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COMMERCIAL AVIATION

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

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss various issues affecting airline passengers, including airline-imposed fees, mishandled baggage, and the refundability of various government-imposed taxes and fees to passengers. The U.S. passenger airline industry has been under tremendous financial pressure over the last decade, first from security threats that inhibited air travel, then from volatile fuel costs, and more recently from falling demand due to an economic recession. Only recently has air traffic begun to recover. In response to these pressures, passenger airlines have adapted their business models. In 2008, for example, many airlines introduced fees for a variety of passenger services, most notably for a first or second checked bag, for which separate charges did not previously exist. 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. 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. The revenues from baggage and many other fees are not subject to the 7.5 percent excise tax on amounts paid for domestic air transportation, which, via the Airport and Airway Trust Fund, is used to help fund the Federal Aviation Administration (FAA), including its operation and development of the air traffic control system and oversight of aviation safety. In addition, charging separate fees for checked baggage raises questions about whether the quality of checked baggage service has improved since the fees were introduced. Other government fees on airline tickets help pay for other government services, such as for security, immigration, customs, and agricultural inspections. However, with the exception of fees for security services, it is not clear if and how these various government-imposed fees are refundable to passengers who do not use their nonrefundable tickets. However, the refundability of these fees is not always clear or communicated to airlines or consumers.

My statement today summarizes our most recent report on these issues, which is being released publicly at this hearing today.¹ In this report we examined (1) the nature and scope of the fees airlines charge to passengers, including the fees' relationship to the costs of the services

¹GAO, *Commercial Aviation: Consumers Could Benefit from Better Information about Airline-Imposed Fees and Refundability of Government-Imposed Taxes and Fees*, [GAO-10-785](#) (Washington, D.C.: July 14, 2010).

provided and the transparency of the fees; (2) the potential impact of such fees on revenues used to help fund FAA; (3) changes in the numbers of checked and mishandled bags, the amount of compensation paid to passengers for mishandled bags, and other related consumer issues; and (4) the process, if any, for refunding government-imposed taxes and fees to passengers who do not use their nonrefundable tickets. We have previously reported on issues related to these objectives.²

To address these issues, we developed a list of airline fees based on research of travel and 17 airline Web Sites and corroborated the data with airline officials;³ analyzed Department of Transportation (DOT) financial and operating data; reviewed applicable laws, regulations, guidance, and past studies; and interviewed officials from the airline industry, trade associations, consumer groups, global distribution systems, DOT, and the Internal Revenue Service (IRS). More detail on scope and methodology is available in the full report, which we completed in accordance with the Generally Accepted Government Auditing Standards.

Background

Increasingly, airlines are charging fees to supplement fare revenues. Some fees, such as those for unaccompanied minors, reservation changes or cancellation, and oversized or overweight baggage, have existed for years. Other fees are new, including those introduced since 2008 for services that did not previously entail separate charges, such as fees for a first and second checked bag, early boarding, seat selection, and meals. New services, such as Wi-Fi access, also generate fee revenue. Information on many airlines' fees for services is available through the airlines' Web Sites but not through the global distribution systems⁴ that make fare

²See GAO, *Commercial Aviation: Airline Industry Contraction Due to Volatile Fuel Prices and Falling Demand Affects Airports, Passengers, and Federal Government Revenues*, [GAO-09-393](#) (Washington, D.C.: Apr. 21, 2009); *Federal User Fees: Key Aspects of International Air Passenger Inspection Fees Should Be Addressed Regardless of Whether Fees Are Consolidated*, [GAO-07-1131](#) (Washington, D.C.: Sept. 24, 2007); and *Summary Analysis of Federal Commercial Aviation Taxes and Fees*, [GAO-04-406R](#) (Washington, D.C.: Mar. 12, 2004).

³We chose these 17 U.S. passenger 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 the Bureau of Transportation Statistics in 2008 and transported about 77 percent of domestic revenue passengers in 2008.

⁴The three main global distribution systems are Amadeus, Sabre, and Travelport, which combined, generated more than \$9.6 billion in revenue in 2008.

information available to online (e.g., Expedia and Travelocity) and traditional brick-and-mortar travel agencies.

The Internal Revenue Code imposes several excise taxes to help fund FAA, including a 7.5 percent tax on amounts paid for the transportation of a person for domestic air transportation. This tax applies to fees such as for peak/holiday travel and unaccompanied minors, but does not apply to many other fees, including fees for checked baggage. The federal government also imposes fees to help other agencies cover their costs for security screening, customs, immigration, and agricultural inspections among other things.⁵ DOT requires the airlines to include the costs of certain government-imposed excise taxes in their advertised fares. In addition, DOT requires the airlines to disclose their fees and associated policies for checked baggage but not for other optional fees; to separately report their revenues from baggage fees and reservation change and cancellation fees; and to report the incidence of mishandled checked bags as well as compensate passengers for damages. Finally, according to DOT, it has the authority to ensure passengers are not misled regarding their rights, such as their eligibility for refunds of government-imposed taxes and fees.

Summary of Key Issues

- **Fees for optional services are based on costs and other factors and are not fully disclosed to passengers at the time of booking.** Airlines have imposed a variety of fees on a range of optional services, such as checked and, most recently, 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 \$7.9 billion in 2008 and 2009 from baggage fees and reservation change and cancellation fees alone—the only fees revenues airlines are required to separately to DOT. Although small compared with total airline operating revenues, fee revenues are growing. In the first calendar quarter of 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. However, information

⁵Immigration inspection fees are divided between two Department of Homeland Security agencies—Customs and Border Protection and Immigration and Customs Enforcement. Agricultural inspection fees are divided between Customs and Border Protection and the U.S. Department of Agriculture. 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.

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. Meanwhile, the airlines could fully disclose all of their fees to consumers searching for fares, but according to global distribution systems representatives, are unlikely to do so unless compelled because such disclosure will make airlines less competitive as fares displayed would be higher if fees were included.⁶ On June 8, 2010, DOT issued a Notice of Proposed Rulemaking 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 website’s homepage.⁷ DOT also states in the proposed new rule that it is considering requiring that U.S. and foreign airlines make this fee information available to applicable global distribution systems that package fare information for online and traditional travel agencies, which combined sell the majority of tickets.⁸

- **Airlines’ increasing reliance on fee revenues reduces the proportion of total passenger revenue that is taxed to help fund FAA.** The IRS has determined that many airline-imposed fees are not related to the transportation of a person—the basis for imposing the 7.5 percent excise tax on domestic air transportation⁹—according to applicable Treasury regulations and IRS guidance¹⁰—and, thus, only a

⁶To improve travel agencies’ ability to provide information on and payment for airline-imposed fees, the Airline Tariff Publishing Company, which provides fare information to global distribution systems has developed a product to distribute fee information. 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 the company, which is allowing global distribution systems to access it on a test basis.

⁷DOT, *Enhancing Airline Passenger Protections*, Notice of Proposed Rulemaking, 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.

⁸DOT, *Enhancing Airline Passenger Protections*, Notice of Proposed Rulemaking, 75 Fed. Reg. 32318 (proposed June 8, 2010).

⁹26 U.S.C. § 4261(a).

¹⁰IRS guidance includes Revenue Rulings, Private Letter Rulings, and other guidance documents. See 26 C.F.R. §§ 49.4261-7, 26 C.F.R. § 49.4261-8; Priv. Ltr. Rul. 118216-09.

proportion of the total fee revenue is subject to taxation. These excise tax collections are deposited into the Airport and Airway Trust Fund (Trust Fund),¹¹ which is the primary source of funding for FAA. Trust Fund revenues have fallen in recent years, from about \$12 billion in fiscal year 2007 to about \$11 billion in fiscal year 2009, owing to a variety of factors, including lower fares and fewer passengers in 2009 than in 2007. In fiscal year 2009, airlines reported nearly \$2.5 billion in fee revenue from checked baggage (the largest and only measurable untaxed fee).¹² If baggage fees in that year had been subject to the 7.5 percent excise tax, an additional approximately \$186 million in excise taxes or less than 2 percent of total Trust Fund revenues would have been credited to the Trust Fund.¹³

Although this percentage is relatively small, it is likely to grow based on recent trends. In the first quarter of 2010, airlines reported a 33 percent increase in revenues from baggage fees compared to the corresponding quarter in 2009. Since DOT guidance requires airlines to report separately only revenues from baggage fees and reservation change and cancellation fees, we were unable to estimate potential collections from other untaxed optional fees.

- **The imposition of checked baggage fees has contributed to declines in the amount of checked baggage and the rate of mishandled bags per thousand passengers as well as an increase in the amount of carry-on baggage.** 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. However, it is unknown whether baggage fees have had an effect on the rate of mishandled bags per thousand passengers as this information is not available. Despite the introduction of fees, airlines have not significantly changed their compensation methods. Checked baggage fees have also led to greater amounts of carry-on baggage in the cabin, resulting in greater competition for limited overhead storage space. A recent survey of flight attendants

¹¹26 U.S.C. § 9502.

¹²Because 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 about \$457 million in baggage fee revenues. Revenues from reservation change and cancellation fees are already subject to the 7.5 percent excise tax as they are considered fees paid for the transportation of persons.

¹³For 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.

found that more than half had concerns about the amount of carry-on bags, while a third of the attendants noted concerns about the safety of crew and passengers due to injuries from lifting carry-on bags.

- **Refundability of government taxes and fees is not always clear and communication of refund eligibility to the airlines and consumers is lacking.** The refundability of government taxes and fees on unused nonrefundable tickets varies depending upon the tax or fee. According to IRS, aviation excise taxes on unused nonrefundable tickets are not refundable; 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 consumer.¹⁴ In contrast, consumers with unused nonrefundable tickets are entitled to a full refund of the September 11th Security Fee, in accordance with Department of Homeland Security (DHS) Transportation Security Administration (TSA) guidance, but few consumers request a refund because airlines are not required to proactively inform consumers of their right to a fee refund. According to Customs and Border Patrol (CBP), its applicable statutes and regulations authorize the refund of its customs and immigration inspection fees on unused nonrefundable tickets; however, CBP has not issued policy or guidance that clarifies this interpretation or whether airlines can or must refund fees if requested by consumers. The U.S. Department of Agriculture's (USDA) applicable statutes and regulations regarding its inspection fee are silent on whether the fee is refundable on unused nonrefundable tickets, according to the agency.

Report's Matter for Congressional Consideration and Recommendations

In our report, we note that if Congress determines that the benefit of added revenue to the Airport and Airway Trust Fund from taxation of airline-imposed optional fees is important, then it should consider amending the Internal Revenue Code to tax certain or all airline-imposed fees and deposit the revenue in the Airport and Airway Trust Fund. We also make several recommendations to the Secretary of Transportation to improve the disclosure of information on airline-imposed fees and government-imposed fees for consumers and to improve airlines' reporting of fee revenues to DOT. Among these are recommendations for DOT to require that U.S. passenger airlines and foreign airlines that fly within or to or from the United States disclose optional airline-imposed fees and policies that the agency deems important to passengers to know and further require that this information be consistently disclosed across all

¹⁴Rev. Rul. 89-109 (1989) 1989-2 CB 232, as applicable to the 7.5 percent excise tax.

distribution channels used by the airline. Similarly, we recommend that DOT require that U.S. passenger airlines and foreign airlines that fly within or to or from the United States disclose to consumers applicable government-imposed fees on nonrefundable tickets that may be eligible for refunds as these determinations are made by relevant agencies. We also recommend that DOT require U.S. passenger airlines to report to DOT all revenues from optional fees paid by passengers related to their trip in a separate account, exclusive of revenues from baggage fees and reservation change and cancellation fees.

In addition, our report also contains recommendations to the Secretaries of Homeland Security and Agriculture to eliminate the ambiguity regarding their fees which are eligible for refunds. To DHS, we recommend that the department issue guidance to airlines regarding the refundability of its customs and immigration inspection fees. To USDA, we recommend that the department determine whether its inspection fee is refundable and convey this to airlines.

In commenting on a draft of the report on which this testimony is based, DHS and USDA agreed with our recommendations to their respective departments. DOT did not agree or disagree with our recommendations.

Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions you or other Members of the Subcommittee may have.

For questions about this testimony, please contact Dr. Gerald L. Dillingham at (202) 512-2834 or dillingham@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. Individuals who made key contributions to this testimony include Paul Aussendorf, Assistant Director; Amy Bowser; Brian Chung; Lauren Calhoun; Jay Cherlow; Elizabeth Eisenstadt; Christopher Jones; and Maureen Luna-Long.

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