Public Finance and Air Transport

Principles, best practices, and implications for the airline industry

Taxes shape the economy and fund core government functions. Without taxes, most other policies are not financially viable, making tax systems inextricably linked to policymaking.

Several overriding principles guide best practices regarding taxation. Here we review these, compare tax systems, and discuss their application to the air transport industry.

January 2026

FACTS

1. Introduction

Public finance encompasses the processes by which governments raise and spend money, as well as budgeting, taxation, and debt management. Tax systems are central to policymaking. They shape the economy, society, and governance structures. Taxes fund core government functions such as healthcare, education, infrastructure, defense, public safety, and are a key component of national development strategies. Without taxes, most other policies are not financially viable. Taxes are a primary tool for reducing inequality, facilitating economic management, shaping incentives and behavior (where taxes are often more effective than regulation), and supporting broader policy goals. Tax design reveals what a government values, and tax policy choices reflect ideology and vision. A well-functioning tax system increases State legitimacy, public trust, and democratic accountability. In short, tax systems are inextricably linked to policymaking.

In public finance, several overriding principles guide how governments raise, allocate, and manage financial resources to serve the public interest. These principles help ensure fiscal responsibility, economic efficiency, equity, and transparency. In this document, we review key principles and best practices in public finance and discuss their application to the air transport industry.

2. Taxation principles, forms of taxation, and tax competitiveness

The core functions of public finance are to allocate limited resources effectively, distribute them to the greatest benefit, and both stabilize and stimulate the economy over the business cycle. These functions are best fulfilled by adhering to a set of generally agreed principles (Table 1).

Table 1: Taxation principles

Equity	Equity, or fairness, must be a cornerstone in public finance because it is essential for social justice and the legitimacy of the tax system. People with similar abilities to pay should pay similar amounts in taxes. People with greater ability to pay (e.g., those with higher incomes) should contribute more, and taxation systems need to include elements of progressive taxation, without which equity is unlikely to be achieved.
Efficiency	Public finance decisions should minimize economic distortions. This means that taxes, as well as public spending, should not discourage productive behavior, such as savings, investment, or work. Resources should be allocated to maximize economic and social welfare. There is a significant cost associated with inefficient taxation and spending.
Sustainability	Governments must be fiscally responsible and avoid accumulating unsustainable levels of debt. Borrowing should not be used to finance current spending, but rather to support investment and economic growth. Unsustainable debt undermines confidence, increases borrowing costs, and limits future policy options, in addition to placing an outsized burden on future generations who are left with the task of financing and reducing the debt burden, in turn limiting their policy options.
Transparency and Accountability	Budgets, taxes, and spending must be clearly reported and publicly available. Decision-makers must be held accountable for financial outcomes. This prevents corruption and mismanagement and builds trust in public institutions.
Stability and counter-cyclicality	Fiscal policy should stabilize the economy and help smooth the business cycle. Spending can rise, and taxes can fall, in cyclical downturns, while during economic

	expansions, spending should be reined in, and taxes can rise. Such counter-cyclical fiscal policies help maintain employment levels and favor price stability.
Effectiveness	Public spending should be well-targeted and directly related to achieving intended and clearly identified goals. When this is not the case, there is a great risk of leakage and misallocation of limited resources, which will impede the desired economic and social benefits.
Simplicity and predictability	The tax system and budget process should be easy to understand, stable over time, and predictable, to reduce compliance costs, widen the tax net, and allow investors and households to plan with confidence.
International competitiveness	There is a need for tax systems to be designed in a way that allows countries to remain attractive locations for investment and economic activity in an increasingly global and mobile economy. It is essential to ensure coherence with international norms and coordinate through international agreements to prevent double taxation, reduce harmful tax competition, and support sustainable economic growth while preserving each country's taxing rights (Box 1).
Neutrality	Taxation is neutral when it does not affect the normal operation of social and economic activities based on market mechanisms (Box 2).

Source: Multiple, including Musgrave, R.A. (1959) *The Theory of Public Finance*; Rosen, H.S. and Gayer, T. (2021) *Public Finance*. 11th Edition; Stiglitz, J. E., and Rosengard, J. K. (2015) *Economics of the Public Sector*. 4th Edition. New York and London: Norton & Company; United Nations Department of Economic and Social Affairs (2000) *Economic governance: Guidelines for effective financial management*. New York: UNDESA.

Box 1: International competitiveness

A country's tax system does not exist in isolation and must consider the country's international competitiveness. In an interconnected world, capital and labor are mobile resources, as are multinational enterprises. National tax systems must, for instance, try to attract foreign investment and maximize domestic output, in a global context where other countries have similar aims. Countries do not have free rein in that sense, and to some extent, they compete for investment and for taxable profits. Success in that regard depends not only on the tax system but mostly on how well the economy performs overall. Such performance is greatly helped by aligning domestic tax systems with global norms.

Countries generally determine and impose taxes within their borders, while international rules aim to coordinate with domestic laws through international, bilateral, or other agreements. Such coordination or harmonization of rules is necessary because cross-border flows of capital and goods involve parties in different jurisdictions. Fragmented policies introduce a very real risk of double taxation, encourage tax arbitrage, and give rise to distortions in international markets.

Taxation of a country's relationships with the rest of the world (trade, capital flows, etc.) is governed by taxing rights. Regarding direct taxation, two fundamental principles are commonly applied: the residence principle and the source principle (also referred to as the territorial principle). Under the residence principle, a country taxes its residents on their worldwide income, while non-residents are generally taxed only on income sourced within that country. Under the source (territorial) principle, a country taxes income that arises within its jurisdiction, regardless of the residence of the income recipient, and typically does not tax residents on their foreign-source income. In practice, most tax systems apply a combination of residence- and source-based taxation, often through tax treaties and domestic relief mechanisms, which, in the absence of coordination, can give rise to double taxation.

Regarding indirect taxation, particularly value-added tax (VAT) and border tax adjustments, the key distinction is between the destination principle and the source principle. Under the destination principle, VAT

is levied on final consumption within the taxing jurisdiction, regardless of where goods or services are produced, making it a consumption tax. Under the source principle, VAT would be levied on goods and services produced domestically, irrespective of where they are ultimately consumed; in economic terms, such a system would resemble a tax on domestic production (GDP), net of investment. In practice, most countries apply the destination principle, taxing imports and zero-rating exports, thereby ensuring that VAT burdens domestic consumption rather than production.

The non-discrimination principle in international taxation aims to ensure that taxpayers in comparable situations are treated equally across borders, thereby preventing unfair tax advantages for residents over non-residents or vice versa.

A challenge in international taxation is transfer pricing, which refers to the pricing of goods, services, and intangibles transferred between related entities within a multinational enterprise. This issue attracts attention in the context of profit allocation, tax avoidance prevention, compliance, and reporting.

The key principles that apply to international taxation are:

- Avoidance of double taxation, typically achieved through tax treaties and relief mechanisms
- Allocation of taxing rights based on residence principle, particularly for direct taxes
- Application of the destination versus source principle in the design of indirect taxes, notably VAT
- Non-discrimination, ensuring that taxpayers in comparable situations are treated equally across jurisdictions

The current international tax system is a complex hybrid, with several institutions vying for global leadership, including the United Nations (UN) and the Organization for Economic Co-operation and Development (OECD). Air transport is governed by the International Civil Aviation Organization (ICAO), the UN specialized agency for international air transport, although its authority is sometimes compromised by the UN and other organizations, as well as by national governments, despite their representation at ICAO and their endorsement of ICAO standards and recommended practices.

Box 2: Neutrality

Taxes are neutral if they do not affect the optimal allocation of resources, nor people's decisions regarding investment and consumption, nor generate excess and unevenly distributed tax burdens. Taxation is not neutral when it introduces distortions, imposes excess burdens, influences people's decisions on investment and consumption, and causes social resources to deviate from the optimal allocation under market self-regulation.

The concept of neutrality underpins the goal of any tax system to broaden the tax base, thereby allowing for lower tax rates. Tax systems that favor one sector, type of income, or form of investment over another cause fragmentation instead of unification and should not be used unless there is a clear policy justification.

Establishing more uniform rates across any particular type of tax (tax on income, capital, etc.) tends to improve the allocation of investment and finance, reduce tax avoidance, lift productivity, and promote the stability of the economy.

These principles often compete with or come into tension with one another in real-world policymaking. For instance, highly progressive taxes can improve equity but discourage economic activity. A flat tax can be easy

to implement but is inherently unfair. There is also tension between short-term and long-term goals, as well as the issue of using a limited set of policy tools to target multiple goals simultaneously over different time horizons.

Optimization of tax systems is clearly not a simple question of following a set of principles. It is a dynamic and ever-evolving environment with many inherent conflicts that require not only the skill and courage of policymakers, but also arguably some fortunate circumstances. The circumstances pertain as much to the international context as to the domestic situation, both of which will set limits on what can be achieved, and by which means.

2.1. Main types of taxes

Tax systems around the world rely on several main types of taxes, each designed to raise revenue in distinct ways while balancing the principles outlined above. The primary categories of taxes used by most governments include:

1. Personal income tax – levied on wages, salaries, dividends, interest income, and capital gains.
2. Corporate income tax – levied on profits of businesses.
3. Consumption taxes – levied on the purchase of goods and services, such as value-added tax (VAT) or other variants of sales taxes.
4. Excise and specific taxes – targeted taxes on particular goods (e.g., alcohol, tobacco, fuel), frequently used to discourage the consumption or activity targeted.
5. Property taxes – levied on land and buildings based on assessed value.
6. Wealth taxes – levied on the net value of an individual's assets.
7. Capital taxes – including taxes on capital gains, inheritance, and gifts.
8. Social security and payroll taxes – levied on wages and salaries, typically shared by employers and employees.
9. International and trade taxes – customs duties on imports and exports, and withholding taxes on payments to non-residents (e.g., dividends, interest, royalties).

The mix of taxes varies by country, depending on its level of development, political choices, and administrative capacity. High-income countries tend to rely more on income and consumption taxes, while the tax base for income taxes is weaker in developing countries. It is often a challenge for developing countries to broaden the tax bases and bring the informal sectors into the tax net.

While it is difficult to know the distribution of global taxation across these main tax categories, the OECD approximates the tax take across its members as follows (Table 2):

Table 2: OECD average share of total tax revenue per tax category, %, 2024

Tax category	Share of total tax revenue, %
Personal income taxes	24-25
Corporate income taxes	12-13
Social security and payroll contributions	24-26
Value-added tax (VAT) and general consumption taxes	20-21
Other specific consumption taxes and excises	8-11
Property taxes	5
Other residual categories	2-5

Source: OECD "Revenue Statistics 2024", 2024.

It is interesting to note that the current global tax system, as exemplified by that observed in the OECD, aligns somewhat weakly with what economists analyze as efficient forms of taxation. This is likely due to the difficulty in enacting tax reform, given the presence of powerful vested interests and complex politics.[1]

[1] Stiglitz, J.E. (2002) "New perspectives on public finance: recent achievements and future challenges", *Journal of Public Economics*, 86(3), pp. 341–360.

2.2. Economic efficiency and international competitiveness of tax systems: A comparative overview

The most efficient and effective forms of taxes are those that align the best with the principles reviewed above. When assessed in that light, the types of taxes can be ranked according to their efficiency and effectiveness. The preferred instrument, land value taxes, happens to be one of the least used. However, some frequently used taxes also are among those considered efficient (Table 3).

Table 3: Forms of taxation in order of economic efficiency

Type of tax	Characteristics
Land value tax[2]	A form of tax designed to capture the "economic rent" of land, i.e., the unearned increment in value. It is non-distortionary, encourages productive land use, and does not discourage investment or labor. It does, however, require accurate and updated land valuation systems.
Broad-based consumption taxes	Less distortionary than income taxes as they tax spending, not savings. They are, however, regressive and can be a burden to implement.
Taxes on economic rents and natural resources	Rents, or excess profits, are unearned and taxing them does not reduce investment incentives. These taxes are common in natural resource taxation (oil, gas, mining). Rents can be hard to measure, and volatile.
Simplified corporate taxes on cash flow or rent	Taxing business cash flow or economic rents avoids disincentives to invest by allowing immediate expense of capital costs, and it also avoids complex depreciation and interest deductibility rules.
Excise and specific taxes	These taxes are often efficient in terms of altering consumer behavior (alcohol, tobacco), but they can be regressive, costly to administer, raise little money, and highly distortive.

Source: Stiglitz, J. and Rosengard, J. (2015) *Economics of the Public Sector*. 4th edition. Norton and Company.

Turning the tables and instead ranking different types of taxes according to how inefficient they are yields the following:

Table 4: Forms of taxation in order of their economic inefficiency

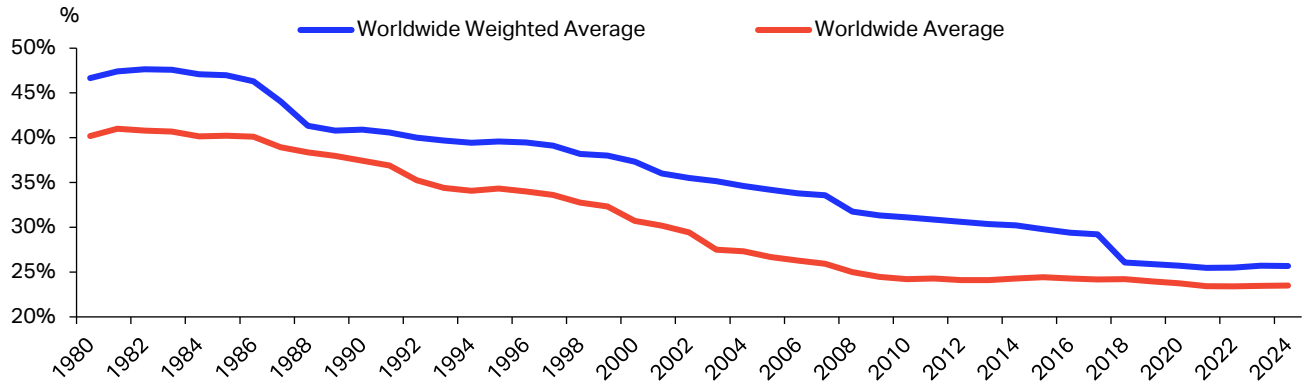
Type of tax	Characteristics
High marginal income taxes	Tend to discourage work, saving, and entrepreneurship.
Payroll taxes	Increase labor costs and can reduce employment (though often necessary for social insurance).
Traditional corporate income taxes	Distort investment and location decisions.
Turnover taxes (gross receipts)	Taxing every stage of production creates cascading effects and economic inefficiency.
Tariffs on trade	Distort trade and resource allocation, harm consumers and global supply chains.
Narrow-based, specific consumption taxes	Less efficient than broad-based consumption taxes with fewer exemptions. They can lead to inefficient consumption patterns, high compliance costs, and can cascade, distorting production and prices.

Source: Stiglitz, J. and Rosengard, J. (2015) *Economics of the Public Sector*. 4th edition. Norton and Company.

[2] Favored by economists from Adam Smith to Milton Friedman, including George, H. (1879) *Progress and Poverty*.

Tax systems evolve over time in response to international and domestic developments. Over the past few decades, there has been a shift toward lower marginal tax rates on corporate and individual income, particularly among OECD countries, in line with the findings in Table 4. This trend has been offset by an increase in revenue raised from broad-based taxes, such as payroll taxes and value-added taxes. There are, of course, variations around these trends. For instance, the trend of declining corporate income tax rates over time (Chart 1) has not been observed in some OECD countries, including France, the Slovak Republic, and Slovenia. In 2024, the worldwide weighted average corporate income tax rate was 25.7%.

Chart 1: Statutory weighted and unweighted corporate income tax rates, %, 1980-2024



Source: Tax Foundation. Statutory corporate income tax rates were compiled from various sources. GDP calculations are from the US Department of Agriculture, "International Macroeconomics DATA set."

A further trend that has emerged is to broaden the goals associated with the use of tax instruments beyond the traditional purpose of raising government revenue and encouraging investment. Import tariffs, digital service levies, and extraterritorial taxes are increasingly deployed to exert political pressure. In such instances, the economic goals of the tax policies and instruments used are frequently subordinated to goals of influence, often with negative economic outcomes. Focusing on neutral, internationally competitive tax policies that raise revenue with minimal harm to investment and economic growth may be the best way to simultaneously satisfy such potentially conflicting goals.

Given the diverse approaches to taxation among countries, the question arises as to which system might be more effective. The Tax Foundation has developed the International Tax Competitiveness Index (Table 5), which compares the tax systems of the 38 OECD countries across more than 40 tax policy variables.[3]

[3] Tax Foundation (2025) *International tax competitiveness index 2025*. Washington, DC: Tax Foundation, 20 October.

Table 5: International tax competitiveness index ranking, 2025

Country	Overall rank	Corporate tax rank	Individual taxes rank	Consumption taxes rank	Property taxes rank	Cross-border tax rules rank
Estonia	1	2	2	22	1	7
Latvia	2	1	7	20	7	6
New Zealand	3	31	6	1	4	22
Switzerland	4	10	8	2	36	1
Lithuania	5	3	9	25	10	15
Luxembourg	6	20	22	8	16	5
Australia	7	29	15	9	2	33
Israel	8	11	32	11	5	10
Hungary	9	4	3	38	22	4
Czech Republic	10	8	10	32	6	11
Sweden	11	6	19	26	8	13
Turkey	12	21	5	17	24	8
Canada	13	22	27	7	25	18
Slovak Republic	14	24	1	34	9	24
United States	15	9	17	4	30	35
Netherlands	16	23	30	14	21	3
Costa Rica	17	34	23	6	12	30
Mexico	18	26	14	12	3	36
Austria	19	19	26	16	17	16
Germany	20	30	33	13	14	9
Norway	21	13	29	23	15	14
Japan	22	35	34	5	23	25
Greece	23	16	4	30	29	23
Finland	24	7	28	28	19	19
Slovenia	25	12	11	29	26	21
Korea	26	25	38	3	31	29
Denmark	27	17	36	19	13	34
Chile	28	32	24	10	11	38
Iceland	29	15	20	24	27	26
Belgium	30	18	13	27	32	27
Ireland	31	5	37	36	18	28
United Kingdom	32	28	25	33	37	2
Portugal	33	36	21	21	20	32
Spain	34	33	18	18	35	17
Poland	35	14	35	35	28	31
Colombia	36	37	12	15	33	37
Italy	37	27	16	37	38	20
France	38	38	31	31	34	12

Source: Tax Foundation.

Estonia comes first in this ranking, and other top-ranked countries share many of its tax system's characteristics. These include efficient systems for taxing both corporate and labor income, lower rates on individual income taxes, exemptions for capital gains, broad-based consumption taxes, and competitive cross-border regimes without withholding taxes on interest or royalties. Incidentally, Estonia has a land value tax, one of the taxes considered most efficient.

France comes last in this ranking. France has the highest corporate tax rate among OECD countries, at over 36%, accompanied by multiple surtaxes and other distortionary taxes applied to various forms of income, assets, and transactions. Italy comes second to last and is lumbered with numerous taxes and levies on the property sector, and its relatively high VAT rate of 22% applies to one of the narrowest consumption tax bases in the OECD.

In between, it is interesting to note Sweden's 11th position overall, but the country climbs to 6th place regarding corporate taxes. Switzerland ranks 4th overall, but only 10th in terms of corporate taxes. New Zealand manages to rank 3rd overall, despite a 31st position regarding corporate taxation. The US ranks 15th overall, placing 9th in corporate tax rates. Ireland's corporate-friendly system is well-known, and it ranks 5th on that score, while dropping to 31st overall. This is due to high personal income and dividend taxes, as well as a relatively narrow base to which VAT is applied.

3. Corporate taxes

Looking at corporate taxes more specifically, they are a direct tax on a corporation's profits. All OECD countries levy a tax on corporate profits, but the tax rates and bases vary significantly across countries. The highest rates in the world are around 50% and the lowest non-zero rates are around 5.5%. There are also several jurisdictions that do not tax corporate income under specific conditions and for certain types of companies. On average, the corporate income tax rate in OECD countries stood at 24.3% in 2025.[4] Corporate income taxes reduce the after-tax rate of return on corporate investment. This increases the cost of capital, resulting in lower levels of investment and economic output. Corporate taxes can also lead to lower wages for workers, lower returns for investors, and higher prices for consumers.

While corporate income taxes can have a significant impact on a country's economy, they generate a relatively low amount of tax revenue for most governments, averaging around 12-13% among OECD countries in 2024 (Table 2).

The Tax Foundation's analysis of corporate tax systems encompasses three key subcategories: corporate tax rates, cost recovery, as well as incentives and complexity (Table 6).

[4] Tax Foundation (2025) *International tax competitiveness index 2025*. Washington, DC: Tax Foundation.

Table 6: International tax competitiveness index - Corporate taxes, 2025

Country	Corporate Tax Rank	Rate Rank	Cost Recovery Rank	Incentives/Complexity Rank
Latvia	1	6	2	1
Estonia	2	11	1	3
Lithuania	3	3	4	22
Hungary	4	1	37	27
Ireland	5	2	28	20
Sweden	6	9	18	5
Finland	7	6	26	4
Czech Republic	8	10	24	6
United States	9	24	3	12
Switzerland	10	5	10	30
Israel	11	16	9	14
Slovenia	12	11	27	10
Norway	13	11	30	8
Poland	14	4	11	36
Iceland	15	6	23	32
Greece	16	11	34	9
Denmark	17	11	29	13
Belgium	18	20	6	17
Austria	19	16	12	26
Luxembourg	20	18	14	28
Turkey	21	20	16	24
Canada	22	26	20	15
Netherlands	23	25	17	19
Slovak Republic	24	19	22	31
Korea	25	27	13	23
Mexico	26	32	25	2
Italy	27	29	5	33
United Kingdom	28	20	19	34
Australia	29	32	21	11
Germany	30	35	8	25
New Zealand	31	30	35	16
Chile	32	28	38	7
Spain	33	20	32	35
Costa Rica	34	32	36	21
Japan	35	31	31	29
Portugal	36	36	7	37
Colombia	37	37	33	18
France	38	38	15	38

Source: Tax Foundation.

Hungary has the lowest corporate tax rate among all OECD countries, at 9%, followed by Ireland at 12.5%[5] and Lithuania at 15% (thus ranking among the top 3 in this subcategory). The US ranks relatively low, 24th, which is still significantly better than France's 38th and lowest rank of all, or Germany's 35th place. The three highest corporate income tax rates among OECD member countries are France at 36.1%, Colombia at 35%, and Portugal at 30.5%.

Cost recovery is a crucial aspect of corporate taxation because profits are typically calculated as revenue minus costs. If a tax code does not allow businesses to account for all the costs of doing business, it will inflate a business's taxable income and its tax bill. This increases the cost of capital, which dampens investment and economic growth. Chile ranks last in terms of cost recovery, while Estonia ranks first. The US ranks third, and France ranks 15th in this subcategory, ahead of the UK's 19th rank.

A tax incentive is a tax credit, deduction, or preferential tax rate that exclusively applies to a specific type of economic activity, altering relative prices and influencing both production and consumption patterns. Incentives can also pertain to intellectual property regimes and support for research and development. Complexity measures the number of separate taxes and rates that apply to business income, the existence of surtax rates on business income, and the amount of revenue countries collect from business profits taxes other than the corporate income tax. While France is ranked last regarding incentives and complexity in its corporate tax system, Switzerland is only marginally better, ranking 30th. What is also surprising is Sweden's stellar 5th ranking in this subcategory and Mexico's impressive 2nd place.

Airlines are, of course, subject to these corporate taxes, as is any company operating domestically or internationally. Airlines have traditionally been taxed based on their residence, where the airline's effective management is, ensuring that income from international flights is not taxed multiple times in different countries, as per ICAO's Policies on Taxation in the Field of International Air Transport (Doc 8632). However, a modification to Article 8 of the UN Model Tax Convention[6] has opened the door for States to use source-based taxation of airlines' profits. This is rather astonishing, given ICAO Doc 8632, ICAO Template Air Service Agreement, the OECD Model Tax Convention on Income and Capital provisions, and considering the risks of double taxation, administrative complexity, and higher administrative costs – all of which are detrimental to the global air transport network.

Total taxes paid by airlines are obviously commensurate with the total taxable income. Net profit margins, that is revenue minus costs and taxes, have never exceeded 5% in the airline industry. Net profits are expected at USD 41 billion in 2026, which corresponds to a net profit margin of 3.9%.[7] Industry-wide data for other industries is difficult to obtain at the global level. In the US, industries earning comparable net profit margins include farming and agriculture (3.9%), trucking (3.8%), and automotive retail (3.4%). The highest net profit margin in the US was seen in the semiconductor industry at 30.4%.[8] In that light, it is clear that the airline industry is a low-margin industry.

4. Consumption taxes

Consumption taxes are the least distortionary when the base to which they apply is broad, allowing the tax rate to be lower and ideally the same across goods and services. Exempting various forms of consumption from VAT will tend to push up rates on the remaining tax base. Taxing intermediate inputs can lead to a cascade, leading to taxing the same parts or products multiple times. Systems must credit any taxes already paid in the supply chain. However, when levied at the same rate and properly structured across a broad consumption tax base, consumption taxes can be low and relatively distortion-free. They do, however, penalize low-income

[5] Ireland: 12.5% for trading corporations (15% above a certain revenue threshold), 25% for non-trading corporations.
[6] United Nations Department of Economic and Social Affairs (2021) *United Nations Model Double Taxation Convention Between Developed and Developing Countries*. New York: UNDESA.
[7] IATA (2025) *Global outlook for air transport*. December 2025. Available at: iata.org/en/iata-repository/publications/economic-reports/global-outlook-for-air-transport-december-2025/.
[8] Stern NYU (2026) *Margins by sector (US)*. Available at: https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html.

earners who will pay a higher percentage of their income in such taxes than richer households. High and distortive consumption taxes will stimulate the informal sector and self-provided goods and services.

The average general consumption tax rate in the OECD is 19.4%, with Hungary at the high end, at 27%, and the US at the low end, at 7.5%. New Zealand has the broadest consumption tax base at 96% of total consumption, followed by Luxembourg and Korea. Mexico, the US, and Colombia have the narrowest consumption tax bases, around 35-36%. The average share of total consumption in the OECD to which the tax applies is 55%.

Consumption taxes are levied as a percentage of the air ticket's value at the time of ticket sale. They are collected at the time of issuance and remitted to the relevant tax authority within a time-limited period (generally monthly or quarterly) after the ticket sale. They are paid by the consumer, not by the airline, or any business selling goods or services that are subject to VAT. However, airlines and businesses in general may be affected indirectly by such taxes if they are implemented in a way or at a rate that discourages consumption and lowers demand for the product or service.

VAT is commonly applied to domestic passenger flights at the standard or a reduced rate, although practices vary widely across countries, with some jurisdictions exempting domestic air transport or applying preferential rates. Where VAT is charged, business travelers may, subject to national rules, reclaim VAT on eligible air travel expenses. If passenger air transport is zero-rated, no VAT is charged on the ticket, but input VAT incurred by the supplier can be reclaimed. By contrast, if exempt, no VAT is charged, and none can therefore be reclaimed.

International passenger flights are typically zero-rated or exempt from VAT in the country of departure, consistent with ICAO policies that call for the reduction or elimination of taxes on international air transport (ICAO Doc 8632[9]). This treatment reflects the application of the destination principle, avoiding complex multi-jurisdictional administration, and ensures that international transport services, treated as exports, are not subject to domestic consumption taxation.

Within the European Union, international passenger transport and most intra-EU air travel are currently VAT zero-rated. However, the European Commission is reviewing Article 148 of the VAT Directive, with the possibility of changes to the VAT framework for air transport.[10]

[9] ICAO's Policies on Taxation in the Field of International Air Transport (Doc 8632) provides for States to "reduce to the fullest practicable extent and make plans to eliminate as soon as economic conditions permit all forms of taxation on the sale or use of international transport by air. The ICAO commentary adds that "the normal practice with respect to the sale or use of international air transport is to zero rate" VAT and consumption taxes, explaining that this approach avoids the increased costs and administrative complexity that would otherwise burden international air travel."
[10] IATA has submitted its response to the EU public consultation on EU VAT Reform, October 2025, accessible here.

Table 7: International tax competitiveness index - Consumption taxes, 2025

Country	Consumption Taxes Rank
New Zealand	1
Switzerland	2
Korea	3
United States	4
Japan	5
Costa Rica	6
Canada	7
Luxembourg	8
Australia	9
Chile	10
Israel	11
Mexico	12
Germany	13
Netherlands	14
Colombia	15
Austria	16
Turkey	17
Spain	18
Denmark	19
Latvia	20
Portugal	21
Estonia	22
Norway	23
Iceland	24
Lithuania	25
Sweden	26
Belgium	27
Finland	28
Slovenia	29
Greece	30
France	31
Czech Republic	32
United Kingdom	33
Slovak Republic	34
Poland	35
Ireland	36
Italy	37
Hungary	38

Source: Tax Foundation.

5. Concluding comments

Public finance principles provide a clear framework for designing tax systems and assessing their economic performance, equity, and long-term sustainability. As a uniquely global network industry, international civil air transport is particularly dependent on the principles of neutrality, international coordination, and efficient taxation. Airlines operate across multiple borders in interconnected systems where any local disruption will cascade and ripple globally. Any fragmentation of policies across the network will create distortions, introduce inefficiencies, and curtail service, impacting connectivity across the global economy and capping economic growth. Tax systems support economic growth and government revenue collection the best when they are applied uniformly, in transparent and predictable tax regimes that align with international norms.

International air transport has long benefited from widely accepted principles aimed at avoiding double taxation and preserving the neutrality of cross-border services. Departures from these principles, including the expansion of consumption taxes on international travel or unilateral changes to profit allocation rules, introduce administrative complexity and economic inefficiency, ultimately affecting connectivity, consumers, and trade.

For policymakers, the challenge is not whether to tax, but how to tax well. Sound public finance policy should support all forms of economic activity in the economy and provide social protection for vulnerable populations. Long-established public finance principles promote tax systems that foster economic resilience and contribute to economic development. Departures from such principles will come with a cost in terms of missed policy objectives and lower government revenue. Air transport, a low-margin industry operating across numerous jurisdictions simultaneously, is existentially dependent upon internationally harmonized rules. Unification, rather than fragmentation, is necessary for all countries individually and for the global economy to leverage fully air transport's capacity to accelerate growth and improve living standards.

Appendix – Selected reading list

This paper focuses on the areas of public finance and taxation with the most direct relevance to the airline industry, largely ignoring other important taxes such as personal income taxation, property taxation, and inheritance taxes, as their effects on air transport are more indirect. The question of how the international tax system is governed will be addressed in a forthcoming publication. Readers seeking a broader treatment of these topics may refer to the selected reading list provided below.

For a discussion, history, and principles of public finance

- Auerbach, A.J. and Hines Jr., J.R. (2001) *Taxation and economic efficiency*. NBER Working Paper No. 8181. Cambridge, MA: National Bureau of Economic Research.
- Bali, A. S., Capano, G., and Ramesh, M. (2019) "Anticipating and designing for policy effectiveness", *Policy and Society*, 38(1), pp.1-13.
- Capasso, S., Cicatiello, L., De Simone, E., Gaeta, G.L. & Mourão, P.R. (2021) "Fiscal transparency and tax ethics: Does better information lead to greater compliance?", *Journal of Policy Modeling*, 43(5), pp.1031–1050.
- Desmarais-Tremblay, M., Johnson, M. and Sturn, R. (2023) "From public finance to public economics", *The European Journal of the History of Economic Thought*, 30(5), pp.934–964.
- Diebold, N.F. (2011) "Standards of non-discrimination in international economic law", *International and Comparative Law Quarterly*, 60, pp.831-865.
- Frenkel, J., Razin, A. and Sadka, E. (1990) *Basic concepts of international taxation.* NBER Working Paper No. 3540. Cambridge, MA: National Bureau of Economic Research.
- Hiort af Ornäs Leijon, L. (2015) *Tax policy, economic efficiency and the principle of neutrality from a legal and economic perspective.* Working Paper 2015:2. Uppsala: Uppsala University, Faculty of Law.
- Jalles, J. T., Kiendrebeogo, Y., Lam, R., and Piazza, R. (2024) "Revisiting the countercyclicality of fiscal policy", *Empirical Economics*, 67(3), pp.877-914.
- Matthews, S. (2011) *What is a "competitive" tax system?* OECD Taxation Working Paper No. 2. Paris: OECD.
- OECD (2024) *Tax administration 2024: Comparative information on OECD and other advanced and emerging economies*. Paris: OECD Publishing.
- OECD (2024) *Taxation and inequality: OECD report to the G20 finance ministers and central bank governors*. Paris: OECD Publishing.
- OECD (2025) *Enhancing simplicity to foster tax certainty and growth: OECD report to the G20*. Paris: OECD Publishing.
- Pistone, P., Roeleveld, J., Hattingh, J., Pinto Nogueira, J.F. and West, C. (2019) *Fundamentals of taxation: An introduction to tax policy, tax law, and tax administration,* Amsterdam: International Bureau of Fiscal Documentation (IBFD).
- Stewart, M. (2022) *Tax and government in the 21st century*. Cambridge: Cambridge University Press.
- Wyplosz, C. (2007) *Debt sustainability assessment: The IMF approach and alternatives*. HEI Working Paper No. 03/2007, Geneva: Graduate Institute of International Studies.

For discussions regarding economic efficiency and international competitiveness of tax systems

- Aldred J. (2011) "Tax by design: The Mirrlees Review (OUP, 2011)", *New Political Economy*, 17(2), pp. 231–238.
- Brautigam, D., Fjeldstad, O.-H. and Moore, M. (2008) *Taxation and state-building in developing countries: Capacity and consent.* Cambridge: Cambridge University Press.
- Gordon, R.H. (2010) *Taxation in developing countries: Six case studies and policy implications*. New York: Columbia University Press.
- IMF (2014) *Spillovers in international corporate taxation.* Washington, DC: International Monetary Fund.
- OECD (2024) *Tax policy reforms 2024: OECD and selected partner economies*. Paris: OECD Publishing.

- OECD (various years) *Consumption tax trends*. Paris: OECD Publishing.
- Slemrod, J. and Bakija, J. (2008) *Taxing ourselves: A citizen's guide to the debate over taxes*. 4th edition. Cambridge, MA: MIT Press.
- Smith, A. (1776) *An inquiry into the nature and causes of the wealth of nations*. London: Printed for W. Strahan and T. Cadell, in the Strand.

For an air transport industry-specific discussion of taxation

- IATA (2025) *Specific taxes on the use of air transport*. Available at: https://www.iata.org/en/iata-repository/publications/economic-reports/specific-taxes-on-the-use-of-air-transport/.
- IATA (2025) *Taxes applied to air transport enterprises and services*. Available at: https://www.iata.org/en/iata-repository/publications/economic-reports/taxes-applied-to-air-transport-enterprises-and-services/.
- IATA (2025) *The fiscal landscape of international air transport*. Available at: https://www.iata.org/en/iata-repository/publications/economic-reports/the-fiscal-landscape-of-international-air-transport/.

Iata.org/economics
economics@iata.org

International Air Transport Association
SS135-800 rue du Square-Victoria, Montreal, QC, H3C 0B4, Canada