

# ON-DEMAND AIRCRAFT USED OUTSIDE THE STATE SALES TAX EXEMPTION



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2019-TE6

## EVALUATION SUMMARY

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2019

YEAR ENACTED	2014
REPEAL/EXPIRATION DATE	July 1, 2019
REVENUE IMPACT	None
NUMBER OF TAXPAYERS	None
AVERAGE TAXPAYER BENEFIT	None
IS IT MEETING ITS PURPOSE?	No, because it has not yet been used

### WHAT DOES THIS TAX EXPENDITURE DO?

The On-Demand Aircraft Used Outside the State Exemption (On-Demand Aircraft Exemption) excludes aircraft typically used for non-scheduled, “on-demand” flights that are primarily outside of Colorado from sales and use tax.

### WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not directly state a purpose for the On-Demand Aircraft Exemption. We inferred that this exemption was intended to incentivize the purchase of on-demand aircraft that will be primarily used outside the state, as well as to provide an incentive for Colorado companies that provide aviation maintenance and/or refurbishment services to hire more Colorado-based employees.

### WHAT DID THE EVALUATION FIND?

The exemption did not incentivize the purchase of on-demand aircraft nor directly impact employment within the state, but it may be supporting Colorado’s aviation sector to a limited degree by streamlining the administrative burden for purchasers of on-demand aircraft primarily used outside Colorado.

### WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider evaluating the eligibility requirements of the On-Demand Aircraft Exemption to determine if they should be expanded to allow more purchasers to take the exemption.

# ON-DEMAND AIRCRAFT USED OUTSIDE STATE SALES TAX EXEMPTION EVALUATION RESULTS

## WHAT IS THE TAX EXPENDITURE?

House Bill 14-1374 [Section 39-26-711.8(1), C.R.S.] created the On-Demand Aircraft Used Outside State Exemption (On-Demand Aircraft Exemption), which exempts new and used aircraft from sales and use tax when they are purchased for use by “on-demand” air carriers, regardless of whether the purchaser is a resident of Colorado. To qualify for the exemption, the aircraft must:

- Be purchased between July 1, 2014 and July 1, 2019.
- Only remain in Colorado for final assembly, maintenance, modification, or completion.
- Be removed from Colorado within the longer of:
  - ▶ 120 days after the date of sale, or
  - ▶ 30 days after completion of maintenance, interior refurbishment, paint, or engine work associated with the sale.
- Not be in the state for more than 73 days in the 3 years following the calendar year in which the aircraft is removed from Colorado.

An aircraft that is hangared or parked overnight is considered to be “in the state” for purposes of determining eligibility to take the exemption.

To claim the exemption, the purchaser must provide an affidavit to the seller stating that the aircraft will be used by an on-demand aviation company. Neither statute nor Department of Revenue guidance

explicitly define “on-demand” air carrier. However, Federal Aviation Administration (FAA) regulations and Department of Revenue guidance generally define them as aircraft that carry passengers or freight on flights that are not scheduled in advance, or four or less scheduled flights per route, per week. Common examples of on-demand air carriers include air charter, cargo, air ambulance, and firefighting services. The exemption is set to expire July 1, 2019.

If the physical delivery of the aircraft occurs in Colorado, the seller is required to report the value of exempt sales to the Department of Revenue using either its Retail Sales Tax Return (Form DR 0100) or Retailer’s Use Tax Return (Form DR 0173). The amount sellers report on these forms is aggregated with several other sales tax exemptions and sellers are not required to report how much is attributable to this specific exemption.

#### WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this exemption. Based on the statutory language and committee testimony, we infer that the primary intended beneficiaries of this exemption are Colorado-based on-demand air carriers who have aircraft that primarily operate outside the state.

There are no data available on the number of Colorado on-demand air carriers who might qualify for the exemption. Stakeholders estimate that there are at most about 100 aircraft suitable for on-demand operations sold in Colorado every year—mostly to out-of-state buyers—with typical sales prices of \$1 million or more and that many on-demand aircraft used in Colorado are purchased in other states. While some of these aircraft are purchased by on-demand air carriers, they are frequently purchased by wealthy individuals or businesses who may later lease them out to on-demand air carriers. Based on information we received from the Colorado Aviation Business Association and other stakeholders, we determined that as of December

2018, there were about 38 Colorado on-demand air carriers that operate about 115 aircraft primarily within the state and 440 aircraft primarily outside the state. Based on our review of the legislative history for House Bill 14-1374 and discussions with stakeholders, we identified two of these Colorado on-demand air carriers that might purchase or lease aircraft to be primarily used outside of the state and therefore, be eligible for the exemption.

We also inferred that Colorado businesses that perform maintenance, refurbishment, customization, and other post-manufacturing services for on-demand aircraft may also benefit from this exemption since they are often used by Colorado aircraft purchasers for pre-purchase inspections and post-purchase work.

#### WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. Based on the statutory language, we inferred that the purpose was to incentivize the purchase of aircraft, especially by Colorado residents, that will be used by an on-demand air carrier outside of the state by establishing a sales and use tax exemption similar to the exemptions allowed for the sale of commercial aircraft and other aircraft used primarily outside of the state. Since 1984, sales of aircraft to commercial airlines have been exempt from state sales and use tax [Section 39-26-711(1)(a) and (2)(a), C.R.S.]. Moreover, since 2008, sales of aircraft used for out-of-state travel have been exempt from state sales and use tax when purchased by someone who is not a resident of Colorado [Section 39-26-711.5, C.R.S.]. The On-Demand Aircraft Exemption provides a similar benefit to Colorado residents.

In addition, based on committee testimony, we inferred that another purpose of the exemption was to increase the number of mechanics and other maintenance and refurbishment positions that Colorado aviation companies hire. Aircraft buyers often hire an aviation service firm to conduct a pre-purchase inspection of the aircraft, and once the sale has closed, the aircraft typically undergoes a lengthy period of maintenance

and refurbishment at the same airport where the sale took place. Colorado aviation stakeholders estimate that about 80 percent of individuals or entities who purchase aircraft within Colorado follow up the purchase with aircraft maintenance and/or refurbishment, such as repainting, re-carpeting, and installing new interior features in the aircraft. Stakeholders estimate that this maintenance and refurbishment typically takes about 3 to 5 months. During this time, the purchaser typically employs avionics technicians, mechanics, and other workers to conduct this maintenance and refurbishment, usually from a company based at the airport. According to the Colorado Aviation Business Association, the average aircraft used by on-demand air carriers supports about five Colorado employees earning, on average, \$105,000 per year. In addition, stakeholders estimate that refurbishment contracts are often worth \$500,000 to \$4 million per aircraft.

**IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?**

We determined that the On-Demand Aircraft Exemption is not yet meeting its purpose because we could not identify any taxpayers that have used it. The exemption does not seem to have incentivized the purchase of aircraft that are to be used by an on-demand air carrier outside of the state. In addition, we determined that the exemption has not yet helped to increase the number of aircraft maintenance and/or refurbishment jobs in Colorado.

Statute does not provide quantifiable performance measures for this tax expenditure. Therefore, we created and applied the following performance measures to determine the extent to which the expenditure is meeting its purpose:

**PERFORMANCE MEASURE #1:** *To what extent has the On-Demand Aircraft Exemption helped increase the number of aircraft purchased in Colorado that are to be used by an on-demand air carrier outside of the state?*

**RESULT:** As of December 2018, it appears unlikely that the On-Demand Aircraft Exemption has helped to increase the number of aircraft purchased in Colorado that are to be used by an on-demand air carrier outside of the state because it does not appear that the exemption has been used. Specifically, although we lacked data to confirm whether the exemption has been used, none of the stakeholders we identified as potentially eligible for the exemption reported using it when we contacted them.

**PERFORMANCE MEASURE #2:** *To what extent has the On-Demand Aircraft Exemption helped to increase the number of aircraft maintenance and/or refurbishment jobs in Colorado?*

**RESULT:** Since the On-Demand Aircraft Exemption has likely not been claimed, it has not yet directly increased aircraft maintenance and/or refurbishment jobs in Colorado. While the Colorado Department of Labor and Employment’s employment statistics show a slight increase in the private “Air Transportation” sector from 14,804 employees in 2014 to 15,774 in 2018, this is a large, aggregated category of job types and employment specific to aircraft maintenance and refurbishment cannot be broken out. Federal Bureau of Labor Statistics data showed an increase of only 10 employees in the aircraft mechanics/service technicians sector in Colorado from 2014, when the exemption was created, to 2017, the most recent year for which data is available. These data, along with information we received from stakeholders, suggest that the exemption has not directly increased relevant aviation sector employment in Colorado.

#### WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

The On-Demand Aircraft Exemption likely has had no revenue impact to the State and no economic costs or benefits because it does not appear to have been used. Although the Department of Revenue does not collect information from taxpayers on their use of the exemption, one stakeholder reported that on-demand aircraft companies have been

using what they consider to be legal tax avoidance strategies that do not involve this exemption to avoid paying sales tax in Colorado. These strategies include purchasing, but not taking legal possession of the aircraft from the manufacturer until the aircraft has been outfitted and completing the aircraft's refurbishment in another state. However, the exemption has only been available to taxpayers for a few years. Thus, its economic impact could grow over time if the exemption continues. In addition, changes made in December 2017 to the federal tax code, now allow taxpayers to deduct 100 percent of a new or used aircraft's cost on their federal tax returns immediately after its purchase for aircraft placed into service between September 27, 2017 and January 1, 2023, and reduce the taxes they owe when they use an aircraft management firm. This change may increase the number of aircraft purchased by and/or leased to on-demand air carriers that could qualify for the exemption.

The potential impact of the exemption is difficult to estimate since the type of aircraft that on-demand air carriers lease or purchase varies considerably, from small helicopters or planes not much bigger than those used by flying schools, to medium-sized jets that can hold 30 passengers. The Colorado Aviation Business Association estimates that an average aircraft that could qualify for the exemption and is often used by Colorado on-demand air carriers that operate outside the state costs about \$1.6 million. At that price, each individual or company claiming the On-Demand Aircraft Exemption would incur a tax savings of about \$48,000 per aircraft.

#### WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the On-Demand Aircraft Exemption would have a relatively small impact on the intended beneficiaries. According to stakeholders, very few Colorado on-demand operators have bases outside the state that might allow them to primarily use the aircraft outside of Colorado, as the exemption requires. However, one stakeholder indicated that the exemption is important and is one reason

that it continues to service many of its aircraft in the state after they are purchased outside of Colorado. Although the stakeholder did not report taking the exemption directly, it said that the exemption reduces its administrative workload since it simplifies its record-keeping and tax accounting for many of its aircraft purchases. In addition, staff from a large Colorado aircraft maintenance and repair organization said that they frequently field calls from potential clients who ask about the State's aircraft exemptions and mention that they are a large factor in their decision to close the transaction and/or service/refurbish their aircraft in Colorado. Even though most of these callers are from outside of Colorado and, thus, have no need for the On-Demand Aircraft Exemption, it is possible that eliminating the exemption could cause them to favor conducting their business in other states if they feel like it is an important symbol of how "aviation-friendly" Colorado is.

Finally, while it is unlikely that the On-Demand Aircraft Exemption would be the main reason an on-demand air carrier currently based in another state decides to relocate to Colorado, it might factor into their decision-making alongside other influences, such as the availability of skilled aviation workers, and may make Colorado a marginally more attractive candidate for a carrier's headquarters. Air carriers who routinely purchase or lease aircraft sometimes spend a significant amount of administrative resources structuring the transactions to minimize their sales and use tax burden, such as by closing the sale and/or transferring title of the aircraft in a low-sales-tax state, then outfitting them in another aviation-friendly state that allows the aircraft to stay in the state for a lengthy servicing period without incurring use tax. Moreover, use tax rules often vary considerably across states, and the Department of Revenue has not issued clear guidance on how long on-demand aircraft owned or leased to businesses can remain in Colorado without incurring use tax. The On-Demand Aircraft Exemption makes navigating complex sales and use tax issues somewhat easier for on-demand air carriers who plan to primarily use their aircraft outside the state, and consequently might make Colorado a slightly more favorable location for operators and the firms they contract work out to.



## ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 45 states and the District of Columbia that have a sales tax, 15 have sales and/or use tax exemptions related to the purchase of on-demand aircraft. In addition, many states offer other aviation-related tax expenditures, as shown in EXHIBIT 1.1.

### EXHIBIT 1.1. NUMBER OF OTHER STATES (INCLUDING THE DISTRICT OF COLUMBIA) WITH AVIATION-RELATED SALES AND/OR USE TAX EXEMPTIONS

ITEM	NUMBER OF STATES WITH AVIATION-RELATED TAX EXEMPTIONS
Aircraft Parts	40
Commercial Aircraft	40
Aircraft Primarily Used Outside State	25
Aviation Fuel	19
On-Demand Aircraft	15

SOURCE: Bloomberg BNA and the Aviation Owners and Pilots Association.

EXHIBIT 1.2, compares Colorado's overall aviation-related tax provisions to those of neighboring states and states that aviation stakeholders report being Colorado's regional competitors for aviation business. It should also be noted that this exhibit only takes into account the comparative state sales tax provisions related to the aviation industry and does not factor in sales and use taxes levied by counties, municipalities, and special districts. According to the Tax Foundation, Colorado has the third highest average combined local sales and use tax rates in the U.S.

**EXHIBIT 1.2.  
COMPARISON OF AVIATION-RELATED STATE SALES TAX  
PROVISIONS  
IN COLORADO AND OTHER STATES**

STATE	EXEMPTION <sup>1</sup> FOR SALES OR LEASES OF COMMERCIAL AIRCRAFT?	EXEMPTION <sup>1</sup> FOR SALES OR LEASES OF AIRCRAFT PURCHASED BY OUT-OF-STATE RESIDENTS AND PRIMARILY USED OUTSIDE STATE?	EXEMPTION <sup>1</sup> FOR SALES OR LEASES OF ON-DEMAND AIRCRAFT?	EXEMPTION <sup>1</sup> FOR SALES OF AIRCRAFT PARTS?	EXEMPTION <sup>1</sup> FOR OCCASIONAL OR ISOLATED SALES OF AIRCRAFT?
Arizona	Yes	Yes	No	Yes	Yes
Colorado	Yes	Yes	Yes	Yes	No
Idaho	Yes	Yes	No	Yes	No
Kansas	Yes	Yes	No	Yes	Yes
Missouri	Yes	Yes	No	Yes	Yes
Montana	No sales tax	No sales tax	No sales tax	No sales tax	No sales tax
Nebraska	Yes	Yes	Yes	Yes	Yes
New Mexico	Yes	50 percent deduction from gross receipts tax	50 percent deduction from gross receipts tax	Yes	Yes
Oklahoma	Yes	Yes	No	Yes	No
Texas	Yes	Yes	Yes	Yes	Yes
Utah	Yes	Yes	No	Yes	No
Washington	Yes	No	No	Yes	Yes
Wyoming	Yes	No	Yes	Yes	No

SOURCE: Office of the State Auditor review of Bloomberg BNA, the Aviation Owners and Pilots Association, and other third-party sources.

<sup>1</sup>Includes states with partial exemptions in each category.

**ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS  
WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?**

There are a number of other aviation-related state tax expenditures:

**COMMERCIAL AIRLINES SALES AND USE TAX EXEMPTION [SECTION 39-26-711(1)(A) AND (2)(A), C.R.S.]:** The sale, storage, use, or consumption of aircraft used or purchased for use in interstate commerce by a commercial airline is exempt from state sales and use tax.

**OUT-OF-STATE AIRCRAFT SALES TAX EXEMPTION [SECTION 39-26-711.5, C.R.S.]:** The sale of a new or used aircraft to a non-Colorado resident is exempt from state sales tax if it only remains in Colorado

after the sale for a limited time, according to similar time-based requirements as aircraft eligible for the On-Demand Aircraft Exemption.

**AIRCRAFT PARTS SALES AND USE TAX EXEMPTION [SECTION 39-26-711(1)(B) AND (2)(B), C.R.S.]:** The sale, storage, use, or consumption of any tangible personal property that is to be permanently affixed or attached as a component part of an aircraft is exempt from state sales and use tax.

#### WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

The Department of Revenue does not collect information on the On-Demand Aircraft Exemption on its sales and use tax forms. Specifically, individuals and businesses that sell aircraft subtract the exempt sales from their net sales on the Colorado Retail Sales Tax Return (Form DR 0100) or Retailer's Use Tax Return (Form DR 0173). These exemptions are typically reported on the "other" exemptions line on the forms, which aggregate several exemptions that do not have specific reporting lines. In addition, the Consumer Use Tax Return (Form DR 0252) does not have a line for taxpayers to report any exemptions or deductions. Therefore, the Department of Revenue does not capture this information in GenTax, its tax processing and information system.

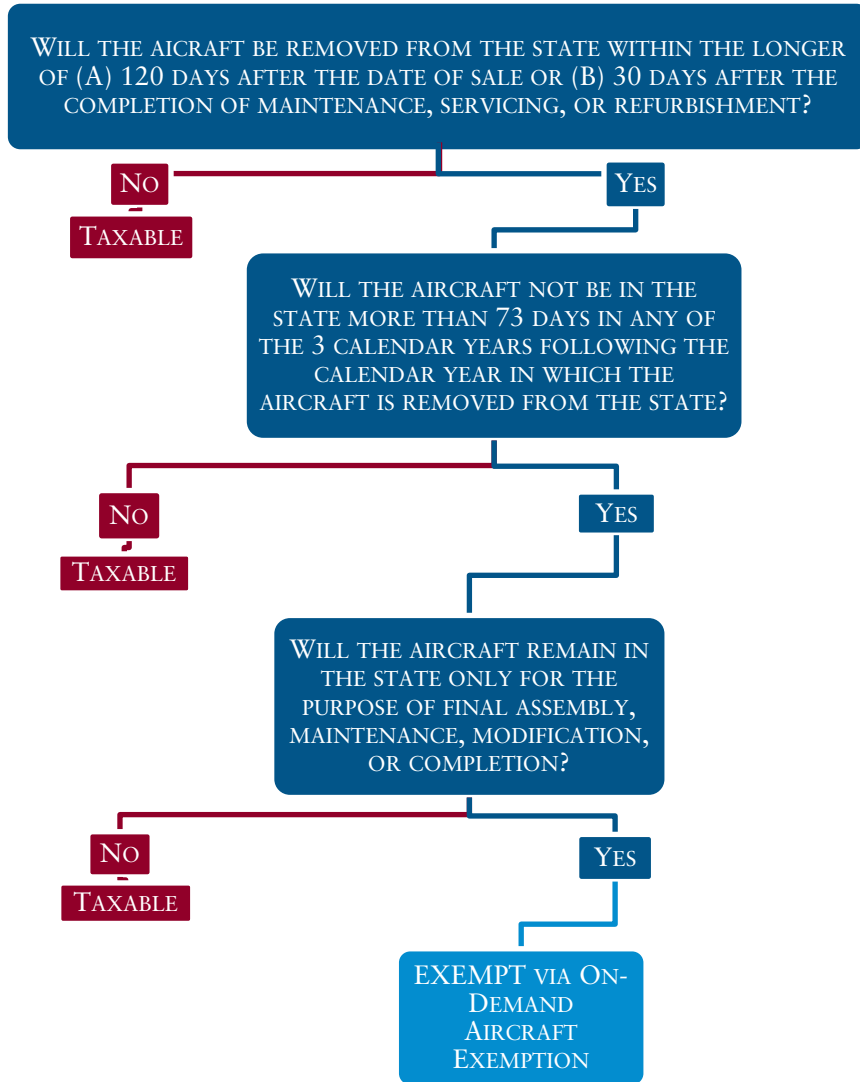
In addition, the Department of Revenue does not require that taxpayers who claim the On-Demand Aircraft Exemption submit information to the Department of Revenue that would assist in evaluating it. Currently, the affidavit that taxpayers who claim the exemption submit to the seller is not required to include any information on whether the taxpayer was incentivized to purchase the aircraft by the exemption, or whether the taxpayer intends to reinvest the tax savings into his/her business. Taxpayers are not required to submit the affidavit or any other documentation to the Department of Revenue in order to claim the exemption.

We had to rely on information provided by aviation stakeholders to determine if any taxpayers may have claimed the exemption and its revenue impact, as well as to assess whether the exemption is resulting in the creation of additional jobs. However, this lack of data could impede future evaluations of the exemption if taxpayers refuse to provide feedback, or if many more taxpayers claim it in future years. If the General Assembly wants to know how many taxpayers claim the exemption, how much they claim, and whether the exemption incentivized their purchases, the Department of Revenue would need to add separate reporting lines to Forms DR 0100, 0173, and 0252 and capture the data in GenTax. However, according to the Department of Revenue, this type of change would require additional resources to change the form and complete the necessary programming in GenTax (see the Tax Expenditures Overview Section of the Office of the State Auditor's *September 2018 Tax Expenditures Compilation Report* for additional details on the limitations of Department of Revenue data and the potential costs of addressing the limitations).

#### WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO EVALUATE THE ELIGIBILITY REQUIREMENTS OF THE ON-DEMAND AIRCRAFT EXEMPTION TO DETERMINE IF THEY SHOULD BE EXPANDED TO ALLOW MORE PURCHASERS TO TAKE THE EXEMPTION. Based on our review of the legislative history of House Bill 14-1374 and our discussions with stakeholders, we identified only two companies in Colorado that might qualify for the exemption due to the eligibility requirements. Specifically, although there are about 38 on-demand air carriers based in Colorado, most of them would not qualify for the exemption because their aircraft either only operate in Colorado or if they operate outside the state, they still cannot meet the exemption's requirements limiting the amount of time the aircraft spend in the state. EXHIBIT 1.3 illustrates the eligibility requirements of the On-Demand Aircraft Exemption.

**EXHIBIT 1.3.  
CURRENTLY EXEMPT ON-DEMAND AIRCRAFT PURCHASES  
BY COLORADO RESIDENTS**



SOURCE: Office of the State Auditor-created decision tree based on the requirements of Section 39-26-711.8, C.R.S.

Revising the exemption to include all aircraft purchased for use by on-demand air carriers, regardless of whether they are used within or outside Colorado, would increase the number of purchasers able to take the exemption. However, it could also lead to a larger revenue impact for the State and we did not evaluate the extent to which such a change would increase economic activity in the aviation industry. House Bill 18-1083, which passed the General Assembly during the 2018 Legislative Session would have made a similar change, but was vetoed

by the Governor, who cited a lack of evidence that the bill would have increased aircraft purchases and additional aircraft storage in Colorado. This bill would have broadened the Commercial Airlines Sales and Use Tax Exemption [Section 39-26-711, C.R.S.] to include all aircraft purchased for use by on-demand air carriers, whether they are used within or outside of Colorado, and would have defined what constitutes an “on-demand air carrier.” A Colorado Aviation Business Association study of the bill’s impact estimated that Colorado on-demand operators would bring in about two additional aircraft per year because of the bill, and Legislative Council estimated its annual revenue impact at \$90,000 to \$224,000. However, we did not verify the extent to which additional aircraft would have been purchased or brought into the state under the bill.