Expected Outcome – 'Just & Reasonable'
E³ Consulting summarise the Upper Tier Tribunal decision in J D Wetherspoon v HMRC

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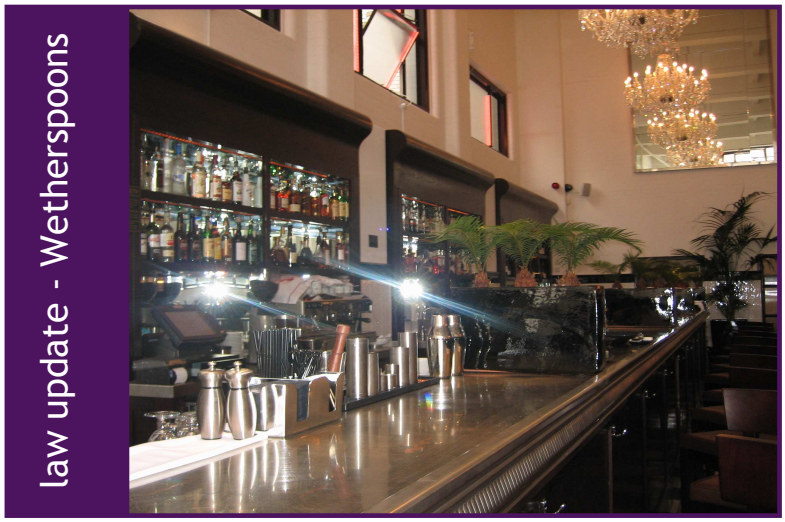
The Upper Tier Tribunal published its tax decision on 31 January 2012 in relation to ***J D Wetherspoon Plc (JDW) and HM Revenue & Customs (HMRC) ref: FTC/05 & 83/2010 [2012] UKUT 42 (TCC)***.
This follows on from the original Special Commissioner's decision in December 2007 and the First Tier Tribunal's decision published in December 2009.



The tribunal focused on three particular areas that were still disputed:

- Plant or Premises for Timber Panelling
- Incidental Expenditure
- Apportionment of Preliminaries

Drawing upon the facts of the case, we have highlighted the potentially far reaching issues and impact of this case to other client situations. JDW had appealed against the disallowance by HMRC of claims for capital allowances for expenditure on the fitting out and refurbishing of public houses which had originally been made in its revised corporation tax return for the accounting year to 31 July 1999, and disallowed in a closure notice dated 14 May 2003. The effect of the closure notice was to adjust downwards the expenditure in that year on qualifying allowances in respect of building costs, professional fees and head office costs from some £33.7m to approx £17.5m.

The parties sensibly had agreed to limit the purview of the Special Commissioners to two pubs as 'test cases', namely the Prince of Wales, in Cardiff and First Post, in Cosham (near Portsmouth). The aggregate value of the disputed items was, nonetheless, still some £0.5 million in relation to the Prince of Wales and around £84,000 in relation to the First Post. Each of these aggregates related to a large number of individual disputed items in each pub.

Under long established Capital Allowances legislation, whether old rules under CAA1990 (as this case) or the more recent and current legislation under CAA2001; significant levels of refurbishment or fit out costs may qualify for capital allowances. E³ Consulting as Property Tax Specialists, can often secure additional claims where previous analyses were superficial or possibly ignored altogether and enhance the tax savings to clients by amending in a current, previous or open tax year.

1. **Plant or Premises - Timber Panelling s.24 CAA1990 (s.11 CAA2001)**
    - JDW had claimed the timber panelling in their pubs as a decorative asset and referenced the Scottish & Newcastle decision as a basis for their claim for capital allowances.
    - The key point being "whether the decorative panelling is more appropriately described as part of the premises in which the pub's trade is carried on or instead as an embellishment used to enhance the atmosphere of those premises" with reference to s.24 and Schedule AA1 (now ss.21-23 CAA2001).
    - The Tribunal held that the panelling was an "unexceptional component" of the pubs and had therefore become "part of the premises" also rejecting the previous convention that looked at the method of fixing as some indicator of eligibility. It held that this panelling was not eligible as a decorative asset.
    - Under the same logic, the decorative cornicing, architraves and balustrading were also denied capital allowances.

- Interestingly, the Tribunal referred to the Wimpey International Ltd v Warland (1988) case where panelling had been permitted, and not appealed but that the permissible panelling "was by no means unexceptional".

In summary we conclude that HMRC will no doubt be more robust in challenging any assets in this 'grey area' and that successful claims for capital allowances on panelling and other decorative assets must be carefully considered on a case by case basis to demonstrate that they are "exceptional components" and that do not fail the premises test.

2. Incidental Expenditure – works under s.66 CAA1990 (s.25 CAA2001)

- HMRC queried a number of cost items claimed by JDW for expenditure on "building alterations connected with installation of machinery or plant" and so incidental to the installation of plant and machinery. The decisions are summarised below:
  - Splashbacks / Tiling / Flooring
    i. A splashback to other new plant and machinery which produces splashing (e.g. sinks) is allowable.
    ii. Splashbacks do not extend to part of a fully tiled wall even if there is some splashback function.
    iii. Non slip and wipe-clean floors were needed for the operation of the equipment, not for the installation of the equipment and therefore were held as not eligible.
  - Strengthening of Kitchen Floor
    i. The existing timber floor was removed and a strengthened concrete floor installed to take the load of kitchen equipment and accepted as incidental to the installation of the commercial kitchens and therefore allowable as deemed expenditure on plant and machinery.
  - Kitchen Lighting
    i. The Tribunal ignored the point, leaving the parties to determine the answer by reference to its function – and allowed as plant if it had specific trade functionality and that where the lighting was to be allowable plant, it follows the associated works such as cutting holes would be too.
  - Toilet Cubicles
    i. Panels to hide cisterns and pipework preserved as eligible from prior decision, together with demountable cubicle partitions.
    ii. Confirmation that blockwork cubicles are not eligible for tax relief.
    iii. Tiling to the walls, as with kitchens, was not allowable, except if there were simply splashbacks.
  - Cold Store Floor & drainage
    i. Sloping floor was installed within a cold store so that spillages of beer or water, etc would flow into the drainage channel and associated trade effluent system and accepted as eligible s.66 works.
    ii. Held that demolition costs of old floor, removed to allow for new cold store floor, also part of the s.66 expenditure.

iii. Tribunal considered it immaterial that the costs of the inclined floor were relatively high in comparison to the costs of the drainage system and ruled that no pre-requisite that costs determine eligibility.

- Hoist Shuttering

i. Shuttering constructed around the food hoist was previously accepted as allowable.

ii. Appealing the tiling on the shuttering was determined as not allowable on the basis it was *"simply a finishing coat round the shuttering, no more eligible for allowances than the painting"*.

It was a long held industry viewpoint that JDW were attempting to push the accepted boundaries of s.66 too far. This decision has confirmed that there needs to be sufficient nexus to the plant and machinery so installed to benefit from s.25 CAA2001 to deem the associated works as eligible. Careful analysis of any refurbishment or alteration project by Property Tax Specialists can and will continue to achieve enhanced tax savings from inclusion of associated works, but HMRC will need to be satisfied these cost were necessary part of the installation of plant and machinery, and not just works supplementary works that are part and parcel of the wider building project.

3. Preliminaries

- Preliminaries are, the project 'on costs' such as site cabins, craneage, welfare facilities for site operatives, scaffolding, etc. and are rarely attributed to any single item of building works. Therefore convention is that these overhead costs are best apportioned across the project expenditure in proportion to the qualifying and non qualifying costs.
- HMRC has regularly challenged those claiming capital allowances on the most appropriate way to apportion preliminaries and generally sought to exclude some preliminary costs before apportionment or detailed analyses of the preliminary costs to attempt to link directly those related to specific items of plant & machinery.
- The Tribunal determined that "it cannot have been the intention of the legislature that a trader should have to spend more on the minute attribution of preliminaries to underlying items of work than either their cost or the value of the capital allowances thereby to be obtained" and so held that HMRC's cross appeal on this point entirely failed and a pro rata apportionment of preliminaries is allowable.

E³ Consulting has always maintained a just and reasonable apportionment of preliminaries (and professional fees) is an appropriate and pragmatic approach to attributing the 'correct' proportion of these costs into capital allowances (or land remediation tax relief) claims. We have regularly negotiated claims along this viewpoint, but will now have case precedent to ensure HMRC treat these costs reasonably.

E³ Consulting, operate from offices in Southampton and London and work with clients that own, operate or invest in property across the UK and overseas. If you would like to discuss any aspects of this case and it's implications for you or your projects further, then please contact our team to see how we could help evaluate, evolve and enhance the available tax savings from any property expenditure. Contact us on healthcheck@e3consulting.co.uk or telephone 0345 230 6450.