



WORLDWIDE AIR TRANSPORT CONFERENCE (ATCONF)

SIXTH MEETING

Montréal, 18 to 22 March 2013

Agenda Item 2: Examination of key issues and related regulatory framework

Agenda Item 2.6: Taxation of and other levies on international air transport

THE ECONOMIC IMPACT OF UNJUSTIFIED AND EXCESSIVE TAXATION

(Presented by International Air Transport Association (IATA) and
Airports Council International (ACI))

EXECUTIVE SUMMARY

Taxation on international aviation should be limited to what has been resolved by the Council in ICAO's Policies on Taxation in the Field of International Air Transport (Doc 8632). The growing proliferation of taxes outside the scope of Doc 8632 and the diversion of revenues away from the aviation industry is harmful to the economic and social well-being of States that impose such taxes; to worldwide economic growth; and to the sustainable development of the aviation industry.

Action: The Conference is invited to agree to the recommendations presented in paragraph 6.

References: ATConf/6 reference material is available at www.icao.int/meetings/atconf6.

1. INTRODUCTION

1.1 ICAO policies and guidance material on taxes are clearly defined in Assembly Resolution A37-20, Appendix E, as well as in the *ICAO's Policies on Taxation in the Field of International Air Transport* (Doc 8632).

1.2 Air transport is a cornerstone of the global economy. It ensures the mobility of businesses and people and contributes significantly to economic growth. The sector as a whole represents 3.5% of global GDP and supports over 56 million jobs as reported in 2012 by the Air Transport Action Group (ATAG) in *Aviation Benefits Beyond Borders*. A properly functioning air transport sector is a vital enabler of sustainable economic growth worldwide. The aviation sector provides benefits to the global economy in several important ways:

- a) direct contribution through the output of the aviation sector (airlines, airports and ground services, aerospace) estimated at USD 538.9 billion and 8.36 million jobs;

- b) indirect contribution through the aviation sector's supply chain estimated at USD 617.1 billion and 9.34 million jobs;
- c) induced contribution through the spending by the employees of the aviation sector and its supply chain estimated at USD 288 billion and 4.4 million jobs;
- d) aviation enables contributions through catalytic benefits which include benefits through tourism, estimated at USD 762 billion and 34.5 million jobs; and
- e) in total, aviation's global economic impact is estimated at USD 2206 billion and supports generating 56.6 million jobs globally.

1.3 There is increasing concern with the growing proliferation of taxes beyond the scope of ICAO policies levied on international air transport. Although the industry fully respects the right of autonomous States to impose taxes, excessive taxation on international air transport for the sole purpose of generating State revenues has a severe negative impact on the global economy, the national economic welfare and endangers the sector's economic recovery. Moreover, such taxes are socially not sustainable as they usually affect lower income travellers in a disproportionate manner.

1.4 With on-going pressure on users and infrastructure providers to invest in modernizing infrastructure and avionics capability, more States withdraw from providing public funding for such means, yet unjustified taxation on aviation has not decreased but increased over the past decade.

2. BACKGROUND

2.1 ICAO defines a "tax" as "a levy that is designed to raise national or local government revenues which are generally not applied to civil aviation in their entirety or on a cost-specific basis".

2.2 ICAO defines a "charge" as "a levy that is designed and applied specifically to recover the costs of providing facilities and services for civil aviation".

2.3 It is widely accepted that imposition of general business, sales, and income or use taxes levied fairly and uniformly on the conduct of all businesses within a political jurisdiction should be considered the legitimate right of governments.

2.4 Taxes and charges on international air transport should only be levied in compliance with ICAO Policies on Charges and Taxation in a justifiable, equitable and non-discriminatory manner. Any other form of excessive taxation should be opposed as it has a detrimental impact on airline and airport finances and on consumers and constitutes a material obstacle to the development and expansion of international travel and trade.

2.5 The Council repeatedly reaffirmed its opposition to charges proliferation in the last edition of ICAO's Policies on Charges for Airports and Air Navigation Services (Doc 9082/9) "*In this regard the Council is concerned about the proliferation of charges on air traffic and notes that the imposition of charges in one jurisdiction can lead to the introduction of charges in another jurisdiction*".

2.6 Excessive taxation beyond the scope of ICAO policies significantly lowers the ability for the industry to generate sufficient revenue for the execution of essential programs such as the Global Air Navigation Plan and its required Aviation System Block Upgrades. The revenue available to those in the aviation value chain (regulators, infrastructure providers, users) is substantially lowered as a result of the

current taxation trends. Several studies such as Aviation Taxes and Charges by IATA, which compare the contribution across transport modes in some countries in terms of taxes and user charge payments, show aviation is carrying a greater burden. In the cases studied, aviation makes the highest net contribution of all modes when expressed in terms of passenger journeys. There is also strong evidence to suggest that in some countries this trend is worsening, with aviation singled out as target.

3. GLOBAL TAXATION DEVELOPMENTS

3.1 Over the past decade a significant proliferation of unjustified and discriminatory aviation taxes on a global scale has been witnessed by the industry. In parallel, several new taxation schemes that were implemented have been withdrawn after it became clear they did significant harm to demand and the economy of the imposing State, to the detriment of passengers, operators and infrastructure providers, for example:

3.1.1 Following the implementation of an air passenger departure tax in a European State, the number of passengers leaving from airports in that State decreased, while the number of transfer passengers (to whom the tax did not apply) continued to increase. A Government study determined that the tax accounted for 2 million fewer passengers and an economic research body calculated the loss of business for airlines, airports, tour operators and the tourism industry at approximately EUR 1.2 to 1.3 billion while it only generated around EUR 300 million per year. As a result, the Government decided to withdraw the tax only one year after its introduction.

3.1.2 A European State without airports in neighboring States (i.e. an island) looked to introduce a EUR 1.53 per passenger tax. The Parliament eventually decided not to implement the tax after research showed that the tax would likely result in an 11 per cent fall in price-sensitive visitor arrivals.

3.1.3 A State in the Asia-Pacific region proposed a 17 per cent increase in its tax on international departing passengers with an annual CPI based adjustment. Following strong industry reaction including evidence that the increase would damage the national economy, the State Government agreed to remove the CPI based indexation of the tax.

3.1.4 The introduction of air passenger taxes in several European States without exception resulted in a significant loss of traffic (a drop of 27 per cent between 2007 and 2011 in one State) and loss of competitive position (negative growth in the imposing State while neighboring States experienced continued growth of traffic).

3.1.5 A recent PWC study (February 2013) on a European State's Air Passenger Duty suggests that, if the duty was abolished, the loss of revenue to the government would offset itself and 60,000 jobs could be created between now and 2020.

3.2 Several States implemented air passenger taxes often portrayed as environmental levies. In reality, these so-called "green" taxes are simply blunt instruments for public revenue generation which do not deliver any environmental benefit.

3.2.1 Other examples of passenger taxes singling out aviation are taxes levied only on air passengers for aid purposes, so-called 'solidarity taxes'. While for a good cause, solidarity taxes in their current form must be considered a discriminatory practice and should be removed. The industry favors voluntary schemes.

3.2.2 Different regions continue to levy taxes on air transport since the 1990's that discriminate against air passengers as they are only levied on air transportation. These taxes increase regularly while competing modes of transportation such as cruise lines, railways and road transport continue to be exempt or even subsidized.

3.3 Plans to implement a regional per passenger tourism tax were revealed in the Caribbean. The industry demonstrated that the expected negative impact from the USD 280 million fund would have far outweighed the expected revenues and the idea was eventually withdrawn. Aviation is a critical pillar of tourism and increased aviation costs can have a devastating effect on tourism, travel and the national economy. States compete with each other for inbound tourism and inward investment and any passenger tourism taxes will hurt the national economies as they encourage tourists to travel to other States where no such taxes exist.

3.3.1 It is the industry's opinion that such practices are in violation of Article 15 of the Convention on International Civil Aviation (Chicago), which provides that "*... 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 of persons or property thereon.*" Although the English version of the article does not specifically state the word "taxes", it is important to note that both the French and the Spanish texts do, respectively "droits" and "taxes" in French and "derechos" and "impuestos" in Spanish. It is becoming increasingly common in regions with highly competitive cruise markets to only levy passenger taxes on air passengers, which are then used for destination marketing that benefits all modes of transport including the cruise lines. This form of cross-subsidization directly conflicts with ICAO's Policies as listed in Doc 9082.

3.4 Value Added Tax and other consumption or sales taxes levied on international air transport operations and related services are of serious concern. Examples of such practice are common in, although not limited to, Africa and Latin America. In general, the international passenger air fare is simply multiplied by the tax rate, often regardless of place of sale.

3.4.1 In addition, many States impose VAT and similar taxes on a number of services or equipment related to international air transport, e.g. on airport charges, air navigation charges, passenger charges and/or service fees, aircraft supplies and spare parts, etc. We are aware of at least one country in South America that charges a 16 per cent VAT on ATC charges. Another example exists in Asia-Pacific, where one country adds a service charge to air navigation service charges and to the passenger service fee.

3.5 Some States (or individual Provinces within a federal system) within Latin America, North America and Africa impose VAT or GST on jet fuel used in international flights without the right of reclaim. At least one State in the Caribbean is charging a 7 per cent stamp duty on jet fuel used for international flights. In 2012, one European State passed a law introducing a tax requiring holders of compulsory petroleum stocks to pay a 4% levy on the value of their stocks.

3.5.1 These practices are in violation of Article 24 of the Convention on International Civil Aviation (Chicago), which provides that, inter alia, that "*... fuel and lubricating oils on board an aircraft of a Contracting State... shall be exempt from customs duty, inspection fees or similar national or local duties and charges*".

3.5.2 They also contradict ICAO Doc 8632 principles with respect to taxation of fuel, lubricants and other consumable technical supplies, which states that "*... it is common practice of many States with respect to aircraft engaged in international transport generally to exempt from all fuel and*

lubricants on board on arrival in each customs territory and, on a basis of reciprocity, to exempt from or refund taxes on fuel and lubricants taken on board at the final airport in that customs territory...”.

4. ECONOMIC AND SOCIAL EFFECTS OF TAXES

4.1 The main rationale of most of these unwarranted aviation taxes is to generate additional revenues for the general budget of a country. However, evidence from some countries indicates that the economic loss from the taxes on the economy as a whole can outweigh the expected return from the tax. Overall, taxes on air transport discourage travel, reduce consumer benefit, hamper connectivity, and can retard economic development.

4.2 The extent of the decrease in air travel depends on the price sensitivity of travellers and shippers as well as the characteristics of the market. Reduced air transport in a country will lower the provision of air transport services which in turn would result in less contribution from the sector to GDP and employment. The supply chain associated with air transport services will also be smaller as will the other activities supported by the supply chain. With fewer visitors, spending from visitors would be adversely impacted.

4.3 Travellers and shippers may switch to other modes of transport, choose other destinations, or refrain from traveling or shipping altogether – all of which would be less desirable to consumers. With its speed, reliability and reach, there is no close alternative to air transport for many of its customers.

4.4 Increased taxation can result in reduced frequency of air services, lower number of destinations being served and/or bring about a change in the type of destinations. Aviation connectivity facilitates getting products to market, moving business people, reducing production costs, increasing productivity, and attracting foreign direct investment, and generally stimulating international trade.

4.4.1 **Getting products to market.** Air freight delivers goods, especially high value goods, quickly, across long distances, accounting 35 per cent of international trade by value. A vital component of air freight includes express freight, which is essential for perishable products like medical supplies and pharmaceuticals.

4.4.2 **Moving business people.** Air travel is used to close business deals, convert perspective customers into clients, retain existing customers, establish new contacts and build networks, maintain relations with customers, invest in their employees. A study by Oxford Economics¹ gathered survey data on the overall importance of air transport and found that some 80% of the firms report that air services were important for the efficiency of their production.

4.4.3 **Reducing production costs.** As manufacturing becomes an increasingly global activity, re-structuring operations and logistics towards rapid (often ‘Just in Time’) delivery and minimal stock-holding is vital to the success and competitiveness of some businesses. According to a study, businesses in one Member State reduced their “inventory to output” ratio by some 20 per cent over the last 20 years, which delivered over USD 9.5 billion a year in efficiency to companies, allowing them to stay competitive, invest in new equipment and deliver profits.

4.4.4 **Increasing productivity and innovation.** Agglomeration at airports can lead to accelerated productivity and growth, over and above the gains from better connectivity, or decisions on

¹ Airline Network Benefits, Oxford Economics, 2006

where to operate. Airport agglomerations particularly attract high value international services in sectors like law, finance, real estate and creative industries.

4.4.5 **Attracting foreign direct investment (FDI).** FDI has many drivers and the quality of air links is an important one. Several studies^{2, 34} have demonstrated that good air links are an important factor when businesses decide where to locate. Evidence also points to the potential to lose FDI if air links worsen.

4.4.6 **Stimulating international trade between developed and emerging markets.** A European study indicates that countries trade more with emerging markets that are connected with frequent flights than with those which are not connected. Furthermore, trade with connected countries grows at a faster rate.

4.5 As reported by ACI EUROPE in its *Position on Aviation Taxes in the EU*, in some countries, the introduction of aviation tax has had a major impact on passenger traffic and diverted passengers to neighbouring countries, leading to a lower than anticipated tax return for the government. In those instances where governments have decided to backtrack and suspend these taxes, passenger volumes have not returned and have remained lower than anticipated both due to changed travel patterns and the earlier decisions from airlines to withdraw capacity from those airports affected.

4.6 The international aviation sector was heavily hit by the economic and financial crisis in 2008/2009. Airlines and airports lost millions of passengers due to the crisis, with a major impact both on aeronautical (air fares and airport charges) and commercial revenues (e.g. retail). The industry supports measures to enable airlines and airports to boost economic recovery, including a reconsideration of economic regulation, a public financing of aviation security measures and the abolition of national taxes. These measures are more relevant than ever, in particular in light of the persistent economic problems in some States.

4.7 In addition, it should be noted that already today, increasing numbers of airlines are privatised and airports largely finance their infrastructure themselves, both through airport user charges and revenues from commercial activities.

5. CONCLUSIONS

5.1 The current proliferation of discriminatory aviation taxes and the trend of State governments to introduce unfair tax schemes or increase existing taxes to make up for budget deficits should be halted. Instead, the following provision in ICAO Doc 8632 should be considered: “... *each Contracting State shall reduce to the fullest practicable extent and make plans to eliminate as soon as its economic conditions permit all forms of taxation on the sale or use of international transport by air, including taxes on gross receipts of operators and taxes levied directly on passengers or shippers*”.

5.2 The industry fully supports the conclusions and recommendations of ATConf/6-WP/10.

5.3 Notwithstanding the political and financial difficulties faced by many States and the resulting pressure on regulators and infrastructure providers to accept the diversion of taxation, the Conference is invited to encourage policy makers and national governments to stop further proliferation of taxes and imposing inequitable burdens on the aviation sector as it hampers the sustainable

² European Cities Monitor, Cushman and Wakefield, 2010

³ Aviation: The Real World Wide Web, Oxford Economics, 2009

⁴ The Business Case for Airport Expansion, London Chamber of Commerce, 2006

development of infrastructure required for continued global growth. Unjustified additional taxation provides no net benefit to governments, damages the world economy as a whole, and puts the sector at a competitive disadvantage in relation to other modes of transport.

5.4 The Conference is asked to recommend that States uphold and actively support ICAO's Policies on Taxation in the Field of International Air Transport (Doc. 8632) and ICAO's Policies on Charges for Airports and Air Navigation Services (Doc 9082). Accordingly, the Conference is requested to call upon all States to impose levies only to recover the costs of providing services and functions which directly relate to and benefit civil aviation operations.

6. RECOMMENDATIONS

6.1 The Conference is invited to:

- a) request States to adhere to ICAO's policies on taxation and ensure its recommendations are followed by all relevant taxing authorities within those States;
- b) request States to avoid imposing any unjustified or discriminatory taxes on international aviation, and reduce or eliminate any such existing taxes, as they have a negative effect on the competitiveness of the aviation industry and impact States' national economies;
- c) request States to perform a cost benefit analysis for existing taxes beyond the scope of ICAO's Policies on Taxation to determine the net impact of aviation taxes on economic growth and social well-being as well as the impact on the industry; and
- d) request ICAO to update and strengthen the guidance material (Doc 8632, *ICAO's Policies on Taxation in the Field of International Air Transport*).

— END —