# The Impact of Taxation on the Development of Air Transport

Presentation by Stuart Halstead of Deloitte LLP

***The views expressed herein are those of the author and do not necessarily reflect those of his employer***

## Setting the scene

Good afternoon everyone. I thought I would start by reading you a few lines; perhaps you could have a think as to where you might have heard them before:

> *"International air transport plays a major role in the development and expansion of international trade and travel…"*
>
> *"…the imposition of national or local taxes on the acquisition of fuel, lubricants and consumable technical supplies for use by aircraft…may have an adverse economic and competitive impact…"*
>
> *"…lack of implementation of the rule [of reciprocal exemption] involves either multiple taxation [of enterprises] or considerable difficulties of income allocation…"*
>
> *"…the imposition of taxes on the sale or use of international air transport tends to retard its further development by increasing its cost to the operator…the shipper…and to the traveller…"*

They are of course taken from ICAO's doc 8632, its policies on taxation in the field of international air transport. They are, I think, useful terms of reference for this particular session. The message here is clear: sensibly managing the tax burden avoids harming the development of air transportation. To put it slightly differently: taxation hurts the industry, with sale and use-based taxation potentially doing more harm than other forms.

I should admit at this point that my day job involves them working on both sides of the fiscal fence. I help governments develop tax revenues and revenue efficiency whilst on the other hand I assist the aviation sector, airlines in particular, deal with tax issues that crop up at home and abroad. As ideologically controversial as this might seem, I do think that it enables me to understand both sides of the taxation argument and find a sensible middle ground.

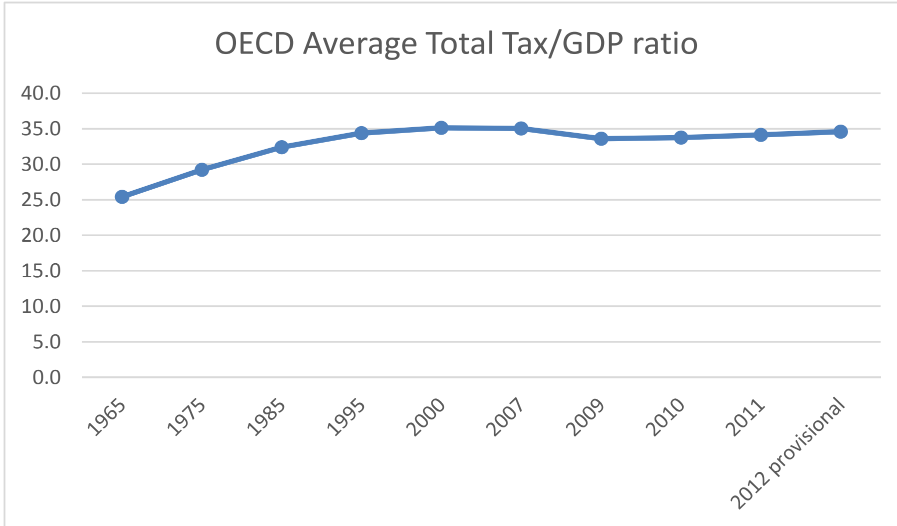
## What's in the statistics?

The air transport sector value chain is impacted at many, many points by taxation. I say impacted not necessarily in the negative sense, but simply in the sense that taxation has become a discrete consideration which affects decisions taken by the business. You know the impacts I am talking about, such as the corporate taxes paid by an aircraft manufacturer, the increasingly exotic array of indirect ticket taxes that must be charged to passengers and so on.

But to what extent do these various and often times cascading forms of taxation harm the development of the industry?

Well, net post-tax profits are going to be something in the region of USD 18bn globally this year according to recent figures from IATA. That is up from USD 10bn last year, and a substantial improvement of the USD 25bn of losses witnessed in 2008. Margins are up too ranging from around 2 percent in Europe to approximately 5 percent in North America. In 2013 the values were a relatively measly .25 percent in Europe and a slightly more respectable 3.8 percent in North America.

I suppose that comparison between Europe and North America is interesting isn't it? Is it possible to conclude that Europe, traditionally associated with generally high rates of taxation and extensive taxation regimes is excessively depressing post-tax margins as a result of tax policies that it has adopted? Can we get there though? Well, I don't think so. Look back to 2007 and you will see that Europe and North American after tax margins were remarkably similar at around 4 percent or thereabouts.

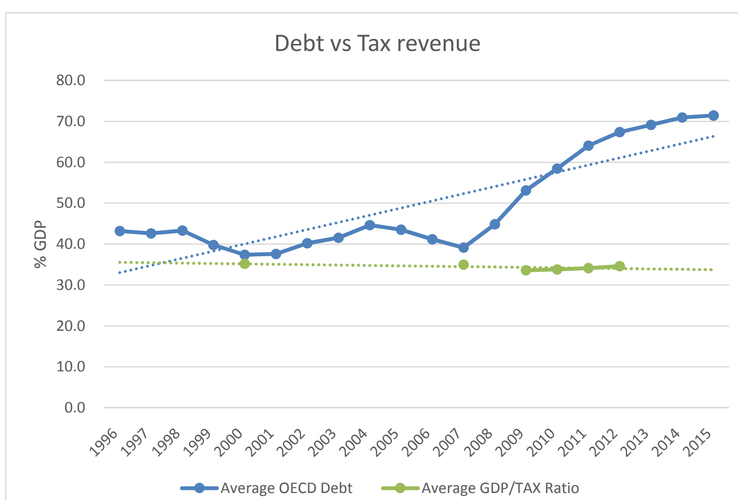



Okay, so were there some major fiscal changes occurring in the post 2008 period which could have given rise to the squeeze on post-tax margins then? Well, again, it doesn't look that way. OECD average Tax/GDP ratios have stayed relatively constant throughout that period – essentially demonstrating that on a global scale at least, there hasn't been a big countercyclical tax collection drive or new tax deployment which has had any noticeable impact on this important indicator.

I'm not sure whether you will have had the opportunity to read Severin Borenstein's paper on the impact of taxation of the industry. I have done so – I try to get to grips with everyone's perspective on these things. By way of a potted summary, he essentially rules out the usual suspects of fuel and taxation as the root cause of underperformance in the sector. Instead, he points the finger at the persistent downward trending of base fares as a consequence of increased convergence between the LCC's and full-service carriers, coupled with stubbornly high operating costs for the legacy carriers. Yes airlines pay a lot of tax (120bn in 2014 according to IATA), but that isn't the problem according to Borenstein.

**Mismatch**

There is another factor that cannot be ignored I believe, and I think that it is a particularly important consideration for this audience. Aside from what could be a neat economic debate about the pros and cons of taxation, in the real world persistent and substantial structural deficits have taken hold across the globe. The picture becomes



ever more stark when one looks at the consistency of the Tax/GDP ratio over the same period – as a Government you simply cannot ignore the yawning gap between the tax and spend.

Perhaps the biggest challenge facing ICAO, bearing in mind its own position on taxation, is that the long-run benefits associated with low taxation (i.e. enhanced investment, productivity growth and GDP returns) do not coincide with short to medium term political cycles. Faced with alarming deficits and the need to return to balanced budgets, the swift-acting and relatively assured tool of sustained or increased taxation would, in my view, be a more obvious means to deliver more swiftly manifesto pledges than removing or reducing taxes already in place. As much as there might be an emotional flight to lower taxation therefore, it is hard to overcome the cold hard realities of managing a national budget day-to-day.

**What now?**

So if we take the view that taxation is a fact of life for the industry, the challenge then becomes that of best managing it. I spend a large amount of my time assisting my clients eliminate tax issues that crop up in far off destinations. It is a drain on management time and one which I feel is difficult to avoid. Ideally, every tax system would look the same, tax rates would be the same, taxing jurisdictions would seek to apply the same models in order to capture a fair share of revenue and so on. The trouble is of course that the world is very large and every country tends to deploy its own particular brand of taxation.

In my recent experience, tax authorities have been spending increasing amounts of time looking at foreign airlines in particular to decide whether or not they are actually involved *"…the transportation of passengers or cargo…"* with respect to everything that they are doing (and in particular any ancillary activities). You might be of the view that attempting to disaggregate the functions of an airline might be a little odd, but when you think that there could be a chance to collect a decent bit of tax on the end of an investigation such as that, then you can understand why the authorities might go through the intellectual exercise in the first instance.

This challenge is only going to become more apparent as New Distribution Capability gains traction; GDSs' will provide a very nifty means by which airline operations can be thoroughly dissected and analysed from a tax perspective. Furthermore, loyalty scheme developments and their gradual uncoupling from the primary business is also likely to rouse the interest of tax authorities, most likely to the alarm of operators.

The fact of the matter is, in my view, that taxation in much the same form as it currently takes (save the gradual decline of direct taxation in the overall tax mix) is here to stay. Finding ways to best manage its impact is likely to provide greater reward in the long-term than attempting to persuade government to abandon deficit reduction plans in the immediate term, at least.

*Stuart Halstead is an indirect tax specialist at Deloitte LLP (Middle East). In 2013 he established their Aviation Tax Services team in the region in order to address a clear and growing need for a group of specialist advisors capable of working with leading full service and low cost carriers based in the region. An economics graduate, Stuart has a keen interest in tax policy matters affecting the industry. He works hard to elevate practical tax issues identified onto the ground to the attention of policy-makers in order that more permanent and effective solutions be embedded into the fiscal landscape.*

*Separate from his work in the aviation sector, Stuart works extensively with Government agencies responsible for policy development and its integration into revenue management systems. This work provides him with key insights across a range of tax policy initiatives and provides the opportunity to develop and implement preferred or most appropriate practices.*

*Stuart holds a Master' degree from the University of Glasgow in Economics and Economic History (UK), a post-graduate diploma in Economic History, and holds a professional indirect tax qualification (UK).*