Civil Aviation Authority

NERL NR23 Price Control Model – taxation review

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1 Background

The Price Control Model ('PCM')

1.1 The Civil Aviation Authority ('the CAA') has engaged Grant Thornton UK LLP to support review the tax related calculations of a Price Control Model ('PCM') which is an analytical tool to aid the calculation of the appropriate price that NATS En Route Limited ("NERL") can charge to its customers for the NR23 regulatory period. The NR23 period commences on the 1 January 2023 and ends on the 31 January 2027.

1.2 The PCM is intended to calculate a tax allowance which shall be reflected within the price which NERL can set. This will ensure NERL is able to receive an appropriate level of return when taking into account the following:

i) Legislated and announced (to the extent not yet written into the tax legislation) corporation tax rates, allowances and a reliefs

ii) Existing legislation, case law, accounting standards and HM Revenue & Customs (HMRC) policy

iii) Projected levels of capital expenditure

iv) Projected levels of corporate debt interest payments

1.3 It is intended that the model provides a calculation for tax which is reasonably straightforward but maintains the ability to take into account relevant material considerations in order to estimate the tax costs in the NR23 regulatory period.

1.4 Please note, this report was prepared prior to recent announcements outlined by the Government on 23 September 2022 and therefore this report reflects the rates, allowances and reliefs at the time our work was performed (24 August 2022) as opposed to the date of publication. We would recommend the CAA review recent announcements to reflect any changes in rates and allowances within the PCM.

Approach to corporation tax

1.5 We understand the PCM will consider current tax only and will not consider the impact of deferred tax.

1.6 The CAA intend to use a "building block method" (denoted "Method 1") for the calculation of current tax under which a profit chargeable to corporation tax is arrived at using the core revenue building blocks within the PCM (i.e., operating expenditure, depreciation in respect of the Regulatory Asset Base (RAB) and the regulatory return using a vanilla WACC) from which tax shields are deducted such as interest paid and capital allowances. The applicable tax rate is then applied to this value to arrive at an estimated tax charge.

1.7 This approach is well established and is used by a number of other regulators in the calculation of tax, however, is conceptually different to how UK corporation tax is calculated on a legislative basis and how NERL would calculate their actual corporation tax liability payable to HMRC.

1.8 Therefore, the CAA wished to investigate the appropriateness and accuracy of this method by performing a parallel tax calculation which follows more closely standard UK corporation tax principles (i.e. a specific cash adjustment for tax based on high level tax calculations following UK tax legislative rules – denoted "Method 2").

1.9 Under Method 2, the model will calculate a notional tax charge based on a modelled profit before tax figure. While this will not be identical to the PBT of NERL as a corporate entity, we understand that this should represent a reasonable estimate for the current tax cost for the regulated entity. Adjustments will be applied to this notional PBT for the various items considered tax sensitive, in order to calculate a profit chargeable to corporation tax on which a tax rate is applied to arrive at an estimated tax charge.

1.10 The intention is that Method 2 can act as a robust sense check to verify the tax cost modelled under Model 1 and ensure it is not materially different than under Method 2 which more closely follows UK corporation tax law. Furthermore, where variances may arise, understanding the reasoning for these amounts and gaining comfort these should exist within the context of the PCM environment.

1.11 Within Method 1 and Method 2, there are several common inputs including the tax rate applied, loss utilisation and capital allowances and as part of the work performed, we have reviewed the reasonableness of these inputs along some other relevant tax shields (e.g., interest deductibility, R&D relief and Patent Box relief).

2 Corporation tax rate

Background

2.1 As part of our work, the CAA has instructed Grant Thornton UK LLP to review the accuracy and appropriateness of the corporation tax rate used within the PCM and also consider expected changes to the extent these are not yet written into the tax legislation.

2.2 The PCM under review shall cover the regulatory period from 1 January 2023 to 31 December 2027.

Corporation tax rates

2.3 At Spring Budget 2021, the government announced an increase in the Corporation Tax main rate from 19% to 25% for companies with profits over £250,000 together with the introduction of a small profits rate of 19% with effect from 1 April 2023. Given the scale of activities of NERL, the small profits rate is not considered material for the purposes of the PCM and is not considered in further detail.

2.4 Therefore, as at the date of this report, the below headline corporation tax rates are expected to apply for the below periods of account:

- Year ended 31 December 2023 – 23.5%
- Year ended 31 December 2024 – 25%
- Year ended 31 December 2025 – 25%
- Year ended 31 December 2026 - 25%
- Year ended 31 December 2027 – 25%

Conclusion and recommendations

2.5 On review of the PCM provided to us for review, the above referenced UK corporation tax rates are correctly reflected in the PCM for the duration of the regulatory period.

2.6 We understand the tax rates included within the model should be included at nominal value and not adjusted for expected inflation on the basis the inputs included in the model are also nominal.

3 Capital allowances

Background

3.1 For UK tax purposes, depreciation calculated under GAAP is not an allowable deduction in computing the profits of a trade chargeable to corporation tax and tax relief for such expenditure is instead provided by way of capital allowances. Given the substantial capital expenditure incurred by NERL historically and the forecasted expenditure, a key factor in calculating any tax allowance will be the impact of capital allowances. The following reliefs are available to UK companies:

i) Annual Investment Allowance (AIA)

ii) First Year Allowances (FYAs)

iii) Writing Down Allowances (WDA's)

iv) Structures and Buildings Allowances (SBA's)

v) Research and Development Allowances

vi) Super deductions (temporary measure qualifying new plant and machinery acquired between 1 April 2021 and 31 March 2023.)

vii) s1308 CTA 2009 claims (capitalised revenue expenditure in respect of R&D activity)

3.2 Within both the approaches to calculate the tax allowance as described above, capital allowances reduce the profits chargeable to tax on which the UK corporation tax rate is applied.

3.3 The CAA has instructed Grant Thornton UK LLP to review the accuracy and appropriateness of the capital allowance calculations included within the PCM, including:

i) Legislated and announced (to the extent not yet written into tax legislation) writing down allowance rates and other capital allowance reliefs or allowances such as the Annual Investment Allowance, Super Deductions etc.

ii) Review the underlying mechanics of the PCM to ensure capital allowances are accurately calculated

3.4 The PCM pools forecasted expenditure into five relief types, namely: 1) Main Pool additions, 2) Special Rate additions, 3) Structures and Buildings Allowance additions, 4) Super Deductions, 5) Expensed additions and 6) Ineligible additions.

3.5 As noted in Appendix II, Grant Thornton UK LLP have not been instructed to consider deferred taxation.

Annual investment allowance

3.6 AIA is available for expenditure incurred on plant or machinery up to a maximum allowance. As at the date of this report, the following AIA limits are expected to apply during the NR23 regulatory period:

- 1 Jan 2023 – 31 March 2023 - £1,000,000
- 31 March 2023 – 31 December 2027 - £200,000

3.7 We understand AIA is not included within the PCM on the basis its quantum is considered immaterial for the purposes of calculating the tax allowance. We consider this assessment reasonable.

First Year Allowances

3.8 First Year Allowances (FYA's) are available where a company incurs capital expenditure on certain qualifying assets which allow 100% relief in the year that it is incurred. Similarly, R&D allowances (RDA's) are available where a company incurs qualifying capital research and development expenditure which allow 100% relief in the year that it is incurred.

3.9 On review of the PCM, whilst there is no designated pool for assets qualifying for either RDA's or FYA's, functionality does exist within the PCM under the category "Expensed" which results in the same overall outcome (namely 100% relief is available for amounts included within this pool).

3.10 On review of NERLs historic returns, we note substantial RDA expenditure is incurred annually and therefore would recommend the CAA require forecasted RDAs to be factored into the calculated tax allowance.

Writing Down Allowances

3.11 Writing down allowances are available on historic expenditure which has not been fully relieved and for new expenditure which is not eligible for AIA or FYAs. Capital expenditure is typically allocated to the "pools" depending on its nature. A calculation is prepared based on the qualifying expenditure within each pool. Namely, writing down allowances are a fixed percentage of the value of the pool, calculated on a reducing balance basis. The fixed percentage is applied to the value of the pool in the tax year to give the 'writing down allowance' deducted from the 'written down value' of the pool. As at the time of this report, the writing down allowance rates expected to apply between the 1 January 2023 and 31 December 2027 are as follows (ignoring super deductions):

Main pool rate – 18%

Special rate pool – 6%

3.12 On review of the PCM, the WDA rates for the main pool and special rate pool are correctly included at 18% and 6% for the duration of the regulatory period in question.

3.13 On review of the PCM, the calculation of the WDA claimed annually is in line with UK corporation tax principles. Amounts forecasted to be acquired during each financial year ("MP_{T1}") are added to the tax written down value brough forward (TWDV b/f_{T1}) on which the relevant writing down allowance rates discussed above are applied to arrive at the yearly writing down allowance for each pool (WDA_{T1}). This value is deducted from the pool value to arrive at the relevant carry forward tax written down value (TWDV b/f_{T2}) - i.e. TWDV b/f_{T1} + MP_{T1} – [(TWDV b/f_{T1}+ MP_{T1}) * Rate] = TWDV b/f_{T2}. No functionality is included within the PCM to model disposals, and we would recommend confirming with NERL whether they expect any material disposals to occur during the regulatory period.

3.14 We note it will be necessary to determine an appropriate tax written down value brough forward for the first year of the regulatory period onto which the forecast additions can be added. Ideally, this will be in the form of available actual data or use values included from the previous regulatory period

3.15 On review of NERL's historic returns, we note substantial WDAs are claimed annually in respect of main pool qualifying assets. Whilst WDAs are claimed annually in respect of special rate pool qualifying assets, the quantum claimed annually is much smaller. However, we would recommend retaining the ability to model special rate pool WDAs in the event forecasted expenditure deviates from historic returns.

Super Deductions

3.16 The super-deduction and special rate first year allowance (SR allowance) temporarily increases relief for companies on qualifying expenditure on plant or machinery from 1 April 2021 to 31 March 2023. The additional reliefs are split into two types:

- a super-deduction of 130% allowances on new plant or machinery that is not special rate expenditure, i.e. it would ordinarily qualify for the 18% main rate writing down allowance (discussed above)
- a first-year allowance of 50% on new plant or machinery that qualifies as special rate expenditure, i.e. it would ordinarily qualify for the 6% rate writing down allowance

3.17 On review of the PCM, additions qualifying for the super deduction are correctly grossed up to reflect the additional 30% deduction available and the full 130% amount is treated as fully deductible in the year of acquisition. We note no functionality exists to account for the 50% relief available on special rate pool assets, albeit on review of the historical NERL returns they disclose trivial special rate allowance pools. The ability to claim super deductions is switched off for periods after 1 January 2023 correctly.

3.18 On the basis we have only reviewed tax returns up to the 31 March 2021 (i.e. before the introduction of the Super Deduction), we have not been able to consider the quantum of claims made by NERL. However, on the basis the relief ceases to apply for expenditure incurred post 31 March 2023, we do not expect the above reliefs to have a material impact on the tax allowance calculated during the NR23 regulatory period.

Structure and Buildings Allowances

3.19 SBAs are available on expenditure constructing a non-residential building or structure, or in certain cases, expenditure on acquiring such a building or structure. SBAs are expected to be given at an annual rate of 3% between the 1 January 2023 and 31 December 2027. The SBA rules are complex and requires substantial supporting information to be included on “allowance statements”.

3.20 On review of the PCM, we note the model does include functionality to model SBA’s and the rate applied is correctly inputted at 3% for the regulatory period. A similar approach to that described in 4.11 is applied, albeit functionality is also included to allow for amounts which should be removed from the SBA pool prior to applying the relevant writing down allowance rate.

3.21 On review of NERL’s historic returns, no claims have been made in respect of the Structures and Buildings Allowance date.

Capitalised revenue expenditure in respect of R&D activities (s1308 CTA 2009)

3.22 On review of NERL’s historic returns, NERL capitalises research and development expenditure and claims 100% relief in the year of acquisition under s1308 CTA 2009. Where a claim under s1308 CTA 2009 is made, depreciation and amortisation relating to these assets is treated as non-deductible.

3.23 Therefore, we would recommend the CAA requires forecasted capitalised revenue expenditure to be factored into the calculated tax allowance. Functionality does exist within the PCM under the category “Expensed” which results in 100% relief for amounts acquired in the period.

Ineligible additions

3.24 Expenditure considered ineligible for capital allowance purposes receives no relief in the year of acquisition nor in future periods.

Conclusion and recommendations

3.25 On review of the PCM provided to us for review, the calculation of capital allowances is mechanically correct and uses the correct rates such that it can adequately estimate the capital allowances claimed by NERL.

4 Tax treatment of anticipated R&D expenditure and patent box claims

Background – R&D

4.1 We understand from the information provided that NERL is considered a large company as it does not meet the SME criteria by virtue of the fact that it has over 500 employees, and it exceeds the total balance sheet threshold of €86m and the turnover threshold of €100m.

4.2 Currently large companies can benefit from a research and development expenditure credit (RDEC) which is a taxable credit payable to the company (subject to the steps outlined below). RDEC is calculated by applying a specified percentage to the company's qualifying expenditure. For expenditure incurred on or after 1 April 2020, the percentage is 13%.

4.3 The legislation sets out a number of steps that prescribe how and in what order the RDEC should be utilised before being paid (typically named Steps 1 to Step 7). Step 1 requires the credit to be set against a company's tax liability for the accounting period. Where any unused credit remains following Step 1, this is then subject to Step 2 and so on until Step 7 where any remaining credit amount after step 6 is repayable to the company.

Application to PCM

4.4 On review NERLs historic tax return, we note significant RDEC claims are made annually and relief is claimed under Step 1 of the RDEC regime (i.e. the credit calculated is offset in full against the UK corporation tax liability).

4.5 We note the PCM does not include functionality to model this relief and would recommend an additional input line is included to allow the calculated tax liability to be reduced by a forecasted RDEC claim. Complexity could arise where NERL is forecasted to generate tax losses as this would mean consideration of Steps 2-7 are required. However, for simplicity, the credit could be carried forward and used to offset future tax liabilities.

4.6 As noted in 5.2, the credit is itself taxable and therefore should be included in the profit before tax of a NERL. Therefore, to the extent any forecast PBT figures includes RDEC as an above-the-line credit, an additional tax charge is recognised. Alternatively, in order to deal with the complexity of the credit being an "above the line" credit, it may also be worthwhile considering simply using a net RDEC credit claim sitting below the line rather than factoring any claim into the profit before tax.

Background – Patent Box

4.7 The Patent Box regime applies to companies within the charge to corporation tax that actively hold qualifying patents. Qualifying companies can elect for a reduced effective rate of corporation tax of 10% to apply to the income generated from the relevant patents ('relevant IP profits'). The reduced rate of corporation tax is given effect by allowing a deduction to be made in the calculation of the company's total taxable profits, rather than by actually applying a reduced rate of tax to the relevant IP profits.

4.8 UK tax legislation sets out a number of steps in how to arrive at the additional deduction. However, these rules are complex and inclusion within the PCM is unlikely to be practical but a simplified approach could be used to include the benefits derived.

Application to PCM

4.9 On review NERLs historic tax return, we note significant Patent Box claims are made annually reducing the profits chargeable to corporation tax.

4.10 Whilst no specific functionality exists to model the Patent Box claim, the additional deduction can be included within the adjustments made to the notional profit before tax and we would recommend this is

required by the CAA to avoid over estimating NERLs tax charge given the quantum of Patent Box claims made historically.

Conclusion and recommendations

4.11 Given the quantum of the RDEC and Patent Box claims made by NERL annually, we would recommend ensuring these are included within the calculation of the tax allowance.

4.12 As noted above, with respect to RDEC, additional inputs will be required to correctly model the impact of RDEC. We understand a simplified approach using net RDEC credit has been included within the PCM to enable RDEC credits to be modelled.

4.13 With respect to Patent Box, sufficient functionality and input already exists within the PCM to model this relief.

5 Tax treatment of interest deductibility

Background

5.1 There are a number of regimes which aims to restrict interest expenditure, namely: Hybrid and Other Mismatch rules, Transfer Pricing and Thin Capitalisation rules, Late paid interest rules for close companies, Unallowable Purpose rules and the Corporate Interest Restriction ("CIR") regime. When determining whether interest expense may be restricted under the above regimes, it is necessary to assess each regime in a specific chronological order before moving onto the next.

5.2 We understand no related party debt is modelled within the PCM and therefore would not expect transfer pricing adjustments to be required to ensure related party transactions are performed on an arm's length basis.

Application to PCM

5.3 We understand the PCM assumes a notional gearing level on which finance costs arise which are an allowable deduction when arriving at the profits chargeable to corporation tax.

5.4 We also understand NERL is within the scope of the CIR regime (and its interest costs are not exempted under the Public Benefit Infrastructure Exemption) and therefore interest costs incurred outside the PCM may be restricted for UK corporation tax purposes under these rules (thereby increasing profits taxable chargeable to corporation tax).

5.5 On review of NERL's historic tax returns, interest costs incurred are fully deductible and suffer no restriction under the CIR or any other rules as set out in the above background.

5.6 No specific functionality exists within the model to consider matters such as CIR as prescribed by tax UK law. However, these rules are complex and inclusion within the PCM is unlikely to be practical. If required, it would be possible to model a restriction by simply adding back "excess" interest costs calculated using a separate working and we would suggest this approach is more practical.

Gearing clawback mechanism

5.7 As noted above, the PCM will calculate a price based on an expected level of notional gearing. However, where a higher level of gearing is adopted, NERL could receive a benefit in the form of additional tax-deductible interest.

5.8 We understand that CAA applies a gearing tax clawback mechanism where the tax benefits from actual gearing above the notional gearing are returned to customers. This involves comparing actual gearing to the notional allowed gearing and if the actual gearing is higher, a subsequent comparison of actual interest incurred versus notional interest incurred in the PCM is performed. If actual interest incurred is greater than the notional interest in the PCM, then the revenue returned is calculated as the difference between notional and actual interest at the tax rate used in the price determination.

5.9 Grant Thornton UK LLP has not reviewed the mechanics of this calculation and understand the CAA is comfortable with this approach.

6 Traffic risk sharing (TRS) mechanism

Background

6.1 We understand the PCM utilises a TRS mechanism designed to share the revenue risk that arises from any variation of actual traffic to forecasted traffic levels.

6.2 Under this mechanism an amount of revenue is forecast to be generated based on forecast traffic levels. Where traffic levels are lower than forecast and therefore actual revenues are lower than allowed, this revenue is then recovered in future years. Under the exceptional circumstances for 2020-2022, the CAA has set out an approach to TRS based on recovery of efficient costs over a longer period of time. We understand that the shortfall is able to be recognised in NERL's financial statements as revenue and is recognised as accrued revenue.

6.3 This shortfall for 2020 to 2022 is indexed to inflation so that when accrued revenue is actually recovered it is uplifted in nominal terms resulting in a top up of income.

6.4 We understand following the completion of the RP3 period in 2022, the TRS recognised may be adjusted to reflect variances in cost bases, efficiencies etc which were not reflected in the PCM. This could result in upward or downward adjustments to the TRS.

6.5 The CAA has requested Grant Thornton UK LLP to confirm the UK corporation tax implications of the TRS mechanism and how this may impact NERL's corporate tax liability.

Application to PCM

6.6 UK tax legislation provides that the profits of a trade must be calculated in accordance with generally accepted accounting practice (GAAP), subject to any adjustments required or authorised by law. The starting point for calculating trading profits is usually therefore the profit before tax figure as per the accounts, which is then subject to tax adjustments where applicable, which ultimately leads to the amount of total taxable profits.

6.7 Therefore, the profit before tax figure should include all revenue recognised for accounting purposes (whether accrued or actually generated) and UK corporation tax would be paid on this in respect of the period of recognition.

6.8 To the extent any downward or upward adjustments are required due to the reasons outline in 6.3 and 6.4, these amounts would also be taxed by reference to the period in which they are recognised in NERL's financial statements.

7 Tax treatment of brought forward losses

Background

7.1 Finance (No 2) Act 2019 introduced new rules in respect of the utilisation of brought forward losses for periods after 1 April 2017. These rules apply a restriction on the utilisation of brought forward losses in excess of a £5 million de minimis threshold. This £5m allowance is available on a group basis. Broadly, to the extent profits have not been extinguished by the use of £5m brought forward losses, and further losses are available, 50% of remaining profits can be sheltered. The approach to calculating the actual remaining profits to which the 50% restriction applies is both complicated and involved and we note the PCM uses a simplified mechanism to arrive at the 50% restriction which is reasonable to prevent modelling being overly onerous.

7.2 Based on the forecasted information provided, we understand NERL is not anticipated to generate losses in the NR23 period.

PCM loss mechanism

7.3 The PCM allows for the input of a brought forward loss value on commencement of the regulatory period. To the extent appropriate, it will be necessary to determine an appropriate brought forward value for the first year of the regulatory period.. This would either likely be based on actual losses suffered by NERL per their submitted corporation tax returns or use of the value brought forward from the prior regulatory period.

7.4 We note the historic NERL tax returns show no taxable losses being generated in the financial yeas ended 31 March 2019, 31 March 2020 and 31 March 2021 and in all periods NERL generated taxable profits.

7.5 To the extent the PCM calculates a taxable loss in any given period, this amount is added to the loss brought forward pool and carried forward into future periods for possible utilisation against future taxable profits generated. We note no functionality exists to model the capability to surrender losses by way of group relief to other group companies.

7.6 The PCM uses a simplified approach to the loss brought forward utilisation rules. Firstly, the £5m allowance is utilised in full to the extent required, after which the remaining profits are sheltered by losses up to 50% . Whilst not strictly correct, this simplified approach appears reasonable in modelling the brought forward loss utilisation.

7.7 We note a risk exists if other group companies may utilise the £5m deduction allowance which would result in excess of loss relief arising in the PCM but is consistent with the approach to not model other group related matters (e.g. group relief). Based on a review of the historic NERL tax return, group relief claims have been made by NERL but these are modest.

Conclusion and recommendations

7.8 On review of the PCM provided to us for review, the calculation and utilisation of losses within PCM is consistent with UK corporate tax principles

8 Appendices

Appendix 1: Sources of information

8.1 We have prepared our report using the following information as provided by the Civil Aviation Authority :

- NERL year end 31 March 2021.pdf
- NERL CT Computation year ended 31 March 2020.pdf
- NERL CT Computation year ended 31 March 2020.pdf
- CAA RFI Q69 Tax-WACC calculator.xlsm
- CAA RFI Q69 - NATS Financial model - regulatory assumption document - Autumn 2021v4.1_CAA.docx
- CAA NERL PCM_07z_run_0f.xlsm
- 20220310_assumptions file sheet 4_v4.1_CAA.xlsb.xlsx

Appendix 2: Scope of works

Scope of work

8.2 NATS En-route Limited (“NERL”) is subject to economic regulation by the Civil Aviation Authority (“CAA”).

8.3 With the current regulatory period due to expire (RP3), the CAA is in the process of finalising the Price Control Model (PCM) for the upcoming regulatory period “NR23”. Within this model, NERL is given a tax allowance based on the estimated UK corporation tax liability that the regulated entity (a notional company) will incur. We understand NERL has submitted its business plan to the CAA which includes details of its approach to tax. Within this business plan, the estimated tax costs have increased significantly for NR23 compared with RP3.

8.4 We shall prepare a 5–10-page memo suitable for publication which:

- High level review of the tax calculations in the PCM to assess their accuracy, reasonableness and that these align with the CAA’s objectives for modelling tax of the notional company
- Comments on the extent to which the tax calculation in the PCM appropriately estimates any taxable losses incurred by the notional company during the previous price control period (RP3) and utilisation of these losses
- Comments on the reasonableness of the tax calculations in the context of prevailing UK tax policy as at the date of the memo that might impact NERL and the notional company and any announced changes during the NR23 period. This shall include:

  i) Review and commentary on tax rates, allowances and reliefs used within the PCM for UK corporation tax purposes only (e.g. capital allowances and Research and Development (R&D)

  ii) Treatment of expenditure within model (e.g. capital expenditure and tax adjusting items) for UK corporation tax purposes only

  iii) High level considerations of possible Corporate Interest Restrictions (CIR) and UK transfer pricing to assess the extent to which these items should be considered within the PCM

  iv) Review of historical NERL corporation tax returns and forecasts prepared by NERL

  v) Review of NERL’s business plan and approach to taxation

8.5 Within our fee, we expect to answer two rounds of queries and hold one call with the CAA on the completion of our work. To the extent there are further rounds of comments or queries, our fees for dealing with such queries will be based on the agreed hourly charge out rates.

8.6 We note that the PCM was originally developed for the CAA by Grant Thornton UK LLP under a separate agreement for modelling services, however the scope of that engagement did not include the provision of taxation advice.

8.7 For the avoidance of doubt:

- Our work covers UK corporation tax only (and not any other taxes including, but not limited, to VAT, employment taxes and stamp duty)
- Our work covers a high-level review of the model and its calculations, and we shall not reperform any such calculations
- We shall not:
  - Comment on the appropriateness of any tax treatment adopted by NERL in historic tax returns
  - Perform a detailed review of complex matters including, but not limited, to a capital allowance claims, CIR calculations, R&D claims, transfer pricing policies, thin cap or hybrid or other mismatches (historic or prospective)
  - Consideration of other regulatory bodies approach to taxation
  - Provide commentary on accounting or valuation treatments

8.8 We have assumed the following:

- Information shall be provided to us in a timely and complete manner. If the information we receive is not provided in a timely manner or to the expected quality, we will raise this with you immediately where we consider this shall delay the completion of our work.
- We have assumed that we will not require any detailed input from transfer pricing, R&D, CIR and Capital Allowance specialists. If we identify issues that require additional specialist input not included in the agreed scope of work, we will advise you as soon as possible and discuss and agree the way forward appropriately.
- Our engagement is with the CAA only, and we will not be providing any advice to NERL. Any comments and recommendations provided by us shall be for the benefit of CAA only and should not be relied upon by NERL who should make their own arrangements to obtain appropriate tax advice.
- Our scope of work is limited to whether the model and assumptions used in the PCM are reasonable in the context of current UK tax law (as at the date of the memo) and published changes to UK tax legislation and whether the methodology /approach is reasonable.
- Our fees are based on the scope of work as set out above. In the event the CAA requires us to amend/extend our scope of work, we would agree a separate scope and fee in advance of undertaking such work.

Confidentiality and disclaimer

8.9 This report is confidential and has been prepared exclusively for the Civil Aviation Authority. It should not be used, reproduced or circulated for any other purpose, in whole or in part, nor disclosed to third parties, without our prior written consent, except as required by law or regulation or if disclosure is required to HMRC. Such consent will only be given after full consideration of the circumstances at the time. For the avoidance of doubt, we accept no duty of care nor assume any responsibility to any third party.

8.10 We hereby authorise you to publish the report on your website on the condition that (1) you state on your website that the report was prepared exclusively for the Civil Aviation Authority and Grant Thornton UK LLP accepts no duty of care nor assumes any responsibility to any third party' and (2) you do not remove, alter or amend any part of the report.

Forms of report

8.11 For your convenience, this report may have been made available to you in electronic as well as hard copy format. Multiple copies and versions of this report may therefore exist in different media and in the case of any discrepancy the final signed hard copy should be regarded as definitive.

Reliance

8.12 This report is based on current tax rates, tax legislation and HMRC's practice as at the date of this report which may be subject to future change.

8.13 While we have prepared our advice based on our interpretation of the legislation and HMRC current practice, you should appreciate that there can be no guarantee that HMRC will accept this. As with all tax planning, there is a risk that HMRC could challenge the analysis and conduct an enquiry into the tax return.

The general anti-abuse rule

8.14 The general anti-abuse rule (GAAR) is aimed at preventing abusive tax arrangements which would not have been contemplated when the relevant tax legislation was formulated. We have taken the risk of the GAAR applying to this particular transaction into consideration as part of our advice to you. However, while we do not consider that the proposed transaction is of a nature targeted by the GAAR, we cannot preclude the possibility that HMRC may seek to argue that the GAAR applies. The legislation and guidance in this area is likely to evolve as cases are brought before the GAAR advisory panel, the Tribunals and higher courts. There is, therefore, a risk that the tax advice that forms the scope of this engagement may be challenged by HMRC using the GAAR. In this event, it may require time and costs in disputing its assessment, even if you are successful in establishing that the GAAR does not apply. If HMRC successfully counteracts the tax planning in reliance on the GAAR, the transaction will not achieve some or all of its expected tax consequences. Where additional tax is assessed, interest and penalties may apply.

This document has been prepared only for Civil Aviation Authority (CAA) and solely for the purpose and on the terms agreed with Civil Aviation Authority (CAA) in our agreement dated 27 April 2022.

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