LINDA LINGLE
GOVERNOR

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LT. GOVERNOR

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DIRECTOR OF TAXATION

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DEPUTY DIRECTOR

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HOUSE COMMITTEE ON FINANCE

TESTIMONY REGARDING HB 2860 HD 2
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: FEBRUARY 26, 2008
TIME: 10:00AM
ROOM: 308

This bill proposes exempt aviation fuel purchased from a foreign trade zone from the state general excise and use taxes for fuel used in inter-island travel.

The House Committee on Economic Development & Business Concerns amended this bill's effective date for purposes of further discussion.

The House Committee on Transportation amended the bill by including the comments of the Department's prior testimony.

The Department of Taxation (Department) takes **no position** on this legislation; however **offers the revenue impact**.

This bill amends the general excise and use tax law regarding the exemptions from taxation that are currently allowed. Presently, aviation fuel purchased in a foreign trade zone is exempt from state taxation for those flights that are bound for an out-of-state or foreign destination. Because these flights are considered within interstate or foreign commerce, taxation is exempt pursuant to federal law. There is no corresponding exemption for inter-island flights because these flights are not considered to be in foreign or interstate commerce for tax purposes.

I. SUBSTANTIVE COMMENTS.

The Department appreciates the amendments made by the prior committee that included a workable definition of inter-island flight, which defines the appropriate commerce to carry out the intent of the measure as "two points between the State." This definition, coupled with the appropriate tax exemptions in the relevant tax chapters, makes this legislation technically accurate.

II. REVENUE IMPACT.

After considering recent additional information regarding aviation fuel sale data, it is the Department's position that this legislation will result in a revenue loss of approximately:

- $5.1 million loss, FY2009.
- $5.3 million loss, FY2010.
- $5.5 million loss, FY2011.

LINDA LINGLE
GOVERNOR
MARSHA WIENERT
TOURISM LIAISON

TOURISM LIAISON

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Written statement of
MARSHA WIENERT
Tourism Liaison
Department of Business, Economic Development & Tourism
before the
HOUSE COMMITTEE ON FINANCE
Tuesday, February 26, 2008
10:00 a.m.
State Capitol, Conference Room 308

in consideration of
HB 2860 HD2
RELATING TO TAXATION.

Chair Oshiro and Members of the House Committee on Finance.

The Department of Business, Economic Development and Tourism supports the intent of HB 2860 HD2, which exempts from general excise and use taxes the fuel sold from a foreign trade zone for inter-island air transportation by common carriers.

In as much as we support the intent of HB 2860 HD2 and believe that the inter-island carriers should have the same exemptions in general excise and use taxes as airlines traveling out-of-state, we are concerned about the cost implications generated by this proposal.

Therefore, we must oppose this bill, as it will impact the priorities outlined in the Administration's Executive Supplemental Budget.

Thank you for the opportunity to comment on HB 2860 HD2.

52(b)

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, USE, Exempt Foreign Trade Zone aviation fuel

BILL NUMBER: HB 2860, HD-2

FIN 2/26

INTRODUCED BY: House Committee on Transportation

BRIEF SUMMARY: Adds a new section to HRS chapter 237 and a new paragraph to the definition of "use" under HRS section 238-1 to provide that the sales of aviation fuel categorized as privileged foreign merchandise, non-privileged foreign merchandise, domestic merchandise, or zone-restricted merchandise that is admitted into a foreign trade zone and purchased in a foreign trade zone and is made directly to or used by any common carrier for consumption or use in air transportation between two points in the state, shall be exempt from the state's general excise and use tax laws.

EFFECTIVE DATE: July 1, 2034

STAFF COMMENTS: Currently aviation fuel is imported and stored in Hawaii Fueling Facilities Corporation (HFFC) storage tanks. HFFC was established in 1969 to provide fuel storage and distribution to its member airlines. On September 1, 1997, the HFFC began operating under the Foreign Trade Zone (FTZ) at the Honolulu International Airport. Fuel purchased from HFFC for use in aircraft of HFFC members is exempt from the imposition of the general excise, use, and fuel taxes since they are operating in the FTZ. When the fuel is then pumped through the HFFC's bonded fuel lines and provided to the aircraft, the fuel remains in interstate commerce and technically is outside the jurisdiction of the state and the imposition of state taxes. The current exemption from taxes for product within the FTZ but sold for consumption outside the state applies only when the consumption of such product occurs out of state where sales are made to any common carrier in interstate or foreign commerce.

The purpose clause notes that the rising cost of fuel has added to the challenges of the local airlines and that the cost of the general excise and use tax exacerbates these challenges. Exempting the fuel used for intrastate air transportation would help level the playing field and create a fairer market for all airlines.

While it is the federal law which confers exempt status on products in the FTZ, recognizing that the products have not entered the country, it is understood that the states can further define that recognition with respect to use of products that have FTZ exempt status. This is what this measure proposes with respect to tax laws imposed by the state.

Digested 2/25/08

TESTIMONY OF KEONI WAGNER ON BEHALF OF HAWAIIAN AIRLINES IN SUPPORT OF H.B. NO. 2860, HD 2, RELATING TO TAXATION

February 26, 2008

To: Chairman Marcus Oshiro and Members of the House Committee on Finance:

My name is Keoni Wagner and I am the Vice President for Public Affairs for Hawaiian Airlines presenting this testimony on behalf of Hawaiian Airlines in support of H.B. No. 2860, HD 2.

This bill provides an exemption from state general excise and use taxes on fuel purchased from a foreign trade zone (FTZ) and used for interisland air transportation within the State of Hawaii. The state currently exempts from these taxes all fuel sold from an FTZ that is used for flights between Hawaii and the mainland or international destinations. We continue to believe that this same exemption should apply to interisland flights and respectfully request that legislation be passed to make this exemption more explicit.

Thank you for the opportunity to testify on this measure.

AIRLINES

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February 26, 2008

Representative Marcus Oshiro, Chair
Representative Marilyn Lee, Vice-chair

RE: HB 2860, HD2 Relating to Taxation

Chair Oshiro, Vice-Chair Lee and Members of the Committee:

My name is Stephanie Ackerman and I am Senior Vice President, Public Relations and Government Affairs, for Aloha Airlines. Thank you for this opportunity to testify in strong support of HB 2860, HD2.

In the past we have urged lawmakers to act on this matter to remedy an inequity in current state law that places an undue tax burden on Hawaii-based interisland carriers.

The existing statute (Section 212-8) grants a General Excise and Use tax exemption to airlines when they purchase jet fuel from the Hawaii Foreign Trade Zone for flying in interstate or foreign commerce. This is consistent with Federal law governing foreign trade zones and interstate commerce. However, the law is not being applied consistently and as a result, there is discrimination against Hawaii-based air carriers. Legislation is required to ensure that the Hawaii Department of Taxation applies the GET and use tax exemption when airlines purchase fuel from a foreign trade zone for use in interisland flying, which is regulated by Federal law as interstate commerce.

The Commerce Clause of the U.S. Constitution gives Congress sole power to regulate interstate commerce. Contrary to the testimony submitted by the Tax Department that "*...court cases conclude that transportation from one point in a state through international territory and back to another point in the same state is not interstate commerce,*" the U.S. Court of Appeals, Ninth Circuit, in *Island Airlines, Inc. v. C.A.B., (352 F.2d 735)*, held that:

> "The high seas over which interisland flights flew while traveling among the various islands of Hawaii, were a "place" within statute defining jurisdiction of the Civil Aeronautics Board over interstate commerce as transportation between points in the same state over a foreign country or high seas as well as over another state."

The Court also cited that the Congress in Senate Committee Report 86-80 on the Hawaii Statehood Act on aviation matters, said:

> "Hawaii presents a unique situation with respect to the impact of statehood on the federal regulation of air transportation between the main islands. ...most, if not all, of the interisland air transportation passes through airspace not a part of the territory. ...interstate air transportation, which is defined to include not only transportation between a place in a state and a place in any other state, but also transportation between places in the same state through the airspace over any place outside thereof.. ***...with the admission of Hawaii as a state, interisland air transportation will remain subject to the economic controls provided by the Federal Aviation Act including other applicable federal legislation, because that transportation, or most of it, while between places in the same state, will pass through airspace outside the state***. In the other states, air transportation of this kind passing through airspace outside the state of slight volume in comparison with air transportation merely between places in the same state. ***...the Committee wishes to make it clear that ...the provisions of the Federal Aviation Act and other applicable federal legislation to the State of Hawaii should continue in accordance with the definition of interstate air transportation as contained in that Act.***"

Title 49 U.S. Code, section 40102 (Federal Aviation Act) specific defines "interstate air transportation" as "the transportation of passengers or property by aircraft as a common carrier for compensation, or the transportation of mail by aircraft ...between a ***place*** in ***Hawaii and another place in Hawaii through the airspace over a place outside Hawaii.***"

As we understand it, Federal law preempts the State from imposing GET on the sale of fuel from a foreign trade zone when the fuel is used in interstate commerce, which includes points within the State of Hawaii.

With that in mind, we return to the equity issue. We believe that ALL flights operated by common carriers must be considered interstate transportation; therefore the GET exemption on fuel must apply to ALL of them.

We support HB 2860, HD2, and urge you to amend the effective date to July 1, 2008.

Passage of this bill will do what is fair, by clarifying and expanding the scope of the current GET exemption to include locally based airlines. In this way, you will also be recognizing the vital role that interisland airlines play in the economy of our state by bridging our communities, and employing more than 6,500 Hawaii residents.

march of dimes

Hawaii Chapter
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February 25, 2008

Representative Marcus Oshiro
Chair
House Committee on Finance
State Capitol, Room 224

RE: HB 2860 HD2 Relating to Taxation

Chair Oshiro, Vice Chair Lee and Members of the Committee:

My name is Carmella Hernandez and I am State Director of the Hawaii Chapter of the March of Dimes. I am testifying in support of HB 2860.

In 2006, the March of Dimes honored Aloha Airlines with the Franklin Delano Roosevelt Award for Distinguished Community Service. Aloha Airlines has long supported the March of Dimes and many other not-for-profit organizations in Hawaii in numerous ways. For example, when expectant mothers on the Neighbor Islands are in danger, and specialized medical treatment is not available where they live, Aloha provides air transportation to Oahu so they can get the care they need. There are many times when a baby is born premature on a Neighbor Island and needs to be flown to Honolulu to be cared for at Kapi'olani Medical Center's neonatal intensive care unit. Aloha provides tickets so that the parents can come to Honolulu and stay with their baby. Sadly, there are times for a variety of reasons that the mother cannot come to be with her baby. Aloha Airlines helps these babies by flying the mother's breast milk to Oahu for them. This may sound like a small thing, but to the health of these tiny babies, there is nothing better for them than having their mother's breast milk. Aloha has also donated tickets for Neighbor Island families that have children with cancer to bring them here to specialists at Kapi'olani for life saving treatment.

Aloha continues to provide free tickets to the March of Dimes staff and volunteers when we need to travel to the neighbor islands to set up our biggest fundraising event – March for Babies. A practice they have done for more than 15 years. And as an incentive for our walkers to raise money, Aloha Airlines donates tickets for us to give as prizes for each of our five walk sites top fundraisers. They also help us raise money by putting an Aloha Airlines team of employees who come out to support the walk and by donating tickets to our annual ball that we include in our auction. They do not often take credit for their community giving, but they keep on giving, in good times and bad. Their name says it all, they always have and will continue to show much Aloha for the people of Hawaii.

As I understand it, Aloha and other Hawaii-based carriers are asking Hawaii's lawmakers to remedy an inequity, by clarifying state law to extend a tax exemption that other airlines already have. If federal law does indeed regard them as interstate carriers, and if interstate carriers are exempt from GET on fuel purchases from the free trade zone at Honolulu Airport, then you should act swiftly to unburden Hawaii's airlines and secure those benefits for them.

Our inter-island airlines have been dedicated to serving Hawaii for decades. Without the reliable passenger and cargo service they provide, and the helping hand they offer to Hawaii's people, we would all be lost. Charities depend on our local businesses to support and fund our important work in the community. When business profits decline due to a slowing economy and increased costs, so does a company's ability to contribute to the organizations that help our community in time of need. Aloha Airlines is always ready to help when the need arises, as noted earlier – in good times and in bad - now its time for the Aloha State to help all our local airline companies by passing HB 2860. To help them is to help the communities we live in. I urge you to think of who we are and what we care about, and pass House Bill 2860 to give our local airlines the same benefits already enjoyed by other airlines.

Thank you,

Carmella H

Carmella Hernandez
State Director
March of Dimes Hawaii Chapter

Representative Marcus Oshiro, Chair
Committee on Finance

RE: HB 2860 HD2 Relating to Taxation

Chair Oshiro, Vice Chair Lee and Members of the Committee:

My name is Randy Kauhane and I am Assistant General Chairman of the International Association of Machinists and Aerospace Workers (IAM) District 141 for Aloha Airlines, Hawaiian Airlines, United Airlines and Philippine Airlines, testifying in strong support of HB 2860.

Our members are concerned that current tax law is not being applied fairly, depriving our local Hawaii-based airlines of tax advantages enjoyed by all other airlines flying from Hawaii.

It is not fair that airlines are granted General Excise and Use tax exemption when they purchase jet fuel from the Hawaii Foreign Trade Zone for flying out-of-state but airlines that fly within the State of Hawaii are denied this exemption. Under federal law, all common use carriers in the United States, including Hawaii's locally based airlines, are regulated by the same laws that govern interstate commerce.

Hawaii's airlines operate under the same federal regulations. It does not seem right that the state Taxation Department has chosen to treat some airlines one way and others another way, when we are all engaged in interstate commerce under federal law.

We urge you to pass House Bill 2860. Thank you.

Rep. Marcus Oshiro, Chair
Rep. Marilyn Lee, Vice-chair

Committee on Finance
Tuesday, February 26, 2008, 10 AM

RE: HB 2860 HD2 Relating to Taxation

Chair Oshiro, Vice-chair Lee and Members of the Committee:

I am Kamuela Clemente, testifying on behalf of the Transport Workers Union, representing Dispatchers, Assistant Dispatchers and Crew Schedulers of Aloha Airlines.

We strongly support passage of HB2860, which exempts interisland carriers from the general excise tax and use tax on sales of aviation fuel from a foreign trade zone for use in interstate air transportation.

For one thing, the current law is unfair to our interisland carriers because they are common carriers in interstate commerce just like the overseas carriers that already take advantage of this exemption.

For another thing, we believe that interisland air transportation is interstate commerce under federal law and should be treated equally under the law.

Finally I urge you to act in support of the working people of Hawaii, including our Aloha Airlines employees, who are so committed to serving the communities of our State.

Mahalo Nui Loa,

Kamuela Clemente

Committee on Finance
Rep. Marcus Oshiro, Chair
Rep. Marilyn Lee, Vice Chair

Chairman Oshiro, Vice Chairman Lee and Members of the Commttee

RE: Testimony in support of HB 2860 HD2 Relating to Taxation

I am Randall Cummings, an Aloha Airlines pilot, representing the Aloha Airlines Pilots' Union, testifying in strong support of HB 2860

Bill summary

Currently aviation fuel purchased in Hawaii's Foreign Trade Zone ("FTZ") for use on flights originating in Hawaii and terminating outside of Hawaii is exempt from state excise tax under Hawaii Revised Statutes section 212-8. This exemption is consistent with the purpose of the FTZ to facilitate international and interstate commerce. This bill proposes to extend that exemption to any aviation fuel sold in the FTZ for use on interisland flights. Hawaii's foreign trade zone was established under the provisions of 19 U.S.C. 81a-81u, 15 CFR 400, and 19 CFR part 146. While Hawaii's interisland airlines do not depart the state, they nonetheless are engaged in 'interstate commerce' for the purpose of federal regulations and federal law.

Testimony in Support

There are three strong reasons why this bill should be enacted into law:

First: Legally, the exemption from excise tax on airline fuel to airlines leaving the state is based on their operation within 'interstate commerce' as it is applied to federally regulated airlines. Airlines that complete domestic flights within the state of Hawaii are also engaged in 'interstate commerce' as it is defined under federal law.

Second: As a matter of equity, the state department of taxation is in a situation where it must discriminate among Federally Regulated airlines based on whether their flights will terminate within the state or not. This results in some airlines receiving preferential treatment over others, without any legal or policy basis.

Third: As a matter of policy, it is good policy to reduce taxes on the interisland airlines, as the airlines provide a vital lifeline for our island state, and because higher costs resulting from the taxes have a dramatically negative impact on Airline employees and on charities supported by the local airlines. This policy argument is especially true where the taxes being applied go in to the general fund and are not earmarked for aviation infrastructure.

I. Interisland airlines operate within 'interstate commerce' and therefore this bill is mandated by federal law:

The state department of taxation currently grants a G.E.T. exemption for fuel purchased within the

Foreign Trade Zone for use on flights that leave the state. This exemption is provided in accordance with federal law mandates that State G.E.T. shall not interfere with the flow of interstate commerce. This very issue has been litigated before the U.S. Supreme Court. In the 1983 case of *Aloha Airlines v. Director of Taxation*, citation 464 U.S. 7 (1983), appellants Aloha Airlines and Hawaiian Airlines prevailed in their argument that Hawaii's G.E.T. on interisland airline tickets was in violation of Federal Law. Hawaii's GET on interisland tickets was found to be preempted by Federal Law and was therefore determined to be invalid in the U.S. Supreme Court.

It is abundantly clear that even though a flight may originate and terminate within the state of Hawaii, it is nonetheless within the economic umbrella of interstate commerce, and must be treated as such in every way. Indeed the only reason the federal government has the authority to regulate the airlines is because of the limited powers granted to the federal government by the U.S. Constitution's Interstate Commerce Clause. Conceptually one can easily see how air freight originating on the neighbor islands and then changing planes in Honolulu for out of state destinations does not suddenly become 'interstate commerce' the minute it changes planes in Honolulu. Passengers as well often change planes. Federal law does not discriminate between the part of the flight that happens within Hawaii and the part that leaves the state. We ask the legislature to provide guidance to the state department of taxation by enacting this law.

Extending the exemption to interstate airlines will allow the tax department to treat all airlines equally

It is inappropriate for a state government to provide benefits to one class of individuals and not to another without a policy basis for doing so. The law as it is being applied forces the tax department to make an artificial distinction between airlines, thus conferring benefits on some, while burdening others. Without a legitimate purpose for doing so, the law is both improper and unfair.

This tax exemption will assist in stabilizing the airlines, will benefit Hawaii's airlines' 7000 employees, and will benefit the communities that these airlines serve

Most airline costs are fixed costs and are difficult or impossible to reduce. These fixed costs include:

1. Fuel
2. Taxes and fees
3. Aircraft and equipment leases
4. Facility leases
5. Maintenance costs
6. Other miscellaneous expenses, such as food concessions, technical and I.T. services, etc.

The other major airline expense is labor. Because airlines have little 'wiggle room' with regards to these costs, they routinely turn to labor for cost concessions. Over the past few years Aloha's employees have endured a 20% pay cut. Hawaiian Airlines' employees have endured similar cuts. Hawaii Island Air had substantial layoffs. The tax exemption provided by this bill will help the airlines remain viable and will reduce the pressure on the airlines to ask for wage and benefit cuts of their employees by reducing the interisland airlines' fixed costs. It will also allow the airlines to continue to make generous charitible donations, both financial and in-kind.

The reduction in interisland airlines' fixed costs that will result from this bill's tax exemption will benefit Hawaii's airline employees

In the words of Southwest Airlines' former CEO Herb Kelleher, "an airline is made up of people, not airplanes." Any reduction in taxes, whether State or Federal will directly benefit the over 7,000 people who work for Hawaii's interisland airlines, as well as their families and dependents. It is the peculiar nature of the our industry that rising costs are seldom passed on to consumers, and as a result, the high cost of fuel and the heavy tax burden that air carriers shoulder are impacting the bottom line of our local airlines. As airline employees who have sacrificed so much, we urge you to act on this measure to help reduce fixed costs and ensure the stability and viability of Hawaii's interisland airlines.

Public policy favors passage of this bill

Hawaii's interisland airlines are a vital part of Hawaii's economy. They provide a vital service to our communities. The well-being of Hawaii's airline employees is vital to our airlines. The tax exemption provided by this bill will be good for these employees, it will be good for the interisland carriers, and it will be good for Hawaii. This is really about treating all airlines that serve our state fairly, and taking care of the employees who work for Hawaii's interisland airlines, which ultimately provides economic benefits for all of Hawaii. This is good public policy.