

INITIAL STATEMENT OF REASONS FOR THE AMENDMENT OF CALIFORNIA CODE OF REGULATIONS, TITLE 18, SECTION 25137-7 AND ADOPTION OF CALIFORNIA CODE OF REGULATIONS, TITLE 18, SECTION 25101.3

PUBLIC PROBLEM, ADMINISTRATIVE REQUIREMENT, OR OTHER CONDITION OR CIRCUMSTANCE THAT THE REGULATION IS INTENDED TO ADDRESS

The proposed amendment to existing Regulation section 25137-7, and the promulgation of Regulation section 25101.3, is intended to clarify ambiguity in the grouping of aircraft for purposes of determining factors used to apportion the income of air transportation companies that conduct business both inside California and outside California, and to conform to the State Board of Equalization's unpublished decision in *Appeal of Alaska Airlines* (February 28, 2007).

SPECIFIC PURPOSE OF THE REGULATIONS.

The proposed amendments to existing Regulation section 25137-7 are necessary to clarify the ambiguities in the current regulation, which allows aircraft grouping to occur on an inconsistent basis, sometimes based on the power plant (two engine, three engine, etc.) and in other cases, by the aircraft model (DC-10, Boeing 747, etc.). (See Cal. Code Regs., tit. 18, § 25137-7, sub. (e).) The proposed amendments to existing Regulation section 25137-7 will require air transportation companies to group aircraft by model for purposes of calculating the payroll factor and sales factor of the apportionment formula.

The proposed new Regulation section 25101.3 is necessary to remove current ambiguities in grouping aircraft for purposes of calculating the property factor in light of the State Board of Equalization's unpublished decision in *Appeal of Alaska Airlines* (February 28, 2007). The State Board of Equalization determined in that appeal that Revenue and Taxation Code section 25101.3 does not require grouping of aircraft to calculate the property factor. New Regulation section 25101.3 would require air transportation companies that conduct business both inside California and outside California to group aircraft by model, consistent with amended Regulation section 25137-7, for purposes of calculating the property factor.

NECESSITY

Currently, Regulation section 25137-7 is ambiguous because air transportation companies must group aircraft fleets by model in some circumstances and by type in other circumstances for purposes of determining the payroll factor and sales factor.

The State Board of Equalization concluded in an unpublished decision dated February 28, 2007, that Revenue and Taxation Code section 25101.3 does not specify whether air transportation companies are required to group aircraft by model or by type for calculating the property factor of the apportionment formula. (See *unpublished decision, Appeal of Alaska Airlines* (2007).) Air transportation companies currently choose whether to group aircraft by model or by type to determine their property factor.

The proposed amendment to Regulation section 25137-7 and the adoption of new Regulation section 25101.3 would require air transportation companies that conduct business both inside California and outside California to group aircraft by model to determine the payroll factor, sales factor and the property factor of the apportionment formula. This would provide clear and consistent rules for air transportation company taxpayers.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDIES, REPORTS OR DOCUMENTS.

The Franchise Tax Board examined and considered the regulatory history of current Regulation section 25137-7 and legislative history of Revenue and Taxation Code section 25101.3, including bill analysis and public hearing documents. The Franchise Tax Board did not rely upon any other technical, theoretical, or empirical studies, reports or documents in proposing amendments to Regulation section 25137-7 and the adoption of new Regulation section 25101.3.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON AFFECTED PRIVATE PERSONS OR SMALL BUSINESS.

The Franchise Tax Board has determined that there were no alternatives considered which would be more effective in carrying out the purpose of the proposed amendments to Regulation section 25137-7 or proposed new Regulation section 25101.3, or would be as effective as and less burdensome to affected private persons or small businesses than the proposed amendments. In addition, the proposed amendments and proposed new regulation section pertain to corporate taxpayers and therefore do not affect private individuals.

ADVERSE ECONOMIC IMPACT ON BUSINESS

The Franchise Tax Board has determined that proposed amendments to Regulation section 25137-7 of Title 18 of the California Code of Regulations, and the adoption of proposed Regulation section 25101.3 of Title 18 of the California Code of Regulations, will not have a significant overall economic impact on business. The proposed amendments and new regulation simply clarify the grouping of aircraft for purposes of apportioning the income of air transportation companies.