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Implementation of Kerosene Fuel Taxation in Europe

Part II: Legal Approaches

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To go beyond taxing only kerosene fuel uplifted for domestic flights and apply such a kerosene tax on fuel uplifted for flights between the territories of the agreeing states, two or more Member States of the EU / ECAA need first to agree to do so on a bi- or multilateral agreement basis in accordance with Art. 14 paragraph 2 ETD.

The agreement could simply contain the consent of the agreeing states to introduce a kerosene fuel tax for flights between their territories. It should additionally set out the taxation conditions such as the taxation procedure itself, tax rates as well as de-minimis clauses and freight exemption clauses with respect to existing Air Services Agreements (ASAs). The taxation should be based on the airport refuelling process, as only kerosene fuel taken on board an aircraft can be taxed according to Art. 24 of the Chicago Convention.

As mentioned, the agreement has to include de-minimis and special exemption clauses. To avoid potential conflicts with some international ASAs which may contain kerosene fuel tax exemption rules, all non-EU / ECAA registered operators of intra-EU passenger flights which fall within the scope of an ASA including tax exemptions also for kerosene fuel uplifted should be completely free of any taxation. For EU and ECAA operators of passenger flights and non EU / ECAA operators not falling under an ASA with tax exemption also for uplifted kerosene fuel which will be subject to the kerosene tax for all operations above the de minimis level, the most practicable approach is to establish a pay and refund model. Freight flight operators should generally be exempted from fuel taxation.

Furthermore, Member States and the European Union should continue to renegotiate ASAs. They should remove the mutual fuel tax exemption provisions contained in any international and intra-EU ASAs. In the future all this may pave the way to implement an EU-wide kerosene fuel tax in the Energy Tax Directive for all operators operating intra-ECAA flights.

3 Legal Approaches

3.1 European framework for Taxation (Energy Tax Directive, European Directive 2003/96/EC)

Under the governing European Law it is possible to implement a tax on kerosene fuel.

Although Art. 14 paragraph 1 lit. b ETD (European Directive 2003/96/EC) states that *“Member States shall exempt the following from taxation […]: energy products supplied for use as fuel for the purpose of air navigation other than in private pleasure-flying.”* Member States are still entitled to implement kerosene fuel taxation under the requirements of Art. 14 paragraph 2 ETD.

This provision gives Member States the legal option to tax kerosene fuel uplifted to an airplane for domestic flights without further requirements. Furthermore, this rule states that *“where a Member State has entered into a bilateral agreement with another Member State, it may also waive the exemptions provided for in paragraph 1(b)”.* Thus, an agreement on the legal basis of Art. 14 paragraph 2 ETD can permit EU and ECAA Member States to implement a kerosene fuel tax on fuel uplifted for flights between their territories, regardless of the operator's origin and nationality.

Additionally, it would be advisable to revise the ETD with the objective to delete the whole exemption rule for kerosene fuel taxation as stated in Art. 14 paragraph 1 lit. b ETD. Under this assumption an agreement between the Member States would no longer be necessary. It has to be noted that such a revision requires a unanimous act of the Council after consulting the European Parliament and the Economic and Social Committee as set out by Art. 113 TFEU.

3.2 Possibilities of Tax Arrangements

This presentation and document focusses on the possibilities of Tax Arrangements in bi- or rather multilateral agreements for a taxation of kerosene fuel taken on board an aircraft for intra-EU-flights. First of all, there are international obligations determining the design of such a taxation rule, since such a kerosene taxation rule shall fit into the regulatory context of the European Law and into the regulatory context of the Chicago Convention. It is also to be determined to what extent Member States may impose kerosene fuel taxation rates.

In the case at hand, under the requirements of the current version of the ETD and in accordance with the Excise Duty Directive (European Directive 118/2008/EC) the best approach to implement a kerosene fuel tax in Europe is to tax the fuel uplifted by an aircraft at the airport.

One might also consider whether a tax may be based on other parameters such as the actual (or as reported) consumption of fuel during the flight or on an average consumption in relation to flight plans i.e. a flat tax.

It has to be seen that such a taxation base may constitute a violation of Art 24 of the Chicago Convention which prohibits the taxation of on board fuel inter alia for incoming flights. Fuel taxation related to the real consumption of kerosene during a flight may cause fuel to be taxed which has remained on board from an earlier flight. This may especially result in fuel being taxed which has been brought from another country and has remained on board, for example when an operator's aircraft only stops at an airport without refuelling (or only refuels some kerosene fuel).

Moreover, Art. 7 paragraph 1 of the Excise Duty Directive, European Directive 118/2008/EC, states that an *"Excise duty shall become chargeable at the time, and in the member state, of release for consumption"*. Hence, the kerosene fuel tax shall expressis verbis only become chargeable at the time of release for consumption. Therefore, the tax cannot be based on the fuel consumption itself.

Under these provisions it is the best approach to implement a taxation rule only based on the refuelling process, in the appearance of an (real) excise duty.

Furthermore, there may arise a practical problem, as, even if this would not be a desirable approach it seems to be legally possible that different Member States may agree on individual bilateral agreements under Art 14 Sec 2 ETD. If one agreement implements a taxation based on real fuel consumption but the other agreement bases the taxation on the refuelling process this may lead to a double taxation of kerosene fuel within the EU / ECAA airspace. This is especially the case, if an aircraft refuels in state A for two subsequent flights (to state C via state B) and state A taxes the whole refuelled fuel. In the case at hand, when state B and C taxes the real consumption for the flight between their territories, the fuel consumed during the flight from state B to state C is double-taxed. Additionally, this would be clearly a violation of Art. 24 of the Chicago Convention as the states B and C tax fuel brought by the aircraft into their territory (as already seen above).

3.3 Determining the Tax Rate and Tax Rate Ranges

In principal the ETD sets out a minimum level of 330 Euro per 1000 litre (33 ct per litre). Notwithstanding, Art. 14 paragraph 2 ETD states that *"Member States may apply a level of taxation below the minimum level set out in this Directive"*.

Therefore, Member States are free to agree on a fix value for both states and are also free to agree on a tax range which could lead to the agreeing states setting different tax rates.

The implementation of such a tax range is not a violation of either international law nor of European Law.

On the international level, the principle of the equality of states is not violated since both states have the same obligation and opportunity to set their tax rate.

Additionally, from a legal perspective, European Law especially Art. 14 ETD does not set out the obligation to agree on the same tax rate.

Taking into account the fact that Member States have been able to introduce different tax rates before the Directive came into force and the fact that Art. 14 paragraph 2 ETD is silent as to the question of whether Member States shall agree on an identical tax rate, it can be assumed that Art. 14 paragraph 2 ETD does not affect the freedom of Member States to agree on divergent tax rates.

Furthermore, the European principle of equal treatment is not violated since all operators in principal will be taxed at the same tax rate in one Member State.

This may also lead to the situation that only one agreeing state does implement a kerosene fuel tax, since the agreeing states are free to set the tax range also starting from zero percent.

3.4. Avoiding Unequal Treatment and De-minimis clauses

As already seen under paragraph **2.3,** implementing a bilateral agreement for taxation may give rise to unequal treatment between different operators; on the one hand those who are taxed under a bi- or multilateral agreement and on the other hand those who are privileged under an ASA's tax exemption clause. To avoid such unequal treatment, two approaches have to be considered:

Firstly, it would be possible to renegotiate ASAs to delete such tax exemptions for intra EU flights. That process is well underway and could be accelerated.

Secondly, implementing de-minimis clauses may avoid any potential unequal treatment, since Art. 11 of the Chicago Convention and the European Law require a non-discriminatory taxation regime.

The EU-ETS contains a de-minimis-rule which states that flights are exempted *"which, but for this point, would fall within this activity, performed by a commercial air transport operator operating either:*
— *fewer than **243 flights per period** for three consecutive four-month periods, **or***
— *flights with **total annual emissions lower than 10 000 tonnes per year**."*

Since the EU-ETS' de-minimis rule is based on a fixed number of flights and on the total annual emissions it may not be regarded as a blueprint for a fuel tax de-minimis clause in an agreement under Art. 14 paragraph 2 ETD.

First of all, applying a kerosene fuel tax based on the total annual emissions may lead to a violation of Art. 24 of the Chicago Convention, since fuel which was already on board an aircraft before being refuelled may well be consumed in the subsequent flight (see above).

Furthermore, a de-minimis clause based only on a fix number of flights and without the possibility of modification would lead to a violation of ASAs exempting kerosene fuel taxation if a foreign operator aims to exceed the number of exempted intra-EU flights. Therefore, the de-minimis-rule has to be designed to accommodate an adaptable number of exempted flights according to the level of foreign carrier operations.

However, the contracting states may agree on a certain number of exempted flights in the agreement itself so long as there is a mechanism to adjust the agreement to include a higher amount of exempted flights when this becomes necessary. To lower the amount of exempted flights is only possible for the adjustment for upcoming time periods, because retroactive taxes are prohibited under the rule of law, Art. 2 TEU.

At the moment foreign operators offer intra-EU passenger flights, but only a few flights per week and per operator. Additionally, some foreign freight operators, esp. from the USA, offer a high amount of intra-EU flights per week and per operator. Therefore, pure freight flights should be exempted from kerosene fuel taxation. Flights with belly hold freight are still considered as passenger flights.

Furthermore, the implementation of de-minimis clauses needs to be considered in designing the bilateral agreement, since it might be necessary to introduce different taxation procedures for EU / ECAA operators and foreign operators.

Firstly, some ASAs prohibit any kind of fuel taxation so it is legally questionable to introduce a pay and refund scheme for non-EU / non-ECAA operators privileged by an ASA, since a higher administrative effort is required. Thus, non-EU / non-ECAA operators falling under an ASA with complete tax exemption should be completely free of fuel taxation.

On the other hand, the (legal) person liable to pay the excise duty is the (legal) person releasing the fuel and not the operator. It is difficult for kerosene fuel providers to evaluate whether the current flight which is provided by an EU / ECAA operator or a foreign operator not falling under an ASA with complete tax exemption is exempted by the de-minimis-clause or not. Therefore, in this case the most practical approach to implement the taxation would be a pay and refund model for all EU / ECAA operators.

For reasons of practicability, this unequal (pure) procedural treatment is lawful, since it is justified.

3.5 Cooperation and Support by EU institutions

The European Commission may offer guidelines as “soft law” for the application of Art. 14 paragraph 2 ETD and the implementation of such bilateral agreements in form of general explanations and interpretative communication of EU law. Additionally, the European Commission may offer a draft agreement. By doing so, the European Commission could have a coordination function and provide legal security of having consistent agreements.

However, given a lack of legal basis, these actions and advices would not be binding. Hence, EU / ECAA Member States may differ from potential guidelines and draft agreements.

Additionally, an informal coordinating committee of participating member states – possibly organized similar to the Eurovignette CoCom, where the Commission also participates – might be helpful to organize kerosene fuel taxation for intra-EU-flights and intra-ECAA-flights on the basis of bi- or multilateral agreements in a coherent and effective way.