LCB File No. T052-99

ADOPTED TEMPORARY REGULATION OF THE NEVADA TAX COMMISSION

(Effective June 17, 1999)

May 11, 1999

Air Transportation Companies ~~[Operating Large Aircraft]~~

NAC 361.451 Applicability. ~~[NAC 361.452 to 361.468, inclusive, apply to each air transport company which primarily operates aircraft capable of carrying more than 60 passengers or a payload of more than 18,000 pounds over a regular interstate or intercounty route on a certain schedule at a published rate.]~~ Except as specifically provided in NAC 361.4685, these sections do not apply to a taxpayer whose property is assessed under NAC 361.4685, 361.469 and 361.4695.

NAC 361.452 Cost approach indicator of value. The cost approach consists of:

1. Determining the gross book cost ***for financial reporting purposes*** of all ***taxable*** operating ~~[facilities]~~ ***property,*** including, but not limited to, airframes, engines, propellers, radio equipment, miscellaneous flight equipment, spare parts and assemblies, leased aircraft, improvements to leased equipment, construction work in progress, ground property and equipment, land, expendable parts, materials and supplies and leased property; and

2. Deducting from the gross book cost the accrued book depreciation ~~[as permitted by regulatory agency requirements which includes]~~ ***recorded for financial reporting purposes, which may include*** physical, functional and economic obsolescence. ***Additional obsolescence must be deducted when adequately quantified.***

NAC 361.454 Income approach indicator of value: Formula for determination.

1. The capitalized income approach ~~[converts to value, by use of a capitalization rate for the industry, the net operating income before allowances for federal income taxes, depreciation and amortization as well as flight equipment lease payments.]~~ ***consists of deducting from the normalized and annualized gross operating income any direct and indirect normalized and annualized operating expenses specifically related to the normalized and annualized gross operating income including any annualized book depreciation. Deferred income taxes will be treated as an operating expense. Normalized and annualized rental expense on operating property leased from others, less imputed depreciation, income taxes and other applicable expenses, will be disallowed as an operating expense.***

2. The resulting adjusted net operating income will be capitalized (converted to value) using an appropriate capitalization rate for the airline industry group. The capitalization rate for the typical company will be used for the carriers being appraised in each airline industry

group. The market capitalization rate will be derived from calculations made for selected carriers in each airline industry group.

~~[2.]~~ ***3.*** The operating income to be capitalized into taxable value will be ~~[the most recent year's adjusted net operating income.]~~ ***normalized and annualized*** based on the most recent year's adjusted net operating income. When the most recent year's net operating income is ***typically*** not a reasonable representation of ~~[a company's]~~ ***an airline's*** net operating income, such as where ***the airline's*** net operating income tends to be cyclical, a 3- or 5-year average of adjusted net operating incomes ***will be normalized and annualized and*** may be used.

4. It may be necessary to capitalize the net operating income before book depreciation and income tax if the normalized and annualized net operating incomes results in a negative amount. Components for depreciation and income tax must be added to the appropriate capitalization rate if either of these operating expenses are included in the adjusted net operating income to be capitalized.

5. Any normalization or annualization adjustments to a company's net operating income must be based on known, measurable and experienced changes in a company's operation or taxable property as of the current year's reporting date.

NAC 361.456 Income approach indicator of value: Capitalization rate. The ~~[base]~~ capitalization rate will be established from a selected number of carriers and determined in the following manner to arrive at the typical company in the airline industry ***group*** when the information is available:

1. The band-of-investment method will be used in the compilation of the capitalization rate.

2. The band-of-investment method represents the cost of the money needed by the typical company in the airline industry ***group*** to acquire its operating plant and carry on its operations. It is composed of two factors:

(a) The capitalization ratios of the typical company; and

(b) The cost of the items which comprise the total capital structure of the typical company.

3. A "typical company" means a theoretical company which is representative ~~[of a group]~~ of ***the*** carriers within ~~[the]~~ ***an*** airline industry ***group***. These carriers will be ~~[similar]~~ ***comparable*** in amount of revenues, bond ratings and nature of operations. ***Nature of operations includes, but is not limited to, the size, route structure and fleet diversification of the air carriers.*** Certain nonairline conglomerates, ***which have airline operations in Nevada*** will be studied in light of other similar conglomerates. Regular carriers will not be grouped with conglomerates where possible. Development of typical company factors will reflect input by the carriers ***within the airline industry group,*** which are centrally assessed.

4. The items which comprise the total capital structure of the typical company are those amounts ~~[reflected under the credit side of the balance sheet indicating]~~ ***as recorded for financial reporting purposes that represent*** the sources of the money or capital funds made available to acquire the ~~[properties reflected under the debit or asset side of the balance sheet.]~~

taxable operating property of the airline industry group. For the purposes of this ~~[paragraph]~~ ***subsection***, "capital funds" means money obtained from:

(a) Creditors through notes or bonds;

(b) Stockholders through stocks, paid-in capital and undistributed retained earnings; and

(c) Similar financial capital accounts ~~[though]~~ ***except*** not from the Federal Government through deferred ~~[federal]~~ income taxes. ~~[Each item will be given consideration.]~~ The ***total*** capital structure of the typical company will be derived through the use of a statistical median from the calculations of the selected sample ~~[firms]~~ ***carriers***.

5. ~~[The assignment of cost to the long-term bonded indebtedness component of the capital structure will be determined on the basis of outstanding bonded indebtedness of a selected number of carriers. The coupon rate, date of maturity and annual average of the high and low market price quotations of those securities will be considered in computing the indicated yield rate (cost).]~~ ***In addition to the total capital structure of the typical company derived by the department pursuant to subsection 4, the taxpayer may present and the department shall consider the total capital structure of the typical company based upon the common equity, preferred equity and the long-term debt percentages as developed from market information for comparable carriers in the airline industry group. The total capital structure of the typical company as developed by the taxpayer must be derived from the use of market information from the calculations of the selected sample carriers.***

6. ~~[The annual high-low average yield compiled by Moody's Investors Service (Public Utility and Transportation) or another selected service, approved by the executive director of the department, will be used for the assignment of cost to the preferred stock component of the capital structure. If the grades of the securities cover more than one rating, then the high-low annual average yield for all of these classifications will be used.]~~ ***The annual average of high-low monthly yields to maturity compiled by Moody's Investors Service (Public Utility and Transportation), or another accepted service approved by the executive director of the department, will be used for the assignment of a cost to the long-term bonded indebtedness component of the total capital structure.***

7. ***The assignment of cost to preferred stock will be determined in a manner consistent with subsection 6.***

8. The assignment of cost to that portion of the ***total*** capital structure which represents equity for the typical company ***in each airline industry group***, will be determined in the following manner: ~~[~~

~~(a) For each selected carrier, the common stock value is the average of the annual high and low market price quotation during the year multiplied by the yearly average number of shares outstanding.~~

~~(b) For each selected carrier, the income before extraordinary items (available to common equity shareholders) is divided by the calculated market value of the common stock.~~

~~(c) The equity rate of the typical company is the statistical median of the equity rates for this entire group of carriers selected for the specific airline industry sample.]~~

(a) The department shall develop an equity rate for each airline industry group based on one or more of the following models:

(1) Discounted cash flow (DCF);

(2) Capital asset pricing (CAPM);

(3) Risk premium analysis (RPA).

(b) The department shall also consider the results of cost of equity studies provided by carriers of the airline industry group based on the models set forth in paragraph (a).

(c) When considered applicable, the cost of equity capital established for the ***airline*** industry group may be determined by using additional models, ***such as direct capitalization***, accepted in the appraisal and financial communities and approved by the executive director of the department.

~~[8.]~~ ***9.*** The capitalization rate of the typical company ***for the airline industry group*** will be calculated by using a weighted method, (band-of-investment) which is the ***total*** capital structure percentage times the component rate percentage. The weighted values are then totaled and rounded to four decimal places to get the ~~[base]~~ capitalization rate.

EXAMPLE:

TYPICAL COMPANY RETURN	MEDIAN CAPITAL WEIGHTED STRUCTURE X	RATE =	
Common Equity	42.50%	11.20%	4.76000%
Preferred Equity	9.25%	9.35%	.86488%
Long-Term Debt	48.25%	9.45%	4.55963%
Base Capitalization Rate for Industry			10.1845%

~~[To this base capitalization rate will be added increments for income tax and depreciation. The formula for computation of the income tax increment is as follows:~~

~~T = Tax per dollar of capitalized value.~~

~~i = Income tax rate.~~

~~A = Rate of return plus sinking fund annuity at that same rate.~~

~~L = Life expectancy.~~

~~B = Percentage of long-term debt in capital structure.~~

~~I = Interest rate on long-term debt.~~

~~i (A - 1 - B I)~~

~~T = L~~

~~1.00 - i~~

~~The depreciation rate is based on the sinking fund factor using the yield rate and the estimated remaining useful life of the equipment.]~~

~~[9.]~~ ***10.*** The determination of the income value indicator requires the capitalization of the adjusted net operating income at the current capitalization rate. Financial data for selected ~~[companies]~~ ***carriers*** in each ***airline*** industry ***group*** as presented in the latest annual reports by Moody's Investors Service (Public Utility and Transportation) or another accepted service, approved by the executive director of the department, will be used in the compilation of the capitalization rate of the typical company.

~~[10. An alternative to the capitalization rate method in subsections 1 to 8, inclusive, may be the use of a rate for the industry as published by Western States Association of Tax Administrators or other recognized tax related organization, approved by the executive director of the department.]~~

NAC 361.458 ~~**[Market or]**~~ **stock and debt approach indicator of value.**

1. The ~~[market or]~~ stock and debt approach proposes a value for the entire firm***, but is generally recognized as a less applicable methodology for determining the value of taxable property***.

2. The stock and debt indicator will be determined by multiplying either the average monthly, quarterly or annual high and low market price quotations when available for all the securities which are actively traded in the market place, including common stock, preferred stock and long-term debt, by the number of shares outstanding at the end of the year. Computations of the present worth of income flows may be made to determine ~~[the value of]~~ ***values for*** securities which are not actively traded.

3. A part of the value of the stock of a holding company will be apportioned to the airline based on the following ratios of the airline to the holding company. The comparison will be based on historical cost weighted 33 1/3 percent and net operating income before income taxes weighted 66 2/3 percent. If the net operating income does not reflect a profit, the gross operating income will be used.

4. To this amount will be added items such as customer advances for construction which are nontaxable for federal income tax purposes, current liabilities less dividends declared, the present worth of leased property over the lease period together with any other items conforming to the theory that if a person were to purchase all the stock and assume all the outstanding liabilities of a company, he would have acquired all the assets which appear on the asset side of the balance sheet and, therefore, own the company.

5. From this amount will be deducted the market value of all ~~[nonassessable assets]~~ ***exempt or nonoperating property,*** including, but not limited to, cash, accounts receivable, notes receivable, miscellaneous investments, temporary investments, nonoperating properties and other current and accrued assets and properties not subject to the ad valorem property tax imposed by NRS 361.315 and 361.320.

NAC 361.460 Reconciliation of indicators of value.

1. Immediately related to the valuation process is the reconciliation of one or more indicators of value to reach the final estimate of value for the system.

2. The analyst will reconcile in writing to the taxpayer the relative significance, applicability and defensibility of the indication of value derived from each approach to arrive at, in the professional judgment of the analyst, the appropriate final estimate of system value for the air transport company.

3. The analyst will reconcile in writing to the taxpayer the facts, trends and observations determined in the analysis and review the conclusion and the probable validity and reliability of that conclusion.

NAC 361.462 Deduction of depreciated cost of nonallocable flight equipment.

1. The depreciated cost of the nonallocable flight equipment will be deducted from the total depreciated cost of the flight equipment.

2. For the purposes of this section:

(a) "Flight equipment" includes, without limitation, airframes, engines, propellers, radio equipment, miscellaneous flight equipment, spare parts and assemblies, leased aircraft and improvements to leased equipment.

(b) "Nonallocable flight equipment" means only that property or equipment which is not attached or required to be aboard or part of an aircraft which is ready for flight.

3. Every item of property which is required to be aboard for the operation of the aircraft will be classified as allocable flight equipment.

4. The only instances when an aircraft will be classified as nonallocable are when:

(a) The carrier purchased an aircraft which was not delivered or was delivered too late to have participated in the creation of the allocation statistics; or

(b) An aircraft which is owned by the carrier was leased to and operated by another party.

5. The percentage of the total amount of tangible personal property of the carrier which the allocable flight equipment represents will be calculated and applied to the total estimate of value of the assessable property of the carrier.

NAC 361.464 Allocation of value of interstate companies.

1. Since the unit rule of valuation will be used for the described properties, an allocation of those properties operating in Nevada will be made.

2. The allocation will:

(a) Total 100 percent for all states in which a company operates; and

(b) Reflect the quantity of property in each state, as well as the use or value of the property in each state.

3. Allocation factors will be those that are readily available rather than requiring some new or additional statistic, and a factor will not be an allocation itself.

4. The interstate allocation will be made in proportion to the contribution to the unit value made by the property in Nevada. Allocation will be made in the light of the property value. It is the value of the existing property which is being allocated, not merely the amount of the physical property.

5. Available quantity elements such as cost and economic or use elements such as revenue will be used in the determination of the allocation.

6. The following elements will be considered in the allocation of allocable flight equipment to Nevada and are assigned the following weight:

(a) Air and ground time weighted to the original cost of allocable flight equipment, 50 percent;

(b) Originating and terminating tonnage, 15 percent; and

(c) Revenue ton miles flown, 35 percent.

NAC 361.466 Development, application of factor for property located in Nevada.

1. The depreciated cost of the total tangible property of the carrier will be related to the estimate of value for the system for that same property in the form of a percentage. (This estimate of value will be determined by using the three approaches to value divided by the depreciated cost of the total tangible property.)

2. The factor so developed will be applied to that ground property having situs in Nevada.

NAC 361.468 Addition of property located in Nevada. The adjusted estimate of value for the situs property in Nevada will be added to the flight equipment which was allocated to Nevada for the final estimate of value for Nevada.

Air Transport Companies ~~[Operating Small Aircraft; Charter Air Carriers]~~ *Not Covered by NAC 361.451 to 361.468*

NAC 361.4685 Applicability. NAC 361.469 and 361.4695 apply to each:

~~[1. Air carrier which primarily operates aircraft capable of carrying a maximum of 60 passengers or a maximum payload of 18,000 pounds over a regular interstate or intercounty route on a certain schedule at a published rate.]~~

~~[2.]~~ ***1.*** Air transport company ***or industry group such as regional airlines or unscheduled airlines*** for which information is insufficient to complete a valuation pursuant to NAC 361.451 to 361.468, inclusive.

~~[3.]~~ ***2.*** ~~[Charter air carrier which is domiciled in Nevada and primarily leases or rents aircraft for unscheduled interstate or intercounty flights.]~~ The property of ~~[a]~~ ***an unscheduled or*** charter air carrier which is not domiciled in Nevada ~~[must]~~ ***may*** be ~~[assessed as migratory property]~~ ***valued under NAC 361.4685 to 361.4695, inclusive and placed on the unsecured tax roll***.

NAC 361.469 ~~**[Formula for assessment.]**~~ ***Flight equipment valuation and allocation.***

1. All ***allocable*** flight equipment ~~[will]~~ ***may*** be valued in accordance with the Personal Property Manual adopted by the Nevada tax commission for each fiscal year, ***or by use of approved valuation and costing service guide books***.

2. A portion of the value of the flight equipment will be allocated to Nevada based on an average of the data described in subsection 3 ***herein, or those under NAC 361.464*** when the information is available and considered applicable.

3. The weighted ground time ratio, as indicated by flight schedules, plane hours, originating and terminating tonnage and revenue ton miles flown in Nevada, as a percentage of the system, will be used as the statistic for allocating value ~~[in]~~ ***to*** Nevada.

NAC 361.4695 Property located in Nevada To the value of the flight equipment allocated to Nevada will be added the depreciated book cost of all ground property in Nevada including, but not limited to, buildings and improvements, furniture, fixtures, machinery and equipment, ***and non-allocable flight equipment. The value of property which is not represented by depreciated book cost, such as operating leased and rented property, may be added to determine the operation's total Nevada value***.

ADOPTED TEMPORARY REGULATION
OF THE NEVADA TAX COMMISSION

INFORMATIONAL STATEMENT

The following statement is submitted for adopted amendments to Nevada Administrative Code (NAC) 372.

1. A description of how public comment was solicited, a summary of public response, and an explanation of how other interested persons may obtain a copy of the summary.

Notices of hearing for the adoption and amendment of the proposed temporary regulations were posted at the following locations: Department of Taxation, 1550 East College Parkway, Carson City, Nevada; Nevada State Library, 100 Stewart Street, Carson City, Nevada; The Legislative Building, Capitol Complex, Carson City, Nevada; each County Main Public Library; Department of Taxation, 4600 Kietzke Lane, Building O, Suite 263, Reno, Nevada; Department of Taxation, 555 East Washington Avenue, Las Vegas, Nevada.

A copy of the notice of hearing and the proposed regulations were placed on file at the State Library, 100 Stewart Street, Carson City, Nevada, for inspection by members of the public during business hours. Additional copies of the notice and the proposed temporary regulations were also made available and placed on file at the Department of Taxation, 1550 East College Parkway, Carson City, Nevada; Department of Taxation, 4600 Kietzke Lane, Building O, Suite 263, Reno, Nevada; Department of Taxation, 555 East Washington Avenue, Suite 1300, Las Vegas, Nevada Department of Taxation, 850 Elm Street, No. 2, Elko, Nevada; and in all counties in which an office of the Department of Taxation is not maintained, at the main public library, for inspection and copying by members of the public during business hours.

The hearing was held on May 11, 1999 at the Department of Education, 700 East Fifth Street, Main Conference Room, Carson City, Nevada. It appears that due to the primarily procedural nature of the proposed temporary regulations, only affected or interested persons and businesses as set forth in #3 below responded to the proposed temporary regulations and testified at the hearing. A copy of the transcript of the hearing, for which a reasonable fee may be charged, may be obtained by calling the Nevada Department of Taxation at (702) 687-4896, or by writing to the Nevada Department of Taxation at 1550 East College Parkway, Suite 115, Carson City, Nevada, 89706.

The proposed temporary regulations, for practical purposes, were discussed at three workshops and has been heard and considered at one public hearing of the Nevada Tax Commission.

2. The number of persons who:

(a) Attended the hearing: 29

(b) Testified at the hearing: 2

(c) Submitted to the Tax Commission written comments: Written comments were submitted by the airline industry requesting the amendments to the administrative code prior to the hearing. No other written comments by the general public were submitted to, or received by, the Department of Taxation or the Nevada Tax Commission.

3. A description of how comment was solicited from affected and interested persons, a summary of their response, and an explanation how other interested persons may obtain a copy of the summary.

Comments were solicited from affected and interested businesses and persons by the notices set forth in #1 above, by direct mail to all county assessors, and by direct mail to the approximately 150 interested businesses and persons on the Department of Taxation's mailing list.

Comments from the above-referenced industry in #2 were received relative to the original regulations and proposed draft of the temporary regulations with respect to property tax assessment issues in regard to central assessment jurisdiction.

4. If the temporary regulations were adopted without changing any part of the proposed regulation, a summary of the reasons for adopting the temporary regulations without change.

The proposed temporary regulations were modified at public workshops prior to adoption, due to issues raised by the Department of Taxation and by the affected airline industry. The proposed temporary regulations were not changed at the public hearing since no additional concerns were raised by the affected industry, the Department of Taxation or Tax Commission members, and the Tax Commission believed no changes other than those made at the workshops were necessary.

5. The estimated economic effect of the adopted temporary regulations on the businesses which it is to regulate and on the public. These must be stated separately, and each case must include: (a) Both adverse and beneficial effects; and (b) Both immediate and long-term effects.

(a) Adverse and beneficial effects.

The proposed temporary regulations present no foreseeable or anticipated adverse economic effects to businesses or the public. However, the temporary regulations may impact the assessed valuations established for centrally assessed air transport properties, which could have an economic effect on businesses and the general public. That effect cannot be quantified at this time.

(b) Immediate and long-term effects.

Same as #5(a) above.

6. The estimated cost to the agency for enforcement of the adopted temporary regulations.

The proposed temporary regulations present no significant foreseeable or anticipated cost or decrease in costs for enforcement. However, it appears that there may be some minor additional administrative costs for the Department of Taxation, which cannot be quantified at this time.

7. A description of any regulations of other state or governmental agencies which the temporary regulations overlap or duplicate and a statement explaining why the duplication or overlap is necessary. If the temporary regulations overlap or duplicate a federal regulation, the name of the regulating federal agency.

The proposed temporary regulations are particular to the Department of Taxation practices and procedures and do not appear to overlap or duplicate regulations of other state or local governmental agencies.

8. If the temporary regulations include provisions which are more stringent than a federal regulation which regulates the same activity, a summary of such provisions.

There are no known federal regulations pertaining to state assessed property tax procedures, which are the subject of the proposed temporary regulations.

9. If the temporary regulations provides a new fee or increases an existing fee, the total annual amount the agency expects to collect and the manner in which the money will be used.

The proposed temporary regulations do not provide a new fee or increase an existing fee.