



## Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

---

May 27, 2009

Joint Committee on Finance

Paper #369

### **Definition of Air Carrier (General Fund Taxes -- Income and Franchise Taxes)**

[LFB 2009-11 Budget Summary: Page 275 , #24]

---

#### **CURRENT LAW**

Under current law, certain types of multi-state businesses, including air carriers, are required to use special apportionment formulas to allocate income to Wisconsin.

#### **GOVERNOR**

Create a definition of "air carrier" modeled on the Federal Aviation Administration definition of "direct air carrier," for state income and franchise tax purposes. This provision would increase state income and franchise tax revenues by an estimated \$4,000,000 annually.

#### **DISCUSSION POINTS**

1. Under Wisconsin law, formula apportionment is used if a corporation's Wisconsin activities are an integral part of a unitary business which operates both within and outside of the state. In these cases, the corporation adds its total gross income from its in-state and out-of-state unitary activities, subtracts its deductions, and multiplies the amount of net income by its apportionment ratio as determined by the Wisconsin apportionment formula. The apportionment ratio is used to approximate how much of a corporation's total net income is generated by activities in Wisconsin.

Most corporations, insurance companies, nonresident individuals, estates, and trusts apportion income to Wisconsin using a single sales factor apportionment formula. However, Interstate air carriers, motor carriers, railroads, pipeline companies, and telecommunications companies are required to use different apportionment formulas to determine Wisconsin net taxable income.

2. Specifically, the apportionable income of interstate air carriers is apportioned to Wisconsin on the basis of a ratio obtained by taking the arithmetic average of the following three ratios:

- a. Ratio of aircraft arrivals and departures in state to total aircraft arrivals and departures.
- b. Ratio of revenue tons handled at airports in state to total revenue tons handled.
- c. Ratio of originating revenue in state to total originating revenue.

3. No specific definition of "air carrier" is provided under current law. Prior to 2003, there was no statutory reference to "air carrier." The method for apportioning business income of interstate air carriers was provided under administrative rules. Under the provisions of 2003 Wisconsin Act 37, single sales factor apportionment was phased-in over three years for state corporate income and franchise tax purposes. The Act also included the current law provision that specifies that the net business income of "air carriers" should be apportioned pursuant to administrative rule.

4. Department of Revenue aggregate statistics for tax year 2006 indicate that there were 75 businesses that were categorized as air carriers under the North American Industry Classification System (NAICS). Of the total, 20 air carriers used the special three-factor apportionment formula.

5. Assembly bill 75 would define "air carrier" as a person who provides or offers to provide air transportation and who has control over the operational functions performed in providing that transportation. As noted, this is the FAA definition, used for certification of "direct air carriers." These air carriers would continue to use the special three-factor apportionment formula for determining net income.

6. "Indirect cargo air carriers" would be required to use the single sales apportionment formula used by most corporations, to determine net income. An "indirect cargo air carrier" is any U.S. citizen who undertakes to engage indirectly in air transportation of property, and uses, for the whole or any part of such transportation, the services of an air carrier, or a foreign air carrier that directly engages in the operation of aircraft under a certificate, regulation, or order, or permit issued by the [federal] Department of Transportation or the Civil Aeronautics Board, or the services of its agent, or another indirect cargo air carrier.

7. The Department of Revenue indicates that using the direct air carrier definition would ensure that only companies with control of operational functions in providing air transportation could use the special three-factor apportionment formula. This would conform with the intent of current law, and DOR administration of the law. The Department also indicates that indirect cargo air carriers have contested DOR's current administration of the law.

8. Following are examples of the definition of air carrier used by other states for

income/franchise tax purposes;

*California.* The business of air transportation includes the operation of scheduled airlines, supplemental air lines, and air taxis.

*Connecticut.* Any person who engages in the transportation by air, of person or property for hire, and which makes landings or takeoffs, or air pickups or deliveries in this state.

*Iowa.* Aircraft that are operated by air carrier authorized and certified by the U.S. Department of Transportation.

*Illinois.* (Sales tax exemption) Sold to, or used by, an air common carrier certified by the carrier to be used for the conduct of its business as an air common carrier for a flight or destination, or for a return from location or locations outside the U.S.

*Michigan.* Aircraft operated by an air carrier authorized and certified by the U.S., federal or foreign authority to transport air cargo or passenger in interstate or foreign commerce.

9. Since the bill was introduced, DOR has recommended that the definition of "air carrier" be clarified. Specifically, the Department recommends that "air carrier" be defined to mean a person who provides or offers to provide air transportation and whose business is 51% or more the provision of air transportation during the tax year. "Air carrier" would not include an air freight forwarder, or an aircraft lessor. This provision would have a minimal fiscal effect.

## **ALTERNATIVES**

1. Adopt the Governor's recommendation
2. Delete the Governor's recommendation and, instead, define "air carrier" to mean a person who provides or offers to provide air transportation and whose business is 51% or more the provision of air transportation during the tax year, and provide that "air carrier" would not include an air freight forwarder, or an aircraft lessor.
3. Delete the Governor's recommendation.

Prepared by: Ron Shanovich