Prohibition Against Taxes on International Airlines

The current draft of the "American Clean Energy and Security Act of 2009" (the "Legislation") establishes a carbon cap and trade program for reducing greenhouse gas ("GHG") emissions by adopting the "upstream" approach of capturing the carbon output of various companies by charging the suppliers of the fuel that these companies combust. In the case of airlines, it is clear that the oil companies through fuel suppliers would pass some or all of this cost onto their airline customers in the form of a "carbon tax" surcharge or via higher fuel costs that would otherwise be charged in the global market. This creates a "de facto" impermissible tax on fuel sold to international airlines under international and U.S. law. The Legislation, therefore, should be amended to exclude this illegal tax on international airlines.

The Chicago Convention bans fuel taxes

The Convention on International Civil Aviation, also known as the Chicago Convention, was negotiated in 1944 to enable the establishment of the international commercial aviation system. [1] It outlined rules of airspace, aircraft registration and safety and details the rights of the signatories in relation to air travel. Furthermore, the Convention establishes the International Civil Aviation Organization (ICAO), charged with coordinating and regulating air travel in line with the principles contained therein. The United States is one of 190 States Parties to the Chicago Convention and therefore bound by its provisions.

The preamble of the Convention provides that the signatories have agreed on the Convention so that "…international civil aviation may be developed in a safe and orderly manner and that international air transport services may be established on the basis of equality of opportunity and operating soundly and economically." [2] In that regard, the framers of the Convention recognized from the beginning that international air transport poses a number of challenges in the field of taxation. Unlike fixed industries, commercial aviation by its nature operates in multiple jurisdictions, each with their own tax regimes. As part of its effort to ensure that the industry operate "soundly and economically", the Chicago Convention, and subsequent interpretations of that Convention by the ICAO Council, sought to avoid multiple taxation of international airline operations, including taxes on the fuel these airlines consume abroad.

ICAO defines a tax as a levy to raise general national and local government revenues that are applied for non-aviation purposes.[3] While fuel and/or energy taxes may be applied to domestic aviation, Article 24(a) of the Chicago Convention states that "(f)uel . . . on board an aircraft of a contracting state . . . **shall be exempt** from customs duty, inspection fees or similar national duties or charges."[4] This provision was extended by the ICAO Council in a 1999 Resolution, which states: " fuel … **taken on board for consumption**" by an aircraft from a contracting state in the territory of another contracting State departing for the territory of any other State **shall be exempt** from all

[1] Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180, 15 U.N.T.S. 295 (the "Chicago Convention")
[2] Chicago Convention, Preamble
[3] ICAO Doc 9082/7 *Policies on Charges for Airports and Air Navigation Services* (8th Ed. 2009).
[4] 61 Stat. 1180, 15 U.N.T.S. 295 (emphasis added)

customs or other duties…..[5]" Moreover, the Resolution broadly interprets the scope of the Article 24 prohibition to include "import, export, excise, sales, consumption and internal duties and **taxes of all kinds levied upon . . . fuel**"[6].

While some governments have expressed interest in removing this ban on taxation, it is clear that this would require a renegotiation of the Chicago Convention. For example, in 2000, the European Parliament's Economic and Monetary Affairs Committee called on the European Commission to pursue negotiations to amend the Chicago Convention to allow for the taxation of fuel for environmental purposes. No such renegotiation of the Chicago Convention occurred and this historic ban on fuel taxes remains in force today.

In sum, Article 24 and the subsequent Council Resolution opposes the imposition of taxes or charges on the uplift of fuel in the United States by foreign carriers. As will be demonstrated below, the inclusion of oil companies in the proposed cap and trade system results in a "de facto" tax on airline fuel consumption. As such, the Committee should expressly prohibit the imposition of a tax on foreign carriers as a result of the cap and trade system imposed on oil companies in order to be consistent with this international treaty.

U.S. Bilateral Air Services Agreements ban fuel taxes

As noted above, the U.S. is a signatory to the Chicago Convention and therefore bound by its language. Although ICAO's 1999 Resolution on Article 24 is considered as guidance materials for the member states, it would be unfortunate if the United States chose to ignore this Resolution and its international obligation not to impede international aviation through an impermissible tax.

In contrast to Resolutions providing guidance on the Chicago Convention, the U.S. Government does not have the authority to avoid its obligations under its U.S. bilateral air services agreements as they have the force of U.S. law. Most, if not all, U.S. bilateral air services agreements include similar clauses to the ICAO Resolution's expanded view of the Chicago Convention prohibition against taxes on international fuel. For example, Article 9 of the Model U.S. Air Transport Agreement includes the following language:

1. There shall also be exempt, on the basis of reciprocity, from the taxes, levies, duties, fees and charges:
    c. **fuel,** lubricants and consumable technical supplies **introduced into or supplied in the territory of a Party or used in an aircraft of an airline of the other Party engaged in international air transportation**, even when these supplies are to be used on part of a journey performed over the territory of the Party which they are taken on board…

As such, U.S. bilateral air services agreements similarly contain the provisions of the 1999 ICAO Council Resolution extending Article 24 to cover fuel uplifted by foreign carriers while in the U.S. The air services agreement fuel tax exemption is based on

[5] *ICAO's Policies on Taxation in the Field of International Air Transport*, ICAO Doc. 8632-C/968 (3d rd. 2000)
[6] Id.

reciprocity with the other bilateral agreement signatory. The United States has certainly benefited from this prohibition as it prevented our trading partners from using taxes to impede U.S. airlines from operating economically in key markets around the world.

The Legislation imposes a de facto fuel tax on airlines

As noted above, the Legislation does not impose a direct tax on international fuel. Rather, it requires oil companies to buy allowances for the combustion of that fuel. As such, one might argue that the fee oil companies pay for the allowances is not a tax at all and that international airlines should not be exempt since they do not pay the fee directly to the government.

U.S. courts and foreign courts have addressed cases where the government has sought to characterize an emissions tax as a fee to avoid prohibitions on taxes. In U.S. v South Coast Air Quality Management District [7], the U.S. government contended that an emissions fee imposed on a military installation is impermissible because it is really a tax as " the purpose of the emissions fee is to provide an economic incentive for permittees to reduce their pollution.[8]

Similarly, In Automobile Club of Oregon v. State of Oregon[9], the plaintiffs argued that a State imposed emissions fee violated the Oregon Constitution that required any tax on fuel be used exclusively for the construction, maintenance or repair of public roads. The State argued that, rather than a tax, it was an emission fee that was part of a "broad-based response" to address air pollution problems in the state. The Oregon Supreme Court noted that "the characterization of a levy is **determined by its function, not by the label the legislature attaches to it**." The court went on to hold that:

> "[T]he emission fee is a 'tax or excise levied on the ownership, operation or use of motor vehicles' under Article IX, subsection 3a(1)(b) of the Oregon Constitution. We reach the same conclusion by accepting the state's characterization of the **emission** fee as a **charge** for polluting the airshed, because polluting the airshed is an inescapable incident of the operation or use of motor vehicles , and a state-imposed 'fee' or **'charge'** for operating or using a vehicle **is** a **tax** or excise on its operation or use for purposes of Article IX, subsection 3a(1)(b).

Finally, the European Court of Justice ruled in 1999 that a Swedish tax based on CO_2 output of fuel violated an EU Law prohibiting taxes on fuel similar to the ICAO Council Resolution. In doing so, they observed that " there is a direct and inseverable link between fuel consumption and the polluting substances on which the tax was levied, and that the tax should be regarded as levied on consumption of the fuel itself", thereby contravening the European Law.[10]

In the case of the Legislation, its clear purpose is to reduce GHG emissions. The fuel producers are required to purchase allowances "for each ton of carbon dioxide equivalent of greenhouse gases that would be emitted from the **combustion** of any

[7] 748 F.Supp 732 (1990)
[8] 748 F Supp 732 at 739.
[9] 840 P.2d 479 (1992)
[10] Braathens Sverige AB v Riksskatteverket, Case 346/97 (ECR [1999] I-3419)

petroleum based or coal based fuel . . . “[11] As in Automobile Club, the emissions to be curtailed “are an inescapable incident of the operation or use” of existing commercial aircraft. As such, the allowance fee is a tax placed on the end-user airlines via the fuel supplier intermediary. The only practical difference between the Legislation as written and a requirement that the end user pay an emissions tax is that the Legislation delegates the tax collection process to the oil producers. While the purpose behind this approach is to capture all fuel consuming industries at the choke point of the fuel supplier, it has the practical effect of violating the letter and spirit of ICAO guidance and U.S. bilateral-treaty prohibitions against such taxes.

There can also be no question that the tax paid by the airlines would ultimately revert to the government. Under the draft legislation, the oil companies would be required to purchase an allowance, either directly from the government or from other industries whose carbon output falls below the U.S. Government targets. However, in either case, the tax paid by the airlines in the form of a carbon surcharge or higher fuel prices would result directly from U.S. regulation and ultimately end up in the government’s coffers. The fact that the Obama Administration’s budget proposal projects $646B in government revenue from the cap and trade program leaves not doubt where the government expects the money to go.

Conclusion

The Legislation’s proposed emissions trading scheme results in a “de facto” tax on fuel used in international aviation. As such, it is prohibited from the letter and spirit of U.S. and international law. The Committee should therefore include language in the Legislation that excludes from the cap and trade fuel supplied to foreign carriers.

It is important to note that current U.S. policy is to exclude taxes on fuel for all international flights (both foreign carriers and U.S. carriers). While Article 24 applies only to fuel uplifted by foreign carriers, the U.S. Government has historically decided to exclude taxes on all international flights to minimize competitive distortions between U.S. and foreign airlines. Clearly, this same need to minimize competitive distortions would apply in the case of the Legislation. As such, we encourage the Committee to include language to exclude from the cap and trade fuel supplied to **ALL** carriers flying international routes.

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[11] “American Clean Energy and Security Act of 2009” Sec 722(a)(2)(emphasis added)