

MULTISTATE TAX COMMISSION
AIRLINE REGULATION HEARING

December 6, 1982
Denver, Colorado

Hearing Officer: Chris Eliopoulos, Assistant State Solicitor General, Department of Law, Denver, Colorado. I have been appointed pursuant to Article VII of the Multistate Tax Compact and Section 7(e) of the Multistate Tax Commission Bylaws as the Hearing Officer to conduct this hearing today. With me is Mr. Eugene F. Corrigan, Executive Director, Multistate Tax Commission. At this time I would ask Mr. Corrigan to make a statement for the record as to what notice and method was used to give notice of this meeting.

Corrigan: I might note that we had a prior hearing on a proposed airline regulation on March 22, 1978 and that the regulation which was proposed then has been substantially changed as a result of that hearing and of subsequent conferences with personnel of airlines, of the ATA and of states. The notice of this hearing was given by publication in the Multistate Tax Commission Review of October 1982, Volume 1 No. 4, which was distributed in October. Those present here are: Cassie Bradley of Federal Express; Bill Dowd of TWA; Bob Novy and Bill Zermuehlin of United Airlines; John Choinier of Republic Airlines; Dave West of the Air Transport Association; Tom Currigan of Continental Airlines; Dave Heiss and Bill DeSantis of Western Airlines; William Speckman, Assistant Conferee, Colorado Department of Revenue; Bill Folk of Frontier Airlines; John Mintken, Alaska Department of Revenue; and Steve Krenkel, of the Minnesota Department of Revenue.

We have received some responses from states which I will ask to be introduced into the record. Our procedure allows for accepting further correspondence within the next couple of weeks. I have a letter of commentary from Robert Kessel, of the Alaska Department of Revenue; one from Gerald Goldberg of the California Franchise Tax Board raising some questions; one from the California State Board of Equalization; one from Mr. Nike Thompson of the Missouri Department of Revenue; one from Robyn Godwin of the Oregon

Department of Revenue; and one from Dave Duncan, Chairman of the Utah State Tax Commission. We will introduce those into the record.

Officer: We will make that correspondence available to anyone here who wishes to review it now. We can go off the record to give you the opportunity to look at it. Let the record reflect that we are meeting in Room B200 of the United Airlines Flight Training Center in Denver, Colorado. Anyone who wants to make an oral comment will be invited to come to the chair on my left. At this time we will go off the record for a few minutes to allow a review of the correspondence.

Corrigan: I request that there be included in the record of the hearing the letters to which I made reference earlier. A copy of the hearing officer's complete report will be distributed to each person who is present today unless we are directed otherwise.

Officer: Are there any comments as to the jurisdiction of the Multistate Tax Commission to hold this hearing today? Any comments on the adequacy of the notice? If there are no comments, we will proceed with any discussion, oral or written, that you wish to submit. I ask the speaker to identify himself or herself at the beginning of each presentation.

Corrigan: Mr. Chairman, Mr. William Dowd of Transworld Airlines has submitted for inclusion in the record a paper entitled "Comments of Air Transport Association of America Concerning the Multistate Tax Commission Proposed Regulation Governing the Apportionment of the Net Income of an Airline for Purposes of Income Taxation." It is dated December 6, 1982.

Dowd: (Mr. Dowd then read the paper referred to above.)

Officer: Thank you, Mr. Dowd. Are there any questions to be directed to Mr. Dowd by the Executive Director or any other party at the hearing? There will be a comment by the Executive Director.

Corrigan: The basic problem that we have is the problem of 100% accountability versus something less. I have been in contact with the ATA, primarily with Dave West in the past couple of years, and have asked for input from the airlines. The result, though, has always been a stalemate because of the different philosophical bases for the two approaches. The departures approach was finally adopted for this purpose because it appeared to come closest to providing the full accountability for which we are looking. The fact is that the Uniformity Committee of the Multistate Tax Commission has emphatically indicated on

behalf of the tax administrators of the member states that 100% full accountability is a must in any regulation which is to be proposed. We are still in the position of being willing to work with the airlines to arrive at a fair distribution of the income, but that very word "distribution" obviously is offensive to the airlines. I can understand your position on that. I hope that you can understand ours.

The failure to have a broad meeting with the airlines is not of my choice but comes from my understanding that the ATA's Task Force has been serving that purpose in its own behalf. I would certainly be willing to consider any alternative regulation aimed at arriving at a fair distribution of income so that we would have full accountability. Whether a state then wanted to tax all of the income which might be attributable to it under that guideline is something for each state to decide. We are looking for a uniform approach to the attribution of a maximum amount of income attributable to a state. The flyover mileage under the proposal from the airlines falls nowhere. You have all heard us refer to that as nowhere income, which does not fit into the philosophy of 100% accountability. There is where our differences become somewhat difficult.

There were a couple of other items aside from that. We used departures instead of some other esoteric approaches because, in discussions with the ATA staff, we were informed that the result would be roughly the same as if we took some other alternative approaches. We had considered revenue miles, and some states still think that maybe there is merit in that. We have been given to understand that the airlines now think there will be merit in that. I would suggest that, if we are to have productive discussions of this approach, we should have some constructive input from the airlines.

Under the proposal made by the airlines, we simply had nowhere income and we would obviously want to eschew that type of a situation. It is my understanding that the information that we were requiring in this proposal is information which might not be as readily available as was contemplated at the time when it was put together...that CAB requirements have changed and that an alternative approach to the regulation might be advisable because of that. We are certainly open to suggestions on that. At our annual meeting in July, Bill Zermuehlin suggested that the original cost provision in our regulation might run afoul of the safe harbor lease possibility. I would think that we might cover that type of situation by putting in some phrase saying "disregarding any safe harbor lease, sale or leaseback situation." But would that really cover the problem? Before you answer, I might also mention that I consider rental

transportation versus rental equipment a possible problem area that I would like to have some feedback on. With that Mr. Chairman, I invite further comment.

Officer: Mr. Dowd, I will give you the opportunity to respond. I want everybody to keep in mind that we are not here in an argumentative type of hearing. We are here to develop the ideas, whether they conflict or are contradictory, in an unargumentative sort of way.

Dowd: I think Mr. Corrigan has put his finger on the problem very eloquently. The concept of the distribution is one that we find particularly repugnant. In our judgment the essence should be whether a formula appropriately measures the economic activity of an airline in that particular jurisdiction. Simply to take the whole and attempt to divide it into parts and let the chips fall where they may is not in the best interests of the states or the airlines. And I think we have shown through negotiations with particular states that agreement can be reached where a particular formula may not, if it were adopted by all states, result in 100% accountability. I think that the preoccupation with that one tenet is what has created most or all the problems existing between the MTC and the airlines. I am not sure that we will ever be able to reach agreement on that.

But I think that we have, with some of your membership, and so I still hold the hope that at some point we could demonstrate that what we are measuring is fair with respect to the states in which we are doing business and that they should not be concerned with income other than that attributed to themselves.

I note with particular interest the comments from the State of Missouri in which they appropriately pointed out that, if you allocate or apportion revenues on the basis of arrivals and departures, you are going to benefit Missouri to the detriment of some of the sister states. Even though they would benefit greatly, they seem to me in their correspondence to express some reservation to this adoption. I think that is the same way that we feel.

We should take a look at what an airline does in a state, the income that is actually generated, (I am not talking about pure sourcing or separate accounting but an attempt to really measure the activity that is performed in that state), and we feel our proposal does just that.

Officer: Before we go any further, I should like the record to make clear that there seems to be some confusion with the word distribution. Is it correct that you are saying that the MTC wants to distribute all income even though it would not legally allocate to each state the income derived from sources other than that state?

Dowd: Yes.

Officer: In other words, the airlines' position is that by legally allocating to each state income earned from sources within that state there might be 100% of the income not taxed.

Dowd: That is possible. And we see the concept of distribution as one that says there is a whole and, as long as I whack it up and piece it out, I've met my test irrespective of whether one state is benefitted or detrimented according to the activities carried on in that particular state.

Officer: I just wanted to know how that word "distribution" was used and I think that you have cleared that up. Mr. Corrigan, any reply?

Corrigan: I am curious to know how a state would be affected detrimentally.

Dowd: I think the possibility exists for a large state which on a mileage or an airtime concept because of its geographical size would in effect be responsible in our judgment for the generation of significant revenues to not have those revenues because of the activity at its airport in that particular state.

Corrigan: Are you thinking of a particular state?

Dowd: I can think of some of the big midwestern states like Nebraska or something like that.

Officer: Do we have any other comments or questions? Mr. West, the Chair recognizes you. Could you come up.

West: My name is David West. I am Director of Taxation for the Air Transport Association. I would like to offer some written comments, more in the nature of mechanics than involved in the discussion of whether or not the factors are appropriate. I want to elaborate a little bit on what Mr. Corrigan said earlier.

There has been concern expressed within our industry about the continued availability of some of the statistical data that has been used historically. That stems from the fact that the Civil Aeronautics Board, as a Federal agency, is due to go out of existence. The requirement that airlines continue to maintain economic and financial data on a consistent basis and report it to the government agency will be discontinued. As a matter of fact, it has already been discontinued for a number of the airlines. The members of the Air Transport Association are more the older members, although there is change occurring with new members coming

on the board. I would simply suggest that it might be worthwhile to continue the dialogue with the MTC staff as it relates to the mechanics of the statistics and how they are to be derived and how they are to be measured. There is a debate in our membership as to the proper way to weight a departure factor and I think that that in itself ought to be resolved among ourselves beyond the question of whether we agree with the 100% factor.

Corrigan: I certainly am receptive to that, and so is our membership. Our membership is becoming anxious that we conclude our deliberations with some speed. As you know, there was a strong inclination at the last annual meeting to adopt the regulation in its present form. The Executive Committee unanimously directed that the regulation be submitted for approval of the full Commission at that meeting. They made that recommendation on the day before the full general session of that meeting. I delayed such action by requesting, at the last minute in response to requests from you, Mr. West and Mr. Zermuehlin, that we first conduct this type of a hearing. At this point I consider it imperative that we come up with a workable regulation very shortly. I would propose that we put approximately a two month deadline on doing so. I think we need to have something ready to submit to the Executive Committee when it next meets which will probably be sometime in late February.

So I urge the airlines to cooperate you and the Task Force to help us to come up with an acceptable proposal which is within the philosophy of our Commission.

I am not the Commission. I try to represent the member states. When I indicate to you that, regardless of what may have happened in one state or another in connection with your negotiations, our membership is very concerned about the 100% accountability, I can assure you that I am speaking on behalf of that membership. However, I would propose that, assuming that we can come up with a regulation which, within that philosophy, distributes the income or attributes the income fairly (and of course fairly has different definitions depending upon one's perspective), we then present it to the Executive Committee. I would propose, and I have not mentioned this with the Executive Committee but I am sure that they would find it acceptable, to have the members of your industry present at the time. That would give you (assuming that we have a proposal in a form ready to make such a presentation; and it is important that we do) the opportunity to discuss face to face with some ten or more of our tax administrators the entire philosophy of the regulation before them. Would that prove to be acceptable to you, do you think?

Dowd: Let me make sure I understand that. Are you suggesting that, if we had a formula that provided for 100% accountability, then we could meet as opposed to...

Corrigan: Well, I would insist upon one that did that because this is what the states are also insistent upon. I cannot speak on behalf of the Executive Committee but I would propose to them that, when we present to them whatever regulation we do, the industry have the opportunity to come in and discuss that or any alternative proposal that you may have. Now, your alternative proposal which is the one that you and Dave West presented to me some 18 months ago, is one which has been given consideration before and will receive it again because it will be included in the transcript of this hearing and will be distributed to all the member states. I am concerned that, while we may disagree in principle, you be satisfied that you have at least had the chance to present your case.

Dowd: I appreciate that.

Officer: Do we have any other comments?

Corrigan: Given the changes in the government requirements because of the phasing out of the CAB, is the departure approach applicable or appropriate or will it result in a fair distribution of income, or as fair a distribution of income as any other approach, given the 100% accountability philosophy; and, if it won't, do you have any suggestions for alternatives?

Dowd: I think we have two questions here. First, I guess because you are putting it into the context of the CAB, I suspect that you are asking whether the statistics will be available. I think there is still a doubt that departure statistics will be available. The second part of the question is whether it is as equitable as any other measure of distribution system. I think this would have to be answered in the negative.

Corrigan: Do you have an alternative then.

Dowd: Well, I think that this is something we would have to discuss. But our alternative would have to be something that actually measures the generation of income as opposed to a purely terminal statistic which, in our presentation this morning, we pointed out just briefly the disparity we would be getting and the problems that can be created when you rely entirely on a terminal factor formula. Our proposal which contains arrivals and departures is used in a mix with the linehaul which then gives it a lot more credibility. I think by itself it has no validity in the distribution system.

Corrigan: I found your example unimpressive solely because you are talking about one flight versus another flight. When I look at the question, what I am looking for is an answer to whether or not the formula distorts the overall income of the industry or specifically of the taxpayer in question. I recognize that, in any formulary approach, there may be some disparity one way or another. My overall question is Do they pretty much work out so that on the average there is a fair distribution? And, if not, what is an alternative? The problem that we have with the so-called linehaul is that the flyover mileage doesn't land anywhere with the result that the income doesn't land anywhere.

Dowd: I am not suggesting that we would not agree with 100% accountability but I think you can work linehaul factors into 100% accountability formulas just as well as you can terminal factors.

Corrigan: If you can come up with an approach that will do that then I urge that we work very hard to do so.

Dowd: I want to make myself perfectly clear that this is not to suggest that we can agree with that type of a system. It is strictly in response to your question as to whether arrivals and departures in fact accurately reflect operations in a system of distribution. I think our answer to that would be no. If we were in your position and looking for 100% accountability and for something which had more credibility, it would have to be a linehaul system.

Corrigan: Mr. Chairman, I would comment that I am very anxious to arrive at anything that, given the 100% accountability philosophy, will give as fair a distribution as any other. I would hope that we could work very zealously on that in the next few weeks and come up with the proposal which will best accomplish that between the industry and the states.

Dowd: That puts us in a rather difficult position in the sense that we are totally opposed to the concept of 100% accountability.

West: May I elaborate the answer I think that I would like the record to reflect: the fact that 100% accountability in the context that we have been discussing divides 100% of an airline's operation between the points where departures take place. In operations between those points of departure, for many of our members, are miles flown outside the continental limits of the United States over either Canada, a foreign country or a republic in the Pacific Ocean or the Caribbean or Mexico, as the case may be. We are very concerned in our industry that those activities which occur outside of the continental borders of the United States would be attributed to points of

departure. We find that to be repugnant in the system. The way that that has been dealt in the airline proposal is to incorporate miles flown factors. I would like to comment at this time that miles flown will be another statistic maintained on an ongoing basis by the airline if for no other reason than that mileage will be the basis that determines payments from the post office for carrying the mail.

Officer: Do we have any further comments or discussion?

Folk: My name is Bill Folk. I am the Tax Manager for Frontier Airlines. I would just like to make a brief comment. I know that the mileage factor probably presents the most difficulty to the Commission, but Frontier has been involved in income taxation allocation problems in many of the states which are members of the MTC. All of those analyses of allocations seem to indicate to me that the fairest way you could do it is on a mileage or RPM basis, something that contains the true economic revenue producing activity of the airline. Again, I realize that it is probably the most difficult way to go but I would not want to see the Commission just turn away from that. Arrivals and departures will produce 100% accountability and 100% taxation but that factor ignores the geography which I think is important in the transportation industry and relative weightings as to which are the most profitable and which are the least profitable routes. For those reasons I would hope the Commission would seriously consider the mileage factor because I think that it truly is the best way to go.

Corrigan: Of course, we are concerned about so-called flyover mileage because, at least in our view, that is where much of the non-attribution of income exists. I know that in two states, Colorado and Montana, flyover mileage is somehow attributed to the states. My understanding, though, is that that is done on a custom basis, that those types of figures are not maintained by the airlines in the normal course of their statistical maintenance). I wonder what your comment on that might be, Mr. Folk.

Folk: Well, as I said, it is certainly the most difficult way to go for many reasons. I can only speak for Frontier. Frontier does have the information. Now I realize many other carriers don't have the information that we do but it is possible to get the kind of information that would be required for a mileage formula.

Corrigan: Including flyover?

Folk: Including flyover.

Officer: Any other comments or discussion?

Corrigan: I wanted to raise the question as to whether, aside from those considerations which have been expressed, there are any other comments which might be aimed at or concerned about the freight industry. In other words, in what we propose or whatever regulation we ultimately come up with here for the attribution of income, are we giving appropriate consideration to the freight portion of it? If our regulation is applicable to passenger operations, is it equally applicable to freight operations? Should we split them off in any way? Should we treat them the same way? Do we affect Federal Express and Purolator and some other companies of that nature in roughly the same way? Should we treat them the same as we do other aspects of air transportation operations?

Officer: May we have a response?

Bradley: I'm Cassie Bradley of Federal Express Corporation. Our operations are very different from those of other airlines. Anytime that you get a departures effect in any factor it is going to have to be somewhat adjusted for Federal Express because of the nature of our business, everything being hauled in and hauled out of Memphis. We don't have planes where things are offloaded and onloaded. Everything goes out at night and comes in in the morning. So, where you get departures, you get a very distinct distortion with Federal Express dependent upon whether a city is a terminating city or a middle city. For instance, if a plane goes from Memphis to Albuquerque to Los Angeles, we would have two departures a day if Albuquerque is not a terminating city. So if it was an intermediate city, you would have two departures, one going west and one coming east. If it was a terminating city, you would only have one. It would land once and would depart. But it would have the same amount of freight because, when it goes out in the morning there will be offloading freight and when it comes back there will be onloading freight. So anything with departures I think would be highly distorted for us. As far as revenue miles are concerned, any sort of time factor I think would be as appropriate for us as it would be for other airlines. We also have extensive ground operations. This would have to be taken into account, because all of our revenue is not strictly air revenue, and is not broken out.

I think that whatever finally is done for the airlines as a whole would have to be a starting point for the freight companies. I think that, because of the factors that I've raised, what is developed for the regular industry would have to be adjusted for freight. I don't think that there's any way around that.

Corrigan: Would you have any suggestions as to an approach that might be more pertinent or more appropriate for either your part of the airline industry or for your airline? Or would you be willing to consider that, at any rate?

Bradley: Certainly we would be willing to consider it. I think that there are going to be the two main areas of concern: air receipts and ground receipts...we don't split them out. We charge one price for pickup of the package, loading it on the plane, taking it to the destination, offloading it onto a truck to be delivered to the person on the other end. To me that is going to be the main problem. I don't know if other freight companies have their price the same as we do.

Corrigan: Would the sourcing of the mailing in each case be a more appropriate approach and do you keep track in that manner in your airline?

Bradley: We do not keep track of totally originating revenue. What we do keep track of is a 50% split. For instance, in our P&L statements, we have had half inbound, half outbound going to that station. Many states have accepted that. I'm not sure that that's the most equitable way. I'm not sure that it accurately reflects the revenue-producing activity that has taken place.

Corrigan: We would certainly be willing to consider any formula that would reasonably reflect income producing activity. We don't know of any formula or accounting procedure which "accurately reflects" because one has to make so many assumptions in trying to do so; but we are certainly willing to consider any recommendation along that line.

Bradley: We also have the problem in that a great portion of our revenue producing activity occurs in Memphis. I think that something would have to be tailor made for Federal Express.

Corrigan: Do Purolator, Emery and other competitors, operate similarly to Federal Express, having a central distribution point to which all packages go and from which they are then outflown?

Bradley: I don't believe that there is any competitor that has one central distribution point. I know that most of them have maybe four or five regionalized distribution points so they would have something of the same problem but it would certainly not be to the same extent. I'm not really sure how their activities go as far as offloading and onloading freight is concerned. But when you get into freight, you have some of the same problems as

the regular airlines; but, in addition to those problems, you have a whole different set of problems that will have to be contended with.

Officer: Ms. Bradley, you or your company have not submitted any written comments?

Bradley: No we have not.

Officer: For the record, you have been invited to submit comments specifically directed towards your type of operation. Let me ask another question: Are you in agreement with the proposed regulation which has been presented by the ATA today?

Bradley: To be quite honest, I just received the proposed regulation this morning. I haven't looked at it in detail. So I will refrain from making any comments on it.

Officer: Any further comments?

Corrigan: I will arrange, when the Hearing Officer has completed his report, to distribute that to everyone who is here. May I, in sending it to you, Dave West, count on your making it available to all of the members of the Task Force and of your association in general?

West: I will redistribute it as soon as I receive it.

Officer: Upon closing, may we make sure that Mr. Corrigan has everybody's name, title and address? No further comments or discussion? It is now 10:20PM. I call the meeting to an end. I understand that the Multistate Tax Compact as well as the bylaws of the Multistate Tax Commission provide for at least one public hearing and that we are at liberty at this time to conform with what Mr. Corrigan suggested, i.e. that further comments in writing will be accepted. We have jurisdiction to do so. I think that the issues are well formed, the positions are well taken at this time. I also understand that there will be an invitation to industry to participate in a meeting with the Executive Committee of the MTC. Is that correct?

Corrigan: I will recommend that to the Executive Committee. I cannot speak for them yet but I think they will accept that.

Officer: I think that there should be some time frame here. What would be reasonable, Mr. Corrigan?

Corrigan: I would suggest two weeks for additional written comments, proposals, recommendations.

Dowd: I think two weeks would be fine but I don't suspect that we will submit any more.

Officer: The point is that you do have an opportunity to submit something further but we will place a timeframe on it within two weeks from today.

Corrigan: We're only speaking specifically about including something you want included in the hearing record. We're not talking beyond that.

Officer: There will be a time frame of two weeks for submission of anything further to be included in the record of today's hearing. Comments, of course, will be accepted at any time between now and any redrafting of the regulation. After two weeks those comments will not be included in the official record of this hearing.

MULTISTATE TAX COMMISSION
AIRLINE REGULATION HEARING

December 6, 1982
Denver, Colorado

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