

Taxing aviation fuel in Europe

Study reveals ways around the regulatory hurdles

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Summary

Aviation is a major source of emissions, increasing 21% within Europe in the last three years, and is projected to continue to grow. If Europe is to meet its climate targets, action is needed and fiscal policy has a key role to play. To date all aviation fuel used in Europe has been tax exempt despite such taxation being permitted on European domestic flights and intra-EU since 2003, the latter subject to bilateral agreements.

It is a misconception that ICAO's Chicago Convention prohibits the taxation of aviation fuel; it disallows taxing fuel already on board an arriving aircraft only, but it says nothing about taxing fuel taken on board prior to departure. Rather, it is intergovernmental air services agreements which often prohibit taxation of kerosene, though this prohibition is being progressively removed from air service agreements for intra-EU flights. Some foreign carriers remain covered by this exemption, however a just released study shows that that this regulatory hurdle can be overcome by including a *de minimis* exemption.

1. Energy Tax Directive and legal obstacles

Under the 2003 Energy Taxation Directive (ETD) most fuels and energy products in the EU are subject to tax. However Article 14 of that Directive permits member states to continue to exempt from taxation aviation fuel for domestic, intra and extra-EU flights. These exemptions first arose in bilateral air services agreements when aviation was expanding post-WWII. It was common practice – encouraged by industry and non-binding resolutions by the UN's aviation agency, ICAO – to include mutual fuel tax exemptions in these agreements and this approach was widely adopted in Europe. The ETD exemption is not mandatory, and EU member states are free to tax aviation fuel for domestic aviation or, through bilateral agreements with other member states, fuel used for flights between them. To date no EU member states have availed of this provision except the Netherlands for domestic aviation. Norway and Switzerland have taxed domestic aviation fuel for many years. For more on taxing domestic aviation fuel, see [here](#).

If two member states were to decide to tax aviation fuel on flights between them as provided for in Article 14, such a fuel tax would affect not only EU-registered carriers operating between the two countries but also any non-EU-registered carriers flying on these routes. Many foreign carriers obtained the right to operate flights between what are now EU member states well before the Union came into being and, consistent with widespread practice at the time, the air services agreements granting such rights included provisions to mutually exempt fuel from taxation. In recent years, under EU negotiating mandates, mutual fuel tax exemptions for intra-EU sectors have been progressively removed but further progress is needed and no attempt has yet been made to renegotiate these provisions covering flights beyond Europe.

In the meantime the frequency and, to an extent, the number of third-country carriers operating flights within Europe has declined significantly due to economics. For example, lower fares driven by no frills carriers and rising crew costs to operate these services have made many extension or add-on flights uneconomic. The exceptions are the US cargo carriers UPS and Fedex which have long enjoyed unrestricted rights to station aircraft in Europe and operate hubs for intra-EU cargo services. These flights are covered by the mutual fuel tax exemption provisions in the EU-US Open Skies agreement. If two EU states agreed to

tax fuel bilaterally, a foreign carrier operating flights between them may be able to lay claim to the fuel tax exemption where their air service agreement still permits. This would potentially lead to claims of competitive distortion with EU-registered carriers.

2. Study on taxing intra-EU fuel

A CE Delft study has examined the issue of taxing aviation fuels in the EU with a view to identifying legal options for being able to apply a fuel tax on all carriers operating within Europe – in order to maintain a level playing field between operators. The study’s contributions from Prof Pablo Mendez de Leon and Aoife O’Leary look in detail at the various legal questions. Both conclude that a fuel tax which applied a *de minimis* to all carriers on the routes affected – either between two member states or, for example, on an intra-EU-wide basis – would be feasible and, importantly, not contravene existing air services agreements because there would be no effective tax incidence on the exempt foreign carriers.

Speeding up the renegotiation of agreements to abolish the fuel tax exemptions for foreign carriers operating within Europe is also identified as an obvious remedy. And, intriguingly, both authors suggest that there may be an option to overcome the mutual fuel tax exemptions in bilateral treaties by simply abrogating the mutual fuel tax exemption clause and testing any legal consequences. Both legal analyses conclude, for example, that (while not tested in court) since the EU-US Open Skies Agreement only exempts fuel from taxation on the basis of ‘reciprocity’, that reciprocity can be withdrawn at any time to allow either side to impose taxation. O’Leary suggests that US agreement to withdraw that reciprocal exemption would not necessarily be required. And in the event that it was, and arbitration under the agreement resulted, the end result would be the withdrawal of comparable benefits by the other side, i.e. the US could begin to tax the fuel of EU carriers departing the US (there are no intra-US flights by EU carriers). In that way the whole edifice of mutual fuel tax exemptions might start to crumble.

The study identifies a number of issues that would need to be further considered before such a tax could be introduced. For example, how to apply the *de minimis* at EU level? How and at what level to set the threshold? And how the fuel tax could be implemented in practice. The study also points out that member states have the legal right to implement additional environmental measures such as a fuel tax beyond the aviation ETS.

The study concludes that aviation fuel used on flights between member states can be taxed if member states enter into a bilateral agreement or a series of bilateral agreements to do so. In order to minimise the risk of successful legal action by non-EU carriers operating between these member states and enjoying a mutual exemption from fuel tax, a *de minimis* threshold for the tax appears to be a good instrument, although there are other options. How the tax and threshold would best be designed requires more analysis.

Conclusions

EU member states and the European Commission now have the opportunity to consider afresh the option of implementing a fuel tax in Europe particularly in light of the Commission’s recent communication on how sectors like aviation can be decarbonised and the urgency to take additional action on climate change emphasised in the recent IPCC 1.5 degrees report. Fuel taxation is widely used in other transport modes and its introduction within the European aviation sector could well spur moves to start resolving the legal obstacles to prevent its wider application to flights beyond Europe.

Further information

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