



MULTISTATE TAX COMMISSION

Report of the Hearing Officer

Proposal to Revise the MTC Special Industry Rule for Apportioning the Income of Airlines (MTC model Reg. IV.18.e)

April 23, 2026

I. Introduction and Procedural Background

On August 2, 2022, the Uniformity Committee created a project to address the MTC model receipts sourcing regulations, including the special industry regulations. The Uniformity Committee formed a work group to undertake this project. That work group is the Model Receipts Sourcing Regulation Review Work Group (the work group).

At the request of a work group member, the work group examined MTC Model Reg. IV.18.e., which contains the special industry rule addressing receipts of airlines (the airlines rule). The work group eventually agreed on proposed revisions to the airlines rule (the proposal). The proposal is attached as Appendix A.

During the process, the work group considered at least four drafts of changes before agreeing on the proposal. The work group received input from the airline industry through Airlines for America. Their written input is attached as Appendix B.[•] MTC staff prepared a briefing book to describe the proposal and its background in detail. The briefing book is attached as Appendix C.

On November 7, 2025, the work group agreed to submit the proposal to the Uniformity Committee. On February 3, 2026, the Uniformity Committee approved the proposal.

On February 17, 2026, the Executive Committee approved the proposal for public hearing. Notice of the hearing was issued on February 20, 2026. On March 24, 2026, the hearing officer held a public hearing.

This report summarizes the proposal's background and substance, considers the public hearing, and explains the hearing officer's recommendation.

[•] This input was provided to the work group during its deliberations, not during the public hearing.

II. Public Hearing

A public hearing was held after 30 days' notice on March 24, 2026 via Zoom Government. No oral comments were received at the hearing. No written comments were received.

III. Summary of Proposal

A summary of the proposal follows. For more detail, review the briefing book attached to this report as Appendix C.

The proposal addresses the airlines rule, which is contained in MTC Model Reg. IV.18.e. The airlines rule provides for a three-factor formula using property, payroll, and sales. The proposal redesignates “sales factor” to “receipts factor.” This change is nonsubstantive but ensures the language of the airlines rule better matches that of the MTC’s other model rules. This report will use the term receipts factor.

The proposal primarily addresses the receipts factor and related terms. The receipts factor uses a departures approach to source “transportation revenue.” Currently, “transportation revenue” is defined to mean “revenue earned by transporting passengers, freight and mail as well as revenue earned from liquor sales, pet crate rentals, etc.”

The proposal redesignates “transportation revenue” to “transportation receipts,” and amends its definition to include two new terms: “passenger transportation receipts” and “freight transportation receipts.” Focusing on “passenger transportation receipts” is more illustrative. The term 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; 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.

The distinction between the current definition of “transportation revenue” and the proposed definition of “passenger transportation receipts” is the clear inclusion of revenue from “points” or “miles” and of revenue from agreements with other airlines, like codeshare agreements. The proposal demonstrates these concepts through Examples 4 and 5.

The definition of “freight transportation receipts” is designed to maintain the substance of the current rule but also address revenue from arrangements with other airlines, like codeshare agreements.

Finally, the proposal defines “airline” to mean:

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.

IV. Hearing Officer Recommendation

No written or oral comments were received on the proposal. Since the airlines rule was adopted in 1983, the airline industry has changed in significant ways. Airlines now receive streams of revenue not addressed by the airlines rule. *See* MTC Briefing Book, attached as Appendix C. The proposal addresses these streams of revenue in appropriate ways.

The hearing officer recommends the proposal be approved by the Executive Committee unamended.

Respectfully submitted,

Jonathan White
Hearing Officer

Appendix A

Proposed Revisions to the MTC Special Industry Regulation on Airlines Submitted by the Model Receipts Sourcing Regulation Work Group Nov. 18, 2025

[Editor's note: All changes from the current text of IV.18.(e), other than changes/additions to the mathematical equations in the Examples, are underscored or shown with a strikethrough. All changes/additions to the mathematical equations in the Examples from the current model are highlighted in blue, rather than underscored.]

Introductory Note: This Regulation IV.18.(e) includes multiple references to the MTC's model General Allocation and Apportionment Regulations, which can be found at [FINAL-APPROVED-2018-Proposed-Amendments-042020.docx](#). The Commission revised these regulations in 2017 to apply market-based sourcing principles to source the receipts from sales of services and intangibles. Whether or not a state has adopted the MTC's model General Allocation and Apportionment Regulations or any alternative framework using market-based sourcing principles, this Regulation IV.18.(e), can serve as a model to source the receipts of airlines.

•• **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] apply to airlines and related parties, including the definition of "receipts" under Reg. IV.2.(a)(6) and the determination of apportionment

factors. “Revenue” or “receipts” are considered received under this regulation when they are recognized by the Internal Revenue Code.

(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.

~~K. "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.~~

Drafter's Note: The Internal Revenue Code and IRS guidance govern when the income of an airline must be recognized. For example, in the case of the sale of loyalty "points" or "miles," the IRS generally allows airlines to defer the related income until the tax year following the tax year in which the sale occurred (unless the "points" or "miles" are redeemed sooner). See IRS Rev. Proc. 2004-34, Rev. Proc. 2011-18.

This Reg.IV.18.(e) does not address when income of airlines is recognized. Rather, it addresses where receipts are sourced in order to apportion income once recognized under applicable law.

L. “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

* Reg. IV.17.(a).(3)(H) reads as follows:

“Related party” means:

(1) a stockholder who is an individual, or a member of the stockholder's family set forth in section 318 of the Code if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially or constructively, in the aggregate, at least 50 per cent of the value of the taxpayer's outstanding stock;

(2) a stockholder, or a stockholder's partnership, limited liability company, estate, trust or corporation, if the stockholder and the stockholder's partnerships, limited liability companies, estates, trusts and corporations own directly, indirectly, beneficially or constructively, in the aggregate, at least 50 per cent of the value of the taxpayer's outstanding stock; or

(3) a corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of the Code if the taxpayer owns, directly, indirectly, beneficially or constructively, at least 50 per cent of the value of the corporation's outstanding stock. The attribution rules of the Code shall apply for purposes of determining whether the ownership requirements of this definition have been met. [or insert state definition]

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; 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.

M. “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.

N. “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 [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 including aircraft parts.

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

Drafter's Note: In the case of airlines, the receipts factor excludes receipts from the sale of aircraft including aircraft parts because these sales are typically not a regular part of an airline's trade or business and inclusion of the related receipts in the factor may cause the apportionment of the airline's income to not fairly represent the extent of its business activity in the state. Note that under section 18.(a), receipts received from transactions or activities other than the sale of

aircraft including aircraft parts may, under certain circumstances, also be excluded from the factor. See Reg. IV.18.(a).

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 including aircraft parts.

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.

Drafter’s Note. Under the MTC’s model General Allocation and Apportionment Regulations, “receipts” are the amounts realized upon the performance of services in a transaction which produces apportionable income in which the income or loss is recognized under the Internal Revenue Code. See Reg. IV.2.(a)(5),(6). Therefore, in the case where a passenger purchases a ticket from one airline to fly on an aircraft operated by another airline (where the two airlines have entered into a codesharing or similar arrangement), if the selling airline receives a commission for selling the ticket and the Internal revenue Code treats only the commission and not the entire ticket price as income to that airline, then the airline’s “receipts” with respect to the sale are limited to the amount of the commission. See, e.g., The Seven-Up Company v. Commissioner of Internal Revenue, 14 T.C. 965 (1950); IRS Chief Counsel Advice No.202138001 (9/24/2021).

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.

Drafter’s Note: A transportation company may transport a passenger or property in part by an aircraft and in part by another means of transportation. For example, customers may hire a delivery company to deliver a package across the country. That company may typically transport packages in part by aircraft and in part by truck. Under the terms of this Reg. IV.18.(e), the company is an airline and under the Trucking Rule, Reg. IV.18 (g), the company may be a trucking company. These

two special industry regulations impose different sourcing methodologies (departures and mileage, respectively).

To address this situation, states may consider adopting guidance to indicate which of these special industry regulations to apply or to indicate how to allocate the receipts between the various modes of transportation.

(3) Records. The taxpayer must maintain the records necessary to ~~arrive at~~ identify departures by type of aircraft as used in ~~these~~ this regulations. ~~Such~~ These 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 (n.p.)	<u>40,000,000</u>
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 (.15 x \$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:

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

Sales Receipts Factor:

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

$$\frac{\$50,000,000}{432,000,000 + 400,000,000} = .1481$$

Payroll Factor:

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

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

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

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

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:

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

$$\frac{\$50,000,000}{432,000,000 + 400,000,000} = .1802$$

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Payroll Factor:

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

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

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

Tax Liability to State Y: $.065 \times \$155,800 = \$10,127$

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

$$\left(\frac{43,200,000 \text{ (747s)} + 80,000,000 \text{ (727s)}}{432,000,000 + 400,000,000} \times \$50,000,000 \right) + \$1,000,000$$

$$\frac{\$60,000,000}{\$60,000,000} = .1401$$

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

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

$$\frac{\$50,000,000}{\$50,000,000} = .1481$$

Example 5:

Airline A and Major Bank are parties to an agreement which authorizes Major Bank to issue an Airline A branded credit card to consumers. Each card prominently displays the airline's name and logo (as well as the bank's name and logo). The agreement gives Major Bank the right to purchase "miles" from Airline A in bulk. Under the terms of the agreement and consistent with the value of the intangibles and miles, 20% of any amount paid by the bank to the airline will be treated as consideration for the licensing of intangible property, such as the right to use Airline A's logo, and 80% will be treated as consideration for the purchase of "miles."

Major Bank awards the miles it purchases from the airline to cardholders, based in part on each cardholder's card usage. Cardholders may redeem their miles for either air travel or for various other goods and services over time. Assume that under federal tax rules to which the state conforms, recognition of the income for sale of miles may be deferred until the miles are actually redeemed, but no longer than the end of the year following the year in which the miles were sold.

During Tax Year 1, Major Bank pays the airline \$10 million, which, under the agreement, is treated as follows:

<u>Total Amount Paid by Major Bank</u>	<u>\$10,000,000</u>
<u>Amount Treated as Paid for Miles</u>	<u>\$8,000,000</u>
<u>Amount Treated as Paid for Intangibles</u>	<u>\$2,000,000</u>

Tax Year 1: Prior to the end of Tax Year 1, cardholders have redeemed 25% of miles, 90% for travel and 10% for other goods and services. In this year, Airline A includes in its receipts factor the receipts from Major Bank and sources them as follows:

<u>Transportation Receipts - sourced using the weighted departure ratio for that year</u>	<u>\$2,000,000</u>
<u>Intangible Receipts - sourced using the applicable rules for sourcing receipts from sales or licensing of intangible property</u>	<u>\$2,000,000</u>
<u>Total Included in Receipts in Year 1.</u>	<u>\$4,000,000</u>

Tax Year 2: Because in Tax Year 2 Airline A recognizes all the deferred income and receipts from selling miles, even if they have not been redeemed, Airline A includes in its receipts factor the receipts from Major Bank and sources them in Year 2 as follows:

<u>Transportation receipts - sourced using the weighted departure ratio for that year</u>	<u>\$6,000,000</u>
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Appendix B



Airlines for America®

We Connect the World

September 23, 2025

Brian Hamer
Senior Counsel, Multistate Tax Commission
444 North Capitol Street NW, Suite 425
Washington, DC 20001

Re: Draft Airline Regulation

Dear Mr. Hamer,

Airlines for America (A4A), the principal trade association for the leading U.S. airlines,¹ welcomes this chance to comment on behalf of the industry regarding the Multistate Tax Commission (MTC) Model Receipts Sourcing Regulation Review Work Group's Discussion Draft of the Special Airline Rule (the Draft) that was released June 30.

Commercial aviation is a unique and complex industry. At the outset of this project to review the MTC's special industry rules, there was not a good understanding among the various stakeholders about how the industry operates, and we appreciate the MTC staff's diligent work to learn about the industry and understand how the current apportionment rule (Reg. IV.18.(e)) works and has been implemented since it was introduced in 1983. We understand that this draft is intended to align the industry rule with the MTC's model General Allocation and Apportionment Regulations and to not deviate significantly from the tax treatment and understanding of the current rule. However, we have identified three significant issues with the Draft that are discussed below. These issues should be addressed before any vote is taken by the Working Group to send the proposed rule to the Uniformity Committee.

Nevertheless, we strongly prefer the current rule – as it works and has proved itself over the long-term – and urge the Working Group to reject a change.

Defending the Current Rule

Overall, we do not see a need to change the current rule. We appreciate that the MTC has undertaken a review of the special industry rules, but in this case, we do not see sufficient justification to support the change. The current rule has worked well for more than four decades, providing an effective framework for state taxation with enough flexibility to allow the commercial aviation industry to evolve and grow without having to regularly revisit or update the rules, and it has done so with little controversy.

Administrability: The current rule is administrable and provides a good measure of airline activities, balancing the ability of the industry to provide data, the need for the states to analyze that data and the time and cost of doing so. Airlines have developed systems to accurately track and report the necessary information, and the states are receiving the data needed to audit airlines and make determinations. We believe the airlines and the states have had few issues with administering the current system and that it continues to work well.

¹ A4A's members are Alaska Air Group, Inc.; American Airlines Group, Inc.; Atlas Air, Inc.; Delta Air Lines, Inc.; FedEx Corp.; Hawaiian Airlines; JetBlue Airways Corp.; Southwest Airlines Co.; United Airlines Holdings, Inc.; and UPS Co. Air Canada is an associate member.

Appropriate apportionment: Most importantly, the current rule allows the states to collect their fair share of income tax from the airlines. Airlines vary in their business models and offerings, but the current rule accommodates this variation. No system will perfectly apportion income, but the current rule works extremely well and captures the airlines' activities and income. At the outset of this project there seemed to be some concern that evolving product offerings were somehow not being captured in the apportionment formula. Those concerns are not well-founded, and the current rule does not result in states foregoing revenue they are entitled to or in shifting income into inappropriate jurisdictions or giving rise to "stateless" income.

Flexibility: The commercial aviation industry has evolved and grown significantly since 1983, and the current rule has been flexible enough to accommodate these changes. It has provided enough detail to guide airlines and the states without stifling innovation or misallocating income. While more detailed rules might seem to provide better guidance, we fear that the downside is that this could create a lock-in effect, where our tax rules become defined by the state of the industry as it exists in 2025. In such a highly regulated, competitive and low-margin industry, it is certain that aviation will continue to evolve. If the rule is not flexible enough to accommodate these changes as they happen, the rule will require frequent revision or force the states to depart from it out of necessity.

Further, the most substantive argument for more detailed rules – that the lack thereof promotes uncertainty, inconsistency and controversy – is not present in this case. There has been very little controversy over the application of the current rule for many years, unlike the concerns that animated the discussion around rule changes for the allocation of ground transportation income by trucking companies.

Conformity: Finally, many states do not conform to the current rule – such as using a mileage or other approach in lieu of the departures method – as legislators and policymakers have already determined what works best for their state's needs or circumstances. They will continue to do so, even with a new and more detailed rule. The proposed changes will add compliance complexity, even if not intended, for both airlines and the states. This complexity and the lock-in effect noted above may push states to depart from the rules to avoid such challenges. Therefore, this update is not likely to increase uniformity and could undermine it and lead to further inconsistency.

Comments on the Proposed Rule

A4A members have identified the following three issues – the definition of receipts, the treatment of mile sales to third parties and the treatment of transportation sold by one airline but operated by another – that could likely create problems if the current Draft is adopted. For the sake of the industry and the states, these issues should be addressed by MTC staff with updates to the proposal before the Working Group votes on whether to forward a new rule to the Uniformity Committee.

1. Definition of receipts

The Draft changes the use of "revenue" in most places in the current rule to "receipts." We understand that this change is to align the special industry rule with the terminology used in the General Allocation and Apportionment Regulations, but we think that if the draft is adopted, greater clarity about the terms' meaning is needed. While receipts and revenue are often used interchangeably, they are not necessarily the same, especially in the context of accounting. This distinction is significant in the airline industry, where the sale and the provision of transportation services are typically not close in time and are, therefore, accounted for very differently for book and tax purposes.

The Draft incorporates the definition of receipts in the General Regulations (Reg. IV.2.(a)(6)), which in turn are defined by reference to the definition of "gross receipts." That is, "the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital in a transaction which produces apportionable income in which the income or loss is recognized under the Internal Revenue Code . . ." (Reg. IV.2.(a)(5)). While this indicates that receipts are receipts for tax purposes, the Draft appears to be inconsistent with this definition.

For example, the Draft defines both passenger and freight “transportation receipts” as “revenue earned by an airline” (prop. Reg. IV.18.(e)(2)(i)(L) and (M)). Further the Drafter’s Note following the definition of transportation receipts in (K), discusses the IRS rules on when income of an airline is recognized and states:

This [regulation] does not address when income of airlines is recognized. Rather, it addresses where receipts are sourced in order to apportion income once recognized under applicable law.

While not part of the proposed rule (and not binding), the Drafter’s Note appears to acknowledge that the definition of receipts is contradictory to when revenue is recognized under the Internal Revenue Code. In addition, bracketed portions of prop. Reg. IV.18.(e)(2)(iv)(A) and (B) state that a reference to the general allocation and apportionment statutes and regulations will be inserted. As a drafting matter, some of the complexity through repetition of the definition sections in (i) and (iv) may not be necessary if the proposed rule is clearer about the intent to use the Internal Revenue Code standard under the General Regulations.

Taken together, we believe that the states will not have enough clarity from these provisions and comments to adopt and apply the rules around income recognition with uniformity. Therefore, we recommend that the proposed rule should clearly state that receipts mean revenue recognized under the Internal Revenue Code.

2. Sale of miles or points

In its definition of passenger transportation receipts, the Draft includes the sale of miles or points in those receipts unless the miles are redeemed for the purchase of goods or services unrelated to air travel. As the Drafter’s Notes further explain, these miles are usually treated as transportation revenue because federal tax rules (see IRC section 451) do not allow income deferral for more than one year beyond the taxable year. The Draft further provides Example 5, which illustrates how the bifurcation between transportation and non-transportation miles would work. While this method makes sense theoretically in matching the use of the miles, we have determined this proposal is not workable as a practical matter and will only lead to further uncertainty and confusion. Because of the ways miles are earned and often held for multi-year periods by customers, these miles are recorded for tax purposes often long before they are recorded for book purposes. We do not believe the tracking required – if it can be done at all – would be adequate to report this information or make it auditable by the states.

For better understanding, take this very common example:

A customer has an Airline X co-branded credit card. She makes purchases with the card, and she receives miles for those purchases in Years 1 through 5. She also takes at least one annual roundtrip flight in those years with Airline X, earning miles from the trips. The customer does not use any accumulated miles until late in Year 5, when she books an award flight and uses some of the remainder for a new suitcase. Because the miles have been pooled in her account, each mile is not identified by how it was earned. For Airline X, any miles the customer earned from the credit card purchases in Years 1 through 3 have already been treated as transportation revenue because they cannot be deferred longer than one year for tax purposes.

Under the proposed rule, it is not clear what the result of this example should be. As an initial matter, should the miles be attributed to miles earned from the trips the customer takes, or should they be attributed to the credit card rewards? If they are attributed to the credit card miles, there are two possible results: (1) the miles for the suitcase are attributed to earlier years and treated as transportation revenue; or (2) the miles are attributed to Year 4 and are then treated as non-transportation revenue. All these positions are reasonable interpretations of the proposed rule.

Therefore, we recommend removing this proposed sale of miles rule and Example 5 from the Draft. Airlines are currently including the sale of miles in income and properly apportioning the revenue. As

noted above, there has been little controversy about the current treatment, even though many states have audited these programs across several airlines.

Other industries: The sale of miles also raises a question of equity. Setting forth prescribed apportionment rules for our loyalty program partnerships will likely create differential treatment from taxpayers in other industries, even though they are similarly situated. Loyalty programs with co-branded credit cards are the norm across many industries, including passenger rail (Amtrak), hospitality and retail. Air transportation is a unique industry, but the partnerships with issuing banks are not unique. The programs are largely similar whether the customer is getting points at a hotel, “cash” to spend at a retailer, or miles on an airline. We urge the MTC staff and the Working Group to consider the broader ecosystem of these programs and their tax consequences before promulgating rules that only apply to one industry.

3. Sale of tickets by one airline for flights on another airline

Finally, we see several issues with the proposed rule on how income is apportioned between an airline that sells transportation for a flight that is operated by another airline. The Drafter’s Note under prop. Reg. IV.18.(e)(2)(iv)(B) notes that the General Allocation and Apportionment Regulations exclude property acquired by an agent on behalf of another from the definition of receipts. The Drafter’s Note then states:

Therefore, in the case where a passenger purchases a ticket from one airline to fly on an aircraft operated by another airline (where the two airlines have entered into a codesharing agreement or similar arrangement), the “receipts” of the selling airline will include the entire price of the ticket, unless it can be shown that the selling airline acted as the operating airline’s agent (assuming the principle underlying Reg. IV.2.(a)(6)(G) applies here). In the event that there is an agency relationship, the “receipts” of the selling airline will include only that portion of the ticket price that the selling airline retains.

We understand that the proposed rule is attempting to apply general apportionment concepts and to conform to the General Regulations. However, we do not believe that this treatment follows longstanding industry practice for codeshare and interline sales and would unintentionally create more problems.

To make the process of purchasing a ticket for passengers as seamless as possible, the distribution system underlying the sale is complex, involving not only the airlines, but also online booking sites, traditional travel agents, software providers, clearinghouses, etc. Further, multiple contracts, agreements and regulations (U.S., foreign and international) govern these transactions to determine jurisdiction and liability, especially for international flights.

Under this proposal, an airline will have to attempt to untangle these complicated ties to determine whether an agency relationship exists, and we note that “agent” is not defined in the General Regulations. Applying various state laws on agency may lead to different results by state. This will cause confusion and inconsistency, and it will place undue administrative burdens on the airlines and state auditors.

In addition, we do not think the proposed rule – which in some cases would allocate all the income to a selling carrier who provides no services other than issuing the ticket – allows for a proper matching of expenses and income because the operating carrier will naturally incur most of the expenses.

Instead, we would urge you to allow the airlines to apply the allocations that the major clearing houses (such as Airline Clearing House) use to determine their transportation receipts from transactions involving multiple airlines. These amounts are already tracked and recorded and are auditable without the complex tracing of sales and relationships.

Conclusion

A4A does not see the need to enact a new special apportionment rule for commercial aviation. The current rule has been tested over time and proved its ability to serve the revenue needs of the states

while balancing the interests of the airlines and allowing the industry to evolve without requiring administrative rewrites. We urge the MTC to not fix what is not broken and keep the current rule.

However, if the Working Group feels strongly that a change is needed, we urge you to make changes to the Draft discussed above before recommending the proposal to the Uniformity Committee. Without those changes, the industry cannot support a change.

Thank you for your time and consideration of this important matter to the aviation industry. If you have any questions or comments, please do not hesitate to email me at jalmeras@airlines.org.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Jon Almeras", with a long horizontal flourish extending to the right.

Jon Almeras
Managing Director, Taxes



Review of the MTC Special Industry Rule on the Sourcing of Airline Receipts (Reg.IV.18(e))

Briefing Book prepared by the MTC staff

Submitted to the Uniformity Committee
Spokane, Washington
April 29, 2025
(updated 11/5/2025¹)

Introduction

In 2022, the Uniformity Committee decided to undertake a project and form a work group to review the MTC’s model receipts (sales) sourcing regulations, including the MTC’s Section 18 special industry rules. The goal of this project is to identify and provide information to the states on issues that may not be sufficiently addressed by these regulations or that may require updates, corrections, or conforming changes following the Commission’s adoption in 2017 of regulations using market-based sourcing for services and intangibles.

At the request of an Oregon state attorney, the work group has commenced examining the special industry rule which addresses the sourcing of airline receipts, Reg. IV.18.(e) (the “Rule” or the “Airlines Rule”), and has reviewed preliminary drafts of possible revisions to the Rule. The Airlines Rule was adopted by the Commission in 1983 and has never been revised.

As part of this examination, MTC staff has conducted research of the airlines industry, and the work group chair along with staff have had a series of conversations with states and industry.

The purpose of this Briefing Book is to provide members of the Uniformity Committee with relevant background and research relating both to the Rule and to the sourcing of airline receipts and to describe possible issues that have been identified with respect to the Rule.

The work group has addressed the Airline Rule during a half dozen meetings. Additional meetings have not been scheduled, pending further direction from the Uniformity Committee.

¹ Text on pp. 3-4 below was updated to reflect application of federal income tax principles to receipts from the sale of plane tickets under codeshare and similar arrangements.

Relevant contents of the Airlines Rule

The Airlines Rule provides that when an airline has income from sources both within and without “this state,” the amount of business income from sources within this state will be determined pursuant to the MTC Compact Art. IV (UDITPA as revised) except as modified by the Rule. As will be discussed below, the Rule, which is captioned “Special Rules: Airlines,” does not define airline.

With respect to the “sales factor” (now referred to as the “receipts factor” in the recommended general model regulations), the Rule generally utilizes a *departures approach* to source “transportation revenue” of airlines. Specifically, the Rule provides for calculating the sales factor as follows:

- The **numerator** of the sales factor includes two components:
 - Total transportation revenue multiplied by a ratio equal to in-state departures of aircraft (weighted as to the cost and value of aircraft by type) over total departures (similarly weighted), plus
 - “Non-flight revenues directly attributable to this state.”
- The **denominator** of the factor consists of “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.”

The Rule further 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.” *See* Reg. IV.18.(e)(2)(iv).

“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.” *See* Reg. IV.18.(e)(2)(i)(J).

Here is a graphic of this computation of the sales factor :

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

In addition to the definition of transportation revenue, the Rule contains various other definitions. For example, it defines departures to mean “all takeoffs, whether they be regularly scheduled or charter flights, that occur during revenue service.” It also defines “cost of airline by type,” “value,” “original cost,” “average value,” and “aircraft ready for flight.” In addition, the

Rule contains an addendum that illustrates how the Rule applies to various specific fact situations. A copy of the Rule is contained in Appendix A of this Briefing Book.

Sections of the Airlines Rule for possible update

During the more than four decades since the Rule was adopted by the Commission, the air travel industry has changed in significant ways. As a consequence, 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, and may trigger disputes between taxpayers and revenue agencies.

It is also important to emphasize that when a regulation is unclear and arguably allows for multiple interpretations, it invites taxpayers to choose the particular interpretation that works best for them. This in turn undermines uniformity and the level playing field.

During the course of the work group's review of the Rule, work group members and MTC staff have identified the following areas where the Rule either does not supply clear guidance or arguably would benefit from updating. It should be noted, however, that the work group has not taken any final vote on whether to recommend changes to the Rule.

A. Codesharing, Interline, and Capacity Purchase Arrangements

There are various circumstances when one air carrier sells tickets to passengers for travel on an aircraft operated by another carrier. These sales are made pursuant to a number of different arrangements common in the industry. Each of these arrangements is governed by a contract between the airline which sells the tickets and the airline which operates the aircraft providing the transportation:

- i. Codeshare arrangements – allow one airline to sell seats under its own airline code and flight number on flights which are operated by another airline, often involving international travel. These arrangements typically exist between alliance partners.
- ii. Interline arrangements – allow airlines to offer itineraries involving different flight segments flown by different carriers and may involve carriers that otherwise compete. Interline arrangements do not involve shared flight codes.
- iii. Capacity purchase arrangements – allow an airline to sell tickets for all of the seats on an airplane operated by another airline. Typically, the airline selling the tickets does more than make ticket sales, such as providing marketing services. These arrangements are usually between a major airline and a regional airline.

The Rule does not expressly address these industry arrangements. If the receipts received by the airline selling tickets are considered “transportation revenue,” they must be sourced by the

airline using the departures approach described in the Rule. If they are not “transportation revenue,” they would be sourced under Article IV’s general sourcing rules.

Only one reported decision has addressed how receipts under codeshare and capacity purchase arrangements are sourced under the Rule: *Oregon Dep’t of Revenue v. Alaska Airlines, Inc.*, 25 OTR 91 (T.C. 2022).

In that case, the Oregon Department of Revenue argued that the receipts retained by Alaska Airlines from selling tickets for travel on other airlines constituted transportation revenue and therefore must be sourced using the departures approach. Alaska Airlines disagreed, arguing that transportation revenue only included revenue from tickets on flights that it operated. The Tax Court sided with the airline, finding that amounts retained by Alaska Airlines were “not for ‘transporting passengers’” and therefore were “not ‘transportation sales.’”² Rather, they were “catchall (‘nonflight’ or ‘miscellaneous’) items that must be sourced pursuant to the standard UDITPA rules.”³

If receipts under codeshare, interline, and capacity purchase arrangements are not in fact transportation revenue under the Rule, then neither the Rule nor the MTC’s general market sourcing regulations adopted in 2017 specifically address how the selling airline’s receipts are sourced.

It is our understanding that some airlines that sell tickets under codeshare and interline arrangements currently treat the receipts they retain (*i.e.*, the receipts they do not share with the operating airline) as transportation revenue. Others do not, perhaps sourcing these receipts to where the headquarters of the operating airline is located. How selling airlines source receipts under capacity purchase agreements also varies, depending on the state involved. In some states, airlines may treat the receipts as transportation revenue; in other states, they may source the receipts according to Article IV’s general sourcing principles.

Because the Rule does not directly address codeshare, interline and capacity sharing arrangements, it also does not directly address which receipts of the selling airline under these arrangements must be included in the numerator and denominator of its receipts factor: is it the entire selling price of plane tickets or only that portion of the price that the airline retains (after sharing the remainder with the operating airline)?⁴

The MTC’s model General Allocation and Apportionment Regulations addresses this topic generally. These regulations provide that receipts are the amounts realized upon the performance of services in a transaction which produces apportionable income in which the

² The Tax Court stated in part: “Nothing in the plain meaning suggests to the court that acts such as advertising, promoting or selling tickets, or otherwise facilitating *another person’s* movement of passengers or freight, constitute ‘transporting’ [italics added].”

³ During the audit period, Oregon generally sourced receipts from the sale of services based on UDITPA’s original methodology--predominant cost of performance.

⁴ In the case of both codeshare and interline arrangements, the fare is allocated between the airlines via an industry clearinghouse, typically within a month of the ticket sale.

income or loss is recognized under the Internal Revenue Code. *See* Reg. IV.2.(a)(5),(6). Therefore, in the case where a passenger purchases a ticket from one airline to fly on an aircraft operated by another airline, if the selling airline receives a commission for selling the ticket and the Internal revenue Code treats only the commission and not the entire ticket price as income to that airline, then the airline’s “receipts” with respect to the sale are limited to the amount of the commission. *See, e.g., The Seven-Up Company v. Commissioner of Internal Revenue*, 14 T.C. 965 (1950); IRS Chief Counsel Advice No.202138001 (9/24/2021).

It is our understanding that airlines that sell tickets under codeshare and similar arrangements typically treat as revenue for sourcing purposes only that portion of the ticket price they retain, *i.e.*, the commission.

B. Sale of Miles/Points

The Airlines Rule does not indicate how airlines must source receipts from the sale of “miles” or “points,” which has become a substantial revenue source for airlines.

Most significantly, airlines sell miles/points in large quantities to various financial institutions that offer co-branded airline credit cards. The financial institutions in turn award these miles/points to cardholders based in part on the amount of card usage. Cardholders may redeem the miles/points for air travel or for various other services or products, such as hotel stays, but they are primarily redeemed for air travel.

A representative of the airlines industry has described how airlines treat the receipts received from credit card issuers for federal and state tax purposes in the following way:

- A portion of receipts is treated as consideration received for the use of intangible property (*e.g.*, airline logos on credit cards) and is treated as marketing revenue; the remainder is treated as consideration received for the sale of miles or points. The breakdown between the two components is apparently negotiated between each airline and card issuers.
- Income related to marketing is recognized in the year in which the sales transaction occurs. The related receipts are sourced according to market-based sourcing principles; they are not treated as transportation receipts. Receipts may be sourced based on the percentage of cardholders in each state.
- The remaining income, *i.e.*, the income related to the sale of miles or points, may be deferred by the airline for up to a year pursuant to §451 of the Internal Revenue Code.⁵ If miles are redeemed before this one-year deadline to recognize income, then the related receipts are treated as transportation revenue if the miles have been redeemed for air travel. If miles are redeemed for some other service or product, then the receipts are treated in accordance with the applicable sourcing rule. If the miles

⁵ For book purposes, income is deferred until the miles are redeemed (subject to some limitations—such as breakage rules).

have not been redeemed by the time the income is required to be recognized, the related receipts are treated as transportation revenue.⁶

Airlines of course also award miles/points to passengers enrolled in loyalty programs in connection with flights. In those instances, the ticket price paid by the passenger is allocated between the current travel and the points.

For book purposes, the income associated with these points is recognized when the points are redeemed (except for anticipated breakage). For federal tax purposes, income relating to these points may be deferred for up to a year. If the points are redeemed during the first year, the receipts are treated as transportation revenue if they are used for air travel and are treated as non-transportation revenue if redeemed for other purposes. If the points have not been redeemed by the time that the income is recognized, the related receipts are treated as transportation revenue.

C. Other receipts

The Airlines Rule states that revenue earned from “liquor sales, pet crate rentals, etc.,” common transactions at the time the Rule was adopted, is transportation revenue. Since the Rule has never been updated, it does not expressly address other transactions that have become common in recent years—such as charges to transport passengers’ luggage or charges for various in-flight services such as entertainment and Wi-Fi.

D. Multimodal Transportation involving both aircraft and other means of transportation or transportation sold with other services

The Rule does not address situations where a passenger or property is transported by a transportation company in part by an aircraft and in part by another means of transportation. For example, customers may hire a delivery company to deliver a package across the country. The company may typically transport packages in part by aircraft and in part by truck.

This common scenario raises two questions. First, does the Airlines Rule apply to the company? Although the Rule does not define airline (see section E. below), the company presumably is an airline because it transports packages by air for a charge. Second, how are the company’s receipts sourced, given that the Airlines Rule and the Special Industry Trucking Rule (Reg. IV.18(g)) impose entirely different sourcing methodologies (departures vs. mileage), and the customer typically pays a single amount for the service. The Airlines Rule does not provide an answer (nor for that matter does the trucking rule).

Similar questions arise (with no answer) whenever a company that transports passengers or property by air also provides other services, such as freight forwarding services, for a combined charge.

⁶ Note that airlines may also sell miles or points to businesses other than credit card issuers. For example, car rental companies may purchase miles and then award the miles to their customers.

E. Lack of language defining airline

The Airlines Rule is captioned “Special Rules: Airlines,” but the text of the Rule nowhere defines airline. Does the absence of a definition create uncertainty regarding the Rule’s application, particularly with respect to taxpayers that transport passengers or packages in part by air and in part by other means? We do not have a definitive answer, although neither work group members nor industry have indicated that this has been identified as a problem to date.

The growing use of drones raises another question: whether businesses that in the future use drones to deliver packages for a charge are or should be covered by the Rule. MTC staff has suggested one possible definition of airline: “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.” This definition would encompass companies that use drones to transport packages or freight.

F. Clarification of the Rule’s Language

Some provisions of the rule could be clarified:

i. Treatment of the denominator of the receipts factor:

The Rule states that the denominator of the receipts factor consists of two categories— “transportation revenue . . . and miscellaneous sales of merchandise, etc.” and excludes “[p]assive income items such as interest, rental income, dividends, etc.”

First, the inclusion of “miscellaneous sales of merchandise, etc., could be interpreted broadly to mean all other receipts or it could be interpreted narrowly to mean only sales of merchandise and no other sales of goods or services.

Second, the exclusion of “passive income items such as interest, rental income, dividends, etc.” could be interpreted to exclude only investment income or receipts not resulting from sales to customers, but it is not clear if this would also include, for example, rental of aircraft on a regular basis to others or the rental of other equipment or real property.

Third, both the description of the sales factor denominator and the definition of transportation revenue use the abbreviated term “etc.” which is inherently unclear and not best drafting practice.

ii. Treatment of the numerator of the receipts factor:

The Rule’s description of the numerator differs from the description of the denominator. The numerator uses the term “non-flight revenues,” which appears broader than the denominator’s “miscellaneous sales of merchandise, etc.” This is

especially confusing given that the numerator is generally assumed to include the same types of receipts as the denominator.

In sum, the language used to describe the sales factor seems ripe for a refresh.

iii. Use of the terms “cost” and “value”

In determining the weighted-departure ratio, the Rule uses the terms “cost” and “value” of aircraft in a way that creates some confusion. For example, the Rule defines “cost of aircraft by type” to mean “the average original *cost or value* of aircraft by type which are ready for flight” and defines “original *cost*” to mean the initial federal tax basis plus the value of capital improvements to such property. . . .”

iv. Finally, some of the Examples in the Rule’s Addendum as presented are difficult to follow.

How states currently require airlines to source receipts

A plurality of states that tax business income utilize the departures approach contained in the Airlines Rule to source the transportation revenue of airlines (or a similar approach). Additional states utilize the departures approach combined with other approaches. *See* Appendix B of this Briefing Book which describes the sourcing method used by each taxing state.

Some states use other approaches to source airline revenue. Fourteen states use a mileage approach. Five states have adopted no special industry rule addressing airlines; four of which use general market-based sourcing principles and one uses cost of performance. Some states use multiple factors.

As MTC staff noted in 1983 when the current Airlines Rule was being developed, the departures approach has a major advantage over the mileage approach: it avoids creating nowhere income. If every state taxed airline income and used the departures approach to source transportation revenue, then all income relating to that revenue would be subject to tax. In contrast, the mileage method arguably enables airlines to exclude flyover miles from the numerator of their receipts factor, substantially reducing in many cases the amount of income that is subject to tax.⁷ For example, only a small portion of the income of an airline flying aircraft between an east coast airport and a west coast airport might be subject to tax by any state. *See, e.g., Northwest Airlines Inc. v. Illinois Dep’t of Revenue*, 692 N.E.2d 1264 (Ill. App.1st Dist. 1998); Ariz. Rev. Stat. §43-1139(B); Tenn. Code Ann. §67-4-2013(a)(5).

⁷ Flyover miles is the total distance an aircraft flies over a state where the aircraft has neither landed nor taken off.

••• **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	<u>40,000,000</u>
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:

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

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:

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

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

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

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

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 (.07 x \$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:

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

Sales Factor:

$$\begin{array}{r} \frac{25,920,000 (747s) + 124,000,000 (727s)}{832,000,000} \\ = .1802 \end{array} \quad \begin{array}{r} = \frac{149,920,000}{400,000,000} \end{array}$$

Payroll Factor:

$$\begin{array}{r} \frac{2,800,000(n.p.) + 10,812,000(.1802 \times 60,000,000)(flight)}{40,000,000 + 60,000,000} \\ = .1361 \end{array} \quad \begin{array}{r} = \frac{13,612,000}{100,000,000} \end{array}$$

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

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

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

Appendix B

SOURCING OF AIRLINES REVENUE BY STATE

**(nuances deleted; this document is for research purposes only
and should not be relied upon as tax advice)**

Mileage Approach (revenue miles⁸ unless otherwise indicated)	Departures Approach⁹ (or similar approach)	Two or More Factors (equally weighted unless indicated)	No Special Industry Rule	Other
Arizona ¹⁰	Alabama	California (Air time by model of aircraft-80% weight; arrivals and departures by model of aircraft-20%) ¹¹	Delaware (MBS—where the service is performed)	Alaska (ground time ratio)
Florida ¹²	District of Columbia (total revenue units ¹³ received or discharged)	Colorado (miles-40% weight; arrivals and departures-60%)	Maine (MBS—where the service is received)	Louisiana (gross apportionable revenue)
Illinois ¹⁴	Idaho	Connecticut (arrivals and departures; revenue tons ¹⁵ ; originating revenue)	Vermont (MBS—where the service is delivered)	
Iowa (mileage)	Indiana	Georgia (miles ¹⁶ -25% weight; tons handled ¹⁷ -25%; originating revenue ¹⁸ -50%)	Virginia (cost of performance)	
Kentucky	Kansas	Hawaii (revenue tons; originating revenue; operating hours)	West Virginia (MBS—where the service is delivered)	

⁸ “Revenue mile” is defined in somewhat different ways as indicated in the footnotes attached to states in this column.

⁹ Departures are weighted by cost and value of the aircraft unless otherwise noted.

¹⁰ Expressly limited to flights beginning or ending in Arizona.

¹¹ If records of actual revenue by model of aircraft are not maintained, the total revenue shall be divided into passenger and freight revenue and allocated to aircraft model based on the ratio of the revenue passenger ton-miles and revenue freight ton-miles of such model, respectively.

¹² A “revenue mile” is the transportation of one passenger or one net ton of freight the distance of one mile for a consideration.

¹³ A “revenue unit” is one ton of freight or 10 passengers.

¹⁴ A “revenue mile” is defined in relevant part as the transportation of one net ton of freight the distance of one mile for consideration and the transportation of one passenger the distance of one mile for consideration.

¹⁵ “Revenue tons” is defined as the weight in tons of revenue passengers at 200 pounds per passenger and revenue cargo received or discharged.

¹⁶ Expressly limited to flights originating or terminating in Georgia.

¹⁷ Actual tons handled is multiplied by 60% in the case of passengers or cargo flown on each flight stage which originates in Georgia.

¹⁸ Originating revenue in Georgia is determine by applying a miles ratio to revenue everywhere.

Mileage Approach (revenue miles ¹⁹ unless otherwise indicated)	Departures Approach²⁰ (or similar approach)	Two or More Factors (equally weighted unless indicated)	No Special Industry Rule	Other
Michigan (miles)	Maryland (originating passengers and originating freight tons)	Minnesota (ton miles ²¹ multiplied by 85%; departures ²² multiplied by 15%)		
Mississippi ²³	Massachusetts	New York (arrivals and departures; revenue tons; originating revenue, the New York numerator in case multiplied by 60%)		
Missouri (mileage; airline may elect an alternative ratio based on investment in transportation facilities)	Montana	Tennessee (originating revenue; miles ²⁴)		
New Jersey ²⁵	Nebraska	Wisconsin (arrivals and departures; tons handled; originating revenue)		
North Carolina (ton miles)	New Hampshire (passengers and cargo enplaned in the state)			
Oklahoma (mileage)	New Mexico			
Pennsylvania ²⁶	North Dakota			
Texas (mileage)	Oregon			
Utah (ton miles)	Rhode Island (upon election of the taxpayer; otherwise where the benefit is received)			
	South Carolina (tons loaded and unloaded)			

¹⁹ “Revenue mile” is defined in somewhat different ways as indicated in the footnotes attached to states in this column.

²⁰ Departures are weighted by cost and value of the aircraft unless otherwise noted.

²¹ Each passenger is considered to weigh 200 pounds; Minnesota miles are limited to flights having a departure point or a destination in Minnesota.

²² Determined on a fleet-type basis.

²³ The numerator of the ratio is computed by multiplying the number of revenue-producing passengers carried on flights landing or taking off within Mississippi by the number of miles flown over the state by the flights. The denominator is determined by multiplying the total number of revenue-producing passengers carried by the total number of miles flown by flights carrying revenue-producing passengers. Revenue from cargo traffic income may be sourced to Mississippi based on the ratio that Mississippi revenue ton miles, or other units of cargo transported, multiplied by Mississippi miles flown bears to the total of such elements of the factor. Alternatively, all business income of an airline may be apportioned to Mississippi in the ratio that Mississippi flight miles bear to total flight miles.

²⁴ Expressly limited to flights originating from or ending in Tennessee.

²⁵ The passenger revenue mile fraction is determined by multiplying the number of revenue-paying passengers aboard the aircraft by the distance traveled in New Jersey divided by the number of revenue-paying passengers aboard the aircraft multiplied by the distance traveled everywhere. The freight revenue mile fraction is determined by dividing the freight ton revenue miles in New Jersey by the freight revenue miles everywhere. A freight revenue ton mile is equal to one ton carried one mile.

²⁶ A revenue mile means average receipts derived from the transportation of persons or property one mile.