Why taxes are not an option in addressing international civil aviation’s carbon footprint

Thu 26 Mar 2015 – While the aviation sector continues to implement new technological and operational measures to mitigate its carbon footprint, including the development of sustainable alternative fuels, these initiatives by themselves will not be sufficient to offset the growth in its emissions and resolve the sector’s climate change dilemma. Given mounting international pressure, regulatory intervention will be required. Some outside the sector, and now even voices within the discussion of ICAO’s Environment Advisory Group (EAG) tasked with developing a global market-based measure (MBM), argue that the easiest way to address the problem is through the imposition of carbon taxes. Dr Alejandro Piera examines the legal barriers embedded in the international civil aviation legal regime that preclude this option.

Environmental regulations attempt to internalise external environmental costs. It was Arthur C. Pigou who first argued that to internalise externalities, governments needed to impose taxes. Although airline advocates view taxes in general as a risk to the industry, in theory at least, taxation may be a viable policy tool to control growth or to reduce fossil fuel dependency. As legal philosopher Lon L. Fuller suggested, taxation quite often seeks not to “raise revenue, but to shape human conduct in ways thought desirable by the legislator.”

Although taxation is an option to address climate change, such an alternative faces numerous hurdles in the international aviation context where fuel – the common denominator for measuring emissions – has traditionally been exempted from taxes.

The tax immunity that aviation fuel enjoys internationally derives primarily from two sources: the Chicago Convention and language that appears in more than 4,000 existing air services agreements, or bilaterals. Although there was no similar provision in its predecessor, the 1919 Paris Convention, Article 24 of the Chicago Convention exempts fuel on board aircraft upon arrival and retained on board upon leaving the territory of another ICAO Member State from taxation.

To understand the rationale of the tax immunity afforded to international aviation fuel, it is worth looking at the proceedings of the Chicago Convention to examine the intention of the drafters when they came up with this tax exemption. The wording of Article 24 finds its origin in the US Proposal of a Convention on Air Navigation submitted to the 1944 Chicago Diplomatic Conference, which suggested exempting from customs duties and taxes fuel on board any aircraft arriving into the territory of another Contracting State.

The proposal also recommended that fuel so introduced into another country’s territory should be afforded national and most-favoured nation treatment. While not explicitly exempting fuel uplifted upon arrival, the proposal sought to ensure that the State of arrival did not discriminate against foreign operators by imposing undue taxes or customs levies that could not be demanded from national operators. The US did not provide a raison d’être for its proposal.

The Netherlands went even further and submitted another proposal to exempt fuel “introduced in the territory of any contracting State if intended solely for use by aircraft on international services.” Industry parlance often refers to this as uplift fuel. During deliberations at the Chicago conference, the Netherlands explained that such an exemption status for fuel was needed in light of already existing conflicting tax treatments given by different countries at the time. While some opted for exempting uplift fuel, others levied very high taxes and charges. In practice, this forced aircraft
operators to take extra fuel on board when flying to highly taxed destinations instead of revenue-generating payload.

Although in essence the Netherlands pursued a purely economic interest – that is to avoid disposing of cargo as a result of having to uplift extra fuel on its carriers’ outbound flights – it might also have indirectly helped to prevent environmentally unfriendly practices such as fuel tankering. In the end, the Dutch proposal was not fully incorporated into the final text of the Chicago Convention, which only exempts from taxes and customs duties fuel already on board the aircraft upon arrival into another Contracting State. The proceedings of the Convention fail to provide an explicit explanation as to why a tax exemption was not accorded to uplift fuel.

The proceedings did, however, provide some additional recommended guidelines for Member States. Since the final text of the Convention did not embrace the notion of freedom of the air, retaining instead the principle of exclusive sovereignty over airspace, the drafters knew that States would be compelled to enter into bilateral negotiations in order to gain market access to other countries where their aircraft operators would want to fly. Thus, in Resolution VIII, the Conference adopted a Standard Form of Agreement for Provisional Air Routes intended to guarantee as much “uniformity as possible in any agreements that may be made between States for the operation of air services.”

Following the original US proposal, this model agreement granted to fuel introduced in the territory of one State party by an aircraft operator from another State party national and most-favoured nation treatment in connection with the imposition of customs duties and taxes. The sample clauses contained in the model agreement have inspired the language incorporated in almost all of the bilateral agreements that later followed the Convention and that are still in force today.

Although only 52 States originally signed the Convention on 7 December 1944, the vision of its drafters has influenced aviation practices for seven decades. The renowned Bermuda Agreement (Bermuda I) entered into between the US and the UK in 1946 followed verbatim the model agreement. The model US open skies agreement exempts both fuel on board and, on the basis of reciprocity, fuel supplied in the territory of one State party to an airline of the other party.

Nearly all bilateral air services agreements have now followed this formula, including the Multilateral Agreement on the Liberalization of International Transportation (MALIAT) and the highly praised US-EU Open Skies Agreement of 2007. This exemption is generally applied to consumption taxes, such as VAT. However, in most cases, this exemption does not cover ‘service fees’ that the airport operator charges to fuel supplying companies. This cost is in most cases later transferred to airlines.

**Creative responses from some states**

As a consequence of the barriers to taxing fuel directly and internalising aviation’s environmental costs to society in general, a number of European countries have been very creative in levying taxes of an environmental nature upon passengers departing on international flights from their airports. These taxes work as genuine excise duties, where the taxable event constitutes the act of exiting the country by air. Technically speaking it is not a tax imposed directly on the use of aviation fuel. The most renowned example is UK’s Air Passenger Duty (APD), which is levied at different rates depending on the distance flown by the passenger.
Similarly, in 2007 the Netherlands announced a proposal to introduce a ticket tax (DTT) on all passengers departing from Dutch airports. The ticket tax would have ranged between €11.25 ($12) for flights within the European Union and €45 ($49) for flights to all other destinations. The Dutch government reversed the implementation of the tax in July 2009, fearful of the tax’s potential to divert air traffic from Dutch airports to neighboring locations.

Similar initiatives have been discussed in France, Germany and Norway. Although the legality of these ‘excise’ taxes may nonetheless be questioned, for they may conflict with the provisions of the Chicago Convention, in practice, some courts in Europe have already rejected the idea that aviation’s Magna Carta prevents States from levying international departure/embarkation taxes. According to this rationale, States retain the sovereign rights to impose these taxes.

**UNFCCC push for an aviation levy**

In preparation for the 21st Conference of Parties that will take place in Paris in December, the Ad Hoc Working Group on the Durban Platform for Enhanced Action met in Geneva in February. Reflecting the diverse views of its constituents and lack of agreement on various issues, the draft text still contains numerous square brackets. For the sector it is worth noting that one of the options suggests that in order to meet the 2°C objective, States should “agree on the need for global sectoral emission reduction targets for international aviation and maritime transport and the need for all Parties to work through [ICAO and IMO] to develop global policy frameworks to achieve these targets.”

This language is indicative of the views of some States within the UNFCCC context that international aviation should be much more active in addressing its carbon footprint. The sector’s objective should not simply be to offset its growth, but rather to establish emission reduction targets. The proposed text does not specify whether these targets should be binding upon States, or whether they should follow the ICAO approach and remain in a non-attributable manner. At this stage of the negotiations, one would assume that they will not be binding. In order to achieve the targets, the proposed text tasks ICAO and IMO with developing a global policy framework. Here it is not clear whether the drafting intention is to suggest a global MBM scheme, such as the one that ICAO is developing, or merely a framework or set of common principles that States could take into account, if and when they decide to implement measures to address international aviation’s GHG emissions.

At the UNFCC meeting in Geneva, States also proposed text to encourage both ICAO and IMO “to develop a levy scheme to provide financial support for the adaptation fund.” In other words, in order to compensate for the environmental externality it generates as a result of the growth of its activity, international aviation should help fund climate change adaptation. For a long time, industry has rejected this proposition. The industry would prefer to reinvest these revenues within the sector to speed up the deployment of cleaner technology. From a climate change perspective, these funds should be used where it is more efficient to achieve environmental objectives. Given the sector’s notoriously high abatement costs, it makes more sense to allocate these funds for climate change activities.

The proposed text does not clarify what this levy scheme would be. If the intention is to develop a carbon tax on fuel used in international flights, the legal argument against it will be very strong as the Chicago Convention prohibits taxing fuel on board aircraft. Similarly, most bilateral air services agreements clearly state that uplift fuel for international operations should not be subject to taxes. However, if the idea is to levy embarkation taxes on passengers departing on international flights for
climate change purposes, the sector’s legal position to fight them is certainly weaker. Here the argument would be whether such levies are tantamount to an excise tax for the sole purpose of leaving, entering or transiting a given country, which is in fact contrary to the spirit of Article 15 of the Convention. In various cases, European courts have rejected this rationale and upheld the validity of such taxes.

Implications for the future

ICAO’s unwavering support of tax exemptions on aviation fuel can only be interpreted as a logical approach if one considers that its very own Assembly is of the view that, because “air transport plays a major role in the development and expansion of international trade and travel”, taxes on aircraft fuel “may [only] have an adverse economic and competitive impact on international air transport operations.” Given the clear emphasis that ICAO constituents place on the growth and development of air transport, it is unrealistic to expect any amendment to the existing international legal regime that would permit the imposition of taxes on fuel.

Although a tax on fuel could be one of the easiest ways to deal with greenhouse gas emissions from international aviation, the long-standing tax immunity precludes this option. Cognisant of this legal barrier, several States as mentioned have taken steps to bypass the Chicago Convention and have imposed various embarkation taxes for environmental purposes. In the context of the UNFCCC, States have – once again – suggested the idea of a levy scheme to tax international aviation and use the proceeds for non-aviation related activities, such as climate change adaptation.

This is a matter of serious concern to the industry given the financial impact could be substantial. In order to prevent the spread of these practices, it is in the sector’s best interest to put in place a system to limit or reduce its carbon footprint. In this regard, the development and successful implementation of ICAO’s global MBM becomes extremely necessary.

An international offsetting scheme seems like a viable option. However, strong political will from major players is required. Likewise, the whole negotiation process should be significantly much more open. For a large number of actors outside aviation circles, more transparency is desirable. We must all realise that the entire international aviation community should be engaged in this process, not just some of the major actors.

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