

REQUEST FOR PERMISSION TO HOLD AN INTERESTED PARTIES MEETING TO CONSIDER (1) ADOPTING A REGULATION CLARIFYING REVENUE AND TAXATION CODE SECTION 25101.3, AND (2) AMENDING TITLE 18, CALIFORNIA CODE OF REGULATIONS, SECTION 25137-7, REGARDING THE APPORTIONMENT OF INCOME OF AIR TRANSPORTATION COMPANIES.

Due to the mobile nature of the air transportation industry, it is generally difficult to isolate and properly measure the level of California activity in comparison to the level of activity everywhere. The Franchise Tax Board looks to Revenue and Taxation Code (RTC) section 25101.3 to calculate the property factor and to Title 18, California Code of Regulations (18 CCR), section 25137-7, to calculate the payroll and sales factors. Each section provides its own formula for each factor. The rules for determining the apportionment factors for the air transport industry, pursuant to RTC section 25101.3 and 18 CCR section 25137-7, have generally been derived from, and are parallel to, the State Board of Equalization's property tax allocation laws and guidelines.

The formula found in RTC section 25101.3 compares business activity for certificated aircraft in California to the business activity of certificated aircraft everywhere. The formula found in 18 CCR section 25137-7 calculates the payroll and sales factors based on the type of aircraft in California compared to the type of aircraft everywhere. Historically, under either section, information based on make and model of aircraft were used in the formula apportionment of income.

At a recent appeal, the State Board of Equalization (SBE) upheld, in an unpublished opinion, the position of Alaska Airlines, Inc. (Alaska Airlines) that a 1973 amendment to RTC section 25101.3 bifurcated the apportionment formula for franchise tax purposes from the property tax allocation laws. The Board went on to decide that an air transportation company could look at its entire fleet of aircraft, instead of individual aircraft, as it calculated its property factor pursuant to RTC section 25101.3.

The SBE also upheld Alaska Airlines' argument that the reference to "type of aircraft" found in 18 CCR section 25137-7 is defined in subsection (e) of that same regulation, and therefore, the Franchise Tax Board could not require the taxpayer to consider make and model of aircraft in computing the payroll and sales apportionment factors.

The SBE's decision in Alaska Airlines' appeal that the property tax allocation laws have no bearing on formula apportionment for franchise tax purposes could potentially impact other airlines that were not parties to the appeal. At the very least, that holding has created uncertainty as to the proper means of apportioning the income of companies involved in air transport. It should be noted that Alaska Airlines' methodology benefits regional carriers, while at the same time adversely affecting airlines with business operations primarily outside of California, including international carriers.

Staff believes that the airline industry should be provided a meaningful opportunity to address the concerns raised by the SBE decision in Alaska Airlines and to have input on how the airline apportionment formula should be administered by the Franchise Tax

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Board in the future. Issues that need to be addressed include the relationship between the property tax allocation laws and formula apportionment of income, and also the definitions of "type of aircraft" and "certificated aircraft."

To provide clarity and certainty with respect to the rules for the apportionment of income of members of the air transport industry, staff requests approval from your Board to initiate an interested parties meeting and begin the process of drafting a new regulation and/or amending the existing regulation for the apportionment of the income of the airline industry to reflect the results of the interested parties meeting.