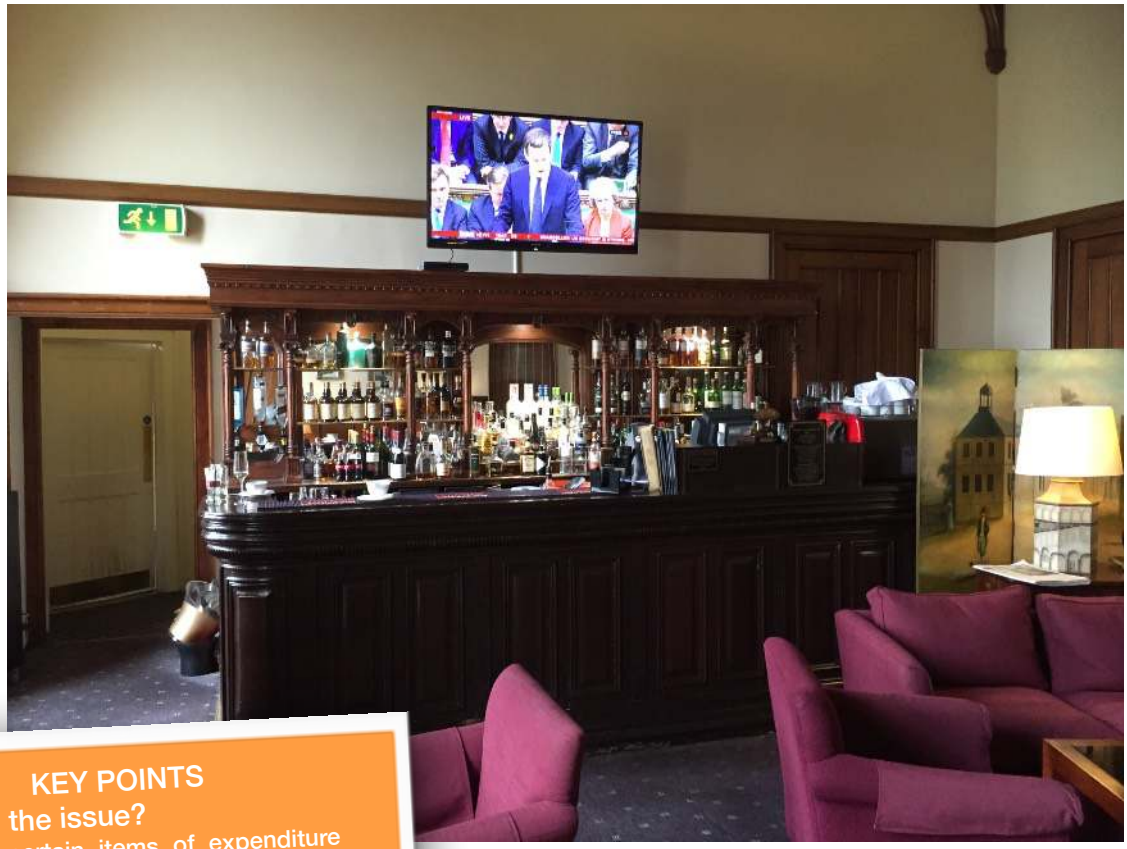
KEY CASES

CASE REFERENCE : JD WETHERSPOON PLC v HMRC FTC/05 & 83/2010 [2012] UKUT 42 (TCC)



KEY POINTS

What is the issue?
Whether certain items of expenditure incurred during refurbishments and redevelopments qualify for capital allowances.

Who does it affect?
Many technical areas that were under appeal in this case are pertinent to all taxpayers incurring capital expenditure on property, so this case has wide-ranging ramifications.

What does it mean for you?
More certainty around what incidental costs will qualify.

How can I apply this to me?
Ensure you can justify the reasoning for including an item of plant.

A case relating to the company's capital allowances claim submitted in its tax return to July 1999 for fitting out and refurbishment works on nearly 300 of its public houses. The capital allowances claim had been queried by HMRC and the tax relief due to the company assessed to be some 50% less. The case eventually reached the Special Commissioners in 2005 with an initial decision in 2007, followed by a First Tier Tribunal's decision published in December 2009 and then the Upper Tribunal decision in January 2012. The 2012 decision focused on three particular areas that were still in contention.

THE FACTS OF THE CASE

The pub group had already lost two appeals against decisions by HMRC in 1999 and 2003 that prevented it from claiming capital allowances for certain expenditure on the fitting out and refurbishing of some of its pubs.

The taxpayer and HMRC had still failed to agree on the treatment of more than 120 items of expenditure, and the Commissioners acknowledged that 'the case involved a mass of detail most of which was not covered in the time which the parties had agreed for the hearing'.

The first hearing focused on sample pub premises in Cardiff and Cosham, rather than the complete portfolio. Commissioners decided to address points of principle, using only a small number of disputed items as examples to illustrate their reasoning. They addressed three issues:

- whether expenditure on certain assets was properly regarded as expenditure on plant and machinery;

- the meaning and scope of CAA 1990, s 66 (now CAA 2001, s 25), dealing with expenditure on building alterations incidental to the installation of plant and machinery; and

- whether and how the project 'on costs', preliminaries and professional fees could be allocated to the cost of plant and machinery.

Following the tribunal hearing the parties were sent away to agree the outstanding items based upon the principles agreed at the first hearing. Unfortunately, the parties were unable to agree all items by the second hearing.

The tribunal then reviewed and provided decisions on the remaining outstanding items. Unfortunately, the parties did not agree with the decisions and an appeal and counter appeal were launched.

THE ARGUMENTS

Issue one

The Commissioners took just one asset of the many in dispute, in order to decide, if the assets were to be properly regarded as plant and machinery. They sought to use it to illustrate the impact of applying general principles around what is plant and what is premises.

The asset they chose to consider was the wood panelling fixed to the walls and used by the taxpayer to create a richer and more inviting atmosphere. The Commissioners were of the opinion that an asset may be plant upon considering the following: if it was used for purposes of the trade, if it retained a separate identity from the premises and the degree of permanence of the affixation - what we capital allowances advisers may term the "premises test".

In the hospitality sector, an asset that is used to create ambience may be plant provided it has not become part of the premises. The Commissioners considered whether the rooms would be complete without the panels, whether the panels were removable and whether the panelling retained a separate entity. The Special Commissioners concluded that the panels, rightly or wrongly, had become part of the premises and would not qualify as plant.

Issue Two

The second matter under consideration related to building alterations 'incidental to the installation of plant and machinery'. Capital allowances are generally available on work required to install items of plant and machinery for the purposes of a trade, and can add a considerable sum to a capital allowances claim.

The query raised is whether expenditure on the alterations was necessary, in order, for the plant to serve its purpose in the building for which it qualifies. In its present form and under earlier Acts the phrase 'incidental to the installation of plant and machinery' has been open to many differing interpretations.

The main deliberations by the Commissioners were, firstly, that the term 'incidental' has a wide definition; secondly, there is a distinct difference between alterations truly incidental to the installation of plant and those which are consequential to the installation; and thirdly, 'incidental' suggests that expenditure under s.66 CAA 1990 may not be disproportionately more than the cost of the plant itself. HMRC were arguing a narrow definition in that the alterations must be incidental to the physical act of installation as opposed to the wider definition, that they must merely be consequential, or related to that installation.

The work the Commissioners took as an example was the wipe-clean wall tiling in a kitchen, which the taxpayer argued was required due to the volume of steam, etc, produced by cookers The Commissioners held that it did not have a sufficient "nexus" with the installation of those cookers. A cooker could 'serve its proper purpose', in the words of Lord Reid, without the tiling. In a similar fashion, alterations to the kitchen walls to install the cookers also did not have sufficient nexus to qualify though partitions and doors to toilet cubicles do.

Issue Three

This issue has been an area that has provided a challenge to capital allowances consultants for a long time.

Preliminaries or overheads whilst they do not form a part of any of the package of works required by the contract, they are required by the method and circumstances of the works.

"Preliminaries are, by their nature, items of overhead expenditure which cannot be, or which have not been, attributed to any single item in the building project."

In valuing capital allowances, these items are usually apportioned among measured work items based upon the amount of qualifying spend on plant and machinery. For a long time, HMRC argued that any apportionment should be performed on a much more specific basis and items not relating to plant and machinery should be excluded before any apportionment. The Special Commissioners agreed that where a cost is properly attributable to one item, it should not be apportioned among the whole. However, the exclusion of expenditure of preliminaries from a capital allowances claim as being non-specific would not reflect the true nature of the expenditure incurred.

HMRC stated that they utilised various cost models to determine what percentage of preliminaries should be allowable. On a broad brush approach, only 50% of these items would be allowable - their preferred "Newstead formula" approach.

The Special Commissioners commented that 'In an ideal world preliminaries could be specifically allocated to individual items' but there could not be any objection in principle to an apportionment which is based upon an estimate.

SUMMARY

Although we welcome the decision of how to treat preliminaries when valuing capital allowances, we feel the interpretation of what is “premises” was flawed, and gave the wrong result from applying the correct questions. The case shows tax legislation is far from clear, so interpretation and application is of the upmost importance, and it is important to always consider the application of sound judgement for each and every claim.

At Ćavetta Consulting, any refurbishment or alteration project is carefully analysed to ensure we achieve enhanced tax savings from inclusion of associated works, researching the items to ensure these costs were necessary part of the installation of plant and machinery, and not just part and parcel of the wider building project.

In addition, we have always maintained that a just and reasonable apportionment of preliminaries, overhead and professional fees is the appropriate and pragmatic approach to attributing the ‘right’ proportion of these costs into capital allowances claims, revenue deductions or land remediation claims.

ABOUT US

At Ćavetta Consulting our directors have considerable experience advising businesses, property investors, landlords and occupiers on all capital allowances implications that impact their business.

Our fee structure is tailored to take account of the tax status of the individual or business and is designed to add value to your business.

We offer free advice to businesses at the pre-planning stage of their business to make them aware of the benefits the tax system allows and a no obligation review of completed or potential schemes in order to determine whether a viable claim for property.

Key Contacts

Scotland (East)
Lois Stirling
0131 610 0056
lois.stirling@cavettaconsulting.com

Scotland (West)
Alan Cadden
0141 432 0056
alan.cadden@cavettaconsulting.com