Special Report

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Florida Council of Economic Advisors at Florida TaxWatch

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The Economic Impacts of Restructuring Florida's Sales and Use Taxes on Fractional Aircraft Ownership

Executive Summary

- Florida's current tax policies regarding fractional ownership of aircraft is placing the State at a competitive disadvantage for attracting growth and business retention in this industry.
- While this industry has considerable growth potential in Florida, the existing tax structure encourages tax avoidance strategies that are costly to the State in terms of foregone economic growth opportunities and tax efficiency. State tax revenues may be expanded by reducing the industry tax burden to be more on par with taxes in other states.
- Minimal revenues are raised by the current tax policies on fractional ownership due to (legal) tax avoidance, as new aircraft are domiciled outside the State.
- An analysis with a computer simulation model of Florida's economy indicates that, under reasonable assumptions, **a significant reduction in the tax rates applied to fractional owned aircraft will support significant job and income creation and generate between $2.3 million and $2.9 million in general fund revenues (net basis) over five years beginning in FY2009-10 and between $7.0 million and $9.2 million in revenues over ten years beginning in FY2009-10**.

Background

Prior owners of corporate aircraft or frequent users of chartered air travel services have found fractional aircraft ownership programs to be a more cost effective alternative. The fractional aircraft industry has grown rapidly in recent years. Fractional owners purchase an interest in an aircraft rather than purchasing or leasing an entire aircraft. Their purchase buys a share of one specific aircraft, and allows them a specific guarantee of proportional access to such aircraft, or an equivalent, within a contracted period. Since their inception in 1986, fractional aircraft ownership programs have provided a means to spread the capital cost, maintenance, and general overhead expenses across a wider base of participants. Therefore, the programs have provided many of the benefits of full ownership at a lower overall cost.

Advantages to fractional ownership also include fewer burdens associated with maintenance, since a management company will provide services such as operation, upkeep, and storage of the aircraft. There is also greater travel flexibility and shorter total travel time associated with private, fractional aircraft ownership than traditional individual private ownership. Along with sharing access to an aircraft, participants in these programs also have the opportunity to lease their share of access to the aircraft.

Florida currently provides Sales and Use Tax exemptions to "qualified aircraft" for such functions as aircraft repair and labor, equipment, sales and leases, and aircrafts purchased in Florida that will not be used or stored in the state. Qualified aircraft must meet minimum weight requirements and larger aircraft are more generally used for commercial use. These exemptions are not similarly extended to fractional aircraft ownership programs.

Current Florida tax policy applies its six-percent State Sales and Use Tax (Section 212.08, F.S.) on fractional aircraft ownership programs and related costs. The continued policy of taxing these programs under current terms represents an economic barrier to the State of Florida by inhibiting the growth of this industry, discouraging new entry into the market, and perhaps eventually encouraging a contraction of the industry and a shift toward more aviation-friendly states with bases of operation. At the same time, current collections of such taxes are of minimal impact to the State of Florida, as fractional jet companies avoid taking delivery of new aircraft within Florida and look for out-of-state maintenance services when practicable. The State's economy and aviation industry is held back from reaching its full potential by a significant tax disadvantage.

Brief Comparative Analysis of Tax Policy

Neighboring and other states have adopted a more favorable tax structure for this industry. **Georgia** exempts aircraft manufactured or assembled in the state when sold for use exclusively outside of Georgia. **South Carolina** imposes a maximum tax of $300 for each aircraft sold in the state. **Louisiana** has an exemption from Sales and Use Tax for items purchased for first use out of state that applies to aircraft. **Texas** exempts aircraft from Sales and Use Tax when sold to an individual or corporation for use and registration in any other state prior to use in Texas. **Massachusetts** exempts the purchase, storage, and significant overhauling or rebuilding of aircraft, including repair and replacement parts, from Sales and Use Taxes.

Aircraft commonly used by fractional aircraft owners in Florida are subject to the State's Sales and Use Taxes applicable to tangible personal property, and aircraft maintenance and repairs. The State's tax policy with respect to fractional aircraft owners is significantly constraining the growth of this industry within Florida and keeping it from achieving its likely potential. The tax disadvantages from taking possession of, making alterations to, storing, maintaining and repairing fractionally owned aircraft in Florida encourages the industry to base its operations outside of the state and reduces the benefits to residents from fractional aircraft ownership. The tax differential between Florida and other states results in economic and fiscal revenue losses. House and Senate bills currently before the Florida legislature would limit Sales and Use Tax on fractional aircraft to $300 per each sale of each fractional ownership.

The Potential Economic and Fiscal Impacts from Reducing Sales Taxes on Fractional Aircraft

Florida is an ideal market for fractional aircraft ownership because of its large number of companies and high population of premium air travelers. The significant Florida Sales and Use Tax liability that can arise from the purchase of an aircraft (whose price may range from $7 million to $24 million) leads fractional aircraft owners under the current tax structure to prefer take delivery and customize their planes outside of Florida. The average price of fractional aircraft typically used in Florida is approximately $13 million.[1] Due to Florida's tax structure, these planes are kept outside of the State for at least six months, before owners use them in Florida. The cost of customizing the plane for the owners' specific needs is estimated at approximately $500,000 and annual maintenance and repairs average approximately $180,000 per year. Alterations and maintenance expenditures of aircraft that are domiciled outside the State represent manufacturing revenues to Florida business establishments that are being diverted to other aviation friendly states.[2]

Minimal sales taxes are currently collected on fractional aircrafts, as the current tax structure leads these planes to be domiciled outside the state. The State legislature's fiscal analysis of January 2007 noted that most fractional aircraft were domiciled outside of Florida for legal tax avoidance, although a small amount of tax revenue was being collected.[3] Taxes that might currently be collected on fractional ownership of aircraft are unlikely to be originating from commercial enterprises managing large fleets in fractional ownership structures. Industry representatives argue that it is financially foolish for these fractional aircraft operators to take possession of aircraft in Florida under the current tax structure.

There were 385 fractional aircraft owners in Florida in 2006, and by 2008 the number of owners is estimated to have grown to approximately 600.[4] The growth in fractional owners suggests that a significant number of fractional aircraft could be delivered in Florida in the future, if fractional aircraft ownership were largely exempt from Florida's Sales and Use Tax. The manufacture of these aircraft would most likely be completed in Florida, providing a significant boost to the State's economy as well as aviation industry. Similarly, maintenance and repairs during the first six months of ownership which are now more likely to occur outside the State would also be serviced by Florida aviation maintenance and repair shops, further stimulating and diversifying Florida's economy.

The potential economic and state fiscal impact from providing a Sales and Use Tax exemption on fractional aircraft was developed under two scenarios. The first scenario considers moderate industry growth over the next decade, while the second examines the impact under a slightly more robust rate of general industry growth. Projected industry expansion in Florida under both scenarios is modest in the Fiscal Year (FY) ending June 2010, in anticipation of only slow economic recovery in 2010.

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[1] This estimate was prepared by the Florida Legislature's Revenue Estimating Conference (REC), analysis of HB 217 and SB 380, January 10, 2007.

[2] Alteration costs are based on interviews with fractional aircraft companies and refer to costs in 2008, estimate of maintenance expenses are those provided in the REC analysis cited above.

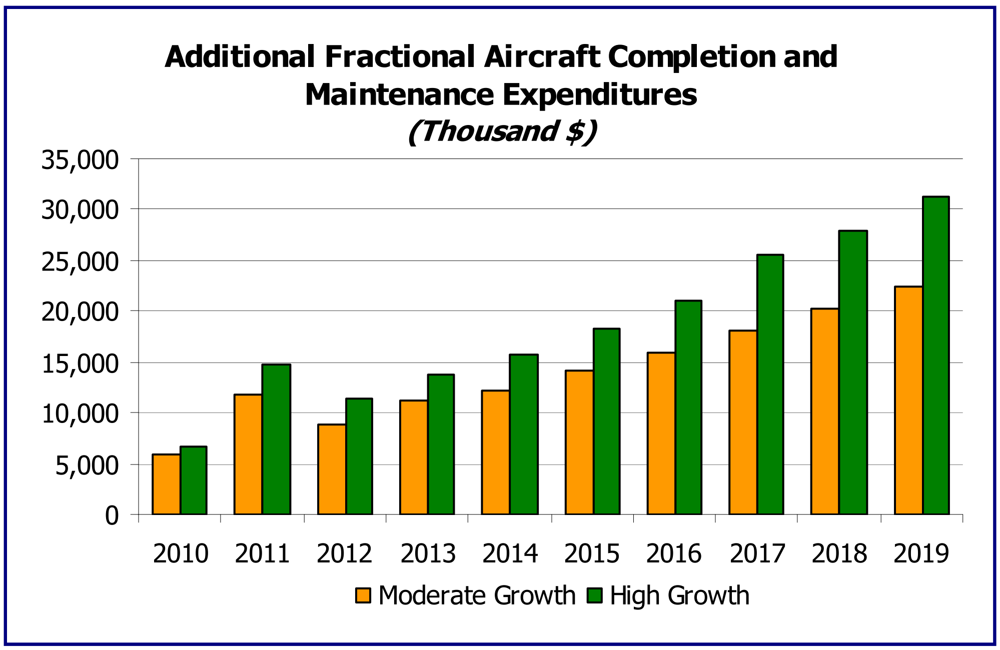
[3] REC analysis cited above, Attachment to analysis of HB 217 and SB 380 – pages 1, 2 and 3.

[4] Estimate for 2006 was obtained from the REC analysis previously cited, while the estimate for 2008 is based on the increase in the size of one Florida fractional jet operator from 2006 to 2008.

The economic and fiscal impacts under both scenarios are driven by the number of aircraft delivered and completed in Florida. The expenditures for customizing the aircraft to the owners' specifications, and the six months of maintenance and repair work that would not have otherwise occurred in the absence of the proposed tax exemption, will have positive impacts on the State economy. These expenditures provide benefits to Florida's workers and businesses, as well as additional fiscal revenues, from the resulting expansion of the State's economic activity.

Limiting taxes on fractional aircraft transactions are expected to encourage additional economic activity in the State's aviation sector. Under the *Moderate Growth Scenario*, annual expenditures on alterations to aircraft, and maintenance and repairs, would rise to $6 million in FY2010, $12.3 million in FY2014, and to $22.5 million in FY 2019. The economic impacts resulting from this economic stimulus to the aviation manufacturing sector were estimated with the aid of a 70 Sector REMI economic simulation model of Florida's economy.

The growth of the fractional aircraft industry would support 50 jobs in FY2010, providing $3.6 million in labor compensation to Florida workers, and contributing $5.2 million to Florida's Gross State Product.[5] The economic activity initiated through additional sales in the State's



aviation industry would also yield $260,000 in additional state general fund revenues in FY2010. The anticipated growth in the fractional aircraft business yields greater economic impacts over time, and by FY2014 the industry is projected to support an additional 96 jobs, $7.4 million in annual labor compensation, $11.2 million in Florida's Gross State Product, and $600,000 in additional State revenues in FY2014. By FY2019 the economic impacts from the proposed change in sales tax policy includes 151 jobs, $12 million in annual labor compensation, $20.2 million in gross state product, and $1.2 million in State General Revenue that year. The proposed change in tax policy as it relates to fractional aircraft transactions is projected to result in a net

[5] Labor compensation and gross state product impacts are expressed in inflation adjusted values representing the equivalent buying power of money in 2009. The projected state revenue impacts, however, are not adjusted for inflation following the typical practice found in government budget projections.

gain of $2 million in State General Revenues during the five-year period from FY2010 to FY2014 and $7 million in State revenues over the ten-year period from FY2010 to FY2019, under the Moderate Growth Scenario. (See Table 1 below.)

Table 1. Economic Impact from Fractional Jet Delivery in Florida: Moderate Growth Scenario[1]
Monetary Values in Thousand $ at Constant 2009 Prices

FY Ending	Total Jobs	Labor Income	Gross Output	Gross State Product	State Revenues[2,3]	
					Annual	Cumulative
2010	50	3,601	10,696	5,199	260	260
2011	99	6,954	21,091	10,325	523	783
2012	77	5,797	16,636	8,468	432	1,215
2013	93	6,907	20,652	10,474	542	1,756
2014	96	7,423	22,283	11,216	600	2,356
2015	110	8,452	25,849	13,071	706	3,063
2016	121	9,432	29,269	14,787	817	3,880
2017	129	10,113	32,092	16,636	911	4,791
2018	145	11,171	36,096	18,121	1,044	5,835
2019	151	12,028	39,662	20,202	1,168	7,003
Average	107	8,188	25,433	12,850	700	
Cummulative		30,682	91,359	45,681	2,356	

Notes: 1) Economic impact based 10 fractional jets completed in Florida in FY 2010 and increasing to 18 by FY2014 and 28 by FY2019. 2) State revenues in current dollars. 3) Values represent net impacts.

Florida's fractional aircraft industry may grow faster than anticipated under the moderate growth scenario, and the economic and fiscal benefits to the State would be higher as well. Under the *High Growth Scenario* the expenditures on alterations to aircraft and maintenance and repairs would rise from $6.6 million in FY2010 to $15.7 million in FY2014 and to $31.3 million in FY 2019. The employment, labor income, Gross State Product and State fiscal impacts would all be higher as well under this high growth scenario. These impacts are indicated in Table 2 below.

Table 2. Economic Impact from Fractional Jet Delivery in Florida: High Growth Scenario[1]
Monetary Values in Thousand $ at Constant 2009 Prices

FY Ending	Total Jobs	Labor Income	Gross Output	Gross State Product	State Revenues[2,3]	
					Annual	Cumulative
2010	56	3,967	11,737	5,571	285	285
2011	124	8,737	26,445	12,852	655	940
2012	100	7,303	21,249	10,845	550	1,490
2013	116	8,549	25,399	12,705	668	2,158
2014	124	9,420	28,526	14,263	766	2,925
2015	142	10,893	33,273	16,709	909	3,834
2016	157	12,194	38,031	19,095	1,059	4,893
2017	185	14,261	45,455	23,026	1,289	6,182
2018	197	15,281	49,471	24,656	1,431	7,613
2019	210	16,547	54,972	27,638	1,614	9,227
Average	141	10,715	33,456	16,736	923	
Cummulative		37,977	113,356	56,236	2,925	

Notes: 1) Economic impact based 11 fractional jets completed in Florida in FY 2010 and increasing to 23 by FY2014 and 39 by FY2019. 2) State revenues in current dollars. 3) Values represent net impacts.

Conclusions

The current tax policy governing Florida's fractional aircraft industry is stifling its growth by encouraging tax avoidance strategies that are costly to the State in terms of both foregone economic growth opportunities and net Sales and Use Tax revenues. A tax policy that is more aligned with regional competitive realities of modern commerce that confront this industry and Florida is needed. By treating fractional aircraft ownership enterprises, from a tax perspective, more like the State treats commercial operators of larger aircraft, additional jobs as well as net growth in the state's Sales and Use Tax and other state General Revenue sources (Corporate Income Tax, Documentary Stamp Tax, etc.) should be generated. Both REMI economic simulation scenarios presented above show considerable economic and net state tax collection gains by reducing the nominal tax burden on this industry which is waiting to expand in Florida… but for these antiquated tax policies.

This Florida TaxWatch *Special Report* was written by **Robert D. Cruz, Ph.D.**, member of the Florida Council of Economic Advisors at Florida TaxWatch, and **David Macpherson, Ph.D.**, Senior Director of Research and Development and a member of Florida Council of Economic Advisors at Florida TaxWatch, and the Rod and Hope Brim Eminent Scholar Chair in Economics at Florida State University, with assistance from **Balazs Khoor**, Research Intern, under the direction of **Dominic M. Calabro, President and CEO**.

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Florida TaxWatch's research recommends productivity enhancements and explains the statewide impact of economic and tax and spend policies and practices on citizens and businesses. Florida TaxWatch has worked diligently and effectively to help state government shape responsible fiscal and public policy that adds value and benefit to taxpayers.

This diligence has yielded impressive results: in its first two decades alone, policymakers and government employees implemented three-fourths of Florida TaxWatch's cost-saving recommendations, saving the taxpayers of Florida more than $6.2 billion -- approximately $1,067 in added value for every Florida family, according to an independent assessment by Florida State University.

Florida TaxWatch has a historical understanding of state government, public policy issues, and the battles fought in the past necessary to structure effective solutions for today and the future. It is the only statewide organization devoted entirely to Florida taxing and spending issues. Its research and recommendations are reported on regularly by the statewide news media.

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