PENNSYLVANIA
Budget and Policy Center

412 N. 3rd Street
Harrisburg, PA 17101
717-255-7156
www.pennbpc.org

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Pa. House Poised to Hand Out Another Corporate Loophole – This Time for Jets

By Michael Wood, Research Director

If you buy a car, a truck, a boat or any other vehicle in Pennsylvania, you pay sales tax. But if you are one of the few in the market for a Learjet or a Gulfstream aircraft, you would get a pass on paying that tax under a bill introduced in the state House of Representatives.

House Bill 1100 would exempt the sale of private and corporate aircraft from the state sales and use tax.[i] At a time when average Pennsylvanians are bearing the brunt of cuts in education and other vital services, the bill effectively creates a $10 million to $14 million annual taxpayer subsidy for individuals who buy airplanes for recreational purposes and for corporations that upgrade jets for executives. While supporters of the measure say it would create jobs, aircraft would not need to be purchased in Pennsylvania to be eligible for the exemption. In fact, Pennsylvanians could purchase planes in Kansas (where most small aircraft are manufactured) or China (where the industry is moving more and more jobs) and pay no sales or use tax.

The legislation would also exempt aircraft repairs and parts from sales tax, creating another disparity in tax treatment for services. A car muffler would be subject to sales tax but not landing gear. At a time when Congress is scrutinizing special tax breaks and the public is clamoring to close loopholes, the House bill moves Pennsylvania in the wrong direction with this luxury tax break.

Wealthy persons and corporations would reap the vast majority of benefits from this bill. The most basic and least expensive new propeller-driven Cessna starts at $112,000, while a Learjet costs upwards of $5 million.[ii] Obviously, few middle-class families or small businesses would benefit from this tax break.

This loophole is a big money loser for the state. The Pennsylvania Department of Revenue estimates the exemption will cost $10 million to $14 million annually in foregone revenue. Proponents claim that "no matter what we (lose) on the sales tax, we're going to make it up on the personal income tax and the earned income tax,"[iii] but this seems highly unlikely as this exemption would have to create at least 6,500 jobs, with an average salary of $50,000, just to pay for itself.[iv] This is more than double the number of people employed in the aircraft industry in Pennsylvania today.

In fact, the loophole wouldn't create jobs. West Virginia enacted a sales tax exemption for airplane repairs to lure jobs to that state, but it hasn't worked. Without such a tax break, Pennsylvania has five times as many aircraft support jobs as West Virginia and, according to the 2007 Economic Census, seven times as many aircraft repair and maintenance companies, employing more than twice as many people.[v]

Tax loopholes don't drive investment decisions. Pennsylvania lawmakers tout a helicopter tax exemption enacted in 2009 as a model for all aircraft, but that exemption hasn't been a game changer. Boeing, which manufactures Chinook helicopters for the U.S. military in Delaware County, did add a new repair facility—in New Jersey.[vi] The federal government doesn't pay sales tax, so that wasn't even a consideration. And the new jobs went to Boeing workers who were transferred from Fort Campbell, Kentucky. Boeing considered facility availability and other costs in making its decision to expand in New Jersey.

Sikorsky Aircraft Corporation purchased Keystone Ranger Holdings, built a new facility, and vastly expanded its services in Coatesville, Chester County, BEFORE the helicopter sales tax exemption was enacted.[vii]

Proponents have oversold the sales tax loophole's impact on industry location decisions in other states, and overdramatized the Commonwealth's current use tax policy on aircraft. In a February 2011 memo to House members, Reps. Richard Geist and Peter Daley claim that in the last three years, "*three corporations decided to locate in other states due to our current fixed wing tax policy*." In fact, each of the referenced companies located their new facilities in states that *do not* exempt aircraft sales from tax.[viii]

Claims were also made that the state's use tax policy hindered companies from relocating to Pennsylvania, as the Department of Revenue supposedly would assess use tax on any aircraft that were moved to the state. The Department issued a statement to correct the record—no use tax is assessed when long-time owned aircraft (or other taxable assets) are relocated to Pennsylvania.

The jet exemption will not revitalize the aircraft construction industry. Under HB 1100, an individual or company could get the tax break whether the aircraft is purchased in Pennsylvania, Kansas, California or China. This bill creates no direct incentive for a company to manufacture aircraft in the Commonwealth. The real effect of the sales tax exemption is to make buying and using planes tax-free for Pennsylvania companies and wealthy individuals.

Giving tax breaks to businesses does not "stimulate economic activity or create jobs"[ix] when paid for through reducing public services, according to a 2004 review by the Economic Policy Institute. A sales tax exemption, which affects the customer—not the business producing the good—is even less likely to create jobs.[x] Tax loophole proponents have offered no way to pay for this exemption, other than a vague hope of new jobs and tax collections on the new business. The loss of tax revenue for the state will likely be passed on in the form of cuts to classrooms, health care, and transportation infrastructure.

There is no accountability to taxpayers. Sales tax exemptions cost the state money in exchange for a promise: to create jobs or increase economic growth in ways that would bring in more tax revenue to support essential services. But there is no accountability if those benefits are not realized. While appropriations from the state budget are reviewed every year and subject to elimination if they are not productive, money spent through tax breaks is not held to a comparable standard. Once a tax break is put in the tax code, it is rarely removed; the public can be left with an expensive program that fails to deliver.

Only four states offer an aircraft sales tax exemption. Massachusetts and Rhode Island fully exempt non-commercial aircraft from sales tax,[xi] and Connecticut and Maine have a partial exemption.[xii] Massachusetts Governor Deval Patrick tried to eliminate the exemption in 2011, arguing, "This exemption can no longer be justified, especially since cars and boats are not exempt, and other states are likely to apply use taxes to aircraft if we do not."[xiii]

Tax loopholes create winners and losers—and distort the economy. By supporting one industry (in this case, aircraft sales and repair), the state encourages private companies to make decisions that may not be based on sound economics. Moreover, no public purpose is served by exempting private aircraft sales and repairs at the expense of other forms of transportation.

Targeted sales tax loopholes create competition among states but are a zero sum game. There is a concerted effort by the small plane industry to create a "wave" of tax breaks in Northeastern states, using the job creation argument.[xiv] Sometimes the plan is to exempt airplane repair and maintenance, aircraft purchases or, as in Pennsylvania's case, both. In reality, the plan is to reduce the cost of corporate jets and leisure aircraft at the taxpayer's expense.

The aviation industry is expert at playing this state-against-state race to the bottom. It has secured special interest exemptions in Connecticut, Maine and New York, and has now set its sights on Pennsylvania. Connecticut's exemption (2002) was touted as a way to bring planes and jobs back from Massachusetts; New York's parts and repair exemption (2004) was sold as a way to bring planes and jobs from Connecticut; Maine's exemption (2011) was promoted as a way to lure flyers back to the state; and efforts to create a Pennsylvania exemption (2007 to present) have cited the need to "maintain competitiveness with other northeastern states that had adopted tax reforms."[xv]

Aircraft manufacturers are moving out of the U.S., not between states. The aviation industry has been hit hard by the economic downturn and, despite the tax breaks it has won, is cutting jobs in the U.S. rather than adding them. Over the past two decades, more investment has shifted overseas.

Business jet production was off by "almost 46.8% in the first nine months of 2009,"according to a Congressional Research Service study, and general aviation giants Hawker Beechcraft and Cessna were laying off more than 6,000 workers in plants in Kansas—the "Air Capital of the World"—about 15% of the state's aerospace workforce.

Cessna is building its new Model 162 Skycatcher in China.[xvi] By doing so, it is able to cut the price of the plane by $71,000 (or about 40%[xvii]) compared to building it in the U.S.[xviii] Cessna is not alone. A report by the consulting firm AeroStrategy found nearly three times as much investment from 1990 to 2009 occurred in aerospace manufacturing in Mexico and China as in the U.S.[xix]

This loophole is a bad tax policy—and a step in the wrong direction. Good sales tax policy would suggest that in order to support important public investments, the sales tax should cover a broad range of purchases and services, exempting only staples and raw materials used to make other products[xx]. An example of this can be found in the Corbett administration's efforts to level the playing field for local businesses by requiring collection of sales tax due on Internet purchases. HB 1100 takes us in the opposite direction by whittling down the tax base to benefit a specific industry.

Conclusion. The creation of an additional sales tax loophole drains funding from investments that help create jobs and build a strong economy, including transportation, public safety, good public schools and a robust system of higher education. This proposed tax break will benefit a few high-income individuals and companies at the expense of working people and smaller Pennsylvania-based industries.

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[i] Items purchased out of state are subject to the Pennsylvania use tax, but under HB 1100, out-of-state jet purchases would be exempt from the use tax.

[ii] Even a plane as old as a 1976 Learjet 35 sells for $395,000, so these are not staple goods. http://www.aircraftdealer.com/aircraft_for_sale/Learjet_35___36/58/page-1.htm

[iii] Peter Jackson, "AP: Even trout get a PA sales tax exemption." *Associated Press*, October 22, 2011.

[iv] This calculation is based on personal income tax collections at 3.07%: 6,500 (jobs) * $50,000 (per job) * 3.07% (PIT rate) = $9.975 million.

[v] U.S. Census Bureau, 2007 Economic Census, 488190: Other support activities for air transportation (accessed December 1, 2011). At the national level, aircraft repair/maintenance comprised 97% of this industry.

[vi] Daniel Walsh, "Army's Chinook helicopters to be worked on at Millville Airport en route to Afghanistan, Iraq," *Press of Atlantic City*, January 19, 2010.

[vii] Ernie Stephens, "General Aviation: Keystone and Sikorsky: A Dutch Treat," *Aviation Today*, February 1, 2007, http://www.aviationtoday.com/print/am/categories/rotocraft/General-Aviation-Keystone-and-Sikorsky-A-Dutch-Treat_8187.html?printbtn=Print+This+Window.

[viii] The three companies listed in the memo (Embraer, Eclipse, and Honda Jet) apparently used other factors than sales tax exemptions to determine their locations. Only one of the three expansions can at this time be deemed as a success. Embraer located its new production facility in Florida—which did not offer a sales tax exemption, but instead offered significant state and local financial assistance to land the facility (details can be found here: Aero-News Network, "Melbourne Officials Approve More Incentives for Embraer," June 26, 2008, http://www.aero-news.net/index.cfm?do=main.textpost&id=b455da0f-8d84-4dea-a8da-07039f9684b5).

The Eclipse project went to New Mexico, again due in part to direct state subsidies—not a sales tax exemption. The original owners went bankrupt and laid off its workforce. The company was recently re-opened at a much smaller scale (for more information, see: Molly McMillin," Eclipse Aerospace reopens orders," *Wichita Eagle*, October 18, 2011, http://www.kansas.com/2011/10/18/2066575/pse-reopens-orders.html#ixzz1g3TQku8V).

HondaJet builds its jets in North Carolina (which charges sales tax on aircraft sales), but decided to locate a sales facility in New York (which also has a sales tax on plane sales). The company gave the following rationale, which does not include sales tax exemptions, for their site selection: "(U)ltimately, Albany and the State of New York provide an ideal balance of culture, future vision, proximity to the major Northeastern markets and technical fit for the site" (http://www.microjetpositions.com/honda_420_microjet.htm). HondaJet has had numerous setbacks, most recently with engine design, that have postponed any aircraft sales until 2013, at the earliest (http://www.autoblog.com/2011/10/11/grounded-again-hondajet-delayed-for-engine-redesign/).

[ix] Robert G. Lynch, *Rethinking Growth Strategies: How state and local taxes and services affect economic development*, Economic Policy Institute, 2004, http://www.epi.org/page/-/old/books/rethinking_growth_%28full%29.pdf.

[x] This is because the sales tax exemption is an indirect incentive. Customers must react to the new "discount" and buy more goods and services than they did before. The company, in turn, needs to recognize the new demand and

reinvest in the business—rather than using the increased earnings for other, competing uses—including investing in higher growth areas. Many things have to go right for this sort of "incentive" to produce new jobs in Pennsylvania.

[xi] Some states (Alaska, Delaware, Montana, New Hampshire, and Oregon) impose no sales tax. A number of states have reduced sales taxes or registration fees in lieu of a tax for aircraft purchases (North Carolina, North Dakota, Oklahoma, South Carolina, South Dakota, and Virginia). See Christopher Younger's "Regional sales & use tax forum" series on *AvBuyer: The Global Aircraft Market Online* for listing of state sales taxation of aircraft. The latest reports by region are found here:
South (Volume 3.2 – January 2011) http://www.avbuyer.com/articles/detail.asp?Id=2027&pt=true;
Midwest (Volume 3.3 – April 2011) http://www.avbuyer.com/articles/detail.asp?Id=1951&pt=true;
West (Volume 3.4 – July 2011) http://www.avbuyer.com/articles/detail.asp?Id=2040&pt=true;
East (Volume 4.1- October 2011) http://www.avbuyer.com/articles/detail.asp?Id=2145&pt=true.

[xii] Only jets that are over 6,000 pounds, "maximum certificated takeoff weight" as determined by the Federal Aviation Administration (FAA), are exempt from Connecticut's or Maine's sales and use tax. See Christopher Younger, "Regional sales & use tax forum (4.1)," *AvBuyer: The Global Aircraft Market Online*, October 2011, http://www.avbuyer.com/articles/detail.asp?Id=2145&pt=true.

[xiii]Deval L. Patrick, "Limiting Certain Tax Expenditures," *FY2011 (Massachusetts) House 2 Budget Recommendations: Issues in Brief*, (accessed November 28, 2011) http://www.mass.gov/bb/h1/fy11h1/exec_11/hbudbrief18.htm.

[xivxiv] State-specific examples of the sales tax repeal efforts can be found on the Aircraft Owners and Pilots Association website: Rhode Island: http://www.aopa.org/whatsnew/region/2005/050107ri.html; New York: http://www.aopa.org/whatsnew/region/2006/060310ny.html; Maine: http://www.aopa.org/whatsnew/region/2005/050519me.html;

[xv] Dan Namowitz, "Pennsylvania aircraft tax exemption clears committee," Aircraft Owners and Pilots Association Online, October 20, 2011 http://www.aopa.org/advocacy/articles/2011/111020pennsylvania-aircraft-tax-exemption-clears-committee.html.

[xvi] http://investor.textron.com/phoenix.zhtml?c=110047&p=irol-newsArticle&ID=1081831&highlight=

[xvii] According to Bill Cox ("Cessna 162 Skycatcher: It's Here!" Plane & Pilot Magazine, December 1, 2009, http://www.planeandpilotmag.com/aircraft/pilot-reports/cessna/cessna-162-skycatcher-its-here.html), the base price of the 162 is $112,250—making the U.S. built price $183,250.

[xviii] J. Lynn Lunsford, "Cessna's New Plane to Be Built in China," Wall Street Journal, November 28, 2007, (accessed November 1, 2011) posted online at: http://www.freerepublic.com/focus/f-news/1932307/posts.

[xix] AeroStrategy, *Aerospace Globalization 2.0: The next stage*, September 2009, http://www.aerostrategy.com/downloads/commentaries/commentary_sept09.pdf.

[xx] This prevents what is called "pyramiding," where sales tax is added to the price of the raw material, which is then used to make another taxable finished good. When the finished good is sold, its price is artificially inflated by the sales tax on the raw materials, which is taxed again. The more taxed raw materials (also called inputs) that are used in a product, the more tax pyramiding would occur. States recognize this and generally exclude inputs from sales tax.