

## Summary: Intervention & Options

Department /Agency:  
**HM Revenue and Customs**

Title:  
**Changes to air passenger duty**

Stage: Implementation

Version: 1

Date: **March 2009**

**Related Publications:** Aviation duty: response to consultation

Available to view or download at: [http://www.hm-treasury.gov.uk/prebud\\_pbr08\\_aviationduty.htm](http://www.hm-treasury.gov.uk/prebud_pbr08_aviationduty.htm)

**Available to view or download at:**

<http://www.hmrc.gov.uk/better-regulation/ia.htm>

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**What is the problem under consideration? Why is government intervention necessary?**

The Government announced at the 2007 Pre-Budget Report (PBR) that it would consult in early 2008 on proposals for replacing air passenger duty (APD) with a tax payable per plane ('aviation duty'). The Government announced at the 2008 PBR that it would reform APD from a two-distance band regime to a four-distance band regime, rather than proceed with a per plane tax. In reaching its decision, it took a number of factors into account, including the need to provide stability in the current economic conditions, agreement for the inclusion of aviation in the EU emissions trading scheme (EU ETS) and the responses to consultation.

**What are the policy objectives and the intended effects?**

Reforming APD into four destination bands provides better signals than current APD, to both passengers and the industry, about the environmental impact of their activities, while keeping the impact of changes and procedures on business to a minimum.

**What policy options have been considered? Please justify any preferred option.**

Option 1 – reform APD. This avoids the disruption and costs associated with the implementation of a new tax, while increasing the number of bands and associated duty rates provides better signals about the environmental impacts of flying. This is the lead option.

Option 2 – retain existing APD structure. Both the Government and stakeholders agreed that the signals provided by the two-band APD could be improved. For instance, under the existing regime, those flying to countries just outside Europe face the same tax charge as those flying to the Far East, despite the significantly different environmental impacts of these flights.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?**

Post Implementation Review will take place around three years after the introduction of the changes on 1 November 2009.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

***I have read the Impact Assessment and I am satisfied that (a) it represents a reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.***

Signed by the responsible Minister:



.....Date: 7/3/09

## Summary: Analysis & Evidence

<b>Policy Option: 1</b>	<b>Description: Reform APD to a four distance band structure</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' One-off transition costs for airlines in 2009 include familiarisation with the changes and updating systems to accommodate the new distance bands and duty rates. Continuing costs are expected to be minimal as administrative procedures will be very similar to the existing APD regime.			
	<b>One-off</b> (Transition) <span style="float: right;">Yrs</span>				
	<b>£ 85,000 - £160,000</b>				
	<b>Average Annual Cost</b> (excluding one-off)				
	<b>£ 45,000 - £85,000</b>	<b>Total Cost (PV)</b>	<b>£ Ongoing</b>		
Other <b>key non-monetised costs</b> by 'main affected groups' Airlines will have to decide how to respond to the changes and whether or not to consult business advisers. We have only looked at the actions all businesses have to take to comply with the changes. No other compulsory key non-monetised costs are expected.					

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' Main benefit will be reduced carbon dioxide emissions from fewer flights. This is valued at £10m in 2010-11 and £20m in 2011-12 using the 'shadow price of carbon' recommended by the Department of Energy and Climate Change for use in policy appraisal (c£28 per tonne of CO2 in 2010-11).			
	<b>One-off</b> <span style="float: right;">Yrs</span>				
	<b>£ N/A</b>				
	<b>Average Annual Benefit</b> (excluding one-off)				
	<b>£ 10m and £20m</b>	<b>Total Benefit (PV)</b>	<b>£ Ongoing</b>		
Other <b>key non-monetised benefits</b> by 'main affected groups' Fewer flights will also lead to reductions in other pollutants, such as nitrogen oxides (NOx) and particulates, alongside less congestion and noise around airports. Reforming APD to better reflect distance travelled (and thus environmental damage) makes the tax system fairer and more efficient.					

**Key Assumptions/Sensitivities/Risks** All costs and benefits are compared with making no changes to APD (other than increasing rates each year for inflation). Carbon savings are estimated using data on passengers and flights from APD returns, the International Passenger Survey, the Civil Aviation Authority and the Department for Transport.

Price Base Year	Time Period Years	<b>Net Benefit Range (NPV)</b> <b>£ Ongoing</b>	<b>NET BENEFIT (NPV Best estimate)</b> <b>£ Ongoing</b>
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What is the geographic coverage of the policy/option?	United Kingdom			
On what date will the policy be implemented?	1 November 2009			
Which organisation(s) will enforce the policy?	HMRC			
What is the total annual cost of enforcement for these organisations?	0.06p per £ collected			
Does enforcement comply with Hampton principles?	N/A			
Will implementation go beyond minimum EU requirements?	N/A			
What is the value of the proposed offsetting measure per year?	£ Nil			
What is the value of changes in greenhouse gas emissions?	£ 10m and £20m			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro ~£125-250	Small ~£125-250	Medium ~£200-400	Large ~£200-400
Are any of these organisations exempt?	N/A	N/A	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)
Increase of	£40k-75k	Decrease of	£ 0
<b>Net Impact</b>			<b>£ 40k-75k</b>

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

### Background and summary of changes

The Government recognises the contribution that the aviation industry makes to the UK economy: providing around 200,000 jobs directly in the industry; employing up to 500,000 people in the supply chain; and contributing at least £11.4 billion to GDP<sup>1</sup>. The Government believes that aviation taxation should ensure the sector pays its fair share towards public services and provide better environmental signals.

The Air Transport White Paper (2003) set out the Government's support for the sustainable growth of aviation. In 2006 the sector accounted for around six per cent of the UK's carbon dioxide emissions; however, this share is forecast to grow to around 10 per cent by 2020, and by 2050, it is estimated that the sector will account for 35 per cent<sup>2</sup> of the UK's carbon dioxide emissions.

Aviation is by its nature international, so the Government believes that action at an international level is needed to ensure the sustainable development of this sector. For this reason, in Budget 2005, the Government highlighted its commitment to aviation joining the EU emissions trading scheme (EU ETS). The Government made this a priority for the UK's presidency of the EU in 2005. The Government has succeeded in its aim of obtaining unanimous agreement to include aviation in the EU ETS from 2012 at a cap of 97 per cent of 2004-06 emissions. Phase III details are being negotiated as part of the EU Climate and Energy package.

At the 2007 Pre-Budget Report (PBR), the Government announced it would consult on proposals to replace air passenger duty (APD) with a per plane tax. Since the 2007 PBR:

- agreement has been successfully reached to include aviation within the EU ETS, as set out above; and
- the Government has completed a formal consultation exercise.

The Government has listened to the points made during the consultation process, and in particular recognises the need to ensure greater stability in tax policy at a time of economic uncertainty, while maintaining its environmental objectives. The Government has therefore decided to reform the APD regime rather than proceed with a per plane tax. Reforming APD avoids the disruption and costs associated with the transition to a new tax, while continuing to send environmental signals to passengers and the industry alike, and ensuring that the sector contributes fairly to public services.

From 1 November 2009, APD will be structured around four distance bands, set at intervals of 2,000 miles from London. This reform will ensure that those flying further will pay a higher rate, improving the signals provided by the duty. Details of the reformed APD rates are set out in Table 1.

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<sup>1</sup> Oxford Economic Forecasting, *The Economic Contribution of the Aviation Industry in the UK*, December 2006

<sup>2</sup> Department for Transport forecast

**Table 1: Air passenger duty rates**

Band and approximate distance in miles from the UK travel	In the lowest class of travel (reduced rate) from:		In other than the lowest class of travel (standard rate) from:	
	1 November 2009	1 November 2010	1 November 2009	1 November 2010
Band A (0-2,000)	£11	£12	£22	£24
Band B (2,001-4,000)	£45	£60	£90	£120
Band C (4,001- 6,000)	£50	£75	£100	£150
Band D (over 6,000)	£55	£85	£110	£170
If only one class of travel is available and that class provides for seating in excess of 40 inches then the standard (rather than the reduced) rate of APD applies.				
The current rates of APD are £10 (reduced rate) and £20 (standard rate) for travel to European Economic Area destinations <sup>3</sup> and £40 (reduced rate) and £80 (standard rate) for travel to all other destinations.				

Reforming APD takes account of the need, in the present economic circumstances, to mitigate the potential impact on the air-freight sector, the impact on employment in this sector, and the wider business community which relies on air-freight services; it will also avoid the potential impacts on domestic routes and regional employment that a per plane tax could have had.

Recognising the short-term economic pressures and consequential reduction in demand for air travel, revenues from the aviation industry have also been revised in the short term from Budget 2008 forecasts. The Government estimates the carbon dioxide impacts of the reform of APD to be 0.6 million tonnes of carbon dioxide (MtCO<sub>2</sub>) in 2011-12. Coupled with savings from the doubling of APD rates in 2007, this will achieve a combined reduction of 1.2 MtCO<sub>2</sub> in 2011-12.

The following sections look at the impacts of the APD reform in more detail.

### **Number of businesses affected**

There are around 280 airlines operating flights to and from the UK which are registered for APD and will be affected by the changes to a greater or lesser extent. No new businesses will be brought within the scope of tax.

### **Compliance cost analysis**

Compliance costs are made up of a number of components, including one-off costs arising from the transition to the new APD regime (e.g. time spent becoming familiar with the changes) and continuing costs of complying with the APD system, known as the administration burden. This covers things such as providing information to HMRC to calculate or verify the amount of tax due and record keeping requirements. The various costs are examined in more detail below.

#### ***One-off costs***

The one-off costs of the APD reform will include familiarisation with the new policy, software changes to update existing systems and, possibly, some re-pricing costs.

<sup>3</sup> EEA destinations comprise all EU member states, Norway and Iceland and countries applying to join the EU. The reduced rates of APD also apply to those in the European Common Aviation Area – Albania, Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia, the Republic of Kosovo, Montenegro, Serbia and Switzerland.

## *Familiarisation*

Familiarisation refers to the time airlines will need to spend reading about and comprehending the nature of the changes. This will mainly involve understanding the new distance bands and identifying those flights falling within each band.

We have assumed a range of between 1-3 hours for small airlines (who are more likely to serve a limited number of destinations) and between 3-9 hours for large airlines who typically operate wide networks. Using hourly wage rates informed by HMRC's Standard Cost Model (SCM)<sup>4</sup>, the estimated cost for a typical small airline is around £25-£75 and for a large airline might be around £65-£200.

In total, familiarisation is estimated to cost around £14,500-£44,600 for all APD registered airlines.

## *System changes/updates*

Some work may be needed to ensure airlines' booking and payment systems can cope with the new distance bands and duty rates. As with familiarisation, much of the APD structure remains unchanged so any system changes or software upgrades are expected to be relatively straightforward, more in line with annual updates rather than wholesale system changes.

Using the SCM, these costs are estimated at around £100-£150 for a small airline and around £300-£500 for a large airline. These average costs translate to total costs of about £72,000-£118,000 for all APD registered airlines.

## *Re-pricing*

It is recognised that some airlines may need to consider whether to change or reprint published material such as internet sites or catalogues as a result of the APD changes. This would give rise to 'menu costs', the costs to a company of changing prices. Airlines typically change prices very frequently, and make extensive use of the internet, and we expect that in most cases the changes will be built into existing re-pricing rounds (and so would not represent an additional unplanned cost). The APD reform was announced at the 2008 PBR with an implementation date of 1 November 2009, giving airlines just under one year to plan for the changes.

## *Total one-off costs*

The total one-off costs of the APD reform are estimated at around **£85,000-£160,000**.

## ***Continuing costs***

The SCM is used to estimate these costs. The model splits the process of returning and recording information into a number of different information requirements, each with its own cost.

Under the APD reform, the basic method of completing tax returns will be unchanged. General administrative processes such as reporting an airline's APD registration number, details of the period for which the return covers and the signatory of the account will be exactly the same, as will recording the total number of passengers carried in the reporting period, including those exempt from paying APD (e.g. cabin crew).

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<sup>4</sup> The SCM is used to estimate the costs to business of complying with HMRC tax obligations. The model looks at the activities a business has to undertake to comply with HMRC obligations, how many businesses are involved and how often they must do so.

Under the new four band distance structure, airlines (or their agents) will be required to collect and return information for passengers flying to a final destination in each of the four bands. Band A (up to 2,000 miles) is very similar to the existing EEA band with the addition of a few North African countries and Russia (west of the Ural Mountains). We assume that the cost to airlines of collecting the relevant information and calculating the duty for Band A passengers will be broadly unchanged from the current EEA band.

Passengers currently accounted for within the non-EEA band will have to be split into three new bands depending on how far they are flying: Band B (2,001-4,000 miles); C (4,001-6,000 miles); or D (over 6,000 miles). This process is expected to take slightly more time. Many airlines will have automated systems and any manual checks should be reasonably quick and straightforward. We assume that it will take no more than 50% longer to complete this task and probably less (we have used a range of 25-50% in this assessment). Using hourly wage rates in the SCM, this gives an additional annual cost of around **£45,000-£85,000**.

### ***Impact on HMRC***

APD is one of the cheapest taxes to collect, costing HMRC just 0.06 penny per pound of revenue collected in 2007-08. Collection costs will be largely unchanged following the APD changes. HMRC computer systems will need updating to reflect the new distance bands and duty rates but the cost of these changes is minimal. Providing advice and guidance on changes to the tax system is a routine part of HMRC's business and does not represent an additional cost to HMRC.

### **Revenue impact**

The Exchequer impact of the APD reform is set out in Table B5 of the PBR on page 194, comparing revenue with that forecast at Budget 2008. As explained in the PBR, tax revenue has been revised down to take account of economic conditions, by around £60m in 2009-10, £160m in 2010-11 and £50m in 2011-12.

### **Economic impacts**

#### ***Passenger demand***

Changes to APD rates and the addition of new distance bands will have an effect on prices and therefore on the number of passengers who fly. HMRC has a model that forecasts APD revenue and passengers based on historic data on air fares, GDP and passenger numbers. Econometric techniques are used to estimate the relationship between these variables.

We estimate that the APD changes will reduce the number of passengers flying from the UK by around 1% in 2010-11 and by around 1.5% in 2011-12 compared with a baseline of no changes to APD (other than increasing rates each year for inflation). Using data from the Civil Aviation Authority on average aircraft capacity and load factors (i.e. proportion of seats filled), this gives an estimated reduction in flights of around 4,000 (0.4%) in 2010-11 and 7,000 (0.6%) in 2011-12, again compared with the baseline. This has environmental benefits (see carbon and environmental assessment below).

#### ***Transit and transfer passengers***

APD has an exemption for transit and transfer passengers<sup>5</sup>, who make up around 13% of all passengers at UK airports. About three-quarters of these passengers are international-to-

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<sup>5</sup> Transfer passengers change aircraft at connecting stops while transit passengers stay on the same aircraft for the onward journey.

international transfers<sup>6</sup> who are exempt from APD so as not to damage the UK's position as an international hub for air travel. If they were subject to UK aviation taxation they might switch to using a European hub airport instead, reducing UK emissions but leaving total emissions in Europe broadly unchanged, and with a loss of traffic from the UK to European hubs. In practice this effect is very difficult to quantify, although it is clearly a risk. Network airlines argue that transfer passengers can benefit the wider economy by allowing airlines to operate a wider network than they might otherwise, which in turn can make commercially marginal services more viable, potentially benefiting regional airports and economies.

APD is also designed to minimise the incentive for passengers to take a short flight to Europe and then connect on to their final destination, instead of flying direct, in order to pay less tax. The 'connecting flight' rule means that passengers departing from the UK pay APD based on their final destination, irrespective of whether this is a direct service or via a series of connecting flights. This is important because it allows APD to be reformed to send better environmental signals, by adding new distance bands and duty rates, without leading to this unintended consequence. It also makes aviation taxation fairer (those who fly longer distances and pollute more pay more) and more efficient (APD sends a better signal about the environmental costs of flying, helping to allocate resources across the economy more efficiently).

Currently some passengers may take commercial decisions which reduce their APD liability by buying separate (i.e. non-connecting) air tickets, where this is possible. This will remain an option under the APD changes. However, in these cases there can be significant time penalties involved, since passengers not on connecting tickets must retrieve their luggage and re-check in at the European hub. There could also be higher airport charges and other costs. The added time and inconvenience will significantly limit the extent to which people choose to buy separate air tickets to avoid paying a modest increase in APD on longer distance flights.

### ***Air freight***

Freight only flights are outside the scope of APD since they carry no passengers so changes to APD do not directly affect the dedicated air freight industry. Air freight is also carried in the cargo hold of passenger aircraft ('bellyhold'). These flights are liable to APD according to the number of passengers carried and their final destinations and this will continue to be the case following the APD reform.

### ***Business and general aviation***

Business and general aviation is an industry term used to refer collectively to the smaller end of aviation. The sector is highly diverse and varies from small air taxi firms and small businesses that operate or manage corporate jets to the private individual who builds and flies his own aircraft as a hobby.

Most of the business and general aviation sector falls outside the scope of APD because the aircraft used in this sector are either less than 10 tonnes or equipped to carry less than 20 passengers (the de minimis threshold for paying APD). The APD changes will therefore have minimal impacts on the sector.

### **Specific Impact Tests**

Full details of the specific impact tests can be found at: <http://www.berr.gov.uk/whatwedo/bre/policy/scrutinising-new-regulations/preparing-impact-assessments/toolkit/page44263.html>. These have been applied to the APD changes in this Impact Assessment.

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<sup>6</sup> E.g. someone flying from New York to Dubai via London Heathrow

## ***Carbon and Other Environment Assessment***

The APD reform is estimated to save approximately 0.4 million tonnes of carbon dioxide (MtCO<sub>2</sub>) in 2010-11 and 0.6MtCO<sub>2</sub> in 2011-12 when compared with making no changes. Allowing for the global warming effect of non-CO<sub>2</sub> emissions released at altitude<sup>7</sup>, these savings are equivalent to around 0.7MtCO<sub>2</sub> in 2010-11 and 1.2MtCO<sub>2</sub> in 2011-12 emitted at ground level.

The emissions savings can be valued (in terms of the avoided damage costs of climate change from fewer tonnes of carbon dioxide emitted) using the 'shadow price of carbon' recommended by the Department of Energy and Climate Change for use in policy appraisal<sup>8</sup>. This gives values of approximately £10m in 2010-11 and £20m in 2011-12. If radiative forcing is included, the values increase to around £20m in 2010-11 and £36m in 2011-12.

There will be other environmental benefits from the APD reform, including reduced emissions of nitrogen oxides (NO<sub>x</sub>) and particulates and less noise and congestion around airports due to fewer flights. These have not been quantified in this assessment.

## ***Competition Assessment***

All airlines operating taxable flights to a given destination band or country will be affected equally by the APD changes, so competition between these businesses will be unaffected.

By altering the relative prices of long and short-haul flights, and introducing new distance bands, there might be competition effects between airlines operating different route networks, to the extent that passengers alter their travel patterns in response to tax changes (e.g. choosing to holiday in Europe rather than the US). As explained in the PBR, the aim of the reform is to send better signals about the environmental impacts of flying, which makes APD fairer and more efficient from an environmental perspective.

The Government recognises the pressures on the aviation industry at this time, from a combination of high oil prices last year and the global economic slowdown reducing the demand for air travel. There have been a number of failures in the sector, including amongst UK airlines. By revising down APD revenues in the short term, the Government is helping support competition at a challenging time for airlines.

More generally, the reform should not limit the ability of suppliers to compete or reduce their incentives to do so. For example, new routes often operate with low load factors initially as the service becomes established. By charging per passenger, APD does not discourage the setting up of new routes.

## ***Small Firms Impact Test***

The APD reform extends the number of destination bands, and consequently the number of rates applicable; however, it does not extend the tax base. The changes therefore affect the existing 280 or so registered airlines, of which approximately 100 are classified as small businesses. No new businesses are brought within the scope of tax.

APD makes allowances for small businesses, with a de minimis exemption for flights made in aircraft of less than 10 tonnes and/or equipped to carry fewer than 20 passengers. This allowance excludes the majority of the small businesses in the aviation sector. As explained above, the vast majority of the business and general aviation sector, which is made up of many small businesses, does not pay APD as they are excluded from the tax and, therefore, are

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<sup>7</sup> Known as radiative forcing. The Government's current central estimate is a radiative forcing multiplier of 1.9.

<sup>8</sup> See <http://www.defra.gov.uk/environment/climatechange/research/carboncost/pdf/HowtouseSPC.pdf>



unaffected by the proposed banding changes. We do not expect the small businesses that do pay APD to be disadvantaged by the changes relative to larger airlines. In general, they are unlikely to operate flights to the long haul destinations affected by the changes, and consequently are less likely to incur the relatively more expensive compliance costs involving advisers and system changes/upgrades. This should mean that a small airline will take less time to implement the changes.

### ***Rural Proofing***

Some services to UK regional airports operate with low load factors. As a per passenger tax, APD should not adversely affect the ability of those living in rural areas to fly compared with those living elsewhere (since less full aircraft pay less tax).

### ***Other impacts***

The changes to APD are not expected to have any significant impacts on legal aid, sustainable development, health, race, disability, gender or human rights.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No