Response from ICAS to the Scottish Government

A consultation on
a Scottish replacement to Air Passenger Duty

3 June 2016

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 20,000 members working across the UK and internationally. Our members work in all fields – predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to contribute to the consultation on a Scottish replacement to Air Passenger Duty (APD) issued by the Scottish Government in March 2016.

3. Our comments below are restricted to our areas of expertise, which in this instance are to share insights from our members into the complex issues involved in the design and implementation of fiscal matters.

4. It is not completely clear that a Scottish replacement for APD, at reduced rates, will necessarily achieve the objectives outlined in paragraph 2.12. Changes to APD in Scotland may contribute to achieving these objectives but it is difficult to identify or verify any causative effect. This is particularly so if an analysis of the consequences across the wide range of stakeholders and taxes is considered. An appendix has been included to illustrate this across the Scottish economy. The appendix is a matrix of the impact on stakeholders together with the impact on all direct and indirect taxes in Scotland, prepared by ICAS and the CIOT and has been discussed with representatives of the Scottish Government.

5. The devolution of APD increases the likelihood of tax competition across the UK. Long haul APD has already been devolved to the Northern Ireland Assembly and there is anecdotal evidence of an impact on flights from Prestwick. A tax system works on a number of complex and interrelated principles and interactions which have been balanced across the UK tax system to date. With the devolution of tax powers, the success of the tax systems in each jurisdiction of the UK depend on each being an integrated and coherent part of the wider economic, legal and constitutional package.

6. A differential in rates of APD between Scotland and the rest of the UK may lead to tax competition as travellers fly from Scotland to reduce their costs. Transport Scotland estimated the impact of this as 300,000 additional flights from Scotland in its paper "Estimate of the impact on emissions of a reduction in air passenger duty in Scotland" which was issued in September 2014. However, there may be changes to the rates of APD charged in the rest of the UK to address switching by customers. Recent experiences with Stamp Duty Land Tax and Land and Buildings Transaction Tax – the basis of the charge and the introduction of a supplement for additional dwellings – suggest that policies adopted by one government in the UK are quickly adopted across the UK.

7. Tax competition can also become tied up with "no detriment" debates if the competition in one part of the UK turns out to be detrimental to another part. At the heart of the "no detriment" principle is the notion that the impact of policy decisions taken in one part of the UK do not impact adversely on the funding of public services in another part.

8. The Scottish Government has indicated that it expects to partly fund the reduction in APD rates in Scotland with tax receipts from the increase in trade and business activity generated by the additional passengers forecast. As noted at point 4 above and the matrix included as an appendix, changes will affect a wide range of stakeholders across the Scottish economy and the tax receipts that are expected to be generated would be across a range of taxes. Under the current devolution arrangements additional tax receipts may arise as follows:

- Increased spending generating additional VAT – under the Fiscal Framework agreement only 50% of any increase will be assigned to Scotland from 2019/20 onwards.
- Increased corporate profits generating additional corporation tax – this remains a reserved matter so receipts will go to the Treasury
- Increased employment generating additional income tax – this may increase tax revenues in Scotland but this is dependent on the type of employment being created – low paid jobs generate lower levels of income tax.
- Increased employment generating additional NIC - this remains a reserved matter so receipts will go to the Treasury.
- Increased employment generating reduced benefits payments - this remains a reserved matter so savings will go to the Treasury.
- Increased business activity generating additional non-domestic rates – this would generate increased revenue for the Scottish Government.

9. The proposals outlined in the consultation propose a Scottish replacement for APD that largely replicates the tax base and structure of the UK-wide APD with minor adjustments. The Smith Commission noted that the devolution of power over APD to the Scottish Parliament would give the Scottish Government the opportunity to make its own arrangements on the design and collection of the tax. Modifying the UK-wide approach may provide certainty for airline operators who collect the tax but it does not allow the design of the tax to address the policy concerns for the Scottish economy and environmental concerns.

10. The forecasts of increased economic activity across Scotland if APD is reduced are dependent on new routes being introduced. The link between reducing the rates of APD in Scotland and increasing air connectivity is not a direct link – this will be dependent on the response of the airline operators and their customers**.** The level of APD in Scotland is only one of a number of factors which affect air connectivity. The modest population of Scotland and the relative proximity of a global hub airport are more significant barriers to investment in developing new routes and services.

11. The proposal in the consultation is that returns for the Scottish replacement for APD will be made on a quarterly basis. At present, taxpayers will be processing their information for UK APD returns on a monthly basis and it is likely to be easier for them to process the information on the Scottish replacement for APD simultaneously, particularly if the new tax is structured similarly to UK APD. The fact that fewer amendments would be required to Revenue Scotland and Tax Powers Act 2014 (RSTPA 2014) if the Scottish replacement for APD required quarterly returns is not an overriding argument in favour of quarterly return periods. The tax administration framework should be the same for all Scottish taxes but the return periods should reflect the nature of each tax.

Air passenger duty – Impact summary

	Tax and Scottish Revenues[1]					
Stakeholder	**Corporation tax**	**Income tax**	**National Insurance**	**Value added tax**	**Air passenger duty**	**Other – non-tax issues**
Tax per GERS[2] 2014-15	**Total £2,920 m**	**Total £11,735m** **Smith £11,196m** **SRIT £ 4,449m**	**Total £8,969m**	**Total £10,734m** **Gross £5,173m** **Net £4,563m**	**Total £309m**	
Scottish government	Share of UK receipts	Will be wholly devolved – benefits from increase or loses from decrease	Share of UK receipts	50% share of any increase or decrease (based on current UK rates)	Wholly devolved – benefits from increase or loses from decrease. If rate reduced by 50%, at first likely to simply have only 50% of previous APD revenues.	Cost of state benefits may be affected by any growth due to reduction in APD
UK government	Benefits from any growth in profits taxable in UK due to APD reduction	Will not share in any benefits or losses	Benefits from any employment growth that increases NIC receipts	Any increase in spending by visitors increases VAT receipts, but possible loss if effect is to encourage UK	Unlikely to be any major direct impact as few Scottish airports close enough to rest of UK to	Any growth in employment may impact on cost of state benefits.

[1] Figures for tax revenues are estimates taken from table 3.1 in "Government Expenditure & Revenue Scotland 2013-14" (March 2015): http://www.gov.scot/Publications/2015/03/1422

[2] The term "Total" is used to refer to the amount calculated as being revenue from Scotland in "General Expenditure & Revenue Scotland 2013-14" (GERS). Under income tax, the term "Smith" is used to refer to the income tax that would be within the Scottish Government's power under the latest Scotland Bill, following the Smith Commission recommendations. "SRIT" is used to refer to the amount under the control of the Scottish Government according to the Scotland Act 2012. For VAT, the gross is the VAT receipts that the Scottish Government estimates will be assigned to Scotland before taking into account VAT refunds.

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				persons to travel and spend abroad.	encourage switching[3].	
Revenue Scotland	No impact	No impact	No impact	No impact	Likely to take on administration and collection of APD	Costs of upskilling Revenue Scotland; also costs of changing the tax; IT costs.
Airlines	May pay more corporation tax if UK profits increase, but some airlines may not be wholly subject to UK corporation tax.	No impact	May have to pay more employers' NIC if reduction in APD leads to more employment	Air travel is not subject to VAT in the UK so impact will be minimal	Substantial gains but these may be reduced if passed onto customers in lower fares, although the UK paper to the House of Commons – see footnote – on APD asserted	Some administrative benefit if APD abolished, but this is likely to be minimal as APD systems may have to be retained for other countries including the rest of the UK. The airlines are likely to

3 In a note entitled "Air passenger duty : introduction" prepared for the House of Commons by Anthony Seely on 19 September 2012, HMRC asserted "…analysis indicates that the price elasticity of demand for changes in APD duty rates is low, and air travel has proven relatively unresponsive to changes in price." However, other studies reach different conclusions. The current rates of APD for travel up to 2,000 miles is £26 standard and £13 reduced. There is no tax on children under 12. Thus for a family of four the saving could be as little as £26 (two adults at the reduced rate).

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					that the demand for travel is relatively inelastic.	consider a number of non-tax issues when deciding whether or not to develop new routes from Scottish airports, for example, availability and cost of slots; likely feasibility of route in terms of passengers; infrastructure.
Operators of other forms of transport (bus, train, coach, taxi, ferry etc.)	May pay less corporation tax if UK profits decrease	No impact	May pay less NIC if reduction in APD leads to less employment due to a fall in customers	Most other transport (except taxis) is zero-rated so unlikely to be a significant VAT effect	Reduction in APD reduces cost of air travel of employees, but reduction partly offset by corporation tax – net benefit will be about 80% of reduction.	Possible opportunities for routes connecting to airports if a significant number of passengers find it acceptable to travel to avoid APD, but seems unlikely.

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Business – company	If profits increase due to lower travel cost by employees, increase in tax paid, but mostly negligible	No impact	As for airlines	Any increase in business activity e.g. more visitors to a hotel, will result in more VAT payable	Reduces cost of air travel of employees, but reduction partly offset by corporation tax – net benefit will be about 80% of reduction.	In the main, the cost of APD is unlikely to outweigh the cost or inconvenience to a business traveller of not travelling from his or her nearest airport.
Business – individual	No impact	If profits increase due to lower travel cost causing increased demand, increase in tax paid but mostly negligible	As for airlines Also increase in class 4 NIC	As for company businesses	Reduces cost of air travel, but reduction offset by income tax and class 4 NIC increase – net benefit could be less than 50% of APD reduction	Possible impact on state benefits entitlement due to higher net income
Employees and jobseekers	No impact	Increase in demand may provide job opportunities but the travel and retail industries	Most new employees will pay NIC because earnings will be over the threshold of	No impact unless they are also travellers, when there is an impact on their employer's	Reduced cost of travel where they travel on business as employees	Possible impact on state benefits as above

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		usually pay low wages, so probably minimal income tax effect. Note also that UK government controls level of personal allowance and this will be linked to the National Minimum Wage	£8,060, but this may be different for part-time workers including those on zero-hour contracts.	business - see below.		
Travellers from Scotland to overseas destinations	No impact	No impact	No impact	Scots travellers will buy goods and services overseas and pay VAT there and not in Scotland	Reduction in travel cost by £26 per traveller over 12 (standard) and £13 (reduced) if journey less than 2,000 miles, or by £142 (£71) if over 2,000 miles.	Reduction may stimulate travel from Scotland. For 4 passengers over 12, the saving could be £568 – worth a train journey in some cases. As noted, business travellers are unlikely to see £142 (£71) as worth the

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						additional travel time
Travellers from Scotland to other UK destinations	No impact	No impact	No impact	Passengers will presumably pay VAT on goods and services in the rest of the UK instead of Scotland	Reduction in travel cost	It seems unlikely that there would be a significant increase in air travellers from Scotland.
Travellers to Scotland from overseas destinations	No impact	No impact	No impact	Increase in VAT due to spending on hotels, restaurants and retail goods, but note minimal impact from business travel as that VAT is potentially refundable.	Reduction in travel cost	The question is whether there would be a significant increase in passengers because of lower APD in Scotland – e.g. London attracts more visitors even though its accommodation costs are significantly more. It may only change

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						the sequence of travel.
Travellers to Scotland from other UK destinations	No impact	No impact	No impact	Shifts some VATable spending from UK to Scotland, but may not be significant.	Reduction in travel cost	Far more travellers are likely to use other transport, so the potential increase in passengers is probably minimal.
People who do not travel by air	No impact	No impact	No impact	No impact	No impact	Whether a reduction in APD encourages these individuals to use air travel in future is moot. Other factors than cost – convenience; time; personal preference re mode of transport – will play a part
Environment	No impact	No impact	No impact	No impact	Reduction in APD potentially reduces the tax's environmental	APD does not in and of itself encourage 'green' behaviours – for

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					impact, but note that APD was not intended to be an environmental tax and, if it does not greatly increase or decrease the demand for travel, it may have minimal impact anyway.	example, it does not encourage airlines to fill planes or use greener planes