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## **HM TREASURY CONSULTATION ON AVIATION DUTY**

The Scottish Council for Development and Industry (SCDI) is an independent membership network that strengthens Scotland's competitiveness by formulating policies to encourage sustainable economic prosperity. Its members are drawn from businesses, local authorities, trades unions, educational institutions and the voluntary sector across Scotland.

SCDI understands that HM Treasury is currently considering responses to the consultation on Aviation Duty and that an announcement may be made over the summer. SCDI members, particularly in the Highlands and Islands, have been expressing growing concern about the potential impact of some of the proposals on the economy. SCDI therefore trusts that the following comments will be considered prior to the replacement for air passenger duty.

Scotland has a small, open economy, and internal and international connectivity are particularly important to the priority of higher sustainable economic growth. The Highlands and Islands are unique within the UK in their geographical area and features, and scarcity of population, and economic and connectivity challenges. Air connectivity is critical in combating perceptions of peripherality, promoting tourism and inward investment, and linking communities. This has been recognised by government in the imposition of Public Service Obligations (PSOs) for services which cannot be justified commercially but which provide lifeline routes. Without public subsidy, the cost of flights would be prohibitive. Since the introduction of the Air Discount Scheme in 2006 there has been a welcome increase in passenger numbers, reflecting a level of suppressed demand, but there is a danger that this good progress could be undermined.

The doubling of fuel costs and general economic downturn are putting strain on the entire aviation industry. The major operator of routes within the

Highlands and Islands, Loganair, has in the last month announced that it will cut back on some services. Individual flights with low occupation rates will be cancelled. Passengers will be re-accommodated on another flight on the same day, but the changes will have some impact on business and visitors numbers during what is shaping up to be a sluggish peak season.

Thus it is essential that HM Treasury's final policy achieves the right balance between the economy and the environment. In SCDI's view, it should:

- Recognise particular regional economic competitiveness challenges;
- Be sensitive to the changing circumstances facing the aviation industry since the consultation document was published;
- Pave the way for a better, transnational form of aviation taxation.

SCDI supports the inclusion of the aviation sector within the EU Emissions Trading Scheme in 2012. This will closely align aviation pricing with its carbon footprint, eliminating stealth taxation, and ensure that Members States which reflect environmental impact in their aviation taxation are not undercut by other Members States seeking to attract more transit/transfer passengers. With the inclusion of aviation within the scheme, other forms of aviation taxation should be immediately withdrawn by the UK Government.

### **Executive Summary**

1. A new Aviation Duty which better reflects the environmental impact of flights and with appropriate exemptions is supported.
2. HM's Treasury's proposal to use Maximum Take-Off Weight as the basis of charging is environmentally flawed. A duty which closely reflects carbon emissions per aircraft type is preferred.
3. The proposal for three distance bands to calculate the level of aviation duty would disproportionately affect UK regional routes. A lower, fourth band should be introduced for these services.
4. The Highlands and Islands' air services continue to warrant an exemption from aviation duty which should apply to all services departing from or arriving at an airport within the region.
5. Similar exemptions or rebate should apply to air services which become liable for fuel duty, including PSO routes and commercial seaplane and other charter services, and to air freight services.
6. It would be economically unjust for Scottish passengers interlining via London Airports to pay their share of double the aviation duty of passengers travelling directly to or from London.

## **Responses to the Questions**

SCDI's response focuses on what it believes are the key questions for the Scottish economy. It has not attempted to answer the more technical questions where it believes other organisations are better placed to comment.

### **1. The Basis of the Duty**

SCDI supports a new Aviation Duty which better reflects the environmental impact, principally climate change causing emissions, of flights. The Government's preferred option for using Maximum Take-Off Weight (MTOW) does not pass this test. MTOW is not an accurate measure of comparative fuel efficiency or carbon emissions. Aircraft with the same weights may emit substantially different amounts of CO<sub>2</sub>. In consequence, MTOW does not provide an incentive to invest in more environmentally-friendly aircraft. SCDI believes that HM Treasury should rather seek to design a duty which closely reflects carbon emissions per aircraft type.

SCDI agrees that flight distance should be one of the factors taken into account in calculating the level of duty. However, it believes that the current proposal would disproportionately affect shorter UK regional routes, particularly internal Scottish services which are not covered by the current exemption. These include economically and socially critical routes between peripheral areas of the Highlands and Islands and Scotland's major cities. It should be recognised that the size of the operators on these routes will mean that they need longer to invest in aircraft which better reflect passenger demand. The lowest payment band at present is for all intra-EU flights which is inadequate given the much greater environmental impact caused by flights to southern Europe than lifeline services within the UK. SCDI supports the suggestion that there should be a fourth band for domestic UK flights, which would better reflect the distances travelled and their environmental impact.

A wide range of international flights to key global economic centres from the UK's hub airport, Heathrow, will remain important to the Scottish economy. The Government must avoid introducing a duty on long-haul flights which makes UK airports uncompetitive and results in airlines opting to fly instead to, or touch down via, European hub airports where charges are lower. This would have no environmental benefit, damage the UK economy, increase journey times and reduce interlining opportunities for many Scottish businesses. While the Inverness-Heathrow flight has been terminated, because Inverness has no direct link to an alternative hub airport in Europe, Heathrow is still used by many Highland businesses for global destinations.

## **2. General and Business Aviation/ Fuel Duty**

Decisions on whether or not to charge air or fuel duty on flights should take into account not just the type of aircraft, but the nature of the route it serves. HM Treasury's proposal is for all flights in aircraft below 5.7 tonnes MTOW to be liable to pay fuel duty which would include a number of lifeline services in the Highlands and Islands, including those provided through PSOs. It would also incorporate the commercial seaplane services which are being trialled to serve island and remote communities without runways and competitive land based transport options. Such flights would transform their economy and quality of life, with very little environmental significance. Highlands and Islands Enterprise has proposed that an exemption or a rebate from fuel duty be offered to all air services using aircraft below 5.7 tonnes MTOW to or from destinations in the region. SCDI supports this proposal.

Most of the UK heavy helicopter fleet is directly involved in the economically vital offshore oil and gas industry. The proposal to levy fuel duty from 2009 and include helicopters in the Emissions Trading Scheme from 2012 will add significantly to operating costs and further reduce the competitiveness of the UK Continental Shelf. This may lead some helicopter operators to relocate their fleet to the other side of the North Sea which would damage the North East Scotland economy and, due to the longer distances travelled and higher carbon emissions, the environment. There needs to be a level-playing field for UK helicopter businesses within Europe. It is not in the economic, energy or environmental interests of the UK for both Fuel Duty and the Emissions Trading Scheme to be imposed upon them.

## **3. Exemptions**

SCDI strongly supported the introduction of the exemption from Air Passenger Duty for flights serving the Highlands and Islands in 2000. The economic, social and geographical circumstances which led to this policy still apply today. The region remains well below the population threshold of 12.5 people or less per kilometre squared which was used to test peripherality. Economic prosperity is still substantially behind the UK and EU averages. Alternative land based transport options are impractical for most journeys to England and, in the case of the islands, to central Scotland. This comparative remoteness is also a key barrier to growing the economically vital tourism industry, worth £839 million per annum to the region. SCDI therefore urges HM Treasury not only to exempt flights departing from the Highlands and Islands from aviation duty, but also those arriving in the region. It also believes that aircraft of less than 5.7 tonnes which are performing the same economic and social lifeline function should be exempt from fuel duty. This would address the anomaly potentially affecting services like the Highlands

Airways' Inverness/Stornoway/Benebecula route which would see it subject to fuel duty while a competing service would be exempt from aviation duty.

It is worth underlining that, not only do air services in the region generate a fraction of UK carbon emissions, studies have shown that the equivalent passenger journeys by car and ferry would actually produce more.

Despite the introduction of the exemption from Air Passenger Duty and, in 2006, the EU-approved Air Discount Scheme by the Scottish Government, the cost of flights to passengers of many of these services is substantially higher than other UK domestic services. Many flights are already producing only a marginal commercial return for operators and, as has already been mentioned, the rising cost of fuel has led to some cancellations. It would therefore be entirely counterproductive and contrary to the UK Government's economic, social and environmental policy goals to apply aviation duty.

SCDI also believes that HM Treasury should reconsider the level of aviation duty applied to all domestic flights to ensure that it is fair when compared to the level for long-haul flights. SCDI understands that passengers on return trips on multi-sector services, such as the flight between Southampton and Inverness via Leeds Bradford, will be required to pay aviation duty four times which will cost more cumulatively than the far more environmentally harmful journey between London and Auckland. If it becomes unsustainable for the Inverness-Southampton flight to land at Leeds Bradford en route this may make the entire service uneconomic which would seriously reduce the Highlands' connectivity to two English regions. SCDI is aware of businesses around the Highlands which use this service and, with road and rail options impractical, is concerned about the economic impact of this proposal.

#### **4. Freight**

The principle that flights carrying freight should be subject to the same form of aviation duty as those carrying passengers is accepted by SCDI. In the case of the Highlands and Islands, this would mean that the same exemptions to aviation and fuel duty apply. Freight volumes normally involve goods which most people in UK would regard as essential to their standard of living and the smooth running of the economy e.g. mail, newspapers and fresh food. Similar availability should apply within the Highlands and Islands, and so air freight services must be financially sustainable. As many flights carry people and freight it would, in any case, be difficult to apply different rules.

#### **5. Transit/ Transfer Passengers**

There are a number of aspects to the proposals which should be reconsidered.

The number of direct international air routes from Scotland has grown in recent years following support from BAA and the then Scottish Executive. However, the new Scottish Government has withdrawn the Air Route Development Fund and the increasing cost of fuel, falling profitability of the airlines and the general economic downturn is likely to impact on further growth of the network. HM Treasury's proposals would immediately impose full aviation duty on start up flights which would make it much harder for airlines to develop new routes or increase frequency. There is a strong case for complete or partial exemptions for a period following their introduction.

In the circumstances set out above, interlining, especially through Heathrow, will therefore remain critical for Scotland's connectivity and the Scottish economy. Almost half (45%) of passengers travelling to Heathrow from three main Scottish Airports in 2006 are transferring rather than 'point to point'. Scottish transfer passengers represent 25% of all Heathrow transfer passengers.

The proposal for duty to apply to each individual leg of an aircraft's journey would mean that passengers travelling between Aberdeen to the Middle East via London would pay their share of aviation duty on four flights compared to two flights for passengers flying from London. This is likely to be a significant disadvantage to the Scottish economy, which is not justified in terms of the relatively small environmental impact of the domestic leg, and further threaten the future of Scottish services to the UK's hub airport.

## **6. Administration of a Per Plane Duty**

Aviation duty is a tax by Government on the operations of the airlines. SCDI's believes it is logical, therefore, for aviation duty to be collected by the airlines (as at present) rather than airport operators. If airport operators were to assume responsibility, this would impose a significant administrative burden which they are not currently resourced. In the case of the main airports in the Highlands and Islands, which are publicly owned, managed and subsidised, this burden would ultimately have to be met by the taxpayer.

Yours sincerely

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