Legislative Analysis

USE AND SALES TAX EXEMPTIONS FOR CERTAIN AVIATION EQUIPMENT

Phone: (517) 373-8080
http://www.house.mi.gov/hfa

Analysis available at
http://www.legislature.mi.gov

House Bill 4350 as enrolled
House Bill 4351 as enrolled
Sponsor: Rep. Bronna Kahle
Committee: Tax Policy
Complete to 12-26-18

(Vetoed by the Governor 10-16-18)

BRIEF SUMMARY: House Bills 4350 and 4351 would amend the Use Tax Act and the General Sales Tax Act to provide use and sales tax exemptions for parts or materials affixed or to be affixed to all aircraft, except for shop equipment and fuel. This would be an expansion of current sales and use tax exemptions for aircraft parts and materials, as explained below. The bills also make complementary changes to other provisions dealing with domestic air carriers.

FISCAL IMPACT: According to the Department of Treasury, the bills would collectively reduce sales and use tax revenue by approximately $4.0 million on an annual basis. The reductions would have small impacts on the School Aid Fund, constitutional revenue sharing, and the General Fund.

THE APPARENT PROBLEM:

According to testimony before the House Tax Policy Committee, most neighboring states provide **a sales and use tax exemption** for the purchase of parts and materials used in the maintenance and servicing of aircraft. These "flyaway" tax exemptions first applied to out-of-state aircraft and were designed to lure aviation business to certain states since aircraft are mobile and modifications are costly. As the "flyaway" exemptions increased in number, the exemptions were extended to in-state aircraft. Michigan has a "flyaway" tax exemption, but the exemption only applies to out-of-state aircraft. As such, Michigan-based aviation service businesses say they are losing in-state clients who are able to simply fly planes to tax-exempt states for maintenance and service.

THE CONTENT OF THE BILLS:

House Bills 4350 and 4351 would amend the sales and use tax treatment of aircraft in the following ways:

- The existing use and sales tax exemptions would be expanded so that they would apply to parts or materials affixed or to be affixed to all aircraft. (These exemptions do not apply to shop equipment and fuel.)
- The provisions dealing with exemptions for the sale of aircraft to domestic air carriers and the use of aircraft by domestic carriers would be re-written to reflect the other amendments.

House Bill 4350 would amend the Use Tax Act (MCL 205.94k). House Bill 4351 would amend the General Sales Tax Act (MCL 205.54x). The bills would take effect 90 days after enactment.

Currently, the exemptions for parts and materials differ, depending on whether or not the aircraft involved is a domestic air carrier. That distinction would be removed, since the exemptions would now apply to parts or materials affixed or to be affixed to <u>all aircraft.</u>

(The term "domestic air carrier" is limited to entities engaged primarily in the commercial transport for hire of air cargo, passengers, or a combination of air cargo and passengers as a business activity.)

<u>Current parts and materials exemptions for other than domestic carriers</u>

Currently, the use and sales tax exemptions on *parts and equipment* apply to aircraft that are <u>not</u> domestic air carriers only if both of the following conditions are met:

- The aircraft leaves the state within 15 days after final billing or approval of return to service, completion of the maintenance record, or completion of test flight and ground test (whichever is earliest).
- The aircraft was not based or registered in this state before the service, and the aircraft will not be based or registered in this state after the service

HBs 4350 and 4351 would **remove** these conditions and instead simply specify that the sales and use taxes do not apply to the sale of parts or materials, excluding shop equipment or fuel, affixed or to be affixed to <u>any aircraft</u>. The bills define aircraft as "an aerial vehicle that is used in aviation, other than an unmanned aerial vehicle."

<u>Current use tax exemption for domestic air carriers</u>

Under current law, **use tax** exemptions already apply to parts and materials (other than shop equipment and fuel) affixed or to be affixed to an aircraft owned or used by a domestic air carrier that is any of the following:

- An aircraft for use solely in the transport of air cargo or a combination of air cargo and passengers with a certificated takeoff weight of at least 6,000 pounds.
- An aircraft that is used solely in the regularly scheduled transport of passengers.
- An aircraft owned or used by a domestic air carrier solely for the transport of passengers (other than regularly scheduled flights) if the aircraft has a maximum certificated takeoff weight of at least 6,000 pounds and is designed to have a maximum passenger seating configuration of more than 30 seats.

HB 4350 would eliminate this language and create the following exemption:

> The tax levied under this act [Use Tax Act] does not apply to the use of an aircraft by a domestic air carrier if the aircraft has a maximum certificated takeoff weight of at least 6,000 pounds and is used solely in the transport or air cargo, passengers, or a combination of air cargo and passengers.

<u>Current sales tax exemption for domestic carriers</u>

Under current law, **sales tax** exemptions already apply to the sale to a domestic air carrier of one or more of the following:

- An aircraft for use solely in the transport of air cargo, passengers, or a combination of air cargo and passengers with a certificated takeoff weight of at least 6,000 pounds.
- Parts and materials, excluding shop equipment or fuel, affixed or to be affixed to an aircraft for use solely in the transport of air cargo, passengers, or a combination of air

> cargo and passengers that has a maximum certificated takeoff weight of at least 6,000 pounds.

HB 4351 would eliminate this language and rewrite the exemption as follows:

> The tax levied under this act [General Sales Tax Act] does not apply to the sale of an aircraft to a domestic air carrier if the aircraft has a maximum certificated takeoff weight of at least 6,000 pounds and is for use solely in the transport of air cargo, passengers, or a combination of air cargo and passengers.

ARGUMENTS:

For:

Proponents of the bills say that current tax policy places Michigan aviation service businesses at a competitive disadvantage to businesses in neighboring states. If Michigan charges 6% sales tax on all parts needed for a service repair, and Wisconsin charges 0% tax, an individual is simply going to fly to Wisconsin for the required services (so long as the cost of flying is less than the sales tax amount). Michigan-based businesses have, and will continue to, suffer revenue and employment losses. Michigan, as neighboring states have already done, needs to extend its exemption to in-state aircraft and allow businesses to compete equally. According to testimony, there are six similar bills in state legislatures across the country, and 29 states have already made aviation parts and materials sales and use tax exempt for both in-state and out-of-state aircraft.

For:

According to testimony, there are ninety-seven aircraft service and repair businesses across Michigan. These businesses are vital to local communities, providing jobs for residents, tax revenue to government, and creating associated economic activity. Instituting the tax reforms in these bills will improve the job creation climate in Michigan, especially in the aviation industry.

Against:

The use and sales tax exemption for aircraft parts and materials is a further erosion of the tax base that supports vital functions like schools and local governments. While one further exemption seems like a small change, the larger picture is the frequent introduction of legislation that provides special tax "carve outs" for specific items or businesses. Since the bill directly impacts sales tax revenue, the majority of the revenue loss will be borne by the School Aid Fund. [An amendment was offered in committee to each bill that would insert intent language for the Legislature to appropriate General Fund dollars to the School Aid Fund to fully compensate for any loss of revenue from the bills. The amendments failed.]

Response:

This is a small decrease to state revenue collections, and is designed to level the playing field for aviation service businesses. Without a level playing field, businesses may leave the state or lay off workers, either of which would deprive the state of various sources of revenue, including property taxes, income taxes, and businesses taxes.

Against:

An exemption for parts and materials used in the repair of aviation aircraft simply benefits those wealthy enough to own or utilize an aircraft. There are no such sales or use tax exemptions for an individual who owns and services an automobile at a local dealership.

Response:

The aircraft service industry is unique. Owners have numerous options and are highly price-conscious since planes are mobile and repairs can be costly. These two factors differentiate the industry substantially from other industries.

Against:

The use tax is designed to capture tax revenue where the purchaser did not pay sales tax on personal property. As such, the use tax already captures state revenues that are lost when aircraft travel out-of-state for repair. For instance, if an individual flies to Wisconsin and spends $5,000 on new tires, that individual is required to return to Michigan and remit use tax on the purchase.

Response:

While the individual is required to remit use tax, it is unknown how often this occurs. Additionally, in these cases the Michigan-based business has still lost the service contract.

Neutral:

Sales and use tax rates are just one component of the business environment in a state. There is no way of knowing that the sales and use tax rate is *the specific* reason for declining aviation business revenues or growth in Michigan, and no promise that the industry will rebound or grow with the tax exemptions proposed in the bills.

Neutral:

A more effective way to level the playing field might be to form multi-state compacts or agreements that treat and tax certain economic activity, like aircraft maintenance, in a similar way so that states are not in competition with one another on tax policies and incentives that seek to attract businesses. Too often, states engage in a "race to the bottom," competing for new business while damaging state treasuries and public services.

Vetoed 10-16-18:

In his veto message, Governor Snyder wrote that "consideration of tax exemptions before we have a more complete picture on incoming revenues, other recommended revenue reductions, and any necessary investments, represents a change in course from the fiscally responsible principles that have helped put our state back on solid financial ground over the last eight years. As such, I do not believe it is appropriate to consider tax exemptions like those found in House Bills 4350 and 4351 at this time."

Legislative Analyst: Patrick Morris
Fiscal Analyst: Jim Stansell