

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is a darker shade of blue. The hourglass is centered on the page.

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Aviation Taxes and the Airport and Airway Trust Fund

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August 12, 1997

Abstract. Reauthorization of excise tax revenues for the airport and airway trust fund has been a contentious issue for the last two years. Most of the concern during this period was about future funding needs for the Federal Aviation Administration. The issue has now become an element of the tax plans embedded in House and Senate FY1998 budget reconciliation proposals.

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Updated August 12, 1997

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Aviation Taxes and the Airport and Airway Trust Fund

Summary

Reauthorization of excise tax revenues for the airport and airway trust fund has been a contentious issue for the last two years. Most of the concern during this period was about future funding needs for the Federal Aviation Administration (FAA). The issue, somewhat unexpectedly, became an element of the tax plans embedded in House and Senate FY1998 budget reconciliation proposals. The House proposed a major structural change in how aviation taxes would be imposed. The Senate proposed a tax regime closer to the existing system of taxation.

The Taxpayer Relief Act of 1997 (P.L. 105-34) imposes a new system of taxation effective October 1, 1997. This system is a compromise that adopts the structural elements of the House proposal at financial levels that reflect Senate interests. The new taxes will raise an additional \$ 3 billion during the next 5 years, over what might have been expected if the current system had been reauthorized without change.

Authority to collect taxes for the airport and airway trust fund expired twice in the last two years, on January 1, 1996 and January 1, 1997. The first expiration lasted almost 8 months and cost the trust fund approximately \$4.0 billion in revenues. The second expiration was much briefer, about two months, costing the trust fund an additional \$1 billion. Under the existing taxation system any stoppage equates to a loss of about \$500 million in each month when revenues are not collected. The taxes would have expired again on September 30, 1997, without further reauthorization. Prior to the inclusion of this issue in the reconciliation process, it was expected that Congress would take up the revenue issue after receiving a report on the financial needs of the FAA by the National Civil Aviation Review Commission (NCARP). The NCARP report was expected in late summer 1997.

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Aviation Taxes and the Airport and Airway Trust Fund

Reauthorization of excise tax revenues for the airport and airway trust fund has been a contentious issue for the last two years. Most of the concern during this period was about future funding needs for the Federal Aviation Administration (FAA). The issue, somewhat unexpectedly, became an element of the tax plans embedded in House and Senate FY1998 budget reconciliation proposals. The House proposed a major structural change in how aviation taxes would be imposed. The Senate proposed a tax regime closer to the existing system of taxation.

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The Airport and Airway Trust Fund Tax Reinstatement Act of 1997, (P.L. 105-2), enacted February 28, 1997, had provided for the most recent reinstatement of aviation excise taxes. That reauthorization, however, provided taxing authority only through September 30, 1997. The reauthorization period in the Act was specifically chosen to insure that the tax issue would have to be taken up prior to the beginning of FY1998. Prior to the inclusion of this issue in the reconciliation process, it was expected that Congress would take up the revenue issue after receiving a report on the financial needs of the FAA by the National Civil Aviation Review Commission (NCARP). The NCARP report was expected in late summer 1997.

The 1996 and 1997 lapses in tax collection provided an economic windfall for the many airlines. According to one source, "the U.S. major airlines gain \$182.0 million per month while the ticket tax is dormant."¹ As a result, many airlines were viewed as less than anxious for the renewal of any tax regime, even on a short-term basis.

¹ Ticket Tax Could Return More Quickly With Trust Fund Shortfall Analysts Say. *Aviation Daily*. February 3, 1997. p. 187.

Origins

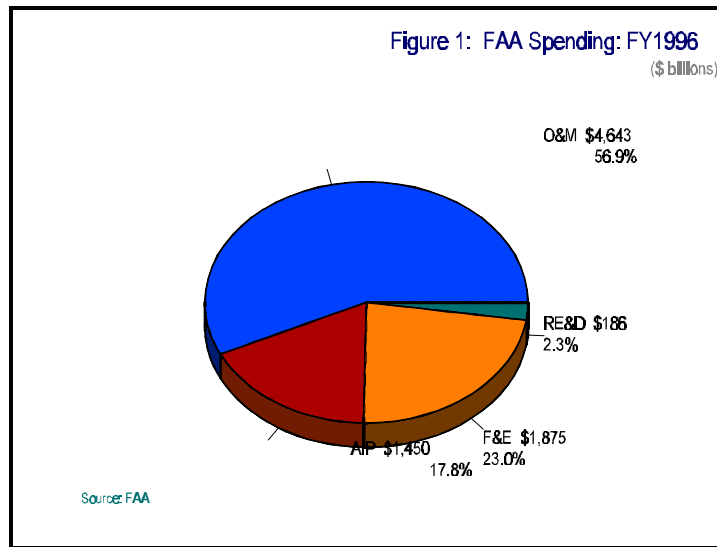
The airport and airway trust fund was created by the revenue title of the Airport and Airway Development Act of 1970 (P.L. 91-258). The “aviation trust fund,” as it is also known, was established to provide funding for capital improvements to the nation’s airport and airway system. The scope of the aviation trust fund, like the highway trust fund on which it was modeled, has been expanded over time. The most recent reauthorization of the fund, prior to passage of the Taxpayers Relief Act of 1997, occurred in the aforementioned Airport and Airway Trust Fund Tax Reinstatement Act of 1997. A temporary extension of the taxes also occurred in August 1996 as part of the Small Business Job Protection Act of 1996 (P.L. 104-188). Prior to these temporary extensions, the last regular reauthorization of the fund occurred with passage of Federal Aviation Administration Authorization Act of 1994 (P.L. 103-305). The most recent change in the levels of revenue dedicated to the trust fund occurred as part of OBRA 90.²

The aviation trust fund receives the majority of its funding from a 10% tax on domestic airline tickets. Other funding is obtained from a 6.25% cargo waybill tax, a \$6 international departure tax, and taxes on aviation fuels used by general aviation – 15 cents/gallon on aviation gasoline and 17.5 cents/gallon for jet fuel. The trust fund receives significant revenue each year from interest on the balance in the fund, which is held in U.S. Treasury securities.

In FY1996, the trust fund provided approximately 70% of all funding for FAA activities and programs. The remainder of funding was provided from Treasury general funds. In some previous fiscal years the trust fund had provided as much as 75% of the FAA’s total funding. The FAA budget is viewed as having four major components: operations and maintenance (O&M); facilities and equipment (F&E); research, engineering, and development (RE&D); and the airport improvement program (AIP).

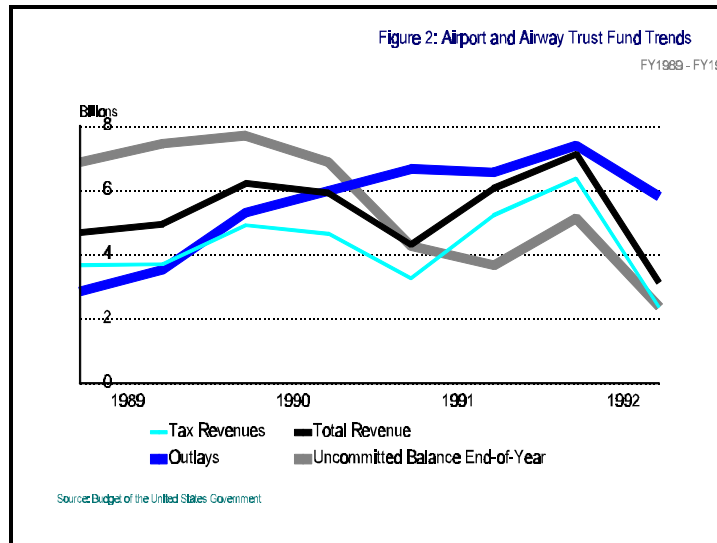
The distribution of total federal funding for these programs and activities is shown in figure 1. For three of these programs (F&E, RE&D, and AIP) all of the funding is from the trust funds. For O&M, the trust fund contribution has been somewhat fluid. Since FY1991, however, the trust fund O&M contribution has been in the neighborhood of 50% of the total.

² P.L. 101-508. Omnibus Budget Reconciliation Act of 1990. November 5, 1990. Title XI. Section 11213.



Trust Fund Balances and Outlays

Figure 2 shows trends in trust fund revenues and outlays for the period FY1989 to FY1996; outlays from the fund increased in most of the years, and did so even in years where revenues deposited in the fund decreased.



The aviation trust fund had an uncommitted balance of \$5.1 billion at the end of FY1995. This uncommitted balance dropped dramatically in FY1996 due to the temporary lapse in revenue collections for the fund. The uncommitted balance in the fund is sometimes, and controversially, referred to as the “surplus.” The existence of this balance has been a continuing source of controversy between congressional authorizing and appropriating committees.³ This was particularly the case prior to

³ The surplus issue is a major component of an ongoing congressional initiative to change the budgetary treatment of the transportation trust funds. A more detailed discussion of this issue (continued...)

FY1996 when the uncommitted balance was quite large. Authorizing committees, supported by the aviation community, view the surplus in the fund as a breach of contract with those paying the taxes. They contend that the taxes are collected solely to improve the national aviation system. Appropriators, however, take the view that aviation taxes are part of the unified budget system and that federal spending for aviation activities must be done in accordance with the establishment of overall budget priorities.

The almost 8-month lapse in authority to collect taxes for the aviation trust fund during 1996 had a significant effect on the balances in this fund. By some estimates, over \$4 billion in revenues were not collected during this period. Spending from the fund, however, did not diminish. The 2-month lapse in 1997 cost the funds an additional \$1 billion. These stoppages have had an obvious net effect of dramatically reducing the unexpended balance in the fund. According to an April 1996 GAO report, the existing balance in the trust fund would have been depleted by the end of calendar year 1996 if the fund had not been reauthorized in August 1996.⁴ Similar predictions were made for 1997 prior to the fund's reinstatement.

Budget Implications

The insecurity surrounding trust fund revenues during the last 2-years had some serious potential short-term implications. The Department of Transportation and Related Agencies Appropriations Act, 1997 (P.L. 104-205), for example, assumes that the taxes will be collected at a level sufficient to fund the FAA and its programs during the year.⁵ The assumptions in FY1998 appropriations discussions to date also assume continuation of the trust fund. With passage of the Taxpayer Relief Act of 1997 these issues have more-or-less disappeared.

The User Fee Issue

There is a longstanding debate in the aviation community about the usefulness and/or desirability of user fees as a mechanism for funding the FAA. The existing tax

³ (...continued)

can be found in: U.S. Library of Congress. Congressional Research Service. *Transportation Trust Funds: The Off-Budget Debate Continues*. CRS Report 96-989, by John W. Fischer. updated May 9, 1997. 20 p.

⁴ U.S. General Accounting Office. *Airport and Airway Trust Fund: Effects of the Trust Fund Taxes' Lapsing on FAA's Budget*. GAO/RCED-96-130. Washington, U.S. Govt. Print. Off., April 1996. p. 1.

⁵ For a discussion of transportation appropriations for FY1997 see: U.S. Library of Congress. Congressional Research Service. *Transportation and the FY1997 Budget*. CRS Report 96-453, by John W. Fischer. Updated October 4, 1996. 16 p., for a discussion of transportation appropriations for FY1998 see: U.S. Library of Congress. Congressional Research Service. *Appropriations for FY1998: Department of Transportation and Related Agencies*, CRS Report 97-208, by Paul F. Rothberg and Duane Thompson. May 12, 1997. 14 p.

system is certainly based on collections from users, but this system is viewed by many observers as a less than perfect proxy for a user fee system. The ticket tax, for example, is collected on the basis of a wide range of fares charged by airlines for what is essentially a standard product, an airline seat. The operating requirements of the air traffic control (ATC) system, however, are based on the movement of aircraft. A 200-seat aircraft and a 20-seat aircraft, operating under ATC control, require a similar level of ATC services, but obviously pay into the trust fund at very different rates.⁶

The debate about how best to charge users was an important element of discussion in the process that led to passage of the Federal Aviation Reauthorization Act of 1996 (1996 Act)(P.L. 104-264). During consideration of this legislation the House took the position that user fees should be studied as an FAA funding mechanism, but that for the short term it would be expedient to reinstate the excise taxes in the pre-existing system for 3 years. The Senate originally called for a shorter reinstatement of the tax system, 18 months. The compromise in the 1996 Act is the establishment of a 21-member “National Civil Aviation Review Commission” (Review Commission). The Review Commission, which began meeting in the late spring of 1997, is tasked with proposing a new user fee financing system for the FAA. The 1996 Act also called for an independent assessment of the FAA’s financial requirements through the year 2002. The outside assessment was completed earlier this year.⁷ The 1996 Act gives the Commission 6 months to formulate its recommendations following completion of this outside assessment. The Commission is expected to make these recommendations in late summer 1997.

The User Fee Proposal of the Coalition for Fair FAA Funding

It is said that nature abhors a vacuum. A similar effect might be observed in the discussion about renewal of aviation taxes. The absence of a clear prospect of renewal of excise taxes that occurred in early 1996 encouraged proposals from individuals and groups seeking an alternative to the current system of taxation.

Prior to 1996, most of the debate about user fees centered on whether general aviation aircraft pay a proportionate share for their use of the system. The airline industry typically had been seen as an interested, but basically non-participant party in this debate.

In late May 1996, seven major airlines and the Regional Airline Association began actively promoting a replacement user fee system. Operating as “The Coalition for Fair FAA Funding” (Coalition), this grouping put forward a proposal that would replace the airline ticket tax element of the current system with a new user fee system.

⁶ For a historical perspective on the user fee issue see: U.S. Library of Congress. Congressional Research Service. *Reorganization of the Federal Aviation Administration: Safety and Efficiency Issues*. CRS Report 94-371, by John W. Fischer, J.Glen Moore, and Pamela Hairston. April 28, 1994. p. 16 - 18.

⁷ Coopers & Lybrand. *Federal Aviation Administration Independent Financial Assessment: Final Report*. February 28, 1997. Some information in this report is considered proprietary by its authors. The report is available to congressional requestors from the Federal Aviation Administration.

Instead of a ticket tax, fees would be collected on each one-way domestic airline flight on the following basis: a \$2 fee per airplane seat (\$1 for commuter aircraft), \$4.50 for each passenger origination, and \$.005 per nonstop revenue passenger mile (one passenger flying one mile). According to documents prepared by the Coalition, this proposal would raise just slightly less on an annual basis than the current tax structure.⁸ The Coalition views its proposal as a fairer approach to funding than the ticket tax, because it would charge for actual use of the aviation system. The Coalition acknowledges that a certain group of airlines (i.e., Southwest, America West, Reno Air, and Valujet) would contribute more to the trust fund under their proposal than they had previously.

Not surprisingly, Southwest and some other smaller airlines disagree with the specifics of the Coalition proposal. They view it as an attempt to raise their costs and, hence, their fares, thereby affording Coalition airlines a certain competitive advantage. The position of these smaller carriers has been bolstered by the findings of the GAO's previously mentioned December 1996 report on trust fund issues. The report suggests that a user fee system for funding the FAA could be desirable if properly structured. The report, however, finds that the Coalition's proposals raise a number of competitive issues, because of the way in which additional costs would be imposed on smaller airlines.

Throughout the remainder of 1996, and well into 1997, the Coalition was unable to obtain significant support for its proposal from the Clinton Administration or congressional sources. They did, however, keep the user fee issue in front of Congress and the Clinton Administration. The Administration is on record as supporting a greater role for user fees in funding the FAA, and included \$300 million of unspecified user fees in its FY1998 budget submission for the FAA.

Congress looked at the aviation tax issue early in the 1st Session of the 105th Congress in a couple of different forums. The Aviation Subcommittee of the House Committee on Transportation and Infrastructure held hearings on aviation user fees on February 5 and 13, 1997.⁹ This hearing occurred during the period in which the aviation taxes had lapsed, but the hearing also discussed the long-term user fee issue. Also, the House Committee on Ways and Means, at the direction of Chairman Archer, formed a transportation tax task force to examine all transportation taxes, including those for aviation. This task force met several times early in the session. It did not produce any specific formal recommendations on aviation user fees. The task force, however, is known to have collected substantial information about various possible tax implementation scenarios.

⁸ Roberts Roach & Associates. *Air Traffic Control User Fees*. Washington, June 7, 1996. p. 13.

⁹ U.S. Congress. House. Committee on Transportation and Infrastructure. Subcommittee on Aviation. *Proposals to Establish User Fees for Federal Aviation Administration Services*. Hearing. February 5 and 13, 1997. Washington. U.S. Govt. Print. Off. 307 p.

The Revenue Reconciliation Process

The needs of the budget reconciliation process captured the aviation tax issue. As part of their respective plans to accommodate significant tax cuts and at the same time, establish a glide path to a balanced budget in FY2002, both the House Committee on Ways and Means and the Senate Committee on Finance addressed the long-term structure of the aviation tax system in their revenue reconciliation proposals. In each instance, the Committees chose to raise aviation tax levels, and hence, revenues. They also provided taxing authority for 10 years. Both of these actions could be viewed as, at least in part, removing the long-term assumption of a linkage between aviation taxes and FAA funding needs.

The revenue reconciliation process, vis-a-vis aviation taxes, has focused on the issue of providing additional revenues for the budget in the years ahead. The approaches chosen by the House and Senate to meet this goal were significantly different, but the net budgetary effects were similar. The revenue projections in the House proposal showed aviation tax revenues of approximately \$34.2 billion over 5 years. Senate revenue projections were comparable.

The specifics of the House and Senate proposals are shown in table 1. The House proposal made the more dramatic changes to the aviation taxation system of the two. The House has, in part, adopted the proposals of the Coalition and established a flat tax on airline flight segments. To accommodate this change in taxation the House reduced the ticket tax and established a new flat rate segment tax.¹⁰ The net effect of this action is to reduce taxation levels on higher fare, long-haul domestic flights in some instances and at the same time, increase taxes on some lower fare, short-haul flights. Southwest Airlines, not surprisingly, launched a major public relations and advertising campaign against this initiative.

Both proposals aggressively increased taxation on international air travel. The high departure and arrivals charges imposed in the House bill, may or may not, be comparable in dollar terms to the new tax on the domestic segment of international flights imposed by the Senate in conjunction with its lower departure and arrivals taxes. Airlines do not typically publish separate fares for the domestic portion of an international trip.¹¹ As a result, it is difficult to know with any precision how airlines would charge for this portion of the trip. The increased taxation of international travel will raise the cost of this travel. Whether, and how much, this will affect international travel remains to be seen. International travel is known to be price sensitive, but other factors, such as exchange rates and physical security in destination countries, also affect the decision to travel outside the United States.

A controversial element in the both proposals was the application of the ticket tax (7.5% House, 10% Senate) to “amounts paid for right to award free or reduced

¹⁰ This tax is also being called a “head tax” by some. This is a confusing usage because the already existing airport passenger facility charge is also sometimes referred to as a head tax.

¹¹ The Senate bill provides instructions for airlines as to how the international segment tax is to be computed.

rate air transportation.” This tax would apply to frequent flyer awards earned as part of credit card use, rental car use, and other programs tied to the airlines frequent flyer programs. These widely used programs have not been subject to taxation in the past.

The House bill also diverted the existing 4.3 cent/gallon tax on aviation gasoline and jet fuel to the airport and airway trust fund. This would provide the trust fund with a significant increase in revenue. The Senate bill did not have the same provision, but the Senate bill did redirect the portion of the 4.3 cents/gallon tax on highway fuels to the highway trust fund and to a new intercity rail trust fund.

Effects of the Taxpayer Relief Act of 1997

The aviation tax provisions of the Taxpayer Relief Act of 1997 are a compromise between the House and Senate proposals. Structurally, Congress adopted the House proposal on airline passenger taxation. As a result, many observers are suggesting that the views of the Coalition representing the 7 largest U.S. airlines prevailed in the debate. This view is only partially true. The Coalition originally proposed a system that was entirely based on user charges. The reduction of 2.5% in the general passenger ticket tax is a movement in that general direction, but is a far cry from its elimination. In addition, future growth of the segment tax could, over time, mitigate the effect of the percentage reduction and could lead to higher total dollar levels of taxation on some airline fares. For example, a \$240 round trip fare from Washington National to Denver on a major airline, involving 4 segments, is currently taxed at a rate of \$24. When the new system is fully implemented, and the segment fee has reached the \$3 level, this same trip will be taxed at a rate of \$30.

Table 1. Aviation Excise Tax Provisions in FY1998 Revenue Reconciliation Legislation

Current Law	H.R. 2014, Revenue Reconciliation Act of 1997	S. 949, Revenue Reconciliation Act of 1997	P.L. 105-34, Taxpayer Relief Act of 1997
10% tax on all domestic airline tickets	7.5% tax on all domestic airline tickets	10% tax on all domestic airline tickets	7.5% tax on all domestic airline tickets phased in as follows: 10/1/97 - 9/30/98; 9% 10/1/98 - 9/30/99; 8% 10/1/99 - 9/30/07; 7.5%
no comparable provision	no comparable provision	10% tax on domestic segment of international flights	no comparable provision
no comparable provision	no comparable provision	tax on flight segments to “qualified rural airports” is reduced to 7.5%	7.5% on domestic airline tickets to “qualified rural airports”. No phase in.
no comparable provision	<p>Flight segment tax, an additional fixed dollar tax is imposed on all domestic flights. A flight segment is defined as a “single take-off and single landing”; tax imposed at time of enactment is \$2.00; tax increases each calendar year</p> <p>1999 \$2.25 2000 \$2.50 2001 \$2.75 2002 \$3.00</p> <p>beginning in 2003; this tax is adjusted for inflation on the basis of changes in the Consumer Price Index (CPI)</p>	no comparable provision	<p>Flight segment tax, an additional fixed dollar tax is imposed on all domestic flights. A flight segment is defined as a “single take-off and single landing”; tax imposed beginning 10/1/97 is \$1.00; tax increases as follows: 10/1/98; \$2 10/1/99 - 12/31/00; \$2.25 for calendar year</p> <p>2000; \$2.50 2001; \$2.75 2002; \$3.00</p> <p>beginning in 2003; this tax is indexed for inflation on the basis of changes in the Consumer Price Index (CPI)</p>

Current Law	H.R. 2014, Revenue Reconciliation Act of 1997	S. 949, Revenue Reconciliation Act of 1997	P.L. 105-34, Taxpayer Relief Act of 1997
no comparable provision	payments to airlines for right to award free or reduced rate air transportation subject to 7.5% tax rate, e.g. frequent flyer awards based on credit card use.	same as House, except tax rate is 10%	payments to airlines for right to award free or reduced rate air transportation subject to 7.5% tax rate, e.g. frequent flyer awards based on credit card use. No phase in.
\$6 international departure tax	\$15.50 international departure tax	\$8.00 international departure tax	\$12.00 international departure tax. Indexed to CPI beginning January 1, 1999 ^a
no comparable provision	\$15.50 international arrivals tax	\$8.00 international arrivals tax	\$12.00 international arrivals tax. Indexed to CPI beginning January 1, 1999
6.25% cargo waybill tax	same as current law	same as current law	same as current law
15 cents/gallon tax on general aviation use of aviation gasoline	same as current law	same as current law	same as current law
17.5 cents/gallon tax on general aviation use of jet fuel.	same as current law	same as current law	same as current law
4.3 cents/gallon tax on aviation gasoline and jet fuel deposited in U.S. Treasury General Funds	4.3 cents/gallon tax on aviation gasoline and jet fuel deposited in Airport and Airway Trust Fund	no comparable provision	4.3 cents/gallon tax on aviation gasoline and jet fuel deposited in Airport and Airway Trust Fund

^a Includes special provisions for Alaska and Hawaii travel retaining applicability of \$6 departure tax equivalent. This rate is subject to CPI indexing beginning 1/1/99.

It is true that some low-fare airlines will experience greater tax burdens and that these will likely translate into higher fares. It would not appear, however, that the increase in tax levels for this carrier group is so great vis-a-vis the potential effects on its competitors that the low-fare airlines might be put at a major competitive disadvantage.

The new tax system raises costs dramatically for two groups of travelers; international travelers and frequent flyer program participants whose mileage is earned by non-flying activities, such as credit card use. For the international traveler the effect will be immediate and visible. The \$18 per round trip increase in arrival and departure taxes is probably not, however, sufficient in and of itself to cause any large change in travel behavior. For frequent flyer program participants the effect of the new tax system is likely to take some time to implement and may be somewhat invisible to program participants. This is because the tax is imposed at what might be thought of as the wholesale level. This puts the onus of how to change these programs on the program operators who may choose a variety of different ways to pass on their additional costs, some of which might be quite subtle.

Finally, the imposition of a new aviation tax regime at this time will likely make it more difficult for those seeking a new financial structure for funding federal aviation activities. Additional revenues in the trust fund do not necessarily equate to additional funding for aviation. In fact, the balanced budget agreement allows for only modest increases in overall transportation spending in the years ahead. As a result, it is possible that the tax increases in the Taxpayer Relief Act will become a new issue in the context of the long standing congressional discussion of the budgetary status of all transportation trust funds.