



Scottish Chambers of Commerce Network: Outline points on Air Passenger Duty, Air Departure Tax and the Highlands and Islands Exemption

Introduction

Connectivity is a vital enabler of businesses and communities. In the Highlands and Islands region, the diverse geography of the area requires an equally diverse transport mix, and affordable air travel, both for business users and consumers, is a cornerstone of the regional economy.

The majority of flights across the UK are subject to Air Passenger Duty, a tax paid by passengers dependent both on final destination, and on class of travel.

Currently flights departing from the Highlands and Islands region are exempt from Air Passenger Duty (APD), under the Highlands and Islands exemption which has operated since 2001.

Following the Smith Commission recommendation that the Scottish Parliament have “*the power to charge tax on air passengers leaving Scottish airports*”, and the subsequent Scotland Act 2016, The Scottish Government has moved to develop an alternative tax in the form of Air Departure Tax, or ADT.

After consultation, the Scottish Government were nearing the final stages of the devolution of this tax. The devolution, and proposed lower rates of ADT, in comparison to APD, were called for by the Scottish Chambers of Commerce Network.

On 5th October, the Cabinet Secretary for Finance and Constitution (now Cabinet Secretary for Finance, Economy and Fair Work), Derek Mackay MSP, in an [update to Parliament](#), detailed that the devolution and subsequent operation of ADT was being delayed, due to State Aid issues related to the Highlands and Islands Exemption.

In this statement, the Minister highlighted a number of key points, for example, in relation to the H&I exemption:

“The exemption is a feature of air passenger duty and should be a feature of air departure tax, supporting not just residents but businesses and tourism in the area.”

Furthermore, in the same update:

“It is not a technical argument. Aviation is critical to the Highlands and Islands, helping to support a diverse range of businesses and enabling residents from the more remote regions to access essential services that cannot be provided in their areas. Without it, there is a real risk that the Highlands and Islands will suffer economic detriment.”

It seems relatively clear from this position that, legal challenges aside, the Scottish Government is committed to the principle of retaining an exemption to any type of air passenger duty on departing flights in the H&I Region.

As such, it is deeply concerning to the Scottish Chambers of Commerce, our business members, and the communities they operate in, that the current discourse around the exemption appears to focus on justifying the existence of the exemption itself.

As outlined by the Cabinet Secretary in his 5th October update, Aviation is critical to the continued prosperity and economic growth of the Highlands and Islands, and the exemption is a key feature of this. The focus of both the UK and Scottish Governments should be on addressing the legal issues preventing devolution of powers and the operation

of ADT, with the exemption in place, not on justifying the existence of an exemption which is widely recognised to provide critical benefits to the region at large.

Outside of concerns around the framing of this debate, Scottish Chambers of Commerce welcomes the Scottish Government's commitment to consult on this issue and to attempt to reach a solution. As part of this consultation and the initial working group on the H&I exemption, Scottish Chambers of Commerce representatives have been asked for evidence on two further areas by the Scottish Government team:

1. It has been raised by the Scottish Chambers of Commerce Network that the business and social impact of the exemption here is more significant in the Highlands and Islands region than in central belt - can you elaborate?
2. That expanding the Air Discount Scheme (ADS) is not an appropriate model as a route to replace the exemption, particularly for Wick airport, and that further expansion / operation of the ADS on H&I routes will not achieve substantively similar outcomes to continued operation of the exemption as it currently stands.

The first question can broadly be referred to as *the impact of the exemption*, the second question concerns *the suitability of an expanded Air Discount Scheme* as a solution to the notification / exemption issue.

Impact of the Highlands and Islands Air Passenger Duty Exemption to the region:

As outlined by Cabinet Secretary Mackay on 5th October 2017, the APD Exemption is absolutely critical to connectivity and broader economic stability in the Highlands and Islands Region.

In this area, it's possible to gain understanding of the impact of reductions in APD from existing studies conducted by the aviation industry.

Air Transport Provision in Remoter Regions, an academic text edited by Williams & Bråthen, provides some initial evidence on the impact of fare reductions on remote routes, specifically with regards to Scotland. [One section](#) explains the impact of fare reductions across a number of PSO routes in Scotland, referencing a study conducted by Reference Economics on these routes. The study showed a clear relationship between the percentage of fare reduction, and the subsequent increase in passenger numbers. A reduction in fares between Glasgow and Barra of 30 per cent, seen an increase in passenger numbers of approximately 18 per cent. Meanwhile, a minor reduction of 7 per cent on the Campbeltown to Glasgow route only observed a 3 per cent increase in passengers.

This is a critical observation in light of research from the Fair Tax for Flying Campaign that illustrates that in certain routes between Scotland and the rest of the UK, Air Passenger Duty accounts for up to 58 per cent of the overall fare.

Given the general proportion that APD can account for on short haul flights across the UK, and the clear evidence from the Reference Economics study that fare discounts provided

by passenger numbers in these remote areas, it's fairly clear that loss of the exemption, and reintroduction of additional charges in any form, would have an impact on access to connectivity for both businesses and residents in the H&I region.

There's also two key recent studies which reinforce this assertion, produced by the Airlines UK, in partnership with Frontier Economics.

[The first, and most](#) recent study details the current effects of APD on the viability of routes across the UK, and its estimated impact on closed routes.

They argue the UK is losing out on 60 direct routes because of the high rates of APD relative to other jurisdictions. Direct effects of this have been observed in Scotland, with Ryanair [referencing APD](#) as a key driver of the decision to close its Glasgow base and move flights to Edinburgh.

Airlines UK, along with ABTA, also commissioned a report on 2017 [specifically on Scotland](#):

This report suggests that Scotland's direct long-haul connectivity is in need of significant improvement, but highlights the indirect connectivity to hub airports as a key strength.

From the report on APD rates, it's clear that APD has been a key driver in the closure of routes which are currently seen as undersubscribed or of marginal profitability. Through their analysis, it is estimated that if APD was not in operation, it's possible that all of the closed routes analysed by Airlines UK would still be in active use.

"We have considered how the abolition of APD would impact on new connections in the UK:

Short-haul: If an airline were to operate a new short-haul connection with an average load of 100 passengers, it would need to generate at least £1,300 per flight just to cover APD, or nearly £500,000 per annum for a daily connection. For domestic connections, where APD is levied on both the outbound and inbound legs, this rises to around £1 million per annum."

Figure 7 Dropped routes might have been viable if APD had been abolished

	Number of routes which could have been viable
0% cost pass through scenario	4-8 out of 8 routes considered
100% cost pass through scenario	3-7 out of 8 routes considered

Source: Frontier analysis

The results suggest that under the 0% cost pass through scenario 4-8 of the 8 routes could have been viable if APD had been abolished. The range in our results relates to the time horizon considered:

- The higher number assumes that the route must make a cash contribution to the business – i.e. that the revenue generated is greater than the direct cost of operating the route, including fuel, airport charges, crew costs, etc.; and
- The lower number assumes that in addition to the above the routes must also cover all contribution-type costs (e.g. head office costs and aircraft costs).

There are clear implications for this study in the light of the H&I exemption. If the operation of APD has contributed to the closure of a number of routes across the UK, it's clear that removing the exemption from the H&I region is likely to have a similar disruptive effect across this region.

Furthermore, the second report emphasises that Scotland's main connectivity strength lies in its ability to connect to other key hubs - bringing APD or a less effective alternative than a zero-rate exemption into the H&I region risks fundamentally jeopardising this key strength.

Suitability of an Expanded Air Discount Scheme:

The Air Discount Scheme provides a discount of 50% on certain eligible air routes. This is currently limited to permanent residents of certain Scottish Islands and the Caithness and Sutherland region.

As an initial point, it should be noted that in an earlier briefing provided by Cabinet Secretary Mackay, hosted in response to a Freedom of Information request, there has already been some suggestion that the ADS is unsuitable as an alternative to the exemption. The following is contained in an annex to FOI/17/02267:

Options related to the Air Discount Scheme.	Consideration was given as to whether expanded support could be made available through a revised Air Discount Scheme. Any such option would however have limited coverage (as the case for narrow exemption above), be potentially administratively complex [Redacted]
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This clearly indicates that the ADS does not provide a comparative benefit to the current exemption in terms of coverage to travellers flying from the area. Just as the Scottish Government is committed to the concept of no detriment to the public purses as a result of the devolution of this tax power, they should be equally committed to ensuring that citizens and visitors to the area do not receive a detriment as the result of a less comprehensive exemption that that which is currently in place.

ADS is also administratively complex at present. Those eligible who wish to take advantage of the scheme are currently required to complete an application form, with a subsequent time delay in processing / receiving access to the scheme.

From a Chambers of Commerce perspective, business travel was removed from the ADS scheme in April 2011. Flights travelling for Business purposes are currently exempt from the ADS.

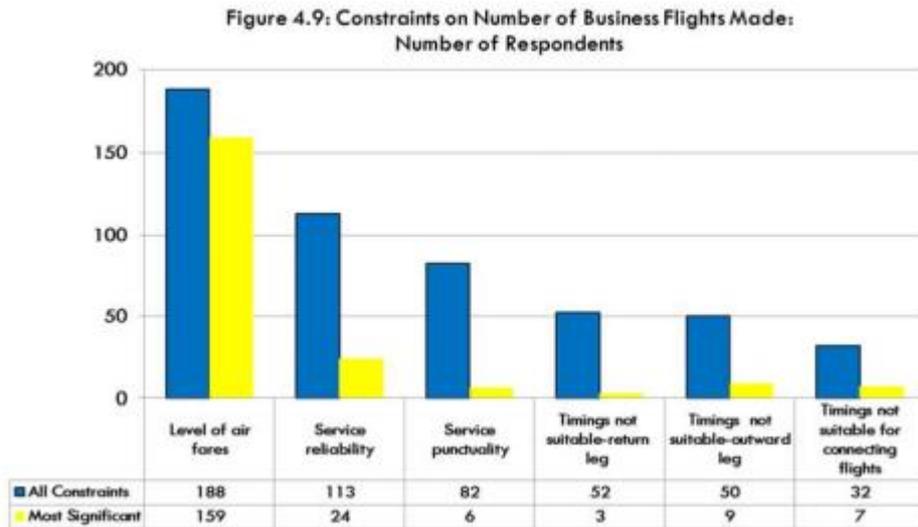
There's already [a comprehensive study](#) conducted of the effect of ADS on fares more widely in the H&I Region, conducted by Reference Economics. In addition to emphasising further the challenges business face from increased flight costs, the study highlights once again the importance of air travel for the H&I region. As seen in Table 4.4 of the Reference Economics study, over half of businesses use air travel either solely or mostly for their outbound business trips:

The results are shown at **Table 4.4**.

TABLE 4.4: USE OF DIFFERENT TRANSPORT MODES FOR OUTBOUND BUSINESS TRIPS	
Transport Modes Used	Proportion of Respondents
Use air for <i>all</i> these trips	23%
<i>Mostly</i> use air for these trips	35%
Use air <i>as much as</i> other modes of transport	14%
Use air <i>less than</i> other modes of transport	9%
Use air <i>much less than</i> other modes of transport	19%
Total	100%

The same study, in figure 4.9, also highlights that the high level of air fares is the main constraint to firms when it comes to accessing air travel:

Figure 4.9 shows that *level of air fares* are very much seen as the main constraint on the number of flights made.



However, the reference economics report references debates in the Scottish Parliament, in which Keith Brown MSP, in his capacity as Transport Minister, stated that the European Commission's view was that organisations involved in economic activity should not profit from the scheme as it was notified to the Commission.

As mentioned, business use was exempted from the ADS in 2011, with Scottish Government bodies stating that the scheme was never designed to include businesses. Given that the withdrawal of ADS applicability had a direct impact on flight costs, this also seeks to highlight potential impacts of the H&I exemption withdrawal. Reference Economics illustrate that over 90% of the firms they engaged with experienced negative effects following the revised ADS eligibility. As part of their study, they asked firms to further detail these impacts, which included:

- Greater use of surface travel rather than air: **17%**
- Fewer flights made: **14%**
- Reduction in the amount of staff training/development/CPD: **13%**
- No reduction in flights as air has to be used: **10%**

The remit of this study was to appraise the impact, and basis for inclusion, of all business travel within the Air Discount Scheme. Reference Economics offered a number of potential solutions to this issue. The first was to provide support via the industrial de minimis regulation, however, this implies an administrative burden for firms - who would have to apply / register with any scheme, and continue to monitor levels of aid received to ensure they comply with the de minimis threshold.

Furthermore, the ADS as stands, aside from not covering businesses, is also resident focused in nature. The Reference Economics study analyses the benefits of restating the ADS for businesses in this context, and also in the context of the operation of the current H&I APD exemption. The APD exemption, unlike the ADS, covers passengers flying from the region, not just residents on an application basis, and therefore provides additional economic benefits by reducing the cost of the return leg of any journey for tourism. Similarly, the Reference Economics Study focuses on the legal justification to the ADS as it would apply to businesses resident in the area.

Ultimately, Scottish Chambers of Commerce would argue that an expanded ADS appears to be unsuitable as a true replacement for the H&I APD exemption, or as a way to replicate this exemption when Air Departure Tax is brought into operation. Existing analysis of this scheme has focused on its use in a residential context, and there appear to be clear legal and administrative challenges into widening out the usage of this scheme further.

However, should it appear as if the Highlands and Islands exemption will not be replicated, it seems sensible that, where there is legal justification, the Scottish Government should look to expand this to provide some level of economic stability to businesses.

Concluding Comments

The Scottish Chambers of Commerce Network appreciates the consultative approach of the Scottish Government in seeking an appropriate solution for replicating the Highlands and Islands exemption once Air Departure Tax is brought into operation.

It is clear from a range of external sources, including aviation bodies, and reports commissioned by the Scottish Government themselves, that increasing flight costs in any sense represents a risk to routes with lower levels of passenger numbers, with airlines clear that many routes which have recently closed could have remained in operation had APD not been applied at the excessive rates of today.

It's also clear from the report from Reference Economics that businesses in the areas covered by the ADS are reliant on aviation as a core component of their connectivity to the wider world. There were clear negative impacts when business eligibility from the ADS was disputed, and it's reasonable to infer that these impacts would be magnified if the H&I APD exemption is not replicated fully as part of Air Departure Tax.

Scottish Chambers of Commerce believe it essential that both the Scottish and UK Governments work in partnership to deliver the devolution of Air Departure Tax in a manner which does not damage the vital connectivity needs of the Highlands and Islands. This means ensuring that an equivalent exemption remains in place.

The Air Discount Scheme, even in an expanded capacity, does not appear to be this equivalent. It's crucial that the Scottish Government design an alternative that also protects both business, and tourism-related travel, in the Highlands and Islands region.

About the Scottish Chambers of Commerce Network

Scottish Chambers of Commerce (SCC) is Scotland's largest business network. SCC brings the views of the business community together, forming a clear and powerful expression of Scottish business opinion through its network of 26 accredited Chambers of Commerce, representing 11,000 members.

