

Welsh Affairs Committee

Oral evidence: [Devolution of Air Passenger Duty to Wales](#), HC 1575

Tuesday 8 January 2019

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Members present: David T. C. Davies (Chair); Tonia Antoniazzi; Guto Bebb; Chris Davies; Geraint Davies; Susan Elan Jones; Ben Lake; Jack Lopresti.

Questions 1-57

Witnesses

[I](#): Sir Paul Silk, Chair of the Commission on Devolution in Wales; and Gerald Holtham, Chair of the Independent Commission on Funding and Finance for Wales.

[II](#): David Phillips, Institute for Fiscal Studies; Mike Trotman, Associate Director, Deloitte LLP and member of the Chartered Institute of Taxation's Indirect Tax Technical Committee and Welsh Technical Sub-Committee; and Tom Walsh, Deloitte LLP.

Examination of witnesses

Witnesses: Sir Paul Silk and Gerald Holtham.

- Q1 Chair:** Good afternoon to Sir Paul Silk and Mr Holtham. Thank you for coming this afternoon. We have about 10 questions for this panel. I am keeping a bit of an eye on the clock because we might have at least one, and possibly two, votes coming in the middle. I am sure you will understand that things are a bit up in the air at the moment, for various reasons. We will do our best so there is no discourtesy to anyone before that happens.

May I first ask you both to summarise the conclusions you made on the respective merits and disadvantages, perhaps, of devolving air passenger duty? Mr Holtham first, left to right.

Gerald Holtham: When I look back at the report, what we said was that the Welsh Government should consider these three small taxes, one of which was air passenger duty—not because any of them had any revenue significance, but because they could be useful policy instruments, as long as they were not too expensive. That depended on the mechanism that the British Government used for reducing the block grant, once the tax was transferred. At the time we were writing, it was not clear what they were going to do.

We said the tax could be devolved but they should keep an eye on the cost. Our thinking was as follows: we knew that the Calman commission had recommended that APD be devolved in Scotland and we obviously looked at the Calman recommendations. Where we did not like the analysis or we thought that the Welsh circumstances were different, we rejected them. But we took the view that, all things being equal, you should keep devolution as symmetrical and simple as possible. If they were going to have it in Scotland, we should have it in Wales, unless there was a strong argument against.

Sir Paul Silk: We had the advantage of reporting after both Gerry's report and Calman, so we were able to look at the arguments in favour of the devolution of APD in both those reports. We came to the conclusion that APD was one of the smaller taxes that should be devolved. Most of our effort was concentrated on looking at major taxes that should be devolved, rather than APD, as indeed was the case with Gerry.

- Q2 Chair:** Has anything happened since then to change your minds about those recommendations?

Sir Paul Silk: In my case, having read some of the evidence in preparation for this, I am more convinced that it is a good idea than I was at the time. You might have noted a certain amount of equivocation in our report about whether APD should be devolved. I think I would be less equivocal about it now.

- Q3 Chair:** Mr Holtham, the same?



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Gerald Holtham: No, I think not, really. The only difference is that it has become much less material. It always was an extremely small tax from a revenue point of view, and it has halved since 2010. It now raises only £6 million in Wales, so it is not even a rounding error.

Q4 **Chair:** Why do you think the Government left this out? Why do you think the Government had not devolved this?

Gerald Holtham: Because of lobbying from airports in England—Bristol in particular, and, I think, to a lesser extent perhaps, Birmingham—who thought that it would give Cardiff an unfair advantage and divert traffic from them.

Q5 **Chair:** Would it, do you think? Yes or no. Can I push you on that?

Gerald Holtham: I haven't done any independent study of this. The most recent and thorough study was the Northpoint one, which I think was commissioned by the Welsh Government. That concluded that, yes, there was bound to be some diversion, but it would be extremely small in relation to the growth in air traffic, so you would not see a reduction in traffic in any other airport. It might grow a little more slowly, but you could justify some diversion from a UK national point of view, because Cardiff is an underutilised resource.

Instead of lengthening runways somewhere else, why not use one that it is underused? I think the Northpoint argument was that, yes, there is some diversion, but it is tolerable, and defensible in terms of the best use of available infrastructure.

Q6 **Ben Lake:** As part of the work that you both conducted, and from the contributors to some of the evidence sessions that you held, what were the biggest practical difficulties in devolving APD that they had identified?

Gerald Holtham: I do not think there is much of a practical difficulty. It is an easy tax to collect, and it is a very easy tax to know where it has been collected. One of the reasons that Calman and we thought, "Yes—this is a reasonable candidate," is that it does not raise any issues of collection, evasion or anything else. It is rather simple on that point.

Q7 **Ben Lake:** Moving on then to other EU states that perhaps have different rates of APD, one of which is Germany, I wonder whether you have a view on the way in which it works in Germany across the different regions, and whether there are any examples that could be applied to the UK?

Sir Paul Silk: I am not aware of whether there is any differential in tax in the different länder in Germany.

Gerald Holtham: I gather there is, but I am not an expert. The state aid rules, as applied by the EU, depend on physical distances. I am speaking from memory, but I believe that if two airports are more than an hour's journey apart they do not consider them to be in the same market for air traffic services, for short-haul flights. For long-haul flights, they have to be, I think, two hours apart—something like that.



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There are certain conditions laid down, which you should probably check rather than take my word for, for determining whether something is state aid or not. There are criteria depending on physical distance and time of travel, which determines whether you can have different tax rates applied to different airports, or whether they can be regarded as in different regions.

Sir Paul Silk: Precisely how that would operate after Brexit is, of course, an interesting question.

Ben Lake: I will not push you for an answer now.

Chris Davies: I should state that Sir Paul is a constituent of mine. Welcome to London, Sir Paul.

Ben Lake: He is one of your bosses.

Q8 **Chris Davies:** Absolutely. My question really relates to the block grant. How would you suggest that the Westminster Government address the block grant if tax is devolved to the Welsh Government?

Gerald Holtham: I can tell you how they would do it. You are probably all familiar with this, but there is an issue with how you adjust the block grant when you devolve tax.

In the first year, there is no difficulty—it is what the tax has been raising revenue-wise—but after that you cannot link the reduction in the block grant to the revenues received in the devolved territory, because if you do that you have not devolved the tax. If I put a tax rate up and it turns £100 million revenue, or £120 million, and you knock £120 million off the block grant, what have I done?

The adjustment of the block grant cannot be correlated with the actual revenues that are received in the devolved territory. That enables the devolved territory to have a policy instrument. They can raise or lower the tax and they will get more or less revenue and it will not be cancelled by the block grant. It also exposes them to risk: if the revenue goes up or down for reasons that they cannot control, they will have to take the lumps. It devolves risk, but it devolves authority, too.

On the other hand, you cannot just take the first year's revenue and say, "Okay. It is £100 million this year, so you will pay £100 million for ever", because the tax base will grow with the economy and inflation. You have to index the deduction to something, and the obvious something is the growth of tax revenue per head in England. That is what we recommended for income tax, and it is more or less what they have done, roughly.

It did not occur to us that you would want to do exactly that for all taxes, but that is what the Treasury has done. If it devolves APD, it will index the deduction from the Welsh block grant to the growth of APD revenues in the UK. Those double every 10 years, so you will have to run damn hard just to stay where you are. In that sense, it is an expensive tax to be devolved, because of how they will do the block grant adjustment. All you



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can say is that it has become such a trivial tax at £6 million that it really does not matter. It is not even a rounding error.

- Q9 **Chris Davies:** You mentioned in the previous answer that Cardiff was an under-utilised resource. If Cardiff became a much more utilised resource and therefore brought in more tax for that particular purpose, would that be an unfair advantage to Wales?

Gerald Holtham: I don't think so. As I say, I am dependent here on other people's research, but there would be some deviation of traffic. There is no question about that, but it would be quite small.

Bristol is a good hour away, so there may be small competition around the Newport area on which way you go for short-haul traffic. Birmingham is two hours away, so there may be small competition in Gloucester or Hereford over which way you go, but they are far enough away that there is quite a distinct catchment area. I think the diversion would be quite small relative to the expected growth of air traffic. That was the Northpoint conclusion, and it sounds sensible. I do not see why one would not accept it.

Sir Paul Silk: Of course, the present Welsh Government have said that they would reduce the rate of APD to zero. That would mean that there would be no tax revenue in Wales from APD.

- Q10 **Chris Davies:** Do you think, Sir Paul, that after your review, the Welsh Government are now in a position to take on more additional tax? Do you think the performance is such that we should allow further tax-raising powers to go to Cardiff Bay?

Sir Paul Silk: The important tax they will have to deal with is income tax, and that will be the really important test of their ability to deal with taxation and vary it in a way that is accountable, which was very important for us.

- Q11 **Chris Davies:** Getting to my point, do you think we should not even be discussing this now, but waiting until it has had a test?

Sir Paul Silk: No. This is such a small tax and so easy to administer that I do not think questions of competence enter into this.

Chris Davies: I didn't raise competence, of course; you did.

- Q12 **Chair:** Just a quick question to Mr Holtham. Based on what you are saying, there is a danger, if we devolve air passenger duty, that we will see a big growth in APD collected across the UK if things such as the next Heathrow runway go ahead, which could impact negatively if the UK Government decided to reduce the Welsh block grant by ever increasing amounts to make up for an air passenger duty tax that we may not be raising.

Would it not be easier therefore to calculate—I was trying to do it just now—what £6 million is as a percentage of the total £3.5 billion collected and deduct whatever that percentage is from the block grant? There must



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be a way of doing it that is not unfair on the Welsh Government, if you were going to do it.

Gerald Holtham: The point is that the Treasury is probably not going to consider it worth even thinking about. It is £6 million in a budget of £15 billion; suppose it does double over the next 10 years, then it is £12 million. It is still less than one-tenth of 1% of the budget, so it has become a trivial number. I cannot imagine that they are going to spend a lot of time on devising different methods of doing the block grant.

- Q13 **Susan Elan Jones:** I am a north Walian, so I am a bit concerned about this. I am concerned when Manchester airport submits evidence that says things like "While it could be argued that the devolution of APD could aid the development of Cardiff airport, it could have a major impact on the ability of those serving the north of the country, predominantly Manchester airport, to attract new routes of strategic importance to the north Wales economy." John Lennon airport in Liverpool has made a similar submission. We all know that no one from north Wales uses Cardiff airport. Surely it is not the same sort of argument that you could have about devolving broadcasting, policing, or other aspects. Whatever the views, you would be talking about devolution to Wales. Surely this is about devolution for what is basically an airport for Cardiff and the areas surrounding it. Is that the case?

Sir Paul Silk: The purpose of the devolution of APD would be the economic incentivisation of the Cardiff area. The Welsh Government will do things to economically incentivise north Wales, so you could equally argue that doing a lot of work on the A55 does nothing for the people of Haverfordwest or Swansea, but it is economic investment in north Wales and incentivisation of the development of the economy of north Wales. By the same measure, the devolution of APD is a way in which the economy of the Cardiff region can be incentivised.

Gerald Holtham: The other thing I would say is that if the spillover from Cardiff having this advantage is small for Bristol and pretty well negligible for Birmingham, I cannot imagine that it has any effect at all on Manchester. Manchester is serving a totally different catchment area, and one with a much larger population than Wales. I do not think that the fact that somebody decides to put a flight into Cardiff from New Jersey or something would make any difference to what they decide to do with Manchester. I take the point that it does not do anything for north Wales—I absolutely accept that—but I do not think the spillover is big enough to give you a negative effect, either.

- Q14 **Susan Elan Jones:** I am conscious that in your good selves, I am speaking to two people who I regard as probably the academic parents, as it were, of much of the modern devolution settlements. We know that how devolution is viewed in different parts of Wales is very, very different. When we talk about the north Wales growth deal, we talk about it in terms of the economy, but we also talk about it in terms of the cohesiveness of Wales. Do you not think that if we place an emphasis on this, it does not do much to engender warm feelings across north Wales?



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Sir Paul Silk: If I were in the Welsh Government and I were faced with the possibility of the devolution of APD, I would do the sort of thing that I think Manchester airport suggested in their submission to you, which is to invest in the transport infrastructure between Manchester airport and north Wales. You are absolutely correct that you need to do something palpable to benefit the economy of north Wales at the same time.

Susan Elan Jones: So if we do this, more money for north Wales. I heard it here first.

Gerald Holtham: I think the point is that if APD is devolved and the Welsh Government does abolish it—and I cannot think why they would not abolish it, since there is no other reason to get it; it is no good for revenue—they are spending £6 million, in effect, on Cardiff airport. In terms of an overall allocation of resources within Wales, it is perfectly reasonable for people in the north to say, “Well, there is £6 million there. What is coming up here?”. That is a perfectly reasonable question, but I do not think the £6 million in itself is doing any harm to north Wales.

- Q15 **Geraint Davies:** You mentioned that this £6 million is small beer to a certain extent, but is there not more significant strategic risk of market distortion if this precedent is taken to other UK airports? I am thinking in particular of the issue of London. If I was the London Mayor, I would say, “The Welsh have got APD. I want it for Heathrow.” In so far as Wales depends on block grant generated by money in London, if we suddenly say, “You can have the devolution of your APD and we will have it in London—or, indeed, Manchester,” we don’t know where it is going to end. Don’t you think there are much bigger risks to Wales from that than the small pennies we are going to gather from APD—which will be nothing, of course, if we reduce it to nothing?

Gerald Holtham: The thing about Heathrow is that there is excess demand for slots at Heathrow. They are not desperate to find airlines that want to fly out of Heathrow. In fact, I would have thought, as a matter of national policy, that if you would mobilise existing resources elsewhere to take some of the heat off Heathrow, then that is quite reasonable. If you are going to stop people driving two hours to get to Heathrow—they can drive half an hour to Cardiff, or something—you are going to save a lot of resources on ground transportation as well.

- Q16 **Geraint Davies:** I think you are making my point for me. My point is, if the Mayor says “I should have control of APD because the First Minister does,” as you say, because of restrictions around Heathrow the Mayor might increase APD and raise lots of money, whereas we would choose not to. Then suddenly we have got more money for London and less for Wales, because we have let the cat out of the bag.

Gerald Holtham: It is a policy choice whether you want to spend this money because you think the development of the Cardiff airport will bring sufficient benefits to the economy as a whole. It is not something I have looked at. I know the Welsh Government thinks it is a good deal.

- Q17 **Geraint Davies:** Taking another example of strategic game theory, for



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want of a better expression, if the Mayor of Bristol and the Mayor of Manchester say “We want APD” and decide to respond because they are a bit paranoid about us taking their money, and they simply reduce APD, isn’t there a global problem of aggregate taxation, that the overall amount of take is driven down? Secondly, the overall amount of carbon is driven up, so it is completely environmentally irresponsible and very high-risk financially. I don’t see why people support it, frankly.

Gerald Holtham: There were several points running together there. It is true, of course, that the more you devolve taxes, the more scope you create for tax competition, and that does tend on the whole to lead to a lower overall rate of tax. If you think that you don’t want to reduce APD for, say, environmental reasons, you are not going to be devolving it to London, Bristol and other places. You have, however, already devolved it to Northern Ireland and Scotland, areas with their own legislatures. You have got another area with its own legislature, which is not very close to London, where you haven’t devolved it; so there is a sort of anomaly there. I take the point that you would not want to devolve this to every local authority. Otherwise it would cease to exist.

- Q18 **Geraint Davies:** If it was, for argument’s sake, devolved to Bristol, and they decided to follow the lead of Wales to have lower tax and more carbon, in essence, to the lowest level, so it would have no impact on transfer of custom between Bristol and Cardiff, it would simply mean we all had less money for public services and more smoke in the air. How can that be good?

Gerald Holtham: I do not think anybody is arguing, as I say, for devolution of APD to every local authority.

- Q19 **Geraint Davies:** Well, no, but Bristol would, wouldn’t they? If I was the Mayor of Bristol, I would, because I would be concerned about competitive pricing.

Jack Lopresti: Can I just let you know that this is way outside the boundaries? I know you are talking generically and theoretically, but it is not—

Geraint Davies: I am just making the case. This doesn’t seem to have been thought about yet. It is the next move. It is not like the tenth move ahead in a game of chess. Clearly, Bristol will ask for this. What would then be the point of Wales asking for it?

Gerald Holtham: Yes, but they won’t get it.

Chair: My Clerk is drawing my attention to the possibility of a vote fairly shortly. I am going to try to get through these questions, with this panel anyway, before that happens, so perhaps I could now go to Jack Lopresti.

- Q20 **Jack Lopresti:** Sir Paul, your commission recommended specifically that APD for direct long-haul flights be devolved initially. Why did you draw a distinction between long-haul and short-haul flights?



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Sir Paul Silk: My recollection is that this was an attempt to offer some sort of olive branch to Bristol, because we were concerned that Bristol felt strongly—as it did—that this was detrimental to its economic interests. I know that there is some argument about whether Bristol has long-haul flights or not, but Cardiff airport has a longer runway than Bristol, and has fewer restrictions on the number of flights that it has, so the possibility of long-haul flights coming into Cardiff, without doing a disservice to Bristol, was the basis for our recommendation.

At the same time, we also recommended that it should be considered in the context of the possibility of devolution—I take the points that have just been made about this—more widely inside the UK, so there could be a regional disparity between the rates of APD inside England, as well as Wales, Scotland and Northern Ireland.

- Q21 **Jack Lopresti:** You have been, I won't say dismissive—I am not trying to make this a difficult point—but you have played down the potential risk to the expansion of Bristol and the operation of it. I was looking through the paperwork earlier. I looked at the York aviation report, which clearly says, "Bristol Airport contends that devolution...would have a significant impact on its existing route network and future development plans". You are saying that is not the case.

Gerald Holtham: That has been controverted by the Northpoint report, which is subsequent. The York report took a single criterion for all flights, long haul and short haul, of an hour and a half, I think—so you had to be more than an hour and a half away. Of course, Bristol is not more than an hour and a half away from Cardiff, hence the conclusion. But, for example, state aid rules in Europe discriminate in terms of long haul and short haul and whether you are competitive, depending on how far away you are—instead of being one and a half for everybody, it's an hour in two. On those grounds, for long haul flights, Bristol and Cardiff might be competitive, but Bristol doesn't have much capacity for long haul, and for short haul, they are barely competitive, because you are now not an hour and a half apart. Taking the criteria used by the European Commission, and doing a more refined analysis, Northpoint controverted the points that the York report made. To be honest, I am not an expert in the area, so I have gone with the latest report.

- Q22 **Tonia Antoniazzi:** This question is for Paul. Your report states that there would be wider economic benefits if APD was devolved for direct long-haul flights. What would those economic benefits be?

Sir Paul Silk: All the evidence that I have read suggests that if you have more long-haul flights, you incentivise the economy locally. You bring in tourism, you develop trade and you increase the number of jobs in the local economy. Now, we didn't do a detailed analysis of what those economic effects might be, but I think the Welsh Government in evidence to this Committee has done more of that work, and there is evidence from that that there would be economic benefits to the wider region.

- Q23 **Tonia Antoniazzi:** I know that my hon. Friend has already touched on



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this, but would the economic benefits be felt in North Wales at all?

Sir Paul Silk: I think the frank answer to that is no.

- Q24 **Chris Davies:** The Minister, Lord Bourne, told us that Scotland was a very different case from Wales. If I remember correctly, Lord Bourne sat on your commission. Was he right?

Sir Paul Silk: Yes, I think that is correct. The porosity of the border between England and Scotland is much less than that between Wales and England. I am not an expert, in any sense, on airports but, as I understand it, the likelihood of travelling from the north of England to Edinburgh is much smaller than the likelihood of travelling across the border between Wales and England. There is a difference between the airports in Scotland and in Wales. There is a principle about devolution, the principle being that if a tax is devolved in Scotland and Northern Ireland, then the argument has to be made for the tax not to be devolved in Wales, if we have a devolved tax regime for the three nations.

- Q25 **Chris Davies:** Do you agree with that, Mr Holtham?

Gerald Holtham: As I was saying at the beginning, there is something to be said for simplicity and symmetry in the devolution agreement. That is not an overriding principle, so there may be reasons why you don't do it, but I would agree with Sir Paul that that is where the burden of proof lies. You have to make the case for it being different rather than just assuming it should be.

- Q26 **Chris Davies:** You recommended early on that the Welsh Government have a lot of negotiation and discussion with the Scottish Government prior to the Scottish Government receiving devolution of that tax. Did much discussion go on?

Gerald Holtham: I am not aware of much discussion about this particular tax.

- Q27 **Chris Davies:** Gentlemen, you both say that Scotland is very different from Wales in that respect. Are we really looking at a blanket devolution, whereby just because other parts of the country have it, Wales should have it? Or are we looking at the practicalities—really, the fact that we shouldn't be devolving because of the proximity of Bristol and Cardiff? You have already given a reason for saying they are very different and they shouldn't affect each other, but most people would tend to think they would. You can probably tell by my thoughts that I am still quite reluctant about devolving airport duty, but you aren't, evidently.

Gerald Holtham: There are two competing principles in play here. I think that is right. There is one principle that says: other things equal, let's keep it symmetrical and simple. There is also a principle that says that one should, on the whole, avoid tax distortions that cause people to make economic decisions for purely tax purposes. So the question is: if you have two principles in conflict, how great is the distortion that would be created by having a different APD in Wales and in England? Here, I am in the same



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position as you. I am a consumer of research rather than a generator of it. The latest reports suggest that the diversion that would occur from Birmingham, and particularly Bristol, would be small in relation to the growth of traffic in those airports. So they would not, in effect, really notice it. That would lead to a more balanced use of existing infrastructure. If you accept that argument, you come to the conclusion that the market distortion argument in this case is not strong enough to overturn the keep-it-symmetrical argument. There is a discussion there because we have two principles in conflict. I accept that.

- Q28 **Susan Elan Jones:** We down here in London have the dubious privilege of reading the London *Evening Standard*. If there is one thing we read from that, it is how London pretty much regards itself as its own superstate. Certainly, there is a great demand for greater tax devolution in London, and it cuts right across the parties. I know my colleague made reference to this earlier, but aren't we also basically saying to London local authority leaders—potentially the Mayor and the Greater London Assembly—to lobby for APD devolution for Heathrow, Gatwick and the other London-based airports? Even if we regard what would happen for Cardiff as relatively small fry, in the scheme of things, the same is certainly not true of those, is it?

Gerald Holtham: Looking at it from a national transport policy point of view, it is completely perverse to create incentives to increase demand in an area that already has excess demand, and to reduce demand in an area that has deficient demand. The point here is that Heathrow is chocka, and there is no particular advantage in making it more chocka. Cardiff is underused. Transferring some of that traffic makes sense. There is also the regional policy element that south Wales is poor relative to London. Why do you want to privilege London at the expense of south Wales? The opposite makes at least some sense.

- Q29 **Susan Elan Jones:** You might if you were a Londoner. You might if you had influence on this place.

Gerald Holtham: The thing about London is that they have a massive tax base, if the British Government would just let them do what they wanted with things like council tax. Can you imagine how much council tax you could collect in London if you were free to do it? London has this enormous tax base that it is constrained from using by British Government rules. I would tell them to go and look at that first and stop worrying about APD.

- Q30 **Geraint Davies:** May I ask a question directly following that answer? Surely the issue is that in the United Kingdom we have a system in which we distribute from the more wealthy areas of London and the south-east to the less wealthy areas of the north, Scotland and Wales. There is the other idea that we allow people to raise their own tax and do what they like with it, and that is what we are beginning to do in Wales. The problem that Susan Elan Jones and I are talking about is this: we have mentioned APD and how lots of money is being made out of Heathrow, which they would want to keep, and the case just mentioned is about stamp duty, which we have had devolved. Since the value of Camden is



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more than that of Wales, as soon as we give these powers to the London Mayor to raise council tax and stamp duty, suddenly he or she can make an enormous amount of money while we make very little and then end up in a worse place. So how can that make sense for Wales?

Sir Paul Silk: There has to be, in a Union, a method of equalising wealth, and that would be something that, inside the United Kingdom Union, one would expect to continue. So there are going to be rich areas of the United Kingdom that will have to subsidise the poorer areas. That is an essential—

- Q31 **Geraint Davies:** I know, but the thing with this strategy is that it is undermining that principle, because otherwise we allow the London Mayor, as Gerald has suggested, to raise council tax and then we say, “Actually, you’ve got too much money. We’ll take some out and put it in Wales.”

Chair: I think we are probably going slightly beyond air passenger duty for Wales.

Geraint Davies: But it is the same principle.

Chair: A quick thought on that, then, but it is perhaps a bit beyond our remit.

- Q32 **Geraint Davies:** I am just making the simple point that if they raise money in Heathrow, as they are allowed to because they said, “We want that right as well,” we could lose out.

Gerald Holtham: It is not clear to me that there is any necessary implication there. Why does the fact that they raise more money mean that Wales loses out? The way in which the system has been set up is that there is a block grant that goes to Wales—not based on relative need, by the way, but there it is—and if you take a tax, they don’t give you the tax; you have to pay for it with a reduction in the block grant.

Chair: Order. Thank you very much indeed, Mr Holtham and Sir Paul, for coming in.

Examination of witnesses

Witnesses: David Phillips, Mike Trotman and Tom Walsh.

Chair: Mr Trotman, Mr Walsh and Mr Phillips, thank you all for coming along this afternoon. Shall we start with Guto Bebb?

- Q33 **Guto Bebb:** Welcome. I have a few questions to start off with. In general terms, what are the characteristics that make a tax a good one to be devolved?

David Phillips: In general, there are a number of characteristics that we are looking for in a good candidate for devolution. The first is that the location of the tax base is clearly identifiable, so that you know how to apportion tax bases between different jurisdictions. For example, a

property tax is a very good tax to devolve because you know where a house or a business property is located.

You also want a devolved tax to be relatively stable rather than volatile, given that sub-national Governments—the Welsh Government, for instance—tend to have less ability to borrow to smooth their revenues. A tax that is very volatile poses a bigger problem for them than for the UK Government, which can smooth it over the cycle by borrowing and saving.

You also want a tax with a relatively immobile tax base. If there are differences in tax rates between areas, you do not get tax-motivated shifts in where taxpayers are located or in where they are doing—or claiming to be doing—their taxable activities. That is so that you are not distorting the economy.

In general, you want identifiability, immobility and stability. They are good things to have in a devolved tax when thinking about the system as a whole. That can sometimes come into conflict with what individual sub-national areas might want. They might want a tax where there is a lot of mobility and a lot of scope to attract more business and increase their tax bases with different policies. There can be a conflict between the general principles of what is a good tax to devolve at a national level, and an individual authority or part of the country wanting a tax that goes against the national principles, because it thinks, “If it is devolved just to us, we can game the system,” if you like.

Q34 Guto Bebb: Would you agree, Mr Walsh?

Tom Walsh: I would agree with all that. The only thing I would add from a business perspective is that, first, there must be the appropriate infrastructure. Where the tax is collected by HMRC at the moment, for the equivalent body that would collect the tax going forward, you would want that infrastructure to be set up well in advance. You would also want some cohesion and collaboration, in terms of some of the specifics around the way the legislation is implemented. There should be published guidance and, in the context of APD, special accounting schemes. You would want a suitable transition period for the transition or the devolution to be as seamless as possible from a business perspective. That really cuts to the compliance profile. Whereas at the moment, under UK law and practice, APD is accounted for by the airlines on a monthly basis, business would want that to be reflected in any devolution so it does not flip out to annually or quarterly, which would lead to differences with the status quo.

Mike Trotman: To add to that, we also need some degree of certainty from the taxpayer’s point of view. Any business needs to be able to predict with some degree of certainty the future of their tax liability in order to plan their business. The framework that Tom alluded to needs to include checks and balances, appeals processes and means by which taxes can be reviewed. If necessary, legislation must be changed to address that.

David Phillips: There are two other characteristics of a tax that is worthwhile devolving. One is that you think that the preferences or the



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optimal tax policy for the tax differ between different jurisdictions and it is not possible for central Government to apply different tax rates in different areas. If you think that some areas have a preference for lower tax rates, particular forms of tax, higher tax rates or different distributional profiles, you might want to devolve it to the local area. You may also do it if you think, for instance, that the economic effects of the tax could be quite different for the local area. For instance, in some areas you might have more congestion, and therefore congestion charges should be higher, but in other areas you want lower taxes because congestion is much less of an economic issue.

The last thing I was going to say was about the distribution of tax bases. It was said in the earlier session that we have a system of fiscal equalisation around the UK. Devolving taxes potentially makes that fiscal equalisation more difficult. There can be benefits in devolving taxes either where there is not much differentiation in the tax base between different areas or where it is relatively straightforward throughout the system to do that redistribution.

- Q35 Guto Bebb:** You have highlighted the principles about what makes a good tax to be devolved, and the challenges we face in deciding whether the interests of the national Government or sub-national Government come into play. How does APD fit into that? Is it a tax that should possibly be devolved, or does it raise particular problems? We have already heard about the two reports on the impact on Bristol. One highlights that there will be an impact and the other says that it will be less so. To what extent would APD be considered a good tax to devolve?

David Phillips: In general, the criteria set out mean that property tax is the best to be devolved, followed by something like personal income taxes, with expenditure taxes and corporate taxes bringing up the rear. Of course, APD is a form of expenditure tax. In general, it is not usually seen as a particularly obvious candidate for devolution. For many expenditure taxes, such as VAT, the location of the tax base is hard to identify. Where is value added? Is it at the shop, in the warehouse or in the headquarters? For APD, you know where the flights are, so the administrative issues that come with many indirect taxes and expenditure taxes aren't there for APD.

It is quite a volatile tax, meaning that it goes up and down quite a lot. In the Welsh context, according to the HMRC figures, we are talking about £6 million. I think Cardiff airport has estimated that it is about £14 million, taking into account recent growth in air traffic there. Even so, that is a very small part of the Welsh Government's budget, so that volatility is manageable at a Welsh level. The key deciding factor is the mobility issue—the mobility of the tax base. What we should rely on is the extent to which differences in the tax rates distort the aviation market around the UK, and then distort economic activity, and what knock-on effects that could have on tax rates, tax policy and things like that.

- Q36 Chair:** Great. Mr Trotman?



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Mike Trotman: There must be a challenge, or there often would be a challenge, if a tax is designed for one jurisdiction with aims and objectives specifically for that jurisdiction and then you take it out and apply it to a different jurisdiction, and perhaps have different aims and objectives for it. That is a challenge with any devolution of any tax. If the objective for APD in Wales is different from the initial designed objectives of the tax, that is a challenge that would have to be overcome.

- Q37 **Geraint Davies:** In terms of the profile of taxes, may I ask David Phillips whether, given that the nature of taxes in the UK is redistributive from London and the south-east to poorer areas such as Wales, the north and even Scotland, is there not a real danger that if we devolved APD to Wales, the London Mayor will say, "I want it," and once he has got hold of it he will put it up, with the biggest airport in the world—Heathrow—and make lots of money and keep it in London, and we will lose out? Or perhaps the Mayor of Bristol will say, "I want it," and he will reduce APD as well, so there will be no net effect. In fact, the net effect will be just to have a lower tax take and more carbon emissions. How does this make any sense?

David Phillips: There are a couple of issues there. To take the London issue first, London is very important for the overall level of APD revenues in the UK—it is about half in London. If you include the greater south-east I think it is about three quarters from that area. Having said that, it is still a relatively small part of the overall tax base. We are talking about £3 billion overall—so about £2-and-a-bit billion from the south-east of England. That is in the context of a UK Budget of around £800 billion, so it probably would not undermine the full system of fiscal redistribution even if this was devolved fully to London.

I think there would also be a really big question about what arrangements are made around what in Wales we call the block grant adjustment. When you devolve it to London you would need to say, "Well, we are devolving additional revenues to London from APD. What are we going to do in relation to your other funding streams? We will cut how much we give you in grant funding, and you need to fund some of this from APD going forward." If you think that London is going to have strong revenue growth in APD in future, you can index that initial adjustment and say, "Look, we think there is actually scope for substantial increases in APD, because of the environmental costs and so on. We are going to have this figure go up by 5%, 6% or 7% a year, and you can still get those revenues to redistribute to the rest of the country via the block grant adjustment."

- Q38 **Geraint Davies:** But would it not be better to have central control over that, and to differentially increase APD, because there is not enough capacity at Heathrow, even though it is huge, to make money to give to places such as Wales, rather than Wales, Bristol or London unilaterally putting it up or down to take business from other areas, or to make loads of money so that other people cannot have it?

David Phillips: Following on from what Gerry said, on the devolution of APD to Wales, it would not necessarily follow that you would get

devolution to other parts of the UK. It may increase the bargaining and the amount of pressure on it.

Geraint Davies: Well, everyone would argue for it, of course.

David Phillips: Would it be better to keep this as a central tax? I think it would come back to the question I posed at the start: is this a tax for which we think there are very unequal tax bases around the country, and there is potential for quite significant spill-over effects between different airports if there are different tax rates in airports? All of those would point towards not devolving the tax, versus do we think this is something where the preferences and/or the efficiency arguments in terms of what is the optimal tax rate, in terms of congestion, pollution and other things, differ enough around the country for it to be worthwhile devolving? I do not have a view on that, but those are the criteria.

Q39 **Chair:** Mr Walsh or Mr Trotman, do you have a different perspective on that?

Tom Walsh: It is a slightly different perspective. Talking to that specific point about the potential for different rates of APD within the UK, I am not a state aid or competition lawyer but the one thing that is incredibly important—it is part of that debate and it is something to do as early as possible—is really to gauge the impact of potential state aid or competition-type challenges, first to devolution but also the prospect of having different rates or regimes of APD in different parts of the UK.

Certainly we have seen that with the developments in Scotland, which were cited in the media as being down to the Highlands and Islands exemption. However, I have always questioned in my mind, certainly while we in the UK are part of the EU, whether regional APD rates and bands are even possible. So I think that should be looked at in detail.

Chair: Thank you very much. Between you, you have very cleverly answered a few of our other questions, so I will go to Chris Davies.

Q40 **Chris Davies:** Gentlemen, what are the practical considerations of devolving the tax to the Welsh Assembly? How is it collected at the moment and how would it be collected by the Welsh Government, as opposed to the British Government?

Tom Walsh: At the moment APD is subject to self-assessment, in that the airlines collect it through the fares that they charge to passengers who depart from UK airports, and then every month they submit an APD return to HMRC, and also payment at the same time. Those are the broad mechanics of the tax and how it works, subject to self-assessment.

As to what the practicalities could or should be like in the future if devolution happens, I guess that they very much depend on the nature of the devolution. For example, if devolution happened and there were separate returns, I could easily see that that would be burdensome for the airlines, compared with the status quo, whereby a single monthly return is submitted.



Equally, however, it would give Government, Treasury, HMRC and tax authorities a clearer sight of how much APD is applicable to individual airports or individual regions. That is quite difficult at the moment, because the numbers that are currently submitted to HMRC on APD returns are very high-level and do not break down by individual airports, until such time as HMRC officers audit the position of the airline.

- Q41 **Chris Davies:** What about within Wales? The Welsh Government themselves are setting up a new tax office that would deal with this.

Mike Trotman: There is the recently established Welsh Revenue Authority, which has responsibility for overseeing the two devolved taxes—the landfill tax and the stamp duty land tax. It is early days, but it is already managing the tax and publishing guidance, as published law, and it is managing to control compliance with those two taxes, so the infrastructure in that sense is there. The revenue streams for those two taxes are very much higher than for APD.

- Q42 **Chris Davies:** Would it be a difficult tax to manage and collect?

Tom Walsh: I think it depends on the quality and extent of the handover, if I am honest. Certainly, from some of the conversations we had with Revenue Scotland within the past 18 months or so, I think it was clear that the handover from HMRC was absolutely integral to the success of devolution.

The other aspect to it is that all of the airlines that are impacted by UK APD would request enough of a lead-in time to adjust to any new rules from a tax reporting perspective. The reason for that is that the time between booking and departure can be anything up to 12 months, so there is a need to understand the impact of APD and its equivalents well ahead of time.

- Q43 **Tonia Antoniazzi:** One of the recommendations made by the Silk Commission supported the idea of the UK Government devolving APD for direct long-haul flights initially. What advantages would there be in focusing just on long-haul flights?

David Phillips: I think that, similar to what was said in the previous session, one of the potential benefits from that is that, given the way the airport market is operating in Wales and the south-west of England, it would cause potentially less distortion to the airport market. There would be less of an impact on Bristol airport given there is less scope to develop long-haul routes at that particular airport. It could also be because most estimates of how responsive people are to APD tend to suggest that they are less responsive to price when it comes to long-haul flights. There would be less distortion because people are less responsive.

Even though APD is higher for long-haul flights, it tends to be a smaller portion of the price. Again, that would tend to mean that a given tax change would have a smaller impact on the market. It was mainly that this would be a way of introducing some discretion over APD in a way that



could be beneficial to Wales as it develops its long-haul markets in a way that will have less of a knock-on effect on neighbouring markets.

Tom Walsh: The only counter to that, thinking about recent developments, would be the inverse of what happened in Northern Ireland, whereby the Northern Irish zero rate for long-haul flights was implemented as a direct result of rate shopping, for want of a better term, between people taking off from Dublin versus Belfast. I think it is a factor to be considered. There is still a question mark over whether consumer and passenger behaviour is really impacted by APD. I suspect that it is, but I think there are probably a lot of other factors that contribute to that, not least because fares typically vary, often by the day and the hour. Understanding the impact of that charge is important and is probably a contributory factor rather than the sole factor.

- Q44 **Tonia Antoniazzi:** As a consumer I go for the cheapest price. What do you think the economic impact would be on Bristol, Manchester and Liverpool if we devolved the APD for long-haul flights? What about Bristol? Would there be an impact?

Mike Trotman: There are reports, as the previous gentleman alluded to. The institute has not looked at that, so we would defer to those reports. I do not think we could add anything to that.

- Q45 **Chair:** Are you saying that it would have an impact on Bristol or that it would not?

Mike Trotman: I am saying neither. We as an institute have not looked at the economic pros and cons of the Bristol and Cardiff dilemma. We have not looked at it in our reports and others have, so we have no view.

Tom Walsh: I defer to David on the economic aspect, but from my perspective there seem to be a number of reports that come up with a number of different conclusions or arguments for whether there is an adverse economic impact for Bristol. I point to the Northern Ireland and Republic of Ireland issue that I mentioned earlier, but I think there is probably a need for some kind of independent study to really gauge what that economic impact would be and, again, to gauge what the behavioural impact would be of the APD rates as and when they change. The key thing is the different profile between the airports in question, the different routes that are serviced from them and the different airlines that operate from them, because all that will contribute to the potential economic impact.

David Phillips: I echo that. I will not give an answer on whether it will be a big negative, a small negative or a positive impact, but I can say what some of the factors are that might influence that. Tom said that there has been a number of different studies and the answers are as many as the number of studies. To be honest, some of that reflects the fact that, to some extent, the person who pays the piper will call the tune.

There is also a lot of uncertainty in this area. For example, how will airlines respond to a reduction in the tax? How much will get passed on in



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the form of lower prices? How much will be higher profit margins? Both can affect the provision of flights and the demand for those flights. How responsive are tourists and business people to the price of airline tickets—both outgoing and incoming? How much of the change in flights at Cardiff that could result would be genuine new activity—an assimilation of overall number flights—versus displacement from other airports, such as Bristol most certainly, but other airports in England, too.

A lot of the numbers rest on assessments of the productivity impacts of connectivity, which are very uncertain. How wide an area will the productivity impacts actually impact? Some studies suggested that south-west London could benefit from lower APD in Cardiff, for long-haul flights in particular, if that meant that south-west England became more connected to the rest of the world via Cardiff, because those connections do not exist via Bristol. On the other hand, if it is very localised spill-over effects and most of it is short-haul passengers, because they are more responsive, then that could actually have detrimental effects.

It is really uncertain. There are studies out there but, as I said, there is definitely correlation between what they have been done for and the answer that has been provided. I am sure that the Committee have thought of this, but I suggest that it could be worthwhile for some experts on, say, transport economics or economic geography to be asked to give evidence on this, so they can assess—perhaps more impartially and with more expertise than I can—the different studies that exist on the economic impacts.

Chair: Thank you for the suggestion.

- Q46 **Guto Bebb:** My question is the reverse of the one I asked earlier. We heard from the first panel that there should be a default assumption that, because APD has been devolved to Scotland and partially devolved to Northern Ireland, the case should be made by those who are opposing devolution of APD to Wales. The question I would ask, really, is whether there were any stronger arguments for the devolution of APD in the Scottish and Northern Irish contexts than exists in Wales, and whether there are any arguments that you can see as to why the Government have taken a view about APD in Wales that they have not taken in Scotland and Northern Ireland.

Tom Walsh: There are definitely some differences. My starting point in relation to Scotland is that of course devolution has not happened in its entirety yet. In terms of the current process, it is still the same as it always has been, and the rules have not changed from an airlines perspective.

Then I look at Northern Ireland, which is clearly unique because it shares its border with another EU member state. Some of those issues were discussed earlier, such as the differential between a flight that takes off from Belfast versus the Republic of Ireland, which has now scrapped its equivalent of APD. Even when it was in existence under Irish law, the rates were a lot less, as they are across other European countries. I can



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see some differences between the Scottish, Northern Irish, and then Welsh positions in terms of the rules as they have been implemented and the uniqueness in Northern Ireland. Whether that changes the position in terms of devolution, and whether devolution should just follow because it exists in those two regions, is probably something that somebody else is better qualified than me to answer.

- Q47 **Chris Davies:** Mr Walsh, you mentioned earlier how important the handover from the Westminster Government to the Scottish Government was. I assume that handover went reasonably smoothly, unless you can tell us differently. What I am trying to get at is what lessons can be learned from the handover, and from handing devolution of this tax to another region.

Tom Walsh: I must confess that my knowledge on that went as far as a couple of conversations with representatives from Revenue Scotland at the time before the plug was pulled in relation to the state aid position, so from my perspective I do not think the handover was sufficiently developed because of what happened on the macro level in terms of the devolution of the tax.

However, certainly during those conversations, it was abundantly clear that there needed to be that sufficient handover, not least because there is an awful lot of knowledge within HMRC. There is published guidance that sets out HMRC's interpretation of the primary law under the Finance Act 1994, and then within APD, a number of airlines have what are termed special accounting schemes—specific schemes under the tertiary legislation that allow them to account for APD in certain circumstances. I can imagine that from a practical perspective, those sorts of specifics would need to be handed over sufficiently. Probably the worst thing for an airline to face is for a new taxing authority to take on a new devolved tax, but not have any oversight of what went before and the operations before. That is where I think the complexity comes in.

- Q48 **Chris Davies:** We understand from the earlier panel that the figure is going to be so low—£6 million—by the time it is set against the block grant and so on. With your tax adviser's hat on, is it really worth pursuing from a Welsh perspective?

Tom Walsh: I think it depends. It probably goes beyond the tax technical implications. It almost certainly goes beyond that into the economic ramifications. You take the £6 million or whatever that might become and then also factor in what the economic benefits to Cardiff and the Welsh economy might be. From a tax adviser's perspective, my role is predominantly to advise clients on how to pay the right amount of tax. I think the relevance of that number compared with the £3.7 billion that is collected annually should be factored in and considered, but I think the economic impact more broadly is a crucial part of the decisions that should be and need to be made.

- Q49 **Chris Davies:** The Welsh Government bought Cardiff airport, and they have invested heavily in Cardiff airport. Could you see that therefore they



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could say the icing on the cake is to absorb £6 million and not put that on Cardiff airport? Could you see that happening?

Tom Walsh: Conceptually, I could see it happening. The one practical roadblock in my mind is the point I mentioned earlier around the concept of state aid and whether the competition piece could mean that that was not viable from a legal perspective. This is a complex area and not one that I am qualified to comment on extensively, but when I think about both pre-Brexit, when there will be EU state aid processes to consider, and even post-Brexit, depending on what the competition law landscape looks like, I think it is a leap to suggest that the £6 million could be cast aside without considering those detailed and pretty complex matters.

Q50 **Chris Davies:** One could see, certainly, whatever happens, the Welsh taxpayer picking up the bill for further subsidisation of Cardiff airport, but we won't go down that route.

What would the main financial implications be of the devolution of this tax to Scotland?

Tom Walsh: If I am honest, I don't know because of the point at which it was stopped dead in its tracks. I just don't think it was devolved or moved enough.

Q51 **Chris Davies:** Do either of the other gentlemen know?

David Phillips: What was agreed with the devolution of APD was that they would devolve APD from 2018-19. That was the initial agreement. In that year, they would make a deduction from the block grant funding equivalent to what the levies were forecast to be in that year. That would then be reconciled to outturns, once that was available. In subsequent years, the amount taken off the Scottish block grant would be indexed in line with what happened to APD revenues per person in the rest of the UK. If Scottish revenues from APD per person grew more quickly, the Scottish Government would be up in terms of revenue. If the Scottish revenues grew less quickly per person in the rest of the UK, it would be down in terms of revenues. That depends on whether that is because of growth in the tax base—the number of people flying—or growth or falls in the tax rates. That was the general push.

I am not sure what has happened to Scottish air passenger traffic relative to the rest of the UK in the last couple of years, although I think Edinburgh airport particularly is doing pretty well. I am sure there are figures on that if you are interested in how Scotland would be faring if it was actually now fully devolved.

Q52 **Chris Davies:** You mentioned the myriad reports that are out there. You could take a view on any of them because they all say something different. Is there a report on how the English airports, just south of the Scottish border, have been affected? Have they been affected?

David Phillips: Given that devolution is effectively on hold at the moment and there have been no changes in tax rates, I would not have thought there would have been an impact yet, although there could be an



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anticipatory effect. I am not sure. I would be surprised if Newcastle airport hadn't put a study together in advance of it, but I have not read those reports.

Chris Davies: Okay.

- Q53 **Susan Elan Jones:** I would like to ask how important you feel revenue from APD is to UK public finances and the economy, Mr Phillips. Others can chip in afterwards if they would like.

David Phillips: Revenue from APD is about £3 billion or so per year. That is less than 0.4% of overall tax revenues. In the grand scheme of things, it is not a significant source of revenue. However, of course, there is upwards pressure on the demand and cost of public spending, which means that over the next few decades the Government will either need to pare back public services more or raise significant sums of money to meet those rising costs and demands. Reduction or abolition of a tax bringing in revenues, even if they are relatively small, makes that task of bringing in the revenue to pay for the rising demands and costs more difficult. Of course, if a tax is small and it is no longer there, it does not make such a big impact on the overall figures, but that is not really the question you should be asking. The question is, does the benefit of abolishing a tax or the benefit of changing a tax policy in any way outweigh the costs? Even if a tax is very small, you still need to think really carefully about the cost-benefit of any changes to that tax policy.

Mike Trotman: I would add that what you want to do with the tax is a policy decision. Even a small tax can send a message. Increasingly, we see taxes that are behaviour-changing taxes and designed to be so, in particular environmental taxes. You can make it send a message by retaining it, even if it is a relatively small fundraising tax.

- Q54 **Susan Elan Jones:** If I can go on from that, I think there is a certain amount of mind reading as to what my next question is going to be. We know that some of the airlines and airports across the UK have called for air passenger duty at various points to be abolished completely. What do you think the impact of that would be and—this is the ultra-critical question—how would the Government make up the shortfall?

David Phillips: I would start by saying that APD is relatively high compared to other taxes of a similar type in an international context, although that does not necessarily mean that it is too high. Other countries could be under-taxing air travel. In terms of domestic air travel, the UK is actually unusual in not subjecting it to VAT. Domestic air travel is VAT zero-rated, whereas in places such as Germany and some other countries it is subject to VAT. Although APD can be higher, the total tax burden is not always higher than in other countries.

It should be recognised that in many ways air travel is under-taxed. Airline fuel is not subject to tax like fuel for road transport, for instance, and airline tickets are not subject to VAT domestically or internationally. The current APD is like a hybrid tax. It is partly a crude environmental tax. For airlines, if you were thinking about the tax in terms of an environmental



tax, the number of passengers is not really a good proxy for the environmental damage being caused, because most of it is caused by the plane. That is the heavy thing—the people are just sitting in there. It is an environmental tax, but a relatively crudely designed tax. It could be reformed to make it better. For instance, there have been proposals in the past to have a per-plane tax or an emissions-based tax. Those would make it better targeted at the emissions side of things. It is also a revenue-raising tax to make up for the fact that there is not VAT. It is a kind of hybrid tax.

If it were removed, you would likely see two things. First, you would see an increase in air traffic. You would likely see an increase in people's use of flights. The demand elasticity is actually bigger than zero, so you would see more outgoing flights, and that would probably affect also more incoming flights as well, so there would be an impact on travel, tourism, business travel and so on. You would also see an impact on pollution, because that would mean more flights. The exact impact would depend on the extent to which it is increasing load factors versus the extent to which it is increasing the number of flights.

How could the UK Government make up lost revenues? Through any number of means. It could decide to spend less; it could decide to increase any number of taxes. In the context of other taxes, it is the equivalent of about 0.6p to 0.7p on income tax, 0.6p to 0.7p on VAT, and a similar amount—or a bit more actually, but a similar amount—on employee rates of national insurance. So not huge amounts of revenue, but as I said, in the context of generally increasing costs, you probably want a good rationale for abolishing the existing tax.

Mike Trotman: It is a technical or academic point, but hybrid taxes are difficult taxes in that generally, if you have a purpose for a tax, it is better to have a single purpose rather than a number of different purposes. We see this often in environmental taxation, where tax changes behaviour. If you want to change people's behaviour from environmentally bad behaviour to environmentally good behaviour, and you are successful in doing that, you end up raising no revenue at all. With taxes that are both environmentally targeted and revenue-raising, there is always a bit of a conflict that is hard to resolve.

Tom Walsh: The only other point that I would make, which I think is interesting to that debate, is that over the past 25 years since APD was introduced, it has got increasingly complex in terms of rule changes and the tinkering around the edges, and the rates have increased considerably from the amounts in 1994. There is no doubt that—arguably as with all taxes—as the years have gone by and the legislation has changed, it has become more and more complicated. There is probably a need to review it. Whether that results in abolition or other significant changes is a matter to be considered in the broader context of what it means for the economy, for airlines and for passenger transport more generally.

Q55 **Tonia Antoniazzi:** To what extent does Brexit—my favourite topic—strengthen the case for devolution of APD?



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Tom Walsh: If I may start with the tax technical piece. Unlike VAT, which is the other indirect tax that we all know very well, APD is not underpinned by a principal EU directive, whereas VAT is. The APD legislation is the Finance Act 1994 and a number of statutory instruments, so it is different from VAT in terms of reliance on EU law. Therefore, I think that it is fundamentally a UK legislative tax, and is therefore a UK legislative question when looking at the technical basis for APD.

The real Brexit implication that I can think of—I have already mentioned it a couple of times—is the whole point around EU state aid and what it will look like pre and post Brexit; whether it is some kind of equivalent competition international law, rather than state aid, which will presumably only exist this side of Brexit, depending on what Brexit looks like. For UK secession from the European Union, rather than having a tax that is underpinned by an EU directive, the key point will be around how state aid and the equivalent competition piece impacts the future of APD.

David Phillips: In terms of the key criteria, we talked at the start about what makes a good tax to devolve. In terms of how it links to APD, I do not see Brexit having a big impact on the more fundamental economic arguments for devolution or not.

- Q56 **Tonia Antoniazzi:** EU rules on aviation state aid and tax devolution were all listed as reasons why the UK Government could not devolve APD. Could that change after Brexit? Are those valid reasons for not devolving APD?

Tom Walsh: I hate to shirk the question, but I think it depends on, first, what that devolution would look like and, crucially, what Brexit would look like. We are really at the mercy of understanding what Brexit and some of those international treaties would look like. Of course, the taxation of the aviation industry is underpinned by the Chicago convention, so there is not just UK and EU law to consider, but the broader international landscape to think about. It is difficult to answer that question at this point in time.

- Q57 **Tonia Antoniazzi:** Other than Brexit, has anything significant changed in the last two years that could affect the case for devolution of APD to Wales?

David Phillips: Nothing has materially changed in terms of the broad economic or fiscal arguments. On the Brexit issue, to come back on that, if it is something, it will be those issues that you mentioned, but I agree that it is too early to say. It will depend on what agreements are reached and, actually, what state aid rules the EU applies within itself post Brexit. Otherwise, nothing jumps out at me as being a material change that would affect these kinds of criteria.

Mike Trotman: What has happened, of course, is the devolution of other taxes and the setting up of the Welsh Revenue Authority. The process that the Welsh Government went through to consult and to liaise with stakeholders around Wales was a materially successful transition of those taxes, so in the sense of a reversal having taken place on those taxes, that is a positive in my view.



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Chair: Thank you. Keep coming here.