Comments Regarding JLARC's Tax Preference Review

Preliminary Report Regarding Commuter Air Carriers (Property Tax)

September 26th, 2019

The following comments are made on behalf of San Juan Airlines in response to the JLARC's 2019 review of the Commuter Air Carrier's Property Tax methodologies and exemptions. These comments are intended to supplement those made on behalf of Kenmore Air during the same review period. This testimony is provided by the owner of San Juan Airlines, an FAA Part 135 commuter airline with its headquarters in Bellingham, Washington. The following testimony is intended to provide reasoning for both maintenance and expansion of the tax preference under review.

Background:

In January of 2014, at the request of Kenmore Air, the legislature approved a special excise tax, rather than a central assessment and property tax on their assets. This request was made primarily to help streamline the tax process, as the aircraft in question are difficult to valuate based on several factors including aircraft condition, airframe time, engine time, and current market conditions. This benefit was limited to 'Commuter Aircraft' (as defined by FAA Part 135 regulations), located primarily on private property, that are owned and operated on scheduled routes.

Who we are: San Juan Airlines

Since 1950, the stewards of San Juan Airlines have provided an essential link between the San Juan Islands and the nearby mainland. The airline has continually carried doctors, nurses, patients, medical samples and supplies, professionals, trades people, residents, food, and freight between the islands and the mainland at the Bellingham and Anacortes locations. Today, San Juan Airlines is also the only air carrier to serve Point Roberts near the Canadian border. Without this vital service, accessibility to medical professionals and services, home building and maintenance workers, air freight, and timely travel options to and from the islands would simply not exist. In many cases, when considering travel to and from the islands for business, the time – cost savings benefit often makes flying a more economical option than utilizing water-based transportation. Additionally, with water-based service becoming less accessible with the reduction in ferries, and increased passenger demand (especially in the summer months), the airline is becoming all that much more critical to both the residents and the local economy.

About the business:

The airline owns and operates a small fleet of five Cessna Aircraft. The vintage of these aircraft range between 1969 and 1975. Most of the aircraft used in the operation are currently valued in the marketplace at about 1/5th of the price of comparable new aircraft. Purchasing new aircraft for our mission simply isn't an option because the economy of scale and ticket affordability doesn't allow us to do so.

An unfortunate result of owning an aging fleet, however, is that the maintenance cost over time is extensive as they require constant rebuilding and refurbishing. The environment they operate in is more demanding than the aircraft were designed to work in when considering the number of operations per day they experience. To keep them operating safely, each aircraft is partially disassembled, inspected, and repaired for every 100 hours of flight time accumulated per FAA regulations. These '100-hour inspections' occur approximately 30 or more times a year on the fleet. Estimated annual cost of keeping the fleet of five operational is somewhere in the order of 25% of the original purchase price of the aircraft. Engines must be changed (per regulation) once about every 3 years and represent between ½ to ¼ the value of the aircraft depending on the everchanging market. Additionally, new avionics requirements, airworthiness directives from the factory requiring airframe upgrades, and damage incurred from operating in a rugged environment also represent significant capital costs. In short, these aircraft are flying restoration projects, requiring significant yearly investments in parts and equipment, that are also subject to Washington State sales tax.

It should be noted that not only is San Juan Airlines subject to these challenges, but so are other FAA Part 135 airline operators, as well as FAA Part 61 flight schools. These operations across the United States serve as the backbone for young pilots requiring a certain level of experience before obtaining ATP licenses, allowing them to fly for the larger carriers. The U.S. is somewhat unique in this respect, as the FAA's requirements for entry level pilots is much higher than in other parts of the world. These requirements are part of the reason why the US has a much higher safety record in commercial aviation, than nearly ever other country in the world. Pilots are trained to understand aerodynamics and to have the skill to hand-fly airplanes, rather than to be fully rely on automated computer systems to do so.

It should also be noted that there is a significant pilot shortage in the U.S. as a result of many small operators simply going out of business due to the unfriendly business climate in the US. Market factors, taxes, availability of capital equipment and parts at reasonable prices, fuel prices, facility fees, and airport rental rates are all contributing factors in the decline of General Aviation. It is our desire to help educate lawmakers about that business climate in hopes that they can aid the operators in the State of Washington in maintaining this vital industry.

A general aviation business is not an endeavor that one takes on with the hopes of becoming monetarily wealthy. Anyone involved in this industry at the small scale understands that financial rewards are low at best. There's a cliché widely known in the general aviation community that states "If you want to make a small fortune, start with a large one." We here at San Juan Airlines understand this yet continue to operate out of a passion for both aviation, and the island communities we serve.

Why Tax Relief?

With respect to addressing the immediate topic at hand of excise tax vs. central property assessment, we would respectfully ask that the legislature consider the following.

The Washington State Excise tax laws for aircraft as they are currently written only apply to commuter aircraft that are held primarily on private property. As an operator struggling to keep the business serving the local community, it would be our hope that the legislature would extend the benefits of the

current law to all commercial aircraft operators operating aircraft under 6000 lbs, be it a commuter airline, charter airline, or flight school. Central assessments on these pieces of equipment are subjective at best, time consuming to maintain from year to year, and not necessarily a fair representation of the tax burden the owners should carry.

If a survey of all the aviation businesses in the State were conducted, it is our belief that that survey would reveal that almost all small aviation businesses operating aircraft under 6000 lbs are doing so with aircraft older than 40 years old, and are subject to the same types of issues as San Juan Airlines with respect to tax challenges and operating costs.

As noted previously, fluctuations in aircraft values and proper valuation of those aircraft is very difficult to assess on an annual basis. It's also very difficult to predict the annual tax cost associated with the aircraft.

Additional Tax Challenges:

Below is a summary of some of the taxes already being paid by the small FAA Part 135 commuter operators in the industry.

- Federal Excise Tax of 7.5% to 12% on Passenger Transport (varies based on number of passengers on the flight as well as the locations being served.) Certain exemptions apply for aircraft under 6000 lbs as well as for travel to and from a rural airport, but those exemptions are not applicable to aircraft operating on an 'established line'. For a commuter airline, established lines make up the supermajority of the routes.
- Federal Excise Tax of 6.25% on Freight Carriage
- FAA Mandated Passenger Facility Tax on specified airports for special projects of $4.50 / person. On an average $96 ticket, this equates to an additional 4.5%.
- Washington State B&O Tax on Scenic Flights
- Washington State Public Utility Tax on Freight
- Federal Corporate Taxes
- Total yearly taxes on average equate to ~ 18% of gross revenue. Fuel and Labor account for approximately 65% of gross revenue, and an additional 10% is reinvested back into the fleet. This leaves little to be able to cover loan interest on capital equipment and profits (if any.)

Small airline profit margins are represented by single digit percentages at best. In many cases, these entities operate at a loss, but are sheltered under the umbrella of a larger corporation with discretionary resources. The ability to operate as an independent company who is solely focused on aviation is becoming increasingly difficult over time as the price of fuel increases, parts availability for aging aircraft decreases, and parts costs increase due to lack of supply. Unless the airline is well established, with capital equipment that has been owned for long periods of time (where the aircraft were obtained under significantly different economic conditions), it is nearly impossible to start or even maintain a business in the industry. The rate of attempts and failures of independent operators and flight schools

in recent years attests to this fact. These are factors simply not faced by the larger airlines (aka FAA part 121 operators like Alaska Airlines) where the economies of scale and overhead are significantly different than they are for smaller / local operators. Additionally, local Seaplane companies are not subject to the Federal Excise Tax requirements as there are exemptions that apply for those aircraft. Land based airplanes are at an immediate competitive disadvantage in this regard.

With that in mind, any additional relief would also be welcome as the general aviation community at large is in jeopardy of either disappearing, or at least being controlled by a single monopoly owned by a larger corporation with interests not focused on aviation, aviation safety, and a desire to provide the regional communities they serve with reliable, safe travel options. It is our belief that lawmakers have already recognized this need in the past, as an exemption is already in place for sales tax imposed on FAA Part 135 Commuter operators purchasing light aircraft to be used in intrastate commerce.

It should also be noted that when considering the financial impact to the owner of an aircraft, that the usage purpose of that aircraft should very much be factored into the tax rate. For a wealthy, private owner, an aircraft is a luxury. For a large, for profit company with large economies of scale, excise tax on equipment is the cost of doing business. For a small general aviation company, it's a critical piece of highly capital-intensive equipment required to run an operation that serves a small community, as well as adding to the tax base of local economies. These aircraft represent a very significant percentage of the overall value of the business, which in turn translates any additional taxes into a significant operating expense.

In Closing:

We at San Juan Airlines would like to thank all those individuals taking the time to further understand the challenges of this vital industry, and for their consideration in not only maintaining the current tax preferences but extending them beyond their current scope. We are available for comments or questions upon request.

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