

WISTRAND

MEMO

TO: Hjelmco AB

FROM: Ola Wiklund, Attorney, Associate Professor in European Community Law
Roger Persson Österman, Associate Professor in Fiscal Law

DATE: February 5, 2008

RE: **Taxation of Aviation Gasoline (AVGAS)**

1 PREFACE

Sweden intends to introduce a general, high tax on AVGAS (see Department of Finance memo dated January 15th, 2008: "Beskattning av flygbränsle"). The tax will have a hard impact on the society sector that utilizes minor aircraft.

This will in all probability entail negative consequences in the form of wasted values in the existing aircraft fleet, severe unemployment in a very specific trade, which will cause countermeasures at great costs, fewer aerodromes in the more thinly-populated areas of the country, plus consequences for the crisis management of the society.

These consequences should be balanced against a calculated tax revenue of € 2 million.

It should be noted that the negative effect in the labour market of the proposed tax probably exceeds € 2 million.

No social cost-benefit analysis has been performed when preparing the proposal. In the proposal (p. 13) it is stated that its effects cannot be established with any certainty. In spite of this statement and the lack of analysis, the effects are estimated to be marginal. Hence the conclusion is not substantiated at all and it must be perceived as remarkable that the authors of the memo take their mission so lightly.

The proposal can also be questioned from the viewpoints of constitutional and fiscal law. The purpose of this memo is only to clarify the legal framework behind fiscal measures of the suggested nature.

2 EUROPEAN COMMUNITY LAW

2.1 Fuel taxes are regulated in the European Community law, more specifically in the Directive on Energy Taxes 2003/96/EC (henceforth “the Directive”). Article 14 regulates the tax exempt valid for aircraft fuel. Point 1 states that

”In addition to the general provisions set out in Directive 92/12/EEC on exempt uses of taxable products, and without prejudice to other Community provisions, Member States shall exempt the following from taxation under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemptions and of preventing any evasion, avoidance or abuse (...)

b) Energy products supplied for use as fuel for the purpose of air navigation other than in private pleasure-flying.. (...)”

Member States may limit the scope of this exemption to supplies of jet fuel (CN code 2710 19 21).

To sum up, the Directive on energy taxation states that other aviation than private pleasure flying shall be exempt from energy taxes. The exception may be delimited to aviation kerosene (henceforth JET A) only.

Thus the Directive enables Sweden to impose taxes on AVGAS used in all forms of aviation. At the same time, the Directive implies an obligation for Sweden to impose such a tax on pleasure traffic.

Legislative history of EC-juridical legislation, which could further explain the aims of the European legislator, is more or less non-existent. Therefore it is not possible to establish the background to the fact that the Directive enables a member state to impose taxes on all kinds of AVGAS.

2.2 The Directive constitutes what is called secondary legislation and must be in accordance with the Community Primary Law (the Treaty) and it must also be in accordance with the general principles of law stated in the Community law. Furthermore, all Community law must comply with international conventions.

It can be noted that the possibility, stated in the Directive, to impose taxes on AVGAS used in other aviation than private pleasure flying is contrary to the principle of equal treatment. The part of aviation using JET A is granted a very substantial tax advantage.

In addition, the tax is discriminating as it disfavours some companies in an arbitrary way. It is only possible to discriminate against a person if there are very strong, general reasons. It must be a question of safeguarding public order, safety and health.

- 2.3 The measure must also be proportional. In its assessment of proportionality in taxes and fees, the European Court of Justice has been influenced by German law (see Moëll "Proportionalitetsprincipen i skatterätten" Juristförlaget in Lund 2003 p. 118). In that connection it is most interesting that a German court rejected a German tax legislation similar to the present subject matter (Finanzgericht Düsseldorf sentence 4 K 3864/06 VM, dated 7th Nov. 2007).

An assessment of proportionality according to the Community law is made in a way that the assessed measure shall be *appropriate* and *necessary* in order to achieve the objective.

The objective of the proposed tax is to impose taxes on AVGAS used for private pleasure flying. The means, i.e. the measure, is to impose tax on all AVGAS. The reasons given in the proposal for taxing all AVGAS is that such a regulation does not entail *problems of delimitation* between other air traffic and private pleasure flying. The *administrative burden* for the companies would decrease. *The polluter* would furthermore pay tax for the environmental impact of the air traffic.

Is it appropriate and necessary to impose tax on all AVGAS in order to achieve the objective of taxing AVGAS used for private pleasure flying? In the assessment it is important to note that only a minor part of consumed AVGAS is used for private pleasure flying, namely 10 % (see p. 13 of the proposal).

It can be noted that this cannot be considered appropriate. Possibly it may be necessary as it cannot be ruled out that separating AVGAS used for private pleasure flying is administratively onerous. However, it is clear from the proposal that this is not impossible. It is also clear that other EU states have regulations signifying that only pleasure flying is taxed. Sweden had this kind of regulations in the middle of the 1980s.

- 2.4 It is also noted that the possibility can be used in a way that could imply unlawful governmental support. The tax exempt for only aviation using JET A is likely to conflict with the rules on governmental support of the Treaty (article 87).

2.5 In addition it can be noted that the possibility is in discrepancy with the international conventions (the Chicago Convention) closed within the framework of the activity in ICAO (International Civil Aviation Organization) which is a subsidiary of the UN. The Convention states that international aviation shall be exempt from tax (although the Convention does not regulate pleasure flying). Naturally it cannot be presumed that all aviation crossing land borders is performed using only JET A for fuel. In northern Sweden, for example, international movements with smaller aircraft are probably quite common for other purposes than private pleasure flying. Note that in the preamble of the Directive (p 23) it is particularly observed that the international obligations shall be followed.

2.6 The Directive's stated possibility to tax AVGAS used in other aviation than private pleasure flying is hence extremely doubtful.

The problem with the unlawful character of the Directive should however not be exaggerated. Directives are not immediately binding but instead directed towards the national legislator who is obliged to introduce national legislation that fulfils the objectives of the Directive. The act of introducing Directives into national legislation is called implementation.

The Community Court of Justice has pointed out that the legislator has a responsibility to ensure that Directives are implemented in a correct way (see, e.g., case C-1666/98 Socridis). Hence a national legislator cannot introduce unlawful legislation even if a Directive per se enables such a liberty of action.

Consequently, the Swedish legislator cannot use the Energy Tax Directive as a justification for introducing regulations that conflict with the principle of equal treatment in the Community law, that discriminate, or that violate regulations on governmental support or international conventions.

2.7 The proposed tax is contrary to the principle of equal treatment in EC law and the ban on discrimination in EC law. In addition it constitutes illicit governmental support. It is probably also at odds with international commitments.

3 THE INSTRUMENT OF GOVERNMENT AND THE EU CONVENTION ON HUMAN RIGHTS

3.1 Taxes must be imposed in accordance with regulations of the Swedish constitutional law and the Instrument of government. Taxes must also be imposed in accordance with the EU convention on human rights.

3.2 It is noted that the Swedish legislator, in accordance with the Instrument of government and the EU convention, has relatively wide possibilities to decide on the design of taxes.

3.3 The Instrument of government offers weak protection for the individual. There can be no doubt that the possibility of legally favouring or disfavouring various persons or groups in Sweden is a political authority according to the constitutional law (Påhlsson; "Likhet inför skattelag" Iustus förlag 2007 p. 49).

Laws must be general and cannot be addressing one person only. The Supreme Administrative Court has, however, found that as long as the regulations are generally stated, and in theory may encompass several individuals, the generality requirement is fulfilled even if it is quite clear that only one person will be subject to the rule (RÅ80 1:92). The legal situation may, however, have been changed in a direction more stringent for the legislator (see statements in SOU 1999:59 p. 64 ff).

3.4 The proposal to introduce tax on AVGAS is probably not at odds with the Instrument of government.

3.5 In contrast, the EU convention limits the legislator in a more apparent way.

Discrimination is not allowed (see e.g. Darby vs Sweden ECtHR Series A number 187).

Operators using AVGAS are apparently discriminated in a negative way compared with operators using JET A.

However, unlawful discrimination is not to hand only because there is a negative discrimination. The difference in treatment must lack objective and legitimate motivation in order to constitute unlawful discrimination.

The EU court has elaborated its view in several cases and has concluded that the objective of the discriminating court must have legitimacy. There must also be a reasonable proportionality between the objective and the means.

- 3.6 The reasons given in the proposal for taxing all AVGAS are that such a regulation does not entail *problems of delimitation* between other aviation and private pleasure flying; the *administrative burden* for the companies would decrease; and *the polluter* would in addition pay tax for the environmental impact of aviation.

Firstly, it must be analyzed whether the desire of the Swedish national tax board for simple rules is such an objective and legitimate reason to imply that discrimination does not exist. Without a doubt it is legitimate to consider such an interest when regulating taxes.

Secondly, it must be analyzed whether it is also a legitimate and objective reason to lower the administrative burden for the companies. In principle, it should be considered as a legitimate reason. However, in the present situation, and quite on the contrary, the companies do not wish to be relieved of such a burden. Therefore, the reason lacks the required objective legitimacy.

Thirdly, the reason for taxing the polluter must be analyzed. In short it can be noted that since JET A is worse from an environmental point of view, the reason lacks all legitimacy for taxing AVGAS.

The Tax Board's desire for simplicity is consequently the only carrying reason. A judgement of proportionality shall therewith take place. Such a judgement of proportionality is performed in a slightly different way than at the application of the Community law (see above).

- 3.7 The objective of the proposed tax is to impose taxes on AVGAS used for private pleasure flying. The means to do this is to impose tax on all AVGAS.

The judgement of proportionality should consider how the proposed tax hits its target. According to the proposal (p. 13), around 90 % of the total use of AVGAS is for other aviation than private pleasure flying. The objective of taxing 10 % of the totally used AVGAS is achieved with the means of taxing also the 90 % used in other aviation than private pleasure flying.

By now it is clear that the means by far miss the mark. However it cannot be ruled out that the reasons for using the means are so strong that it still can be perceived as proportional. The conditions may be such that there should be no administrative burden at all. It may entail an unreasonable administrative burden to tax only the AVGAS used for pleasure flying.

The Government's expressed opinion is of interest in this matter. In its government bill on the budget for 2008, the Government stated that the administrative burden with respect to the AVGAS tax should be kept down "as far as possible" (prop. 2007/08:1 p. 129). Hence the Government has not ruled out the existence of a certain administrative burden.

However, it is evident already from the proposal (p. 9) that there are other possibilities to tax the private pleasure flying without causing an unreasonable or impossible administrative burden. The existence of other possibilities is also shown by the fact that other EU states have chosen to tax only AVGAS used for pleasure flying (e.g. Poland). In an assessment of the EC convention it is important to consider also how other member states have designed their tax legislation.

3.8 From this it seems apparent that the means are not in proportion to the objective. The proposed tax is in contravention of the ban on discrimination of the EC convention.

4 **SUMMARY**

The proposed tax is in contravention of the Community law and the EC convention on human rights.

It is however not in contravention of the Instrument of government.

Ola Wiklund

Roger Persson Österman

(Translated by Madeleine Kamlin, www.kamlin.com. The Swedish version shall take precedence).