



Taxing aviation fuels in the EU



CE Delft

Committed to the Environment

Taxing aviation fuels in the EU

This report is prepared by:

Jasper Faber

Aoife O'Leary

With a contribution by Pablo Mendes de Leon

Delft, CE Delft, November 2018

Publication code: 18.7R09.036

Aviation / Taxation / Duties / Fuels / European legislation / Market / Effects

Client: Transport and Environment

Publications of CE Delft are available from www.cedelft.eu

Further information on this study can be obtained from the contact person Jasper Faber (CE Delft)

© copyright, CE Delft, Delft

CE Delft

Committed to the Environment

Through its independent research and consultancy work CE Delft is helping build a sustainable world. In the fields of energy, transport and resources our expertise is leading-edge. With our wealth of know-how on technologies, policies and economic issues we support government agencies, NGOs and industries in pursuit of structural change. For 40 years now, the skills and enthusiasm of CE Delft's staff have been devoted to achieving this mission.



Content

1	Summary	3
2	Introduction	4
	2.1 General subject and nature of the report	4
	2.2 Problem definition	4
	2.3 Outline of the report	5
3	Possibilities for and constraints to taxing aviation fuels in Europe	6
	3.1 Subject and nature of this chapter	6
	3.2 Legal analysis of possibilities to tax aviation fuels	6
	3.3 Remaining issues	7
	3.4 Conclusion	8
4	Possible revenues of aviation fuel excise	9
5	Conclusion	10
A	Preliminary legal analysis of taxation of aviation fuels in Europe	11
	Executive Summary	11
	Table of contents	12
	A.1 The position of carriers under European LAW	12
	A.2 The position of air carriers under the International framework	15
	A.3 The Chicago Convention on international civil aviation (1944)	15
	A.4 Conclusions and possible solutions	17
B	Legal Analysis of Domestic and Intra-EU Aviation Fuel Taxation	19
	B.1 Introduction	19
	B.2 The Energy Taxation Directive	20
	B.3 2002 Open Skies Case	20
	B.4 Excise Duty Directive	21
	B.5 The Emissions Trading System	21
	B.6 The Chicago Convention	22
	B.7 Bilateral Aviation Agreements	23
	B.8 Reciprocal Exemptions	25
	B.9 Exempting US carriers	27
	B.10 De Minimis	27
	B.11 Conclusion	29
C	List of non-EEA aircraft operators active on intra-EEA routes	30



1 Summary

This paper analyses the taxation of aviation fuels in EU Member States on intra-EU flights. Its main focus is the legality of these taxes and it also provides estimates of the potential revenues.

Fuels used in commercial aviation are exempt from excise duties in the EU, in contrast to fuels used on road and rail transport. However, the Energy Taxation Directive permits EU Member States to impose a tax on aviation fuel used in domestic flights without limitation as well as on intra-EEA flights between Member States on the condition that the affected States have entered into a bilateral agreement to do so.

If Member States were to enter into a bilateral agreement to tax fuel on flights between them, such a measure could also affect aircraft operators registered in a non-EU Member State, as they sometimes operate on intra-EEA routes. In that case, it is possible that some of these airlines would be subject to separate bilateral air service agreements that prohibits both States from taxing fuels.

Such a situation could potentially distort the competitive market. This report explores whether, and if so how, such a market distortion could be limited or avoided altogether.

The legal analysis shows that it appears to be possible for EU Member States to tax aviation fuels on flights between them even when non-EU carriers are enjoying a mutual exemption from fuel tax operate on those routes. There are several ways to minimise the chances that a legal challenge by these carriers would be successful. The most promising option seems to be the introduction of a *de minimis* threshold.

The potential revenues of an excise duty on aviation taxes is several billions of euros per year.



2 Introduction

2.1 General subject and nature of the report

This paper analyses the taxation of aviation fuels in EU Member States on intra-EU flights. Its main focus is the legality of these taxes and it also provides estimates of the potential revenues. The paper is primarily intended to draw attention to the possibility of taxing aviation fuels on domestic and intra-EEA flights and to identify some remaining issues which need to be clarified. A full legal and economic analysis was beyond the scope.

2.2 Problem definition

Fuels used in commercial aviation are exempt from excise duties in the EU, in contrast to fuels used on road and rail transport¹. However, the Energy Taxation Directive permits EU Member States to impose a tax on aviation fuel used in domestic flights without limitation as well as on intra-EEA flights between Member States on the condition that the affected States have entered into a bilateral agreement to do so².

Currently, all EEA Member States exempt aviation fuels sold to aircraft on international voyages from taxation (both for intra-EEA and extra-EEA flights), but some levy excise duty on domestic flights.

If Member States were to enter into a bilateral agreement to tax fuel on flights between them, such a measure could also affect aircraft operators registered in a non-EU Member State, as they sometimes operate on intra-EEA routes. In that case, it is possible that some of these airlines would be subject to separate bilateral air service agreements that prohibits both States from taxing fuels.

Such a situation could potentially distort the competitive market: Suppose two EU Member States agree to tax aviation fuels on flights between those states, and that an airline from a non-EU country operates one or more flights between those countries. This airline could argue that it would not have to pay the tax due to the bilateral air service agreement between either of the EU Member States and the non-EU country in which the airline is registered. If this argument is justified, the non-EU airline would have lower costs and could gain a competitive advantage relative to EU carriers operating on the same route.

This report explores whether, and if so how, such a market distortion could be limited or avoided altogether. It especially analyses the potential of *de minimis* provisions in fuel taxation as a way to limit the distortion.

¹ Energy Tax Directive 2003/96/EC (Article 14(1)(b)): 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.

² Energy Tax Directive 2003/96/EC (Article 14(2)): Member States may limit the scope of the exemptions (...) to international and intra-Community transport. In addition, 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).



2.3 Outline of the report

Chapter 3 summarises the legal analysis of a *de minimis* threshold in an agreement between Member States to tax aviation fuels. Chapter 4 presents an estimate of the potential revenues. Chapter 5 provides conclusions.

Annex A contains the full text of the legal analysis. Annex B is a list of non-EU aircraft operators active on intra-EEA routes.



3 Possibilities for and constraints to taxing aviation fuels in Europe

3.1 Subject and nature of this chapter

This chapter contains a summary of two legal analyses of the possibilities for EU Member States to impose excise duties on fuel used for on intra-EEA flights. It is based on more elaborate analyses that are reproduced in Annexes A and B.

3.2 Legal analysis of possibilities to tax aviation fuels

EU Member States wishing to tax aviation fuel on flights between those states can enter into a bilateral agreement to do so. This was explicitly allowed for under the Energy Taxation Directive (ETD) from 2003. Even though such a bilateral agreement would subject aviation to a new tax, the chances of successful legal action of EU carriers operating routes between those states against that tax would be small because the ETD specifically allows for such a bilateral agreement and the law governing the EU internal air transport market does not address fuel taxation.

There are a number of non-EU aircraft operators that are offering commercial services between airports in EEA Member States (see Annex C). Most of these consume limited amounts of fuel on intra-EEA routes, with three exemptions: a Swiss low cost carrier and two American Express Airlines. Many of these foreign airlines operate under bilateral air service agreements or under the EU-US Open Skies Agreement which exempt them from fuel taxes³.

This means that if EU Member States were to conclude a bilateral agreement to tax aviation fuel on flights between those states, non-EU airlines could oppose such a tax with a reference to the air service agreement. If this opposition would be successful, a situation could emerge in which EU carriers would be taxed, whereas their foreign competitors would not. This would distort the competitive market.

The issue of distorting the competitive market does not arise with regard to taxing fuel used on domestic flights. The only foreign carriers that have the right to operate domestic flights in EU Member States are members of the European Common Aviation Area (ECAA). In addition to being granted the rights to operate domestic EU flights under the ECAA, they must agree to abide by additional EU aviation legislation, including the Energy Taxation Directive. Therefore any domestic fuel tax in an EU Member State can be imposed the same on that country's domestic carriers and any other EU or ECAA carriers operating domestically within that country. There are several places around the world (e.g. in the US, Brazil, India and

³ Article 11(2): "There shall also be exempt, on the basis of reciprocity, from the taxes, levies, duties, fees and charges referred to in Paragraph 1 of this Article, with the exception of charges based on the cost of the service provided: (...) (c) fuel, lubricants and consumable technical supplies introduced into or supplied in the territory of a Party for use in an aircraft of an airline of the other Party engaged in international air transportation, even when these supplies are to be used on a part of the journey performed over the territory of the Party in which they are taken on board".



Japan) which impose taxation on domestic but not international flights without any issues arising.

However, EU Member States have several recourses to legal action against fuel taxes:

1. A *de minimis* provision could be introduced exempting non-EU carriers in practice. Whether this provision is on the basis of the amount of fuel used, the number of flights, or yet another basis is not a legal case. There is a legal precedent in the EU ETS directive, which introduced an exemption on the basis of the number of flights and the total quantity of emissions. In case of a fuel tax, the *de minimis* threshold could for example be based on the amount of fuel, on the number of flights, or on the total tax receipt.
2. Several recent air service agreements allow for the taxation of fuels. This means that foreign aircraft operators from these countries could not bring a case on the basis that there is a bilateral agreement which has been breached. The Member States and the EU could renegotiate the agreements with the other countries involved. The EU-Swiss bilateral for example, already does not provide a fuel tax exemption and thus does not need to be renegotiated⁴).
3. In the case of American carriers, the EU-US Open Skies Agreement foresees in referral of tax cases to the Joint Committee, which should decide on the basis of consensus. If consensus is not reached, the EU and the US may seek arbitration. The outcome of such a procedure is by nature unpredictable but the guidance provides for the suspension of 'comparable benefits' which would presumably including the US imposing fuel taxation in the US, which, in fact, is already being imposed.
4. Finally, most bilateral air service agreements exempt fuel used from taxation 'on the basis of reciprocity'. While the question has not been tested in court, this could be interpreted to mean that either party to the agreement can terminate the reciprocity. If this interpretation holds up in court, it would allow for the taxation of fuel used by foreign airlines.

A question that will arise is how a possible taxation ties into the Emissions Trading System (ETS) which places a cap on the amount of CO₂ intra-EU aviation can emit. However, the ETS was not designed to be the only measure mitigating aviation's climate impact. The ETS Directive states itself that it is part of a wider "comprehensive and coherent package of policies and measures implemented at Member State and Community level." And the ETS was designed as a Directive in order to be a minimum harmonising measure.

3.3 Remaining issues

The legal analyses conclude that a *de minimis* threshold could be a way to facilitate the introduction of taxation of aircraft fuel on intra-EEA flights and circumvent obstacles pertaining to mandatory exemptions regarding taxation of aircraft fuel raised by air services agreements.

Another way to facilitate the introduction of intra-EU fuel taxation would be for the EU to abrogate its exemption of fuel taxation in the international agreements. Both legal analyses conclude 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. The legal analysis in Annex B considers

⁴ See the text of the Agreement here ec.europa.eu/transport/modes/air/international_aviation/country_index/switzerland_en



the procedure under the EU-US Open Skies Agreement to conclude that US agreement to withdrawing 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 EU carrier fuel on flights departing the US (there are no intra-US flights by EU carriers).

Still, several issues remain to be analysed in more detail, such as:

- At which legislative level would the *de minimis* threshold be set? The legal analysis suggests that the threshold should preferably be set at the EU level, potentially as an amendment of the Energy Taxation Directive, rather than at the bilateral or national level, in order to prevent distortion of competition. However, taxes would be levied by Member States, and an EU-wide *de minimis* threshold would require them to exchange information on the amount of fuel taxes. A threshold per Member State would circumvent this problem.
- If non-EU carriers benefitting from a mutual fuel tax exemption were to exceed the threshold in the future due to an increase in their activities or otherwise, would they then become liable for a tax?
- Would any *de minimis* provision be deemed to act as a cap on activity and as such be at odds with other provisions of the air service agreement?
- Should the threshold be based on the amount of fuel uploaded, the number of flights or another parameter?
- How the threshold would be implemented in practice. A tax rebate would probably have the lowest administrative costs and the lowest potential for fraud, but would a tax rebate be the same as an exemption?

3.4 Conclusion

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 also other options. How the tax and the threshold would best be designed, requires more analysis.

4 Possible revenues of aviation fuel excise

The potential revenues of an aviation fuel excise duty are about 6 billion euros for international intra-EEA flights and approximately 50% higher when domestic aviation is also included, as shown in Table 1.

Table 1 - Calculation of potential revenues of an aviation excise duty

Item	Quantity	Source
Verified aviation CO ₂ emissions in the EU ETS, 2016 (million tonnes) ⁵	61	European Environmental Agency ETS Data Viewer
Calculated fuel use in EU ETS scope	20	IPCC emission factor for jet kerosene is 3.15
Amount of jet fuel supplied in EEA for domestic flights, 2016 (million tonnes)	6	Eurostat, Supply, transformation and consumption of oil - annual data [nrg_102a], version 1-2-2018
Calculated fuel use on international flights in EU ETS scope (million tonnes)	13	
Calculated fuel use on international flights in EU ETS scope (billion litres)	17	Exxon Mobile fuel specifications: Jet kerosene energy density is 775-840 kg/m ³ . Here, the value 800 kg/m ³ is used.
Potential tax revenue when taxed at € 330 per 1,000 litres (€ billion)	5.6	Energy Taxation Directive minimum rate

This amount does not take a *de minimis* threshold into account.

According to the EU ETS Transaction Log, emissions of non-EEA airlines in the scope of the EU ETS amounted to 0.9 Mt, or about 1.5% of total emissions. The largest airline consumed about 74 million litres of fuel on intra-EEA routes. Exempting airlines the first 100 million litres from taxation for each airline would suffice to ensure that these airlines do not have to pay tax.

A tax revenue of € 5 billion would, if passed on to the passengers, amount to a little over € 10 per passenger.

⁵ Note that flights to and from outermost regions are exempt from the EU ETS. As a result, the total emissions on inter-EEA flights are higher than the verified emissions under the EU ETS. Flight data analysis suggests that the different amounts to 5.5 Mt CO₂ per year.



5 Conclusion

It appears to be possible for EU Member States to tax aviation fuels on flights between them even when non-EU carriers and enjoying a mutual exemption from fuel tax operate on those routes.

There are several ways to minimise the chances that a legal challenge by these carriers would be successful. The most promising option seems to be the introduction of a *de minimis* threshold.

The potential revenues of an excise duty on aviation taxes is several billions of euros per year.



A Preliminary legal analysis of taxation of aviation fuels in Europe

By Pablo Mendes de Leon
February 2018

Executive Summary

Directive 2003/96/EC mandatorily exempts aircraft fuel consumed on commercial flights between EU States from taxation. Taxes are levied on energy products as defined in this Directive. At the same time it allows EU/EEA Member States to waive this exemption pertaining to taxation of aircraft fuel through bilateral agreements, and for other purposes as detailed below.

So far, no examples of such bilateral agreements are known. The present brief report endeavours to contextualise this option in light of European and international law. From an international air law point of view, aircraft fuel used on transit flights is not taxable. The same is generally true for aircraft fuel introduced in foreign territory and used on international flights.

However, multilateral air services agreements such as the EU-US agreement on air transport and certain bilateral air services agreements all of which have been concluded in the 21st century open the door for a waiver of this exemption on intra-EU/EEA flights when two, or more, European States engage into an agreement on taxation of aircraft fuel, or when they refer to a waiver pursuant to domestic law. Thus, they provide a legal basis for the introduction of taxation of aircraft fuel.

A revision of Directive 2003/96/EC ought to address these recent developments, and explain the term “international conventions” justifying, in the views of the EU policymakers, a continuation of the aircraft fuel tax exemption.

In order to facilitate the introduction of taxation of aircraft fuel and circumvent obstacles pertaining to mandatory exemptions regarding taxation of aircraft fuel raised by air services agreements, thought could be given to include a *de minimis* measure in a revised version of Directive 2003/96/EC. Such a measure should preferably be taken at the EU rather than at any other level, whether bilateral or national, in order to harmonise conditions for the introduction of a partial or total waiver of the exemption. However, the establishment of such a measure requires a very careful assessment of its legal and economic implications.

A *de minimis* measure has been used in, for instance, the EU ETS Directive (2008/101). When the EU considers the introduction of an aircraft fuel tax, preferably in conjunction with a *de minimis* measure, regard must be had to general principals of EU law. They include the non-discrimination principle, the fiscal neutrality of the proposed tax measure, a prohibition of infringement of free movement of air services and compliance with European competition and State aid rules.



Table of contents

- A.1 The position of carriers under European LAW
 - A.1.1 The scope of EU Energy Taxation Directive 2003/96
 - A.1.2 The EU/EEA internal market
 - A.1.3 The regime of the European Common Aviation Area (ECAA)
 - A.1.4 The *de minimis* measure

- A.2 The position of air carriers under the International framework
 - A.2.1 The Chicago Convention on international civil aviation (1944)
 - A.2.2 Air Services Agreements
 - A.2.3 The EU-US agreement on air transport of 2007 as amended in 2010
 - A.2.4 ICAO resolutions

- A.3 Conclusions and possible solutions

A.1 The position of carriers under European LAW

A.1.1 The scope of the EU Energy Taxation Directive 2003/96

EU Council Directive 2003/96, henceforth also referred to as the Directive, is the principal directive addressing the taxation of energy products including aircraft fuel. It obliges EU States to impose taxes on energy products in accordance with the Directive. That said, it proceeds from the fiscal autonomy of the EU States which is evidenced by the large number of exemptions and derogations laid down the Directive. Moreover, EU States must take into account their relations with non-EU States as to which see Section A.2.

Among others the Directive is designed to enhance the level playing field in the internal market by establishing minimum levels of taxation at an EU level. At the same time, it endeavours to promote the competitiveness of EU undertakings internationally.

The last mentioned objective plays an important role in relation to international air transport as commercial air transport between EU/EEA States is mandatorily exempted from taxation of aircraft fuel. However, fuel consumed for the performance of air transport can be taxed in the event of:

- a Private pleasure flying in which case fuel must be taxed, following which provision France, Portugal, the United Kingdom, Malta and Sweden attempted to disregard the concerned exemption in which effort they did not succeed because the EU Commission wished to strictly apply the Directive.
- b Commercial air traffic using fuel which is not jet fuel (CN code 2710 1921).
- c Domestic air traffic, that is, carriage by air within an EU State.
- d Intra-EU traffic in case two EU States have entered into a bilateral agreement, in which case the concerned Member States are allowed to apply a level of taxation below the minimum level set out in the Directive.

As far as we can see, the last mentioned event has not been put in practice but it is referred to in the EU-US agreement on air transport of 2007 as amended in 2010 as to which see Section A.4.

While the Directive speaks of ‘a bilateral agreement’ between two EU States, it does not specify the form, let alone does it give indications for the substance of such an agreement. Thus, at first sight, it would seem that EU States are free to choose the form and substance of such an agreement.



The question is whether ‘a bilateral agreement’ means:

- A new bilateral agreement between two EU States, focussing exclusively on taxation of aircraft fuel to be applied by the EU air carriers flying the routes covered by the new bilateral agreement, in which case it may be critical to apply the new bilateral agreement to non-EU air carriers because they are subject to another regime, for instance the EU-US agreement on air transport of 2007 as amended in 2010 as to which see Section A.3.2, or exempted by virtue of a *de minimis* measure as to which see Section A.1.4.
- An amendment of an existing air services agreement as to which see Section A.3.1.
- An amendment of a tax agreement between two EU States which is not the most likely option as it covers subjects which are different from the current one, that is, principally, the avoidance of double taxation of companies and persons working in the two States.

Remarkably, Article 11(6) of the EU-US Agreement on air transport (see Section A.3.2) speaks of a waiver to be granted by “two or more Member States” pursuant to Directive 2003/96 whereas 14(2) of this Directive refers to bilateral agreements between EU States. Reference is made to the remarks on this point made in Section A.4.

A.1.2 The EU/EEA internal market

The EU internal air transport market is governed by EU Regulation 1008/2008. Its geographical scope is extended to the territories of the European Economic Area (EEA), that is, Norway, Iceland and Liechtenstein. Special arrangements are made with Switzerland in a treaty with the EU.

While EU Regulation 1008/2008 principally aims to create a level playing field in the EU internal air transport market by harmonising conditions for the operation of air services within that market,

it does not address taxation of aircraft fuel.

At various instances, Regulation 1008/2008 refers to “bilateral agreements between Member States” notably in the context of access to intra-EU routes pricing freedom of EU air carriers. This Regulation stipulates that restrictions on access to routes and pricing are abolished and that provisions in such “bilateral agreements between Member States” are “hereby superseded.” The bilateral agreements in question are bilateral air services agreements.

It follows that Regulation 1008/2008 supersedes the relevant provisions of bilateral air services agreements between EU States but that such agreements are not cancelled in toto by this regulation as such bilateral agreements contain provisions which are not covered by it, for instance, the taxation of aircraft fuel. Reportedly, Spain has cancelled all its bilateral air services agreements with other

EU States whereas the Swedish website, listing all of its bilateral air services agreements, does not mention the intra-EU agreements.

From a legal perspective it would seem that the bilateral air services agreements between EU States ought to stay in force as not all matters covered by these agreements are superseded by EU law, as exemplified by taxation of aircraft fuel, cooperation in the context of aviation security conventions and transportation between EU States who have overseas territories and such overseas territories as such territories fall outside the scope of Regulation 1008/2008 and EU law generally.

A.1.3 The regime of the European Common Aviation Area (ECAA)

In December 2005 the EU concluded a Multilateral Agreement on the establishment of a European Common Aviation Area (ECAA) with eight South-East European partners, namely, Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the former Yugoslav Republic of Macedonia, Romania, Serbia and Montenegro and the U.N. Mission in Kosovo. The objective



of this agreement is to integrate the said neighbouring South-East European countries with the EU's internal aviation market which, at the time, consisted of 25 EU Member States as well as Norway and Iceland.

The eight South-East European countries agreed to the full application of the EU's aviation law also referred to as the EU *acquis*. They will do so in a step by step procedure which is supervised by the EU Commission. Once they fully implement the EU's aviation *acquis*, airlines from the South East European countries will have open access to the enlarged EU internal air transport market.

The *acquis* of the EU encompasses the implementation of the above Directive 2003/96. The only applicable provisions applying to the 'accession countries' are those laid down in Article 14(1)(b) and (2) pertaining to the exemptions in air transport. Reference is made to the discussion in Section 1.1.

A.1.4 The *de minimis* option under EU law

In Section A.1.1 it was concluded that EU States are permitted to engage into bilateral agreements, however framed, with the purpose of taxing aircraft fuel on intra-EU flights covered by that agreement. In that context, it must be examined how to deal with non-EU air carriers operating the same intra-EU flights as they are flying under other agreements. For instance, US cargo carriers operate intra-European services under the EU-US agreement of 2007 as amended in 2010 as to which see Section A.3.2. It may be critical to subject non-EU air carriers to bilateral agreements concluded between EU States because, for instance, other agreements such as the mentioned anterior EU-US agreement, may conflict with the provisions of the intra-EU bilateral agreement.

The application of the *de minimis* threshold could be adopted as an exemption measure for carriers who do not meet the criteria drawn up in the measure. This option would legally circumvent the obstacle referred to above, that is, that it may be critical to subject non-EU air carriers to a bilateral agreement between EU States in light of existing arrangements. While the EU Court of Justice has observed that, among others, the freedom to provide services, including the provision of air services, is so fundamental that restrictions ought not be permitted, the same court has, in other decisions, expressed the view that, if the effect of the measure is "too remote" and it lacks a significant effect on the market access, it is not caught by EU Treaty provisions. These decisions regarded EU undertakings, whereas the current scenario would principally and practically be designed to affect non-EU undertakings, that is, non-EU airlines. However, it will be shown below, in relation to the EU ETS Directive, that non-EU airlines may also be exempted from environmental measures pursuant to the *de minimis* measure.

Regulation 1008/2008 does not provide quantitative thresholds for accessing the air transport market governing the operation of intra-EU/EEA air services. All EU/EEA carriers meeting the quality standards mentioned there are permitted to operate these services, and must comply with all of the conditions drawn up in that regulation. The same regime applies to air carriers operating their air services under bilateral and multilateral air services agreements as to which see Sections A.3.1 and A.3.2.

De minimis provisions, do, however, occur in European regulations affecting air transport. For instance, EU environmental law provides examples of *de minimis* and/or quantitative measures exempting operators of aircraft from compliance with the concerned obligations. In the first place, reference is made to EU Directive 2008/101 on the establishment of the EU Emission Trading System (ETS). It comprises *de minimis* exemptions for airlines, whether EU/EEA or non-EU/EEA airlines, operating either fewer than 243 flights per period for three consecutive four months periods or flights with total annual emissions lower than 10,000 tonnes CO₂ per year. Thus, the provisions drawn up in Annex I of EU ETS Directive 2008/101 could serve as an example for a proposal pertaining to the introduction of an aircraft fuel taxation measure.



Secondly, there are other examples of EU regulations providing for quantitative thresholds. However, the situation envisaged in those regulations is different from the present scenario.

The establishment of a *de minimis* measure must be diligently scrutinised because of its legal and economic impact. It may affect the competitive conditions of the performance of intra-European air transport, and thus, the level playing field, raising also air policy and legal questions.

A.2 The position of air carriers under the International framework

A.3 The Chicago Convention on international civil aviation (1944)

The Chicago Convention of 1944 forms the constitution of international civil aviation. It is adhered to by 192 States per February 2018, that is, practically all States in the world, including all EU/EEA States. The EU is not a party to it as only States can accede to this convention. It would seem that the proposal for an amendment of Directive 2003/96 when referring to “international conventions” preventing the EU from abolishing these exemptions has this convention in mind.

The Chicago Convention contains one provision which directly affects the subject of this study, namely, Article 24(a) which reads as follows:

- “*Fuel, lubricating oils, spare parts, regular equipment and aircraft stores on board an aircraft of a contracting State, on arrival in the territory of another contracting State and retained on board on leaving the territory of that State shall be exempt from customs duty, inspection fees or similar national or local duties and charges. This exemption shall not apply to any quantities or articles unloaded, except in accordance with the customs regulations of the State, which may require that they shall be kept under customs supervision.*” (italics added).

The term “similar national or local duties and charges” must be understood to encompass national taxes. For instance, Germany may therefore not tax fuel that was tanked in France on board aircraft making a stop in Frankfurt or flying through German airspace without stop in Germany to Moscow, even if such fuel was consumed in Germany, falling under Germany’s fiscal jurisdiction.

However, the cited provision does not say anything about the taxation of fuel taken on board in, for instance, Portugal, when such fuel is used for a flight between Lisbon and Rio de Janeiro. This matter is regulated by air services agreements as to which see the next section.

A.3.1 Air Services Agreements

There are about 5,000 Air Services Agreements (ASAs) concluded between States regulating the operation of international air services internationally. As a matter of international and constitutional law or other national acts, international agreements including ASAs normally supersede the application of national law. Hence, even if national law, or in the case of the EU, EU law would allow taxation of aircraft fuel, the ASA would supersede the application of domestic law, EU law being regarded as domestic law. This legal state of affairs may explain why the EU refers to the applicability of “international conventions” in, for instance, the proposal for an amendment of Directive 2003/96.

Most of the ASAs are bilateral agreements, with notable exceptions such as the EU-US agreement on air transport of 2007 as amended in 2010 as to which see the next section, and the EU-Canada agreement on air transport of 2009. These are multilateral agreements



as they are concluded by the EU and its Member States on the one side, and the US and Canada respectively on the other side.

The vast majority of the ASAs contain language which forbids taxes and levies on fuel, lubricants, spare parts and the like which are not unloaded from an aircraft but re-exported to another country on the international air services agreed upon in the concerned ASA. It follows from the previous section that taxation of aircraft fuel in transit is not only contrary to Article 24 of the Chicago Convention as signalled in the previous section but also to ASAs including such a clause.

ASAs also address fuel supplied in another State. Under most ASAs, fuel introduced in into an aircraft on the territory of the other State - party to the relevant ASA - is equally exempted from taxation and charges under exemption clauses in ASAs.

The following expressions in those clauses merit attention:

- The word “use” could be interpreted in such a way that fuel that is taken on the aircraft but not used for the subsequent international flight could be taxed. This practice is known as ‘tankering’ but little or nothing is known about its application in practice.
- The words “on the basis of reciprocity” can be understood to mean that only as long as the two concerned States exempt aircraft fuel from taxation such exemption falls under the scope of the exemption. In other words, the quoted words would leave the door open for one of the two bilateral partners to go its own way as to tax exemption because such exemption is subject to the condition of reciprocity. However, this interpretation has never been put to a legal text whereas not all ASAs contain this language. Should one of the two States proceed to tax fuel on its territory used by aircraft engaged in an international flight falling under an ASA including the clause that State would positively discriminate its own designated airline(s) because it or they would be more victimized by the taxation than any other airline. Positive discrimination is allowed under international trade law. However, this practice has never been legally checked.
- The prohibition to tax aircraft fuel is directed towards States. In the United States, individual states, for instance, Florida or California, can tax aircraft fuel consumed even on international flights.

Meanwhile States may, or are reviewing their policies and laws in this respect. For instance, the Agreement between the United Kingdom and the Kingdom of the Netherlands of 2006 on the operation of air services by carriers of the Netherlands Antilles allows for the imposition of taxation of aircraft fuel on domestic and international flights falling under this agreement. While it may be too early to speak of a trend, the cited clause may be seen as a sign on the wall to begin with.

A.3.2 The EU-US agreement on air transport of 2007 as amended in 2010

This agreement merits special attention because of the large amount of air traffic representing around 14 per cent of global air traffic. Moreover, some of the largest non-EU carriers that operate on intra-EU routes are US carriers (see Section A.1.4). As such, they could be affected by a bilateral agreement between EU Member States regarding the taxation of aviation fuel.

The EU-US agreement on air transport proceeds from the traditional model exempting aircraft fuel used on international flights, and this on the basis of reciprocity. However, the same article opens the door for taxation of fuel used by US airlines on intra-EU flights covered by an agreement concluded between “two or more” EU States envisaging to apply a waiver of the exemption contained in Article 14.1(b) of EU Council Directive 2003/96. In such cases, the Joint Committee established under this agreement must consider the matter.



These provisions have not been modified in the Protocol of 2010 amending the agreement of 2007. However, the Protocol articulates the “importance of protecting the environment” and stimulates Parties to discuss environmental, including noise and emission related measures, to the greatest extent possible, through the Joint Committee.

During the nineteenth meeting of the U.S.-EU Joint Committee Meeting of the Joint Committee which took place on 16 November 2016 in Berlin, the US delegation raised concerns about “environmental taxes imposed by EU Member States” and “had reached out to EU States to address any adverse effects on international aviation and to ensure compliance with Article 15” of the EU-US agreement on air transport. The records of this meeting do not refer to taxation of aircraft fuel, or to the application of Directive 2003/96. Hence it is presumed that the US concerns expressed above do not directly affect the present subject.

A.3.3 ICAO resolutions

ICAO continues to promote the imposition of charges benefitting international civil aviation rather than taxes which serve the national budget generally. Moreover, ICAO also supports tax exemption clauses pertaining to exemption of aircraft fuel used on international flights.

A.4 Conclusions and possible solutions

The above report is designed to analyse provisions of Directive 2003/96 with particular reference to the exemption of taxation of aircraft fuel. Following that analysis, it has indicated ways and means to address this exemption.

For intra-EU/EEA commercial air traffic, the Directive provides for a principal avenue, that is, the conclusion of bilateral agreements between EU/EEA States. Such agreements must pave the way for partial or total waivers of the exemption in question. That solution raises the question as to how free EU States are to conclude a new bilateral agreement or to amend an existing air services agreement in light of the current European, and international aviation law regime.

The above sections contextualise this avenue by looking at various branches of law. The interaction between various branches of law, that is, principally environmental law, air transport law, international law and European law, create a rather complicated picture of the legal state of affairs.

It is concluded that the legal status of bilateral air services agreements between EU/EEA States is unclear. According to European law, provisions of such agreements which are governed by European law are “superseded” by European law but this is not the case for the present subject which is not ‘re-regulated’ by European law. Thus, the clauses on taxation of aircraft fuel laid down in such intra-EU/EEA air services agreements should still be in place but it is questionable whether the EU/EEA States still manage their intra-EU/EEA air services agreements and consider them as a basis for the intra-EU/EEA operations.

An amendment of the Directive with the aim of introducing the taxation of aircraft fuel on intra-EU/EEA flights through Article 14 is apparently not on the agenda. The document laying down a proposal for an amendment explains that this position is caused by the presence of “international conventions” preventing the EU from abolishing these exemptions. The term “international conventions” is not specified in the said document.



Also, attention could be paid to the formulation of Article 14(2) of the Directive where it refers to bilateral agreements between EU States whereas Article 11(6) of the EU-US Agreement speaks of a waiver to be granted by “two or more Member States.” This provision, with special reference to the words “or more” appears to be a more logical option. The EU-US Agreement appears to provide the more logical option because it creates flexibility and enhances the geographical scope of the measure from a bilateral to a plurilateral regime.

Importantly, the *de minimis* threshold for emission trading ought to be regulated at the EU level rather than in a bilateral agreement between EU States. The threshold should be set at such a level that non-EU air carriers are not subject to the application of aircraft fuel taxation, thus avoiding prohibitions laid down in existing bilateral air services agreements to that effect, as to which see Section A.3.1. The advantage of regulation of a *de minimis* threshold at the EU/EEA level would harmonise the conditions of such bilateral agreements on the taxation of aircraft fuel. It would not only exclude non-EU/EEA air carriers from the application of taxation of aircraft fuel but also EU/EEA air carriers operating air services below the threshold set by the EU measure. Harmonisation at the EU level may be relevant in light of the applicability of general EU principles such as non-discrimination, compliance with competition law provisions and the maintenance of a level playing field in the internal air transport market.

Thus, thought could be given to propose an amendment of Article 14 of Directive 2003/96 by adding a provision to the effect that, while EU States are permitted to enter into bilateral agreements on the taxation of aircraft fuel, they should take into account the *de minimis* measure as defined by the same amended Directive. EU Directive 2008/101 could serve as an example for this. At the same time, the consequences of the establishment of such a measure in the present context should be cautiously checked in light of economic, legal and air policy considerations.



B Legal Analysis of Domestic and Intra-EU Aviation Fuel Taxation

By Aoife O'Leary, December 2017

CONTENTS

- B.1 Introduction
- B.2 The Energy Taxation Directive
- B.3 2002 Open Skies Case
- B.4 Excise Duty Directive
- B.5 The Emissions Trading System
- B.6 The Chicago Convention
- B.7. Bilateral Aviation Agreements
 - B.7.1 Agreements between the EU Member States
 - B.7.2 The European Common Aviation Area
 - B.7.3 The EU-US Open Skies Agreement
- B.8 Reciprocal Exemptions
- B.9 Exempting US carriers
- B.10 De Minimis
- B.11 Conclusion

B.1 Introduction

This annex considers the legal possibilities for imposing a tax upon the fuel used in EU member state domestic and intra-EU aviation. It will consider the relevant treaties and laws:

the Chicago Convention, the EU-US Open Skies Agreement, the Energy Taxation Directive, and the Excise Duty Directive. It reaches the conclusion that taxation can be imposed on fuel used in domestic aviation without legal impediment. But for intra-EU aviation, in order to comply with the bilateral agreements the EU has signed with third countries, the EU must ensure that fuel uplifted by foreign carriers is not taxed until these constraints are removed. A de minimis exemption from intra-EU fuel taxation can achieve this. The Netherlands and Norway (a member of the European Common Aviation Area - detailed below) have domestic aviation fuel taxes although domestic flights in the Netherlands have been phased out. Internationally, the US, Japan, India and Brazil, amongst others, have domestic fuel taxes. There are no intra-EU aviation fuel taxes.

It should be noted at the outset that the question of taxing domestic fuel in the EU has been considered before by the UK Parliament and by Prof. Eckhard Pache for the German Federal Environment Agency, both of which came to the conclusion that taxing domestic aviation fuel in the EU presented no legal difficulties.



B.2 The Energy Taxation Directive

The Energy Taxation Directive (ETD) 2003/96/EC allows Member States to tax fuel used in domestic aviation and to agree bi-laterally to tax flights between two Member States.

Article 14 in relevant part states:

“(1)...Member States shall exempt the following from taxation...(b)energy products supplied for use as fuel for the purpose of air navigation other than in private pleasure-flying...(2) Member States may limit the scope of the exemptions provided for in Paragraph 1(b) and (c) to international and intra-Community transport. In addition, 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) and (c). In such cases, Member States may apply a level of taxation below the minimum level set out in this Directive.”

This allows Member States to place a tax on fuel supplied for domestic aviation, i.e. to limit the tax exemption to just intra-EU and international flights without requiring any change to EU law or any agreement with any other Member State.

It further allows Member States to impose taxation on flights between one Member State and another where the two Member States have signed a bilateral agreement. Under this wording, for a tax to be applied to all intra-EU flights it would require all Member States to sign a bilateral agreement with every other Member State. However, if all Member States agreed to tax intra-EU aviation fuel, then amending the Directive to remove the need for bilateral agreements would be a more appropriate procedure.

The ETD allows Member States to agree bilaterally to impose taxation on all flights between those Member States agreeing to do so. However, there are other bilateral and horizontal agreements between Member States or the EU and third countries which exempt fuel used in international flights from taxation. If, for example, Germany and France agreed bilaterally to tax fuel on all flights between the two countries but a US carrier also operated flights between these two countries, and therefore was subject to the fuel tax, this could be a violation of the exemption from fuel taxation in the US-EU Open Skies Agreement (detailed below). Exemptions from fuel taxation in agreements with third countries are not compatible with two Member States being able to agree bilaterally to tax fuel uplifted for flights between them (unless some sort of an exemption for international carriers is provided for). Therefore, the EU must expedite the renegotiation of those agreements with third countries in order to allow Member States to implement intra-EU fuel taxation as envisaged in the ETD.

B.3 2002 Open Skies Case

Where the EU does not have a bilateral agreement in place with a third country, there are often bilateral agreements between the individual EU Member States and the third country. However, it is probable that any exemption from fuel tax included in a such a bilateral agreement between an individual Member State and a third country would not be valid as far as intra-EU fuel taxation is concerned. This is because in the 2002 Open Skies case⁶ the Court of Justice of the European Union (CJEU) ruled that provisions of such bilateral agreements breached EU law where it was not in the competency of the Member State to grant exemptions to third countries. The exemptions in that case related to the right of establishment for air carriers. However, a similar argument could be made in relation to

⁶ Commission v United Kingdom, Denmark, Sweden, Finland, Belgium, Luxembourg, Austria, Germany, Cases C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98.



fuel taxation, as the EU now has established competence through the Energy Taxation Directive.

B.4 Excise Duty Directive

Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty (the 'Excise Duty Directive') sets out when and how excise duty can be placed on aviation fuel. Article 1 of the Directive states that it applies "to excise duty which is levied directly or indirectly on the consumption of the following goods (hereinafter 'excise goods'): (a) energy products and electricity covered by Directive 2003/96/EC". Directive 2003/96/EC covers aviation fuel and it thus comes under the provisions of the Excise Duty Directive.

The Excise Duty Directive states in article 7(1) that "Excise duty shall become chargeable at the time, and in the Member State, of release for consumption." Aviation fuel is released for consumption at the airport as the aircraft is fuelling. This would mean that the tax should be charged at that point. Therefore, a domestic fuel tax system cannot require airlines to submit all their domestic flight information once a year (for example) and pay the tax at that point, but rather the tax must be imposed as the aircraft fuels. Aircraft may take on fuel for more than just a domestic flight, while the tax is to be imposed on fuel used in domestic flight. The Excise Duty Directive does contemplate reimbursements under Article 11 "for the purpose of preventing any possible evasion or abuse." Tax paid on fuel use for non-domestic flights could be reimbursed this way, for example if an airline uplifted fuel for safety purposes that was not ultimately used in the flight, but tax had been paid thereon, that tax could be reimbursed later.

B.5 The Emissions Trading System

The Emissions Trading System (ETS) seeks to account for the CO₂ emissions of aviation. Therefore, a question could be asked whether it would be permissible to impose a fuel tax as it could be primarily an environmental measure and thus seen as duplicating the work of the ETS.

There is nothing in the ETS Directive (2003/87/EC) which says it can be the only charge on the carbon emissions from entities covered by the ETS. Indeed, Recital 23 of the ETS Directive situates the ETS within the wider context of "a comprehensive and coherent package of policies and measures implemented at Member State and Community level." And recital 26 of the ETS states that further measures at EU, Member State and international level will be needed: "notwithstanding the multifaceted potential of market-based mechanisms, the European Union strategy for climate change mitigation should be built on a balance between the Community scheme and other types of Community, domestic and international action." These recitals clearly contemplate additional measures imposed as well as the ETS.



In general EU law, Directives (such as the ETS) are intended to be minimum harmonisation measures only, i.e. Member States have the possibility to enact further or more stringent measures in addition to the legislation in the Directive. This is especially so with regard to environmental measures where the right for Member States of "maintaining or introducing more stringent protective measures" for the environment is explicitly retained in Article 193 of the Treaty on the Functioning of the European Union. However, it must be noted that there are certain conditions attached to enacting policies under Article 193:

1. The additional measures must result in a level of protection of the environment that is higher than the one pursued by the EU measure.
2. It must fall within the field of application of the EU measure by following the same objectives.
3. It must not frustrate the secondary objectives of the EU measure.
4. Where such an additional measure would affect other EU provisions, it must not violate the principle of proportionality.
5. And it must be notified to the European Commission.

None of these conditions should present a problem for any Member State wishing to impose a fuel tax on its domestic flights. Importantly the Netherlands and Norway already tax domestic aviation fuel and Norway even labels its fuel tax as a "CO₂-tax".

In three cases the CJEU has looked at the objectives of the ETS and found that the protection of the environment by reducing GHGs is the principal, overarching objective of the ETS. The secondary objectives found were cost-effectiveness and economic efficiency. The imposition of a fuel tax should not interfere with these objectives other than that it could be argued that to the extent that the fuel tax lowered emissions, it would also then lower the ETS price. This could be seen as reducing the economic efficiency for other sectors under the ETS as it would incentivise less emissions reductions. However, as a fuel tax would accord with the primary objective of the ETS, it is unlikely a challenge to a fuel tax based on distorting the economic efficiency of the ETS could succeed.

B.6 The Chicago Convention

The Chicago Convention provides no obstacle to placing a tax on domestic or intra-EU aviation fuel. The Convention bans parties from imposing taxes on fuel already on board an aircraft when it lands in another country but it contains no prohibition on taxing the fuel sold to aircraft in a country. Further, the Chicago Convention is not applicable to domestic aviation.

It is often suggested that the Chicago Convention exempts aviation fuel from taxation. However, the Chicago Convention only exempts fuels already on-board aircraft when landing, and retained on board when leaving, from taxation. Article 24 states: "Fuel ... on board an aircraft of a contracting State, on arrival in the territory of another contracting State and retained on board on leaving the territory of that State shall be exempt from customs duty, inspection fees or similar national or local duties and charges."

Therefore, Article 24 does not prohibit the taxing of fuel taken on board in a particular country but rather prohibits the taxation of fuel that was already on board the aircraft when it landed, i.e. Member States cannot tax aviation fuel purchased in another country that arrives on board the aircraft.

The purpose of this Article is to prevent double taxation.



Another article of the Chicago Convention that is sometimes said to ban fuel taxes is Article 15. This article states: "No fees, dues or other charges shall be imposed by any contracting State in respect solely of the right of transit over or entry into or exit from its territory of any aircraft of a contracting State or persons or property thereon."

Therefore, it prohibits only those charges which are levied solely for transit, entry into or exit from a particular country. A domestic fuel tax would not be levied to grant transit rights but rather for general revenue raising reasons, along (probably) with an environmental component, meaning that the tax would not be based on transit, entry into or exit from a country and so not fall foul of the Article 15 ban.

Second, the tax would not be a 'charge' - a charge is a levy based on a service rendered as opposed to a tax which is levied without any service given in return. It could be questioned whether a tax would come under the definition of 'fee' or 'due' but the wording makes clear that 'fee' and 'due' are simply types of charges. Indeed, ICAO itself has distinguished between taxes and charges in numerous policy documents, for example in the 5th recital of the "Council Resolution on Environmental Charges and Taxes" of 9 December 1996:

"Noting that ICAO policies make a distinction between a charge and a tax, in that they regard charges as levies to defray the costs of providing facilities and services for civil aviation, whereas taxes are levies to raise general national and local governmental revenues that are applied for non-aviation purposes."

Therefore, Article 15 does not prohibit the levying of general taxation without a service provided, i.e. it does not prohibit the imposition of a tax on fuel for domestic aviation or intra-EU aviation either to raise general revenues or for environmental purposes.

ICAO has produced various policy documents that suggest that no taxes should be placed on aviation fuel. However, none of these are legally binding and thus will not be examined here.

Finally, even if Article 24 or 15 of the Chicago Convention banned fuel taxation - which they do not - the Chicago Convention is not applicable to domestic air transport. Therefore, regarding the case of a domestic fuel tax, the Chicago Convention is not relevant. The Chicago Convention is an international treaty designed to promote and facilitate international civil aviation. This is clear from its official title - "Convention on International Civil Aviation" and from the wording of the preamble which consistently refers to developing international aviation. Therefore, only where specific provisions refer to domestic aviation should they be made applicable to domestic flights. Neither of the articles referred to in this note do so and therefore it must be assumed that they apply only in relation to international aviation.

B.7 Bilateral Aviation Agreements

The EU and its member states have many bilateral aviation agreements with third countries. As such it is beyond the scope of this paper to detail all the agreements. Instead, this section shall look at the agreements involving the EU Member States themselves, the European Common Aviation Area Agreement and the Open Skies EU-US bilateral agreement.

B.7.1 Agreements between EU Member States

All EU Member States have had unlimited cabotage rights in all other Member States since 1996 (Regulation (EEC) 92/2408). However, the Energy Taxation Directive was agreed in 2003, after the unlimited cabotage rights were granted. If a member state had needed the permission of another Member State to impose a fuel tax on domestic aviation this would have been reflected in the Energy Taxation Directive. Indeed, it is clear from Article 14(2) of the Directive that bilateral agreements are needed to tax fuel used in flights between Member States but no such bilateral agreements are needed for the taxation of fuel used on domestic flights. This makes clear that the Member State can place a tax on the fuel of the aircraft of another Member State operating domestic flights in its territory without the explicit consent of the other Member State.

With regard to imposing an intra-EU fuel tax, again, as the Energy Taxation Directive was agreed after unlimited cabotage rights were granted, the ETD must be assumed to have taken the unlimited cabotage rights into account. As discussed above, the ETD clearly allows Member States to sign bilateral agreements to tax the fuel used on flights between the Member States signing the bilateral agreement. This will include the flights between those two Member States that are flown by aircraft of another Member State due to the unlimited cabotage rights being granted before the ETD was signed.

B.7.2 The European Common Aviation Area

The European Common Aviation Area (ECAA) grants all members all nine freedoms of the air.

This means that each of the ECAA countries has the right to fly domestically in every other member of the ECAA, i.e. it grants cabotage rights to all ECAA members. In terms of a domestic fuel tax, it could mean fuel taxes being placed not just on aircraft operated by EU registered airlines, but ECAA airlines as well. Therefore, it must be questioned whether it would violate any legal agreements to tax fuel used by ECAA member airlines for a domestic flight in another ECAA member.

Article 1 of the ECAA Agreement applies the Energy Taxation Directive (ETD) to all the members of ECAA. As discussed, the ETD expressly allows all Member States to apply taxation to domestic aviation fuel. By adopting the ETD into the list of EU laws by which all the members of ECAA must apply, it means that the members of ECAA must also agree that each member is entitled to impose a domestic aviation fuel tax. Further, as mentioned above, both the Netherlands and Norway (both ECAA members) have taxes on domestic fuel, applied without legal challenge. Further, there is a Joint Committee established by Article 17 of the ECAA Agreement which monitors the implementation of the Agreement. There have been no reports of any objections to domestic fuel taxation in the ECAA Joint Committee. Therefore, it can be concluded that applying a domestic fuel tax does not violate the ECAA agreement.

No other bilateral agreements have been signed with countries outside the EU which grant traffic rights within Member States. There are agreements (notably the EU-US bilateral) which allow other countries traffic rights between Member States but not domestically within a single Member State. Therefore, bilateral agreements with countries outside of the EU do not preclude taxation of aviation fuel for domestic flights as no foreign airlines have the right to operate domestic flights on which they would have to pay the tax.

In considering an intra-EU fuel tax, the members of ECAA must abide by the ETD. Therefore, to impose a fuel tax on flights between an EU member state and an ECAA member state, a bilateral agreement must be signed. Once a bilateral agreement is signed then the carriers



from that ECAA state could be taxed the same as any other EU Member State carriers flying between those two countries - no specific exemption would need to be made for the ECAA members.

B.7.3 The EU-US Open Skies Agreement

Article 11 of the EU-US Open Skies Agreement concerns fuel taxation (among other things). Article 11(1) repeats the ban from the Chicago Convention on taxing fuel already on board an aircraft when it lands in another country (Article 24 of the Chicago Convention discussed above). Article 11(2) then goes on to state:

“2. There shall also be exempt, on the basis of reciprocity, from the taxes, levies, duties, fees and charges referred to in Paragraph 1 of this Article [all import restrictions, property taxes and capital levies, customs duties, excise taxes, and similar fees and charges that are (a) imposed by the national authorities or the European Community, and (b) not based on the cost of services provided, provided that such equipment and supplies remain on board the aircraft], with the exception of charges based on the cost of the service provided:

- (c) fuel, lubricants and consumable technical supplies introduced into or supplied in the territory of a Party for use in an aircraft of an airline of the other Party engaged in international air transportation, even when these supplies are to be used on a part of the journey performed over the territory of the Party in which they are taken on board”.

Therefore, this fuel exemption throws up three interesting points:

- Fuel is exempted from taxation based on reciprocity (discussed below).
- The only exempt taxation is that imposed by the national authorities or the EU, i.e. US States, German Länder, French Departments, etc. can impose a fuel tax without violating the agreement (US States already do).
- The Agreement only exempts fuel used in international flights, not domestic flights - therefore EU Member States can place a tax on all domestic flights without violating the Open Skies Agreement.

B.8 Reciprocal Exemptions

As stated above, fuel used in international flights under the EU-US Open Skies Agreement, is exempt from taxation "on the basis of reciprocity". It is important to understand what reciprocity means. There is no definition in the Agreement. One explanation is suggested by a 1999 report written for the European Commission by a consortium including the International Institute of Air and Space Law where it was stated:

"It is noted that the words "on the basis of reciprocity" could be understood to mean that only as long as the two concerned countries exempt aircraft fuel from taxation, such exemption falls under the scope of the cited provision. Thus, the quoted words would leave the door open for one of the two bilateral partners to go its own way as to tax exemption, because such exemption is subject to the condition of reciprocity. This interpretation has however never put to a legal test."

Under this interpretation, then either side (the US or EU) can begin to tax fuel used in international aviation without violating the agreement. The wording of Article 11 is not a ban on fuel taxation, rather an agreement that if one party begins to tax fuel, the other party may too. There are some further articles of the Open Skies Agreement that assist with understanding what reciprocity was intended to mean.



Article 18 of the Open Skies on the Joint Committee reads:

"1. A Joint Committee consisting of representatives of the Parties shall meet at least once a year to conduct consultations relating to this Agreement and to review its implementation.

2. A Party may also request a meeting of the Joint Committee to seek to resolve questions relating to the interpretation or application of this Agreement...

4. The Joint Committee shall also develop cooperation by: ... (e) making decisions, on the basis of consensus, concerning any matters with respect to application of Paragraph 6 of Article 11."

Article 11(6) states: "In the event that two or more Member States envisage applying to the fuel supplied to aircraft of U.S. airlines in the territories of such Member States for flights between such Member States any waiver of the exemption contained in Article 14 (b) of Council Directive 2003/96/EC of 27 October 2003, the Joint Committee shall consider that issue, in accordance with Paragraph 4(e) of Article 18."

Thus, the Open Skies Agreement sets up a Joint Committee to review implementation and resolve questions relating to the Agreement. Article 11(6) and 18(4) require consensus decision making if any Member States wished to come to a bilateral agreement to tax the fuel used on all flights between the Member States as foreseen in Article 14 of Council Directive 2003/96/EC: the Energy Taxation Directive (ETD).

It is important to note that Article 18 detailing the purpose of the Joint Committee only refers to consensus decision making in two places. One is Article 18(4) above - where two (or more) Member States agree bilaterally to impose fuel taxes under the current ETD wording - and the other is related to Annex 4 ownership of airlines. This suggests that nothing else in the Open Skies Agreement must be decided by consensus. If you specifically state that consensus is required for two types of issues that could arise under the agreement, then the assumption must be that consensus is not required for other types of issues arising under the agreement. Therefore, if the EU imposed a fuel tax in any manner which was not that of Article 14(b) of the ETD, the agreement of the US would not be required. Where fuel tax is imposed in a manner that is not via a bilateral agreement as foreseen in Article 14(b) of the ETD, there is no requirement for consensus. The Open Skies Agreement very clearly only refers to consensus in two situations and while one is the bilateral imposition of a fuel tax in accordance with Article 14(b) of the ETD, the other is not the imposition of a fuel tax in any other manner (it relates to the ownership of airlines). While there is no reason given for the imposition of a requirement for consensus for the case of a bilateral agreement to tax fuel, as opposed to a decision to tax fuel agreed in any manner outside of Article 14(b) of the ETD, it could be supposed it would be because the imposition of a fuel tax in only two countries and only for the flights that travel between those two countries could be seen as a breaking up of the common aviation market in the EU and so require a higher level of agreement, compared to the imposition of a fuel tax across all intra-EU flights.

In such a situation - where the ETD was amended to require aviation fuel tax on all intra-EU flights - then there are still two reasons to involve the Joint Committee as set out in Article 18: (1) to review implementation and (2) if there was a request for interpretation resolving, but neither of these reasons to involve the Joint Committee require the Joint Committee to come to a consensus decision.



If the reciprocity clause is interpreted to allow the EU to impose fuel taxes under Article 11 as it currently stands then this would be a matter for discussion at the Joint Committee under Article 18(1) but anything referred to the Joint Committee under Article 18(1) does not require approval by the US before it can go ahead - as stated above, consensus between the EU and US is only required for two reasons: where bilaterals under the ETD are agreed or where the ownership of airlines is in question.

The EU could also present an intra-EU tax to the Joint Committee for interpretation because the EU is unsure of whether they are allowed under Article 11 to impose intra-EU fuel taxation without amending the Open Skies Agreement. Under Article 18 they can seek an agreed interpretation of Article 11. Under Article 18(2) the parties are to “seek to resolve” questions of interpretation. Therefore, while the EU should seek to resolve any question of interpretation in good faith, the agreement of the US would not be required before the EU could unilaterally impose a fuel tax.

Regardless of how the EU approaches the Joint Committee, if an intra-EU fuel tax was to be imposed, and a consensus was not reached (even if not required), the dispute can be referred to “any person or body agreed by the parties”, or failing that to arbitration under Article 19. The arbitration would consist of one judge appointed by each of the parties and one appointed by agreement of the judges already appointed. If the third judge cannot be agreed by consensus, then ICAO appoints the third judge.

If something is not resolved by the arbitration or one of the parties does not comply with the decision of the arbitration then under Article 19(7), “the other Party may suspend the application of comparable benefits arising under this Agreement until such time as the Parties have reached agreement on a resolution of the dispute. Nothing in this paragraph shall be construed as limiting the right of either Party to take proportional measures in accordance with international law.” There is no definition of what exactly “comparable benefits” are under the agreement. But it could be assumed that it would be the imposition of taxes on EU carriers (extra-US as no EU carriers fly intra-US). However, all of this is moot if the EU can find a way to impose intra-EU fuel taxes (the Open Skies does not concern itself with domestic taxes as explained above) without any incidence on US carriers.

B.9 Exempting US carriers

The Open Skies agreement sets out the rights of both EU and US carriers to operate in both places. For the purposes of this paper, the important question is if an intra-EU fuel tax was imposed, would any US carriers conducting international flights be caught by it. The answer is that US cargo carriers have as much as 90 flights a week between EU Member States. If an intra-EU fuel tax is imposed and the US carriers paid fuel tax on those intra-EU flights (and the definition of reciprocity under Article 11 did not mean either party could unilaterally impose a fuel tax), then this would violate the Open Skies Agreement.

B.10 De Minimis

Either to exempt the US carriers entirely or avoid any disagreement over the interpretation of reciprocity in Article 11, the EU should consider a *de minimis* arrangement for all airlines operating intra-EU flights.



There are various EU laws which allow for *de minimis* exemptions from otherwise binding requirements. Therefore, in considering how to impose a *de minimis* on intra-EU aviation, looking at other areas where the EU has granted *de minimis* exemptions from EU law is illustrative.

Without going into detail on EU competition law or State aid law, there are exemptions that provide a basis for a fuel tax *de minimis*. First, under general competition law, market distortions that affect less than 10% of the market do not raise concern. Second, the EU is generally not concerned with ‘small’ aid to businesses i.e. up to € 200,000 over three years. Third, under the ETS Directive, carriers operating a limited number of flights into the EU are entirely exempt from having to report their emissions or surrender allowances. Based on these existing *de minimis* exemptions, the following are options which create no legal obstacles and could be employed to ensure that US carriers or other foreign carriers would be entirely exempt from an intra-EU fuel tax:

- a *De minimis* based on the amount of fuel tax paid: Under this *de minimis* provision, all airlines would pay tax on all intra-EU fuel but if in any year an airline pays less than € 66,000 (i.e. € 200,000 over 3 years) then they could apply to get a full rebate of tax paid. It is possible to look on this as a subsidy (similar to a State aid) and so € 200,000 over 3 years is a precedent for a similar type of subsidy the EU allows. The tax would have to be set at a rate where the US carriers would never pay more than € 66,000 a year.
- b *De minimis* based on the number of flights: All airlines would have a certain amount of flights exempt per week or month, e.g. all airlines are allowed up to 90 tax-free flights a week before they must begin to pay fuel tax on the rest of their flights.
- c *De minimis* based on CO₂ emitted or fuel used: Small emitters under the ETS are granted an exemption based on emitting less CO₂ than a certain threshold. As an intra-EU fuel tax would be an environmental measure, two thresholds could be set rather than currently where there is just one. This would mean all emitters below the lowest threshold don't have to worry about the ETS or pay fuel tax. Those between this threshold and the higher threshold would have to comply with the ETS and then those above the second threshold would have to comply with the ETS and pay fuel tax.
- d *De minimis* based on city or airport pairs: A 2005 Commission Working Paper suggested that a fuel tax on intra-EU and domestic flights could be implemented “by making it mandatory while allowing for the possibility to exempt all carriers on specific routes where non-EU carriers operate and benefit from exemptions under unchanged ASAs [bilateral agreements]. Ongoing renegotiation of ASAs would then gradually allow for the taxation of third country carriers on intra-EU flights”⁷.

If US airlines were entirely exempt from any intra-EU fuel tax then no issues under the Open Skies Agreement arise. The Agreement exempts carriers from paying tax but imposes no restriction on the EU imposing a tax on all other carriers.

US carriers might attempt to argue that a *de minimis* arrangement would essentially cap their growth but as long as the *de minimis* was periodically reviewed to ensure that no US carrier had to pay fuel tax, such an argument could not succeed. A fuel tax *de minimis* would not restrict traffic volume or the type of aircraft that could be used by US carriers. No restriction on traffic volumes or type of aircraft follows even indirectly from a fuel tax. The subject of regulation would solely be the environmental externalities caused by aviation or the raising of general tax revenue.

⁷ Staff Working doc SWD 7 final of COM 2018.20 (2018) 20 final.



In summary, Article 11 ensures that if one party imposes a fuel tax, both sides will be free to tax fuel on a reciprocal basis but does not ban the imposition of taxation. The requirement to consult with the Joint Committee is simply to “seek to resolve”, i.e. a soft arrangement which doesn’t prevent unilateralism on tax or for the parties to go to arbitration if they desire. There is no reason why an intra-EU fuel tax cannot exist with a *de minimis* to ensure that US carriers do not pay any tax and thereby avoid any non-EU carriers entirely.

B.11 Conclusion

The Energy Taxation Directive permits EU Member States to impose a tax on aviation fuel used in domestic flights and via bilateral agreements, on intra-EU flights. Nothing in the Chicago Convention prevents the imposition of domestic or intra-EU fuel tax. All ECAA members have unlimited cabotage rights in all other EU Member States. This does not prohibit fuel taxation as the Energy Taxation Directive is included in the ECAA Agreement and clearly contemplates Member States imposing a tax on domestic and intra-EU aviation. Both the Netherlands and Norway have domestic aviation fuel taxes. The Excise Duty Directive requires a fuel tax to be imposed at the time of release for consumption, which would be as the aircraft fuels at the airport and this could result in the situation where airlines pay tax on fuel that is used in extra-EU flights. However, as long as a rebate system is established (potentially by using the data from the ETS) to refund any tax paid on fuel used internationally, this does not pose a problem. There is no reason why a fuel tax and the ETS cannot cover the same domestic and intra-EU flights. The Open Skies agreement only exempts fuel used in international, not domestic, flights from taxation.

It can be argued that the Open Skies Agreement allows for each side to unilaterally impose fuel taxation as the exemption is only on the basis of reciprocity and can be withdrawn at any time. In addition, there are several ways that US airlines could be exempted from any intra-EU fuel taxation including a *de minimis* based on the amount of tax paid, the number of flights or the routes. In conclusion, a domestic fuel tax can be imposed without any legal concerns arising. As long as a *de minimis* is established for intra-EU fuel taxation to ensure foreign carriers are exempt, that too can be imposed, and no legal issues prevent it.



C List of non-EEA aircraft operators active on intra-EEA routes

Aircraft operators flying on routes between EEA airports have to report their emissions to the competent authority and surrender allowances in order to comply with the EU ETS.

The EU Transaction Log contains the names of these operators as well as the verified amount of emissions on intra-EEA routes. Based on information from the Transaction Log, we have compiled the list in Table 2.

Most non-EEA operators have just a few flights on intra-EEA routes and consequently use little fuel. EasyJet Switzerland is the largest non-EEA aircraft operator in terms of fuel use and emissions, followed by UPS and FedEx.

Table 2 - Non-EEA aircraft operators active on intra-EEA routes in 2016

Aircraft operator	Amount of fuel used on intra-EEA routes in 2016 (tonnes)
Latam Airlines Group, S.A.	8,030
Air China Limited	6,556
Cathay Pacific Airways Limited	3,543
China Southern Airlines	2,664
ETHIOPIAN AIRLINES	11,950
Iran Air, The Airline of the Islamic Republic of Iran	1,696
CAL CARGO AIRLINES	3,924
Nippon Cargo Airlines	3,947
EU ETS trading account for KOREANAIR	7,635
Asiana Airlines	4,964
Kuwait Airways Corporation	3,237
Qatar Airways	7,080
VDA_Operator	4,487
Air Bridge Cargo	8,180
Singapore Airlines Limited	9,987
EASYJET SWITZERLAND	66,789
SWISS INTERNATIONAL AIR LINES LTD	111
Emirates	12,805
Atlas Air, Inc.	5,933
United Parcel Service Co	51,689
FEDERAL EXPRESS CORPORATION	56,891

