



Appendix 1

Response To: Air Departure Tax – Consultations on an overall 50% reduction policy plan and an Environmental Report

Based on the text of the document published in June 2017 pertaining to the Scottish Government's consultations on the Air Departure Tax (ADT) and specifically Consultation 1 (overall 50% ADT reduction) and Consultation 2 (assessment of the environmental impacts from the overall 50% ADT reduction), the International Air Transport Association (IATA) presents below its responses and comments.

Consultation 1

Q1: Do you support the Scottish Government's policy plan to reduce the overall burden of ADT by 50% by the end of the current session of the Scottish Parliament? Please answer 'Yes' or 'No'.

Yes, IATA supports the plan to reduce the ADT by 50%.

Implementing the full rate reduction in the Scottish ADT as soon as possible would enhance the realization of the economic and social benefits associated with greater air connectivity with Scotland.

Q2: Please explain your answer to question 1

As noted in the current *Air Departure Tax – Consultations on an overall 50% reduction policy plan and an Environmental Report*, internationalisation is one of the four priority areas that supports the Scottish Government's plans to grow and develop the economy.

Air passenger demand is very sensitive to ticket pricing. According to our analysis, a 10% decrease in price can increase demand by as much as 15%. A 50% reduction in the Scottish ADT rates would undoubtedly boost economic output, employment, and investment, as a reduction in the overall tax burden would improve Scotland's air connectivity with the rest of Europe and the world.

As detailed in our previous submission to the *Consultation on Scottish Replacement to the Air Passenger Duty (APD)* dated 30 May 2016, air connectivity is a key element for the competitive position of countries in Europe, including Scotland, and its regions and cities. Enhanced air connectivity has numerous consumer and welfare benefits. The consumer benefits from improved aviation connectivity (e.g. increases in flight frequencies, the number of non-stop destinations) leads to shorter travel times, increased competition and lower fares. This, in turn, results in lower travel costs for consumers, individuals and businesses alike, and translates into direct consumer welfare gains.

Greater connectivity also provides for wider economic benefits in a number of different areas, including a larger and enhanced customer base for Scottish businesses, enhanced productivity resulting from efficiency gains from greater competition, increased access to Foreign Direct Investment (FDI) and the promotion of innovation through better collaboration between companies and



researchers in different parts of the world. Empirical support for the benefits associated with enhanced connectivity includes the following:

- Productivity - According to InterVISTAS (2015) a 10 percent growth in connectivity by air is associated with a 0.5 percent growth in GDP/capita at the national level in Europe. IATA (2007) finds that a 10 percent growth in connectivity, relative to GDP, can increase long-term productivity in terms of GDP per hour worked by 0.07 percent.¹
- FDI - In the UK, a 10 percent increase in seat capacity is associated with a 1.9 percent increase in FDI outflows and 4.7 percent FDI inflows (PwC 2014).²
- Trade - In the UK, a 10 percent increase in seat capacity is associated with a 1.7 percent increase in UK goods imports and a 3.3 percent in goods exports (PwC 2014).³

Moreover, an analytical update to *The economic impact of Air Passenger Duty* (PwC, May 2015) concluded that the full abolition of the UK APD would result in an increase to GDP of 0.5% in the first year, lead to the creation of approximately 61,000 jobs by 2020, and generate additional net government tax receipts of £0.5 billion in the first two years following abolition.⁴

Consequently, greater air connectivity has significant economic benefits, including enhanced productivity and additional trade, all of which is enabled by a reduction in the overall tax burden faced by passengers.

Q3: If you answered 'Yes' to question 1, please provide any suggestions you may have on the most effective way, in your view, in which a 50% reduction in the overall ADT burden should be applied across tax bands and tax rate amounts in order to achieve the Scottish Government's overall connectivity and sustainable growth objectives.

Per the provision of the *Air Departure Tax (Scotland) Bill*, Part 3, Section 9 (Tax structure), the applicable tax rate under the ADT will be determined by a chargeable passenger's final destination and class of travel. As such, the structure of the tax rates under the Scottish ADT appear broadly comparable to the current structure of the UK APD.

Based on an analysis conducted by IATA of the effective tax burden of the current UK APD for departures from Scotland and considering both the destination bands (i.e., band A, band B destinations) and rates applicable for class of travel (i.e., reduced rate, standard rate), the burden of the current UK APD is greatest for reduced rate passengers under both band destinations, with

¹ Source: *Economic benefits of reducing aviation taxes in Latin America and the Caribbean*. SEO Amsterdam Economics. 2016.

² Source: *Ibid*

³ Source: *Ibid*

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



the single highest incidence of the tax falling on reduced rate band B passengers (effective tax burden of 25.9%).

Please refer to Table 1 below for the effective burden of the UK APD in Scotland under the respective destination band and class of travel categories.

Table 1⁵

**Effective Burden of the UK APD in Scotland
Percent of Underlying Airfare (incl. passenger taxes and charges)**

Destination Band	Reduced Rate (Lowest Class of Travel)	Standard Rate (All Other Class of Travel)
Band A	12.1%	7.6%
Band B	25.9%	11.1%

Given that the burden of the UK APD is disproportionately higher on reduced rate passengers (lowest fare economy passengers) relative to standard rate passengers (business and first class passengers), particular consideration should be afforded to reducing the effective tax rate on passengers travelling in lower classes. This would ensure greater equality in terms of the amount of the ADT paid by passengers as a percentage of the total amount paid (i.e., to airlines, airport authorities and the tax administration) for air travel.

In order to achieve a more balanced distribution of the tax incidence, a greater amount of the overall reduction in ADT rates (i.e., in excess of a 50% reduction) could apply to reduced rate passengers. One potential suggestion, in addition to a reduction in the tax rate, would be to include premium economy class travel in the definition of lowest fare for ADT rate banding purposes.

In general, passengers traveling in economy class are more price elastic (i.e., more sensitive to changes in the cost of airfare) than those traveling in premium classes (i.e., business class, first class). As such, a reduction in the cost of economy class air travel would have a bigger impact on demand, which, in turn, would increase travel, tourism and air connectivity to a greater extent.

In the event a higher reduction in the rate of ADT that applies to lowest fare/economy class travel cannot be implemented, then a simple 50% reduction in the ADT burden across all bands and rate amounts should be applied.

⁵ Note: Effective tax burden analysis based on UK APD rates effective from 1 April 2017 and calculated as the respective APD band and class rates divided by average 12-month airfares for the period ending May 2017 for departures from ABZ, EDI and GLA taken from IATA's PaxIS database and inclusive of the applicable APD and Passenger Service Charge rates. Monetary figures denominated in USD and converted from GBP (where applicable) using six-month average exchange rates from www.oanda.com.



Q4: Please provide any other comments you have on the policy plan.

Need for Clear Transitional Measures

As the UK APD will cease in Scotland from 1 April 2018, and further to our previous submissions, it is of vital importance that the Scottish and UK Governments develop effective and fair transitional rules that provide clear and specific guidance to taxpayers as to the remittance of APD based on the date of passenger travel and collected in advance of the implementation of the ADT.

This is due to the fact that tickets for air travel can be sold up to 12 months in advance of travel and, in certain cases (e.g. charter flights), this can be as much as 18 months in advance. The APD is currently levied and collected at the time of ticket issuance, which in many instances will predate the implementation of the ADT.

However, similar to the proposed ADT, the APD is not due for remittance until the commencement of passenger travel. As such, this potentially creates an issue, based on when the passenger travels, as to which revenue authority the tax should be remitted to. Consequently, guidance from the authorities is necessary in order to avoid unnecessary costs, issues around taxpayer compliance and potential double taxation.

Need for Administrative Simplicity

The Scottish ADT should ensure the relative administrative simplicity associated with the current UK APD from a taxpayer perspective is maintained and that it be aligned with the APD in terms of its design, application and administration to avoid unnecessary and costly duplication.

One particular issue is the ADT treatment associated with class of service upgrades paid for by taxable passengers during the flight and where the upgrade occurs outside of Scotland. For example, if a passenger pays for and is issued a ticket for economy class travel for the route Edinburgh (EDI) – London Heathrow (LHR) –Singapore (SIN) and subsequently pays for an upgrade to business class only on the LHR-SIN segment, the taxpayer (airline) should not be liable for payment of any premium rate of ADT for business class travel. In such situations, the application of the ADT should be commensurate with the ticket as originally issued, otherwise this would present a significant administrative burden to taxpayers in accurately accounting for the tax, as well as be an extrajudicial imposition of the ADT.

As such, the Scottish Government/Revenue Scotland should actively look to clarify the application of the ADT by means of written guidance/interpretation in order to avoid ambiguity as to the application of the tax and the associated compliance challenges that may result for all parties.



Consultation 2

Q1: What are your views on the evidence set out in the Environmental Report that has been used to inform the assessment process?

No comments.

Q2: What are your views on the predicted environmental effects as set out in the Environmental Report?

With the reduction in the ADT rates, it is likely that an increase in demand for air travel will, at least partially, be accommodated through existing supply rather than through an increase. In other words, the forecasted increase in passengers will partially be accommodated through existing flights, i.e. without an increase in the number of flights but through more passengers being carried on existing flights (higher load factors). According to statistical data collected by IATA, average passenger load factors are around 80% (IATA, 2016 World Air Transport Statistics) and as such, a portion of the increase in demand can be accommodated through existing capacity.

Therefore, we believe that drawing a linear relationship between the increase in passengers and the increases in CO₂ emissions and other environmental impacts is subject to important uncertainties and likely to result in an overestimation of the environmental impacts. A more accurate modelling of the impacts of the increase in traffic resulting from a reduction in ADT should take into account the sector-specific responses to increased demand for air travel.

We also believe the modelling of CO₂ emissions overestimates increases in emissions as it assumes that fuel efficiency would only improve by 0.8% per annum. The 0.8% per annum improvement however only takes into account technological improvements and does not factor in operational improvements. A more realistic annual fuel efficiency improvement would be 1.5%, which would also be closer to the annual average improvement rate of 1.67% measured by the industry (IATA, 2016 World Air Transport Statistics).

Furthermore, it is important to take into consideration that increases in net CO₂ emissions from international aviation will be capped at 2020 levels as a result of the implementation of CORSIA from 2021. According to 2015 data published by Transport Scotland,⁶ over 99% of passenger traffic between Scotland and destinations outside of the UK will be on routes covered by CORSIA.⁷ Therefore, the assessment should take into account that net CO₂ emissions from international flights to/from Scotland will not increase beyond 2020 levels, irrespective of the reduction in ADT. Regarding emissions in 2018-2020, it is also important to note that the EU Emissions Trading System will continue to apply to flights within the European Economic Area (EEA). Intra-EEA flights represent

⁶ <https://www.transport.gov.scot/publication/scottish-transport-statistics-no-35-2016-edition/sct01171871341-11/>, consulted on 4 September 2017.

⁷ More information on flights subject to CORSIA: <http://www.icao.int/environmental-protection/Pages/market-based-measures.aspx>



over 81% of international flights to/from Scotland and 100% of domestic UK flights.⁸

Q3: Are there any other environmental effects that have not been considered?

No comments.

Q4: Do you agree with the conclusions and recommendations set out in the Environmental Report?

We agree with the conclusion that a reduction in ADT is likely to lead to some increases in the impacts of air transport on GHG emissions, noise and local air quality as a result of the additional growth in air traffic that will result from a reduction in ADT. However, we believe the report may quantitatively overestimate the environmental impacts and in particular the increase in CO₂ emissions. Most importantly, the capping of net CO₂ emissions from international flights at 2020 levels needs to be taken into consideration.

We also reiterate the view that impacts from modal shifts need to be taken into consideration. For example, if passengers switch from northern English airports to Scottish airports, this may increase CO₂ emissions, but this increase may be offset by a decrease in emissions at other airports. Similarly, some travellers may travel shorter distances by road in order to reach an airport, which would reduce the emissions and noise from, and need for infrastructure for, land transport. Also, when the noise impact of an increase in air traffic is assessed, the potential changes in the noise impact of rail or road transport should also be evaluated or at least recognized. The considerations related to the environmental impact of infrastructure for air transport should also be balanced against similar environmental impacts of infrastructure for land transport.

Q5: Please provide any other comments you have on the Environmental Report.

No additional comments.

⁸ <https://www.transport.gov.scot/publication/scottish-transport-statistics-no-35-2016-edition/sct01171871341-11/>, consulted on 4 September 2017.