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## **Scottish replacement to Air Passenger Duty**

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Response from Aberdeen & Grampian Chamber of Commerce

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June 2016

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## Executive Summary

Aberdeen & Grampian Chamber of Commerce welcomes the opportunity to submit views in relation to the 50% reduction and eventual removal of Air Passenger Duty.

This is an important issue for the Chamber's 1,300 members. Research has shown that APD is damaging economic performance in Scotland and limiting tourism potential.

It is crucial that the Scottish Government uses its new powers over APD after campaigning for a number of years. Members support an immediate 50% reduction and an eventual complete removal of APD. They would, however, caution against bringing in any alternative form of taxation on air passengers. Such an approach would mean any economic benefit generated by the removal of APD would be negated by the new form of taxation.

Chamber members will welcome the Scottish Government's overall policy objectives in relation to air connectivity. However, the Chamber highlights concern that while the objective of APD changes are to "enhance Scotland's connections to new point-to-point destinations as well as enhancing services to key global hubs," the tone in the remainder of the consultation document appears to suggest that direct international connections will be prioritised.

Given the region's peripheral location and small resident population, access to key hubs at Heathrow and elsewhere in Europe are critical. Therefore the reduction and removal, "when resources allow," of APD must be used to ensure benefit to areas that have no viable surface transport alternatives to air travel.

The Chamber recommends that a new zero-rating APD band be introduced, which takes into account distance and travel time, which levies no APD on passengers in the Northern locations when accessing key UK airports used for international connections. This should be introduced because there is no viable alternative to air travel and would mean flights from Aberdeen to London or Inverness to Manchester would pay no APD. Such a mechanism would ensure passengers from these locations are not unfairly penalised for their geographical location on domestic flights but also ensure that the system remains fair between Scottish airports when passengers travel to Europe and further afield.

Given the longstanding campaign to devolve APD, the Chamber recommends that the intended 50% reduction is implemented immediately, i.e. as soon as possible upon conclusion of the consultation. This reduction should be in full and not by increments or bandings in order to maximise the economic potential of the APD reduction.

The Scottish Government must also clarify what they mean by "when resources allow." While the Chamber makes recommendations about what this term should mean, it is likely that Scottish Government departments will eventually only need to manage a simple cash flow issue with a different revenue stream (like tax from businesses and / or individuals) generating income where previously it was generated by APD.

## Context

Aberdeen & Grampian Chamber of Commerce is North-east Scotland's leading business membership organisation. The Chamber represents more than 1,300 businesses with around 130,000 employees across all sectors. Businesses in membership range from sole traders to multinational corporations.

The Chamber has consistently challenged both the UK and Scottish Governments in relation to Air Passenger Duty (APD). The current levels of Air Passenger Duty are punitive and is an additional cost to business due to the high proportion of travelers from the North-east flying for business purposes.

Research has shown that APD is limiting economic growth. Research conducted by York Aviation<sup>1</sup> in 2011 on behalf of Aberdeen, Edinburgh and Glasgow Airports found that levels of APD at that time was reducing demand, with a particular negative impact on domestic air services having the largest numeric decrease in provision.

Activity conducted by the Chamber as part of the Smith Commission found that Chamber members were broadly in support of the devolution of APD. Over 60% of AGCC members believed there should be full devolution of APD. This tax had the highest proportion of Chamber members in favour of full devolution, when compared to other taxes which could have potentially been devolved. The Chamber therefore welcomes the quick action to deliver the promised 50% reduction in APD. Having called for the power to change APD it is important the Scottish Government uses this new responsibility.

It should be noted, however, that the ability to connect Scotland to the rest of the UK and internationally relies on a range of factors. While research has shown that APD has resulted in Scotland failing to meet its tourism potential, the delivery and maintenance of key air links relies on other factors such as effective business development by Scottish airports, the Scottish Government promoting Scotland as a good place to visit, live and do business and the commercial considerations of airlines themselves. The reduction of APD would be a first-step in demonstrating the Scottish Government's commitment to improving **all** of Scotland's air connectivity, increasing opportunities for internationalisation and encouraging tourists to visit Scotland.

This consultation response seeks to offer credible suggestions about how APD should be reduced, and then abolished so that it supports economic growth whilst also meeting the Scottish Government's policy objectives. Not all of the consultation questions are answered, this is because some of the questions refer to technical operation of the tax, which will be a matter for the airlines to come to a view.

### **Strategic & Policy Objectives for Improving Scotland's Air Connectivity**

#### **Q1:**

**(a)** Do you agree with our strategic and policy objectives for improving Scotland's air connectivity?

Please answer yes or no.

**(b)** Please explain your answer to Q1(a).

**Q2:** How could a Scottish replacement to APD help achieve these objectives?

The Chamber supports the objective to "enhance Scotland's connections to new point-to-point destinations as well as enhancing services to key global hubs." This is a fair and balanced approach, which would support all airports in Scotland.

However, the Chamber is concerned that the rest of the consultation document appears to prioritise direct international connections to and from Scotland. This is a flawed approach and would be unfair to

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<sup>1</sup> [http://www.aberdeenairport.com/media/1072/apd\\_study-york\\_aviation.pdf](http://www.aberdeenairport.com/media/1072/apd_study-york_aviation.pdf)

airports who would be unable to deliver certain international routes due to a small resident market. Such an approach would not deliver the greatest economic growth possible.

In the case of Aberdeen Airport, an estimated 55% of passengers are travelling for business purposes.<sup>2</sup> This is compared to 27% at Glasgow Airport, 31% at Edinburgh Airport and 33% for Inverness Airport<sup>3</sup>. It is accepted that due to the region's relatively small catchment area only certain routes are commercially viable for airlines. Aberdeen International Airport has been very successful in delivering new routes over recent years, but nevertheless it is unlikely that sufficient market demand exists (in the airlines' views) to deliver point-to-point air links to markets like China, the Middle East and USA. Business travellers from the North-east of Scotland will therefore continue to rely on hubs in order to access foreign markets. Any reduction to APD must ensure these vital links to hub airports (and in particular Heathrow) are supported and encouraged. This would also be the case for other Scottish airports in northerly locations, such as Dundee and Inverness.

The Chamber also believes that the priority of the Scottish Government should be to use APD reductions to protect key UK air routes where no alternative transport options are viable. By definition that would also include key international links.

In addition, the Chamber recommends that another objective is added which reflects that all air links should also support economic development in Scotland. In particular, the additional objective should recognise the importance of air connectivity in driving business development, international trade and tourism growth.

With the Scottish Government stating that they will seek to abolish APD entirely when "public finances allow", the addition of an objective stating the influence air links has on the issues outlined above would help clarify what criteria the Scottish Government will take into consideration when taking a view on the final removal of APD. In this case we recommend that the Scottish Government take a view that "resources allow" when a business case demonstrates that the income generated via additional tourism spend and / or international trade activity, which would have not occurred while APD has been in place, matches the current income APD would have generated for Scotland. At that point the Scottish Government simply has a cash flow issue to manage and should not be a reason to continue levying APD.

The Scottish Government is striving to extend high speed rail to central Scotland to have a journey time between there and London of under three hours. This is perceived as the target to reach to maximise the change from air travel to surface travel. It should be recognised that this same time factor exists for passengers in the north of Scotland and that travel between the north and most parts of England is more than this three hour threshold. Therefore the further north you are the more important UK domestic air travel will be. This should be recognised within the Scottish Government's strategy.

As previously outlined, APD is one factor in a range of issues which is limiting Scotland's ability to attract tourism visitors and constraining business activity. However, a reduction in APD would be a very welcome first step in demonstrating the Scottish Government's commitment to giving Scotland a competitive edge. The Chamber would make the point, however, that this is not the only issue which needs to be addressed in order to improve Scotland's connectivity to other UK and international airports.

## **Scope & Structure of a Replacement to APD**

### **Q3:**

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<sup>2</sup>[http://www.nestrans.org.uk/db\\_docs/20120531\\_Air\\_Links\\_to\\_London\\_from\\_the\\_North\\_of\\_Scotland\\_Final\\_Report\\_1.pdf](http://www.nestrans.org.uk/db_docs/20120531_Air_Links_to_London_from_the_North_of_Scotland_Final_Report_1.pdf)

<sup>3</sup> [http://www.transport.gov.scot/statistics/j357783-11.htm#tb8\\_14](http://www.transport.gov.scot/statistics/j357783-11.htm#tb8_14)

**(a)** Taking into account the scope of the powers proposed to be devolved to the Scottish Parliament, should the UK APD definitions of “chargeable passenger” and “chargeable aircraft” be retained under a Scottish replacement tax? Please answer yes or no.

**(b)** If you answered no to Q3(a), please explain your answer.

**Q4:**

**(a)** Do you think that the current UK APD per-passenger charging model should be retained under a Scottish replacement tax? Please answer yes or no.

**(b)** If you answered no to Q4(a), please explain your answer. Subject to compliance with State Aid rules and current aviation agreements, what alternative charging model(s) should be considered?

The questions relating to scope and structure of APD and bandings, within the context of a Scottish replacement tax, appears contradictory. The Scottish Government has stated its overall approach is to “abolish APD,” but by introducing an alternative tax the government is taxing the industry just via a different method. An alternative method, whatever that may be, does not address the fundamental issue: that the taxation of air passengers is preventing economic growth and discouraging tourist visitors.

The sentiment within the consultation document, however, appears to suggest that the Scottish Government appears to see this as an opportunity to introduce a new tax and raise revenues from air travel, rather than to encourage economic growth. This would be wrong. Chamber members believe that APD should be removed completely, with no “alternative” introduced.

Previous research has already demonstrated that the abolition of APD would generate 61,000 jobs and raise more than a net £0.5 billion in extra tax receipts<sup>4</sup>. In the event of full abolition of APD, revenues from APD would be lost but income would be generated via additional taxes paid by businesses and individuals. This is therefore a cash flow issue within the Scottish Government. As such, the Chamber takes the view in the remaining questions of this consultation that APD should be reduced and eventually abolished, with no alternative method of taxation introduced.

Therefore, further comments submitted to this consultation should be viewed within the context of reducing APD to 50% and then its full removal. The Chamber does not make any recommendations about any form of replacement.

Within the context of the 50% reduction of APD, the Chamber suggests the UK APD definitions of “chargeable passenger” and “chargeable aircraft” be retained. The Chamber also considers that the per-passenger-model also be retained. It is a system which is understood by both the travel industry and passengers.

## **Tax Bands**

**Q5:**

**(a)** Do you think that the current UK APD destination based banding system should be retained under a Scottish replacement tax? Please answer yes or no.

**(b):** • If you answered yes to Q5(a), should destination bands be defined by distance to capital cities or what alternative measures could be considered? What would be the optimum number and definition of bands to support the achievement of the Scottish Government’s strategic objectives for a Scottish replacement tax, as outlined in Chapter 2?

• If you answered no to Q5(a), please explain your answer. What system do you think should be used instead?

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<sup>4</sup> <http://www.bata.uk.com/wp-content/uploads/2015/06/The-economic-impact-of-APD-analytical-update-PwC-May-2015.pdf>

The current overall system of banding is transparent and well-understood by the travel industry. The Chamber would, however, request that changes are made to the bandings in order to support airports in the north of Scotland.

An important consideration not reflected in the consultation document is the importance of supporting and encouraging rail services where viable. The Chamber takes the view that for some Scottish airport catchments, alternative modes of transport are viable for people travelling to London and other parts of the UK. For travellers from the Aberdeen International Airport catchment, these alternative transport modes are unviable, given the journey times.

Therefore, the Chamber suggests that a focus is made on creating a zero-level APD banding which takes into consideration both distance and journey time. In this case, air journeys to other UK airports which by surface-based methods would take more than 4 hours **and** are a distance of more than 350 miles would pay no APD. This would mean passengers from airports north of Dundee would not pay APD when taking a flight to key airports elsewhere in the UK. As previously outlined, there is no viable alternative to air travel for these passengers when accessing locations south of Newcastle, and these people should not be penalised for their geographical location.

All other flights between a Scottish airport and airports within Europe (including the UK) should fall within a second banding. Finally, a third banding for flights to the rest of the world should apply.

The chart below outlines whether certain routes would or would not be liable for APD going forward:

Start	End	Approx distance	Approx surface journey time	Will this journey pay APD?	Explanation
Aberdeen	Wick	96	>5 hours	Exempt	No change to current exemptions
Aberdeen	Glasgow	121	2 hours 40 mins	Yes	Journey time below threshold
Aberdeen	Manchester	354	6 hours	No	Journey time over threshold
Glasgow	Manchester	183	3 hours 20 mins	Yes	Journey time under threshold
Aberdeen	Birmingham	433	7 hours	No	Journey time over threshold
Glasgow	Birmingham	252	4 hours	Yes	Journey time under threshold
Aberdeen	London	545	7 ½ hours	No	Journey time over threshold
Glasgow	London	345	4 hrs 40 mins	Yes	Journey time under threshold
Aberdeen	Amsterdam	859	> day	Yes	Journey outside of UK
Glasgow	Amsterdam	727	> day	Yes	Journey outside of UK

Aberdeen	Paris	815	> day	Yes	Journey outside of UK
Glasgow	Paris	681	> day	Yes	Journey outside of UK
Aberdeen	Dubai	3563	days	Yes	Long haul
Glasgow	Dubai	3625	days	Yes	Long haul

The implementation of such measures would support maintained connectivity for these “remote” regions to the airports in London, whilst also ensuring all Scottish airports are treated fairly when it comes to air links to Europe and further afield.

### Tax Rates

#### Q6:

**(a)** Do you think that the reduced, standard and higher rates system used for UK APD should be retained under a Scottish replacement tax? Please answer yes or no.

**(b):** • If you answered yes to Q6(a), do the UK definitions remain appropriate for practices in the aviation industry in Scotland?

• If you answered no to Q6(a), please explain your answer. What system do you think should be used instead?

**Q7:** Can you provide any evidence on the impact of the introduction of the higher rate which came into effect from 1 April 2013?

As outlined above, the Chamber strongly recommends the introduction of a zero APD rate for passengers flying from the northern parts of Scotland to UK locations. This could therefore be described as the “reduced” rate. All other passenger flying on a standard, “economy and economy plus” type ticket should then be charged the standard rate of APD, with those in first-class eligible for the higher rate.

### REDUCING THE TAX BURDEN

**Q8:** Do you have any views on how and when the planned 50% reduction in the burden of APD should be implemented?

The stated reduction of 50% to APD should be implemented immediately i.e. as soon as possible upon conclusion of this consultation process. This action should also be taken in conjunction with the recommendations above, in relation to the new zero rate banding proposals. The reduction and suggested changes should be implemented in one go rather than by increments so it is simple for airlines for implement.

The Chamber would also take the view that the Scottish Government should clarify when they announce the reduction, what they will define as “when resources allow” when they consider the full removal of APD.

### PASSENGER EXEMPTIONS

#### Q9:

**(a)** Do you think that the current UK APD passenger exemptions should be retained under a Scottish replacement tax? Please answer yes or no.

**(b):** • If you answered yes to Q9(a), to what extent are the existing definitions appropriate for the Scottish industry?

• If you answered no to Q9(a), please explain your answer. Is there any evidence to support the introduction of any additional or alternative exemptions?

Chamber members agree that current exemptions should continue.

After successfully lobbying the UK government for helicopters to be exempt from APD, the Chamber seeks assurances that this approach will continue. Helicopter travel is essential in order to access remote oil and gas rigs. Given the importance of the oil and gas sector to the North-east economy, the current low oil price and requirement for the industry to safely reduce its cost-base, the Scottish Government must not implement any unnecessary further charges on the industry.

### **Connected Flights & Avoiding Double Taxation**

#### **Q13:**

- **(a)** Do you think that the current UK APD rules relating to connected flights should form a baseline position for a Scottish replacement tax? Please answer yes or no.
- **(b)** If you answered no to Q13(a), please explain your answer. What rules do you think should be considered instead?

**Q14:** What situations do you think could result in double taxation after a Scottish replacement to APD is introduced, and how might double taxation in such situations be avoided?

The nature of air travel has changed, and with the growth of the low-cost airlines point-to-point ticketing has increased. When passengers travel to a UK airport and then onwards to an international destination on a non-codeshare airline they are liable for two payments of APD. This is an issue which must be resolved as it unfairly penalises air passengers travelling on a multi-ticket option. Often these passengers will originate from the northern areas of Scotland and it is therefore an unfair tax based on a passenger's geographical location.

Based on the feedback the Chamber has received from members, the best approach may be for the Scottish Government to come to an agreement with the UK Government about instances where payment of APD from a flight originating in Scotland is accepted as full payment of the UK APD.