

EXECUTIVE SUMMARY

A special apportionment formula is utilized to determine the amount of business income earned by an air transportation company that is derived from California sources. This formula is contained in Title 18 of the California Code of Regulations and the California Revenue and Taxation Code:

Regulation section 25137-7 determines the payroll factor and the sales factor of the apportionment formula applied to air transportation companies. This special formula was created under authority of Revenue and Taxation Code section 25137 to address the mobile nature of the air transportation business.

Revenue and Taxation Code section 25101.3 determines the property factor of the special apportionment formula applied to air transportation companies. There is currently no regulation to interpret Revenue and Taxation Code section 25101.3.

Aircraft of an air transportation company are currently grouped by type of aircraft when determining the payroll and sales factors. (Cal. Code Regs., tit. 18, § 25137-7.) The property factor statute, Revenue and Taxation Code section 25101.3, does not require an air transportation company to group aircraft by type. (See the State Board of Equalization's unpublished decision *Appeal of Alaska Airlines* (2007).)

The proposed amendments to Regulation section 25137-7 require air transportation companies to group aircraft by aircraft model to calculate the payroll factor and the sales factor. This will clarify the ambiguities in the current regulation, which allows aircraft grouping to occur on an inconsistent basis, sometimes based on power plant (two engine, three engine, etc.) and, in other cases, by the aircraft model. (See Cal. Code Regs., tit. 18, § 25137-7, sub. (e).)

Proposed new Regulation section 25101.3 would require air transportation companies to group aircraft by model for the property factor as well. This proposed grouping by model is consistent with proposed amendments to Regulation section 25137-7 for grouping by model for the payroll factor and the sales factor and will remove the ambiguity in the current rules that may result in a different calculation for property factor purposes.

Interested parties meetings were held on September 6, 2007 and March 27, 2008 to solicit input from the affected industry. Industry representatives did not object to adopting grouping of aircraft by model and commented that grouping aircraft by model leads to a more fair representation of business activity than grouping by type. This is because aircraft of the same model have similar value, while aircraft of different models but similar power plant configuration may not be similar in value.

Proposed Regulation section 25101.3 and amendments to Regulation section 25137-7 are proposed to be effective for taxable years beginning on or after January 1, 2010.

Staff is requesting permission to begin the formal regulatory process to adopt these regulatory amendments.

Request for Permission to Proceed with Formal Regulation Process on Amendments to California Code of Regulations, Title 18, Section 25137-7, and Proposed Regulation Section 25101.3, Relating to the Apportionment of Income of Air Transportation Companies

A special formula determines the portion of business income earned by an air transportation company that is derived from California sources. California Code of Regulations, title 18, section 25137-7, determines the payroll factor and the sales factor of the apportionment formula applied to air transportation companies. This special formula was created under authority of Revenue and Taxation Code section 25137 to address the mobile nature of the air transportation business.

Revenue and Taxation Code section 25101.3 determines the property factor of the special apportionment formula applied to air transportation companies. There is currently no regulation to interpret Revenue and Taxation Code section 25101.3.

Current Regulation section 25137-7 requires aircraft of an air transportation company to be grouped by enumerated types of aircraft when determining the payroll factor and the sales factor. The type grouping is based on aircraft power plant and, in some cases, the aircraft model. (Cal. Code Regs., tit. 18, § 25137-7, sub. (e).)

Proposed amendments to Regulation section 25137-7 would change aircraft groupings for the payroll factor and sales factor from type to model. Aircraft would be grouped by model based on the manufacturer's designation system. Examples of groupings are included in the proposed amendments.

Proposed new Regulation section 25101.3 would require grouping aircraft by model to determine the property factor. The State Board of Equalization ruled in the unpublished *Appeal of Alaska Airlines* (2007) decision that Revenue and Taxation Code section 25101.3 did not require taxpayers to group aircraft for calculating the property factor. The proposed new regulation would require grouping aircraft by model when calculating the property factor. This is consistent with proposed regulatory amendments that would require grouping aircraft by model for the payroll factor and sales factor. Examples of grouping by model are included in the proposed new regulation.

Interested parties meetings were held on September 6, 2007 and March 27, 2008 to solicit input from the affected industry. Industry representatives were given the opportunity to comment on whether it is preferable to group aircraft by type, as in the current Regulation section 25137-7, or to adopt grouping by model. Industry representatives did not object to adopting grouping of aircraft by model. Industry representatives commented that grouping aircraft by model leads to a more fair representation of business activity than grouping by type. This is because aircraft of the same model have similar value, while aircraft of different models but similar power plant configuration may not be similar in value.

Proposed Regulation section 25101.3 and amendments to Regulation section 25137-7 are proposed to be effective for taxable years beginning on or after January 1, 2010.

Staff requests permission to begin the formal regulatory process to adopt these regulatory amendments.

Section 25101.3 is adopted to read:

25101.3. Air Transportation Companies - Property Factor for Allocation and Apportionment of Income.

(a) The calculation of the "time" and "arrivals and departures" elements of the property factor formula for aircraft operated by members of a unitary group that are engaged in a unitary business of providing air transportation is made by grouping certificated aircraft by model, as defined in subsection (c) of this regulation. A separate allocation ratio is computed for each aircraft model that established a taxable situs within the state during the taxable year. Aircraft models that have not established a taxable situs within the state will not have property assigned to California for the year. Each allocation ratio is then applied to the total value of the carrier's aircraft of each model to which the allocation ratio applies, excluding those models that have not established a tax situs within the state.

(b) The allocation ratio is the amount computed pursuant to subdivisions (a), (b), (c), and (d) of Revenue and Taxation Code section 25101.3.

(c) A "model" of aircraft is defined as all aircraft that can be assigned to a group utilizing the following rules:

(1) All aircraft are grouped with other aircraft of the same manufacturer model, as determined by the manufacturer's designation system.

(2) If a taxpayer operates more than one series of an aircraft model, all series of that aircraft model are assigned to a single model group based on the aircraft manufacturer's designation system.

(3) If a taxpayer operates an aircraft that is part of an aircraft model series or version that is designated by the aircraft manufacturer for freight transportation, this aircraft is assigned to a model group that is separate from the group of aircraft of the same model that the aircraft manufacturer designates for passenger transportation.

(4) If a taxpayer operates an aircraft that can be configured either for freight transportation or passenger transportation, the aircraft is assigned to a group based on the aircraft model and the aircraft configuration.

(d) The following are examples of aircraft model groupings, provided for illustrative purposes only and not intended to identify all series of aircraft models:

(1) Boeing 737 model grouping includes series 737-300, 737-500 and 737-700.

(2) Boeing 767 model grouping includes series 767-300 and 767-300ER.

(3) The Airbus S.A.S. aircraft designation system assigns aircraft models by families. The A310 family includes models A300 and A310. The A320 family includes models A318, A319, A320 and A321.

(4) Airbus A300F4-600R, a freight aircraft, is assigned to a group separate from Airbus A300-600, a passenger aircraft.

(5) Cessna 208 model grouping includes series Cessna 208A and Cessna 208B.

(6) Boeing MD-11F, a freight aircraft, is assigned to a separate group from Boeing MD-11, a passenger or freight aircraft, if the Boeing MD-11 is configured for passenger

transportation. A Boeing MD-11F and Boeing MD-11 are assigned to the same model group if the Boeing MD-11 is configured for freight transportation.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code
Reference: Section 25101.3, Revenue and Taxation Code

Section 25137-7 is amended to read:

25137-7. Air transportation companies—Allocation and Apportionment of Income.

(a) Definitions.

(1) The unitary business of air transportation includes the operations of scheduled airlines, supplemental airlines and air taxis. All members of a unitary group that are engaged in a unitary business of providing air transportation must apportion business income from air transportation as provided in this regulation.

(2) As used in this regulation, “certificated aircraft” means aircraft operated by an air carrier or foreign air carrier engaged in air transportation, as defined in subsections (3), (5), (10), (11), (14), (15), (22), (23), (24), (25) and (26) of 49 USC 1301, while there is in force a certificate or permit issued by the Civil Aeronautics Board of the United States, the Department of Transportation or its successor, or a certificate or permit issued by the California Public Utilities Commission, or its successor, authorizing such air carrier to engage in such transportation.

(3) As used in this regulation, “air taxis” means aircraft used by an air carrier which does not utilize aircraft whose maximum certificated takeoff weight, as determined by the Federal Aviation Administration, is greater than 12,500 pounds in air transportation and which does not hold a certificate of public convenience and necessity or other economic authority issued by the Civil Aeronautics Board of the United States, the Department of Transportation, or its successor, or by the California Public Utilities Commission, or its successor.

(4) “The time in state” is the proportionate amount of time, both in the air and on the ground, that certificated aircraft have spent within the state during a representative period as compared to the total time in the representative period.

(5) “Arrivals and departures” is the number of arrivals in and departures from airports within the state of certificated aircraft during a representative period as compared to the total number of arrivals in and departures from airports both within this state and elsewhere in the representative period.

(6) “Ton-miles” means the product of a plane's tonnage and the miles traveled.

(7) “Flight personnel” means the air crew aboard an aircraft assisting in the operation of the aircraft or the welfare of passengers while in the air.

(8) “Rotables” means components or parts which are rotated between storage and operational use on aircraft.

(9) "Air time" is the elapsed time from when an aircraft, after blocks are removed from the aircraft wheels, first moves under its own power from the boarding ramp for the purposes of flight, to the time the aircraft comes to a rest after landing and blocks are placed on the aircraft wheels.

(b) Apportionment of business income.

The property, payroll and sales factors of the apportionment formula for air transportation companies shall be computed pursuant to Sections 25128 through 25137 of the Revenue and Taxation Code and the regulations adopted pursuant thereto except as provided in this regulation.

(1) Property factor

(A) In General.

(i) The use of the taxpayer's owned or rented aircraft in an exchange program with another air carrier shall not constitute a rental or subrental, whichever the case may be, of such aircraft by the airline to the other participating airline. Such aircraft shall be accounted for in the property factor of the taxpayer.

(ii) Rotables, parts, and other expendables, including parts for use in contract overhaul work, shall be valued at cost.

(B) Numerator. The value of aircraft assigned to this state shall be determined pursuant to Section 25101.3, Revenue and Taxation Code.

(2) Payroll factor—numerator. In determining the numerator of the payroll factor, compensation paid to flight personnel shall be attributed to this state based upon the ratio that air and ground time spent in performing services in this state bears to the total air and ground time spent in performing services everywhere by ~~type model~~ of aircraft. Air time (block to block) by ~~type model~~ of aircraft determined for the taxable year shall be used in computing flight personnel compensation attributable to this state. Ground time of flight personnel shall include the time required by such personnel to perform preflight and postflight activities pursuant to current employer-employee union contracts and includes time on the ground at intermediate stops on scheduled and nonscheduled flights for loading or unloading of passengers, freight, mail or other nonemergency purposes. Air and ground time of flight personnel utilized for training purposes to maintain proficiency shall also be included for purposes of the payroll factor.

(3) Sales factor-numerator.

(A) In determining the numerator of the revenue factor, revenue from hauling passengers, freight, mail and excess baggage shall be attributed to this state based upon:

(i) the ratio which the air time of the taxpayer's aircraft spent in this state bears to the total air time (block to block) of such aircraft everywhere, by ~~type model~~ of aircraft as defined in subsection (e), weighted at 80 percent; and

(ii) the ratio of arrivals and departures in this state to total arrivals and departures everywhere by type model of aircraft weighted at 20 percent. Air time and arrivals and departures (excluding time and arrivals and departures for flight training purposes) by type model of aircraft as defined in subsection (e), shall be used in computing revenue attributable to this state derived from hauling passengers, freight, mail, and excess baggage.

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

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

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

(c) Computation of time factor and arrivals and departures factor.

(1) The property and revenue factors of the apportionment formula are based upon a time factor and an arrivals and departures factor. The payroll factor for flight personnel is based solely upon time. The statistics to be used in computing the time and arrivals and departures factors shall be the annual statistics of the taxpayer or statistics for representative periods.

(2) Annual statistics for the taxpayer's taxable year, if available, shall be used in determining the property, payroll and revenue factors of the apportionment formula. All other rules prescribed for property tax purposes for determining air and ground time and arrivals and departures shall be applicable except as otherwise provided.

(3) If annual statistics are not available, statistics for representative periods shall be used provided that permission to do so has been granted to the taxpayer by the Franchise Tax Board. In the event annual statistics are subsequently maintained on a regular basis, the taxpayer shall use such annual statistics in lieu of statistics from representative periods.

(d) Representative period.

(1) In general.

(A) The representative periods to be used in computing the property, payroll and revenue factors shall consist of the representative periods designated by the

State Board of Equalization for the current property tax assessment year and the immediately preceding or succeeding property tax assessment year, as provided for herein, unless the Franchise Tax Board determines that alternative periods should be designated as representative periods in order to fairly reflect the taxpayer's activities within California.

(B) The statistical data developed for representative periods designated by the State Board of Equalization for property tax purposes shall be used in computing the percentage of the time factor and the arrivals and departures factor. The time factor and arrivals and departures factor shall be computed separately for each ~~type~~ model of aircraft enumerated in subsection (b).

(C) The term "current property tax assessment year" shall be the property tax assessment year for which the State Board of Equalization designates the representative period which falls within the taxpayer's current taxable year for California franchise tax purposes. In the case of an taxable year ending on February 28, it shall be the property tax assessment year for which the State Board of Equalization designates the representative period, the major part of which falls within the taxpayer's current taxable year for California franchise tax purposes. For example, if the State Board of Equalization designates February 23 through March 1 of the current calendar year as the representative period for the next property tax assessment year (beginning July 1, next), the "current property tax assessment year" shall be the property tax assessment year beginning July 1, next with respect to the taxable year ended February 28 of the current calendar year.

(2) Time factor.

(A) Scheduled carriers, scheduled and nonscheduled air taxis.

(i) Scheduled operations, scheduled carriers, scheduled and nonscheduled air taxis.

(I) The representative period shall consist of the representative periods designated by the State Board of Equalization for (1) the current property tax assessment year and (2) the succeeding property tax assessment year unless the taxpayer's taxable year for California franchise tax purposes ends on or after February 28.

(II) If the taxpayer's fiscal year for California franchise tax purposes ends on or after February 28, the representative period shall consist of the representative periods designated by the State Board of Equalization for (1) the current property tax assessment year and (2) the preceding property tax assessment year.

(ii) Nonscheduled operations, scheduled carriers and scheduled air taxis.

(I) The representative period shall consist of the representative periods designated by the State Board of Equalization for (1) the current property tax assessment year and (2) the preceding property

tax assessment year unless the taxpayer's taxable year for California franchise tax purposes ends on or after July 31.

(II) Taxpayers whose taxable year ends on or after July 31 should contact the Franchise Tax Board for instructions as to the representative period to be used.

- (B) Supplemental carriers. The representative period shall be the same as stated in subsection (d)(2)(A)(ii).
- (3) Arrivals and departures factor.
- (A) Scheduled carriers, scheduled and nonscheduled air taxis.
- (i) Carriers reporting departures to Civil Aeronautics Board or Department of Transportation.
- (I) The representative period shall consist of the representative period designated by the State Board of Equalization for (1) the current property tax assessment year and (2) the succeeding property tax assessment year unless the taxpayer's current taxable year ends on or after February 28.
- (II) In the case of taxpayers whose taxable year ends on or after February 28, the representative period shall consist of the representative period designated by the State Board of Equalization for (1) the current property tax assessment year, and (2) the preceding property tax assessment year.
- (ii) Air taxis not reporting departures to Civil Aeronautics Board or Department of Transportation
- (I) The representative period for scheduled operations of air taxis and operations of nonscheduled air taxis will be the same as stated in subsection (d)(2)(A)(i).
- (II) The representative period for nonscheduled operations of scheduled air taxis will be the same as stated in subsection (d)(2)(A)(ii).
- (B) Supplemental carriers.
- (i) Carriers reporting departures to Civil Aeronautics Board or Department of Transportation. The representative period shall be the same as stated in subsection (d)(3)(A)(i).
- (ii) Carriers not reporting departures to Civil Aeronautics Board or Department of Transportation. The representative period shall be the same as stated in subsection (d)(2)(A)(ii).

(e) Aircraft type A "model" of aircraft is defined as all aircraft that can be assigned to a group utilizing the following rules:

(1) All aircraft are grouped with other aircraft of the same manufacturer model, as determined by the manufacturer's designation system.

(2) If a taxpayer operates more than one series of an aircraft model, all series of that aircraft model are assigned to a single model group based on the aircraft manufacturer's designation system.

(3) If a taxpayer operates an aircraft that is part of an aircraft model series or version that is designated by the aircraft manufacturer for freight transportation, this aircraft is assigned to a model group separate from the group of aircraft of the same model that the aircraft manufacturer designates for passenger transportation.

(4) If a taxpayer operates an aircraft that can be configured either for freight transportation or passenger transportation, the aircraft is assigned to a group based on the aircraft model and the aircraft configuration.

Examples of Aircraft Model Groupings for Illustrative Purposes:

1. Boeing 737 model grouping includes series 737-300, 737-500 and 737-700.

2. Boeing 767 model grouping includes series 767-300 and 767-300ER.

3. Cessna 208 model grouping includes series Cessna 208A and Cessna 208B.

4. The Airbus S.A.S. aircraft designation system assigns aircraft models by families. The A310 family includes models A300 and A310. The A320 family includes models A318, A319, A320 and A321.

5. Airbus A300F4-600R, a freight aircraft, is assigned to a separate group from Airbus A300-600, a passenger aircraft.

6. Boeing MD-11F, a freight aircraft, is assigned to a separate group from Boeing MD-11, a passenger or freight aircraft, if the Boeing MD-11 is configured as a passenger aircraft. The Boeing MD-11F and Boeing MD-11 are assigned to the same model group if the Boeing MD-11 is configured for freight transportation.

~~(1) Piston-powered;~~

~~(2) Turboprop-powered;~~

~~(3) Helicopter;~~

~~(4) Turbojet and turbofan-powered;~~

~~(A) Two Engine (~~

~~(B) Three engine~~

~~(C) Four engine;~~

~~(D) DC-8-60 series;~~

~~(E) Boeing 747;~~

~~(F) DC-10 and L1011.~~

Note: Authority cited: Section 19503, Revenue and Taxation Code

Reference: Section 25137, Revenue and Taxation Code