

1. How does the proposed change to REIT status make the credit as good (or better) from the bondholders' perspective? Along with the change to a REIT status, why do UPP need to change the group relief wording in the Tax Deed of Covenant?

Answer:

The financial models demonstrate that the REIT regime is favourable for the bond group and therefore credit positive as the AssetCos will no longer pay corporation tax on their property income.

However, without the changes proposed in the Tax Deed of Covenant in relation to group relief surrenders it will not be possible to justify REIT conversion for UPP as it will expose UPP Group Limited to taxable income on accrued sub debt income from the bond group (which it can no longer shelter with interest on shareholder debt) – the intention is to provide a favourable position going forward for the Bond Group while not adversely impacting the tax position of UPP Group Limited (and other entities outside of the Bond Group).

We anticipate for the Bond Group to surrender tax losses to UPP Group Limited for as long as UPP Group is within the REIT regime or until the sub debt between Hold Co and UPP Group Limited is repaid.

2. What is the value to bondholders of the tax losses which will be permitted to be surrendered to UPP Group Limited under the proposed amended Tax Deed of Covenant?

Answer:

The Tax Deed of Covenant will continue to prioritise utilisation of losses against taxable profits (if any) of Bond Group companies.

In any case, within a REIT regime, the tax losses generated by payment of sub debt interest have no value to bondholders or to the AssetCos / other members of the UPP Bond Group. This is because profits at the AssetCo level are exempt from UK corporation tax and there are no other impacts or obligations, as a result of the REIT regime, at the AssetCo level. Any taxable profits in any members of the Bond Group will be de minimus and no other new losses will be generated in the REIT regime by Bond Group members.

By way of comparison, if the AssetCos were not in a REIT regime, i.e. if UPP were not to convert to a REIT, to the extent possible (subject to BEPS restrictions) the sub-debt interest at the AssetCo can be deducted against property profits but it will not be enough to shelter the AssetCo from UK corporation tax. With effect from 1 April 2017, the AssetCos will be subject to BEPS restrictions and will be restricted with the use of existing losses brought forward as per the FA (No2) 2017. As reflected in the financial modelling, the AssetCos will be in a worse net cash and "credit" position than within a REIT regime notwithstanding any surrender of the tax losses contemplated.

3. Does the proposal have any other impact on existing brought forward Bond Group losses?

Answer:

Based on draft tax computations for the period to August 2017 bond group companies have existing brought forward tax losses of approximately £215m.

On conversion to REIT status these losses, which are “non-trading loan relationship debits (NTRL)”, will no longer be offset against property income, which will be tax exempt, but carried forward to offset against sundry interest and other non-property income with no time limitation. These losses will not be surrendered outside of the UPP Bond Group.

In the event that UPP ceases to qualify as a REIT the NTRL losses will again be available to offset against property rental income, albeit subject to the 50% restrictions of the Finance Act (No2) 2017. On this basis UPP considers that the REIT proposal has no adverse impact on the existing loss position of the bond group.

4. Is there a risk of change of tax law so that the Bond AssetCos become, at a later date, subject to tax on their rental income?

Answer:

There is (as is currently the case) a change of law risk in relation to the tax treatment of the Bond Group and it is not possible to determine what the impact of any future change in law may be.

However, in the event that the UPP Group ceased to comply with the criteria for REIT status, under the law at present:

(i) this would not impact upon the tax position afforded to the Bond Group as a result of being within a REIT for any previous financial year in which the UPP Group qualified for REIT status – there is no reversal of the previous position; and

(ii) in relation to the then current (and any future) year in which the UPP Group does not comply with the criteria for REIT status, the position would be broadly similar to the current arrangements. In these circumstances, under the continuing provisions of the Tax Deed of Covenant (clause 10.7) group relief surrenders are only permissible to non-bond entities after all possible “internal” group relief surrenders within the bond group.

5. Is there a credit risk on the entity to whom tax losses are surrendered between the date of surrender and the date of "repayment" when/if the tax is suffered by the Bond AssetCo?

Answer:

UPP proposes that losses surrendered are paid for on a £ for £ basis (not a deferred basis) as already contemplated in the Tax Deed of Covenant.

The existing tax covenant makes provision for payment to be made on the date when group relief is claimed by inclusion in the claimant company's tax return – this would be within 12 months of the end of the relevant accounting period¹. This will mean that payment for the group relief is made substantially at the same time as this is claimed by the claimant company – there isn't a period of time for which the surrendered losses are held by the claimant company for which the Bond Group has not received payment.

It is worth noting that the Bond Group is not currently surrendering losses to the UPP Group and, accordingly, the sale of these losses (which do not need to be used by the Bond Group while within the REIT regime as there will be no amounts for them to be offset against) will result in a cash gain for the Bond Group. If the project is performing these amounts paid for the losses can be distributed at the next distribution date in the ordinary manner (assuming the distribution tests are met) – if the project is not performing these amounts will be trapped by the existing distribution tests and will be available for use by the Bond Group.

¹ Note that the surrendering company must consent to the surrender on submission of the claim; therefore, unless payment is made group relief could be withheld by the relevant Bond company.