Air Departure Tax (Scotland) Bill

Financial memorandum

Introduction

1. As required under Rule 9.3.2 of the Parliament's Standing Orders, this Financial Memorandum is published to accompany the Air Departure Tax (Scotland) Bill, introduced in the Scottish Parliament on 19 December 2016. The contents are entirely the responsibility of the Scottish Government and have not been endorsed by the Parliament.

2. The following other accompanying documents are published separately:

- statements on legislative competence by the Presiding Officer and the Cabinet Secretary for Finance and the Constitution (Derek Mackay MSP) (SP Bill 3–LC);
- Explanatory Notes (SP Bill 3–EN);
- a Policy Memorandum (SP Bill 3–PM).

3. The Policy Memorandum explains in detail the background to the Bill and the policy intention behind the Bill. The purpose of this Financial Memorandum is to set out the costs associated with the measures introduced by the Bill, and as such it should be read in conjunction with the Bill and the other accompanying documents.

Background

4. The Bill is brought forward as a consequence of measures enacted in the Scotland Act 2016[1] ("the 2016 Act") which received Royal Assent on 23 March 2016. The Bill makes provision for a tax charged on the carriage of passengers by air from airports in Scotland, to be called Air Departure Tax ("ADT"). The 2016 Act also provides a regulation-making power at section

---

1 http://www.legislation.gov.uk/ukpga/2016/11/part/2/crossheading/devolved-taxes

19 to disapply UK Air Passenger Duty ("APD") in Scotland. The primary APD law can be found in the Finance Act 1994 (sections 28-44 inclusive and schedules 5A to 6), as amended.

5. Revenue Scotland, Scotland's tax authority for devolved taxes, will be responsible for the collection and management of ADT. The proposed legislative framework for the collection and management of ADT will be provisions in Part 4 of the Bill and the Revenue Scotland and Tax Powers Act 2014 ("RSTPA 2014"), as amended by schedule 2 of the Bill.

6. The provisions of the 2016 Act which disapply the existing UK APD regime in Scotland will be brought into force with effect from 1 April 2018 by regulations laid by Her Majesty's Treasury in the UK Parliament. The intention is that the provisions introducing ADT will come into force as soon as APD is disapplied. At that point, in order to ensure the continued collection of tax receipts, the Scottish Government will have arrangements in place for the collection and management of ADT and, from that day on, all receipts raised in respect of ADT will be added to the Scottish Consolidated Fund.

Summary of costs arising from the Bill

7. Table 1 below summarises the costs expected to arise from the Bill.

Table 1: Summary of costs

	Set-up costs	Annual running costs	Tax revenue 2018-19*
Revenue Scotland	£1,455,000	£555,000	-
Scottish Fiscal Commission	£75,000	£55,000	-
Scottish Government	-	-	£326,000,000
Local Authorities	-	-	-
Aircraft Operators	-	£75,000	-

* Estimated tax revenue is based on the assumptions outlined in Section A on the tax rate amount and trends in travel by air.

Costs on the Scottish administration

8. The financial implications of the Bill for the Scottish Administration have been considered under three sub-headings:

A. Implications of ADT for the Scottish budget. ADT receipts will vary depending on the number of chargeable passengers carried on chargeable aircraft, exemptions claimed, the tax band and tax rate structure and the tax rate amounts set;
B. The administrative and compliance costs that Revenue Scotland is likely to incur as the body responsible for collecting and managing ADT; and
C. The costs that the Scottish Fiscal Commission is likely to incur as the body responsible for preparing official tax receipt forecasts for ADT for the Draft Budget 2018-19 onwards.

9. All costs detailed in this document are based on a scenario whereby the tax banding and tax rate structure, exemptions and tax rate amounts for ADT are similar to those under APD. The proposed tax rate structure is set out in the Bill as introduced, and detail on the tax banding structure, exemptions and tax rate amounts will be delivered at a later date.

10. The estimated costs cover the implementation of the Bill from 2016-2017; they do not include the costs of legislating to bring ADT into existence. In practice, costs of legislating will be borne within the existing administration budgets of the Scottish Government and the Scottish Parliament.

11. Under paragraph 36 of the fiscal framework[2] agreed between the Scottish Government and UK Government, the Scottish Government will reimburse the UK government for any net additional costs wholly and necessarily incurred in 'switching off' APD in Scotland. Her Majesty's Revenue & Customs ("HMRC") has confirmed that there will be no net additional costs from switching off APD (relatively few changes are likely to be required to HMRC's systems) and therefore there will be no reimbursement from the Scottish Government to the UK Government.

A. The implications for the Scottish budget from ADT

12. The net effect on the total Scottish budget depends on tax receipts from ADT offset by an adjustment to Scotland's block grant. This Memorandum does not discuss the block grant adjustment. However, in relation to ADT, under the terms of the fiscal framework the Scottish Government's budget will be reduced to reflect the fact that the Scottish

[2] http://www.gov.scot/Publications/2016/02/3623/1

Government will retain receipts from ADT from 1 April 2018 onwards. The reduction will be set equal to the amount of estimated APD generated in Scotland in the year immediately prior to devolution (2017-18). In subsequent years this amount will be indexed in line with the growth in comparable receipts per person in the rest of the UK (see paragraphs 15-19 of the fiscal framework agreement for an overview of this indexation mechanism). The devolution of powers over APD to the Scottish Parliament does not therefore give the Scottish Government any additional resources, all other things being equal, unless rates were raised above levels in the rest of the UK. Similarly, if rates were reduced below levels in the rest of the UK, then there would be a reduction in the Scottish budget.

13. Tax receipts will vary depending on the number of chargeable passengers carried on chargeable aircraft, exemptions claimed, the tax band and tax rate structure and the tax rate amounts set. Detail on the tax banding structure and tax rate amounts is not set out in the Bill and will be delivered at a later date. The Scottish Government is committed to delivering a 50% reduction in the overall burden of ADT by the end of the fifth session of the Scottish Parliament, with the reduction beginning in April 2018, and with a view to abolishing the tax when resources allow. The Scottish Government will publish information on the full range of impacts of a 50% reduction in the overall burden of ADT when it publishes its proposals on how the reduction should be implemented. This is likely to include assessments of the economic, financial, environmental and transport (including rail) impacts.

14. The Office for Budget Responsibility ("OBR") published its "Economic and fiscal outlook – November 2016"[3] report on 23 November 2016. The report forecasts how much APD would be generated in Scotland from 2016-17 to 2017-18 as well as future revenue from a Scottish replacement tax from 2018-19 to 2021-22. The forecast, which is set out in Table 2 below, is based on the assumption that the same share of APD revenue would be raised in Scotland throughout the forecast period. The share of APD revenue raised in Scotland was estimated by using the mid-point between the 2015-16 estimates presented by HMRC (9.6 per cent) and the Scottish Government (9.1 per cent) in the National Statistics Government Expenditure and Revenue Scotland ("GERS") publication.

[3] http://budgetresponsibility.org.uk/efo/economic-and-fiscal-outlook-november-2016/

15. It should be noted that the HMRC estimate of 2015-16 outturn is £296 million and the Scottish Government's estimate presented in GERS is £275 million. The OBR forecast uses a baseline centred on the average of these two estimates and should be interpreted accordingly.

Table 2: Tax revenue forecast

Year	Estimate
2016-17	£302,000,000
2017-18	£313,000,000
2018-19	£326,000,000
2019-20	£342,000,000
2020-21	£360,000,000
2021-22	£378,000,000

16. As a consequence of the methodology used, the forecast for the Scottish replacement tax from 2018-19 onwards moves in line with the UK forecast, which is driven by the estimated number of passengers across the different APD bands and the applicable tax rate. APD tax rate amounts are set to rise in line with the Retail Prices Index forecast, rounded to the nearest pound, in line with the UK Government's stated uprating assumption. The forecast is therefore also affected by the inflation forecast. A separate adjustment is included in the model for the increasing trend in the share of passengers using low-cost operators.

17. From 1 April 2017 the Scottish Fiscal Commission will assume responsibility for the production of independent forecasts of revenues from ADT that will inform the Scottish Government's Draft Budget 2018-19 and onwards.

B. Costs to revenue Scotland of administration and compliance of ADT

18. Revenue Scotland[4] was established by the RSTPA 2014 as a Non-Ministerial Department ("NMD") on 1 January 2015. As an NMD, governed by a Board, Revenue Scotland is part of the Scottish Administration, accountable to the Scottish Parliament to ensure that the collection and management of the devolved taxes is independent, fair and impartial.

[4] https://www.revenue.scot/

19. Revenue Scotland is the tax authority responsible for the collection and management of Land and Buildings Transaction Tax (“LBTT”) and Scottish Landfill Tax (“SLfT”). These taxes came into effect on 1 April 2015, replacing their UK equivalents (Stamp Duty Land Tax and UK Landfill Tax respectively). Revenue Scotland will also be responsible for the collection and management of ADT from 1 April 2018 and will establish a programme of activity to deliver the systems, processes and other requirements for ADT.

20. The Scottish Government will meet the additional costs to deliver ADT. These include the costs associated with the programme to deliver ADT and the costs of establishing a staff team to collect and manage the tax from 1 April 2018.

21. Revenue Scotland’s costs have been presented under two headings: set-up (programme) costs and running costs, with each one split between staff, IT, non-staff and other programme costs. Set-up costs are those estimated to be incurred during the development of a business case and establishment and management of the programme from April 2016 to 1 April 2018. Costs are rounded to the nearest £5,000. Some modest staff and other costs have been incurred prior to the introduction of the Bill and are included in the costs below.

Table 3: Summary of estimated Revenue Scotland set-up costs for ADT

	2016-17	2017-18	Total Set-up costs	Further information
Staff costs Programme	£130,000	£630,000	£760,000	1.75 FTE in 2016-17 10.25 FTE in 2017-18
Operations	£80,000	£270,000	£350,000	1.25 FTE in 2016-17 5.75 FTE in 2017-18
Non-salary costs Programme	£35,000	£65,000	£100,000	Includes training, office equipment etc.
Operations	£25,000	£65,000	£90,000	
Other costs	£10,000	£25,000	£35,000	Includes Gateway Reviews, stakeholder

				events, travel and subsistence etc.
IT costs	0	£120,000	£120,000	Development of new ADT module on Revenue Scotland's existing tax collection system
Total	£280,000	£1,175,000	£1,455,000	

22. The staff costs provided in Table 3 above represent Revenue Scotland's best estimate of the staffing resources that will be needed for the programme to deliver ADT. Staff costs are based on the Scottish Government's average salary costs for 2015-16 and a 1% uplift across grades for each year thereafter.

23. The non-staff costs cover the need for desks, IT, training and other running costs associated with employment of staff. These are assumed to be £5,000 per annum for each member of staff.

24. The 'other costs' in Table 3 above and Table 4 below include associated programme costs or other costs associated with managing the tax such as Gateway Reviews, stakeholder events and travel and subsistence related to compliance activity required to protect the revenue.

25. An annual inflation rate (using OBR/Bank of England Consumer Price Index projections) of 2% is applied to all IT costs. Due to the tendency to underestimate programme costs, HM Treasury advises an Optimism Bias uplift should be applied in project appraisals. An Optimism Bias uplift of 41% is recommended for outsourced IT projects and this has been applied to all IT costs in both Table 3 above and Table 4 below. The IT costs also include VAT at 20%.

26. The costs to collect and manage the tax in the first year, 2018-19, are set out in Table 4 below.

Table 4: Summary of estimated Revenue Scotland running costs for first year of ADT

	2018-19	Further information
Staff costs	£450,000	9.75 FTE
Non-salary costs	£60,000	Includes travel and subsistence, training, office equipment etc.
Other costs	£25,000	Includes travel and subsistence, stakeholder events etc.
IT costs	£20,000	Estimated running costs for new ADT module on Revenue Scotland's existing tax collection system
Total	£555,000	

27. In the first year of the tax, additional costs will be incurred, comprising staff costs of closing down the programme after the introduction of tax (£125,000, 1.75 FTE) and the associated non-staff costs (£20,000). This means that the total costs, including the programme-related costs, for ADT in 2018-19 have been estimated at £700,000.

C. Costs to the Scottish fiscal commission of preparing tax receipt forecasts for ADT

28. The Scottish Fiscal Commission ("SFC")[5] was established in June 2014 as a non-statutory body, with an initial remit to provide independent scrutiny of Scottish Government forecasts of receipts and economic determinants from taxes devolved to Scotland. The fiscal framework agreed between the Scottish Government and UK Government, which accompanied the Scotland Act 2016, resulted in the remit of the SFC changing.

29. On 1 April 2017 the SFC will be become a Non-Ministerial Department within the Scottish Administration, and will assume responsibility for the production of independent forecasts of revenues from the fully devolved taxes (including ADT) and income tax in Scotland. It will also, subject to parliamentary approval, become responsible for preparing independent forecasts of onshore GDP and demand-led social security

[5] http://fiscal.scot/

expenditure. Analysts in the SFC will develop a model of ADT and then maintain the model and produce independent forecasts of revenues to inform the Scottish Government's Draft Budget 2018-19 and onwards.

30. The costs provided in Table 5 below estimate the set-up costs that the SFC is expected to incur in 2017-18 as it prepares to takes on the responsibility of producing independent forecasts of ADT revenues. The costs provided in Table 6 below estimate the running costs that the SFC is expected to incur in 2018-19, after ADT has come into effect. Costs are rounded to the nearest £5,000.

31. The staff costs provided in the tables represent the SFC's best estimate of the staffing resources that will be needed to prepare for and then produce independent forecasts of revenues of ADT. Staff costs are based on the Scottish Government's average salary costs for 2015-16 and further uplifted by 1% thereafter. The non-staff costs cover the need for desks, IT, training and other running costs associated with employment of staff. These are based on 5% of the SFC's projected total non-staff costs.

Table 5: Summary of estimated SFC set-up costs for ADT

	2017-18	Further information
Staff costs	£65,000	Based on 0.75 FTE B3 and 0.4 FTE C1
Non-salary costs	£10,000	Based on 5% of Commission projected total non-staff costs Includes travel and subsistence, training, office equipment etc.
Total	£75,000	

Table 6: Summary of estimated SFC running costs for first year of ADT

	2018-19	Further information
Staff costs	£45,000	Based on 0.5 FTE B3 and 0.25 FTE C1
Non-salary costs	£10,000	Based on 5% of Commission projected total non-staff costs Includes travel and subsistence, training, office equipment etc.
Total	£55,000	

Costs on local authorities

32. There are no costs associated with the introduction of ADT that are expected to be incurred by local authorities.

Costs on other bodies, individuals and businesses

33. Economic appraisal captures the full costs of a programme, no matter who incurs them, and is used to ensure that public sector funds deliver the maximum benefits to society as a whole. Since aircraft operators will be the taxpayers under ADT, the relative costs they are expected to incur for implementation and operation of the tax (but excluding the tax burden) are included in this section.

34. In summer 2016, Revenue Scotland held two workshops with representatives of aircraft operators to help inform the development of its Business Case for ADT. Given the relatively small numbers of taxpayers of APD, the views of aircraft operators provided at the workshops have strong credibility in representing the sector.

35. As UK APD has been a well-established tax since 1994, is assumed that the data on the numbers of air passengers departing Scottish airports is already available from aircraft operators' existing systems for the purposes of APD and that there will be no additional IT development costs to aircraft operators arising from the introduction of ADT.

36. At the workshops, aircraft operators estimated the staffing resource required to complete tax returns at two days per return. Most of this resource is required to obtain the necessary data from the aircraft operators' own systems for the purposes of completing a tax return. It has been assumed that there are 100 regular aircraft operators making quarterly tax returns, totalling 800 working days in total per annum. Aircraft operators' staff rates are assumed to be equal to Revenue Scotland administration officer A3 grade pay.

37. The costs to 100 airlines for making quarterly tax returns for ADT are calculated as follows:

Annual salary (2018-19) (based on A3 grade)	£24,203

Salaried hours per annum	1950
Annual admin (8 days * 7.5 hours)	60
Administrative cost per aircraft operator	£745
Number of aircraft operators	100
Total estimated cost to industry	£75,000 (to nearest £5,000)

38. The total annual cost to 100 aircraft operators for making ADT returns is therefore estimated at £75,000, or £745 per aircraft operator.

39. The aircraft operators are liable to pay ADT per chargeable passenger. However, there is nothing in the Bill that either requires or prevents aircraft operators from passing the cost of the tax (or the benefit of any reduction in the tax) onto passengers. The tax banding structure and tax rate amounts are not set out in the Bill and will be delivered at a later date. Table 7 sets out current bands and rates of UK APD.

Table 7: UK APD rates for flights originating in the UK (excluding Northern Ireland)[6]

Destination Bands and distance from London (miles)	**Year**	**Reduced rate: (lowest class of travel available on the aircraft)**	**Standard rate (for travel in any other class of travel)**	**Higher rate: (aircraft of 20 tonnes or more equipped to carry <19 passengers)**
Band A (0 to 2,000 miles)	2016	£13	£26	£78
	2017	£13	£26	£78
Band B (over 2,000 miles)	2016	£73	£146	£438
	2017	£75	£150	£450

[6] https://www.gov.uk/government/publications/rates-and-allowances-excise-duty-air-passenger-duty/rates-and-allowances-excise-duty-air-passenger-duty

This document relates to the Air Departure Tax (Scotland) Bill (SP Bill 3) as introduced in the Scottish Parliament on 19 December 2016

Air Departure Tax (Scotland) Bill

Financial memorandum

Produced and published in Scotland by the Scottish Parliamentary Corporate Body.

All documents are available on the Scottish Parliament website at:
www.parliament.scot/documents