

Request for Permission to Proceed with the Formal Regulatory Process

To Adopt Proposed Regulation section 25137-15, Addressing the Apportionment of Income of Space Transportation Companies

At its meeting on March 24, 2015, the Franchise Tax Board (FTB) authorized staff to convene one or more Interested Parties Meetings to discuss a possible regulatory effort for the apportionment and allocation of income derived from Space Transportation Activities, including the transportation of people or cargo into and from Space. The first Interested Parties Meeting was held July 9, 2015. At that meeting staff and participating interested members of the public (participants) discussed whether there was a need for a regulation and broadly discussed the unique legal issues facing the space transportation industry. A second Interested Parties Meeting was held April 13, 2016. At that meeting draft language was discussed.

A. Background

Taxpayers doing business both within and without the State of California are required to apportion their business income. Over the past several decades the FTB has promulgated several special industry regulations providing rules for the apportionment of business income from particular industries. Among the industries subject to special apportionment formulas pursuant to regulations are the air transportation, sea transportation, trucking, and railroad industries.

The space transportation industry is still very new and has novel legal issues that are best resolved through regulation rather than conflict. Furthermore, many of the novel legal issues that could cause disruption in the administration of the tax laws can be analogized to issues that arose in other transportation industries. For these reasons, FTB staff studied potential issues that could arise in the apportionment of business income from space transportation and then held an Interested Parties Meeting in order to learn the concerns of members of the public.

B. The First Interested Parties Meeting

On May 28, 2015, FTB published a notice of a first Interested Parties Meeting. At the Interested Parties Meeting, held July 9, 2015, staff asked participants for ideas on how space transportation activity should be defined, what kind of issues participants felt needed to be addressed in a regulation, and for details as to how the space transportation industry worked. Staff also inquired as to whether participants felt existing special industry regulations for the apportionment of income from other transportation industries was a good starting point for a space transportation industry regulation.

The meeting was well attended and input was received that allowed staff to undertake the process of drafting proposed regulatory language addressing the needs of the space transportation industry.

C. The Second Interested Parties Meeting

On March 18, 2016, FTB published a notice of a second Interested Parties Meeting together with draft language of a possible regulation on its regulatory activity website. At that meeting, held April 13, 2016, staff discussed the draft language with participants and sought comments on the proposed language. Suggestions were made by members of the public and many of those suggestions have been incorporated into the language which staff is presenting with this request.

Working together with interested parties, staff believes it has developed a proposed regulation that fairly reflects the business activity of the space transportation industry and provides clear guidance on how the income of such activities should be apportioned. Therefore, staff requests your Board's permission to begin the formal regulatory process under the Administrative Procedure Act.

Title 18, California Code of Regulations
Text of Regulation Section 25137-15 is adopted to read:

25137-15. Apportionment and Allocation of Income of Space Transportation Companies

(a) When a space transportation company derives income from sources both within and without this state, the amount of business income attributable to sources within this state shall be determined pursuant to this regulation.

(b) *Definitions.* As used in this regulation:

(1) "Space transportation company" means a taxpayer that generates more than 50 percent of its gross receipts from the provision of space transportation activity for compensation in a taxable year.

(2) "Space transportation activity" means the movement or attempted movement of people or property, including without limitation, launch vehicles, satellites, payloads, cargo, refuse, or any other property to space.

(3) "Launch" means to move or attempt to move people or property from Earth to space. For purposes of this regulation, "launch" also includes the movement or attempted movement of people or property from space to Earth.

(4) "Launch vehicle" means a conveyance built to place people or property in, or operate in, space.

(5) "Payload" means the people or property placed into a launch vehicle for the purpose of space transportation activity.

(6) "Launch contract" means a binding legal agreement between a taxpayer and an unaffiliated third party to provide space transportation activity.

(7) "Space" means an altitude of 62 statute miles or more above the surface of the Earth.

(8) "Separation" means the geographical point at which a payload physically separates from a launch vehicle.

(9) "Gross receipts" means gross receipts as defined in Revenue and Taxation Code section 25120.

(c) *Apportionment of business income.*

(1) In general. The sales factor of space transportation companies shall be determined in accordance with Revenue and Taxation Code sections 25134 to 25137, inclusive, and the regulations thereunder, except as modified by this regulation.

(2) Sales factor numerator. In determining the numerator of the sales factor of a space transportation company, gross receipts shall be attributed to this state based upon a mileage factor, weighted at 80 percent, and a departure factor, weighted at 20 percent.

(3) Computation of the mileage and departure factors.

(A) Mileage factor. The mileage factor shall be determined by computing the mileage ratio applicable to each launch contract for which the taxpayer recognizes revenue in the taxable year.

1. Mileage ratio numerator. The numerator of the mileage ratio for each launch contract shall be the total projected mileage that all launch vehicles launched or planned to be launched pursuant to that launch contract will travel within this state. If a launch occurs or is planned to occur in this state, the contribution of that launch to the numerator of the mileage ratio shall be 62 statutory miles. If a launch occurs or is planned to occur outside of this state, the contribution of that launch to the numerator of the mileage ratio shall be zero.

2. Mileage ratio denominator. The denominator of the mileage ratio for each launch contract shall be the total mileage that all launch vehicles launched pursuant to that contract are projected at the time of the execution of the contract to travel from launch to separation.

3. If the Internal Revenue Service or the Franchise Tax Board is prevented by reasons of secrecy or confidentiality imposed by governmental authorities from determining the projected mileage of any launch contract, the mileage ratio denominator of such contracts shall be conclusively presumed to be 310 statutory miles multiplied by the number of launches pursuant to that contract.

4. Mileage factor numerator. For each launch contract under which revenue is recognized in a taxable year, the mileage ratio for that contract shall be multiplied by the revenue recognized from that contract in the taxable year. The product shall be added to the products for each launch contract for which the taxpayer recognizes revenue in the taxable year the sum of which shall be the numerator of the mileage factor.

5. Mileage factor denominator. The total revenue recognized from all launch contracts during the taxable year shall be the denominator of the mileage factor.

(B) Departure factor.

1. Departure factor numerator. For each launch contract under which the taxpayer recognizes revenue in a taxable year, the contribution to the numerator of the departure factor shall be the number of launches in this state as specified in the contract at the time of execution of the contract. The numerator of the departure factor shall include all launches in this state specified in the contract regardless of the taxable year in which the launches occur or are planned to occur. The numerator of the departure factor shall be the sum of the contributions to the numerator factor for all launch contracts under which the taxpayer recognizes revenue.

2. Departure factor denominator. For each launch contract under which the taxpayer recognizes revenue in a taxable year, the contribution to the denominator of the departure factor shall be the number of launches everywhere as specified in the contract at the time of execution of the contract. The denominator of the departure factor shall include all launches specified in the contract regardless of the taxable year in which the launches occur or are planned to occur. The denominator of the departure factor shall be the sum of the contributions to the departure factor for all launch contracts under which the taxpayer recognizes revenue.

(d) *Records*. The taxpayer shall maintain all books and records necessary to determine the mileage factor, departure factor, and revenue recognized in the taxable year pursuant to all launch contracts for such time as any statute of limitation remains open for examination of the taxpayer's return.

(e) Example.

Taxpayer is a space transportation company that has entered into three launch contracts that result in the recognition of revenue in taxable year 201X. The first contract ("Contract A") is for two launches outside this state where the launch vehicles will each travel 1,000 miles from launch to separation. Taxpayer will recognize \$2,000,000 of revenue in taxable year 201X from this contract. The second contract ("Contract B") is for one launch from outside of this state where the launch vehicle will travel 10,000 miles from launch to separation. Taxpayer will recognize \$500,000 of revenue in taxable year 201X from this contract. The third contract ("Contract C") is for one launch from within this state where the launch vehicle will travel 1,000 miles from launch to separation. Taxpayer will recognize \$1,000,000 of revenue in taxable year 201X from this contract. Taxpayer also has \$500,000 of revenue from other than space transportation activities. The taxpayer's sales factor numerator from launch-related revenue in the taxable year shall be determined as follows:

	Contract A	Contract B	Contract C
Gross receipts recognized in 201X	\$2,000,000	\$500,000	\$1,000,000
Mileage ratio for each contract	$(0+0)/(1,000+1,000)=0$	$0/10,000 = 0$	$62/1,000 = 6.2\%$
Contribution to mileage factor numerator from each contract	$\$2,000,000 \times 0 = \0	$\$500,000 \times 0 = 0$	$\$1,000,000 \times .062 = \$62,000$
Mileage factor numerator	$\$0 + \$0 + \$62,000 = \$62,000$		
Mileage factor denominator (total launch contract revenues recognized in taxable year)	$\$2,000,000 + \$500,000 + \$1,000,000 = \$3,500,000$		
Mileage factor	$(\$62,000 \div \$3,500,000) = 1.7714\%$		
Departure factor for all contracts in the taxable year	$1 \text{ launch from this state} \div 4 \text{ launches everywhere} = 1/4 = 25\%$		
Sales factor: Mileage factor weighted 80% plus departure factor weighted 20%	$(1.7714\% \times 80\%) + (25\% \times 20\%) = 6.42\%$		
Gross receipts to be included in sales factor numerator in the taxable year multiplied by taxpayer total gross receipts	$.0642 \times \$4,000,000 = \$256,800$		

(f) *Combination of Space Transportation Activities with other Trades or Business.* (Reserved.)

(g) *Effective Date.* This regulation shall be effective for taxable years beginning on or after January 2016.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.

Reference: Section 25137, Revenue and Taxation Code.

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