••• **Reg. IV.18.(e). Special Rules: Airlines.** [Adopted July 14, 1983]

The following special rules are established with respect to airlines:

(1) In General. Where an airline has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to Article IV. of the Multistate Tax Compact except as modified by this regulation.

(2) Apportionment of Business Income.

(i) General Definitions.

The following definitions are applicable to the terms used in the apportionment factor descriptions.

A. "Value" of owned real and tangible personal property shall mean its original cost. (See Article IV.11. and Regulation IV.11(a).)

B. "Cost of aircraft by type" means the average original cost or value of aircraft by type which are ready for flight.

C. "Original cost" means the initial federal tax basis of the property plus the value of capital improvements to such property, except that, for this purpose, it shall be assumed that Safe Harbor Leases are not true leases and do not affect the original initial federal tax basis of the property. (See Regulation IV.11(a).)

D. "Average value" of the property means the amount determined by averaging the values at the beginning and ending of the income year, but the [insert here the appropriate title of the administrative agency] may require the averaging of monthly values during the income year if such averaging is necessary to reflect properly the average value of the airline's property. (See Article IV.12. and Regulation IV.12.)

E. The "value" of rented real and tangible personal property means the product of eight (8) times the net annual rental rate. (See Article IV.11. and Regulation IV.11(b).)

F. "Net annual rental rate" means the annual rental rate paid by the taxpayer.

G. "Property used during the income year" includes property which is available for use in the taxpayer's trade or business during the income year.

H. "Aircraft ready for flight" means aircraft owned or acquired through rental or lease (but not interchange) which are in the possession of the taxpayer and are available for service on the taxpayer routes.

I. "Revenue service" means the use of aircraft ready for flight for the production of revenue.

J. "Transportation revenue" means revenue earned by transporting passengers, freight and mail as well as revenue earned from liquor sales, pet crate rentals, etc.

K. "Departures" means, for purposes of these regulations, all takeoffs, whether they be regularly scheduled or charter flights, that occur during revenue service.

(ii) Property Factor

A. Property valuation. Owned aircraft shall be valued at its original cost and rented aircraft shall be valued at eight (8) times the net annual rental rate in accordance with Article IV.11. and Regulation IV.11. The use of the taxpayer's owned or rented aircraft in an interchange program with another air carrier will not constitute a rental of such aircraft by the airlines to the other participating airline. Such aircraft shall be accounted for in the property factor of the owner. Parts and other expendables, including parts for use in contract overhaul work, will be valued at cost.

B. The denominator and numerator of the property factor. The denominator of the property factor shall be the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the income year. The numerator of the property factor shall be the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year.

In determining the numerator of the property factor, all property except aircraft ready for flight shall be included in the numerator of the property factor in accordance with Article IV.10.-.12, inclusive. Aircraft ready for flight shall be included in the numerator of the property factor in the ratio calculated as follows:

Departures of aircraft from locations in this state weighted as to the cost and value of aircraft by type compared to total departures similarly weighted.

(iii) The Payroll Factor

The denominator of the payroll factor is the total compensation paid everywhere by the taxpayer during the income year. (See Article IV.13.-.14.) The numerator of the payroll factor is the total amount paid in this state during the income year by the taxpayer for compensation. With respect to non-flight personnel, compensation paid to such employees shall be included in the numerator as provided in Article IV.13-.14. With respect to flight personnel (the air crew aboard an aircraft assisting in the operations of the aircraft or the welfare of passengers while in the air), compensation paid to such employees shall be included in the ratio of departures of aircraft from locations in this state, weighted as to the cost and value of aircraft by type compared to total departures similarly weighted, multiplied by the total flight personnel compensation.

(iv) Sales (Transportation Revenue) Factor.

The transportation revenue derived from transactions and activities in the regular course of the trade or business of the taxpayer and miscellaneous sales of merchandise, etc., are included in the denominator of the revenue factor. (See Article IV.1. and Regulation IV.1.) Passive income items such as interest, rental income, dividends, etc., will not be included in the denominator nor will the proceeds or net gains or losses from the sale of aircraft be included. The numerator of the revenue factor is the total revenue of the taxpayer in this state during the income year. The total revenue of the taxpayer in this state during the income year is the result of the following calculation:

The ratio of departures of aircraft in this state weighted as to the cost and value of aircraft by type, as compared to total departures similarly weighted multiplied by the total transportation revenue. The product of this calculation is to be added to any non-flight revenues directly attributable to this state.

(3) Records. The taxpayer must maintain the records necessary to arrive at departures by type of aircraft as used in these regulations. Such records are to be subject to review by the respective state taxing authorities or their agents.

EXAMPLES OF THE MANNER IN WHICH THE MULTISTATE TAX COMMISSION AIRLINE REGULATION WOULD APPLY TO SPECIFIC FACT SITUATIONS

Example 1: Assume the following facts for an airline for a tax year:

1. It has ten 747s ready for flight and in revenue service at an average cost per unit of $40,000,000 for nine of the aircraft. It rents the tenth 747 from another airline for $9,000,000 per year. At eight times rents, the latter is valued at $72,000,000 for apportionment purposes. The total 747 valuation is, therefore, $432,000,000 for property factor denominator purposes.

2. It has twenty 727s ready for flight in revenue service at an average cost per unit of $20,000,000. The total 727 valuation is, therefore, $400,000,000 for property factor denominator purposes.

3. It has nonflight tangible property (n.t.p.) valued at an original cost of $200,000,000.

4. It has the following annual payroll:

Flight personnel	$60,000,000
Nonflight personnel	40,000,000
Total	$100,000,000

5. From its operations, it has total receipts of $50,000,000, business net income of $1,000,000, and no nonbusiness income.

6. It has the following within state X:

a. 10% of its 747 flight departures (.10 x $432,000,000)	$43,200,000
b. 20% of its 727 flight departures (.20 x $400,000,000)	$80,000,000
c. 5% of its n.t.p. (.05 x$200,000,000)	$10,000,000
d. 15% of its n.p. payroll (.15x$40,000,000)	$6,000,000

7. State X has a corporate tax rate of 10%.

The airline's tax liability to state X would be determined as follows:

Property Factor:

$$\frac{43{,}200{,}000\ (747s) + 80{,}000{,}000\ (727s) + 10{,}000{,}000\ (n.t.p.)}{432{,}000{,}000 + 400{,}000{,}000 + 200{,}000{,}000} = \frac{133{,}200{,}000}{1{,}032{,}000{,}000} = .1291$$

Sales Factor:

$$\frac{43{,}200{,}000\ \text{(747s)}\ +\ 80{,}000{,}000\ \text{(727s)}}{432{,}000{,}000\ \ +400{,}000{,}000} = \frac{123{,}200{,}000}{832{,}000{,}000} = .1481$$

Payroll Factor:

$$\frac{6{,}000{,}000\text{(n.p.)}\ +\ 8{,}880{,}000(.148\text{x}60{,}000{,}000)\text{(flight)}}{100{,}000{,}000} = \frac{14{,}8800{,}000}{100{,}000{,}000} = .1488$$

Average ratio: (.1291 + .1481 + .1488)/3 = .4260/3 = .1420

Taxable Income in State X: .1420 x $1,000,000 = $142,000

Tax Liability to State X: .10 x $142,000 = $14,200

Example 2: Same facts except that paragraphs 6 and 7 are changed to read:

6. It has the following within state Y:

a.	6% of its 747 flight departures (.6 x $432,000,000)	$25,920,000
b.	31% of its 727 flight departures (.31 x $400,000,000)	$124,000,000
c.	3% of its n.t.p. (.03 x$200,000,000)	$6,000,000
d.	7% of its n.p. payroll (.07x$40,000,000)	$2,800,000

7. State Y has a corporate tax rate of 6.5%.

The airline's tax liability to state Y would be determined as follows:

Property Factor:

$$\frac{25{,}920{,}000\ \text{(747s)}\ +124{,}000{,}000\ \text{(727s)}\ +\ 6{,}000{,}000\ \text{(n.t.p.)}}{432{,}000{,}000\ \ +400{,}000{,}000\ \ +200{,}000{,}000} = \frac{155{,}920{,}000}{1{,}032{,}000{,}000} = .1511$$

Sales Factor:

$$\frac{25{,}920{,}000\ \text{(747s)}\ +124{,}000{,}000\ \text{(727s)}}{432{,}000{,}000\ \ +400{,}000{,}000} = \frac{149{,}920{,}000}{832{,}000{,}000} = .1802$$

Payroll Factor:

$$\frac{2{,}800{,}000(\text{n.p.}) \quad + \; 10{,}812{,}000(.1802\text{x}60{,}000{,}000)(\text{flight})}{40{,}000{,}000 + 60{,}000{,}000} = \frac{13{,}612{,}000}{100{,}000{,}000} = .1361$$

Average ratio: (.1511 + .1802 + .1361)/3 = .4674/3 = .1558

Taxable Income in State Y: .1558 x $1,000,000 = $155,800

Tax Liability to State Y: .65 x $155,800 = $10,127