

**PROPOSED REGULATION OF THE
NEVADA TAX COMMISSION**

LCB File No. R026-99

July 7, 1999

EXPLANATION – Matter in *italics* is new; matter in brackets ~~[omitted material]~~ is material to be omitted.

AUTHORITY: §§ 1-8, NRS 360.090 and 361.320.

Section 1. NAC 361.451 is hereby amended to read as follows:

361.451 ~~[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]~~ *the provisions of NAC 361.452 to 361.468, inclusive,* do not apply to a taxpayer whose property is assessed ~~[under]~~ *pursuant to* NAC 361.4685, 361.469 and 361.4695.

Sec. 2. NAC 361.452 is hereby amended to read as follows:

361.452 The cost approach consists of:

1. Determining the gross book cost *for financial reporting purposes* of all *taxable* operating ~~[facilities including, but not limited to,]~~ *property, including, without limitation,* 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, without limitation,* physical, functional and economic obsolescence.

Additional obsolescence must be deducted when adequately quantified.

Sec. 3. NAC 361.454 is hereby amended to read as follows:

361.454 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, without limitation, 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 *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]~~

the net operating income ~~[.]~~ *of an airline*, such as ~~[, where a company's]~~ *where the* net operating income *of the airline* 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. The net operating income may be capitalized before deducting any book depreciation or income tax if the normalized and annualized net operating income results in a negative amount. If any book depreciation or income tax is added to the net operating income before the net operating income is capitalized, the capitalization rate must include a component for that book depreciation or income tax.

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

Sec. 4. NAC 361.456 is hereby amended to read as follows:

361.456 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 airline industry.]~~ *an airline industry group*. These carriers will be

~~[similar]~~ *comparable* in amount of revenues, bond ratings and nature of operations. Certain nonairline conglomerates *which have airline operations in this state* 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. *As used in this subsection, “nature of operations” includes, without limitation, the size, route structure and fleet diversification of the air carrier.*

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. For the purposes of this paragraph,]~~ *taxable operating property of the airline industry group. As used in this 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.

FLUSH ~~[Each item will be given consideration.]~~ The capital structure of the typical company will be derived through the use of a statistical median from the calculations of the selected sample ~~[firms.~~

~~—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).] carriers.~~

5. *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 must be derived from the use of market information from the selected sample of carrier calculations.*

6. The annual *average of* high-low ~~[average yield]~~ *yields to maturity* 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]~~ *long-term bonded indebtedness* component of the *total* 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.]~~

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.~~

~~—8.] 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 method.~~

~~(2) Capital asset-pricing.~~

~~(3) Risk premium analysis.~~

~~(b) The department shall also consider the results of cost of equity studies provided by a carrier 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, including, without limitation, direct capitalization, accepted in the appraisal and financial communities and approved by the executive director of the department.~~

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	MEDIAN CAPITAL STRUCTURE	X RATE =	WEIGHTED RETURN
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 <i>Group</i>			10.1845%

FLUSH ~~[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.~~

~~— $i(A - 1 - BI)$~~

~~— $T = \frac{L}{1 - i}$~~

~~— $1.00 - i$~~

FLUSH ~~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.]~~

Sec. 5. NAC 361.458 is hereby amended to read as follows:

361.458 1. The ~~[market-or]~~ stock and debt approach proposes a value for the entire ~~[firm.]~~ *carrier, 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 including, but not limited to,~~ *exempt or nonoperating property, including, without limitation,* 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.

Sec. 6. NAC 361.4685 is hereby amended to read as follows:

361.4685 *1. The provisions of* NAC 361.469 and 361.4695 apply to each ~~of~~:

~~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. Air~~ *air* transport company *or airline industry group, including, without limitation, regional airlines or unscheduled airlines,* for which information is insufficient to complete a valuation pursuant to NAC 361.451 to 361.468, inclusive.

~~3. Charter air carrier which is domiciled in Nevada and primarily leases or rents aircraft for unscheduled interstate or intercounty flights.~~

2. The property of *an unscheduled or* a charter air carrier which is not domiciled in Nevada ~~must be assessed as migratory property.~~ *may be valued pursuant to NAC 361.4685, 361.469 and 361.4695 and placed on the unsecured tax roll.*

Sec. 7. NAC 361.469 is hereby amended to read as follows:

361.469 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 in accordance with other books or manuals that provide guidance in establishing value approved by the executive director of the department.*

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 *or described in 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.

Sec. 8. NAC 361.4695 is hereby amended to read as follows:

361.4695 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,]~~ *without limitation,* buildings and improvements, furniture, fixtures, machinery ~~[and equipment.]~~, *equipment and nonallocable flight equipment. The value of the property which is not represented by the depreciated book cost, including, without limitation, leased and rented property, may be added to determine the total value of the operation in this state.*