[DISCUSSION DRAFT 11/1/24]

[All changes from the current text of IV.18.(e), other than changes/additions to the mathematical equations in the Examples, are blacklined.]

[All changes/additions to the mathematical equations in the Examples from/to the current model are highlighted in blue, rather than blacklined.]

[Key language additions in this discussion draft which were not part of the 6/27/23 discussion draft are highlighted in yellow. Note that if language was added to the current model by the 6/27/23 discussion draft, but deleted in this draft, the deletion is not indicated.]

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

The following special rules apply ~~are established with respect~~ to airlines and, with respect to the sourcing of "points" or "miles," also apply to certain other taxpayers that are related to an airline:

Drafter's Note: The provision of this Reg. IV.18.(e) relating to the sourcing of receipts from the sale of certain "points" or "miles" applies not only to airlines but also to any taxpayer that is related to an airline under Reg. IV.17.(a).(3)(H). See Reg.IV.18.(e)(2)(iv)(C).

(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.~~ Except as otherwise provided in this Reg. IV.18.(e), the apportionment provisions of [insert reference to general allocation and apportionment statutes and regulations – see model Compact Art. IV and the model General Allocation and Apportionment Regulations] applies to airlines and related parties, including the definition of "receipts" and the determination of apportionment factors.

(2) Apportionment of Business Income.

(i) General Definitions.

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

A. "Airline" means a taxpayer that transports passengers, freight, or packages by air for a charge and that holds an air carrier certificate issued by the Federal Aviation Authority or a foreign air carrier permit issued by the U.S. Department of Transportation.

B. "Value" of owned real and tangible personal property ~~shall~~ means its original cost. (See Article IV.11. and Reg.~~ulation~~ IV.11(a).)

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

D. "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 Reg.~~ulation~~ IV.11(a).)

E. "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 Reg.~~ulation~~ IV.12.)

F. 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).)

F. "Net annual rental rate" ~~means the annual rental rate paid by the taxpayer~~ has the meaning stated in Reg. IV.11.(b).

G. "Property used during the income year" includes property which is available for use or is capable of being used in the taxpayer's trade or business during the income year. (See Reg. IV.10.(b).)

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

I. "Related party" has the meaning stated in Reg. IV.17.(a).(3)(H).

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

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

K. "Passenger transportation receipts" means revenue earned by an airline from:

I. selling air transportation services to transport passengers and their baggage, including but not limited to the sale of capacity on its aircraft to other airlines or entities in order to transport passengers, the sale of tickets to passengers under agreements (*e.g.*, codesharing agreements) with other airlines, baggage fees, and the sale of "points" or "miles" which may be redeemed by the purchaser or by a third party for air travel whether such "points" or "miles" are actually redeemed for air travel; and

II. selling or renting property or services to be used or consumed by passengers during the course of air transportation, including but not limited to the sale of food or liquor, the sale of on-flight services such as entertainment and Wi-Fi, and the rental of pet crates.

L. "Freight transportation receipts" means revenue earned by an airline from:

I. selling air transportation services to transport freight, packages, or mail, including but not limited to the sale of capacity on its aircraft to other airlines or entities in order to transport freight and the sale of freight transportation services under agreements (*e.g.*, codesharing agreements) with other airlines; and

II. selling or renting property or services to be consumed or used during the course of an aircraft flight.

M. "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 Reg.~~ulation~~ 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 [insert reference to 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)~~ Receipts 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.~~

A. **Denominator.** The denominator of the receipts factor is the total amount of receipts of the taxpayer under [insert reference to general allocation and apportionment statutes and regulations – see model Compact Art. IV and the model General Allocation and Apportionment Regulations] during the income year except for receipts from the sale of aircraft.

Drafter's Note: Note that the definition of "receipts" in the model General Allocation and Apportionment Regulations (Reg. IV.17) excludes interest and dividends.

B. **Numerator**. The numerator of the receipts factor is the total amount of receipts of the taxpayer in this state during the income year. The total receipts of the taxpayer in this state is:

(I) the taxpayer's transportation receipts in this state during the income year; and

(II) any other receipts attributable to this state during the income year under [insert reference to general allocation and apportionment statutes and regulations – see model Compact Art. IV and the model General Allocation and Apportionment Regulations] except for receipts from the sale of aircraft.

The taxpayer's transportation receipts in this state during the income year is determined by multiplying the taxpayer's transportation receipts by the departure ratio. The departure ratio is the ratio of the number of departures of its aircraft in this state weighted by the value of aircraft by type to the number of departures of its aircraft everywhere weighted by the value of aircraft by type.

C. If a taxpayer and an airline are related parties under Reg. IV.17.(a).(3)(H), but the taxpayer is not an airline, the taxpayer will source any receipts from its sale of "points" or "miles" that may be redeemed by the purchaser or by a third party for air travel by applying the departures ratio applicable to the related airline.

(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~~ Airline A 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 transportation 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~~ Receipts Factor:

$$\frac{\dfrac{43{,}200{,}000\ (747s) + 80{,}000{,}000\ (727s)}{432{,}000{,}000 + 400{,}000{,}000} \times \$50{,}000{,}000}{\$50{,}000{,}000} = .1481$$

Payroll Factor:

$$\frac{6{,}000{,}000\ (n.p.) + 8{,}880{,}000\ (.148 \times 60{,}000{,}000)(flight)}{100{,}000{,}000} = \frac{14{,}880\cancel{0}{,}000}{100{,}000{,}000} = .1488$$

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:

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

~~Sales~~ Receipts Factor:

$$\frac{\dfrac{25{,}920{,}000\ (747s) + 124{,}000{,}000\ (727s)}{432{,}000{,}000 + 400{,}000{,}000} \times \$50{,}000{,}000}{\$50{,}000{,}000} = .1802$$

Payroll Factor:

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

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

Example 3: Same facts as example 1, except that the airline sells $10 million of swag at U.S. airports, with 10% of swag sales occurring at airports in State X (thus increasing receipts from operations to $60 million), and earns $1 million of interest income from various bank accounts:

Receipts Factor

$$\frac{\left(\frac{43{,}200{,}000 \text{ (747s)} + 80{,}000{,}000 \text{ (727s)}}{432{,}000{,}000 + 400{,}000{,}000} \text{ x } \$50{,}000{,}000\right) + \$1{,}000{,}000}{\$60{,}000{,}000} = .1401$$

Example 4: Same facts as example 1, except that Airline A's receipts include the following:

(1) $3 million from its sale of plane tickets are to passengers who will fly on airplanes operated by Airline B pursuant to a codesharing agreement between Airline A and Airline B; and

(2) $2 million received from Airline C pursuant to a codesharing agreement between Airline A and Airline C. Under this agreement, Airline C sold plane tickets to passengers who will fly on airplanes operated by Airline A and remitted a portion (i.e., $2 million) of its receipts from the sale of those tickets to Airline A.

Receipts Factor

$$\frac{\frac{43{,}200{,}000 \text{ (747s)} + 80{,}000{,}000 \text{ (727s)}}{432{,}000{,}000 + 400{,}000{,}000} \text{ x } \$50{,}000{,}000}{\$50{,}000{,}000} = .1481$$

Example 5: Same facts as example 1, except that in addition Airline A sells 5 million "miles" to a credit card issuing bank for a total of $5 million. The bank will award these points to cardholders based in part on each cardholder's card usage. The cardholders may redeem the miles for either air travel or various other goods and services.

Receipts Factor

$$\frac{\frac{43{,}200{,}000\ (747s) + 80{,}000{,}000\ (727s)}{432{,}000{,}000 + 400{,}000{,}000} \times \$55{,}000{,}000}{\$55{,}000{,}000} = .1481$$