airline Regs

TWA

605 THIRD AVENUE, NEW YORK, NEW YORK, U.S.A. 10016

April 29, 1981

Mr. Eugene F. Corrigan
Executive Director
Multistate Tax Commission
1790 30th Street
Boulder, Colorado 80301

Dear Gene:

At our meeting on February 11, 1981, Dave West and I outlined an apportionment formula which we believe may form the basis of a compromise between state tax administrators and the airline industry. At the conclusion of the meeting, you asked us to present our proposal in a more formal manner, accordingly we are enclosing a draft regulation which details our proposal.

As you well know, the airline industry has steadfastly maintained that the only reasonable method of allocating income to the various states for purposes of income taxation is a one factor formula based on revenue passenger miles. The proposed formula represents a significant departure from that position.

The regulation proposed by MTC in 1977 consists wholly of terminal factors and in our opinion does not realistically reflect the operations through which an airline derives its income. We believe that the formula presented in the draft regulation enclosed fairly measures the economic significance an airline has on a particular jurisdiction. As such it fairly apportions to a state the income which is reasonably attributable to that state. It should be noted that the proposal includes a situs or terminal element in the numerator of each of the three factors, ground property, ground personnel payroll and situs sales. The inclusion of this element takes into account the activities performed on the ground by an airline and allocates income to the state accordingly. In addition to distributing terminal property, payroll and sales, situs activities are further taken into account through the use of an arrival and departure factor when allocating flight property, flight wages and flight revenues. Thus the proposal presents a balance between an all terminal apportionment formula as proposed by the MTC and an all line haul proposal consistently endorsed by the airlines.

In order to help you evaluate our proposal, we compiled some statistics which measure the increase the adoption of such a formula would have over the use of a mileage formula. Several airlines were asked to compute an allocation factor for a certain state (currently an MTC member) under a mileage formula and then to compute an allocation under the proposed formula. Three responses have been received and while we would like to have shown you more at this time, we felt that we should not delay submitting the draft regulation to you. We will provide you with further comparisons as they are received. You will note that in each case there is a marked increase:

	Mileage Factor	Proposed Formula	Increase/(Decrease)
Airline A	27	32	19%
Airline B	9.4	11.7	25%
Airline C	0.57	0.68	21%

We request that you and the member states of MTC seriously consider the proposal presented. If you have any questions or desire any further information, we are at your disposal.

Very truly yours,

Bill Dowd

William Dowd, Director-
Tax Research & Planning

cc: D. West - ATA

Horace Gailey, Supervising Auditor
Corporate Franchise Division
State Tax Commission
Salt Lake City, Utah 84134

Enclosure

DRAFT REGULATION FOR APPORTIONMENT OF INCOME

AIRLINES

Special Rules: Airlines The following special rules are established in respect to airlines:

A. 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 this regulation. In such cases, the first step is to determine which portion of the airline's income constitutes "business" income and which portion constitutes "nonbusiness" income under Article IV.1 and Regulation IV.1 thereunder. Nonbusiness income is directly allocable to specific states pursuant to the provisions of Article IV.5 to .8, inclusive. Business income is apportioned among the states in which business is conducted pursuant to the property, payroll, and sales apportionment factors set forth in this Regulation. The sum of (1) the items of nonbusiness income directly allocated to this state, plus (2) the amount of business income attributable to this state constitutes the amount of the taxpayer's entire net income which is subject to tax by this state.

B. Business and Nonbusiness Income. For definitions and rules for determining business and nonbusiness income, see Reg. IV.1.

C. Apportionment of Business Income.

1. The Property Factor.

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

b. General Definitions. The following definitions are applicable to the numerator and denominator of the property factor:

(1) The "value" of owned real and tangible personal property shall mean its original cost. (See Article IV.11. and Reg. IV.11.(a).)

(2) "Original cost" means the initial federal tax base of the property plus the value of capital improvements to such property. (See Reg. IV.11.(a).)

(3) "Average value" of property means the amount determined by averaging the values at the beginning and ending of the income year, but the Department of Revenue 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.11 and Reg. IV.12.)

(4) 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 Reg. IV.11. (b).)

(5) "Net annual rental rate" means the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

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

(7) "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's routes.

(8) "Airtime (hours)" means "hours ramp to ramp" as defined in the Civil Aeronautics Board (CAB) Uniform System of Accounts.

(9) "Airtime (hours) in this state" means the number of hours computed from the time an aircraft leaves a terminal in this state until it crosses the border of this state plus the number of hours computed from the time an aircraft crosses the border of this state until it comes to rest at a terminal in this state.

(10) "Arrivals and departures" means the number of times that an aircraft lands or takes off from an airport in revenue service.

(11) "Arrivals and departures in this state" means the number of times that an aircraft lands or takes off in revenue service from an airport located in this state.

c. <u>The Denominator and Numerator of the Property Factor</u>. 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, and Reg. IV.10. - .12, inclusive.

Aircraft ready for flight shall be included in the numerator of the property factor in the same ratio as sales (revenue) from hauling passengers, freight, mail and excess baggage is included in the sales (revenue) factor as determined under 3. below.

2. <u>The Payroll Factor</u>. The denominator of the payroll factor is the total compensation paid everywhere by the taxpayer during the income year. (See Article IV.13. - .14. and Rev. 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 nonflight personnel, compensation paid to such employees shall be included in the numerator as provided in Article IV.13 - .14 and Reg. IV.13. - .14. With respect to flight

personnel (the air crew aboard an aircraft assisting in the operation of the aircraft or the welfare of passengers while in the air), compensation paid to such employees shall be included in the same ratio as sales (revenue) from hauling passengers, frieght, mail and excess baggage is included in the sales (revenue) factor as determined under 3. below.

3. Sales (Revenue) Factor. All revenue derived from transactions and activities in the regular course of the trade or business of the taxpayer which produces business income is included in the denominator of the revenue factor. (See Article IV.1. and Reg. IV.1.) The numerator of the revenue factor is the total revenue of the taxpayer in this state during the income year. In determining the numerator of the revenue factor, revenue from hauling passengers, freight, mail and excess baggage shall be attributed to this state based upon: (a) the ratio which the airtime of the taxpayer's aircraft spent in this state bears to the total airtime (ramp to ramp) of such aircraft everywhere, by type of aircraft weighted at 80%; and (b) the ratio of arrivals and departures in this state to total arrivals and departures everywhere by type of aircraft weighted at 20%. Airtime and arrivals and departures by type of aircraft shall be used in computing revenue attributable to this state derived from hauling passengers, freight and mail. Receipts from other business activities shall be included in the numerator in accordance with statute.

If records of actual revenue by type of aircraft are not maintained, the total revenue shall be divided into passenger and freight (which shall include express, excess baggage and mail) revenue and allocated to aircraft type on the ratio of the revenue passenger ton-miles and revenue freight (which shall include express, excess baggage and mail) ton-miles of such type, respectively. Expressed as a formula, the computation for each type of aircraft would be:

$$\frac{\text{Revenue Passenger Ton-Miles by Type}}{\text{Total Revenue Passenger Ton-Miles All Types}} \times \text{Total Passenger Revenue} = \text{Passenger Revenue by Type}$$

$$\frac{\text{Revenue Freight Ton-Miles by Type}}{\text{Total Revenue Freight Ton-Miles All Types}} \times \text{Total Freight Revenue} = \text{Freight Revenue by Type}$$