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Aviation Taxes and Fees: Major Issues

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Summary

The existing federal aviation tax structure is primarily a user fee based system that has developed over the last 30 plus years. Prior to September 11, aviation taxes and fees, while not popular with the airline industry, were not regarded by most as a major policy issue. This situation has now changed, especially as a result of new security based fees imposed in the fall of 2001. Given the airline industry's continuing financial problems, the industry is now asking Congress for some form of tax relief. The industry believes that such an action can be justified in light of the large security costs imposed on aviation as a result of the events of September 11. With passage of P.L. 108-11, Emergency Wartime Supplemental Appropriations for FY2003, the industry has been granted a four month suspension of the aviation security fee beginning June 1, 2003. This report provides an overview of the existing aviation tax structure and provides a brief discussion of some of the issues associated with it. This report will be updated as warranted by events.

There are a wide range of federal taxes and fees imposed on the airline industry, almost all of which are statutorily linked to federal aviation programs. The tax and fee structure, shown in Table 1, has evolved over time. The passenger security fee, which was imposed beginning in 2002, is the newest fee. Passenger Facility Charges (PFCs) originated in 1990 and were modified more recently. Many of the airport and airway trust fund related fees originated along with the trust fund in the 1970s. Immigration, Customs, and Agricultural inspection fees in some form predate the aviation specific taxes and fees discussed in this report.[1] A few of the fees discussed here have broad application that goes well beyond aviation. The Customs Service, Immigration and Naturalization Service (INS), and the Animal and Plant Health Inspection Service (APHIS) all provide extensive services related to other modes of transportation. Some of the Immigration, Customs, and Agricultural fees are linked to the cost of providing inspections services. That is, the fee

[1] For the purposes of this report the discussion focuses on federal activities that have an aviation related tax or fee. Programs such as aeronautical research provided by NASA, funded entirely by U.S. Treasury General Funds, are therefore outside the framework of this discussion.

is modified periodically to provide the agency performing the service with full cost recovery.

Table 1: Aviation Related Federal Taxes and Fees, FY1998-FY2002 (millions of dollars)

Tax or Fee	Level of Contribution	Revenues				
Airport and Airway Trust Fund		1998	1999	2000	2001	2002
Passenger Ticket Tax	7.5% on all domestic airline tickets	5,455	5,941	5,103	4,805	4,726
Segment Tax	$3.00 per flight segment defined as a single take-off and single landing (tax level indexed to CPI beginning in FY2003)	547	1,339	1,655	1,556	1,532
Waybill Tax	6.25% cargo waybill tax	313	412	500	493	474
Fuel Tax	19.3 cents/gallon on general aviation use of gasoline 21.8 cents/gallon on general aviation use of jet fuel 4.3 cents/gallon on commercial aviation jet fuel	659	1,009	887	769	789
International Departure/Arrival Tax	$13.40 international departure tax (indexed to CPI) $13.40 international arrivals tax (indexed to CPI)	948	1,484	1,349	1,336	1,282
Rural Airports Tax	7.5% on domestic airline tickets to “qualified rural airports”	48	57	86	82	80
Frequent Flyer Awards Tax	7.5% on awards of free or reduced rate air transportation, e.g. frequent flyer awards based on credit card use.	141	149	159	150	148
Total Tax Revenue		8,153	10,423	9,739	9,191	9,031
Interest on Investments	Interest paid on Treasury Bonds held in the Airport and Airway Trust Fund	543	698	805	882	860
Total Trust Fund Income**		8,696	11,121	10,688	10,149	10,069
Passenger Facility Charges (PFCs)	PFCs are essentially local taxes that require federal authority for collection (also sometimes referred to as head taxes). $1.00 to $4.50 per emplaned passenger at commercial service airports. Maximum of $18 may be imposed on a round trip ticket.	1,449 CY	1,514 CY	1,557 CY	1,585 CY	2,019 est. CY
Overflight User Fees	Charged on flights transiting the United States and using air traffic control services. $33.72/100 miles in enroute environment and $15.94/100 miles in oceanic environment.			0	30	28 est
Transportation Security Administration (TSA) Fees						
Passenger Security Fee (collection suspended 6/1/03 -9/31/03)	$2.50 per enplanement on flights originating at an airport in the United States. Maximum of $10 per round trip. Collection of this fee began February 1, 2002					1,038-1, 665 est*
Air Carrier Security Fee (collection suspended 6/1/03 - 9/31/03)	To be determined by the TSA. Fees may not exceed the aggregate cost paid by the airline industry for security screening in Calendar Year 2000. Adjustment of per-carrier limit beginning in FY2005					300-1,000 est*
Immigration and Naturalization Service						
Inspection Fee	$7 per arriving international airline passenger					

Customs Service						
Inspection Fee	$5 per passenger, not collected from passengers originating in Mexico, Canada, or the Carribean	271	217	235	243	94 year-to-date 3/02
Animal and Plant Health Inspection Service						
Passenger Inspection Fee	$3.10 on each arriving international passenger (Fee was $2.00 in FY1999, $2.05 in FY2000, and $3.00 in FY2001)not collected from passengers originating in Canada		96	132	142	
Commercial Aircraft Inspection Fee	$65.25 per aircraft on international arrivals (Fee was $59.75 in FY1999, $60.25 in FY2000, $64.00 in FY2001,and $64.75 in FY2002) Not collected from aircraft operating solely between Canada and the United States		28	38	42	

* Low estimate from DOT Inspector General (fiscal year). High estimate from Air Transport Association (based on 2000 calender year).
** Total trust fund income includes refunds of taxes and offsetting collections not shown in table. Includes Alaska and Hawaii departures/arrivals tax of $6.70.
Sources: U.S. Government. Office of Management and Budget. *Budget of the United States Government*, various years. Agency budget submissions to Congress for the appropriate fiscal year. Federal Aviation Administration for PFCs. Customs Service. APHIS

Who Pays the Tax

With a couple of notable exceptions the taxes and fees under discussion here are collected by airlines as part of the airline ticket. The taxes, however, are statutorily imposed on the airline passenger not on the airline itself. This does not mean that the effects of the tax are borne entirely by the passenger. Airline's must, for example, address how much of the tax can be passed on to the consumer in terms of higher fares without negatively depressing traffic.

Although fees, as discussed above, have an impact on airline travel, those fees imposed prior to September 11th probably did not create a significant barrier to travel. Since September 11th, however, it is argued that the new higher fees, along with other factors, such as security related hassles and delays, may be having a noteworthy impact on travel. To the extent that a traveler's costs are raised, and not all costs are directly measurable in dollar terms, there is always the possibility of the consumer seeking alternate means of making a trip or, perhaps foregoing a trip altogether. The key is what constitutes an acceptable cost from the consumer's standpoint. Notwithstanding the repercussions of September 11, the long term evidence shows that fees in existence prior to that date hardly dissuaded air travel which grew steadily on a long term basis for decades.

As mentioned above, airlines in most cases are collection agents for these fees. In many instances an airline bills the passenger for the fee at the time a ticket is sold. At some specified interval, the airlines are required to turn the proceeds over to the U.S. Treasury for deposit in the appropriate account. During the period between ticket sale and distribution to the Treasury, airlines are typically allowed to hold these funds in appropriate financial instruments and retain any interest payments made on these instruments. By way of example, the APHIS program requires quarterly payments, but the rules are written in such a way that an airline could retain some of these fees and earn interest on them for up to four months. The ability to retain interest has always been viewed as a way to offset an airline's costs of collection. The amount of interest that an airline might receive in this manner was not inconsequential during periods of high interest rates. At the present time, however, low interest rates have greatly reduced the attractiveness of using this funding mechanism as a way to offset the costs of collection incurred by the airline.

There are four fees that the airlines pay directly. The first, and smallest in dollar terms, is the APHIS aircraft inspection fee on aircraft arriving from outside the United States. The second fee is a 4.4 cent per gallon tax on jet fuel used by the airline industry. Of this amount 4.3 cents is deposited in the airport and airway trust fund, with the remaining 0.1 cent placed in the non-aviation related leaking underground storage tank (LUST) trust fund. The third fee is the overflight fee, which is normally levied on non-U.S. airlines that are transiting United States airspace. This fee is designed to offset the cost of air traffic control services provided to these air carriers during transit, although the funds collected are used to fund a portion of the Essential Air Services program.

The newest direct fee is the air carrier security fee imposed on the airlines as a result of the Aviation and Transportation Security Act (ATSA)(P.L. 107-71) enacted on November 16, 2001. The actual size of this fee is still unknown, but it is expected to be significant. A debate is currently underway between the airline industry and the Department of Transportation (DOT) regarding the size of the fee. The annual fee is limited to the amount that the industry spent to provide security in calendar year 2000. The airline industry, at the time of this writing, contends that the fee should be in the range of $300 million. The DOT Inspector General's Office contends that the airlines themselves indicated last fall that the amount in question should be around $1 billion. An audit is currently underway. By law this fee cannot be adjusted until FY2005. It is worth noting that an effect of establishing this fee will be the long term elimination of the industry's potential future direct costs for increased security, because it transfers the security responsibility to the newly established Transportation Security Administration (TSA).

What the Taxes and Fees Pay For[2]

The Airport and Airway Trust Fund (Aviation Trust Fund). The trust fund pays for the majority of the Federal Aviation Administration's (FAA) programs and activities. The trust fund pays for all of the FAA's airport improvement program (AIP), facilities and equipment program, and research, engineering and development program. It pays for most of the FAA's operations and maintenance program which also receives General Funds from the Treasury.

Revenue collections for the trust fund have typically exceeded FAA expenditures on a historical basis, despite a long standing debate on the appropriate level of U.S. Treasury General Fund support. The most recent reauthorization of aviation programs, the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (FAIR 21)(P.L. 106-181) tries to match trust fund revenues to FAA program spending. The expectation, prior

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[2] For a detailed discussion of agency budgets and activities see CRS Report RL31308, *Appropriations for FY2003:Transportation and Related Agencies*.

to September 11th, was that even with this match the unobligated balance in the trust fund would continue to increase.

Passenger Facility Charges (PFCs). The PFC is essentially a local tax received by the airport that can only be imposed with FAA approval. PFCs have been a lucrative source of income for U.S. airports. At the beginning of February 2002, the FAA was reporting that 330 airport locations were approved for PFC collection (310 were actually collecting), on the basis of 1,015 separate approved applications. The total amount approved for collection from these applications in the future is approximately $33 billion. Combined with increased AIP spending authorizations in FAIR21, PFCs have gone a long way toward meeting assumed airport construction needs.

Transportation Security Administration Fees (TSA). Recently transferred to the new Department of Homeland Security, the TSA remains a work in progress. It has been charged with creating a federal transportation security presence for all modes of transportation in a very short period of time. For the moment, most of TSA's efforts are focused on airline and airport security. By year end 2002, TSA had approximately 64,000 employees (well above a 45,000 level suggested by Congress) of whom 44,000 were passenger or baggage screeners at airports. The agency also employees air marshals and others whose primary function is to ensure the physical security of the aviation system. Additionally, TSA is charged with procuring new equipment to facilitate explosive detection and other security functions. The agency is likely to grow even further in the years ahead as it assumes greater responsibility for security of surface and maritime transportation modes.

Other fees. Fees collected by Customs, INS, and APHIS are designed to pay for the inspection services that each of these agencies provides. The revenue history in table 1 for the Immigration and Naturalization Service (INS) has been left blank because INS agency budget submissions do not appear to track this separately. The INS budget is somewhat difficult to understand, due in part to changes in agency accounting practices over the last few years. Also, the INS makes no attempt to separate its air and sea user fee by mode. APHIS, on the other hand, has a very transparent process which is used to set its inspection fees.

Major Issues

The airline industry has expressed considerable concern that a growing range of federally imposed taxes and fees is having a major impact on their potential profitability. This is not a new concern. The industry has expressed this view several times during the last decade when new fees were imposed and existing fees were raised. The dramatic decline in the financial fortunes of the airline industry since September 11th has reenergized industry complaints about high taxes and fees. Most recently the Chairman of Delta Airlines has detailed the industry's concern that the existing tax structure, is a major barrier to industry profitability and needs to be revisited by Congress and the Bush Administration.[3] The industry is especially concerned about the new security fees added by ATSA and would like to see them repealed or otherwise mitigated.

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[3] Crawley, John. *U.S. Airlines Want Tax Relief to Avert More Trouble.* Reuters. December 11, 2002.

Security Fees. Security fees are the central issue in the ongoing discussion of the airline industry's request for assistance in dealing with their financial problems. The airline industry is convinced that these fees are harmful to them and in some cases that they are unreasonable. The industry contends that it is still paying for some security at airports and that federal actions have greatly impacted the industry's cost structure. Potential federal actions, such as the cost of training pilots to handle firearms, are costs that the industry believes the federal Treasury should bear.

The authors of ATSA thought they had created a framework that would pay for a significant portion of the new TSA's annual budget. The budgetary needs of TSA have, so far, outstripped most of the funding needs estimates made at the time ATSA was enacted. For FY2002, TSA required $2.2 billion in initial funding and an additional $3.4 billion in emergency supplemental funding. For FY2003 the Administration requested $4.8 billion, but many observers believe additional funds will be required. ATSA expected that $2.5 billion would come from the new security fees and be the primary source of funding for the new agency. As can be seen in Table 1, the security fees are not estimated to raise this amount in FY2002 and there is concern that the $2.5 billion may not be raised in future years as well. An increase in the passenger security fee is understandably opposed by the airline industry. In fact, as noted earlier, Congress has recently suspended the aviation security fees for four months, 6/03 - 9/03. Congress is left, therefore, with the issue of responding to TSA's budgetary needs and at the same time considering the airline industry's continuing plea for fiscal relief.

Trust Fund Revenues. Airline traffic year-over-year between FY2001 and FY2002 was down well over 10% and revenues were down 15%. FY2002 revenue collections for the trust fund were down slightly more. A further drop in collections for FY2003, as a result of the Iraq War and the SARS outbreak in Asia is also likely. As mentioned earlier, FAA spending is closely linked to trust fund revenues as a result of FAIR21. A drop in availability of trust fund monies could cause appropriators to seek additional Treasury general fund monies for FAA programs, not an easy task in a budget deficit situation. A continuing decrease in trust fund revenues could also have significant implications for the next FAA program reauthorization expected during the 1st Session of the 108th Congress.

Passenger Facility Charges. Airlines continue to oppose the imposition of PFCs in some instances, especially when the projects approved have more application to airport landside activities rather than to airside activities. In the current economic context the airlines feel that PFC collections for what they consider nonessential projects are exacerbating their financial problems. Others argue, however, that PFCs have, at least in some instances, obviated the need for airports to raise landing fees charged to airlines in order to build desired infrastructure.