

PRELIMINARY REPORT:
2019 TAX PREFERENCE PERFORMANCE
REVIEWS

Commuter Air Carrier Airplanes (Sales and Use Tax)

LEGISLATIVE AUDITOR'S CONCLUSION:

Since 2009, the number of commuter air carriers has increased by one. There has been no change in the total number of small or rural airports served, but service has increased in some locations and ended in others.

July 2019

Sales and use tax exemption for commuter air carriers on purchases of airplanes, airplane parts, maintenance, and repairs

The preference provides a sales and use tax exemption for commuter air carriers when they purchase airplanes, or parts, maintenance, and repair services for airplanes, that are used primarily for in-state flights.

Commuter air carriers:

- Operate "small aircraft" with 60 or fewer seats.
- Carry passengers on at least 5 round-trip flights per week.
- Fly according to published flight schedules.

**Estimated Biennial
Beneficiary Savings**
\$447,000

Tax Type
Sales and Use Tax
RCWs 82.08.0262(1)(a)(iii),
82.12.0254(1)(a)(ii)
Applicable Statutes

The preference was enacted in 2009 and has no expiration date.

One of three inferred public policy objectives met

The Legislature did not state a public policy objective when it passed this preference in 2009. JLARC staff infer three public policy objectives based on legislative testimony by the primary sponsors and industry representatives.

Objectives (Inferred)	Results
1. Encourage expanded in-state commuter air carrier service.	Unclear. The number of commuter air carriers has increased by one. Flight service has increased to the San Juan Islands, but service has ended in other areas of the state.

Objectives (Inferred)	Results
2. Maintain air service to Washington's small or rural airports.	Unclear. The total number of airports and airfields served has remained the same between 2009 and 2018, but service locations have shifted. More flights are concentrated in the San Juan Islands.
3. "Level the playing field" with potential out-of-state competition from an Oregon-based commuter air carrier.	Met. Preference removes a potential competitive disadvantage. No out-of-state carriers have directly competed with Washington carriers since 2009.

Recommendations

Legislative Auditor's Recommendation: Clarify expectations for levels of service and locations served

The Legislature should clarify its expectations for this preference by adding a performance statement that clearly states the public policy objectives and metrics to determine whether the objectives have been met. The Legislature should clarify what it hopes to achieve in terms of frequency of flights and locations served.

More information is available on the Recommendations Tab.

Commissioners' Recommendation

[Available October 2019.](#)

REVIEW DETAILS

1. What is the preference?

Sales and use tax exemption for commuter air carriers on purchases of airplanes, airplane parts, maintenance, and repairs

Preference has three inferred objectives

The Legislature did not state a public policy objective when it passed this preference. The preference was passed before the Legislature required a performance statement for new tax preferences.

JLARC staff infer three public policy objectives based on legislative testimony by the primary sponsors and industry representatives.

1. Encourage expanded in-state commuter air carrier service by providing a sales and use tax exemption on airplanes used primarily for in-state transportation.
2. Maintain air service at Washington's small or rural airfields.

3. "Level the playing field" with potential out-of-state competition from an Oregon-based commuter air carrier.

Sales and use tax exemption for airplanes used primarily for in-state travel

Commuter air carriers:

- Operate small airplanes with 60 or fewer seats.
- Carry passengers on at least five round-trip flights per week.
- Fly according to published flight schedules.

This sales and use tax exemption applies to carriers that purchase airplanes, or parts, maintenance, and repairs for airplanes, that are used primarily for in-state travel (i.e., more than 50% of flights).

Under separate statutes, carriers are already exempt from [sales](#) and [use](#) tax for airplanes that are used primarily for out-of-state travel, such as flights between Washington and other states.

Preference has no expiration date

The preference was enacted in 2009 and has no expiration date.

2. Gains and losses for in-state flight service

Since preference began, there is one new commuter air carrier in Washington. Service has increased to the San Juan Islands and ceased in other locations.

Since 2009, the total number of commuter air carriers in Washington has increased from two to three. The number of flights and locations served in the San Juan Islands has increased, but service has been lost in other areas of the state.

Preference was described as removing a disincentive to expand in-state flight service

Representatives for Kenmore Air, a Washington commuter air carrier, testified at 2009 legislative hearings that the preference would potentially allow it to expand its in-state flight service.

At the time, Kenmore Air used its seaplane fleet to fly between in-state locations (e.g., between Kenmore and the San Juan Islands) and out-of-state (e.g., between Lake Washington and Victoria, B.C.). State law already provided a sales and use tax exemption for airplanes used more than 50% of the time for out-of-state flights.

Kenmore Air representatives explained that its in-state flights were close to the 50% mark. If it increased the number of in-state flights, Kenmore risked losing the sales and use tax exemption it

currently received on its entire seaplane fleet. Increasing in-state flights meant that its ratio of out-of-state to in-state travel would fall below 50%.

With the preference, Kenmore Air's entire fleet would be exempt under the existing or the new sales and use tax exemption. The air carrier representatives indicated that the preference would encourage it to expand its in-state flight service.

Commuter air carriers report that the bulk of their revenue is from passenger service, not freight transportation.

Number of commuter air carriers has increased by one

When the preference was enacted in 2009, two commuter air carriers operated in Washington. As of 2018, there are now three commuter air carriers in the state.

Exhibit 2.1: Three commuter air carriers operating in 2018

Corporate Name	Doing Business As	Based Out Of
Kenmore Air Harbor, Inc.	Kenmore Air Express, Kenmore Air	Kenmore
Rugby Aviation, Inc.	San Juan Airlines	Bellingham
West Isle Air, Inc.	Friday Harbor Seaplanes	Renton

Source: JLARC staff analysis of U.S. Department of Transportation data and interviews with Washington commuter air carriers.

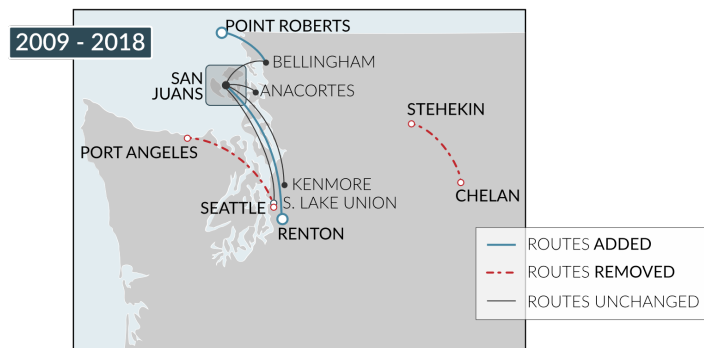
Flights have increased to San Juan Island locations and have begun to serve Point Roberts, but flights have ended in other locations

JLARC staff identified the following changes to in-state flight service since the preference began:

- There are more commuter air carriers flying to more locations in the San Juan Islands in 2018 than in 2009.
- A route between Bellingham and Point Roberts was added.
- Service was lost to Port Angeles.
- Service was lost between locations on Lake Chelan.

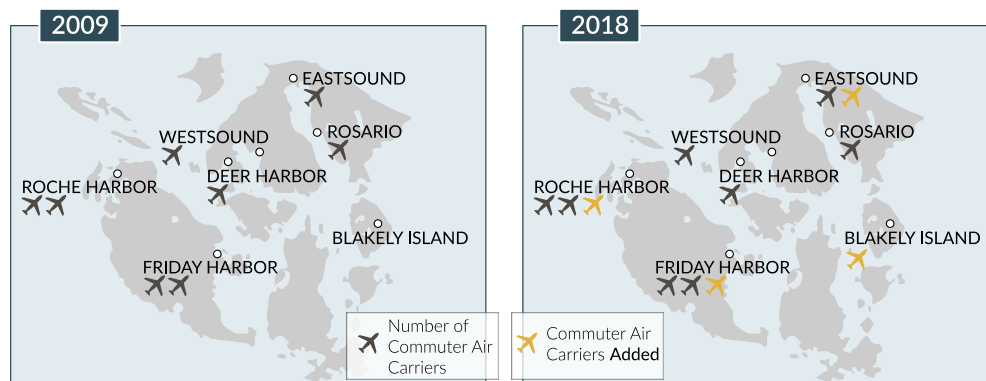
JLARC staff were unable to directly compare the number of scheduled flights offered by commuter air carriers in 2009 to the number of flights offered in 2018 because sufficient 2009 data was not available.

Exhibit 2.2: Olympic Peninsula and Eastern Washington lost flight service, Point Roberts and San Juan Islands gained service



Source: JLARC staff analysis of 2009 and 2018 flight schedules, interviews with various airport and commuter air carrier personnel.

Exhibit 2.3: More commuter air carriers with additional flights are serving the San Juan Islands



Source: JLARC staff analysis of 2009 and 2018 flight schedules and interviews with various airport and commuter air carrier personnel.

3. Same number of airports served; shift in locations

No change in the total number of small, rural airports served, but flights are now concentrated in the San Juan Islands

An industry representative testified in 2009 that the preference would help maintain air service to small or rural airports in Washington.

At the time, there were concerns about maintaining this service. The Washington State Department of Transportation Aviation Division projected that smaller commercial service airports could be at risk of losing service in the future if they relied on a single air carrier for scheduled flights.

As of 2018, two small, rural airports (Point Roberts and Blakely Island) and one urban airport (Renton) have gained commuter air carrier service. During the same time frame, commuter air

carrier service was lost in Port Angeles and between two points on Lake Chelan. Overall, there has been no net change in the number of locations served.

Exhibit 3.1: No net change in number of locations served by commuter air carriers between 2009 and 2018

Small or Rural Airports with Scheduled Commuter Air Carrier Service	2009	2018
Port Angeles (land)	Kenmore Air Express	No service
Chelan (sea)	Chelan Seaplanes	No service
Stehekin (sea)	Chelan Seaplanes	No service
Blakely Island (land)	No service	San Juan Airlines
Port Roberts (land)	No service	San Juan Airlines
Renton (sea)	No service	Friday Harbor Air
Kenmore (sea)	Kenmore Air	Kenmore Air
Seattle Lake Union (sea)	Kenmore Air	Kenmore Air
Bellingham (land)	San Juan Airlines	San Juan Airlines
Anacortes (land)	San Juan Airlines	San Juan Airlines
Friday Harbor (San Juan Island) (land and sea)	Kenmore Air Express (land), San Juan Airlines (land)	Kenmore Air Express (land), San Juan Airlines (land), Friday Harbor Air (sea)
Roche Harbor (San Juan Island) (land and sea)	Kenmore Air (sea), San Juan Airlines (land)	Kenmore Air (sea), San Juan Airlines (land), Friday Harbor Air (sea)
Rosario (Orcas Island) (sea)	Kenmore Air	Kenmore Air
West Sound (Orcas Island) (sea)	Kenmore Air	Kenmore Air
Deer Harbor (Orcas Island) (sea)	Kenmore Air	Kenmore Air
Eastsound (Orcas Island) (land)	Kenmore Air Express	Kenmore Air Express, San Juan Airlines
Lopez Island (land and sea)	Kenmore Air (sea)	Kenmore Air (sea), San Juan Airlines (land)

Source: JLARC staff analysis of 2009 WSDOT Aviation Division system plan, commuter air carrier web-based schedules as of November 2018, and interviews with Washington's three commuter air carriers.

Unclear if commuter air carrier service to small or rural airports has been maintained as envisioned by Legislature

As of 2018, most commuter air carrier service in Washington is to or from destinations in the San Juan Islands. Three commuter air carriers now serve the San Juan Islands. As of January 2019, there is no commuter air service to the Olympic Peninsula, Southwest Washington, or Eastern Washington.

While there has been no net change in the number of small, rural airports served, it is unclear if the shift in locations is what the Legislature envisioned for maintaining service.

Potential for new or resumed service in future years

As of January 2019, Oak Harbor and Port Angeles airport personnel report that the airports are working to re-establish commuter air carrier service in the near future.

- Port Angeles was last served by a commuter air carrier in 2014.
- Oak Harbor was last served by a commuter air carrier in 2008.

West Isle Air has indicated that it hopes to resume scheduled flights between points on Lake Chelan in 2020. The service has not operated since 2016.

4. Preference removes potential competitive disadvantage

No out-of-state carriers have directly competed with Washington carriers since 2009

In 2009, bill sponsors from the House and Senate noted the preference was needed to "level the playing field" with an Oregon-based commuter air carrier. Out-of-state carriers typically do not pay Washington sales or use tax on their airplanes, or airplane parts, maintenance, or repairs.

Potential out-of-state competition never entered market

SeaPort Airlines, an Oregon-based carrier, started providing direct flights between Portland International Airport and Boeing Field in June 2008. In 2011, it ceased those flights.

SeaPort never directly competed with any Washington commuter air carrier routes since the preference was enacted. The Oregon-based air carrier filed for bankruptcy and ultimately liquidated in September 2016. No other out-of-state commuter air carriers have entered the Washington market since then.

5. Three commuter air carriers benefit

Washington's three commuter air carriers benefit from the preference

Tax preferences have direct beneficiaries (entities whose state tax liabilities are directly affected) and may have indirect beneficiaries (entities that may receive benefits from the preference, but are not the primary recipient of the benefit).

Three commuter air carriers are direct beneficiaries

According to the U.S. Department of Transportation and industry sources, three commuter air carriers currently operate in Washington and benefit from the preference:

- **Kenmore Air Harbor, Inc.**, doing business as Kenmore Air (seaplanes) and Kenmore Air Express (land-based).
- **Rugby Aviation, Inc.**, doing business as San Juan Airlines.
- **West Isle Air, Inc.**, doing business as Friday Harbor Seaplanes. Chelan Seaplanes is also owned by West Isle Air, but has not operated since 2016.

Indirect beneficiaries are located in areas served by flights

Residents and local businesses of communities serviced by commuter air carriers, as well as tourists, may indirectly benefit from the preference.

6. Estimated biennial savings: \$447,000

In 2021-23 biennium, the estimated direct beneficiary savings is \$447,000

JLARC staff estimate the direct beneficiary savings for fiscal year 2018 is \$202,000. The estimated beneficiary savings for the 2021-23 Biennium is \$447,000.

JLARC staff based these estimates on average expenditure data for a two-year period provided by industry representatives. The estimates are for expenditures on airplane maintenance, engine purchases, and other capital costs. They do not include any airplane purchases because the representatives did not anticipate any during this time period.

Exhibit 6.1: Estimated direct beneficiary savings from sales and use tax exemption

Biennium	Fiscal Year	Estimated Parts, Maintenance, and Repair Costs	State Sales Tax	Local Sales Tax	Estimated Total Beneficiary Savings
2017-19 (7/1/17-6/30/19)	2018	\$2,112,000	\$137,000	\$65,000	\$202,000
	2019	\$2,165,000	\$141,000	\$66,000	\$207,000
2019-21 (7/1/19-6/30/21)	2020	\$2,215,000	\$144,000	\$68,000	\$212,000
	2021	\$2,258,000	\$147,000	\$69,000	\$216,000

Biennium	Fiscal Year	Estimated Parts, Maintenance, and Repair Costs	State Sales Tax	Local Sales Tax	Estimated Total Beneficiary Savings
2021-23 (7/1/21-6/30/23)	2022	\$2,310,000	\$150,000	\$71,000	\$221,000
	2023	\$2,364,000	\$154,000	\$72,000	\$226,000
	2021-23 Biennium	\$4,674,000	\$304,000	\$143,000	\$447,000

Source: JLARC staff analysis of average expenditure data for two-year period provided by industry representatives for estimated maintenance, engine purchases, and other capital expenditures for airplanes. Estimate does not include any airplane purchases during the three biennia covered, per discussions with industry representatives. Growth for 2019 and beyond is calculated using I.H.S. Markit Growth Factor, Tables 1118, Prices and Wages, Consumer Prices All Urban, November 2018.

7. Applicable statutes

RCWs 82.08.0262(1)(a)(iii), 82.12.0254(1)(a)(ii)

RCW 82.08.0262

Exemptions - Sales of airplanes, locomotives, railroad cars, or watercraft for use in interstate or foreign commerce or outside the territorial waters of the state or airplanes sold to United States government - Components thereof and of motor vehicles or trailers used for constructing, repairing, cleaning, etc. - Labor and service for constructing, repairing, cleaning, etc.

(1) The tax levied by RCW 82.08.020 does not apply to:

(a) Sales of airplanes (i) to the United States government; (ii) for use in conducting interstate or foreign commerce by transporting property or persons for hire or by performing services under a contract with the United States government; or (iii) for use in providing intrastate air transportation by a commuter air carrier;

(b) Sales of locomotives, railroad cars, or watercraft for use in conducting interstate or foreign commerce by transporting property or persons for hire or for use in conducting commercial deep sea fishing operations outside the territorial waters of the state;

(c) Sales of tangible personal property that becomes a component part of such airplanes, locomotives, railroad cars, or watercraft, and of motor vehicles or trailers whether owned by or leased with or without drivers and used by the holder of a carrier permit issued by the interstate commerce commission or its successor agency authorizing transportation by motor vehicle across the boundaries of this state, in the course of constructing, repairing, cleaning, altering, or improving the same; and

(d) Sales of or charges made for labor and services rendered in respect to such constructing, repairing, cleaning, altering, or improving.

(2) The term "commuter air carrier" means an air carrier holding authority under Title 14, Part 298 of the code of federal regulations that carries passengers on at least five round trips per week on at least one route between two or more points according to its published flight schedules that specify the times, days of the week, and places between which those flights are performed.

RCW 82.12.0254

Exemptions - Use of airplanes, locomotives, railroad cars, or watercraft used in interstate or foreign commerce or outside state's territorial waters - Components - Use of vehicles in the transportation of persons or property across state boundaries - Conditions - Use of vehicle under trip permit to point outside state.

(1) The provisions of this chapter do not apply in respect to the use of:

(a) Any airplane used primarily in (i) conducting interstate or foreign commerce by transporting property or persons for hire or by performing services under contract with the United States government or (ii) providing intrastate air transportation by a commuter air carrier as defined in RCW 82.08.0262.

(b) Any locomotive, railroad car, or watercraft used primarily in conducting interstate or foreign commerce by transporting property or persons for hire or used primarily in commercial deep sea fishing operations outside the territorial waters of the state;

(c) Tangible personal property that becomes a component part of any such airplane, locomotive, railroad car, or watercraft in the course of repairing, cleaning, altering, or improving the same; and

(d) Labor and services rendered in respect to such repairing, cleaning, altering, or improving.

(2) The provisions of this chapter do not apply in respect to the use by a nonresident of this state of any vehicle used exclusively in transporting persons or property across the boundaries of this state and in intrastate operations incidental thereto when such vehicle is registered in a foreign state and in respect to the use by a nonresident of this state of any vehicles so registered and used within this state for a period not exceeding fifteen consecutive days under such rules as the department must adopt. However, under circumstances determined to be justifiable by the department a second fifteen day period may be authorized consecutive with the first fifteen day period; and for the purposes of this exemption the term "nonresident" as used herein includes a user who has one or more places of business in this state as well as in one or more other states, but the exemption for nonresidents applies only to those vehicles which are most frequently dispatched, garaged, serviced, maintained, and operated from the user's place of business in another state.

(3) The provisions of this chapter do not apply in respect to the use by the holder of a carrier permit issued by the interstate commerce commission or its successor agency of any vehicles whether owned by or leased with or without driver to the permit holder and used in substantial part in the normal and ordinary course of the user's business for transporting therein persons or property for hire across the boundaries of this state; and in respect to the use of any vehicles

while being operated under the authority of a trip permit issued by the director of licensing pursuant to RCW 46.16A.320 and moving upon the highways from the point of delivery in this state to a point outside this state; and in respect to the use of tangible personal property which becomes a component part of any vehicle used by the holder of a carrier permit issued by the interstate commerce commission or its successor agency authorizing transportation by motor vehicle across the boundaries of this state whether such vehicle is owned by or leased with or without driver to the permit holder, in the course of repairing, cleaning, altering, or improving the same; also the use of labor and services rendered in respect to such repairing, cleaning, altering, or improving.

RECOMMENDATIONS & RESPONSES

Legislative Auditor's Recommendation

Legislative Auditor's Recommendation: Clarify expectations for levels of service and locations served

The Legislature should clarify its expectations for this preference by adding a performance statement that clearly states the public policy objectives and metrics to determine whether the objectives have been met. The Legislature should clarify what it hopes to achieve in terms of frequency of flights and locations served.

Legislation Required: Yes

Fiscal Impact: Depends on legislative action.

Letter from Commission Chair

[Available October 2019.](#)

Commissioners' Recommendation

[Available October 2019.](#)

Agency Response

If applicable, available December 2019.

MORE ABOUT THIS REVIEW

Study questions



Proposed Study Questions: Commuter Air Carrier Airplanes

State of Washington Joint Legislative Audit and Review Committee • September 2018

Citizen Commission scheduled a JLARC study of a sales and use tax exemption for commuter air carriers that use airplanes to provide in-state travel



Commuter air carriers:

- Operate "small aircraft" with 60 or fewer seats.
- Carry passengers on at least 5 round-trip flights per week.
- Fly according to published flight schedules specifying the times and routes.

The 2006 Legislature directed the staff of the Joint Legislative Audit and Review Committee (JLARC) to conduct performance audits of tax preferences. This preference is included in the 10-year review schedule set by the Citizen Commission for Performance Measurement of Tax Preferences.

In 2009, the Legislature established a sales and use tax exemption for commuter air carriers that purchase and repair aircraft used primarily for in-state air transportation. The preference has no expiration date.

JLARC staff are also separately reviewing a property tax exemption in 2019 for commuter air carriers paying aircraft excise tax on their airplanes.

2019 study will address whether this preference led to expanded in-state airline service or any changes in airline service at smaller airports

The Legislature did not state an objective for this preference when it was enacted. Based on objectives inferred from statements by the prime sponsor and stakeholders, JLARC staff will answer three questions.

Inferred objectives	Study questions
Provide tax relief to encourage expanded in-state commuter air service.	1) Have commuter air carriers expanded their schedules to add more in-state flights or locations since the preference was enacted?
Help maintain air service that connects small, rural airports throughout Washington.	2) Has there been a change in the number of Washington's small airfields served by in-state commuter air carriers since the preference was enacted?
"Level the playing field" for Washington-based carriers competing with an Oregon-based commuter air carrier.	3) How does the tax burden for commuter air carriers compare between Washington and Oregon?

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Keenan Konopaski, Washington State Legislative Auditor

Proposed Study Questions: Commuter Air Carrier Airplanes

Study Timeframe

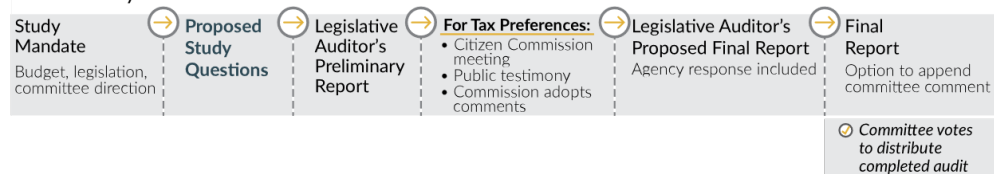
Preliminary Report: July 2019

Proposed Final Report: December 2019

Study Team

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JLARC Study Process



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