

Testimony of

Lawrence J. Krauter

Deputy Executive Director

Lehigh Northampton Airport Authority

On the Topic of

Elimination of the Sales and Use Tax on Aviation

Before the

Pennsylvania House Transportation Committee

Hon. Joseph F. Markosek, Chairman

March 11, 2008

State Capitol Building

Harrisburg, Pennsylvania

Good morning Chairman Markosek and members of the House Transportation Committee, my name is Larry Krauter, Deputy Executive Director of the Lehigh Northampton Airport Authority and Past President of the Aviation Council of Pennsylvania. I appreciate the opportunity to discuss with you today our view that the most important legislative priority of the aviation industry in this Commonwealth is the elimination of the sales and use tax. In short, we are asking for your help to eliminate this regressive tax in order retain companies that are being enticed to relocate out of state; to achieve competitive parity with neighboring states that have a distinct advantage in attracting aviation-related businesses as a result of a more favorable tax treatment of the industry and to continue to make our airports increasingly financially self-sufficient to reduce or eliminate operating subsidies by their sponsoring governments.

The Lehigh Valley Airport System consists of Lehigh Valley International Airport (LVIA), which is a scheduled commercial service airport as well as Queen City Airport, located in the City of Allentown and Braden Airpark located near the City of Easton which are general aviation reliever airports to LVIA.

The Airport Authority is financially self-sufficient and does not use local tax revenues from our County sponsors. We are constantly investing in upgrades to our facilities to meet the needs of our customers and to respond to federal standards for safety and security. We are well positioned to handle increased aviation business at any one of our three airports.

I am able to offer some unique perspectives on this matter as not only does the Airport Authority manage three different categories of airports, we also have owned and operated the FBO at two of these airports since 1990 and 1996, respectively.

While I will provide you with some examples of how we lost actual business and potential opportunities over the years, due to the sales and use tax, I also want to look ahead with you to the tremendous opportunities that await aviation if we can get this right by eliminating the sales and use tax.

Let's talk about opportunities in the eastern part of the state for a moment. U.S. DOT Secretary Mary Peters recently stated that the annual cost of airline delays has reached \$9 billion. Demand for air travel has surpassed 2001 levels and continues to rise. Consistently, the worst of the breakdowns occur in the New York region, accounting for 75% of airline delays. Clearly no one will disagree that there is a problem with airspace and airport capacity in the New York area. General aviation and corporate aviation are also being negatively impacted by these structural problems. The growing costs of ground stop delays; aerial holding delays and diversions for refueling in combination with the high real estate and other operating costs already prevalent for those businesses based at airports in the New York region are driving these companies to focus on airports outside of the New York/New Jersey area as alternatives. It is no longer tenable for these companies to pay premium rates in exchange for deteriorating efficiencies. Furthermore, this problem has created significant interest in airports outside of the New York/New Jersey area for those companies seeking to penetrate the market to serve their aviation customers without basing at a New York/New Jersey airport. The first of these two dynamics has resulted in relocations to LVIA from Morristown, NJ in the form of a major fractional/charter company that leases over 100,000 square feet of hangar, office and shop space as well as a flight department of a major pharmaceutical company headquartered in New Jersey. These companies regularly travel into New York airports to serve clients, but they base their aircraft and support functions at LVIA. We are currently in discussions with a major New York City-based company to move their flight department to LVIA under the same pretext.

The second dynamic has seen LVIA regularly 'shopped' by companies seeking to establish sales and service centers in the Northeast, without having to deal with the associated problems I have previously described. Within the past 12 months, we have been asked to make proposals to Embraer, HondaJet and American Eurocopter for regional sales and service centers. Eclipse has also

prospected in Pennsylvania for a similar facility. Some of these initiatives are being driven by the Very Light Jet industry race to the marketplace and we should be doing everything we can to attract this business to Pennsylvania. For example, it is forecast that as many as 7,600 VLJs will be flying U.S. skies by 2025. There are viable products coming to the market by:

Adam Aircraft (AdamJet 700)	\$2.25M
Cessna Citation Mustang	\$2.6M
Diamond Aircraft (D-Jet)	\$1.3M
Embraer Phenom 100	\$2.75M
HondaJet	\$3.65M
PiperJet	\$2.2M

It is likely that very few, if any, of these aircraft will be purchased in Pennsylvania as long as the sales and use tax exists. They will most likely be purchased in Maryland, Massachusetts and New Hampshire, which do not impose a sales tax on aircraft. That being said, what chances do you think that Pennsylvania airports have of attracting sales and service centers for these aircraft? I can tell you that Embraer already passed and is building a facility right now in Connecticut. What sales representative wants to tell a potential customer that they will need to pay the Department of Revenue \$220,000 when they purchase their HondaJet and base it in Pennsylvania?

In our most recent discussions with a major helicopter manufacturer, they indicated that the State of Maryland is pursuing them to locate their proposed Northeast sales and service center there. The fact that they can operate their facility in Maryland without sales and use tax liability is going to be among the top considerations in their decision. My prediction is that while LVIA offers distinct advantages for this helicopter company, they will go the route of Embraer and end up placing their facility in a neighboring state. The same prediction is sadly also valid in the case of HondaJet, which intends to make a decision this year.

Another problem that the sales and use tax creates for airports making proposals for these sales and service centers is that we have to consider offering our facilities and other consumables such as aviation fuel at below market rates to make up for the impact of the tax if we really want to compete with our neighboring states. Also, as part of minimum standards, most airports charge a percentage-of-gross receipts fee to aeronautical businesses that can range up to 3 percent annually. This fee is being attacked by prospective aviation businesses in light of the state sales and use tax. As a result, the tax is causing downward pressure on the margins of Pennsylvania airports and aviation businesses trying to compete with companies that are not burdened with the same tax in their home state. This is counterintuitive to good business procedure and does not help airports meet their objectives of becoming more financially self-sufficient so they do not need to depend on support from their sponsoring government. Almost every publicly-owned airport regardless of size is under increasing pressure to become self-sufficient from an operating fund standpoint as their sponsoring governments need to respond to other critical and fundamental needs of the community.

I am speaking from experience. As I had mentioned earlier, the Airport Authority's wholly-owned subsidiary FBO business, Lehigh Valley Aviation Services, has just made a large investment to open a Robinson Helicopter Sales and Service Center at Queen City Airport. This commitment required sending our staff of A&P Mechanics to Torrance, California to complete required factory training as well as acquiring significant inventory, manuals and tooling. Robinson Helicopters manufactured 749 R22 and R44 helicopters in 2006. They are the world's largest producer of civil helicopters. A typical R44, a 4-place helicopter, which is the top selling helicopter in the world during the last 4 years can cost in the area of \$350,000. This business decision was made by the Airport Authority due to a rapid increase in based Robinson Helicopters at our airports by owners of small to mid-sized companies locating into the area and input from these

customers that they were tired of flying long distances to Maryland and New York for service. We verified that there was a hole in the regional coverage of service centers centered on Pennsylvania. At this point, I know that all of you can tell me one of the primary contributory factors as to why there was not a service center to be found in Pennsylvania!

Any corporate official in an aircraft maintenance operation will tell you that the margins in the business are thin. That is typical for aviation in general. The sales and use tax is responsible for discouraging the growth of aircraft maintenance, repair and overhaul (MRO) business throughout the state by eroding these already thin margins and requiring businesses to sacrifice profit to offset the sales and use tax impact.

We are taking a business risk by establishing the Robinson Helicopter Service Center and it is too early to tell what reaction our customers will have to our cost disadvantage of 6% on parts and 6% on labor in the marketplace compared with service centers in adjacent states. If it functions anything like the public's reaction to driving long distances for lower airline fares, we may see our Robinson customers exchange the longer trip to out of state service centers for the savings on all but the smallest of jobs.

The sales and use tax is also eroding the fractional ownership and aircraft management and charter business. Many aircraft today are being placed under FAR Part 135 certificates in order to avoid the sales and use tax. The problem for airports or FBOs is that these aircraft then usually get what is referred to as contract fuel, which is an airline-like rate, as opposed to paying retail fuel prices, so the margins again are reduced for those selling fuel. These same operators then fly the aircraft out of state for any major maintenance, repair and overhaul (MRO) work. Why do they do this? Two reasons. First there are no shops in the state largely because of the sales and use tax and second, they do not want to pay the sales and use tax even if there were shops in the state. In aviation, we call this condition the Graveyard Spiral.

One of our based tenants at LVIA estimates that they could add up to 7 new aircraft to their management contract if the sales and use tax was eliminated. This could add 30 new jobs: increase fuel sales and increase hangar rental income. There is no doubt that this formula could be repeated at many airports across the state if the sales and use tax was eliminated.

As far as Part 91 aircraft are concerned, there is virtually no market for these companies to manage aircraft that are not protected from sales and use tax. In a place with a geographic advantage such as LVIA, these companies believe that there is good potential for business from New Jersey in this category.

As you have heard previously, probably the most prominent loss to LVIA attributable to the sales and use tax involved the ITT Corporation, which was the first major corporation to invest in a large hangar to base its fleet of corporate aircraft outside of the New York metro area. ITT contacted us after learning that the Department of Revenue was requiring payment of sales tax on a new Boeing Business Jet (BBJ), 737-400. A BBJ retails for \$43 Million to \$48 Million. The thought of paying nearly \$3 Million in sales tax created enough of an impact for them to take the aircraft out of the state permanently. The clear message to corporate aviation was "Stay out of Pennsylvania". Further efforts during the past several years by the Department of Revenue to collect the sales and use tax have reinforced this message to aircraft owners as their airport landlords were asked to become informants for the collection effort by the State. Many declined.

As Mr. Rockmaker previously states, that message is repeated today by the experts retained as advisors to corporations evaluating aircraft purchases, leases and locations for flight departments.

It is clear that we need to catch up with the other states that have done the math and concluded that sales and use taxes discourage aviation business retention and growth.

Pennsylvania has an excellent system of airports that stand to contribute substantially more to the state economy by attracting new aviation businesses and strengthening existing aviation businesses.

The Legislature must recognize that we can no longer afford to ignore the detrimental impacts of this tax, particularly at a time when aviation is growing and the geographic location of Pennsylvania airports has never had as much upside potential to attract this business as it does right now. We must move quickly and directly to address the matter. We respectfully ask that you co-sponsor legislation once it is introduced and advocate to your fellow legislators and leadership to support the bill. We need you to move it through the process with urgency so we can begin engaging the competition posed by neighboring states that would like to lure away our existing aviation businesses and out-compete us for new aviation business. This is not a "Maybe Someday" topic. We must act now to stem the flow of aviation business out of state.

I hope that my comments have contributed to a better understanding of the policy position taken by the Aviation Council of Pennsylvania on the sales and use tax. Again, thank you for your attention and for the opportunity to present information to you about this important matter. I would be pleased to answer any questions you may have about my comments.

-End-