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Fueling the Debate: Is the EU's Energy Tax Exemption Regime For Aircrafts and Ships Truly Legal?

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1. Introduction

In 2021, the European Commission sought to recast the Energy Taxation Directive ('ETD') to put it in line with the Green Deal objectives. Under this Directive, Member States must exempt from taxation fuel used for commercial air navigation as well as for commercial waterborne navigation (including fishing) within EU waters (see Article 14(1)(b) and (c)). The ETD justifies this tax exemption regime by "*existing international obligations and the maintaining of the competitive position of Community companies*" (recital 23).

In its legislative proposal, the Commission suggested ending the tax exemption regime for intra-EU navigation, while making it optional for extra-EU navigation. It argued that "*through the implementation of the polluter-pays principle*", the ETD "*can contribute to the increased ambition of at least 55% reduction in greenhouse gas emissions by 2030 by ensuring that the taxation of motor and heating fuels reflects better the impact they have on the environment and on health*." (Recital 3 of the proposal)

This proposal, however, is facing the opposition of various Member States. Therefore, given that this is a fiscal matter that requires unanimity in Council as per Article 113 TFEU, the status quo is the most likely outcome of the current negotiation process that is scheduled to end with a vote in the ECOFIN Council in November 2025. As it currently stands, the compromise brokered by the Danish presidency maintains the exemption regime at least until 2035, only subject to minor changes.

As the negotiation process is drawing to a close, environmental associations keep advocating the end of the current exemption regime (see, for example, here and here). Among the arguments that they put forward, two of them indirectly challenge the lawfulness of such a tax exoneration. According to the first argument, the current regime would give the aviation and shipping sectors an unfair competitive advantage over rail and other sustainable alternatives. Viewed from a legal angle, this claim raises the question of the compatibility of the current ETD with the state aid prohibition laid down in Article 107 TFEU and with the general principle of non-discrimination. It will be examined in section 2 below. Under the second argument, the current exemption would fly in the face of the polluter-pays principle. This principle is not just a vague political objective. It is enshrined in Article 191(2) TFEU and has been the subject of abundant case-law. The merits of this claim will be addressed in section 3 below.

2. Compatibility of the tax exemption with the state aid prohibition and the non-discrimination principle

The General Court has addressed the question whether a tax exemption for fuel used by commercial aircrafts is compatible with the state aid prohibition and the non-discrimination principle. In Deutsche Bahn, the German railway company complained about the fact that the German legislation providing for such an exemption introduced a distortion of competition between (high-speed) train companies and air transport companies. While the former paid taxes on the energy they used for transport, the latter did not. According to Deutsche Bahn, this amounted to state aid that is incompatible with Article 107 TFEU and a breach of the non-discrimination principle.

In a five-judge ruling delivered nearly 20 years ago, the General Court rejected Deutsche Bahn's claim. It held that the exemption at issue did not constitute state aid, as it was *imposed* on the Member States under Council Directive 92/81/EEC (later replaced by the ETD). In other words, a subsidy could not qualify as state aid if it were made mandatory under EU law. As regards an alleged breach of the non-discrimination principle, the General Court stated that the difference in treatment between trains and aircrafts was justified by the objective of avoiding a distortion of competition between Community-based airline companies and third-country competitors due to "*the international practice of exempting aviation fuel from excise duties, which is enshrined in the Chicago Convention and in international agreements concluded between States*" (Deutsche Bahn, para. 139).

Two decades later, can the General Court's ruling still be regarded as a valid precedent that would doom to failure any similar challenge of the exemption set forth in the ETD? I personally doubt it. There are plausible grounds to consider that the reasoning of the Court has lost some of its relevance and persuasiveness.

First, contrary to Council Directive 92/81/EEC, which was applicable in that case, the ETD does not contain an absolute tax exemption obligation. According to Article 14(2) ETD, not only are Member States allowed to impose a taxation on domestic transport (say, on a Paris-Marseille flight), but they may also enter into bilateral agreements with other Member States in order to waive the exemption as regards travels between these two States (say, on a Lyon-Milan flight provided there is an agreement between France and Italy). Therefore, the argument that the tax exemption does not qualify as state aid because it is imposed by EU law is not compelling as regards the ETD. Admittedly, the ETD continues to *authorize* such an exemption. However, the fact that a preferential treatment is allowed for by an EU act does not prevent its characterization as state aid (see Commission/Ireland e.a. (paras 45-53)).

Of course, this does not mean that any application of this tax exemption automatically amounts to an impermissible subsidy. State aid law is very fact-sensitive. For instance, this tax exemption could presumably only be regarded as distorting competition and affecting trade between Member states on specific routes that are commercially significant and for which there is substitutability between different modes of transport (such as Lyon-Milan or Paris-Marseille, where there is genuine competition between train and airplane).

Furthermore, in order to establish the selectiveness of the aid, it should be demonstrated that the exemption does not benefit undertakings that are '*in a comparable situation in the light of the objective of the tax*' (Svenska Bankföreningen and Länsförsäkringar Bank / Commission (para. 118)). A '*mere competitive relationship*' is not enough to that effect (Idem (para. 124)).

This brings us to the second limb of the General Court's reasoning according to which airline companies are in a specific situation compared to train undertakings given '*the international practice of exempting aviation fuel from excise duties which is enshrined in the Chicago Convention and in international agreements concluded between States*" (Deutsche Bahn, para. 139).

This argument is ambiguous and unconvincing. While there may be an international "practice" of exonerating airplane fuel, no international convention prohibits the taxation of fuel for commercial aviation. Bilateral agreements to that effect (such as Article 11(2) of the EU-US Open Skies Agreement) are typically based on reciprocity, meaning that a unilateral withdrawal of the exemption would merely release the other party from its corresponding obligation. Subject to very limited exceptions, the same applies to commercial shipping.

In other words, the only valid reason put forward by the General Court to justify a specific treatment of the aviation sector is the existence of a common practice of treating it differently! This is a totally circular reasoning that maintains a vicious circle hampering any attempt at changing the status quo. The alleged need to avoid a distortion of competition between EU and third-country companies is based on a typical prisoner's dilemma argument, one that traps all parties in a suboptimal outcome.

In any event, this argument loses its force if all companies, regardless of their country of incorporation, are subject to fuel taxation for purchases made within EU territory, as the Commission proposes. Moreover, the Commission's proposal targets only intra-EU transport, which further weakens the claim that fuel taxation would distort competition. In any case, justifying one form of discrimination on the grounds of preventing another amounts to poor legal reasoning.

In view of the foregoing, the claim that the tax exemption on fuel for commercial aircrafts and ships amounts to illegal state aid is not without merit. It deserves further scrutiny and could be a major argument in support of the Commission's proposal to end the current preferential treatment granted to air and waterborne navigation. Arguably, this claim must be taken all the more seriously given that, according to the Court of Justice, state aids cannot be held compatible with EU law if they infringe principles of EU environmental law such as the polluter-pays principle (Austria / Commission (paras 44-46 and 100)). As we will see in the next section, there are good grounds to consider that the tax exemption is hardly compatible with that principle.

3. Compatibility of the tax exemption with the polluter-pays principle

The polluter-pays principle was introduced more than 50 years ago in EU law as meaning that "*[t]he cost of preventing and eliminating nuisances must in principle be borne by the polluter*". According to Article 193(2) TFEU, Union policy on the environment *must* be based on that principle, which has found its way into several legislative acts.

As previously mentioned, the Commission's proposal to recast the ETD and eliminate the current exemption regime is explicitly grounded in the polluter-pays principle. But does this imply that maintaining such a regime would entail a violation of that principle and could, therefore, be regarded unlawful? Two objections might be raised to prevent a straightforward affirmative answer.

A. The applicability of the polluter-pays principle

The first one lies with the *applicability* of the polluter-pays principle. According to the ECJ, this principle only applies to environmental legislation, i.e. to legislation based on Article 192 TFEU (UNESA (para 28 and case-law cited)). Insofar as it is based on Article 113 *and* (albeit subsidiarily) Article 192 TFEU, the Commission's proposal to recast the ETD undoubtedly falls within the scope of the polluter-pays principle.

By contrast, both the current ETD and the compromise text prepared by the Danish presidency mention Article 113 TFEU as their *sole* legal basis. Could this difference make the ETD (as it currently stands and in the version proposed by the Danish presidency) escape the polluter-pays principle?

Arguably, such a conclusion sits uneasily with the environmental integration principle enshrined in EU primary law. According to such a principle, the EU must integrate "*environmental protection requirements*" (Article 11 TFEU) and "*a high level of environmental protection*" (Article 37 Charter) in *all* its policies. It should be added that, insofar as the explanations relating to Article 37 of the Charter cross-refer to Article 191 TFEU, there is little doubt that this "high level of protection" standard includes the polluter-pays principle.

Admittedly, pursuant to Article 52(5) of the Charter, the principle set forth in Article 37 can only be used to review the legality of acts that seek to implement it. However, the preamble of the current ETD contains an explicit reference to the environmental integration principle (recital 6). It also mentions that the taxation of energy products is one of the instruments available for achieving the Kyoto Protocol objectives (recital 7). There are therefore good grounds to consider that the ETD seeks to implement a 'high level of environmental protection'.

This conclusion applies with even more force to the compromise version of the recast ETD as it is currently discussed. The preamble of this text expressly refers to the polluter-pays principle. It states that

> "*Energy taxation can contribute to the Union's ambition of at least a 55% reduction in net greenhouse gas emissions by 2030 compared to 1990, as well as to the objective of zero pollution through the implementation of the principle 'polluter pays', by ensuring that the taxation of motor fuels, heating fuels and electricity better reflects the impact those products have on the environment and on health*."

To sum up, there is a case to be made that both the current ETD and its newly negotiated version fall within the scope of the polluter-pays principle. Concluding otherwise would seriously undermine the effectiveness of the environmental integration clause.

B. The margin of discretion in the implementation of the polluter-pays principle

The second issue relates to the *measure of discretion* that the EU legislature enjoys in the implementation of this principle. It emerges from the ECJ's case-law that this discretion operates at two levels.

First, the EU lawmaker has some leeway regarding the choice of the *means* used to comply with a principle or pursue an objective (see *Afton* (para. 28)). In this respect, it should be noted that the polluter-pays principle lies at the heart of another regulatory regime, namely the emissions trading scheme ('ETS'). This scheme is based on a system of greenhouse gas emission allowances that are capped and that can be traded between economic operators. One might argue that by including aviation and shipping activities in the ETS, the legislature simply chose another path than fuel taxation to implement the polluter-pays principle in those sectors.

The problem with that claim is that it is empirically flawed. In 2024, it appears that airlines paid around 3 billion EUR while shipping companies disbursed approximately 2.4 billion EUR as part of the ETS. One ton of CO2 emissions under the ETS currently costs these companies between 60 and 80 EUR while its real, social cost is estimated between 270 and 300 EUR. Based on these figures, the ETS reflects at best a "polluter-pays-the-fourth-principle"! But even that is an overstatement. The aviation sector keeps benefiting from a large amount of free allowances while many commercial ships (including fishing ships) are not even covered by the ETS. In summary, as it currently stands, the ETS is manifestly incapable of complying with the polluter-pays principle, namely of internalizing the environmental cost associated with commercial air and waterborne navigation.

The second level of discretion enjoyed by the EU's political institutions refers to the *balancing* between competing objectives (see AG Medina's opinion delivered on 19 June 2025 in *LF* (paras 96-97)). But what are the objectives that could legitimately curb the application of the polluter-pays principle in this case? As previously noted, it cannot be the need to respect international law since no Treaty binding on the EU contains a general prohibition of fuel taxation for ships or aircraft. As for the objective of avoiding distortions of competition, it should be supported by hard economic evidence. At any rate, it is hard to see how fuel taxation on intra-EU transport (as suggested in the Commission's proposal) would create a competitive advantage for companies located in third-countries. Whether they are incorporated in the EU or elsewhere, the operators will have to purchase fuel in Europe (and will therefore have to pay a tax) to carry out such transport services. As a consequence, they will be treated in the same way.

4. Conclusion

In view of the foregoing, the Council should think twice before deciding to maintain the current tax exemption regime in the revised ETD. Such a status quo may not withstand judicial scrutiny. First, national exemptions regimes might be successfully challenged by competitors on the ground that they amount to impermissible state aid (although a specific, case-by-case assessment would be necessary to determine whether this is actually the case). Second, the relevant provisions of the ETD (whether in its current version or in the "compromise" version put forward by the Danish presidency) could be held invalid on the ground that they run against the polluter-pays principle. Admittedly, this remains speculative, as no EU legislation has yet been found to violate that principle. However, the exceptional nature of the climate crisis may prompt the CJEU to adopt an increasingly assertive stance on this issue – showing less deference to regulatory choices that are not only ill-suited to addressing climate change, but that actively exacerbate it.

And the Commission's role in all this? What options does it have? In theory, it could withdraw its current proposal and introduce a new one, this time primarily based on Article 192 TFEU. By shifting the legal basis, the Commission would eliminate the unanimity requirement in the Council, while signaling that the recast of the ETD reflects a genuine change in policy direction – placing the fight against climate change at the forefront. But it is a risky and highly unlikely (11^{th} hour) move, if only for legal reasons, as the ECJ made it clear that the Commission's prerogative to withdraw a proposal is not absolute and must comply with the inter-institutional balance principle, but also because outvoted Member States would fiercely challenge the legality such a change in legal basis.

As a result, it is likely that the final word in this matter will rest with the ECJ – a reflection of the enduring difficulty political authorities, both within Europe and beyond, face in treating the climate crisis with the seriousness it demands.

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