Consumers and markets group
Economic regulation and competition policy

2 May 2025

Dear Stakeholder,

Consultation on calculation of the NR23 tax clawback mechanism

The purpose of this letter is to consult on our proposed approach to calculation of the tax clawback mechanism for NR23, following a request from NERL for clarity on this calculation.

In November 2023 we published our final decision on the NR23 price control for NATS (En Route) plc (NERL).[1] The NR23 price control includes a mechanism known as the tax clawback.[2] The purpose of the tax clawback is to offset the incentive that would naturally exist for NERL to take on additional debt as a way of reducing its tax liability below the level of the allowance for tax given in the price control. This provides benefits to consumers by incentivising the financial stability of the regulated business (as increases in debt finance above a certain level are discouraged) and by reducing charges if NERL does reduce its tax costs as a result of taking on additional debt.

The amount of the tax clawback is calculated by comparing actual interest costs during the NR23 period with modelled interest costs at the time of setting the NR23 price control. In the NR23 regulatory asset base (RAB) rules we specified how this calculation should be performed. However, we referred to the calculation being finalised before the start of NR23 and have not yet done so.[3] NERL has now sought clarity on how it should calculate actual interest costs, to be comparable with modelled interest costs.

We are therefore seeking to provide additional clarity on the calculation of modelled interest costs. At the same time, we are also correcting a calculation error in the modelled interest costs as part of the calculation of the tax clawback.[4] Correcting this error affects the NR23 RAB rules and means that the net present value of charges in NR23 including the tax clawback will reflect the correct interest costs.

The calculation of modelled interest costs in our price control model was performed at a high level, multiplying the amount of net debt by an interest rate based on the notional company which has a simple capital structure. NERL's actual capital structure is more complicated, for example because it has more than one type of interest-bearing liability. It is therefore not possible to use the same approach when calculating the actual interest cost.

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[1] See https://www.caa.co.uk/commercial-industry/economic-regulation-and-competition-policy/national-air-traffic-en-route-services-nerl/nerl-price-controls/current-price-control-nr23-2023-2027/
[2] See section 7 of the NR23 RAB rules
[3] See footnote of section 7 of the NR23 RAB rules
[4] The original calculation of interest costs in the Price Control Model assumed a bullet repayment profile for a particular debt, which we will correct in the calculation of modelled interest costs to reflect an amortising profile.

To estimate actual interest costs, NERL has provided a range of transaction types that it considers could be excluded from the calculation of actual interest costs as they are not comparable to the calculation of modelled interest costs. We provide a list of the transaction types and our initial assessment in appendix 1. This is based on the principle that:

1. transactions with interest costs that relate to servicing the debt required for financing the business should be *included* in the tax clawback calculation; and
2. other transactions that would be presented in statutory accounts as 'finance costs'[5] but do not relate to servicing debt to finance the business should be *excluded*.

Applying the approach outlined above, we would include the issue costs of bonds, since these are necessary to obtain the interest rate represented by the bond itself and other interest costs, or financing costs akin to interest. Conversely, we would exclude costs which arise from items that do not represent a substantive financing of the business, for example from discounts being unwound, interest not capitalised in the RAB (and therefore not relevant to the RAB) and other costs relating to the financing choices made by NERL.

As shown in appendix 1, NERL has estimated that the net value of transactions to be excluded in the year to 31 March 2024 would be an inflow of £9.4 million. Our initial assessment is to exclude transaction types that amount to an inflow of £34.1 million and include transaction types that amount to an outflow of £24.7 million.

We are consulting on this approach for the NR23 period. We will then make a final decision on how interest costs should be calculated for the tax clawback. We will implement this decision through an update to the NR23 RAB rules, which will classify which transaction types should be included or excluded from the calculation for each of the transaction types listed in appendix 1. The updated RAB rules would also specify the broad principle above for classifying any other transaction types and that NERL should seek guidance from the CAA as needed. A draft of the proposed addition to the RAB rules is shown in appendix 2.

We invite stakeholders to share their views on:

1. our initial assessment of NERL's exemption requests; and
2. our approach to implementing our decision.

Stakeholders who wish to comment on either of these issues should share their views with the CAA no later than 16 June 2025. Comments should be emailed to economicregulation@caa.co.uk and copied to dan.rock@caa.co.uk.

Yours sincerely

Dan Rock
Head of corporate finance

[5] Such as the effect of unwinding the discounting on long dated liabilities.

Appendix 1: proposed treatment of transaction types

	Year to Mar-24 (£m)	NERL's proposed exemption	NERL's rationale	CAA view (based on application of principle described above)
Receivable	32.4	RP3 TRS Return, RP3 TRS Inflation uplift;	Finance income related to unwinding the discount and the associated time value of money regulatory allowances (regulatory return on the RP3 TRS over the RP3 period plus the recognition of the impact of inflation) applied to the TRS debtor over the 10-year recovery period, which is included as finance income for Accounting purposes.	**Conclusion: accept the exclusion from tax clawback Value: £34.1m**
	4.2	Interest Received via Sales;	Finance income/cost related to unwinding the discount and the associated time value of money regulatory allowances applied to the Pension pass through Debtor/Creditor over up to the 15 year recovery period, which is included as finance income for Accounting purposes	
Payable	(2.3)	CP3 Discounting Release, MOD Gainshare discounting, Eurocontrol Discounting, Reinstatement Discounting;	Any other finance costs or income, such as the unwinding of discounting on accounting balances (for example reinstatement provisions for long term property leases).	
	0.8	IAS23 Capitalised interest	Interest capitalised for accounting purposes under IAS23, which is not included in the RAB.	
	(1.0)	Finance cost of financing leases, IFRS 16 finance charges for property leases, cars, furniture and equipment	The total cost of these leases was included in opex in NR23 so it is correct to exclude the financing cost element of these leases (now classified as financing leases under IFRS 16) from "Actual Interest" from tax clawback purposes	
	(18.1)	In effect gain/loss on Index Linked Swap Hedging, Adjustment to change the RPI SWAP to a UKGAAP basis for Tax.	This reflects two transactions. One is the increase in the amount owed under the swap. The swap is used to manage RPI exposure, not to fund the business. The other transaction is an accounting basis adjustment to switch from international to UK rules for the purpose of tax calculations[6]	
	(0.6)	Other interest payable, Amortisation of interest hedging costs, Agency and Advisors fees;	Any commitment, arrangement or agency fees for any facilities, or their recognition for accounting purposes	**Conclusion: reject the exclusion (i.e. include in tax clawback) Value: (£24.7m)**
	(1.1)	Property Pass-through finance costs;	INEA funding interest costs	
	(1.3)	5.25% bond (2026) issue cost amortisation, Bank facility issue cost amortisation;	Amortisation of bond and bank facility issue costs	
	(3.6)	5.25% bond (2026) discount accretion	Accretion of discount on issue of bonds	
Net	**9.4**			

[6] This text paraphrases NERL's original description

Appendix 2: Draft definition of actual interest to be included within the RAB rules

The below is an update to the definition of “Actual Interest” in the Tax Clawback. The following definition replaces footnote 3 on page 54 of CAP2597d:

Footnote 3

Actual Interest is defined as follows. This definition is based on interest income/expense included in NERL’s Corporation tax calculations listing the key inclusions and exclusions required to derive Actual Interest for tax clawback purposes. Items that do not represent a substantive financing of the business have been excluded. The general ledger account number from NERL’s accounting system is also included to provide clarity to users of the RAB Rules. Where a transaction type is not shown in the list below NERL should seek guidance from the CAA as to how that transaction should be treated for the calculation of the tax clawback.

Actual interest income/expense for tax clawback purposes includes:

- Interest Receivable on cash balances (710100)
- RPI Swap Interest Income (710102)
- RPI Swap Interest expense (810100)
- Revolving Credit Facility interest (810105)
- Bond interest (810111)
- Revolving Credit Facility Fees (810120)
- INEA Funding Interest Expense (810124)
- Bond and Bank Facility Fee amortisation (810250 & 810252)
- Bond discount accretion (810251)

The following items are excluded from Actual interest income/expense for tax clawback purposes:

- RP3 TRS Return & Inflation Uplift (710106 & 710107)
- Pension pass-through return & inflation uplift (710110)
- Balance sheet discounting release (710105, 810121, 810122 & 810123)
- Capitalised Interest (810106)
- All interest charges relating to Finance leases (813100, 813101, 813102, 813104 & 813105)
- Fair value adjustments on Index Linked Swap Hedging required under IFRS (813310)
- The adjustment required to change RPI SWAPs from an IFRS to a UKGAAP basis for corporation tax purposes (sourced from NERL’s corporation tax return)

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