State of Oklahoma
Incentive Evaluation Commission

Aircraft Excise Tax Exemptions
Draft Report

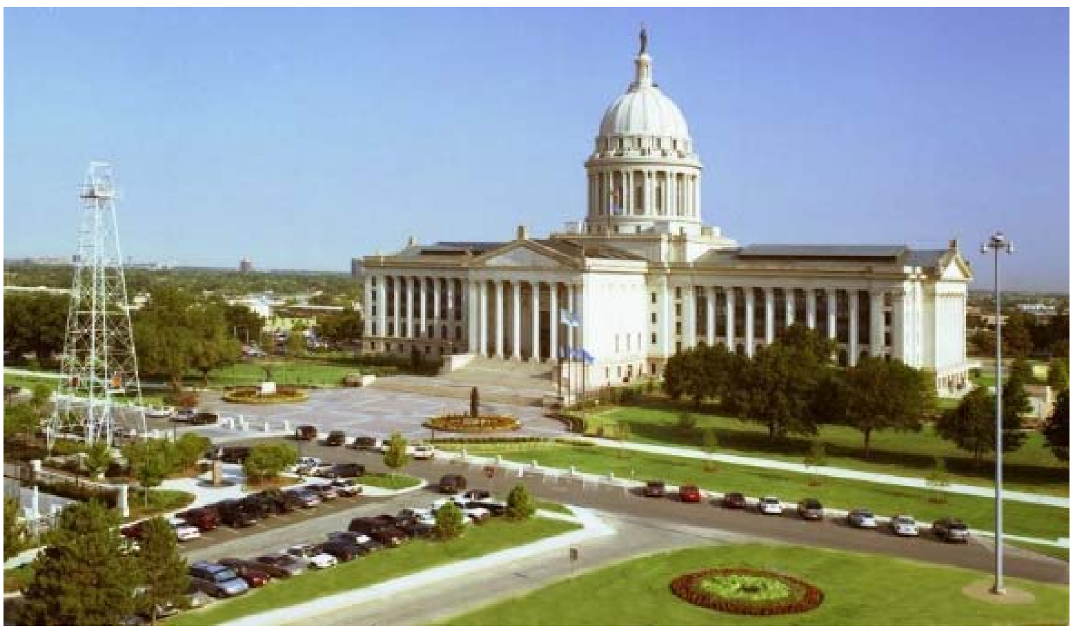

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Table of Contents

At a Glance: Aircraft Tax Exemptions

Statute: §68-6003

Program Goals

- None stated in legislation
- A total of 18 different exemptions have been added since 1984

Fiscal Impact

- An average of $2.6 million in excise tax revenue is foregone annually, which is about 40 percent of actual collections
- Collections are earmarked to support operations of the Oklahoma Aeronautics Commission so do not have broad programmatic impact

Economic Impact

- The available data was not sufficient to conduct an economic impact analysis.

Adequate Protections for Future Fiscal Impact?

- The available data was not sufficient to conduct a comprehensive future fiscal impact analysis
- Absent a material change in this industry in Oklahoma, it is unlikely that these exemptions will have a significant future fiscal impact

Effective Administration?

- Useful information related to the identity of the purchaser and the purchased aircraft is collected,
- However, dealers are not required to explain whether the reported sale was taxable or tax exempt, and if exempt, for what reason

Achieving its Goals?

- Goals are not identified and data does not provide a ready method of determining overall impact on the industry in the State

Retain, Reconfigure, Repeal?

- Reconfigure by focusing the exemptions around a policy goal.

Changes to Improve Future Evaluation?

- Require dealer reporting on aircraft transactions to identify the rationale for exempting sales from excise tax

Executive Summary

Introduction

Enacted in 1984, Oklahoma statutes provide for a 3.25 percent excise tax on the purchase price of aircraft sold in the State. Revenue derived from this tax is used to support the Oklahoma Aeronautics Commission.

The statute also provides a series of 18 categories of exemption from the imposition of the excise tax.

In general, aircraft sales are exempt from the aircraft excise tax if the aircraft is:

1. Still owned by the manufacturer or dealer;
2. Belongs to the federal, state or local government;
3. Is sold as a commercial airliner;
4. Is transferred as part of corporate restructuring of various sorts;
5. If reciprocal amount of tax was paid to another state;
6. If the plane is foreclosed or inherited;
7. Is used for agricultural spraying; or
8. Sells for more than $2.5 million to a non-state resident for use out of state (a restricted "fly-away" exemption).

The excise tax collections, which average just over $4.0 million a year, are used to support the operations of the Oklahoma Aeronautics Commission.

The data on this exemption is limited, but thanks to direct analysis of tax reporting data by the Tax Commission research staff, some information for the last two years is available. The data shows that the Aircraft Excise Tax is a volatile revenue source, but collections show some growth trends. More than 500 aircraft sale transactions were recorded in each of the last two State fiscal years. Of the transactions, less than 10 percent were tax exempt, but the tax exemptions reflect foregone revenue that is about 40 percent of the total amount that would have been collected if no exemptions existed. This likely reflects the fact that transactions that are exempt from the tax are for higher priced planes. However, the reports used to identify determine the exempt revenue do not indicate the reason why the transaction was exempt.

Regardless of the source of the exemption, in FY2015 and 2016, the State annually had foregone revenue of about $2.6 million because of the 18 exemptions to the Aircraft Excise Tax.

Even though the exempted revenue is a significant component of what would otherwise be collected were the excise tax applied to all aircraft sales (about 40 percent) the available sales data is insufficient to support an economic impact analysis of any potential benefits resulting from this tax expenditure.

When compared with other states, the project team found that Oklahoma's exemption rules are more numerous and complex than many other and lack a central theme or purpose, which is often found elsewhere. For example, some states exempt aircraft manufactured in their state, and some forego tax on any plane sold for use elsewhere – the so-called "fly-away" exemption.

The project team believes that some of the exemptions, such as technical "paper" transfers, sales between manufacturers and dealers, or sales to a unit of government make sense, are consistent with rational tax policy. Others should be reorganized around a central economic theme such as supporting the manufacturing and/or MRO industry in Oklahoma.

As a result, the project team recommends that the incentive be reconfigured around a specific policy goal or goals that are identified by the Legislature, with those exemptions that do not align with these goals discontinued. The project team also recommends that the reporting of exemptions include specific details related to the source for the exemption.

Introduction, Program Background and Benchmarking

Overview

The Oklahoma Incentive Evaluation Commission (the Commission) was established in HB2182, which was enacted and became law in 2015. It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The Five Year Ad Valorem Tax Exemption for Manufacturing is one of the incentives reviewed in 2016 by the Commission with recommendations to the Governor and the State Legislature.

Introduction

Enacted in 1984, Oklahoma State statute provides for a 3.25 percent excise tax on the purchase price of aircraft sold in the State. Revenue derived from this tax is used to support the Oklahoma Aeronautics Commission.

The statute also provides a series of 18 categories of exemption from the imposition of the excise tax. The exemptions have, in some cases, been added to the statute on multiple occasions.

The following identify the 18 categories of exemption:

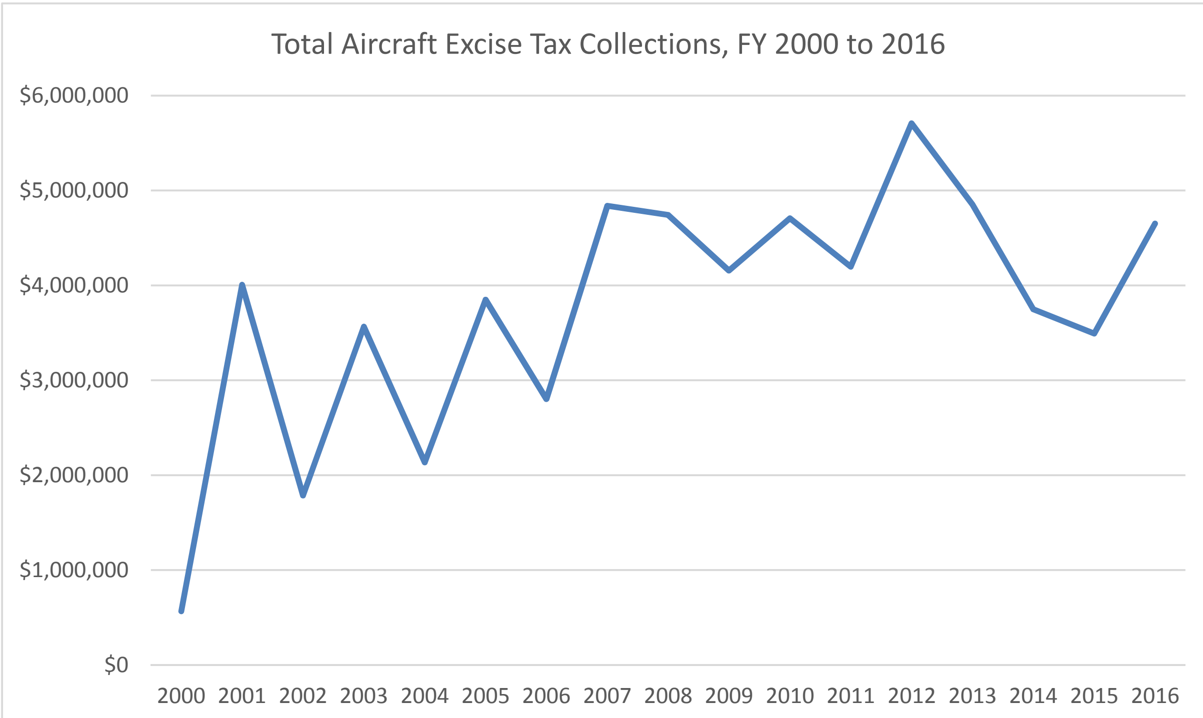
The following types of aircraft are exempt from the Aircraft Excise Tax under Article 68, Section 6001 of the Oklahoma statute:

1. Aircraft manufactured under an F.A.A. approved certificate and which are owned and in the physical possession of the manufacturer of said aircraft. Said aircraft shall have an aircraft exemption license as provided for in Section 254 of Title 3 of the Oklahoma Statutes;
2. Aircraft owned by dealers and in the dealer's inventory, not including aircraft that are used personally or for business. Said aircraft shall have an aircraft exemption license as provided for in Section 254 of Title 3 of the Oklahoma Statutes;
3. Aircraft of the federal government, any agency thereof, any territory or possession, any state government, agency, or political subdivision thereof;
4. Aircraft transferred from one corporation or limited liability company to another corporation or limited liability company pursuant to reorganization of the corporation or limited liability company. For the purpose of this section the term reorganization means a statutory merger, consolidation, or acquisition;
5. Aircraft purchased or used by commercial airlines as defined by paragraph 2 of Section 6001 of this title;
6. Aircraft transferred in connection with the dissolution or liquidation of a corporation or limited liability company and only if included in a payment in kind to the shareholders or members;
7. Aircraft transferred to a corporation for the purpose of organizing such corporation. However, the former owners of the aircraft must have control of the corporation in proportion to their interest in the aircraft prior to the transfer;
8. Aircraft transferred to a partnership or limited liability company when the organization of the partnership or limited liability company is by the former owners of the aircraft. However, the

former owners of the aircraft must have control of the partnership in proportion to their interest in the aircraft prior to the transfer;

9. Aircraft transferred from a partnership or limited liability company to the members of the partnership or limited liability company and if made in payment in kind in the dissolution of the partnership;
10. Aircraft transferred or conveyed to a partner of a partnership or shareholder or member of a limited liability company or other person who after such sale owns a joint interest in the aircraft and on which the sales or use tax levied pursuant to the provisions of this title or the excise tax levied pursuant to the provisions of Section 6002 of this title have previously been paid on the aircraft;
11. Aircraft on which a tax levied pursuant to the provisions of the laws of another state, equal to or in excess of the excise tax levied by Section 6002 of this title, has been paid by the person using the aircraft in this state. Aircraft on which a tax levied pursuant to the laws of another state, in an amount less than the excise tax levied by Section 6002 of this title, has been paid by the person using the aircraft in this state shall be subject to the levy of the excise tax at a rate equal to the difference between the rate of tax levied by Section 6002 of this title and the rate of tax levied by the other state;
12. Aircraft when legal ownership of such aircraft is obtained by the applicant for a certificate of title by inheritance;
13. Aircraft when legal ownership of such aircraft is obtained by the lienholder or mortgagee under or by foreclosure of a lien or mortgage in the manner provided for by law;
14. Aircraft which is transferred between husband and wife or parent and child where no valuable consideration is given;
15. Aircraft which is purchased by a resident of this state and used exclusively in this state for agricultural spraying purposes; provided, if such aircraft is sold, leased or used outside this state or for a purpose other than agricultural spraying at any time within three years from the date of purchase, the excise tax levied pursuant to the provisions of Section 6002 of this title shall be due and payable. For purposes of this subsection, "agricultural spraying" means the aerial application of any substance sold and used for soil enrichment or soil corrective purposes or for promoting the growth and productivity of plants and animals;
16. Aircraft which have a selling price in excess of $2,500,000 and which are transferred to a purchaser who is not a resident of this state for immediate transfer out of state;
17. Aircraft which is transferred without consideration between an individual and an express trust which that individual or the spouse, child or parent of that individual has a right to revoke; and
18. Rotary wing aircraft purchased to be used exclusively for the purpose of training U.S. military personnel or other training authorized by the U.S. government (expires January 1, 2018).

As shown in the following table, the Aircraft Excise Tax is a somewhat volatile source, but it has generally been trending upward since FY2000 (with notable recent dips in FY2013 through FY2015). The fact that the tax collections are generated by a relatively small number of large-dollar transactions each year likely helps explain the volatility of the tax collections.



Source: Oklahoma Tax Commission

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of the exemptions to this excise tax, the specific rationale for the exemptions were not included in the legislation that established them.

Given the disparate nature of the exemptions, the project team and the Evaluation Commission struggled with establishing criteria for evaluation. The following were adopted by the Commission:

1. Growth in sales of exempted aircraft within the state – comparison to the period prior to the credit

2. Growth in employment in aircraft industry within the state – comparison to the period prior to the credit

3. Return on investment related to economic impact from exemption versus its cost

The criteria focus on what might be considered the goals of the exemptions, based on what are often considered to be the rationale for exempting an excise tax (which is a specific tax on consumption).

Benchmarking

For evaluation purposes, benchmarking provides information related to how peer states use and evaluate similar exemptions. At the outset, it should be understood that no states are 'perfect peers' – there will be multiple differences in economic, demographic and political factors that will have to be considered in any analysis; likewise, it is exceedingly rare that any states' set of exemptions will be exactly the same. These benchmarking realities must be taken into consideration when making comparisons – and, for the sake of brevity, the report will not continually re-make this point throughout the discussion.

The process of creating a comparison group for incentives typically starts with a look at bordering states. This is generally the starting point because proximity often leads states to compete for the same regional businesses or business/industry investments. Second, neighboring states often (but not always) have similar economic, demographic or political structures that lend themselves to comparison. However, the comparison group for certain incentives will be broader than just the neighboring states.

A common exemption from aircraft sales and/or excise taxes imposed by the state where the aircraft is delivered is what is known as the "fly-away" exemption. This is a state tax exemption that allows non-residents to purchase and take delivery of aircraft without being subject to the state tax as long as they are not a state resident and are not keeping the plane in the state. This approach is used in several states including California, New Jersey, Illinois, Massachusetts, Texas and Pennsylvania. In Oklahoma, the law provides such an exemption for aircraft that sell for more than $2,500,000.

Various other approaches are used by the benchmark states, including exempting aircraft manufactured in the state. What the exemption policies in many other states have in common is there generally is a specific economic goal that the exemptions strive to achieve.

State	Exemption Requirements[1]
Arkansas	Exemption on parts and maintenance and sales of aircraft to a resident of another state who will base the aircraft outside the state
Washington	Aircraft purchased primarily for interstate or foreign commerce by transporting persons or property for hire
	Aircraft purchased for bare-rental
	Aircraft over 41,000 pounds that are not required to be registered in-state, sold to nonresidents
	Repair and maintenance for nonresidents

1

Arkansas	https://www.nbaa.org/admin/taxes/state/ar/Act1182.pdf
Washington	http://dor.wa.gov/content/findtaxesandrates/othertaxes/tax_aircraft.aspx
Georgia	https://dor.georgia.gov/what-subject-sales-and-use-tax#field_related_links-486-16
Alabama	http://revenue.alabama.gov/salestax/online/40234.cfm
Florida	http://dor.myflorida.com/Forms_library/current/gt800008.pdf
Connecticut	http://www.ct.gov/drs/cwp/view.asp?a=1477&q=269920

State	Exemption Requirements[1]
Georgia	If an aircraft is assembled or manufactured in the state and the aircraft is to be used out of state
Alabama	If manufactured, sold, and delivered in this state if said aircraft are not permanently domiciled in Alabama
	Also exempt are aircraft and parts and components used for aircraft transporting people or property for commerce
Florida	Aircraft sold to nonresidents taking the aircraft out of Florida. Must provide proof of registration in another state to qualify
Connecticut	Must be sold by a manufacturer of aircraft in the state

Fiscal Impact

The following table provides information on the tax collections and taxable transactions related to the Aircraft Excise Tax. Revenue derived from this tax is used to support the Oklahoma Aeronautics Commission. The additional data, from the Tax Commission, for FY2015 and FY2016 reflects the total number of aircraft sales transactions reported in FY2015 and FY2016 and also the number that were tax exempt (listed as net aircraft sales and units).

Fiscal Year	Total Aircraft Sales	Total Units	Taxable Aircraft Sales	Taxable Units	Tax Collected	Exempt Sales	Exempt Units	Tax Foregone
2000	-	-	$17,431,422	-	$566,521	-	-	-
2001	-	-	$123,283,092	-	$4,006,700	-	-	-
2002	-	-	$54,955,699	-	$1,786,060	-	-	-
2003	-	-	$109,709,159	-	$3,565,548	-	-	-
2004	-	-	$65,670,813	-	$2,134,301	-	-	-
2005	-	-	$118,474,327	-	$3,850,416	-	-	-
2006	-	-	$86,198,100	-	$2,801,438	-	-	-
2007	-	-	$148,875,686	-	$4,838,460	-	-	-
2008	-	-	$145,949,478	-	$4,743,358	-	-	-
2009	-	-	$127,884,125	-	$4,156,234	-	-	-
2010	-	-	$144,826,656	-	$4,706,866	-	-	-
2011	-	-	$129,136,306	-	$4,196,930	-	-	-
2012	-	-	$175,638,060	-	$5,708,237	-	-	-
2013	-	-	$149,302,209	-	$4,852,322	-	-	-
2014	-	-	$115,345,072	-	$3,748,715	-	-	-
2015	$222,454,247	502	$107,448,770	470	$3,492,085	$115,005,477	32	$3,737,678
2016	$188,683,155	541	$143,139,770	505	$4,652,043	$45,543,385	36	$1,480,160

Based on the information in the table, the State is foregoing several million dollars in revenue as a result of the 18 different exemptions under the statute. The source data does not indicate which exemption type was utilized. The data also does not support an analysis of the tax revenue generated by the exemptions. For example, some or all of the exempt transactions could have been generated by planes that were transferred as a result of corporate restructuring or other non-economic transactions. As a result, based on the data limitations, the project team is unable to offer an estimate of State tax liability generated by the exempt transactions. As a result, the fiscal impact cannot be calculated.

Economic Impact

As explained in the previous section, the data available for evaluation does not provide sufficient information to conduct an analysis of the economic impact of this exemption. However, it is unlikely that there is a significant impact attributable to the exempt portion of aircraft transactions.

Technical and Administrative Issues

Exemptions from an excise tax are a much different type of incentive than income tax credits. While those claiming an income tax credit generally do so on their tax return (and provide any specific schedules necessary to justify the claim of the credit), excise taxes are generally collected by the seller, and they are required to gather and submit any supporting information to justify the exemption from the purchaser.

In the case of these exemptions, Chapter 138 of the Laws of 1984 provides: "The Tax Commission shall require every person licensed as a dealer in aircraft pursuant to the provisions of Sections 251 through 257 of Title 3 of the Oklahoma Statutes to make a report to the Tax Commission within a period of thirty (30) days after the transfer by such person of the legal ownership of any aircraft." This statute requires significant information, including the name and address of the purchaser, a description of the aircraft, including the name of the manufacturer, the Federal Aviation Administration registration number of the aircraft, the type and year manufactured, the serial number, the date of the transfer, and the amount of the sale price. It does not require the dealer to explain whether the sale was taxable or exempt, and if exempt, for what reason.

Moreover, the Tax Commission's ability to routinely extract information from the dealer filings is limited. It required significant time and effort for the Tax Commission research staff to compile the data needed for this evaluation.

Outcomes

Over the past two fiscal years, there have been 1,043 reported sales of aircraft in Oklahoma. Of that amount, 68, or about 6.5 percent, have been tax exempt. However, on a dollar basis, sales have totaled $411,137,402, of which $160,548,862, or about 39 percent, were exempt. This may be caused by the "fly-away" provision that exempts collection of the excise tax for aircraft sales with a price of over $2.5 million if the plane is immediately leaving the State.

As discussed in preceding sections, the lack of definition in the data reported to the State precludes any practical analysis of policy or programmatic outcomes.

Recommendations

Recommendation: Reconfigure

When viewed in the context of other states or rational tax policy, Oklahoma's 18 exemptions from the application of an excise tax on aircraft are more complex than most. Some of the exemptions – for arm's length/actual retail sales in the common meaning of the word, and sales to units of government are common and make sense. However, the policy rationale for exempting "big ticket" fly-away sales (over $2.5 million), and some of the other specific exemption is not clear. It appears that other states have provided greater focus that aligns with policy goals in this and other areas.

The project team recommends that the Governor and the Legislature consider the goals of exemptions from this revenue source and construct Section 6003 accordingly. For example, several states, including Connecticut, Alabama, and Georgia limit their exemption to the sale of aircraft that are manufactured in their state.

Once a rational set of exemptions is in place, the dealer reporting on transactions should be expanded to include additional information on the nature of exempt sales.