Aviation tax reform

CILT Response to the Treasury Consultation published March 2021

Introduction

The Chartered Institute of Logistics and Transport (CILT) is a professional institution embracing all transport modes whose members are engaged in the provision of transport services for both passengers and freight, the management of logistics and the supply chain, transport planning, government and administration. Our principal concern is that transport policies and procedures should be effective and efficient, based on objective analysis of the issues and practical experience, and that good practice should be widely disseminated and adopted. The Institute has a number of specialist national policy groups, a nationwide structure of locally based groups and a Public Policies Committee which considers the broad canvass of transport policy. This submission contains contributions from all these sources and was led principally by our Aviation Policy Group.

The government's initial policy position on domestic APD:

Q1 *Do you agree with the government's initial policy position that the effective rate of domestic APD should be reduced? In your view, what would be the positive and negative effects of such a change, particularly in light of the government's objectives for aviation tax?*

A1 CILT's consistent view over many years is that APD should be revised, as it has an adverse effect on regional economies and should be replaced by environmental measures. We are therefore supportive of the objectives relating to connectivity and environment. We also recognise that aviation should make a fair contribution to public finances.

Our view is that a reduction in domestic APD would have a positive effect on Union and regional connectivity in particular by improving the viability of thinner routes. As an environmental measure, a reduction in domestic APD would better reflect the shorter distances and therefore lower carbon emissions compared with short haul international routes. In terms of revenue raising, domestic APD is a very small proportion of the total APD take and can be easily compensated by increases in international APD rates.

For these reasons, CILT supports the proposal to reduce domestic APD.

Q2 *What evidence can you provide about the impact of an effective reduction in the domestic rate of APD on Union and regional connectivity?*

A2 CIT's evidence to the Union Connectivity Review showed that the corridors of strategic importance should include air routes between Scotland and England, and between Northern Ireland and England, Scotland and Wales. Air is vital on these routes where distances or water crossings make alternatives less attractive.

Q3 How would a reduction in the effective rate of domestic APD affect airlines? Will the benefits be passed onto consumers in ticket prices or retained by airlines?

A3 The primary benefit of a reduction in domestic APD would be to make routes viable. Fares are market-based and, with current rates of APD, these are not high enough to cover costs of many routes. In particular, this would apply to thinner routes where costs per passenger are inevitably higher. The implication of this is that fares would not go down. The market fare would remain but airlines would not pass the APD amount to the Treasury, making thin routes viable.

Q4 Which domestic air routes, if any, are likely to be introduced/restart following any effective reduction in the domestic rate of APD, and what wider benefits would these routes provide?

A4 As noted in A3, thinner routes not currently viable could be introduced. This means routes between smaller cities (eg. Aberdeen-Southampton, Newcastle-Exeter, Belfast-Cardiff) as well as routes between smaller cities and London or Manchester for long haul connections (eg. Norwich-Manchester). The wider benefits from such improved connectivity include increased investment and employment opportunities in these regions.

Q5 Which existing domestic air routes, if any, would benefit from an increased number of services following any effective reduction in the domestic rate of APD, and what wider benefits would these routes provide?

A5 Some domestic routes operate at a low frequency, sometimes once a day which, if increased to twice or three times a day would permit either day returns or better connections with international flights. Examples include Leeds Bradford-Exeter and Birmingham-Aberdeen. As with new connections, the wider benefits from such improved connectivity include increased investment and employment opportunities in these regions.

Q6 By how much would you estimate that the number of passengers currently flying domestically increase?

A6 Given that fares would probably not reduce significantly (see A3) the increase in domestic passengers would primarily be on thin routes which become viable and therefore the total increase would be small, probably less than the decline over the last 15 years.

Q7 What could the environmental impact of reducing the effective domestic rate of APD be? How could any negative impacts be mitigated?

A7 Given only a small increase in the total number of domestic flights, the environmental impact would not be significant. In particular, small aircraft operating from the smaller airports have limited local impacts. In mitigation, there are real opportunities to trial zero carbon technologies (eg. electric or hydrogen aircraft) on some routes. It would entirely fit with the environmental objective and would send a very strong message to airlines if zero aviation aircraft (such as electric or hydrogen-powered) were exempted from APD. One possible trial area is the Scottish Highlands & Islands, which are already exempt from APD, but a UK-wide exemption would encourage a range of routes to be trialled.

Q8 What could the impact of reducing the effective domestic rate of APD be on other modes of transport (e.g. road/rail)?

A8 As noted at A7 above, there would be only a small increase in total domestic air passengers and therefore any mode shift from rail to air would be minimal. Rail competes favourably on journey time and frequency between many mainland cities and will become even more competitive as HS2 is commissioned such that the overall mode shift trend will continue to be from air to rail. With better domestic air connectivity, passengers who currently have to travel long road distances to Heathrow (where long-distance rail links are currently limited) for international long haul connections would be able to connect from their local airport.

Q9 If the effective rate of domestic APD is reduced, would you favour the introduction of a return leg exemption or a new domestic rate? What would you see as the comparative risks and benefits of these options?

A9 We support a new domestic rate set at one half of the short haul rate. We do not support a return leg exemption. A return leg exemption would be difficult to administer and would reduce flexibility such as using air one way and rail to return.

Q10 Is there an alternative approach to reducing the effective rate of APD on domestic flights, that you think would be more appropriate than either of the options identified?

A10 We have considered a number of options to try and meet the environmental and connectivity objectives better. For example, it would be possible to set the rate by route, such that 'trunk' routes which already provide good connectivity pay a higher rate, or specified thin routes pay no APD (as with the existing Scottish Highlands & Islands routes). Another option would be for a reduced rate where rail journey times are long or for water crossings. However, in our view all of these are complicated which will inevitably lead to comparisons between routes and will also require constant checking to ensure that the objectives are being met. In our view, a simple, single rate is appropriate for all UK domestic departures.

A return leg exemption

Q11 What are your views on the way a return leg exemption could operate as set out in paragraph 2.8? What are the benefits and risks of this proposal? What amendments would you suggest, if any?

A11 CILT agrees with the view that there would be significant administrative complexities with a return leg exemption and does not support this and has therefore not responded to Q12-Q15.

Q12 Do airlines currently differentiate between single and return tickets in their booking systems and, if so, how?

Q13 What evidence could airlines provide to HMRC to demonstrate that a passenger was travelling on a return ticket?

Q14 If the return leg exemption were to be introduced, how quickly could airlines integrate it within their operating systems to allow them to them to provide evidence to HMRC on their APD liabilities?

Q15 Are there any particular considerations around the application of a return leg exemption to business jets, in light of how business jets are operated?

A new band for domestic flights

Q16 Do you agree with the government's initial position that a new domestic band would be the most appropriate approach to reducing the rate of APD on domestic flights?

A16 CILT supports a new domestic band for APD. We propose that the rate should be one half of the first international rate band which approximately reflects the relative carbon emissions.

Q17 What are your views on the way a new domestic rate could operate as set out in paragraph 2.11? What are the benefits and risks of this proposal? What amendments would you suggest, if any?

A17 CILT supports the proposals as set out in paragraph 2.11 of the consultation document. The devolved administrations could continue to adopt different rates if they wished, such as the exemption for Scottish Highlands & Islands routes. We also suggest an exemption for electric or hydrogen powered aircraft as an incentive for a trial.

Q18 If a new domestic rate were to be introduced, how quickly could airlines integrate it within their operating systems to allow them to them to provide evidence to HMRC on their APD liabilities?

A18 If the simple change proposed in A16 is adopted, airlines could adopt this very quickly.

International distance bands

Q19 Do you agree with the government's initial policy position that the number of APD distance bands should be increased? In your view, what would be the positive and negative effects of such a change, particularly in light of the government's objectives for aviation tax?

A19 CILT supports an increase in the number of APD distance bands. The rates for each band should reflect the environmental objectives, primarily greenhouse gas emissions. These are partly related to distance, but there are countervailing factors relating to short and long-haul flights. Short haul flights have higher density seating layouts, while long-haul flights are by larger aircraft. The APD rates for each band should be based on an average emissions per passenger for the routes within each band, which will then take account of the types of aircraft used and seating densities.

While direct comparisons are difficult, it is clear that current rates of UK APD are among the highest in the world and this should be borne in mind when making comparisons with other countries' support for aviation and also their plans for decarbonaisation. Currently, APD generates around £3.6 billion a year and aviation's contribution to UK carbon emissions is around 38 $MtCO_2$. APD is therefore raising revenue at just under £100/tonne. A long-term ambition should be a reduction in carbon emissions to net zero, reflecting the Government's 2050 target. Two key parts of this strategy are the decarbonisation of aviation and participation in the CORSIA arrangements. As carbon emissions are either reduced or offset, the weight attached to the environmental objective of aviation tax should decline over time. Nevertheless, our short-term assumption is that the total tax take from APD should remain at the current level in real terms. This means that international rates should increase to compensate for the reduction in domestic rates.

Q20 What could the impact on the environment [be] of a change to the banding structure? How could any negative environmental impacts be mitigated?

A20 Carbon emissions are approximately related to distance flown, so an increase in the number of bands will better reflect the environmental effects. There are unlikely to be any adverse environmental impacts of an increase in the number of bands.

Q21 What evidence can you provide about the impact of an increase in the number of APD distance bands on international connectivity?

A21 Unless the new international rates are dramatically different from the current rates, there are unlikely to be any major changes in connectivity from airlines either starting or ending routes. In any event, assuming that the total tax take does not change, any increases in connectivity are likely to be balanced by decreases elsewhere.

Q22 Which of the policy options for increasing the number of international distance bands do you think is most appropriate? Please explain your answer.

A22 The primary objective of international APD should be to reflect environmental impacts. Most of these impacts are related to distance, but local impacts are also related to the take off and landing phase. Larger aircraft generally used on longer haul routes are also more efficient per passenger simply because of their size.

We recognise that international relations are a key element in aviation bilateral negotiations and therefore care must be taken when creating bands to ensure fairness. We agree that the first international band should remain as 0-2000 miles. This band encompasses Europe and some of North Africa and, with its special treatment, western Russia.

However, we do not support either of the options in the consultation for three or four international bands, although we prefer the principle of three bands rather than four. See A23.

Q23 Is there an alternative banding structure that could better meet the government's objectives as outlined in paragraph 1.1?

A23 We have considered a number of taxes imposed by various countries. Although almost all of these are lower than UK APD, there are varying structures. Ireland's Air Travel Tax, although abolished in 2014, was based on airport-airport distances. France's 'Taxe de solidarité sur les billets d'avion' is based on travel within or outside the European Economic Area. Sweden has three international bands. In China, there are rates for domestic and international passengers and airlines are also required to pay a tax based on distance and aircraft size, although this is heavily discounted during the recovery from Covid-19.

We have also considered an option of measuring the distance of every route and applying a rate per mile. This would, of course, be very complex and, given that air routes do not always follow the great circle route, would not necessarily fully reflect the actual distance flown.

Option B in the consultation has a band of 2000-5500 miles which would include China and Brazil while the over 5500 mile band includes Mexico. There will always be inconsistencies such as this with the distance based on the capitals, but more logical bands would be 2000-5000

miles (to include North America, the Caribbean, the Middle East and India) and over 5000 miles (to include Mexico, Brazil and China).

Having suggested (A9 and A16) that the domestic rate should be one half of the first international band (0-2000 miles) we suggest that the rates for the second (2000-5000 miles) and third (over 5000 miles) international bands should be proportionate to the emissions per passenger in order to be aligned with the environmental objective. The exact rates can be adjusted to achieve the required overall tax take.

Q24 If a new international distance band structure were to be introduced, how quickly could airlines integrate it within their operating systems to allow them to them to provide evidence to HMRC on their APD liabilities?

A24 If the simple change proposed in A23 is adopted, airlines could adopt this very quickly. Of more significance would be the challenge of amending the price paid by passengers who have already purchased tickets, who would either need to pay more or get a refund. To be fair to passengers it would be appropriate to give six months notice of any change.

Frequent flyer levy

Q25 Do you agree with the government's assessment that APD should remain as the principal tax on the aviation sector? Would you propose any alternative tax measures which could further align the aviation tax framework with the government's environmental objectives?

A25 A frequent flyer tax would be contrary to the environmental objective by making some passengers pay more than their impacts and consequently others would not pay enough. It would unfairly penalise business passengers who are the most frequent flyers thus adversely affecting business connectivity and therefore the UK economy. It should be noted that frequent flyer programmes are not particularly generous in terms of additional flights as rewards, and frequent travellers are more likely to value the other benefits such as lounge access and fast tracking. As well as the complexity of administration noted in paragraph 4.16 of the consultation, it should be noted that the UK government would have to directly tax non UK nationals. This would be almost impossible to enforce and would lead to widespread avoidance, putting a burden back onto UK citizens.

For these reasons CILT does not support the alternative of a frequent flyer tax but does support the use of APD as the principle tax on the aviation sector. However, as noted in A1, as aviation moves towards net zero, the environmental objective is being achieved and therefore becomes less significant.

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