Model Receipts Sourcing Regulation Work Group

--Sourcing of Airline Receipts–
Reg. IV.18.(e)

October 3, 2025 meeting

DESCRIPTION OF PROJECT

- At its August 2, 2022 meeting, the Uniformity Committee agreed to undertake a project and form a work group to review **the MTC's** model receipts sourcing regulations, including the MTC's special industry regulations and its market-based sourcing ("Section 17") regulations.

- The goal of this project is to identify updates, corrections or conforming changes, to consider issues that may not be sufficiently addressed by existing model regulations, and to make recommendations to the Uniformity Committee for its action.

POSSIBLE REASONS TO UPDATE THE AIRLINES RULE

- The Rule was adopted by the Commission in 1983. Since then, the air travel industry has changed in significant ways.
- Airlines now receive various substantial streams of revenue that are not expressly addressed by the Rule nor by guidance issued by the states.
- These gaps may create uncertainty both for taxpayers and for revenue agency staff charged with administering the tax laws.
- Unclear rules can allow for multiple interpretations, undermining uniformity and the level playing field as taxpayers choose the interpretation that works best for them.

SALES FACTOR IN THE CURRENT AIRLINES REGULATION

USING A DEPARTURES METHOD TO SOURCE TRANSPORTATION REVENUE

$$\frac{\left(\frac{\textit{weighted in-state departures}}{\textit{weighted total departures}} \text{ x transportation revenue}\right) + \text{non-flight revenues directly attributable to this state}}{\text{transportation revenue} + \text{miscellaneous sales of merchandise, etc. (except “passive income” items)}}$$

“Transportation revenue” is defined as “revenue earned by transporting passengers, freight and mail as well as revenue earned from liquor sales, pet crate rentals, etc.”

The Rule states that “[p]assive 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 DRAFT REVISION RETAINS THE DEPARTURES METHOD FOR SOURCING AIRLINE TRANSPORTATION REVENUE

$$\frac{\text{Weighted in-state departures}}{\text{Weighted total departures}} \times \text{transportation revenue}$$

THE DRAFT UPDATES THE DEFINITION OF TRANSPORTATION REVENUE TO EXPRESSLY INCLUDE RECEIPTS FROM:

- Selling tickets for travel on unrelated airlines under codeshare, interline, and capacity purchase arrangements.
- Selling points or miles to credit card banks or others (with a caveat*)
- Selling or renting property or services to be used or consumed by passengers during flights, such as the sale of <u>food</u> or liquor, the sale of <u>onflight services such as entertainment and Wi-Fi</u>, and the rental of pet crates
- Baggage fees

*THE POINTS/MILES CAVEAT

If the receipts from the sale of points or miles are redeemed for *goods or services unrelated to air travel* either in the tax year in which they are sold or in the following tax year, then the receipts will be treated as receipts other than transportation revenue (and sourced accordingly).

THE DRAFT REVISION WOULD CLARIFY THE DENOMINATOR OF THE SALES FACTOR

The current language states that the denominator consists of "transportation revenue . . . and miscellaneous sales of merchandise, etc." and excludes "[p]assive income items such as interest, rental income, dividends, etc." and proceeds from the sale of aircraft.

Draft language:

The denominator of the receipts factor is the total amount of receipts of the taxpayer under [general sourcing law] during the income year except for receipts from the sale of aircraft.

THE DRAFT REVISION WOULD CLARIFY THE NUMERATOR OF THE SALES FACTOR

The current description of the numerator differs from the description of the denominator. The numerator uses the term "non-flight revenues" and the denominator uses the term "miscellaneous sales of merchandise, etc."

Draft language:

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 [general sourcing law] except for receipts from the sale of aircraft.

ADDITIONAL NON-SUBSTANTIVE LANGUAGE CLEAN-UP

Example

The current language uses the terms “cost” and “value” of aircraft in a confusing and circular manner.

The draft replaces the term “cost of aircraft by type,” which currently is defined as “the average original cost *or* value of aircraft . . .”, with the term “value of aircraft by type”. *See* Reg. § IV.(e).2(i)(C).

”There is no substantive change because the current language elsewhere defines “value” to mean “original cost” which in turn means federal tax basis plus the value of capital improvements.

THE DRAFT REVISION INCLUDES VARIOUS DRAFTER'S NOTES TO PROVIDE BACKGROUND AND TO IDENTIFY ISSUES THAT STATES MAY WANT TO ADDRESS

Examples of drafter's notes:

- p.3. It is the Internal Revenue Code that governs *when* income of an airline must be recognized, not Reg. IV.18 (e). Rather, Reg. IV.18 (e) addresses *where* receipts are sourced.
- p.6. Invites states to consider adopting guidance to address situations where a transportation company transports a passenger or property in part by an aircraft and in part by another means of transportation.

THE DRAFT REVISION INCLUDES VARIOUS DRAFTER’S NOTES TO PROVIDE BACKGROUND AND TO IDENTIFY ISSUES THAT STATES MAY WANT TO ADDRESS

Examples of drafter’s notes (con’t):

- p.6. Notes that in the case where a passenger purchases a ticket from one airline to fly on an aircraft operated by another airline, the receipts of the selling airline will include the entire price for the ticket unless the selling airline acted as the operating airline’s agent or there is some other rule of law requiring exclusion of the gross receipts.

THE REGULATION'S CURRENT EXAMPLES ARE CLARIFIED AND NEW EXAMPLES ARE ADDED

- Current examples are cleaned up, including adding a bit more math to make the equations more intuitive.

- Three new examples are added:

Ex. 3. Addresses the sourcing of receipts that are not transportation receipts and also interest income

Ex. 4. Addresses receipts from the sale of plane tickets pursuant to a codesharing agreement

Ex. 5. Addresses receipts from the sale of airline "miles."

THE DRAFT REVISION DEFINES "AIRLINE" AND PROVIDES THAT CERTAIN OTHER TAXPAYERS ARE COVERED BY THE REGULATION

1. Definition of Airline (§ IV.18.(e).2(i)(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.

2. Taxpayers other than airlines that would be covered by the regulation:

With respect to the sourcing of 'points' or 'miles', other taxpayers that are *related to* an airline. Related parties are defined by Reg. IV.17(a)(3)(H).

Other Topics to be considered by the work group?