major problem with this approach is that it may not accurately reflect the amount by which an individual's wealth has actually been increased by receipt of these credits. This is due to the fact that secondary markets severely undervalue the credits. The very reason that the secondary exists is that purchasers benefit from the reduced prices. Thus, such a valuation, which is vulnerable to subjective market assessments, usually fails to accurately measure an individual's true accession to wealth.

In addition to this difficulty there is the danger of increased tax evasion. Individuals will be inclined to underreport what they received in the secondary market transaction. In the absence of a completely regulated secondary market, monitoring of the exact amounts of each transaction is impossible.

50. See Belden, supra note 38, at E6. (describing how frequent flyer credits may be sold or exchanged rather than redeemed).
51. See DELTA AIR LINES, INC., supra note 8, at 39 ("The sale, purchase, assignment or barter of Delta SkyMiles Award Travel Certificates and Tickets has been held to be illegal."). But see Harvey D. Shapiro, Buying Miles Is Thrifty - But Iffy, L.A. TIMES, Mar. 9, 1995, at D5. (asserting that individuals will likely be able to sell their miles if they so wish, at the burden of overcoming program restrictions or barriers, and at the risk of engaging in what may constitute illegal activity); Milking the System—Barterer Beware! Buyer Be Scared, INSIDE Flier MAGAZINE, November 1999, available at http://awardtraveler.com/pg11.htm (last visited Feb. 19, 2002) ("Illegal may be a bit of a misnomer because this practice is against program rules, but not necessarily against the law.").
52. See, e.g., Milking the System, supra note 51.
53. Compare the tax consequences of a situation in which an employer gives an employee a new automobile costing $50,000. See Comm’r v. Duberstein, 363 U.S. 278, 278 (1960) (discussing the tax consequences of employer gifts). If the employee turns around and immediately sells this automobile for $2,000, clearly this amount does not accurately represent the employee’s accession to wealth—the former transaction does.
3. Value of Other Items Redeemable

Currently, major airlines have cooperative partnerships with other companies from which individuals can earn flyer credits towards purchases with the cooperating entity. While the vast majority of these programs work “one-way” (i.e., credits may only be accumulated for redemption with the airline, not the cooperating entity), some partnerships work “two-way.” Though small in number, there is nothing to say the amount of such two-way programs will not grow. In addition, an individual who pays for business travel with an American Express, or similar credit card, for which he is enrolled in the Rewards Program or similar incentive program, has two options. The credits he accumulates may be converted into flyer credits with a participating airline, or redeemed for one of many “gifts” offered under the Rewards Program.

The problem with valuing credits based on the redemption item is figuring out which redemption item to use. While possession of a particular number of credits may allow for the purchase of various gifts, basing the valuation of the credits on the fair market value of the redeemable gifts may pose a problem. For example, it might take 5,000 credits to purchase any one of ten items, but it is unlikely that all ten items have the same exact fair market value. Indeed, participating programs may very well offer items of superior value for the same amount of credits as items of inferior value. Such offers could be the result of an inside arrangement or bulk discount that the furnisher of the item provided to the program. In addition, the program’s own available supply of, or the consumer demand for, the goods or services could influence such determinations. Thus, it may not be possible to determine the actual purchasing power of the credits until they are actually used.

It would also be error to assume that the participating program has accurately assessed the fair market value of the item. For example, it is entirely possible that a participating program may assign a value of one hundred dollars to an item that can be purchased elsewhere for seventy-five dollars. To value, and thus tax, the price designated by the program could risk inaccurately inflating an individual’s accession to wealth before or

54. See, e.g., Hilton Hotels Corporation, supra note 39 (citing examples of specific partnership agreements).
55. See, e.g., DELTA AIR LINES, INC., supra note 8, at 8-9 (naming airlines that participate in the Rewards Program).
56. See, e.g., American Express - Membership Rewards, supra note 39 (explaining how miles may be traded in for gifts).
57. Indeed, it would be in the programs’ best interests to label the goods or services with the highest possible fair market value. The higher the perceived value of the redemption, the greater value the individual will place on the transaction, and want to stay with the service.
after redemption.

Furthermore, the fact that these "two-way" programs are recent developments precludes an exhaustive analysis of the phenomenon. It is probable that these programs will expand in both number and services, and that this expansion will cause more complications than can be currently predicted. The above analysis, therefore, should serve to illustrate inherent difficulties involved in attempting to value flyer credits based upon redeemable non-flight goods and services.

4. Two Alternative, but Flawed, Proposals for Valuation

Commentator Lee S. Garsson has suggested that two methods which are found in the Treasury Regulations provide a solution to the complexities inherent in the airlines ticket-pricing scheme. Regulation § 1.61-21(g) is called the "Noncommercial Flight Valuation Rule" and establishes a guideline for taxing an employee for the benefit he or she receives when provided with a personal flight on an employer-provided aircraft. The method establishes a "cents-per-mile" rate plus a terminal charge for such flights taken. The rate and terminal charge are set by the Department of Transportation and result in liability to each individual in the same proportionate amount.

In addition to Garsson's proposal, Dominic Daher has proposed the following system that substantially mirrors the Regulation endorsed by Garsson: "I recommend the valuation of all employee [credits] at $.01 per [credit]... [where] employees would simply multiply the number of employee [credits] used for personal travel throughout the year by the factor $.01, and include that amount in gross income."

However, both Garsson's and Daher's interpretations of the Noncommercial Flight Valuation Rule fail for the same reasons. First, they do not account for the fact that credits may be redeemed for non-flight items, thus imposing a valuation method that is not comprehensive. Second, while the method provides for an easy computation, it fails to make an accurate estimation of an individual's true accession to wealth.

58. See Garsson, supra note 4, at 989-92 (discussing the "Commercial Flight Valuation Rule" and the "Noncommercial Flight Valuation Rule").
60. For example, if the established rate were $.05 per mile, individuals redeeming flights including travel of 100 and 500 miles, respectively, would have taxable income of $5.00 and $25.00, respectively.
61. Daher's proposal, the "Daher Standard," differs from the Regulation in that it applies to credits used for private travel as opposed to miles traveled. In addition, it sets a slightly lower amount than that currently offered in the Regulations and fails to assess the terminal charge found in the Regulations.
62. Daher, supra note 4, at 18.
Rather, it merely provides an arbitrary standard that does no more than sacrifice accuracy for simplicity's sake. Such an arbitrary compromise by the IRS would likely be met with disapproval. In addition, the arbitrary character of the method would only be exacerbated by any attempt at application to non-flight items.

The other bright-line approach, found in Regulation § 1.61-21(h) is called the "Commercial Flight Valuation Rule" and applies to fringe benefit commercial flights.\footnote{63}{Treas. Reg. § 1.61-21(h) (2001); see also Garsson, supra note 4, at 989.} This approach values flights that employees receive for free from their employers at twenty-five percent of the carrier's highest unrestricted coach fare in effect for the particular flight taken.\footnote{64}{Garsson, supra note 4, at 989.} Garsson asserts that application of this type of formula in the frequent flyer context would not undervalue awards as the "highest unrestricted coach fare exceeds the super-saver considerably, and most personal travelers take advantage of the latter."\footnote{65}{Id. at 990.}

While this also provides a simple method of valuation, it presents the same problems inherent in the fair market valuation approach discussed earlier.\footnote{66}{See discussion infra Part V.A.1.} Because this approach makes no effort to determine accurately an individual's accession to wealth, such a system will likely lead to inequitable outcomes. The result often will be that taxpayers will have different tax liabilities for what amounts to the same flight.

Furthermore, application of the principle to the highest fare for all carriers also produces arbitrary results. In cases in which two similar airlines offer comparable flights, different pricing approaches could plausibly result in large discrepancies. For example, on September 30, 2001, Expedia.com (a discount travel website service) listed two round-trip flights from Boston to Philadelphia, leaving October 19 and returning October 21. The price of the first flight, a "bargain fare" was $160.00 while the price of the second, a regular discount fare, was $775.00. Twenty-five percent of $775.00 is $193.75; $33.75 more than the price of another flight on the same day. For an individual placing no preference for one flight over the other, the result of the Commercial Flight Valuation Rule would gauge the taxpayer's accession to wealth above the amount for which that person could conceivably have obtained the flight.

Of course, one could argue that there may be ways to avoid this dilemma such as setting a ceiling on the amount taxed to correspond to the lowest ticket price available. However, the need to tweak the Commercial Flight Valuation Rule only serves to demonstrate an inability to determine accurately the appropriate amount of taxable income.

\footnote{63}{Treas. Reg. § 1.61-21(h) (2001); see also Garsson, supra note 4, at 989.}
\footnote{64}{Garsson, supra note 4, at 989.}
\footnote{65}{Id. at 990.}
\footnote{66}{See discussion infra Part V.A.1.}
5. **A Final Valuation Complexity: The Commingling of Credits Earned Through Business Travel and Those Earned Through Personal Travel**

A final problem involved in the taxation of frequent flyer credits involves the simultaneous use of credits earned through personal travel and through reimbursed business travel. For example, an individual may set up a frequent flyer account with an airline and then take a few flights on personal travel, accumulating credits in the process. Subsequently, such a taxpayer may take a few flights related to business travel for which the taxpayer is reimbursed and receives frequent flyer credits, at which point the taxation question comes into play. If the taxpayer later redeems all of the credits accumulated in the account, valuation becomes complicated under almost any method. First, the IRS will need to determine what credits will be considered taxable, and what credits will not be taxable. Next, under whatever scheme of taxation is adopted, the IRS will need to develop a solution to ensure fairness as well as effectiveness. Thus, the use of personal credits with business credits undoubtedly serves to further complicate the issue.

**B. Monitoring Problems**

The mechanics of frequent flyer programs also offer complexities for reporting purposes. When posed with the question of who is to report the accumulation or redemption of frequent flyer credits, the only reasonable answer is one of the three parties involved—the employee, the employer, or the airline. However, each of the three involves problems unique to that party's position in relation to the overall scheme of these programs.

The first possible reporter, the employee, carries a high risk of tax evasion. As discussed above, individual taxpayers are the least likely to comply with reporting requirements. In the absence of a system that will compensate for the well-founded assumption that individuals will undoubtedly misconstrue the amount of frequent flyer benefits redeemed, taxation of these credits will prove unenforceable. As a result, taxation in

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67. This involves monitoring problems discussed infra Part V.B.
68. *See also* Kanter et al., *supra* note 34, at 34, ("As a practical matter, however, the valuation of frequent flier credits is very difficult—if not impossible.... The problem is compounded by the fact that credits are not 'tagged,' i.e., a frequent flyer credit earned on employer-paid travel looks the same as one earned from employee-paid travel.").
69. *See discussion infra Part V.A.1.
70. *See Hall, supra* note 1, at 853 n.273 (citing tax code provisions demonstrating a congressional intent to subvert widespread tax evasion).
71. This assumption is further bolstered by the fact that many individuals have had
Another approach is to have the employer, who is responsible for tax-withholding and reporting to the IRS, to also report the benefits realized by employees. This argument makes sense if one considers the benefits as part of income received from the employer. While, in essence, this is true, the practical fact is that the benefits are received directly from the airline. As a result, the employer is not typically knowledgeable with respect to the amount of miles accumulated, or the benefits redeemed. Thus, the ability of such employers to ascertain and report the value of credits used by employees would at best be questionable, and would undoubtedly depend on airline cooperation. It would therefore seem unduly burdensome to place this responsibility on employers, who would incur substantial costs in accumulating the information that would be reported to the IRS.\footnote{\textit{See Hall, supra note 1, at 854 ("Because employers cannot track the employee's use of frequent flyer bonuses without excessive cost in order to reclaim the bonuses from the employees, it would be impossible to require an employer to track the bonuses for reporting purposes.").}}

Most commentators support placing the reporting burden on the airlines. Such arguments appear persuasive, given the fact that each airline must keep records of the accounts of individuals participating in such programs in order to effectively monitor the use of such credits for internal purposes.\footnote{\textit{See Hall, supra note 1, at 854.}} These records include the dates the credits were accumulated, the amount of credits accumulated, dates on which credits will expire, identification of the account holder, and information concerning redemption.\footnote{\textit{See, e.g., Continental Airlines, Inc., supra note 8 (describing the earning and use of frequent flyer credits); Delta Air Lines, Inc., \textit{supra} note 8 (describing the mileage credit procedures).}}

Nevertheless, contrary to some commentators’ arguments, it would be an impractical and unfair burden on the airlines to require reporting on their part. First, they would need to implement systems that effectively differentiate between miles earned on reimbursed business travel, and miles earned through personal use. The necessity for this differentiation is based on the fact that the commingling of such miles will prevent proper taxation.\footnote{\textit{See} Canter et al., \textit{supra} note 34, at 319; Daher, \textit{supra} note 4, at 19.} Second, in the case in which employees pay for business travel out of pocket, and then seek reimbursement, it would be necessary for the employers to contact the airlines to ensure proper categorization of the credits. This would require some legwork on the part of the airlines in tracking the flight taken, the applicable credits, and how they were distributed. Otherwise, an employee could conceivably tell the airline the...
flight is for private activity, receive the credits without worry of tax consequence, and subsequently receive reimbursement from the employer. This is only further complicated by the fact that an individual may take a flight for both pleasure and business, thus confusing the issue of how many credits should be attributable to business travel for taxation purposes.\textsuperscript{76}

These monitoring burdens placed on airlines would be substantial and unfair. They would effectively require reporting by airlines as if they were employers themselves.\textsuperscript{77}

\section*{C. Timing Difficulties}

Upon a determination that frequent flyer credits earned on employee travel should be taxed, an interesting question arises as to \textit{when} an individual has experienced an accession to wealth for taxation purposes. Such a determination will be important not only for determining the existence of tax liability, but also for determining the amount of such liability. There are two possibilities for such timing: (1) when the credits are earned or accumulated; and (2) when the credits are redeemed or used. Note also that the second possibility, determining tax liability by the point at which the credits are used, will involve choices between (1) when an award is filed requesting redemption, (2) when a voucher is received, (3) the date the voucher is used to purchase an airline ticket, or (4) the time at which the actual trip is taken.\textsuperscript{78}

Strong arguments exist which support taxation at the point the credits are redeemed or used as opposed to when they are earned or accumulated. First, to choose, for timing purposes, the date such credits were earned or accumulated would be to invite debate as to whether the taxpayer actually has received the benefit being taxed. Taxation at this point in time would involve the problem of determining when an individual has constructive receipt for taxation purposes. This would involve determining when the taxpayer has effectively taken control of such credits so as to experience an accession to wealth.\textsuperscript{79} Second, and as a matter of equity, the argument is

\textsuperscript{76} See Canter et al., supra note 34, at 319 ("Numerous technical questions must be answered if the IRS wishes to broadly attack frequent flyers. For example . . . [i]f the frequent flyer takes a trip for both business and pleasure, how would the frequent flyer miles be characterized and allocated?").

\textsuperscript{77} Cf. Daher, supra note 4, at 19. Also, note that this discussion does not reach the further difficulty of "double-dipping." For example, if an employee purchases a business flight with a credit card with which miles or credits may be accumulated, and also receives miles or credits from the airline, the monitoring concerns now extend to an additional party and the burden increases.

\textsuperscript{78} See Garsson, supra note 4, at 973 (discussing the IRS notice of proposed rulemaking and request for comments concerning the tax treatment of frequent flyer bonus programs).

\textsuperscript{79} See Treas. Reg. § 1.451-2 (2001) ("Income although not actually reduced to a
lucid—great numbers of individuals will never redeem all of the credits earned. These unused credits, as a result, will be forfeited.\textsuperscript{80} To tax an individual for the possession of credits that will never be used, and therefore never trigger an accession to wealth, would be inconsistent with taxation principles.\textsuperscript{81} Third, taxation timed at the date credits are accumulated or earned would lead to valuation problems and cause inequitable results. This is because different airline programs require different credit accumulations for redemption of essentially the same flight.\textsuperscript{82} Taxing a person based on accumulation of credits alone would likely mischaracterize such person’s accession to wealth.

A different question arises, then, as to what type of action should constitute the redemption of these credits. First, of the possibilities mentioned above, one can be disposed of immediately—the time at which the trip is actually taken. Prior to this point, the taxpayer has already received a benefit representing an accession to wealth. For example, subsequent use of a new car received from an employer does not determine whether there has been an accession to wealth, receipt of it does.\textsuperscript{83} Similarly, the use of a flight received as a benefit is immaterial as to whether there has been an accession to wealth, at what point this accession has occurred, and what value has been received.

Second, to time the accession or valuation at the time “when an award is filed requesting redemption” would also be flawed. At this point, the mere filing of the request does not reduce the benefit to possession any more than the period during which the credits are held in an account for the individual. Indeed, the status of these credits is no different than the point at which they are earned—a possibility, which we have seen, is insufficient for a determination of timing.

Of the two possibilities left, the more favorable for timing purposes is when the credits are redeemed (i.e., when a voucher is constructively received by the taxpayer). Such an approach has been endorsed by Sharon

\textsuperscript{80} CONTINENTAL AIRLINES, INC., supra note 8, at 15; DELTA AIR LINES, INC., supra note 8, at 33.

\textsuperscript{81} See discussion infra at Part II.

\textsuperscript{82} See, e.g., Stephanie D. Smith, News: Changes in the Air For Flyers, \textit{MONEY}, Dec. 2000, at 215 (“As a result of the proposed merger . . . . US Airways miles would become United miles . . . . [F]lyers could lose out in other ways . . . . [Currently] you can buy an off-peak domestic round-trip ticket on US Airways with 20,000 miles; you need a minimum of 25,000 miles for the same ticket on United.”).

Pouzar as the fairest, and most practical method.\(^\text{84}\) Indeed, it avoids the problems involved with constructive receipt and expiration. Furthermore, unlike the last possibility—"timing at the point at which the voucher is used to purchase a ticket"—timing at the point of redemption is more workable with any situation involving a secondary market sale of rewards. This is because valuation will not depend on any amount received in the secondary market, but on what the value of the redemption was.

Unfortunately, however, even this approach to timing concerns will not alleviate the problems inherent in valuation and monitoring. As a result, inequitable results will still be bound to follow. In addition, uniform agreement as to whether this is the correct point for timing purposes is far from attainable. Different theories of valuation and monitoring concerns will necessarily influence one's decision as to the timing question. This is because the determination of timing will necessarily affect the viability of valuation theories,\(^\text{85}\) and will also lead to increases or decreases in the burdens placed on monitoring parties. As a result, the method of timing supported above does little to support an argument favoring action by the IRS to tax these benefits.

Another important topic related to the issue of timing is when, and whether, an employer should be allowed a § 162(a) ordinary and necessary business expense deduction for the cost of flights involving employee retention of frequent flyer credits. One author, Dominic Daher, argues that if flyer credits are to be taxable, then employers should not be allowed to take an I.R.C. section § (a)(2) travel expense deduction until the employee actually reports the credits as taxable income.\(^\text{86}\) Daher bases his argument on purported general timing rules found in tax law, and he references, by way of analogy, the property transfer compensation provision of I.R.C. § 83. This provision holds that employers are not allowed to take a § 162 deduction until § 83 income is included by the employee.\(^\text{87}\)

Daher's argument is flawed, however, because it falsely assumes that employers currently attempt to include as part of their deductions the value of the flyer credits. Although it would be questionable whether an employer should be able to take a § 162(a)(1) compensation deduction for the credits kept by employees, there does not seem to be any reason an employer should not be allowed to deduct travel expenses under § 162(a)(2). While § 83(h) simply makes general reference to § 162, § 83

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\(^{84}\) See Pouzar, supra note 4, at 77 (proposing "that frequent flyer benefits be valued at the time they are redeemed for airline tickets").

\(^{85}\) For instance, if valuation is timed at redemption, then supporters of a valuing method based on amount received or receivable in the secondary market will effectively be preempted.

\(^{86}\) Daher, supra note 4, at 19.

\(^{87}\) I.R.C. § 83(h) (2001).
applies to property transfer compensation and, arguably, relates directly to the § 162(a)(1) compensation deduction.

Nevertheless, Daher's argument raises some interesting concerns that are best illustrated by the following example. Imagine that the cost of a business-related flight is $100. The employee pays for the flight, but later gets reimbursed for the full amount. However, the employee also keeps 1,000 miles which we will assume are valued at twenty dollars. The employer then takes a § 162(a)(2) deduction of $100 for the cost of the flight. Now, if the credits are taxable (as many argue), the employee must include the twenty dollars of credits as taxable income. However, the only reason the employee has the credits is because they were the employer's to give in the first place (i.e., they were property transferred as compensation). So, in theory, the employer should also get a § 162(a)(1) compensation deduction in the amount of twenty dollars. However, this raises some obvious concerns because the employer appears to be getting $120 worth of deductions while only spending $100 in business expenses.

One solution to this apparent dilemma would be to have the employer include, as a taxable gain from dealings in property, the twenty dollars worth of flyer credits (i.e., the employer paid $100 and got a flight worth $100 and credits worth twenty dollars). Another solution would be to value the flight, and corresponding § 162(a)(2) deduction, at eighty dollars, thereby protecting the employer from having to report gain as a result of the ticket purchase. If we adopt the first approach—and tax an employer every time credits are received as part of a ticket purchase—then we assume that there is an unfair bargain between the employer and the airline (in which case the employer wins by twenty dollars). If we adopt the second approach, then Daher is at least partially correct in implying that employers have also been gaining a taxable benefit without tax consequence. In this case, they have deducted twenty dollars under § 162(a)(2) that should really be accounted for under § 162(a)(1).

If flyer credits are treated as taxable income, then the argument above illustrates added complexities that will have to be addressed. There will either have to be a determination of the value of the employer's allowable deduction, or acceptance of the counterintuitive idea that unequal bargains exist between employers and airlines. In either scenario, determining the tax treatment involves added difficulties for the IRS.

VI. POLICY CONSIDERATIONS

Outside of the realm of whether taxation principles call for the taxation of frequent flyer credits, and whether such taxation is practically feasible, an interesting and equally important question exists as to whether such taxation is warranted as a matter of general policy. One argument
maintains that by continuing to turn a "blind eye" to the issue, the IRS is not only losing tax revenue, but is also inviting disrespect for the United States tax system that will encourage tax evasion. However, this position appears to be overstated because inaction by the IRS in this situation will hardly be viewed as a laxity in tax enforcement. If nothing else, the present examination has shown the enigmatic character of these credits in the tax situation. While few would dispute that there is a clear accession to wealth involved in the redemption of these credits, it is also true that few would dispute the fact that barriers exist which make taxation in this situation difficult, at the least. It is clear that there are nuances involved in the taxation of frequent flyer credits that make it unfavorable for the IRS to take an affirmative, yet equitable, stance. This does not mean, however, that the IRS should be viewed as powerless to take action, thus warranting disrespect for the tax system. To the contrary, the inaction of the IRS should be viewed as a conscientious decision to avoid unfavorable taxation results.

Furthermore, respect, or no respect, outside of the frequent flyer context, individuals caught evading taxes will still be subject to the same penalties and risks they always have. Unless one considers nonpayment of tax on credits redeemed as tax evasion (which is not really the case as the IRS has not made its policy on the issue clear), it is unrealistic to claim that tax evasion will increase as a result of IRS inaction. While taxpayers may be more inclined to take advantage of flyer credits, it is highly unlikely that the situation will also motivate them to illegally avoid the payment of taxes in other situations. It does not follow from the fact that the IRS has not taken a stance on the taxability of frequent flyer credits, that the IRS has discontinued policing tax evasion in general. Such an argument is illogical.

Nevertheless, the general sentiment is that there is something inherently wrong with allowing these credits to go untaxed. The benefits received through these credits are, in theory, an accession to wealth that should be subject to taxation. Even more troubling is the thought that this type of benefit is more accessible for wealthier individuals who hold well-paying jobs that allow for such frequency in air travel. In addition, it is certain that such individuals will not shy away from the opportunity to gain these benefits. Quite to the contrary, one of the most attractive aspects of these credits is that the individual is basically getting something for nothing. This will allow the situation to self-perpetuate, as people do everything they can to obtain such a benefit. A somewhat ironic, if not

88. Aidinoff, supra note 36, at 1345.
89. See, e.g., 143 CONG. REC. E130 (daily ed. Feb. 4, 1997) (statement of Rep. Kennelly) ("At a time when... suspicion that the Internal Revenue Code is not fair and needlessly complex is at an all time high, it would be sheer folly for the Service to move in this area.").
amusing, fact drives this point home while also demonstrating that the airlines and their partners are all too willing to provide the means for taxpayers to obtain these benefits:

Many people like to pay taxes with [credit card] not only for convenience but also to amass huge amounts of frequent-flyer [credits] or similar points in a hurry. Last month, one taxpayer charged $2 million of federal estimated income taxes. . . . The biggest individual payment by card last year was $7.2 million. . . . In a new twist, American Express says card members who use their cards to pay federal income taxes through April 16 can earn double [credits] on their Delta SkyMiles Card.90

Nevertheless, blame for this problem cannot be placed on the IRS. Although the Service does have the power to interpret and enforce the code, it cannot be forced to exercise this power in a situation where it is impractical to do so. For the IRS to take action would invite debate as to whether it has properly done so. This is not to say, however, that the Service has not attempted to tax these credits. The following section discusses these efforts to date.

VII. ACTION BY THE SERVICE TO DATE AND THE NEED FOR CONGRESSIONAL INTERVENTION

For the last twenty-seven years, controversy has swelled around the taxation of non-statutorily excluded fringe benefits, and the IRS has indicated its inclination to tax them. For example, the Service issued a "Discussion Draft of Proposed Regulations" in 1975, which would have established the expansiveness of I.R.C. § 61 by clarifying which questionable compensatory items would be included in gross income.91 However, the Service succumbed to pressure from Congress, and withdrew the proposed regulations. In 1984, however, Congress passed the Deficit Reduction Act which expanded I.R.C. § 61 to specifically include fringe benefits in taxable income,92 and also added I.R.C. § 132, which provides some statutory exceptions for certain fringe benefits.93 Nevertheless, this Act did not provide for specific treatment of frequent flyer credits. Then, in 1985, Proposed Regulations in the area of fringe benefits were again introduced, with an added solicitation of comments on the taxation of

91. See FREELAND ET AL., supra note 22, at 88.
frequent flyer credits. However, these were also withdrawn.

Finally, a direct effort came in 1995 in the form of Technical Advice Memorandum (TAM) 95-47-001. This ruling by the IRS attacked the issue through the "back door" by effectively disqualifying employee reimbursement plans under § 62(c), which had allowed for employees to reap the benefits of frequent flyer credits accumulated on business travel. By disqualifying the plans, reimbursement would effectively be treated as income to the employee. However, due to a large public outcry, this position was eventually withdrawn.

Yet, the culmination of these events resulted in at least one effort by Congress to treat the issue of frequent flyer credits specifically. In 1997, Congressional Representative Barbara B. Kennelly introduced a bill that called for a specific exemption for frequent flyer credits. Representative Kennelly stated:

I rise today to introduce legislation to clarify that frequent flyer [credits are] not taxable... in light of the Internal Revenue Service's position in technical advice memorandum 9547001, and despite the fact that technical advice memoranda only apply to a given taxpayer and set of circumstances, I feel a clarification is necessary... This is one of those areas where taxation would raise a myriad of questions for which there is no single correct answer, such as appropriate timing... valuation... [and tracking]... Taxation of frequent flyer [credits] would only result in mindless complication and paperwork of nightmarish proportions for millions of Americans, the airlines, and the Internal Revenue Service. And the Service should realize this. [The Service has] opened, closed, and reopened several projects to address the tax treatment of frequent flyer [credits] over the years, all to no avail... My bill would simply explicitly say that frequent flyer [credits] are not taxable.

Unfortunately, however, the bill has not been enacted, and there is no other legislation currently in place to address this issue.

Apart from the question of congressional action, it is clear that the Service should not move forward in this area. There is a fine line that the

94. Taxation of Fringe Benefits and Exclusions From Gross Income for Certain Fringe Benefits, supra note 5.
96. See generally I.R.C. § 62 (providing for deductions from gross income in calculating adjusted gross income).
97. See, e.g., Frequent Flyer Feathers Fly, at http://www.tax.org/taxa/tadiscus.nsf/8525624b005f2cae8525624a0064a42b/0658247b293e117c8525628400063fda8?OpenDocument (last modified Nov. 24, 1995) (reporting that the IRS was reconsidering some of the analysis in the Technical Advice Memorandum 95-47-001).
IRS would need to negotiate to enforce tax policy in this situation without creating tax policy. Such a decision is better left to Congress, which not only has the power to write into tax law special treatment for these credits, but is also the proper authority for consideration of policy issues.

Therefore, the obvious and workable solution to this dilemma is to place the burden on Congress to introduce and push forward statutory treatment to this problem in the form of a specific taxation approach, or an overall exception. In either case, part of the congressional role is to enact law riddled with policy issues. Indeed, included in the tax code’s provisions are numerous instances where one party receives a tax benefit that another does not. Regardless of what action is merited, it is clear that this policy burden should not rest on the shoulders of the Service. Rather, the approach is for Congress to decide.

VII. CONCLUSION

The benefits employees gain through frequent flyer credits earned through business travel clearly constitute taxable income. However, given the complexities that would be involved in any action by the Service to tax these benefits, it is no wonder that the Service has not taken action. Problems involved with valuing, monitoring, and timing the receipt of these credits involve a choice between many flawed alternatives which often lead to inconsistencies or inequitable results. As a result, there is no feasible approach to enforcing the taxation of these credits that will result in a fair treatment to all taxpayers. However, to continue to allow individuals to obtain benefits as a result of employment but not to tax them is contrary to tax principles and inherently wrong. Therefore, congressional action must be taken to settle this issue through direct treatment—whether this results in an exemption or a specified approach to taxation of these benefits.

99. For example, interest deductions for college graduates are allowed but not for credit card users. I.R.C. §§ 221, 163(h) (2001).