

Making aviation pay its way - the case for raising more revenue from plane journeys

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Summary

One of the reasons why air fares are relatively low compared to other forms of transport is that aviation enjoys significant exemption from taxes, including VAT and fuel duty. These exemptions are estimated to be worth about £10 billion a year¹, and mean that aviation is under-taxed compared to road transport.

Green Alliance recommends that the Government raises aviation taxation to remove the disparity with road fuel taxation, and to increase the revenues raised from aviation to allow reduced taxation of income. We estimate that Government could raise an additional £2.5 billion a year by 2013, which could be used to reduce income taxation and support economic growth. For example, £2.5 billion is equivalent to the cost of reducing the employees' National Insurance Contributions by over 0.5%.

Analysis by the Policy Studies Institute suggests that the Government should reform aviation taxation at the same time as increasing its level, and replace the Air Passenger Duty (APD) with a Per Plane Duty (PPD). This would give the airlines a much greater incentive to reduce the environmental impact of planes.

Revenue from green taxation has fallen in the last parliament, but the Coalition Government has committed to increasing it. An early increase in aviation taxation should be the first in a series of tax changes that enable less revenue to be raised from things in society we want to encourage, like job creation and innovation, by placing a fair price on pollution and taxing things we want to reduce, like fossil fuel use.

Correcting historic 'under-taxing' of aviation sector

Aviation has historically been under-taxed, compared to other transport modes. The Treasury estimate that if aviation fuel was taxed at an equivalent rate of road fuel, then the sector would be contributing a further £6.5 billion per year to the Exchequer. Air tickets and the purchase of aircraft equipment are also currently exempt from VAT. If

¹ Treasury Minister Angela Eagle MP stated in a Commons debate on June 10, 2008 that if aviation fuel were taxed at the same rate as cars, coaches and diesel trains then it would pay an additional £6.5 billion in tax. The Transport Select Committee in 2010 calculated that removing the VAT exemption would raise another £2.3 billion.

all tax exemptions are taken into account, then the sector receives approximately £10 billion of tax breaks each year. For example, if you compare a journey made by car from London to Edinburgh, the average tax paid would be around £30, for London to Newquay, it would be around £25, compared to £11 if the passenger took a plane.² The average CO₂ emissions per passenger per km is 2-3 times higher for the airline passenger.³

Per Plane Duty should replace Air Passenger Duty

Taxing the plane and not the passenger will also create a stronger incentive for airlines to be more efficient and maximise the number of passengers per flight.

The Green Fiscal Commission published a major report in 2009, which presented evidence of significant economic, social and environmental benefits to be made if the proportion of national revenue from environmental taxes was doubled over ten years. In particular its economic modelling found that an extra 450,000 jobs could be created over ten years, and UK emissions reduced by over 30MtC.⁴

This evidence suggests that PPD should be increased further in future years, with the extra revenue used to reduce other taxes such as National Insurance Contributions, the so-called 'tax on jobs'. If PPD ultimately raised aviation taxation to the equivalent of road fuel duty and VAT, then it would raise sufficient extra revenue to cut employee NICs by 1.5%.

Effect of PPD on air fares

The impact of the PPD on passengers will depend to what extent airlines pass on the cost in ticket prices and how they distribute those costs between economy, business and first class passengers, as well as freight users and transit passengers. The latter two groups do not pay APD, so are currently exempt from all aviation tax. Our calculations also show that if the PPD were distributed across passengers according to their relative environmental impact, the business and first class tickets would take on a higher proportion of the costs than economy tickets and a higher proportion than they do under APD. This is because premium passengers take up more space and weight in a flight than their economy counterparts.

If Government chose to raise an additional £2.5 billion from plane journeys the estimated average extra tax increase for short haul flights would be around £25 per passenger (business or economy). For longer haul flights the increases would be greater as the tax increases with distance flown. An economy London to New York flight would be taxed by an extra £50-60, and business or first class tickets would go up by £200-300.

According to the Civil Aviation Authority's statistics, most air travel is by the wealthiest 20% of the population, with people on low incomes flying very little. Increasing aviation taxation is therefore not regressive, and can be progressive if other taxes,

² Calculation based on tax of fuel used in an average car travelling those journeys with a single occupant and the rate of Air Passenger Duty for a domestic flight (£11)

³ Source data from ATOC, using SMMT, easyJet and Ryanair figures.

⁴ Green Fiscal Commission (2009), *The case for Green Fiscal Reform*.

which are paid by low-income groups, are reduced as a consequence of the new revenue stream.

Effect of PPD on the aviation industry

PPD would be non-discriminatory in terms of airlines, so all planes that take off from UK airports would be subject to the tax, regardless of carrier. This means that there is no reason why airlines should not pass on the full cost of the duty to their customers, be they passengers or freight.

Studies into the price elasticity of air travel do suggest that higher fares will reduce demand. However, any reduction in demand for flying will be counterbalanced by increases in video-conferencing, train travel or domestic tourism, all of which will provide economic benefits for the country and are more consistent with developing a low carbon economy.

In 2012 the aviation sector will enter the EU Emissions Trading Scheme, which means airlines will need carbon permits to reflect their emissions. However, the terms on which the sector will join the scheme are generous and the overall cap for the EU ETS is not yet sufficient to deliver the reductions in greenhouse gas emissions required to prevent dangerous climate change. If the EU ETS were reformed to ensure full auctioning of permits and a more ambitious emissions cap then there could be a case for reducing national aviation taxation. In the interim tax measures, such as those we propose, will be required to ensure the industry is paying its way, and that competitors in the telecoms and transport sectors are not disadvantaged.

Technical issues

There are a number of detailed technical issues around the design of the PPD that would need to be resolved before its introduction. The Policy Studies Institute have produced a more detailed briefing on the PPD, *A new basis for aviation taxation*, which addresses many of these.⁵ We recommend that the details be resolved by Government so that the measure can be introduced by April 2011.

Acknowledgements

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⁵ Policy Studies Institute (2010), *A new basis for aviation taxation* – a briefing on the introduction of an aviation tax based on per-plane duty, by Simon Dresner.