ADT Highlands and Islands Working Group – 10 October 2018 – Paper 1

GERMANY – Tax Reduction for flights to and from certain North Sea Islands (SA.32020)

The previous meeting of the H&I Working Group included a discussion of the German air transport tax case and the appeal to the European Commission (EC). This paper sets out further details on the case and identifies similarities and differences between this case and the Highlands and Islands exemption.

Background

Germany argued its air travel tax discount did not affect intra-community trade because:

- the effects of the notified measure are confined to a particular region;
- the number of passengers is low; and
- all domestic and foreign airlines that offer the relevant transport services may benefit from the reduction.

The European Commission ruled that it could affect intra–community trade *"because of the inherent international character of intra EEA air transport….Flights have tourists, workers, and businesses using the service which can influence trade flows. Also those airlines eligible for the tax reduction could result in higher passenger numbers and could boost their competitive position."*

The EU's official case paper is here:
http://ec.europa.eu/competition/state_aid/cases/241338/241338_1420212_158_2.pdf

Key EU Legislation

The Treaty on the Functioning of the European Union (TFEU) – Article 107 (page 91 of: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2008:115:FULL&from=EN) sets out what state aid is, and the circumstances under which it is considered to be compatible with the single market. A member state needs to make a full evidence based notification against the Treaty seeking EC approval.

107(1) Definition, which gives rise to the four tests – state resources, awarded on a selective basis, with potential to distort trade and competition.

Even if the four tests show that it is state aid, it may be considered compatible if it is:

107(2)

a) Aid of a social character, granted to individuals
b) Aid to repair damage from natural disasters
c) Paid to certain regions of Germany to make up for the economic disadvantages of Germany's former division.

107(3)

a) To promote economic development of areas with low living standards or high unemployment

b) To remedy a disturbance in a member state economy, or a project of common EU interest
c) To facilitate development of certain economic activities or areas without distorting trade
d) Anything else the Commission proposes.

The German case uses 107(2)(a) and 107(3)(c), which are highlighted in bold above. After the German case (2011-2012) a revised General Block Exemption Regulation (GBER) was introduced aiming to reduce the volume of notifications by member states. Scotland's Air Discount Scheme (ADS) operates under Article 51 of the GBER: Support for Social aid for transport for residents of remote regions. (Page 87 of http://ec.europa.eu/competition/state_aid/legislation/gber_regulation_en.pdf)

Summary of the German Case Decision

The Commission's full decision is here:
http://ec.europa.eu/competition/state_aid/cases/241338/241338_1420212_158_2.pdf

Key State aid aspects include:

- Germany's air traffic tax was designed (and recorded in the original Budget Law of 2011) as an environmental tax, and has always exempted residents of the North Sea islands.
- Germany's Budget Law included, but did not enact, a further exemption for other passengers, ie business use and tourists. Germany included these categories in their original notification however this was disallowed as it would not be limited to disadvantaged individuals (ie islands' population).
- Germany argued the tax reduction was not state aid (pgh 35-36) due to geographic isolation of islands, routes open to any airline, eligible routes to land within 100km of the coast.

Over the 18 months of this case, the arguments evolved and extra information was provided by Germany:

- The description of the market (pgh 16-25) includes an observation that the planes on these routes take 3-10 passengers, making flights sensitive to changing numbers of passengers.
- the number of residents is too small a proportion of the passengers for residents alone to sustain the routes, and so business use and tourists were essential (pgh 25-26)
- data showing route reductions in 2011-12, following the introduction of the tax, compared to the routes operating in 2007-10. (Pgh 27-28.)
- Pgh 66-67 show the proportional increase in ticket prices (as a proxy for operating costs) accounted for by the flat-rate tax, with all but two routes increasing by 10-25%.
- Pgh 68-77 present actual historic data showing a decline in passengers following the introduction of the tax, in contrast to a national trend of increasing passenger numbers over the same period.

Over this time Germany changed from asking for the non-resident exemption (100% discount), to asking for a reduction of 80% for non-residents. This 80% is the maximum allowable reduction of an environmental tax, under the EU Environmental Aid Guidelines (EAG). The EC concluded (pgh 82) that the non-resident discount was in line with the EAG “and can therefore be considered compatible on the basis of TFEU 107(3)(c)”. Germany has undertaken to gradually reduce its Air Travel Tax in line with reductions in greenhouse gas emissions created by the aviation industry.

Similarities between the German case and H&I

- Viability of routes depends on non-residents (business use, tourists) in addition to residents to sustain passenger numbers throughout the year.
- Aim is to enable regular and reliable connectivity.
- (Some) airlines are small and vulnerable to reductions in passenger numbers.
- There is a high risk of State aid being present. The EC applied the State aid tests to the German case.
- Where pre-tax fares are low, a flat-rate tax would lead to a significant increase in ticket prices.

Differences between the German case and H&I

The German case was only for routes connecting islands (with no road or rail access that is independent of the tide) to mainland airports within 100km of the coast. The H&I exemption is far broader, covering departures from anywhere in the H&I region (as defined in the APD Designated Region order 2001 https://www.legislation.gov.uk/uksi/2001/808/article/4/made), to any airport – including connecting flights.

The German tax was designed from the outset as an environmental tax, and the Commission’s examination of its compliance with the EAG was important to this case. From the outset the German tax has exempted residents on island routes: the EC approved this under TFEU 107 (2)(a).

German island routes operated with very small aircraft making each flight more dependent on a full complement of passengers – not the case for (a proportion of) flights from Inverness or some island connections.

Germany has used actual, historic data on routes and passenger numbers to illustrate the observed reductions of both following the introduction of the tax. In Scotland we have not enacted such a change and so would instead report hypothetical projections of changes if the exemption were not maintained.

Conclusion

The German case was approved on the basis that connecting flights were essential to support residents of the islands, allowing for economic development by enabling access to short flights which encouraged visits by tourists and business travel.

While it may be possible to develop a similar case for some flights to Scottish Islands, in some cases these flights will already be supported by a PSO or destinations may have established economic benefits from a strong tourism industry. Clear evidence would need to be provided for each island route that the introduction of ADT would deter non-residents from travelling and that routes would no longer be sustainable (EU regulations permit exemptions for residents of remote areas).

Devolved air travel tax powers could only cover flights departing from Scottish airports. For flights leaving Inverness, and destined to other UK mainland or European airports, it would be far more difficult to justify an exemption on this basis.