

Date: 4 July 2018

Item: **Crossrail Central Operating Section (CCOS) – Structure of Rail for London (Infrastructure) Limited’s proprietary interest in the CCOS infrastructure**

1 Summary

1.1 This paper sets out: the proposed structure for Rail for London (Infrastructure) Limited’s (RfL(I)’s) and London Underground Limited’s (LUL’s) proprietary interests in the Crossrail Central Operating Section (CCOS) infrastructure; why and by when such interests are required; and the rationale for the proposed structure.

2 Recommendation

- 2.1 **The Committee is asked to note this paper and approve the completion of the intra-Group lease arrangements that deliver Rail for London (Infrastructure) Limited’s (RfL(I)’s) and London Underground Limited’s (LUL’s) proprietary interests in the Crossrail Central Operating Section (CCOS) infrastructure and to authorise:**
- (a) **Transport for London (TfL) to enter into an agreement for lease with Crossrail Limited (CRL) of the CCOS (excluding the South East Spur (SES));**
 - (b) **TfL to enter into an agreement for lease with RfL(I) of the SES;**
 - (c) **CRL to enter into an agreement for under lease with LUL of the CCOS platforms and related infrastructure at the five existing LUL stations served by the CCOS; and**
 - (d) **CRL to enter into an agreement for lease with RfL(I) of the remainder of the premises to be let to CRL under the agreement for lease mentioned in 2.1 (a) above.**

3 Background

- 3.1 Unlike other rail infrastructure owned and operated by TfL, such as the London Underground and the East London Line, the CCOS is regulated under the Railways Act 1993 (the Act) and The Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 (the Regulations).
- 3.2 One consequence of this is that the operation of rail services on the CCOS needs to be separate from the management of the infrastructure.

- 3.3 RfL(I), a wholly owned subsidiary of Transport Trading Limited (TTL), has been established to act as Infrastructure Manager of the CCOS (the routeway and the RfL(I) CCOS stations, namely Paddington, Canary Wharf, Custom House and Woolwich - see map in Appendix 1).
- 3.4 One of the roles of RfL(I)L, as Infrastructure Manager of the CCOS, will be to grant access to the CCOS infrastructure on a fair and non-discriminatory basis in accordance with the Act and the Regulations.
- 3.5 This will include entering into regulated access agreements with MTR Corporation (Crossrail) Limited (MTRCCL), the operator granted a concession by Rail for London Limited (RfL), to run Elizabeth Line passenger services on the CCOS from 9 December 2018.
- 3.6 Prior to this MTRCCL will require access to facilitate trial running followed by trial operations which again will be undertaken pursuant to regulated access agreements.
- 3.7 In order to grant regulated access RfL(I) will require a proprietary interest in the CCOS infrastructure.
- 3.8 LUL will be responsible for operating the Crossrail platforms and related facilities at the five LUL stations which interface with the CCOS, namely Tottenham Court Road, Bond Street, Farringdon, Liverpool Street and Whitechapel. Again, LUL will require a proprietary interest in those facilities, in the same timescales as above, to enable it to enter into station usage agreements with MTRCCL on an unregulated basis.¹
- 3.9 The land upon which the CCOS is constructed is (or will be) owned by TfL and the infrastructure affixed to this land has largely been paid for by CRL and is recognised as a fixed asset in CRL's Financial Statements.
- 3.10 The structure for providing RfL(I) in particular with a proprietary interest in the land and infrastructure referred to above has been developed in the context of a number of constraints arising from how the delivery of the Crossrail project was structured and a number of other considerations which are detailed below.

Put/Call Option

- 3.11 Under the agreements put in place for delivery of the Crossrail project the Department for Transport (DfT) has a call option over the shares in CRL. This option may be exercised in a number of defined circumstances including the actual or projected total costs of the Crossrail project exceeding a pre-determined level.
- 3.12 TfL has an option to put the shares in CRL on DfT in the event that the actual or projected total costs of the Crossrail project exceed a pre-determined level.

¹ Exemption from the Act requirements to grant third party access by virtue of The Railways (London Regional Transport) (Exemptions) Order 1994 (as amended). Exclusion from the Regulations requirement to grant third party access (Regulation 6 of Part 2) as LUL's network is intended only for the operation of urban or suburban rail passenger services.

- 3.13 The put/call options are supported by an agreement for lease (AfL) dated 21 July 2011 that would enable DfT (through CRL) to draw-down a lease of the CCOS if either option was exercised and would give CRL a long term (150 year) interest in the land comprising the central operating section.
- 3.14 The put/call option arrangements fall away upon Final Completion of the Crossrail project.
- 3.15 Any arrangement involving, for example a change in ownership of the CCOS or the assignment of the benefit of the agreement for lease would require amendment or early termination of the put/call arrangement. Any structuring option that involves amendment or early termination of the put/call arrangements would require:
- (a) the agreement of DfT; and
 - (b) due consideration by TfL as the existence of the put option was explicitly referenced as a safeguard in the event of cost overruns – for the purposes of TfL Board approval for the Crossrail project in 2008 and in the Crossrail Business Rates Supplement Prospectus.
- 3.16 From discussions with both DfT and TfL Treasury it was established that the put/call arrangements should remain in place.

CRL outside of TfL Tax Group

- 3.17 The existence of the put/call arrangements above means that CRL is not part of the TfL Tax Group for corporation tax group relief purposes but should be for chargeable gains purposes.
- 3.18 In structuring RfL(I)'s interest in the CCOS infrastructure the following need to be borne in mind:
- (a) any disposal by CRL of the infrastructure for a valuation in excess of cost should not trigger a taxable gain due to the chargeable gains group rules, but caution would suggest that this conclusion be confirmed by a ruling from HMRC; and
 - (b) any taxable profits (including any such gain above) accruing in CRL cannot be set off against taxable losses of other TfL Group companies.
- 3.19 HMRC has confirmed that granting of lease interests in the CCOS infrastructure between TfL Group companies will be exempt from Stamp Duty Land Tax.

Availability of Tax Reliefs

- 3.20 There are tax reliefs that may be available in respect of certain expenditure incurred in relation to the Crossrail project. Whilst the amounts at stake are not sufficient to drive complex structuring to enable realisation, the proposed structure should, where possible, facilitate claims for these reliefs.

Nature of Proprietary Interest

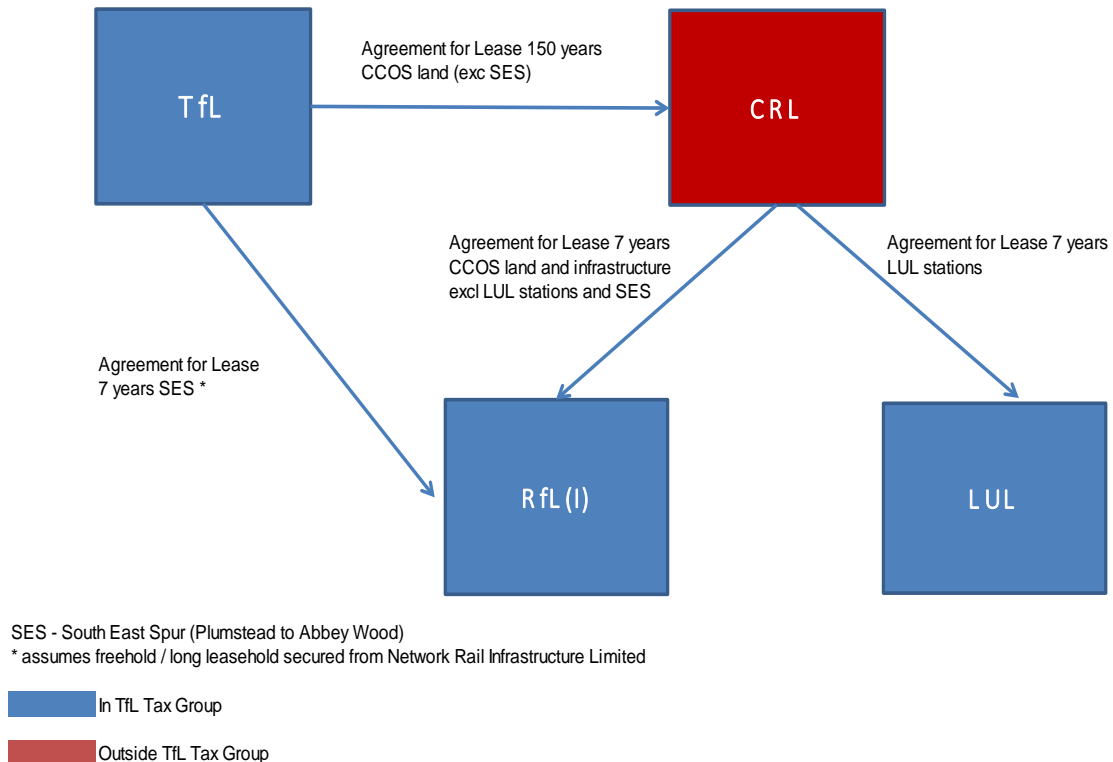
- 3.21 The proprietary interest held by RfL(I) should be sufficient to constitute it as Facility Owner/Infrastructure Manager for the purposes of granting access under the Act and the Regulations.

Restrictions on Infrastructure Managers use of Funds

3.22 The Fourth Railway Package due to be implemented into English law in December 2018 introduces a prohibition on RfL(I)'s ability to pay dividends. The structure should therefore seek to maximise the funds that can be extracted from RfL(I) as part of the cost of infrastructure ownership.

4 Ownership Structure

4.1 The structure is set out below:



4.2 This structure has been determined having due regard to the considerations/ constraints above in particular:

- it continues to support the put/call arrangements;
- there is no disposal of the Infrastructure by CRL;
- it facilitates a claim for land remediation relief (a tax relief) of approximately £1m;
- RfL(I)'s interest in the infrastructure is considered sufficient to grant regulated access;
- funds received by RfL(I) from access charges can be extracted via lease rentals; and
- it continues to support the balance sheet treatment adopted by CRL in respect of the infrastructure assets (see 3.9 above).

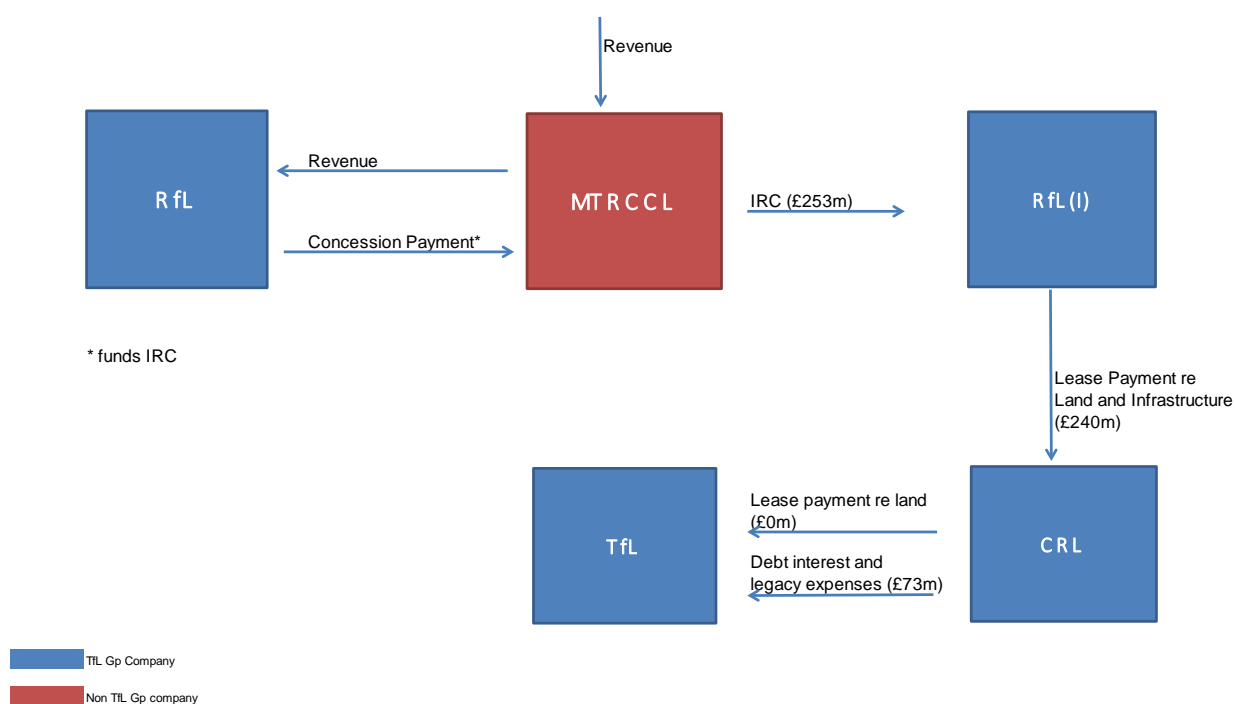
- 4.3 A new AfL will replace the existing AfL between TfL and CRL. The new AfL defines the demise on a more granular basis reflecting the information available at this stage of the project and extends the demise to include the LUL stations.
- 4.4 Licences to occupy the relevant land are granted under the AfL's (considered sufficient for RfL(I) to sell regulated access pending the grant of the relevant lease) from the start of Trial Running. It is anticipated that none of the leases will be granted in the immediate future pending amongst other things TfL perfecting its title to the entire route. In any event the ownership structure may be re-visited once the Put & Call options fall away (see 4.9 below).
- 4.5 It is proposed that no premium be payable on entering into the leases.
- 4.6 The lease payments in the structure are on an arm's length basis and such so as to avoid significant taxable profits in CRL for the period for which the put/call arrangements remain in place. This is considered in more detail in section 5 below.
- 4.7 There will be a review of CRL's governance structure and processes to ensure compatibility with the additional role of lessor of infrastructure to, and receiver of rental income from, RfL(I). In particular the rentals received by CRL under the RfL(I) lease are to be used to service TfL debt or pay dividends and are not:
- (a) available to be utilised in the Crossrail project; or
 - (b) part of any surplus on winding up of CRL to be shared between the Sponsors.
- 4.8 DfT has agreed in principle that if the put or call options was exercised following the implementation of this letting structure, that steps would need to be taken to collapse it and effectively revert to the extant AfL.
- 4.9 Upon expiry of the put/call arrangements (and as a consequence CRL coming into the TfL tax group for corporation tax group relief purposes) other structuring options can be considered. This could include the purchase of the CCOS infrastructure from CRL by RfL(I) and LUL (e.g. as part of a wider programme that ultimately ends in the winding up of CRL).

5 Financial Implications

Lease rentals

- 5.1 The rental under the lease between TfL and CRL is a nominal amount.
- 5.2 The rentals payable by RfL(I) under the lease with CRL are informed by the income the underlying asset generates for RfL(I) and are designed to be at an arm's length rate. It is worth noting that pending the grant of the lease rents will be payable as a licence fee under the AfL.

- 5.3 This income will be the element of the access charges levied by RfL(I) which comprises the investment recovery charge (IRC)².
- 5.4 Access charges inclusive of the IRC element will be levied by RfL(I) from the commencement of passenger services in December 2018.
- 5.5 The rents under RfL(I)'s lease from December 2018 will comprise 95 per cent of the IRC with RfL(I) retaining a five per cent margin commensurate with the risks it faces in relation to operation, maintenance and renewal obligations in respect of the infrastructure³.
- 5.6 Lease rents/licence fees payable by RfL(I) to CRL for the period from the grant of the AfL through testing to December 2018 are set at a nominal amount.
- 5.7 Projected cash flows under the above arrangements for Financial Year (FY) 2021/22 are set out below:



Taxation

- 5.8 CRL potentially has a taxable profit of £167m (£240m - £73m) in FY 2021/22 resulting in corporation tax payable of some £28m at the current rate for 2021/22 of 17 per cent (as CRL is outside the TfL corporation tax losses group – see 3.17 to 3.18 above).

² In a Regulatory Statement dated November 2008, the Office of Rail and Road gave approval in principle for RfL(I) to levy access charges to recover up to the publicly funded capital cost of the Crossrail project. TfL has developed principles for the levying of an IRC and consulted on its proposals as part of the consultation on the draft 2019 CCOS Network Statement. Consultation responses received raised no material issues with the above proposals and principles and as a result in its Consultation (Conclusions) Report TfL concluded it should proceed with implementing the principles set out in the Consultation.

³ RfL(I) recovers the costs of operation, maintenance and renewal of the infrastructure through access charges. However these access charges will be fixed for periods of five years.

- 5.9 The taxable profit may be reduced slightly by TfL charging a rental above a nominal amount for the lease of the land but to eliminate it requires the availability of significant tax deductions.
- 5.10 This is achieved by CRL claiming capital allowances on the CCOS infrastructure spend.
- 5.11 A report by Deloitte has confirmed that approx. £2.5bn of the CCOS infrastructure spend qualifies for capital allowances resulting in an initial capital allowance deduction available of approximately £230m.
- 5.12 Projections show that the availability of capital allowances should result in no tax payable by CRL before FY 2023/24⁴. This is beyond the anticipated date for Final Completion of the Crossrail project and thus the put/call arrangements should have lapsed and any CRL taxable profit can be potentially group relieved, subject to sufficient tax losses being available elsewhere in the TTL Group. To provide certainty in relation to this, discussions are ongoing with DfT to amend the Sponsors Agreement to incorporate a Longstop Date (31 March 2022 or earlier) by which the put/call arrangements will lapse if neither party has given notice to exercise.
- 5.13 In order for CRL to be eligible to claim the capital allowances the lease from CRL to RfL(I) must not be classified as a long funding lease.
- 5.14 For this to be so the lease must either:
- (a) have a term of less than five years; or
 - (b) (i) the lease must not be treated for accounting purposes as a finance lease; and
 - (ii) the present value of the minimum lease payments must be less than 80 per cent of the market value of the leased plant and machinery; and
 - (iii) the lease term must be less than 65 per cent of the economic life of the leased assets.
- 5.15 The lease term will be seven years less one day, this lease duration covers the term of the MTRCCL Concession. This means that condition 5.14 (a) will not be met, however the nature of the CCOS infrastructure assets eligible for capital allowances is such that the conditions in 5.14 (b) will be satisfied under such a lease term.
- 5.16 The capital allowance estimate in 5.11 is inclusive of allowances in relation to expenditure on the LUL CCOS stations.
- 5.17 In order that these allowances are available to offset the rental income receivable by CRL under the RfL(I) lease it is proposed that CRL retain ownership of the LUL CCOS stations until Final Completion (and the lapse of the put/call arrangements).

⁴ Capital allowances are calculated on an amortising written down value (i.e. the tax deduction reduces year on year from the initial £230m) but the IRC, and thus the taxable CRL rental income, increases year on year by RPI

- 5.18 CRL will grant LUL use of these stations under a lease term of seven years less one day for a nominal rental.
- 5.19 TfL wrote to HMRC setting out the above lease structure and offering to respond to any queries. No substantive questions have been raised by HMRC.

Accounting

- 5.20 The leases are all intra-group and will thus eliminate on consolidation in the TfL Group accounts.
- 5.21 In the individual company accounts the leases will need to be accounted for in accordance with the new leasing standard IFRS 16 (applicable for accounting periods beginning on or after 1 January 2019).

6 The SES

- 6.1 Network Rail Infrastructure Limited (NR) is the owner of the SES comprising that part of the CCOS from Plumstead portal to Abbey Wood (excluding Plumstead sidings).
- 6.2 The CCOS infrastructure on the SES is being delivered by NR as part on the On-Network Works (ONW).
- 6.3 NR is remunerated for the ONW by a Crossrail Supplementary Access Charge (CSAC) payable by TfL.
- 6.4 TfL is in negotiation with NR to obtain a proprietary interest in the SES prior to the commencement of testing of the CCOS infrastructure.
- 6.5 When TfL acquires this interest it will enter a further AfL under which the SES will be leased to RfL(I) for seven years less one day at a rental that comprises that element of the CSAC attributable to the SES.
- 6.6 This AfL will provide interim rights of occupation as set out in 4.4 above.
- 6.7 The above enables RfL(I) to recover the element of the CSAC attributable to the SES through its access charging framework from train operators that use the SES.

List of appendices to this report:

Appendix 1 – Map of CCOS.

Background Papers

None

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Appendix 1 Map of CCOS

