

# Consultation on aviation tax reform: AEF response



11<sup>th</sup> June 2021

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## The government's initial policy position on domestic APD

### **1. 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?**

No. Our view is that aviation taxes should increase – a top-line message shared by numerous environmental organisations including the signatories of the ‘Building back better for aviation’ joint NGO briefing last year<sup>1</sup>. Whatever the actual effect of the policy in terms of aviation demand and therefore environmental impact, it has triggered very strong opposition from environmental campaigners and, since it was first announced by ministers, has been frequently cited in the press as evidence that the Government is not serious about delivering on its climate objectives.

We note that the consultation lists three Government objectives for aviation tax, of which the “primary objective”, it states, is for APD “to ensure that airlines make a fair contribution to the public finances.” Other objectives are that aviation tax: “supports Union and international connectivity” and “aligns with our environmental objectives, particularly the government’s commitment to net zero emissions by 2050”.

With respect to the primary objective, we do not consider that at its current rate APD effectively ensures that airlines make a fair contribution to public finances. Grant Shapps has described the Government’s support to the aviation industry in response to the Covid pandemic as ‘unprecedented’<sup>2</sup>. This is notwithstanding the fact that aviation has historically benefitted from the absence of fuel duty and VAT on tickets and that it is an activity undertaken disproportionately by people on higher incomes. Lowering the domestic APD rate will do nothing to address what we consider to be a shortfall in the contribution made by the aviation sector to public finance, even if total tax take is maintained by introducing higher rates on longer-distance routes. The Treasury has previously estimated that imposing duty and VAT on aviation fuel at the rates paid by motorists, for example, could generate revenue in excess of £10billion per annum.

The proposal also fails to meet the aim for aviation tax to align with the Government’s environmental objectives, including its commitment to net zero emissions by 2050. We welcome the fact that the Government recently committed to formally include international aviation in the carbon budgets legislated under the UK Climate Change Act. Emissions from UK domestic and international aviation in 2018 were 124% above 1990 levels, while globally, aviation emissions in

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<sup>1</sup> <https://www.aef.org.uk/2020/06/05/building-back-better-for-aviation-joint-ngo-briefing/>

<sup>2</sup> <https://www.gov.uk/government/speeches/beyond-the-crisis-speech-to-the-aviation-industry>

2019 were around 1GtCO<sub>2</sub>, approximately 2% of all anthropogenic emissions. In the UK, emissions from domestic and international flights were 38.2MtCO<sub>2</sub>e in 2018 (of which 1.5MtCO<sub>2</sub>e was generated by domestic flights and 36.7MtCO<sub>2</sub>e by international flights). In 2019 this figure reached a record high of 38.5MtCO<sub>2</sub>e, 10% higher than in 2015. This was around 7% of all UK GHG emissions in 2018 although this figure does not take aviation's non-CO<sub>2</sub> impacts into account. According to the latest scientific evidence, the aviation sector's total climate warming impact between 2000 and 2018 was three times that associated with its CO<sub>2</sub> emissions alone.

We agree with the view of the Climate Change Committee, the IEA (which recently considered this issue in an international context) and numerous other expert analysts that achieving net zero aviation will require policy measures to reduce air passenger demand.

The consultation notes that domestic aviation generates only a small proportion of total aviation emissions. Nevertheless the proposal generates precisely the wrong signals about aviation a time when:

- a) There is unique window of opportunity to influence public habits and expectations following the Covid pandemic. As argued by Lorraine Whitmarsh, Covid restrictions have led to a number of climate-friendly lifestyle changes including less flying, and many people plan to retain these changes once restrictions are lifted. But "while COVID-19 may represent a unique window of opportunity, a switch to low-carbon lifestyles is only likely to occur with appropriate infrastructure and incentives to promote and lock in new routines."<sup>3</sup>
- b) The Government has yet to publish its long-awaited net zero aviation policy consultation.
- c) The UK is preparing to host a major climate conference at which it plans to showcase its environmental leadership.

Regarding the new objective that aviation tax should support Union and international connectivity, we assume that industry respondents will argue that a positive effect of the proposal to cut domestic APD would be an increase either in passenger numbers (if the cost saving were to be passed on) or routes (if the cost saving was to be matched by an increase in the fare charged by airlines which allowed new routes to be profitable). The Government may also see political advantages to equalising the tax payable between Belfast and Dublin – an issue highlighted by the Prime Minister when he trailed this aspect of the APD proposals to the media at a time of high-profile Brexit-related negotiations with the Government of Northern Ireland.

We recognise that the current situation means that less APD is levied not only on flights to Dublin compared with Belfast but also on routes to near-European destinations compared with domestic destinations, which may appear anomalous. Ideally, the return leg of these journeys would be taxed in the country of departure at a rate comparable to the UK's. Alternatively, we would suggest that the UK's rate on international routes be increased, while the rate for some or all domestic routes is retained at the current level, as set out in response to question 16.

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

A clearer definition of 'connectivity' is required to be able to answer this question. The Treasury should not reach any conclusions in the absence of a full review of connectivity that includes virtual and rail connections.

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<sup>3</sup> <https://theconversation.com/net-zero-will-mean-breaking-bad-habits-but-can-we-get-there-in-time-161053>

Many 'peripheral' parts of the UK already benefit from an APD exemption as a result of being designated as PSO routes, so the beneficiaries of the cut would disproportionately be airlines and passengers on dense routes like London-Glasgow/Edinburgh which are already well connected by rail.

### **3. 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?**

We don't have evidence on this point. We note that evidence supplied by the aviation industry of the possible impact in terms of routes operated (if the benefit were to be internalised by airlines with the prices charged by airlines being increased proportionally to the APD cut) or of passengers flying (if the benefit were passed on) of a 100% APD reduction remain highly uncertain<sup>4</sup>.

It is worth noting that in the case of PSO routes, the absence of APD is not in itself sufficient to make the route viable without additional financial support. And previous APD cuts, like Northern Ireland's decision to scrap APD for long-haul routes, showed no demonstrable impact on passenger numbers, suggesting that APD cuts won't guarantee increased traffic volumes.

### **4. 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?**

### **5. 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?**

### **6. By how much would you estimate that the number of passengers currently flying domestically increase?**

We will leave others to speculate on possible new routes, increased use of existing routes or increases in passenger numbers that the change may stimulate. We suggest that the Treasury should assess not only the potential 'wider benefits' of new routes but also disbenefits. As one example, there is currently a PSO route in operation between Newquay and Heathrow. While this may be beneficial to residents of Newquay in having access to London (and onward destinations) it may also facilitate a lifestyle of second home ownership in Newquay, to the detriment of local people in terms of house prices for example. There will also be environmental disadvantages to stimulating an increase in air travel.

### **7. What could the environmental impact of reducing the effective domestic rate of APD be? How could any negative impacts be mitigated?**

As noted in the consultation, domestic aviation represents only a small proportion of total aviation emissions given the short distances covered (around 4% of total UK aviation emissions in 2019). Even if the proposed APD reduction was successful in delivering the aim of increasing domestic air travel

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<sup>4</sup> <https://airlinesuk.org/wp-content/uploads/2018/09/The-Impact-of-Air-Passenger-Duty-on-Airline-Route-Economics-4.pdf>

the CO2 impact would be relatively small. The more significant disbenefit of the measure would, in our view, be the signal it gives that the Government has no coherent strategy or messaging in relation to aviation demand and emissions. While APD is not an environmental tax per se, it should be structured to communicate the right messages to encourage consumer behaviour. Cutting tax on domestic routes which have reasonable lower carbon alternatives fails to achieve this.

Local environmental impacts in terms of noise or of air pollution generated by travel to and from the airport could be considerable. Domestic flights will inevitably overfly more people per km flown than international flights.

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

We would anticipate the rail sector losing some of its market share to aviation, but don't have access to modelling on the proportion of journeys that would be switched from one transport mode to another as opposed to those that would be newly generated.

**9. 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?**

N/A

**10. 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?**

N/A

## A return leg exemption

**11. 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?**

We don't support the proposal. The fact that it would result in a reduction in the tax levied on business jets is particularly galling given that business and private jets are the most polluting option for travel available.

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

N/A

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

N/A

**14. 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?**

N/A

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

N/A

## A new band for domestic flights

**16. 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?**

As set out above we don't support reducing APD on any distance band. Alternatives could be:

- Retaining the current rate for all domestic journeys but increasing it for international routes
- Retaining the current rate for domestic journeys that cannot feasibly be made by rail (for example if the rail journey can be made in a given time limit) but increasing it for international routes
- Retaining the current rate for domestic journeys, but providing relief from other taxes such as future carbon charges for domestic air journeys powered by renewable energy

**17. 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?**

N/A

**18. 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?**

N/A

## International distance bands

**19. 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?**

We agree that it would be sensible to increase the number of bands in order to levy APD in as fair a way as possible.

**20. What could the impact on the environment of a change to the banding structure? How could any negative environmental impacts be mitigated?**

Applying an escalating rate of APD to a larger number of distance bands could help to reinforce the message that the CO2 impact of a flight is closely related to distance flown. A change to the banding that results in an increase in the APD paid on all but domestic routes could provide an opportunity for the Government to communicate this message to the public.

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

N/A

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

We don't have a strong view, but see merit in policy option B.

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

N/A

**24. 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 provide evidence to HMRC on their APD liabilities?**

N/A

## Frequent flyer levy

**25. 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?**

We think it's unlikely that a single tax measure will be able both to deliver the revenue-raising and environmental pricing required to ensure both that the industry invests in zero carbon technologies and that ticket prices reflect the environmental damage of a flight. In the absence of an effective kerosene tax and of VAT on tickets, APD should be retained and increased in order to help meet the stated primary objective of aviation tax to ensure that the aviation sector makes a fair contribution to public finances. Additional financial measures should be introduced in parallel to internalise environmental costs in ticket prices.

Historically, while the government has recognised that APD rates correlate only loosely with the CO<sub>2</sub> from a given flight, it has been reluctant to introduce a tax that might be open to accusations that it is a proxy fuel tax, given the legal complications around introducing such a measure. We note that the EU is now giving serious consideration to the possibility of introducing a kerosene tax, and that the post-Brexit UK-EU air services agreement allows us to negotiate kerosene taxes to EEA states. Nevertheless, there may be advantages to retaining APD as a justifiable revenue-raising tool, particularly given the need to rebuild public finances following the Covid pandemic, and to introduce targeted environmental measures alongside it.

We are disappointed that the consultation has not explored additional tax options such as a kerosene tax or an air miles levy. The brief section devoted to a Frequent Flyer Levy implies this has been assessed only as an alternative to APD. However, the CCC has never, to our knowledge, recommended replacing APD with a Frequent Flyer Levy. Their recommendation has been that given the need to limit air passenger growth in order to achieve climate targets, the Government should consider measures such as "carbon pricing, a frequent flyer levy, fuel duty, VAT or reforms to Air Passenger Duty, and/or restricting the availability of flights through management of airport capacity"<sup>5</sup>. A report for the CCC in 2019 called for the introduction of an air miles tax, that would vary not by number of trips but by distance flown, and this was the option most strongly supported by the Citizens Assembly on climate change.

The simplicity of administering Air Passenger Duty compared to potential supplementary approaches – the only reason cited in the consultation for rejecting an FFL – is not a good reason for failing to consider other options for introducing new charges on aviation more fully. The Government's forecasts of aviation CO<sub>2</sub> assume levels of carbon charging far in excess of anything likely to materialise from current policy measures such as the UK ETS (which will cover only flights within the EU) or CORSIA. In the absence of such pricing, the emissions forecast would be higher still, and the aviation sector even further from delivering net zero emissions than is currently expected.

To deliver on its commitment to consult on Aviation Tax reform, rather than just a proposal to tweak APD levels and a brief dismissal of the concept of a frequent flyer levy, the Government should present a more detailed set of options for carbon charging in addition to retaining APD, including for example:

- a new levy to close the gap between the carbon pricing anticipated under the UK ETS for flights between the UK and Europe compared with flights to countries outside Europe
- a new charge to allow the Government to invest in the carbon removal technologies that will be essential to ensure that remaining aviation emissions will after 2050 all be balanced by removals

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<sup>5</sup> <https://www.theccc.org.uk/wp-content/uploads/2020/12/Sector-summary-Aviation.pdf>

- the possibility of a reduced rate of such carbon taxes being levied on any flights operated using a zero-carbon form of energy such as electricity or hydrogen (though this is likely to be relevant only for domestic or very short haul trips in the short- to medium-term)
- a fuller consideration, as called for by the Association of Accounting Technicians and the Zero Carbon campaign among others, of the possibility of introducing an Air Miles Levy or Frequent Flyer Levy.