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Attracting Aerospace: The Risks of a Property Tax-Heavy State Tax Structure

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When examining the tax structures of business-aggressive states, a common pattern emerges: reduced income and franchise taxes offset by steeper sales and property taxes. While this approach may work for some industries, it can create significant barriers for capital-intensive sectors, particularly defense aerospace.

The defense aerospace sector represents a massive economic opportunity. With the U.S. defense budget approaching one trillion dollars and global military spending increasing due to geopolitical tensions, defense aerospace offers communities an excellent opportunity for economic growth.

What makes defense aerospace particularly attractive is its unique relationship with government contracting. Under the Federal Acquisition Regulation, savings from state and local incentives must flow through to federal contracts, creating a true public-private partnership. This partnership benefits multiple stakeholders: the federal government receives cost savings, communities gain high-paying jobs and capital investment, companies secure contracts, and the regional workforce benefits from employment opportunities.

However, the sector's revenue structure creates specific challenges regarding state and local taxation. Defense contractors operate under strict profit margins, typically between 6% and 12%, as regulated by the Federal Acquisition Regulation. While cash flow stability compensates for these limited returns (thanks to monthly progress payments from the federal government), this structure means that property and sales taxes, rather than income taxes, become the primary tax-related factors in site selection decisions.

This dynamic has become increasingly important as the defense industry has shifted away from government-owned facilities. Modern "capabilities contracts" require contractors to own their production assets, eliminating the traditional federal tax exemption. As a result, defense aerospace contractors must now factor substantial property tax burdens into their location decisions, despite often having minimal impact on public services due to their self-contained security and fire control systems and highly educated workforce with typically smaller families.

Consider a flight simulation training center. With four simulators costing $25 million each, an 8% sales tax and 2% annual property tax create an $8 million sales tax liability and $2 million annual property tax burden. In a detailed cost analysis of such a facility, state and local taxation can represent 30% of operating costs without abatements or exemptions - a stark contrast to heritage military facilities where government ownership eliminated these tax burdens.

This tax burden can be decisive in federal contracting. A 10% cost differential typically renders a bid non-competitive; a 30% difference essentially eliminates any chance of winning contracts. Yet defense aerospace facilities offer significant economic benefits, with employment multipliers well above 3:1 and additional benefits from training facilities where students contribute to the local economy.

While some states offer manufacturing equipment sales tax exemptions, and a growing number exempt equipment from property tax entirely, there remains insufficient legislation addressing the private ownership of assets supporting federal military and space contracts. As a result, federal contracts are increasingly moving away from states with higher property tax burdens.

For states seeking to attract and retain defense aerospace facilities, addressing this property tax challenge is crucial. Without adjustment, property tax-heavy structures risk driving away precisely the type of high-value, capital-intensive industries that many regions hope to attract.

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