United States Government Accountability Office

GAO

Report to Congressional Requesters

July 2010

COMMERCIAL AVIATION

Consumers Could Benefit from Better Information about Airline-Imposed Fees and Refundability of Government-Imposed Taxes and Fees

GAO-10-785

Highlights

Highlights of GAO-10-785, a report to congressional requesters

Why GAO Did This Study

To supplement fare revenues, airlines are increasingly charging fees for optional passenger services, notably for checked baggage, for which separate charges did not previously exist. While air fares are subject to a 7.5 percent excise tax that funds the Airport and Airway Trust Fund, which helps fund the Federal Aviation Administration (FAA), many new optional fees are not.

As requested, this report addresses (1) the nature, relationship to cost, and disclosure of airline fees, (2) the potential impact of such fees on the Airport and Airway Trust Fund, (3) checked and mishandled baggage issues; and (4) the process, if any, for refunding government-imposed taxes and fees when passengers do not use nonrefundable tickets. To perform this work, GAO analyzed financial data; reviewed applicable laws and regulations; and interviewed airline and government officials.

What GAO Recommends

If Congress wants to tax currently untaxed airline fees, it would need to amend the Internal Revenue Code. GAO recommends that DOT require airlines to consistently disclose optional fees and notify passengers of any refundable government fees; USDA determine whether its fee is refundable on unused nonrefundable tickets; and DHS issue guidance on the refundability of its fees. USDA and DHS agreed with the recommendations and DOT did not comment on them.

View GAO-10-785 or key components.
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July 2010

COMMERCIAL AVIATION

Consumers Could Benefit from Better Information about Airline-Imposed Fees and Refundability of Government-Imposed Taxes and Fees

What GAO Found

Airlines have imposed a variety of fees on a range of optional services, such as checked and carry-on bags; meals; blankets; early boarding; and seat selection. According to airline officials, the fees are based on a combination of factors, including the cost of providing the service, competition, and consumer demand. The fees have supplemented airline revenues, providing at least $3 billion in 2009—a small but growing amount of total revenues. However, information about the fees is not fully disclosed through all ticket distribution channels used by consumers, making it difficult for them to compare the total cost of flights offered by different carriers. The Department of Transportation (DOT) does not currently require disclosure of airline-imposed optional fees, apart from those for checked bags, but recently issued a Notice of Proposed Rulemaking (NPRM) considering different forms of disclosure of such fees. Meanwhile, a system is being tested to fully disclose all of the fees to consumers searching for fares, but airlines are not likely to disclose them unless compelled to do so.

Airlines' increasing reliance on fees reduces the proportion of their total revenue that is taxed to fund FAA. The Internal Revenue Service (IRS) has determined that many of these fees, including checked baggage fees, are not related to the "transportation of a person"—the basis for imposing the 7.5 percent excise tax. According to GAO's calculations, the checked baggage fee (the largest and only measurable untaxed fee) if taxed in fiscal year 2009 would have accounted for about 2 percent of total Trust Fund revenues but is likely to grow in future years given recent trends. Since DOT guidance requires airlines to report separately only revenues from baggage fees and reservation change and cancellation fees, GAO was unable to estimate potential collections from other untaxed fees.

Since airlines first imposed checked baggage fees, the number of checked bags per passenger has declined, contributing to a decline in the rate of mishandled bags. Despite the introduction of fees, airlines have not substantially changed their baggage service or compensation methods. Checked baggage fees have also led to greater amounts of carry-on baggage, resulting in greater competition for limited overhead storage space.

According to IRS, aviation excise taxes on unused nonrefundable tickets are not refundable, but if an airline refunds the ticket, a proportionate amount of tax may be refunded. In contrast, consumers with unused nonrefundable tickets with expired or lost value are entitled to a full refund of the September 11th Security Fee, but few consumers request a refund because airlines are not required to inform consumers of this. According to the Department of Homeland Security (DHS), applicable statutes and regulations authorize the refund of its customs and immigration inspection fees if services aren't rendered, but DHS has not issued any policy or guidance that makes this clear. The Department of Agriculture's (USDA) statutes and regulations are unclear as to whether its fee is refundable on unused nonrefundable tickets.

Contents

Figures

Abbreviations

ARC Airlines Reporting Corporation
ATPCO Airline Tariff Publishing Company
BTS Bureau of Transportation Statistics
CBP Customs and Border Protection
DHS Department of Homeland Security
DOT Department of Transportation
EMD Electronic Miscellaneous Document
FAA Federal Aviation Administration
GDS Global Distribution System
IATA International Air Transport Association
ICE Immigration and Customs Enforcement
IRS Internal Revenue Service
TSA Transportation Security Administration
USDA U.S. Department of Agriculture

GAO

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United States Government Accountability Office
Washington, DC 20548

July 14, 2010

The Honorable James L. Oberstar
Chairman
Committee on Transportation and Infrastructure
House of Representatives

The Honorable Jerry F. Costello
Chairman
Subcommittee on Aviation
Committee on Transportation and Infrastructure
House of Representatives

The Honorable Bill Pascrell, Jr.
House of Representatives

The U.S. passenger airline industry has been under tremendous financial pressure over the last decade, first from security threats that kept passengers away, then volatile fuel costs, and more recently falling demand due to an economic recession. In response, passenger airlines have adapted their business models. One significant change since 2008 is the introduction of fees for a variety of passenger services, such as a first or a second checked bag, for which separate charges did not previously exist. These fees represent an important source of revenues to U.S. passenger airlines, which collectively posted operating losses of $4.4 billion during calendar years 2008 and 2009.[1] During that same period, airlines reported approximately $7.9 billion in revenues from baggage fees and reservation change and cancellation fees—the two largest sources of fee revenues. However, the revenues from baggage fees, along with many other fees, are not subject to the 7.5 percent excise tax on amounts paid for domestic air transportation, the revenue from which is deposited in the Airport and Airway Trust Fund and which partially funds the Federal Aviation Administration (FAA), including the operation and development of the air traffic control system, among other things. In addition, the payment of separate fees by passengers, especially for checked bags, raises questions about whether the quality of checked baggage service has improved since baggage fees were introduced. The federal government

[1]In this report, references to airlines are specific to U.S. passenger airlines, unless otherwise noted.

also imposes various taxes and fees on passengers to help fund the costs of security, immigration, customs, and agricultural inspections, among other things. However, the refundability of these fees is not always clear or communicated to airlines or consumers.

In this context, you asked us to address the following questions: (1) What is the nature and scope of the fees airlines charge to passengers, are the fees commensurate with the costs of the services provided, and are the fees transparent to passengers? (2) What is the potential impact of such fees on revenues available to the Airport and Airway Trust Fund? (3) What changes have taken place in the numbers of checked and mishandled bags, amount of compensation paid to passengers for mishandled bags, and other consumer issues since airlines began charging more widely for checked baggage? (4) What, if any, is the process for refunding government-imposed taxes and fees to passengers who do not use their nonrefundable tickets?

To address these objectives, we analyzed Department of Transportation (DOT) financial and operating data; reviewed applicable laws, regulations, and past studies; and interviewed officials from the airline industry, trade associations, consumer groups, global distribution system (GDS) companies, DOT, the Department of Homeland Security (DHS), U.S. Department of Agriculture (DHS), and the Internal Revenue Service (IRS). Specifically, to identify the nature and scope of airline-imposed fees, we developed a list of fees based on research of airline and travel Web Sites and corroborated the data in interviews with officials from 17 airlines.[2] To assess the potential impact of such fees on the Airport and Airway Trust Fund, we reviewed existing tax laws and regulations. We spoke with IRS officials about the applicability of the 7.5 percent excise tax imposed on amounts paid for the domestic air transportation of persons to the airline-imposed fees we identified. To examine issues with checked baggage, we reviewed data reported by airlines to the DOT's Bureau of Transportation Statistics (BTS), interviewed officials from BTS and other DOT offices, airlines and trade associations, and other interest groups about compensation for mishandled baggage. To identify mechanisms for returning government-imposed fees and taxes, we reviewed relevant agencies' applicable statutes, regulations, and guidance and interviewed

[2]We chose these 17 U.S. passenger airlines based on several factors. All 17 airlines report annual operating revenues of at least $20 million and together collected more than 99 percent of the checked baggage fees reported to BTS in 2008 and transported about 77 percent of domestic revenue passengers in 2008.

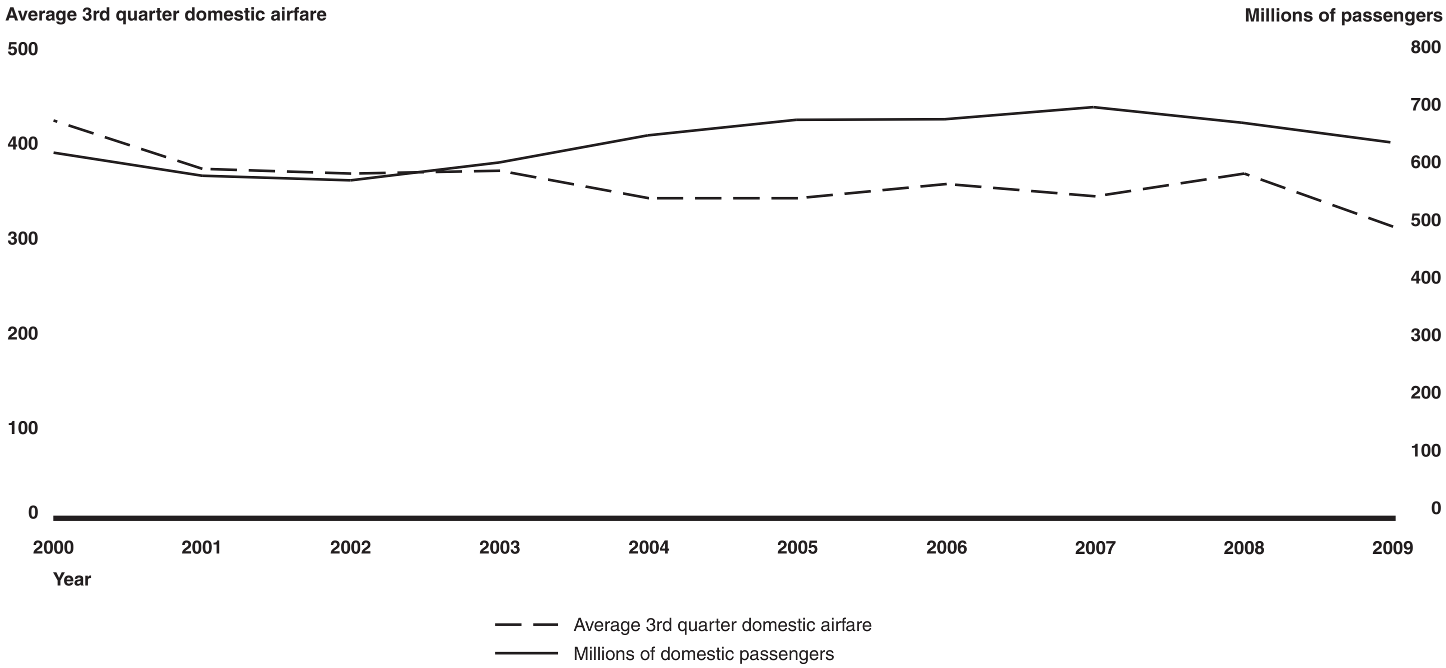
officials from IRS, DHS's Customs and Border Protection (CBP), Immigration and Customs Enforcement (ICE), and Transportation Security Administration (TSA); and the U.S. Department of Agriculture (USDA) responsible for federal taxes and fees applied to airline tickets. We conducted this performance audit from October 2009 through July 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. See appendix I for more information on our scope and methodology.

Background

In recent years, airlines have faced challenging times as fuel costs increased followed by a steep decline in passenger demand due to the economic downturn. The U.S. passenger airline industry[3] incurred nearly $4.4 billion in operating losses during calendar years 2008 and 2009. Volatile jet fuel prices—the airlines' biggest operating expense in 2008—was the chief contributor to airline losses in 2008. Lower passenger traffic measured as enplanements, due to the economic downturn in 2008 and 2009, has also put pressure on many airlines' operating revenues and average 3rd quarter domestic airfares fell in 2009. See figure 1 for average 3rd quarter domestic airfares and domestic passenger traffic from 2000 through 2009.

[3]This covers only passenger airlines with revenues of at least $20 million annually.

Figure 1: U.S. Passenger Airlines Average 3rd Quarter Domestic Fares and Domestic Passengers, 2000-2009 (2010 dollars)



Source: GAO analysis of DOT data.

In response to these economic challenges, airlines began in 2008 to charge for many services for which separate charges did not previously exist.[4] These services include fees for a first or second checked bag, early boarding, seat selection and meals. Charges for other services, such as unaccompanied minors, reservation changes or cancellations, and oversized or overweight baggage, have existed in the airline industry for many years. In addition, other services that are assessed fees, such as for Wi-Fi access, are new offerings. Revenues from fees for all these services have supplemented airlines' fare revenues.

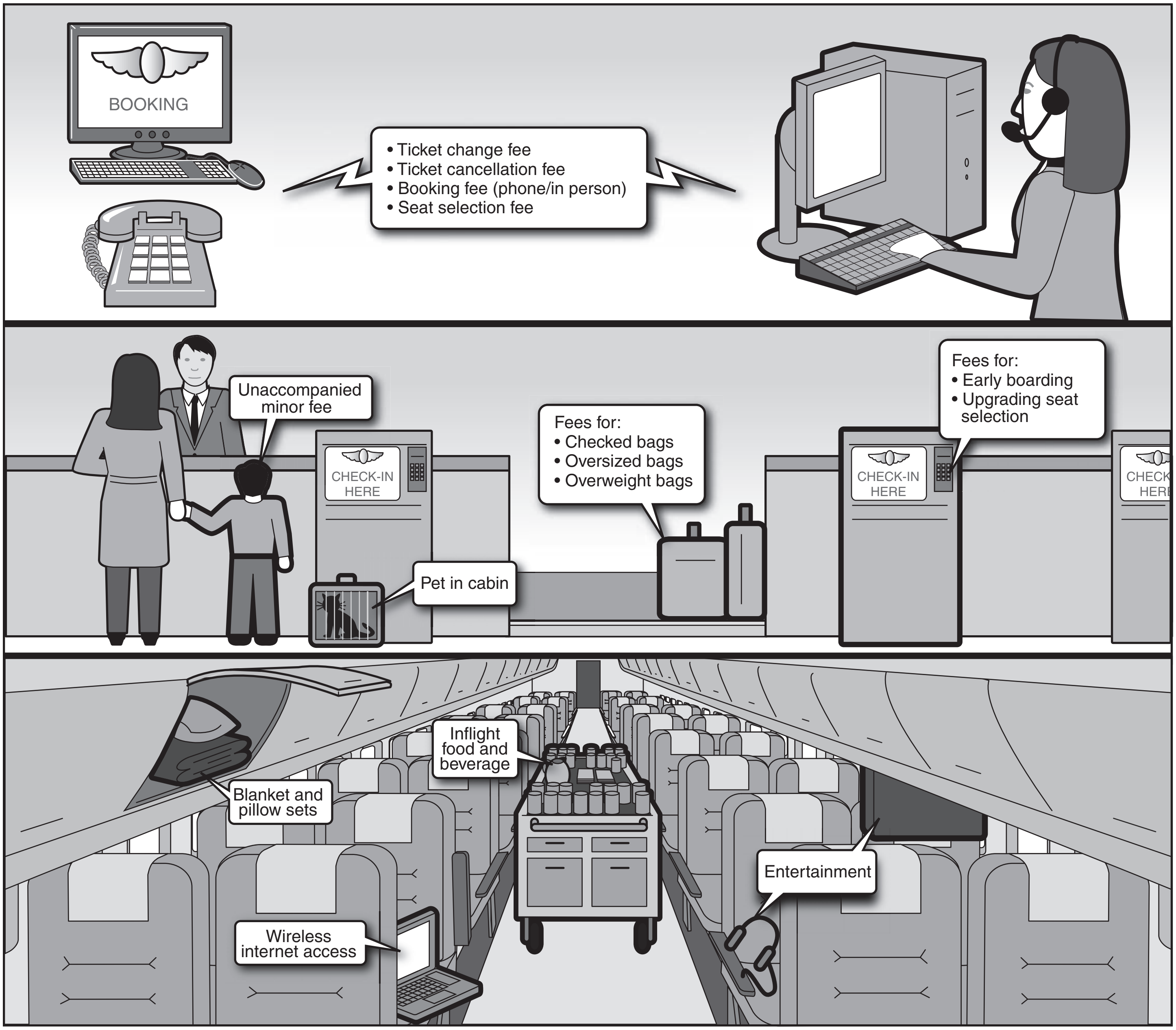
Airlines provide airfare information to the Airline Tariff Publishing Company (ATPCO), the tariff publishing house owned by a consortium of airlines, which, in turn, provides the fare information to GDSs[5] that

[4]Charging fees for services is also known as unbundling of charges, offering a la carte pricing, or charging ancillary fees.

[5]The three main GDSs are Amadeus, Sabre, and Travelport, which combined generated more than $9.6 billion in revenue in 2008.

package this information for use by online (for example, Expedia and Travelocity) and brick-and-mortar travel agencies and airline Web Sites. Once an airline ticket is purchased, the financial transaction is reconciled by the Airlines Reporting Corporation (ARC), another company owned by an airline consortium, which offers payment and settlement services for approximately 170 passenger airline and rail companies worldwide. However, while airfare information and some airline-specific information about fees for optional services is available on airline Web Sites and through GDSs, information on airlines' fees for the majority of optional services is available only through the airlines' Web Sites at booking and check-in, at their airport kiosks, and on board. Travel agencies, which sell the majority of airline tickets in the U.S., can provide fee information to customers only if the agents first search airline Web Sites or contact airline telephone reservation agents. Because airlines differ in how they impose fees for purchase of services, figure 2 depicts selected services and at what point they can currently be paid—during booking, at the airport, and onboard a flight. Fees for services can also be paid at other points besides those shown in the figure; for example, a passenger can often pay checked baggage fees when checking in online before departure.

Figure 2: Select Fees Imposed by U.S. Passenger Airlines and Example Locations Where Offered for Purchase



Source: GAO.

DOT's Office of Aviation Enforcement and Proceedings (OAEP) enforces airline economic regulations, including advertising requirements related to the disclosure of the full fare to be paid by the consumer.[6] DOT requires government taxes imposed on an *ad valorem* (percentage) basis to be included in the advertised fare as well as those airline-imposed fees that are required to purchase a ticket, such as fuel surcharges and peak travel day charges.[7] In addition, in May 2008, DOT issued guidance which requires disclosure of fees and associated policies for checked baggage.[8] Additional DOT guidance also requires that U.S. passenger airlines report revenues from certain fees as part of their Form 41 quarterly financial filings to BTS. In accordance with this guidance, U.S. airlines are required to separately report revenues from baggage fees and reservation change and cancellation fees but not other optional service fees. DOT also prescribes regulations for U.S. airlines regarding the reporting of and compensation for passengers who have had mishandled baggage, for instance, baggage that is lost, damaged, or delayed. Major U.S. passenger airlines are required to report monthly to DOT the number of mishandled baggage reports filed with the carrier and DOT then publishes the data.[9]

[6]The full-fare advertising rule states "[t]he [Civil Aeronautics] Board considers any advertising or solicitation by a direct air carrier, indirect air carrier, or an agent of either, for passenger air transportation, a tour (i.e., a combination of air transportation and ground accommodations), or a tour component (e.g., a hotel stay) that states a price for such air transportation, tour, or tour component to be an unfair or deceptive practice, unless the price stated is the entire price to be paid by the customer to the air carrier, or agent, for such air transportation, tour, or tour component." 14 C.F.R. § 399.84. Through 25 years of enforcement case precedent, DOT has permitted carriers and ticket agents to separately state government taxes and fees imposed on a per passenger basis, such as passenger facility charges and international departure taxes, so long as their existence and amounts are disclosed clearly at the first point in an advertisement where a fare is presented. See e.g., United Airlines, Order 2009-8-17 (Aug. 25, 2009). See also 14 C.F.R. § 399.84 and 49 U.S.C. § 41712.

[7]Fuel charges must be included in the advertised fare; they cannot be stated separately. If they are stated separately, it violates the full-fare advertising rule. See 14 C.F.R. § 399.84 and 49 U.S.C. § 41712. DOT Guidance, *Prohibition of Deceptive Practices in the Marketing of Airfare to the Public Using the Internet*, (Jan. 18, 2001). See also Condor Flugdienst GmbH Consent Order, Order 2009-4-1 (Apr. 1, 2009).

[8]DOT, *Guidance on Disclosure of Policies and Charges Associated with Checked Baggage*, 73 Fed. Reg. 28854 (May 19, 2008).

[9]14 C.F.R. § 234.6. Reports are required of an air carrier certificated under 49 U.S.C. § 41102 that accounted for at least 1 percent of domestic scheduled passenger revenues in the 12 months ending March 31 of each year, as reported to the Department pursuant to part 241 of this title. 14 C.F.R. § 234.2. A mishandled baggage report is a report filed with a carrier by or on behalf of a passenger that claims loss, delay, damage, or pilferage of baggage. 14 C.F.R. § 234.2.

DOT specifies that an airline cannot limit its liability for damages due to disappearance of, damage, or delay to lost baggage, to an amount less than $3,300 per passenger.[10] Compensation is subject to negotiation between the passenger and the responsible airline. TSA, which conducts security screening of checked bags, also submits monthly reports to DOT for mishandled baggage claims filed by passengers against TSA.[11] TSA reviews complaints to determine validity and compensation if TSA liability is determined.

The Internal Revenue Code imposes a 7.5 percent tax on amounts paid for the taxable transportation of a person for domestic air travel.[12] Treasury regulations and IRS guidance set general parameters for which airline fees are subject to the 7.5 percent excise tax. There is also a tax of $3.70 imposed on amounts paid for each segment of domestic travel,[13] and, if applicable, a tax on the use of international air travel facilities (also known as the international arrival/departure tax) of $16.10, for international travel that begins or ends in the United States.[14] Excise taxes collected by airlines are remitted to the IRS and deposited into the Airport and Airway Trust Fund, from which Congress funds FAA programs. FAA operates the air traffic control system, provides grants to airports, and oversees the safety of the industry. In addition to these excise taxes, the government imposes several fees on air travel that are collected by U.S. and foreign

[10] 14 C.F.R. § 254.4. This section applies to any flight segment using a large aircraft, or on any flight segment that is included on the same ticket as another flight segment that uses large aircraft. A large aircraft is defined as an aircraft designed to have a maximum passenger capacity of more than 60 seats. 14 C.F.R. § 254.3. This is also applicable only to domestic flights. This monetary limit is recalculated every 2 years based on the CPI-U. 14 C.F.R. § 254.6. Baggage liability requirements for all flights to and from the United States. are established in the Montreal Convention.

[11] Per 49 U.S.C. § 329(e)(2), the Secretary of Transportation may request that the Secretary of Homeland Security periodically report on the number of complaints about security screening.

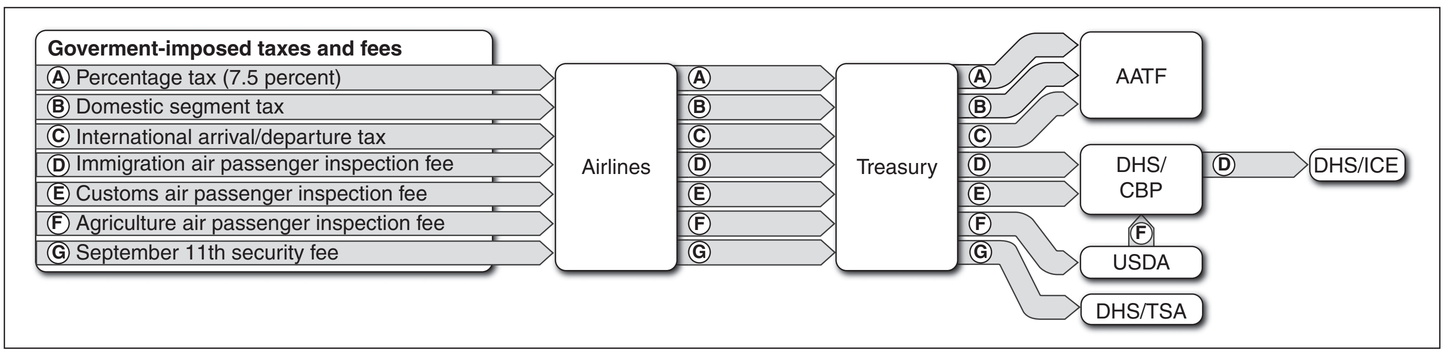
[12] 26 U.S.C. § 4261(a). Taxable transportation is defined as transportation by air which begins and ends in the United States or in a 225-mile zone into Canada and Mexico from the continental United States. 26 U.S.C. § 4262. Throughout we refer to this as domestic air transportation.

[13] 26 U.S.C. § 4261(b). The domestic segment tax is a flat tax based on the number of segments traveled and is not a percentage of amounts paid for transportation.

[14] 26 U.S.C. § 4261(c). Section 4261(c)(3) provides a modified international arrival/departure tax rate of $8.10 for segments that begin or end in Alaska or Hawaii (applies only to departures). The domestic segment tax and international arrival/departure tax are annually adjusted for inflation. Amounts listed are current for 2010.

airlines and remitted to various other government departments and agencies. For example, TSA imposes the September 11th Security fee of $2.50 per enplanement, not to exceed $10 per roundtrip, for aviation security inspection services.[15] Other government-imposed fees are remitted to agencies including CBP and USDA to help pay for customs, immigration, and agricultural inspection activities respectively.[16] See figure 3 for the distribution to agency accounts of passenger-paid government-imposed taxes and fees collected by U.S. and foreign airlines.

Figure 3: Distribution Path to Agency Accounts of Passenger-Paid Government-Imposed Taxes and Fees Collected by Airlines



Source: GAO.

[15]49 U.S.C. § 44940, 49 C.F.R. part 1510. TSA began imposing this fee in February 2002.

[16]Immigration inspection fees are divided between CBP and ICE. Agricultural inspection fees are divided between CBP and USDA. According to the interagency agreements, fees are intended to be distributed among the agencies according to the cost of the activities for which the agencies are responsible.

New Fees for Optional Services Are Based on Cost and Other Factors and Are Not Always Fully Disclosed to Passengers at the Time of Booking

Airlines Have Introduced Fees for Services That They Previously Provided at No Charge as Well as for New Services

Increasingly, airlines are charging fees for a number of optional services for which separate fees did not previously exist. For example, before 2008, airlines' baggage fees generally extended only to passengers who checked a third bag or for overweight or oversized bags. However, since 2008, most airlines have implemented fees for both a first and a second checked bag. Currently, 15 of the 17 airlines we contacted charge $15 to $35 for the first checked bag and 16 of the 17 impose a fee of between $20 and $35 for a second checked bag. One airline recently stated that it will begin to charge up to $45 for a carry-on bag that does not fit underneath the seat. Collection of fees for reservation changes and cancellations, which range from $50 to $150, has grown since 2007. In addition, fees for services that were previously included in the fare paid have also been introduced. These services include meals costing between $2 and $10, telephone booking fees ranging from $5 to $25; and sleep sets, which go for $5 to $12, that include a pillow, blanket, sleeping mask, and earplugs. Appendix II includes information on a sample of optional service fees imposed by 17 airlines as of July 1, 2010.

Airlines are also charging for new services not previously available. For example, some airlines now offer in-flight wireless Internet access, one-time lounge access, and multiplying frequent flyer miles earned for a flight, for a fee. Some airlines are also selling service packages for annual subscription, for example, the option for passengers to pay an annual fee for checking up to two bags per flight as often as they fly with that airline within a year or for priority check-in and security screening. These services can also be purchased in combination and on a per-flight basis with fee amounts varying. For example, one airline offers priority boarding and security screening, free checked baggage allowance, extra seat legroom, and free alcoholic beverages for one fee. Airlines also provide a selection of fares that include specific optional services and benefits depending on the fare with higher fares including more services and benefits. Airlines are also offering third-party services such as hotel and car rental reservations and baggage pick-up and delivery, which can be purchased through the airline's Web Site.

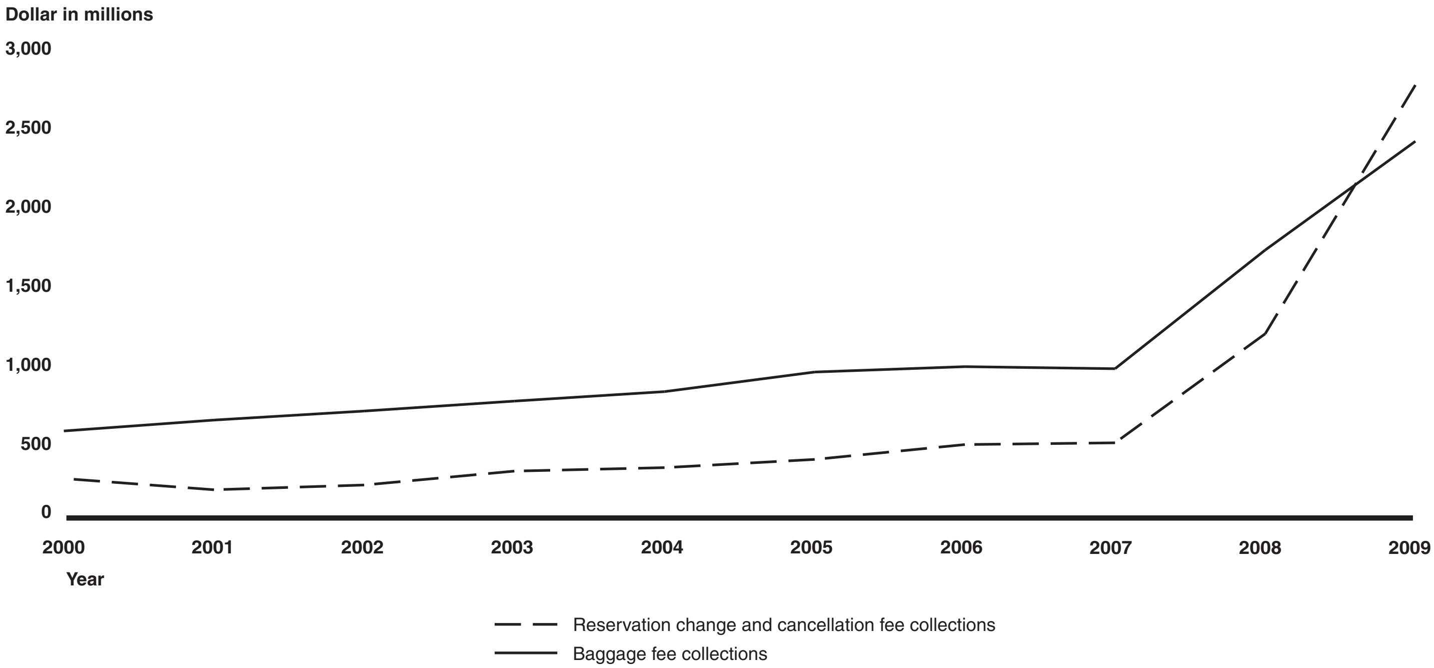
Not all passengers are assessed service fees equally. For example, airlines waive some of these fees for elite members of their frequent flyer programs.[17] In addition, 13 of the 17 airlines we contacted do not charge these fees for their highest-paying passengers, such as those who hold first or business class tickets or full-fare economy class tickets. Airlines may also provide exemptions to select customers such as U.S. military personnel. Airline officials explained that customers who attain status with their airline's frequent-flyer program are likely to remain repeat customers if they are rewarded with service benefits such as baggage fee waivers.

Fees Have Proven Popular with Airlines as a Method of Generating Revenue While Maintaining Fare-Based Competition

According to financial data submitted by airlines to DOT, total revenue from baggage fees and reservation change and cancellation fees—the largest known sources of revenue for optional services—has increased since 2008 following widespread implementation of baggage fees in the United States. In calendar years 2008 and 2009, U.S. airlines collected nearly $3.9 billion in baggage fees and over $4 billion in reservation change and cancellation fees. Collection of fees for reservation changes and cancellations, although implemented prior to 2008, has risen sharply since then following the implementation of additional and/or higher fees for changing or canceling reservations. Accordingly, revenues from baggage fees and reservation change and cancellation fees have grown from less than 1 percent of operating revenues in 2007 to over 4 percent in 2009. Although small compared with total airline operating revenues, fee revenues are growing. In the first quarter of calendar year 2010, airlines reported $1.3 billion in baggage fees and reservation change and cancellation fees—a 13 percent increase from the corresponding quarter in 2009. Figure 4 shows the reported increase in revenues from baggage fees and reservation change and cancellation fees.

[17] Elite members accumulate a specified minimum number of miles flown in a year or have surpassed a specified lifetime threshold.

Figure 4: Total Collections of Baggage Fees and Reservation Change and Cancellation Fees by U.S. Airlines, 2000-2009 (2010 dollars)



Source: GAO analysis of DOT Form 41 financial data.

U.S. airlines must separately identify and report to DOT in their quarterly Form 41 filings only those revenues from baggage fees and from reservation change and cancellation fees, while other fee revenues are reported in a variety of other accounts that may also contain non-fee revenue. In 2009, BTS issued an accounting and reporting directive for U.S. passenger airlines to report ancillary revenues in a like manner. The directive allows airlines to report revenues from fees in different accounts such as in Transport-Related Revenues and Miscellaneous Operating Revenues that include revenue from other sources such as the sale of frequent flyer award miles.[18] Further, the guidance does not include all sources of ancillary revenues. Given this, we are unable to determine total revenues from other airline-imposed fees, such as those for telephone

[18]DOT Research and Innovative Technology Administration Bureau of Transportation Statistics Accounting and Reporting Directive, No. 289, February 20, 2009. DOT includes the sale of frequent flyer award program miles as ancillary revenues whereas we are reporting on revenues only from airline-imposed fees paid by passengers.

booking, seat selection, and early boarding. DOT has reported airline ancillary revenues were $7.8 billion in 2009, up from $5.5 billion in 2008. However, these reported revenues include not only those from the discrete accounts of baggage fees and reservation change and cancellation fees, but also fees from the Miscellaneous Operating Revenues account for such items as pet transportation and revenue from the sale of frequent flyer award program miles. Absent guidance that requires airlines to report revenues from fees in specific accounts, we found that there were differences among airlines in how some fee revenues were reported. For example, we found that telephone booking fees were reported as part of Reservation Cancellation Fees by some airlines and as Transport-Related Revenues by others. In addition, some airlines accounted for revenues from unaccompanied minors as Transport-Related Revenue, Transport Passenger Revenue or Miscellaneous Operating Revenue, while others reported it as part of Reservation Cancellation Fees, and one airline reported fees for unaccompanied minors as revenue from Excess Baggage Fees. Although there is a lack of clarity regarding the revenue amounts from most optional fees, not including those for baggage fees and reservation change and cancellation fees, it is likely that these revenues would be comparatively smaller because, according to airline representatives, these fee amounts are less than those for checked baggage or reservation changes and cancellations.

Airlines Have Imposed Fees, Which Are Partly Based on Costs, for Multiple Reasons

Several factors motivate airlines to make greater use of a pricing strategy that relies on charging fees for optional services. One factor airline officials told us is the opportunity to generate additional revenue while keeping fares lower. Airline officials said that by charging fees for services, they are able to keep fares lower than if fares were inclusive of checked baggage and other services as they had been in the past. Another factor airline officials told us is the ability to differentiate their customers' willingness to pay. In this way, customers that value the service can pay for it while customers that do not want to pay for the service don't purchase it. If airlines charged higher fares rather than charging for optional services, those passengers placing little value on optional services might decide not to purchase a ticket because there is more passenger resistance to higher fares, particularly during difficult economic times, than there is to paying for optional services. Airlines largely compete on their base ticket fares and passengers generally compare these fares when deciding which flight to purchase, often picking the lowest fare displayed. Several economic studies have found evidence that increases in the less transparent part of the price of a product—in this case optional service fees—has less of an effect on sales than increases in the price of the product itself—in this case, fares.[19] Officials from several airlines told us that another reason they impose fees is the ability to differentiate their airlines from their competition by providing some services for free and others at a fee.

Airlines that we interviewed indicated that costs were a consideration in setting fee levels, but other factors were also considered, such as competition and consumer demand. An official at one airline stated that the costs of providing services vary by airport and the routes served. For example, this official told us that the airline analyzes the costs of providing checked baggage service at each of the airports it serves and, while these costs differ, the airline sets a standard checked baggage fee to apply at all locations. Like prices for other products and services sold in a competitive market, fees for these services are also influenced by what competitors charge. Much like airfares, changes in fee amounts may be matched by competitors. In January 2010, Delta Air Lines increased its fee to check a first bag at the airport from $20 to $25, and within a month Continental Airlines, United Airlines, and American Airlines matched the increase. Furthermore, airlines evaluate consumer demand to determine what passengers are willing to pay for. One airline official told us that the airline conducts market research to determine whether a fee for a service would be acceptable to customers. This official said that the airline had eliminated a fee for the first checked bag on international flights and decreased the amount of a fee for its premium services based on customer feedback. Public discontent over a fee can also lead airlines to decide not to impose it. For example, Spirit Airlines announced that it will charge a fee for carry-on bags that cannot fit underneath a seat for travel beginning in August. In response to congressional and public outcry, 5 other airlines

[19]For example, according to economic literature, alcoholic beverages are usually subject to two state-level taxes: an excise tax that is included in the shelf price and a sales tax that is applied at the cash register. Thus, the impact of an increase in the excise tax is likely to be more visible to the consumer than an increase in the sales tax. One study analyzed whether price visibility affected consumer demand and found that it did. Consumer demand was found to be far more responsive to changes in the more visible excise taxes than to changes in the less visible sales taxes. A similar study of purchases of household products found that applying sales taxes at the cash register rather than including them in shelf prices had a smaller impact on consumer demand. In this study, for some products in some stores, the analysts posted tags on the shelf showing the products' prices inclusive of the sales taxes and found that making the full prices visible reduced purchases of the products compared to other products, and the same products in other stores, that did not have their prices similarly tagged. (These studies are discussed more fully in Raj Chetty, Adam Looney, and Kory Kroft, "Salience and Taxation: Theory and Evidence," *American Economic Review*, 99, (2009): 1145-1177).

stated that they will not impose such a fee and to date no other airline has imposed a fee for carry-on bags.[20] Also, in 2008, US Airways tested consumer response by charging $2 for non-alcoholic beverages including sodas, juices, bottled water, and coffee, but discontinued after no other major airline began charging a fee for these drinks.

While airlines have collected a substantial amount of fee revenues, there is no clear link between the implementation of optional service fees and the profitability and financial stability of an airline. For example, American Airlines, Continental Airlines, Delta Air Lines, and Virgin America impose charges for checked baggage and other services, but each reported an operating loss for 2009. Not all profitable or financially stable airlines impose optional service fees. Southwest Airlines has not adopted a fee for a first or second checked bag, but continues to report an operating profit. On the other hand, both Spirit Airlines and Allegiant Air impose many fees for services on passengers and both also reported an operating profit for calendar year 2009.

Airlines recognize that their approach to offering services for a fee gives passengers choices that allow them to travel without paying the fees, such as by carrying bags into the cabin or by bringing their own meals onboard. Some passengers may prefer this approach in which they pay for only the services they want. One airline allows customers either to pay one higher price that includes the fare as well as services or to pay a lower fare for the flight and pay for services if desired. According to an official of this airline, 85 percent of that airline's customers prefer to pay the lower fare and pay for services separately.

[20] In 2010, legislation was introduced that would require the Secretary of Transportation to complete a rulemaking prohibiting carriers from charging for carry-on baggage that falls within the restrictions imposed by the carrier with respect to size, weight, and number of bags. S. 3195, 111th Cong. (2010). Additionally, legislation was introduced to subject carry-on baggage fees to the 7.5 percent excise tax imposed on transportation of persons by air. S. 3205, 111th Cong. (2010).

Most Airline Fees for Services Are Not Incorporated in the Booking or Payment Process, Making It Difficult for Passengers to Compare Prices

Complete information on fees for optional services is not submitted by airlines filing their fare information with ATPCO or incorporated into the GDSs' fare offerings used by travel agencies. In contrast, all airline-imposed required charges, such as fuel surcharges and peak travel day charges, must be included in the advertised fare—the "full fare," or entire price to be paid by the consumer, regardless of distribution channel (airline or travel agent).[21] Unlike fare information, information on other service fees is not available through the GDSs with the exception of checked baggage, as discussed below, although it can be obtained from individual airlines by searching their Web Sites or contacting them directly. DOT does not specify in its advertising guidance that optional service fees be disclosed at ticketing with the exception of checked baggage fees and accompanying policies.[22] As a result, customers using online travel agencies and traditional or corporate travel agents, which together sell 60 percent of all airline tickets, cannot readily obtain and compare information on complete trip prices that include both the fare and selected service fees. This lack of information also makes it impossible for customers using online travel agencies or for travel agents using a GDS to select or make payment for optional services at the time of booking, which for many corporate customers is important for tracking payments. Travel agents and customers must then go directly to airline Web Sites to find out fee information.

Since checking a bag and the associated fees are deemed optional, they are not considered by DOT to be part of the "full fare" for purposes of its advertising rules, and therefore are not required to be disclosed prior to ticketing. However, DOT has required airlines and travel agents, including GDSs, to disclose checked baggage fees and accompanying policies at the

[21]See 14 C.F.R. § 399.84 and 49 U.S.C. § 41712. Fuel charges must be included in the advertised fare; they cannot be stated separately. Stating them separately would violate the full-fare advertising rule and 49 U.S.C. § 41712. DOT Guidance, *Prohibition of Deceptive Practices in the Marketing of Airfare to the Public Using the Internet*, January 18, 2001. See also Condor Flugdienst GmbH Consent Order, Order 2009-4-1 (April 1, 2009). Although DOT's enforcement policy has been to consider "ticket agents," as defined in title 49, subject to the full-fare advertising rule, which on its face applies to "direct and indirect air carriers as well as 'an agent of either,'" DOT's recently-proposed rule would specifically name "ticket agents" as being covered by the rule. DOT, *Enhancing Airline Passenger Protections*, Notice of Proposed Rulemaking (NPRM), 75 Fed. Reg. 32318 (proposed June 8, 2010). According to DOT, this is because the statutory definition of "ticket agent" encompasses entities, in addition to agents of carriers that hold out, sell, or arrange for air transportation. See 49 U.S.C. § 40102(40).

[22]See DOT, *Guidance on Disclosure of Policies and Charges Associated with Checked Baggage*, 73 Fed. Reg. 28854 (May 19, 2008).

time of purchase.[23] However, because this information is not filed with fare information by airlines, it is not readily available to GDSs and, therefore, to travel agents. DOT contends that travel agents utilizing a GDS can find this information by searching airline Web Sites, but GDS and travel agent officials we spoke with said that assuring that this information is accurate and up-to-date is time consuming and not practical if a customer is on the phone. Thus, even though travel agents are held to the same advertising and disclosure requirements as airlines, including those for checked baggage fees and policies, travel agents may not have information on checked baggage fees to accurately meet those requirements by relying on a GDS.

Recently proposed legislation would extend the disclosure requirements to include not only checked baggage fees, but also fees for seat assignments and other services that an airline may charge after the ticket is purchased.[24] In addition, legislation introduced in April 2010 would require the Secretary of Transportation to complete a rulemaking prohibiting airlines from charging fees for any carry-on baggage that falls within the restrictions imposed by the airline with respect to the weight, size, or number of bags, among other things.[25] Further, on June 8, 2010, DOT issued a Notice of Proposed Rulemaking (NPRM) that would, among a number of other things, if adopted, require U.S. and foreign airlines to disclose all fees for optional services, including those for checked baggage, advance seat assignments, and seat upgrades through a prominent link on their Web Site's homepage.[26] DOT also states in the

[23]See *Guidance on Disclosure of Policies and Charges Associated with Checked Baggage*, 73 Fed. Reg. 28854 (May 19, 2008), and 14 C.F.R. § 399.84.

[24]Clear Airfares Act of 2009, S. 2823, 111th Cong. § 2 (2009). See also S. 3195, 111th Cong. (2010).

[25]S. 3195, 111th Cong. (2010).

[26]DOT, *Enhancing Airline Passenger Protections*, NPRM, 75 Fed. Reg. 32318 (proposed June 8, 2010). The comment period closes August 9, 2010. In this context, DOT is seeking comment on whether this requirement should be limited to disclosure of "significant fees" for optional services, including the definition of "significant fee" and whether it should be defined as a particular dollar amount. Comment is also sought on alternatives to this option. DOT is also seeking comment as to whether this provision, proposed 14 C.F.R. § 399.85(c), should apply to ticket agents, as defined in 49 U.S.C. § 40102.

proposed new rule that it is considering requiring that U.S. and foreign airlines make this fee information available to applicable GDSs.[27]

Travel Industry Efforts to Improve Fee Disclosure and Access Are Underway but May Not Lead to Full Disclosure

To improve travel agencies' ability to provide information on and payment for airline-imposed fees, ATPCO, the tariff publishing house, is working to include these fees as part of the information available in GDSs. ATPCO, which provides fare information to GDSs, has developed the Optional Services product—an automated approach to distribute fee information for flight-related services such as checked baggage and seat selection and for non-flight-related services such as lounge access. Airlines could then provide fee information to ATPCO, and, in turn, ATPCO could provide the information to the GDSs. When fully integrated into a GDS, travel agents, including corporate travel agents, could access and purchase optional services at the time of booking. Customers that purchase tickets at online travel agencies could also purchase optional services when booking tickets. This product would allow consumers to search airfares based on the total price of their trip rather than just the base airfare. Currently, 12 U.S. airlines constituting 79 percent of the operating revenues reported by U.S. airlines in 2009 are test filing this information with ATPCO, which is allowing GDSs to access it on a test basis.

In an attempt to ensure industry standards for the display, distribution, and financial settlement of fee transactions, ATPCO is coordinating its efforts with the International Air Transport Association (IATA)—a worldwide trade organization representing approximately 230 airlines—and ARC, which settles ticketing financial transactions. IATA has begun an initiative that would develop a standard for electronic transactions of miscellaneous documents, including those that contain airline-imposed fees. Stemming from its e-ticket effort, which eliminated the majority of paper-based ticketing transactions in June 2008, IATA is developing the Electronic Miscellaneous Document (EMD) standard, which will allow airlines and GDSs to electronically record fees that have been paid for optional services. Once this standard is incorporated by GDSs, customers using a corporate, online, or traditional travel agency would have the ability to pay for optional services at the time of ticketing. Use of the EMD will also facilitate miscellaneous financial transactions between airlines involving tickets that include transportation on more than one airline.

[27] DOT, *Enhancing Airline Passenger Protections*, NPRM, 75 Fed. Reg. 32318 (proposed June 8, 2010).

IATA anticipates that by the end of 2010, GDSs will be capable of issuing EMDs and by the end of 2012 all airlines will have EMD capability.

GDS companies have also developed their own products that accommodate fee information. For example, Sabre has developed a merchandising product that enables the consumer to comparison shop fares, including selections of optional services by incorporating ATPCO's Optional Services product. Consumers could select optional services as part of a fare search to compare airlines' offerings that include the fare and services. Sabre officials told us that its product is currently used in other countries, but no U.S. airlines have committed to providing fee information to ATPCO. Amadeus and Travelport—the next largest GDSs—have developed similar products that, according to officials with these companies, U.S. airlines have not committed to supporting.

GDS and travel agent representatives say that there is little incentive for airlines to disclose their fee information through the GDSs as such disclosure will increase the fare displayed to many passengers if fees are included. Airlines largely compete on fares and passengers compare fares when deciding which flight to purchase, often picking the lowest fare displayed. If one airline provided fee information and another did not, the airline that disclosed the fees would be at a disadvantage. Consequently, according to GDS representatives, it is unlikely that airlines will provide fee information or offer these services for sale through GDSs unless required to do so. In addition, trade associations are advocating that the airline industry work to standardize policies on fee disclosure and access. For example, the Interactive Travel Services Association, Business Travel Coalition and American Society of Travel Agents are leading efforts to have all fees available for sale through GDSs and to establish uniform codes for fee transactions. Similarly, the National Business Travel Association has supported efforts to make fees for services available through GDSs so that corporate travel agents can access and monitor fees when they are instituted or changed, buy services, and track them through their expense management systems.

Overall, we found that airlines we contacted were generally supportive of efforts to improve the transparency of fees for their customers. Officials from one airline indicated that providing the customer an opportunity to pay for additional services at the time of booking would create both greater choice and transparency while still allowing the airline to offer unbundled services. However, officials at another airline were more cautious indicating that the time of booking was not always the best point to sell additional services as passengers may not know at that time what additional services they will need. For example, they may not know how many, if any, bags they will check on the day of travel. Further, officials at another airline indicated that although they support transparency of optional service fees, the GDS environment may not be the best choice for distribution of this information, and there are alternatives to the GDS that can be cost effective to use to inform travel agents and passengers of fees for optional services. Officials from another airline stated that they are waiting until the testing of ATPCO Optional Services product has been completed before they decide whether to provide fee information to ATPCO. As noted earlier, DOT's June 2010 NPRM proposes greater fee disclosure and seeks comment on whether airlines should make this fee information available to applicable GDSs.[28] DOT officials told us that requiring fee disclosure provides additional information and resources to benefit consumers; however, imposing such a requirement must be weighed against the disadvantages of government interference with airline competition and the deregulated GDS environment.

Airlines' Increasing Reliance on Fees Reduces the Proportion of Total Revenue That Is Taxed to Fund FAA

Many Airline-Imposed Fees Are Not Subject to the 7.5 Percent Excise Tax

Unlike fares for domestic air transportation, a majority of the fee revenues collected by airlines on amounts paid by passengers for various airline services, including amounts paid for checked baggage, are not subject to the 7.5 percent excise tax,[29] in accordance with Treasury regulations and IRS guidance.[30] The Internal Revenue Code imposes a 7.5 percent excise

[28]DOT, *Enhancing Airline Passenger Protections*, NPRM, 75 Fed. Reg. 32318 (proposed June 8, 2010).

[29]IRS determinations of the applicability of the 7.5 percent excise tax depend on the facts and circumstances pertaining to the imposition of the fee and, accordingly, may vary from airline to airline for similar services.

[30]IRS guidance includes Revenue Rulings, Private Letter Rulings, and other guidance documents.

tax on amounts paid for the taxable transportation of a person by air, the revenue from which is deposited into the Airport and Airway Trust Fund.[31] Treasury regulations, the last iteration of which were promulgated in the 1960s, set general parameters for which airline-imposed fees are subject to the 7.5 percent excise tax and which are not subject to the tax.[32] As a general rule, all amounts paid to the airline to procure domestic air transportation are part of the tax base unless exempted by regulation or IRS guidance. Generally, all mandatory charges necessary to transport passengers are included in the tax base,[33] but fees for optional services are not.[34] IRS has further clarified which airline-imposed fees are subject to the excise tax in guidance documents, including Revenue Rulings and Private Letter Rulings.[35] Treasury regulations and IRS guidance provide that revenue from many airline-imposed fees for airline services are generally not subject to the 7.5 percent excise tax, including fees for checked baggage, early boarding, phone reservations, and on-board meals.[36] On the other hand, amounts paid for other airline-imposed fees that are required as a condition of receiving domestic air transportation, such as some reservation change and cancellation fees, fuel surcharges, and peak travel day charges, are subject to the 7.5 percent excise tax in accordance with IRS guidance and applicable regulations,[37] and tax revenues from these fees are being deposited into the Trust Fund. See table 1 for a list of airline fees and surcharges on domestic air transportation that, pursuant to IRS guidance and Treasury regulations, are subject to the 7.5 percent excise tax.

[31]26 U.S.C. § 4261(a). 26 U.S.C. § 9502.

[32]26 C.F.R. §§ 49.4261-7, 49.4261-8.

[33]See Rev. Rul. 73-508, 1973-2, C.B. 366.

[34]See Rev. Rul. 80-31, 1980-1, C.B. 251.

[35]A Revenue Ruling is an official interpretation by the IRS of the internal revenue laws and related statutes, treaties, and regulations as applied to a specific set of facts. They are issued for the information and guidance of taxpayers; published revenue rulings may be cited as precedent by the IRS. Private Letter Rulings are taxpayer-specific rulings furnished by the IRS in response to requests made by taxpayers. Since it is taxpayer specific, it cannot be used or cited as precedent.

[36]See 26 C.F.R. § 49.4261-8; Rev. Rul. 80-31; Priv. Ltr. Rul. 118216-09 (Sept. 28, 2009).

[37]See 26 C.F.R. § 49.4261-7; Rev. Rul. 89-109, 1989-2 C.B. 232; Rev. Rul. 73-508, 1973; Priv. Ltr. Rul. 118216-09.

Table 1: Airline-Imposed Fees and Surcharges on Domestic Air Transportation Subject to the 7.5 Percent Excise Tax According to IRS

Subject to 7.5 percent excise tax	Not subject to 7.5 percent excise tax
Fee to upgrade to higher class of accommodation (first or business class) An additional charge, paid in cash, for changing the class of accommodation is a payment for transportation and is subject to tax by regulation.[a]	**Fee for checked baggage** The fee is excluded from the tax base by regulation.[b]
Fee for ticket cancellation when passenger requests refund If an airline keeps a portion of the amount paid for a ticket as a cancellation fee when refunding the ticket amount to the customer, the consumer does not get a refund of tax already paid on that portion of the ticket amount (cancellation fee).[c] There is no additional tax on the amount retained.	**Fee for seat selection/seat preference within class of accommodation** If the service is optional and not a change in the class of accommodation, it is not included in the tax base.[d]
Fee for ticket change of destination or time of travel Additional charges for changing the destination or route, extending the time limit of a ticket, or as "extra fare" are payments for transportation and subject to tax by regulation.[e]	**Fee for early boarding within class of ticket purchased** As long as the fee for early boarding is optional, it is not included in the tax base.[f]
Fee for frequent flyer award redemption Service charge for a passenger to redeem frequent flyer miles.[g]	**Fee to apply already-purchased unused fare to new ticket** If a fee were charged so that the customer could apply the fare (on which tax was already paid) for an unused nonrefundable ticket to a new ticket, then that fee is not included in the tax base because it is optional.[h]
Fee for unaccompanied minors If the fee charged to provide support and care to an unaccompanied traveling minor is mandatory, such fee is taxable because the amount is paid as a condition of receiving air transportation. If it is optional, however, (e.g., for children of a certain age), then it is not included in the tax base.[i]	**Fee for reservation by phone; reservation by Internet** If the airline provides a mechanism for the customer to book travel for free, the use of a mechanism to book that charges a fee is then optional and the reservation fee is not subject to a tax. If there is no mechanism for the customer to book travel for free, the reservation fee is included in the tax base, regardless of the mechanism used.[j]
Charge for peak travel/holiday travel The fee is subject to tax because it must be paid as a condition of receiving air transportation.[k]	**Fee for pet/animal transportation** The fee is treated as a baggage fee and not included in the tax base, per regulation.[l]
Fuel surcharge The charge is subject to tax because it must be paid as a condition of receiving air transportation.[m]	**Fee for standby** Assuming the fee is optional, the fee is not included in the tax base.[n]
	Fees for pillows and blankets The fees are not included in the tax base because they are for non-transportation service.[o]
	Charges for food and alcoholic beverages The charges are not included in the tax base because they are non-transportation services, as described in regulation.[p]

Source: GAO analysis of applicable statutes, regulations, and guidance.

Note: IRS determinations of the applicability of the 7.5 percent excise tax depend on the facts and circumstances of the imposition of the fee and, accordingly, may vary from airline to airline for similar services.

[a]26 C.F.R. § 49.4261-7(c). See also Priv. Ltr. Rul. 118216-09.

[b]26 C.F.R. § 49.4261-8(f)(1).

[c]Rev. Rul. 89-109; but see *United Airlines, Inc. v. U.S.,* 929 F. Supp. 1122 (N.D. Ill., 1996).

[d]Rev. Rul. 80-31.

[e]26 C.F.R. § 49.4261-7(c).

[f]Rev. Rul. 80-31.

[g]Rev. Rul. 73-508. See also Priv. Ltr. Rul. 118216-09.

[h]Rev. Rul. 80-31. See also Priv. Ltr. Rul. 118216-09.

[i]Rev. Rul. 73-508. See also Priv. Ltr. Rul. 118216-09.

[j]Rev. Rul. 80-31. See also Priv. Ltr. Rul. 118216-09.

[k]Rev. Rul. 73-508.

[l]26 C.F.R. § 49.4261-8(f)(1).

[m]Priv. Ltr. Rul. 118216-09 (Sept. 28, 2009); Rev. Rul. 73-508.

[n]Priv. Ltr. Rul. 118216-09; Rev. Rul. 80-31.

[o]26 C.F.R. § 49.4261-8(f)(4).

[p]26 C.F.R. § 49.4261-8(f)(4).

Potential Tax Revenues from Baggage Fees, If Taxed, Would Have Constituted Less Than 2 Percent of Total Trust Fund Revenues in Fiscal Year 2009

We estimate that if baggage fees, which generate the largest fee revenues reported to DOT, were subject to the 7.5 percent excise tax, the additional tax revenues collected in fiscal year 2009 would have contributed less than 2 percent of total Trust Fund revenues. In fiscal year 2009, airlines reported nearly $2.5 billion in fee revenue from checked baggage.[38] If baggage fees in that year had been subject to the 7.5 percent excise tax, an additional approximately $186 million[39] in excise taxes would have been credited to the Trust Fund. This amount is small—less than 2 percent—relative to the approximately $11 billion in revenue that the Trust Fund received during fiscal year 2009. However, this percentage is likely to grow

[38]Because U.S. airlines charge fees for overweight and oversize bags as well as for additional bags, these fees are included in the $2.5 billion. In fiscal year 2007, before U.S. airlines began charging for first and second checked bags, airlines reported $457 million in baggage fee revenues.

[39]For this analysis, we are making the simplifying assumption that the additional tax due would not have caused any passengers to choose not to purchase tickets. Any such reduction in purchases would presumably have been small and would have had the effect of making the increase in taxes collected a little smaller than our estimate. This figure is also based on total baggage fee revenues, including international baggage fees that would presumably not be subject to the 7.5 percent excise tax. If only the portion of baggage fees collected for domestic air transportation had been subject to the excise tax in fiscal year 2009, the estimate of additional amounts credited to the Trust Fund would be smaller. The reported data do not allow us to identify the portion of baggage fee revenues collected on international flights. However, since most travelers on international flights are permitted to check one or two bags at no additional charge as long as they do not exceed a specified weight requirement, we believe that this portion is small and the impact of including these fee revenues is correspondingly small.

because baggage fees have increased and some airlines have introduced additional service fees. For example, in the first quarter of calendar year 2010, airlines reported a 33 percent increase in revenues from baggage fees compared to the same quarter in 2009.

As noted earlier, aside from checked baggage, DOT guidance does not require airlines to separately report revenues received from fees for services that have not to date been considered part of the transportation of persons—such as early boarding, seat selection, and standby—and these revenues are also not subject to the 7.5 percent excise tax according to IRS. Thus, we cannot be certain how much additional revenue Treasury might have collected and credited to the Trust Fund if that tax had been applicable to all these fees.

Extending Scope of the 7.5 Percent Excise Tax Would Require Legislative or Regulatory Changes

The Internal Revenue Code defines taxable transportation in terms of the arrival/departure of the transportation, but does not define or discuss what is "amount paid for taxable transportation of any person."[40] Treasury regulations provide examples of what payments are and are not subject to the 7.5 percent excise tax.[41] Treasury regulations regarding the scope of payments for transportation subject to the 7.5 percent excise tax were established in the 1960s at a time of a regulated and very different airline industry. In light of changes in airline pricing, the Treasury regulations do not discuss many of the fees currently charged by airlines. The recent IRS private letter ruling, which provides some clarification of the applicability of the excise taxes to examples of current airline fees, is based on the facts and circumstances presented to IRS by the letter ruling requester and is not fully applicable to all fees airlines may charge. Without a statutory change with explicit directions on what fees are to be subject to the 7.5 percent excise tax, each new airline fee, or even the facts and circumstances of how each airline charges current fees, may require interpretation on a case-by-case basis as to whether or not to impose a tax. Therefore, eventual effects on the Trust Fund remain unknown.

[40] In April 2010, a bill was introduced that would subject revenues from bags carried on to the aircraft to the 7.5 percent excise tax, as an amount paid for taxable transportation. Block Airlines' Gratuitous Fees Act, or the "BAG Fees Act," S. 3205, 111th Cong. (2010).

[41] 26 C.F.R. part 49, subpart D.

Imposition of Checked Baggage Fees Has Contributed to Decrease in the Rate of Mishandled Bags and More Carry-on Bags

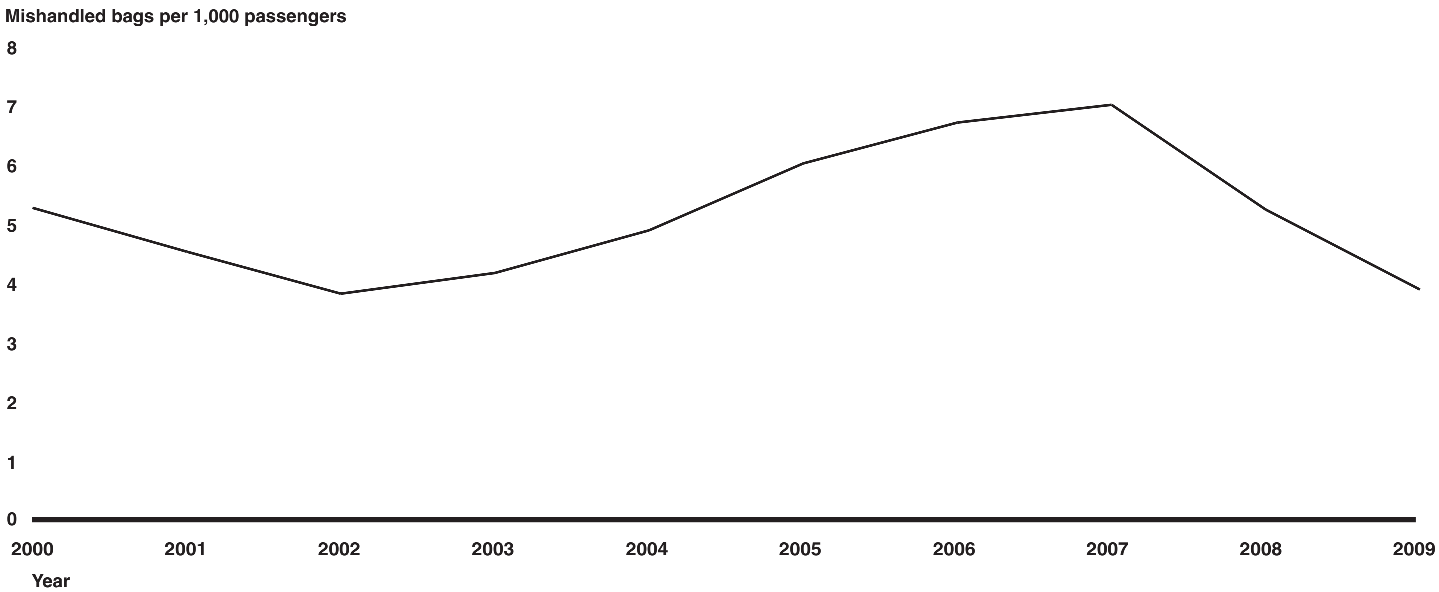
Since Checked Baggage Fees Were Implemented, the Reported Rate of Mishandled Baggage Has Declined

The introduction of checked baggage fees has, by several estimates, led to fewer checked bags, which, among other factors, has contributed to a decline in the number of mishandled bags per 1,000 passengers.[42] Some airline officials told us that the number of checked bags per passenger has decreased since the checked baggage fees were implemented. One airline official said checked baggage had decreased by half and officials at another airline reported the number of checked bags per passenger had decreased by 40 percent. As a result, the rate of mishandled bags per 1,000 passengers has declined since baggage fees were widely implemented. According to data submitted by airlines to DOT, the reported rate of mishandled bags per 1,000 passengers varied from 2000 through 2007 and declined 40 percent (from 7 per 1,000 to less than 4 per 1,000) from 2007 through 2009.[43] Figure 5 shows the decrease in the reported rate of mishandled bags per 1,000 passengers from 2000 through 2009 for U.S. airlines reporting to DOT.

[42]It is unknown whether baggage fees have had an effect on the rate of mishandled baggage per thousand bags as this information is not available.

[43]U.S. passenger airlines that have at least 1 percent of total domestic scheduled service passenger revenues are required to file monthly reports of mishandled baggage with DOT. 14 C.F.R. §§ 234.6, 234.2.

Figure 5: Reported Rate of Mishandled Bags per 1,000 Passengers for Reporting U.S. Airlines, 2000-2009



Source: GAO analysis of DOT data.

Airline Policies Differ in How Compensation to Passengers for Mishandled Bags Is Determined and Have Not Changed Due to the Introduction of Baggage Fees; TSA also Reviews Mishandled Bag Claims

Airline policies to compensate passengers in case of mishandled baggage, as outlined in their contracts of carriage, differ in the assistance to passengers and in the process for determining compensation.[44] For instance, 7 of the 17 airline contracts of carriage that we reviewed specify that baggage will be delivered if delayed, whereas the remaining 10 are silent on the issue.[45] In addition, 10 airline contracts state that efforts will be made to return delayed baggage within 24 hours, whereas the remaining 7 contracts do not specify a time frame. Airline policies on how passengers are compensated for mishandled bags are all subject to DOT's regulatory requirement that precludes airlines from limiting their liability for damages due to disappearance of, damage, or delay to checked baggage, to less than $3,300 per passenger.[46] However, other than this requirement, DOT does not currently specify baggage policies to include in contracts of carriage. DOT conducts random on-site investigations at airlines for compliance with domestic and international air travel rules and has completed 15 investigations in the past 2 years with 7 planned investigations for fiscal year 2010. DOT investigations result in either an enforcement order assessing civil penalties and specifying what the airline must do to be in compliance if problems are found or a notice letter to the airline when minor or no problems are found. DOT has no detailed requirements for how compensation should be determined, instead allowing baggage liability issues between passengers and airlines to be resolved through negotiations and in the courts.[47] Furthermore, most

[44]A contract of carriage is an agreement between a passenger and an airline that encompasses all contractual rights, liabilities, and duties of the two parties. Any term or condition of this contract is legally binding on the airline and the passenger and may be enforced in the courts. Checked baggage is also handled by TSA staff which conduct security screening. TSA has its own liability and claims review process that is different from airlines and which follows the Federal Tort Claims Act and related Department of Justice regulations. According to the Act and regulations, the government's liability and actual damages are generally determined by state tort law and a customer must make a claim within 2 years of the loss. 28 U.S.C. § 2401(b); 28 C.F.R. part 14. TSA and airlines attempted to reach an agreement on processing mishandled baggage claims, however, because of differences in claims processing, that attempt was unsuccessful.

[45]Although the 10 U.S. airlines' contracts of carriage did not say whether they provide bag delivery, the airlines may do so, but not make that service part of the contracts.

[46]14 C.F.R. § 254.4. Per regulation, this amount is reviewed by DOT every two years and adjusted in accordance with the Consumer Price Index. 14 C.F.R. § 254.6. DOT regulations also require notice of this limitation to be provided to passengers. 14 C.F.R. § 254.5.

[47]DOT prescribes what a contract of carriage should generally include, for example, incorporation by reference terminology, which is permissive but not prescriptive. 14 C.F.R. part 253.

airline officials reported that they have not adjusted their compensation policies for mishandled baggage since baggage fees were implemented because, according to some officials, the service provided has not changed. When asked whether DOT should specify airline compensation policies in cases of mishandled baggage in contracts of carriage, the agency responded that it has the authority to act against particular practices on a case-by-case basis and has done so with individual enforcement actions and industry letters to airlines. For example, in October 2009 DOT sent an industry letter to airlines advising that it had become aware of certain policies, such as denied reimbursement for necessities when the baggage is expected to reach the passenger within 24 hours, limited reimbursement to actual expenses up to a fixed maximum amount per day after the first day, and passenger reimbursement for incidental expenses only on the outbound leg of a roundtrip flight—all of which are considered arbitrary limits on expense reimbursement in violation of DOT guidance.[48] DOT's recent proposed rulemaking seeks comment on requiring carriers to include minimum standards in their customer service plans that would reimburse passengers for baggage fees if the baggage is lost or not timely delivered as well as establishing a definition for when a bag is not "timely delivered."[49]

[48]DOT, *Guidance on Reimbursement of Passenger Expenses Incurred as a Result of Lost, Damaged, or Delayed Baggage*, October 9, 2009. The letter further explained that to meet the requirements of Part 254 and the requirements implicit in 49 U.S.C. § 41712, carriers should remain willing to cover all reasonable, actual and verifiable expenses related to baggage loss, damage or delay up to the amount stated in Part 254. DOT took enforcement action against Spirit Airlines in September 2004 in part for limiting its delayed bag expense reimbursement to roundtrip passengers and expenses after the first 24 hours. Order 2009-9-8 (Sept. 17, 2009).

[49]DOT, *Enhancing Airline Passenger Protections*, NPRM, 75 Fed. Reg. 32318 (proposed June 8, 2010). The NPRM also proposes to require carriers to include a provision in their Customer Service Plans to make every reasonable effort to return mishandled bags within 24 hours, to compensate passengers for reasonable expenses that result from delay in delivery, and to include customer service plans in their contract of carriage.

Checked Baggage Fees Have Led to an Increase in Carry-on Baggage and Flight Crew Concerns Regarding Crew and Passenger Safety

According to some airline officials, since checked baggage fees were imposed, there has been an increase in carry-on baggage because some passengers who have chosen not to check a bag for a fee have instead brought bags into the cabin. Airline policies generally state that a passenger can carry on board one bag and one personal item.[50] An employee union representing flight attendants noted that this increase in carry-on baggage can slow passenger boarding and adversely affect the safety of passengers and flight attendants. In a recent survey by the Association of Flight Attendants, more than half of the responding flight attendants cited excess and oversized or overweight carry-on bags. The survey respondents also reported concerns with full overhead bins, an increase in checked bags at the gate, pushback delays, and stressful boarding situations. Almost one-third of the responding flight attendants reported concerns about injuries to airline staff and passengers from lifting carry-on bags.[51] As noted earlier, Spirit Airlines has introduced a fee for carry-on baggage—a policy that the carrier asserts is at least in part aimed at reducing the amount of carry-on baggage.

[50]FAA's Carry-on Baggage Rule, 14 C.F.R. § 121.589, does not set forth specific limitations on the number of bags or items a passenger can bring on to an aircraft; rather, it requires air carriers to have an approved carry-on baggage program in place.

[51]Survey of Flight Attendants, Association of Flight Attendants, February 2010. The results we cite are only representative of the 800 responding flight attendants.

Refundability of Government-Imposed Taxes and Fees Is Not Always Clear and Communication of Refund Eligibility to the Airlines and Consumers Is Lacking

The refundability of government-imposed taxes and fees on unused nonrefundable tickets varies depending on the tax or fee. TSA's September 11th Security Fee, which funds passenger aviation security services, is the only government-imposed fee or tax that is clearly refundable on unused nonrefundable tickets that expire or lose their value, according to TSA.[52] However, according to airline officials, the security fee is rarely refunded because its refundability is not well known by consumers, and a refund is only provided if a passenger requests a refund from the airline.[53] The IRS states that the aviation excise taxes—the 7.5 percent ticket tax, passenger segment tax, and international arrival/departure tax that fund FAA activities—are not refundable on unused nonrefundable tickets; however, to the extent that a portion of the ticketed fare is refunded, the collected tax attributable to that portion of the fare may be refunded to the passenger.[54] Thus, if airline policy allows a passenger to apply part of the fare for an unused nonrefundable ticket as a credit for future travel on the airline, the passenger receives a credit for the proportionate share of the taxes applied to the next ticket (less a change fee) and thus does not have to pay the taxes a second time. If, however, a passenger does not use the credit, the passenger may not receive a refund of the taxes. For example, according to DOT, some airlines offer a credit for the price of the ticket, including taxes and fees, minus a reservation change or cancellation fee and the difference in fares. Normally, passengers have to notify the airline prior to flight departure to qualify for a credit which is valid for 1 year for travel on the airline. However, these airlines would not provide a refund in cash of the ticket price. Because the excise tax is imposed on amounts paid for air transportation and not connected to the transportation itself, taxes paid on unused purchased tickets remain in the Airport and Airway Trust Fund.

[52] 49 C.F.R. § 1510.9(b). Letter from Randall Fiertz, Transportation Security Administration, Acting Director of Revenue, to James Hultquist, Air Transport Association, Managing Director, Taxes. November 21, 2002, Docket No. TSA-02-11120-59. TSA imposes $2.50 per enplanement not to exceed $5 one-way or $10 roundtrip for aviation security inspection services. 49 C.F.R. §§ 1510.9(b), 1510.5

[53] If a collecting airline refunds the TSA fee to a passenger, the airline, through Treasury, submits this "credit" along with the fees it has collected at the end of the month in which the fees were collected, as required by statute. 49 U.S.C. § 44940(e)(3). The airline cannot retain any part of the fee to cover its costs; however, pursuant to statute, the airline is allowed to retain the interest earned from the trust account where fees are held. 49 U.S.C. § 44940(e)(6).

[54] Rev. Rul. 89-109 (1989) 1989-2, CB 232, as applicable to the 7.5 percent excise tax. IRS officials stated that the reasoning in this revenue ruling is also applicable to the passenger segment tax, and the international arrival/departure tax.

In regards to other government-imposed fees, according to CBP, which administers the Customs Air Passenger Inspection Fee and the Immigration Air Passenger Inspection Fee, applicable statutes and regulations authorize the refund of these fees on unused nonrefundable tickets. In the past, as CBP officials noted, the agency has allowed for such refunds and CBP indicated that they would not consider the refund of its fees to be improper insofar as fees can be refunded if inspection services are not provided. However, CBP has not issued policy or guidance that clarifies this practice or whether airlines can or must refund fees if requested by consumers. Additionally, CBP told us that when airlines do refund fees to passengers, it accounts for those with CBP as a "credit" on a subsequent submission of collected fees. In contrast, with respect to the Animal and Plant Health Inspection User Fee, USDA officials said that airlines may have refunded consumers this fee on occasion but do not know the circumstances of this and acknowledge that their controlling statute is silent on this issue. In regards to all of these fees, airline officials told us that they have received few, if any, requests for fee refunds. An official of a trade association that represents travel agencies told us that there is confusion about whether government-imposed taxes and fees are refundable. As a result, this official said, many travel agents state that they do not try to recoup taxes and fees on unused nonrefundable tickets for their customers. Table 2 shows government-imposed taxes and fees, their amounts, and agencies' interpretations of their refundability.

Table 2: Government-Imposed Taxes and Fees and Amounts Paid by Passengers and Legal Basis for Their Refundability on Unused Nonrefundable Tickets

Government-imposed tax/fee	Refund of government-imposed tax/fee authorized?
Passenger Ticket Tax[a] The law imposes a tax of 7.5 percent on the ticketed fare for flights within the continental U.S. or Canada/Mexico 225-mile buffer zone, with certain exceptions;[b] this amount is deposited in the Airport and Airway Trust Fund that primarily funds FAA activities.	No.[c]
Passenger Segment Tax[d] The law imposes a tax of $3.70 per domestic flight segment; this amount is deposited in the Airport and Airway Trust Fund that primarily funds FAA activities.	No.[e]
International Arrival/Departure Tax[f] The law imposes a tax of $16.10 per passenger for all flights arriving in or departing from the United States, Puerto Rico, or the U.S. Virgin Islands; this amount is deposited in the Airport and Airway Trust Fund that primarily funds FAA activities.	No.[g]
September 11th Security Fee[h] TSA imposes $2.50 per enplanement not to exceed $5 one-way or $10 roundtrip for aviation security inspection services.[i]	Yes.[j]
Customs Air Passenger Inspection Fee[k] A $5.50 fee is imposed for the arrival of each passenger aboard a commercial aircraft from a place outside the United States, with certain exceptions, for customs inspection services.	Yes. According to CBP, relevant statutes authorize airlines to refund fees if services are not rendered and have allowed for refunds in the past. However, CBP has not issued policy or guidance that clarifies this practice or whether airlines can or must refund fees if requested by consumers.
Immigration Air Passenger Inspection Fee[l] A $7 fee is assessed for each passenger arriving at a port of entry in the United States, or for the pre-inspection of a passenger in a place outside of the United States prior to such arrival for immigration inspection services.	Yes**.** According to CBP, relevant statutes authorize airlines to refund fees if services are not rendered and have allowed for refunds in the past. However, CBP has not issued policy or guidance that clarifies this practice or whether airlines can or must refund fees if requested by consumers.
Animal and Plant Heath Inspection User Fee[m] USDA imposes $5 per passenger upon arrival from a place outside of the customs territory of the United States for its health inspection services.	Unclear. According to USDA, relevant statutes and regulations are silent as to whether the fee is refundable on unused nonrefundable tickets.

Source: GAO analysis.

[a]26 U.S.C. §§ 4261(a), 4262(a).

[b]26 U.S.C. §§ 4261(a), 4262.

[c]Rev. Rul. 89-109.

[d]26 U.S.C. § 4261(b). A domestic flight segment consists of one take-off and one landing.

[e]Officials with IRS stated that the reasoning of Rev. Rul. 89-109 is applicable here.

[f]26 U.S.C. § 4261(c). Section 4261(c)(3) provides a modified international arrival/departure tax rate of $8.10 for domestic flights beginning or ending in Alaska or Hawaii.

[g]Officials with IRS stated that the reasoning of Rev. Rul. 89-109 is applicable here.

[h]49 U.S.C. § 44940, 49 C.F.R. part 1510.

[i]49 C.F.R. § 1510.5.

[j]See Letter from Randall Fiertz, Transportation Security Administration, Acting Director of Revenue, to James Hultquist, Air Transport Association, Managing Director, Taxes, November 21, 2002, Docket No. TSA-02-11120-59. TSA is considering promulgating further details on refunds under the Final Rule for 49 C.F.R. part 1510, which has yet to be issued.

[k]19 U.S.C. § 58c(a)(5)(A), 19 C.F.R. § 24.22(g).

[l]8 U.S.C. § 1356(d), 8 C.F.R. § 286.2(a).

[m]21 U.S.C. § 136a, 7 C.F.R. § 354.3(f).

Airlines Are Not Required to Notify Consumers That They May Be Eligible for Refunds

Although applicable TSA guidance requires the refund of the September 11th Security Fee on unused nonrefundable tickets that expire or lose their value, at the passenger's request, consumers are generally unaware that they may be eligible for a refund. According to TSA, regulations require airlines to refund the fee to consumers when a change in their itinerary occurs, but this occurs automatically.[55] We asked airline officials to describe the process by which they refund TSA fees to consumers and asked if consumers have requested refunds. Some airlines replied that they have not been requested by consumers to refund the fee and others were not aware that consumers were entitled to a refund but if requested they would issue one. We asked TSA officials why no policy has been developed to notify consumers of their rights. TSA responded that current refund policy sufficiently ensures that refunds will be provided upon request by the airline and TSA has not received complaints regarding an airline failing to comply with TSA regulation and guidance regarding refunds. Similarly, while CBP allows airlines to refund the customs and immigration inspection fees on unused nonrefundable tickets, because the agency has not communicated this to airlines or the public, consumers are unaware that they fees can be requested. We believe that given that consumers are not notified of a potential refund, they may be unlikely to realize their entitlement to such and, thus, would be unlikely to request a refund. DOT has the authority under 49 U.S.C. § 41712 to prohibit unfair or deceptive practices or unfair methods of competition and DOT believes ensuring that consumers are not mislead regarding their rights to refunds is within the scope of this authority. However, DOT staff point out that it has received few, if any, complaints about refundable government fees.

Conclusions

Airlines are increasingly charging fees for optional services that were previously provided without a separate charge. These fees, which may be paid at the time of booking, at check-in, or onboard, are not uniformly disclosed to passengers through the various distribution systems available

[55]49 C.F.R. § 1510.9(b).

to purchase tickets. DOT's current guidance does not require disclosure of airline-imposed optional service fees apart from those for checked bags although the agency issued a Notice of Proposed Rulemaking in June 2010 requesting public comment on this issue. Because information on some of these fees for optional services may be available only through airline Web Sites and not through the global distribution systems used by passengers who purchase tickets through online travel agencies or by travel agents, passengers may have difficulty calculating the total price of a trip and comparing prices among airlines. Making complete, clear, and uniform information on airline fees available through travel agents and airline Web Sites would enable passengers to make fully informed choices about travel options.

While certain airline fares are subject to the 7.5 percent excise tax, this tax does not apply to many airline-imposed fees, and consequently the Airport and Airway Trust Fund receives less revenue than if that tax applied to all fee revenues. IRS has determined that fees for checked baggage and many other services not currently considered to be part of the transportation of a person are not subject to the 7.5 percent excise tax. If baggage fees alone had been subject to the 7.5 percent excise tax in fiscal year 2009, the Trust Fund would have received approximately an additional $186 million in revenues. This amount is expected to grow in future years if airlines continue to shift toward more fee revenue relative to fare revenue.

It is hard to determine the amount of total fee revenues that airlines collect. Currently revenues from fees other than baggage fees and reservation change and cancellation fees are reported in miscellaneous and other accounts that also include revenues from non-fee sources. The BTS accounting and reporting directive on ancillary fees allows airlines to report in their quarterly financial filings to DOT revenues from most fees in various accounts. Not having a clear accounting makes it difficult for policymakers and regulators to determine total revenues from airline-imposed fees and the impact on the airline industry.

Finally, TSA's security fee is refundable on unused, nonrefundable tickets that expire or lose their value; however, there is currently no requirement or process in place to alert passengers that they are eligible for such refunds. Additionally, relevant statutes and regulations authorize CBP, via the airlines, to refund its customs and immigration fees but has not issued any policy or guidance that clarifies this. Finally, it is unclear if USDA's agricultural inspection fee is refundable. Without this guidance and determination of the refund eligibility of USDA's fee, consumers are not aware the fee is refundable and consequently may not be receiving refunds to which they may be entitled.

Matter for Congressional Consideration

If Congress determines that the benefit of added revenue to the Airport and Airway Trust Fund from taxation of optional airline service fees, such as baggage fees, is of importance, then it should consider amending the Internal Revenue Code to make mandatory the taxation of certain or all airline imposed fees and to require that the revenue be deposited in the Airport and Airway Trust Fund.

Recommendations for Executive Action

We are making six recommendations to the Departments of Transportation, Homeland Security and Agriculture.

To improve the transparency of information on airline-imposed fees and government-imposed taxes and fees for consumers and improve airlines' reporting of fee revenues to the Department of Transportation, we recommend the Secretary of Transportation take the following four actions:

- Improve the disclosure of baggage fees and policies to passengers, in accordance with DOT guidance, by requiring that U.S. airlines and foreign airlines that fly within or to or from the United States disclose baggage fees and policies along with fare information such that this information can be consistently disclosed across all distribution channels used by the airline.

- Require U.S. airlines and foreign airlines that fly within or to or from the United States to disclose all airline-imposed optional fees that it deems important to passengers to know and further require that this information be consistently disclosed across all distribution channels used by the airline.

- Require that U.S. passenger airlines and foreign airlines that fly within or to or from the United States consistently disclose to passengers, applicable government-imposed fees on unused nonrefundable tickets that may be eligible for refunds once these determinations are made by relevant agencies.

- Require U.S. passenger airlines to report to DOT all optional fees paid by passengers related to their trip in a separate account, exclusive of baggage fees and reservation change and cancellation fees.

To eliminate the ambiguity regarding the refund of government-imposed fees to purchasers of unused nonrefundable tickets, we recommend that the Secretary of Homeland Security issue guidance regarding the refundability of the customs and immigration inspection fees to U.S. and foreign airlines collecting these fees.

To eliminate the ambiguity regarding government-imposed fees that are eligible for refund to purchasers of unused nonrefundable tickets, we recommend that the Secretary of Agriculture determine whether a passenger is eligible for a refund of the animal and plant heath inspection fee and convey this determination to U.S. and foreign airlines collecting these fees.

Agency Comments and Our Evaluation

We provided a draft of this report to DOT, DHS, Treasury, and USDA for their review and comment. Within DHS, CBP noted in their oral comments that applicable statutes and regulations authorize the refund of customs and immigration inspection fees on unused nonrefundable tickets; however, officials stated that the practice had not been articulated in policy or guidance to airlines. As a result, we modified our recommendation to DHS from determining if consumers are entitled to refunds of customs and immigration inspection fees to issuing guidance to clarify refundability. DHS agreed with this recommendation. On July 9, 2010, DHS provided written comments from the Department and CBP, which are reprinted in appendix III. In comments, USDA also agreed with our recommendation to the Department. DOT neither agreed nor disagreed with our recommendations. All four departments provided technical comments which we incorporated into this report as appropriate.

Copies of this report will be sent to the Secretaries of Transportation, Homeland Security, Agriculture and Treasury. This report is also available at no charge on the GAO Web Site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-2834 or dillinghamg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IV.

Gerald L. Dillingham, Ph.D.
Director, Physical Infrastructure

Appendix I: Scope and Methodology

We were asked to answer the following research questions: (1) What are the nature and scope of the fees airlines charge to passengers, are the fees commensurate with the costs of the services provided, and are the fees transparent to passengers? (2) What is the potential impact of such fees on revenues available to the Airport and Airway Trust Fund? (3) What changes have taken place in the numbers of checked and mishandled bags, amount of compensation paid to passengers for mishandled bags, and other consumer issues since airlines began charging more widely for checked baggage? and (4) What, if any, is the process for refunding government-imposed taxes and fees to passengers who do not use their nonrefundable tickets? To address these objectives, we analyzed airline financial and operating data; reviewed applicable laws, regulations, and past studies; and interviewed officials from the airline industry, the Department of Transportation (DOT), the Internal Revenue Service (IRS), the Department of Homeland Security (DHS), and the U.S. Department of Agriculture (USDA). Our financial analysis relied on airline financial information reported to DOT by airlines from calendar year 2000 through calendar year 2009—the most recently available. We used the Department of Commerce's chain-weighted price index for gross domestic product to adjust dollar figures to 2010 dollars to account for changes over time in the price level of the economy. To assess the reliability of the DOT Bureau of Transportation Statistics (BTS) data, we reviewed the quality control procedures applied by BTS and determined that the data were sufficiently reliable for our purposes.

To identify the nature and scope of airline-imposed fees, we developed a list of fees based on research of travel and 17 airline Web Sites and corroborated the data in interviews with officials from airlines.[1] In interviewing the airline officials, we used a semi-structured interview instrument, which asked questions pertaining to airline-imposed fees and how fee amounts were set. We correlated and assembled the results of the interviews so that airline proprietary information was not disclosed. To assess what is required in the disclosure of airline-imposed fees, we

[1] The 17 U.S. passenger airlines are: Air Tran, Alaska Airlines, Allegiant Air, American Airlines, Continental Airlines, Delta Air Lines, Frontier Airlines, Hawaiian Airlines, JetBlue Airways, Midwest Airlines, Southwest Airlines, Spirit Airlines, Sun Country Airlines, United Airlines, US Airways, USA3000, and Virgin America. We chose these 17 airlines based on several factors. All 17 airlines reported annual operating revenues of at least $20 million and together collected more than 99 percent of the checked baggage fees reported to BTS in 2008 and transported about 77 percent of domestic revenue passengers in 2008. Two airlines—Virgin America and Spirit Airlines—did not respond to our request for information.

analyzed applicable laws and regulations and interviewed officials from DOT's Office of Aviation Enforcement and Proceedings, which establishes laws and guidance related to full disclosure advertisement rules. To assess travel industry efforts to improve fee disclosure and policies, we interviewed officials from the Air Transport Association, International Air Transport Association, Airline Reporting Corporation, Airline Tariff Publishing Company, Sabre, Travelport, Amadeus, Interactive Travel Services Association, Business Travel Coalition, American Society of Travel Agents, and FlyersRights Organization.

To assess the potential impact of such fees on the Airport and Airway Trust Fund, we reviewed existing tax laws and regulations and spoke with IRS officials about the applicability of the excise taxes imposed on amounts paid for air transportation of persons to the airline-imposed fees we identified. We then calculated the potential impact in the most recent complete fiscal year (2009), on the Airport and Airway Trust Fund if revenues from baggage fees—revenues that airlines are required by DOT to report separately and that are not currently taxed—had been taxed at the 7.5 percent excise tax applied to fare revenues. We did not calculate the impact on the Trust Fund of taxing revenues from reservation change and cancellation fees, which are also reported separately, because these revenues are currently subject to the 7.5 percent excise tax. In addition, we were unable to calculate the impact on the Trust Fund if revenues from other currently untaxed fees had been taxed as these fee revenues are not required by DOT to be reported separately and some airlines in our sample did not provide this information to us when we requested it. We also spoke with IRS officials regarding what actions could be taken that would make currently untaxed fees subject to the 7.5 percent excise tax.

To examine issues with checked baggage, we reviewed data reported by airlines to DOT, and subsequently published in DOT's Air Travel Consumer Report. To assess the reliability of this data we interviewed DOT personnel regarding quality control procedures, and subsequently determined that the data were reliable for our purposes. We also interviewed DOT officials from BTS and the Office of Aviation Enforcement and Proceedings, DHS's Transportation Security Administration (TSA), airlines, trade associations, and other interest groups about compensation for mishandled baggage. We reviewed regulations and policies regarding checked baggage liability and disclosure requirements. We also conducted a content analysis of the results of an open-ended question on a survey conducted by the Association of Flight Attendants in February 2010 on the impacts of carry-on baggage. Our analysis enumerated the percentage of the 800 respondents that reported on excessive carry-on baggage and its implications on boarding processes and in-cabin injuries. We reviewed the methodology and data collection instrument used by the Association of Flight Attendants in gathering this information, and determined that the data collected from the 800 open-ended responses was sufficiently reliable for our use. We also conducted an analysis of the contract of carriage of the 17 airlines in our sample. These contracts of carriage were accessed on each airline Web Site and information was corroborated in our interviews with airline officials.

To identify mechanisms for refunding government-imposed fees and taxes, we reviewed relevant agencies' statutes and guidance and interviewed officials from IRS, DHS Customs and Border Protection, Immigration and Customs Enforcement, TSA, and the USDA who are responsible for federal taxes and fees applied to airline tickets. We also interviewed airlines and trade associations on the process for refunding eligible government-imposed taxes and fees. We conducted this performance audit from October 2009 through July 2010 in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Sample of Airline-Imposed Fees for Optional Services

Table 3: Domestic Checked Baggage Fees of 17 U.S. Airlines as of July 1, 2010

Airline	First bag (airport/online)	Second bag (airport/online)	Additional bags (each)	Overweight bags	Oversized bags
Air Tran	$15	$25	3+: $50	51-70 lbs: $49 71-100 lbs: $79	$49-$79
Alaska[a]	$20	$20	3: $20 4+: $50	51-100 lbs: $50	$50-$75
Allegiant	$35/$15-$30	$35/$25-$35	$35/$50	51-74 lbs: $50 75+ lbs: $100	$35
American	$25	$35	3-5: $100 6+: $200	51-70 lbs: $50 71-100 lbs: $100	$150
Continental	$25/$23	$35/$32	3+: $100	51-70 lbs: $50	$100
Delta	$25/$23	$35/$32	3: $125 4-10 $200	51-70 lbs: $90 71-100 lbs: $175	$175-$300
Frontier	$20	$30	3+: $50	51+ lbs: $75	$75
Hawaiian	$25/$23 inter-island: $10	$35/$32 $17 inter-island: $17	3-6: $125 7+: $200 inter-island: $25	51-70 lbs: $50 inter-island: $25	$100 inter-island: $25
Jet Blue	$0	$30	3: $75	51-70 lbs: $50 71-100 lbs: $100	$75
Midwest	$20	$30	3+: $50	51-100 lbs: $75	$75
Southwest	$0	$0	3-9: $50 10+: $110	51-100 lbs: $50	$50
Spirit[b]	$25/$19	$25	3-5: $100	51-70 lbs: $50 71-99 lbs: $100	$100-$150
Sun Country	$25/$20	$35/$30	$75	51-100 lbs: $75	$75
United[c]	$25	$35	3+: $100	51-100 lbs: $100	$100
USA3000	$25/$15	$25	$25	51-70 lbs: $25	$25-$50
US Airways	$25/$23	$35/$32	3-9: $100	51-70 lbs: $50 71-100 lbs: $100	$100
Virgin America	$25	$25	3-10: $25	1st <70 lbs: free 51-70 lbs: $50 71-100 lbs: $100	$50

Source: GAO review of airline Web Sites and interviews with airline officials.

[a]Alaska Airlines does not charge for the first 3 checked bags for trips wholly within the state of Alaska.

[b]Spirit revised its checked baggage fee for travel on or after August 1, 2010 to $25 for each of the first two bags, and $85 for each of the 3rd, 4th and 5th bags.

[c]United also offers a $249 annual fee to check one or two bags per flight without charge.

Table 4: Other Airline-Imposed Fees of 17 Airlines as of July 1, 2010

Airline	Ticket change or cancellation (domestic ticket)	Booking phone/ in person	Unaccompanied minor	Pet in cabin	Seat selection	Inflight food and beverage	Blanket and pillow
Air Tran	$75	$15/$0	$39 direct/non-stop $59 connecting	$69	$6 advance $20 exit row	F: NA B: $6	NA
Alaska	$100 ($75 online)	$15/$15	$25 direct/non-stop $50 connecting	$100	NA	F: $3.50-$7 B: $6	NA
Allegiant	$50 per segment	$15+$14.99 per segment /$0	NA	NA	$4.99-$24.99 varies by flight length and seat.	F: $2-$5 B: $2-$7[a]	NA
American	$150	$20/$20-$30	$100	$100	NA	F: $3-$10 B: $6-$7	$8
Continental	$150	$20/$20	$100	$125	NA	F: $0 B: $6	NA
Delta	$150	$20/$35	$100	$125	NA	F: $2-$8 B: $5-$7	NA
Frontier	$50 - $100	$0/$0	$50 direct/non-stop $100 connecting	$75	$15-$25	F: $3-$7 B: $2-$5[a]	NA
Hawaiian	$100-150 inter-island: $25-$30	$25/$35 inter-island: $15/$35	$100 inter-island: $35	$175	NA	F: $5.50-$10 B: $6.50-$14	NA
Jet Blue	$100	$15	$75	$100	$10 extra legroom	F: $0 B: $6	$7
Midwest	$100	$0/$0	$50 direct/non-stop $100 connecting	$75	NA	F: $3-$7 B: $2-$5[a]	NA
Southwest	$0	$0/$0	$50	$75	$10 priority boarding	F: $0 B: $3-$5	NA
Spirit	$110 ($100 online)	$5/$0 ($5 each way online)	$100	$100	Varies based on location.	F: $2-$5 B: $2-$6[a]	NA
Sun Country	$75	$15/$0	$75/segment	$100	$8	F: $3-$6 B: $5	$5
United	$150	$25/$30	$99	$125	$9/$109	F: $3-$9 B: $6	NA
USA3000	$75	$0/$0	$50	$75	$9-$25	n/a	NA
US Airways	$150	$25-$35	$100 (non-stop flights only)	$100	$5+ Varies by location.	F: $3-$7 B: $7-$8	$7
Virgin America	$100 ($75 online)	$15/$10	$75	$100	NA	F, B: $2-$10	$12

Source: GAO analysis

[a]Fee for some nonalcoholic beverages.

Appendix III: Comments from the U.S. Department of Homeland Security

U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

July 9, 2010

Mr. Gerald L. Dillingham, Ph.D.
Director, Physical Infrastructure
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Dr. Dillingham:

RE: Draft Report GAO-10-785 (Reference # 540204), Commercial Aviation: Consumers Could Benefit From Better Information about Airline-Imposed Fees and Refund of Government-Imposed Taxes and Fees

Thank you for the opportunity to review the draft report concerning the Department of Homeland Security's (DHS) aviation taxes, fees, and surcharges. DHS concurs with GAO's report findings and proposed recommendation. DHS had one recommendation for executive action. We would like to respectfully offer the following comments:

GAO Recommendation: That the Secretary of Homeland Security determines whether a passenger is eligible for a refund of the customs and immigration inspection fees and provide this information to DOT, to eliminate ambiguity of government imposed fees that are eligible for refund to purchasers of unused nonrefundable tickets.

DHS Response: DHS concurs with this recommendation. DHS appreciates the follow-up teleconference call with GAO to discuss the Draft Report and also acknowledges the changes made by GAO in its revised sections of the report.

DHS has reviewed the revised sections of the Draft Report. CBP would like to note that there is no separate ICE fee as referred to in the revised sections. CBP collects and administers the immigration fee and transfers part of the collections to ICE. CBP recommends changing this language throughout the report. CBP also recommends that GAO use the same language in Table 2 for the Immigration fee that they use for the Customs fee.

Thank you for the opportunity to comment on this draft report and we look forward to working with you on future homeland security issues.

Sincerely,

Jerald E. Levine
Director
Departmental Audit Liaison Office

2

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Gerald L. Dillingham Ph.D. (202) 512-2834 or dillinghamg@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following individuals made key contributions to this report: Paul Aussendorf (Assistant Director), Amy Bowser, Lauren Calhoun, Jay Cherlow, Brian Chung, Elizabeth Eisenstadt, Christopher Jones, Maureen Luna-Long and Josh Ormond.

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