KENAI PENINSULA BOROUGH

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Mike Navarre
Borough Mayor

MEMORANDUM

TO: Blaine Gilman, Assembly President
Members of the Kenai Peninsula Borough Assembly

THRU: Mike Navarre, Mayor MN

FROM: Larry Persily, Assistant to the Mayor LP

DATE: Sept. 6, 2016

SUBJECT: Sales tax on sightseeing flights
(Ordinance 2016-31 to update and clarify the borough sales tax code)

This is an unusual situation, though I believe a healthy situation. The mayor is seeking to amend the provision in borough code that exempts air transportation from sales taxes so that the borough and cities could start collecting tax on flightseeing services. The borough attorney is advising the assembly that assessing sales tax on flightseeing services would violate either or both state and federal law. A respectful disagreement, but healthy in that it pushes the assembly to carefully consider the legal issues and public policy and make an informed decision.

There are several points in favor of adopting the ordinance as introduced to treat flightseeing services the same as any other entertainment or tour service in the borough, such as taxi rides, bus tours and boat charters. That alone is probably the biggest public policy objective in this proposal – equality in taxation. Tax exemptions that create protected classes are inherently unfair to others.

In addition, the cities of Wasilla and Kodiak each assess and collect sales taxes on flightseeing operations that take off and land on the same day within city limits. Neither municipality has been challenged in court on their taxation. Elsewhere in the country, I found flightseeing operations in Florida and New Jersey that advertise and confirm they collect sales taxes on their flights. No, collecting sales tax on sightseeing flights is not standard practice in the 107 Alaska cities and boroughs with a sales tax or the 50 states, but it is done in some jurisdictions and should be considered in the Kenai Borough.

As to the legal hurdles — yes, they are real and require careful consideration — there are two: State and federal laws.

As to the state statute that prohibits a local sales tax on air transportation, the statute does not define air transportation, creating an opening for the borough to argue sightseeing flights from Point A to Point A are not air transportation. Rather, we could argue, air transportation is a scheduled or charter flight from Point A to Point B. A state Senate letter of intent accompanied the 1994 legislation that added the air transportation no-tax provision to statute. The non-binding letter of intent did not specifically address sightseeing flights in its reference to banning local taxes on air services. I also researched legislative committee hearings on the bill, and the issue of taxation of sightseeing flights came up at the House committee hearings but not in the Senate — though it was not the bill sponsor who spoke up at the House hearings on flightseeing operations and sales taxes. Rather, it was others who testified and spoke of their own interpretation of the legislation that it would apply to sightseeing flights.

Another point in favor of extending borough sales tax to sightseeing flights is the opinion of Marty McGee, state assessor at the Department of Commerce, Community and Economic Development, who strongly believes sightseeing flights are not air transportation and could be subject to sales tax as an entertainment service. True, that is not a court ruling, or even a legal opinion, but, just like Wasilla and Kodiak, it is worthy of consideration.

As to the federal law limiting local taxation of air commerce, federal court cases ruling against the imposition of local taxes came in the 1980s but, importantly for our argument, they were issued prior to a 2005 U.S. Senate Finance Committee report that addressed the topic of sightseeing flights.

Flightseeing tours are not subject to the federal per-segment tax that is assessed on "taxable transportation" (that $3 per-segment fee we see on scheduled-airline tickets). The law says the tax does not apply to air transportation not operated on established lines. Alaska Congressman Don Young's Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU), passed by Congress in 2005, added a sentence to the per-segment tax law which, according to a 2012 memorandum from the IRS Office of the Associate Chief Counsel, states that as a matter of law, sightseeing flights are <u>not</u> considered to be operated on established lines. The Senate Finance Committee report on SAFETEA-LU said sightseeing flights include "flights of short duration that overlook a glacier, volcano, the Grand Canyon, or other similar attraction and for which the air tour begins and ends at the same point." By short duration, the IRS chief counsel quoted, "the committee intends that the tour occur within a calendar day, irrespective of intermittent stops to view the attraction." The Senate Committee report also explains the policy behind the exclusion from the tax: "Such flights are primarily for entertainment rather than for transportation from one place to another and so should be treated as noncommercial aviation."

I believe the borough could — in the interest of equitable taxation of similar businesses and their customers — cite the 2005 Senate Committee report in making the case that Congress understood and intended to treat sightseeing flights differently than point-to-point air transportation. Yes, it is a different section of the federal code and a different tax at issue, but illustrative of congressional intent. Yes, we could lose if a legal challenge is brought, but we could win.