Capital Allowances 2017-18

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4. Qualifying expenditure

4.1 Introduction

4.1.1 Significance

One of the fundamental conditions for giving plant and machinery allowances is that a person must incur qualifying expenditure.

Law: CAA 2001, s. 11

4.1.2 General rule

The "general rule" is that expenditure constitutes qualifying expenditure if:

> "(a) it is capital expenditure on the provision of plant or machinery wholly or partly for the purposes of the qualifying activity carried on by the person incurring the expenditure, and
>
> (b) the person incurring the expenditure owns the plant or machinery as a result of incurring it."

See **1.5** for a discussion of "capital expenditure".

This general rule is, however, moderated by various other provisions. In particular, Chapter 3 of the plant and machinery legislation is entitled "Qualifying expenditure".

See also **4.13** and **4.14** for discussion of various exclusions from qualifying expenditure. These include cars owned and used by employees, and (in some circumstances) plant and machinery in dwelling-houses.

In *Barclays Mercantile*, certain payments were held to be qualifying expenditure despite a complex set of ultimately circular payments.

Law: CAA 2001, s. 11
Case: *Barclays Mercantile Business Finance Ltd v HMIT* [2004] UKHL 51

4.2 Buildings, structures and land

4.2.1 Introduction

The area of plant and machinery in buildings is an important one. Often poorly understood in practice, the topic needs to be tackled head on as substantial amounts of tax are invariably at stake. Changes introduced from April 2012, albeit subject to transitional rules that applied until April 2014, have further added to the need to grasp the relevant concepts.

The plant and machinery legislation contains two Chapters that are particularly important for understanding the relationship between buildings on the one hand and plant and machinery on the other.

Chapter 3 (of Part 2 of CAA 2001) deals specifically with "Buildings, structures and land" and is considered in this section **4.2**.

There is then a need for a second tier of legislation, dealing with the problems that arise in relation to ownership. This may be, for example, because a tenant installs plant and machinery in a building that belongs to the landlord: complications need to be addressed as to who, if anyone, is then entitled to claim allowances. These rules are found in Chapter 14 of the legislation ("Fixtures") and are dealt with at **Chapters 10 to 14** below.

In a sense, the headings used in the legislation are unhelpful, for Chapter 3 is in reality also concerned primarily with fixtures.

4.2.2 Buildings

The relevant legislation begins with the bald statement that "expenditure on the provision of plant or machinery does not include expenditure on the provision of a building". For clarity, it goes on to state that "the provision of a building includes its construction or acquisition".

Without further statutory provisions, no allowances could be given for assets that form part of a building. Quite specifically, there could be no allowances for fixtures, as that term is for capital allowances purposes defined to mean "plant or machinery that is so installed or otherwise fixed in or to a building or other description of land as to become, in law, part of that building or other land".

Matters are in fact made worse, as the term "building" is then defined to include any asset that:

a. is incorporated in the building,
b. although not incorporated in the building (whether because the asset is moveable or for any other reason), is in the building and is of a kind normally incorporated in a building, or
c. is in, or connected with, the building and is in list A.

List A – assets treated as buildings

List A reads as follows:

1. Walls, floors, ceilings, doors, gates, shutters, windows and stairs.
2. Mains services, and systems, for water, electricity and gas.
3. Waste disposal systems.
4 Sewerage and drainage systems.
5. Shafts or other structures in which lifts, hoists, escalators and moving walkways are installed.
6. Fire safety systems.

Exceptions

If that were the end of the matter, there could be no plant and machinery allowances for any such items. In fact, however, these provisions are all subject to the all-important rules to be found at s. 23 (see **4.2.4** below).

As regards building alterations incidental to the installation of plant and machinery (s. 25), see **4.4**.

The restrictions in s. 21 do not apply to expenditure incurred before 30 November 1993 (or in some cases 6 April 1996), a point that could still be relevant today in relation to historic claims (Sch. 3, para. 13).

Law: CAA 2001, s. 21

4.2.3 Structures

The restrictions relating to buildings, as described immediately above, have a parallel in further restrictions covering "structures, assets and works".

The legislation states that expenditure on the provision of plant or machinery does not include expenditure on the provision of a structure or other asset in list B, or on any works involving the alteration of land. The provision of a structure is defined to include its construction or acquisition.

For these purposes, a structure must be a fixed structure other than a building. "Land" is defined to exclude buildings or structures, but is otherwise defined to mean "land covered with water, and any estate, interest, easement, servitude or right in or over land".

List B – excluded structures and other assets

List B reads as follows:

1. A tunnel, bridge, viaduct, aqueduct, embankment or cutting.
2. A way, hard standing (such as a pavement), road, railway, tramway, a park for vehicles or containers, or an airstrip or runway.
3. An inland navigation, including a canal or basin or a navigable river.
4. A dam, reservoir or barrage, including any sluices, gates, generators and other equipment associated with the dam, reservoir or barrage.
5. A dock, harbour, wharf, pier, marina or jetty or any other structure in or at which vessels may be kept, or merchandise or passengers may be shipped or unshipped.
6. A dike, sea wall, weir or drainage ditch.
7. Any structure not within items 1 to 6 other than–
    a. a structure (but not a building) within Chapter 2 of Part 3 (meaning of "industrial building"),
    b. structure in use for the purposes of an undertaking for the extraction, production, processing or distribution of gas, and

c. a structure in use for the purposes of a trade which consists in the provision of telecommunication, television or radio services.

Exceptions

Once more, there could be no plant and machinery allowances for any such items if that were the end of the matter. In fact, however, these provisions are again subject to the s. 23 rules (see **4.2.4** immediately below).

See also case study 2 at **Appendix 2** in relation to the question of marinas and associated expenditure.

The restrictions in s. 21 do not apply to expenditure incurred before 30 November 1993 (or in some cases 6 April 1996), a point that could still be relevant today in relation to historic claims (Sch. 3, para. 13).

Law: CAA 2001, s. 22; *Interpretation Act* 1978, Sch. 1 (re "land")

4.2.4 Exceptions to the restrictions

The initially severe restrictions for allowances for buildings and structures have been outlined at **4.2.2** and **4.2.3** respectively. Those restrictions are subject to some very important exceptions, given at s. 23.

To avoid confusion, it is advisable to look at s. 23 as constituting two halves that work independently from one another. First, s. 23 lists certain particular provisions to which the restrictions for buildings and structures (given by s. 21 and s. 22 respectively, as described immediately above) do not apply. These provisions relate to thermal insulation, personal security, integral features, and software.

For each of these categories, the legislation has particular rules saying that the expenditure in question specifically qualifies for plant and machinery allowances. For example, allowances for integral features or for thermal insulation are given "as if … the expenditure were capital expenditure on the provision of plant or machinery". Section 23 thus ensures that sections 21 and 22 cannot override those deeming provisions that allow certain types of

expenditure to qualify as plant or machinery. The relevant provisions are all considered in their context later in this book.

List C

The remaining part of s. 23 works differently, though. This provides a long list of assets ("list C"), being "expenditure unaffected by sections 21 and 22". The key point to note is that inclusion in list C does not guarantee that expenditure on the item in question will qualify as plant or machinery; the effect of this part of s. 23 is merely to remove the automatic bar on claiming allowances on the items in question. The background to what is now list C was a perception that the Courts were starting to err too much in favour of the taxpayer in various appeals regarding plant and machinery. Consider, for example, these words in the Revenue response to the Institute of Taxation back in 1994:

> "As you know, court cases have, over the years, increasingly reclassified expenditure on buildings and structures as being expenditure on plant. This erosion in the plant/structure boundary has affected Exchequer receipts and has in itself created continuing uncertainty.
>
> The intention behind the legislation is therefore to strengthen the current boundary, and to ensure that no further erosion takes place. It would of course be difficult for the new rules to replicate past treatment in every case. Nevertheless, the broad aim is to provide exclusions for assets currently regarded as plant as a result of Court decisions, so as to leave the present position unchanged."

The point was made in stronger terms by Stephen Dorrell, speaking for the government when the clauses were debated in Parliament. He was clear that the purpose of the new legislation was "to prevent further changes in the law" and again "to prevent further development of case law". He stated specifically that "we are not seeking to revisit the law established by the Courts" and again that "it is not our intention to change the capital treatment of any class of asset". Once more, he stated that "nothing in the clause is intended to change existing practice of how cases are treated". Occasionally, in areas of doubt, the Courts will try to fathom the intentions of Parliament. In such cases, it may be useful to refer to these

assurances that the government was not seeking to change "existing practice".

"Thus far but no further" was the approach. This was a strange concept, for it meant that if an asset happened to have been the subject of a successful appeal the tax treatment of that particular asset was frozen into the legislation. The statutory rules were being made subservient to the case law, rather than the other way round. This accounts for the bizarre range of assets captured in list C that have little internal logic (though even that unusual approach does not account for other oddities such as the doubling up of refrigeration equipment at items 5 and 9).

To reiterate the key point, inclusion in list C does not guarantee that an item qualifies as plant or machinery. If an asset is initially caught by s. 21 or s. 22 (in broad terms, being respectively a building or a structure) the effect of inclusion in list C is simply to remove the statutory restriction that would automatically prevent a claim. The actual tax treatment of the asset can then be considered on its own merits, using the case law precedents established before or since the statutory rules were introduced in 1994.

List C – expenditure unaffected by sections 21 and 22

List C reads as follows:

1. Machinery (including devices for providing motive power) not within any other item in this list.
2. Gas and sewerage systems provided mainly–
   a. to meet the particular requirements of the qualifying activity, or
   b. to serve particular plant or machinery used for the purposes of the qualifying activity.
3. [Omitted by FA 2008, s. 73(1)(b)(ii).]
4. Manufacturing or processing equipment; storage equipment (including cold rooms); display equipment; and counters, checkouts and similar equipment.
5. Cookers, washing machines, dishwashers, refrigerators and similar equipment; washbasins, sinks, baths, showers, sanitary ware and similar equipment; and furniture and furnishings.

6. Hoists.
7. Sound insulation provided mainly to meet the particular requirements of the qualifying activity.
8. Computer, telecommunication and surveillance systems (including their wiring or other links).
9. Refrigeration or cooling equipment.
10. Fire alarm systems; sprinkler and other equipment for extinguishing or containing fires.
11. Burglar alarm systems.
12. Strong rooms in bank or building society premises; safes.
13. Partition walls, where moveable and intended to be moved in the course of the qualifying activity.
14. Decorative assets provided for the enjoyment of the public in hotel, restaurant or similar trades.
15. Advertising hoardings; signs, displays and similar assets.
16. Swimming pools (including diving boards, slides and structures on which such boards or slides are mounted).
17. Any glasshouse constructed so that the required environment (namely, air, heat, light, irrigation and temperature) for the growing of plants is provided automatically by means of devices forming an integral part of its structure.
18. Cold stores.
19. Caravans provided mainly for holiday lettings.
20. Buildings provided for testing aircraft engines run within the buildings.
21. Moveable buildings intended to be moved in the course of the qualifying activity.
22. The alteration of land for the purpose only of installing plant or machinery.
23. The provision of dry docks.
24. The provision of any jetty or similar structure provided mainly to carry plant or machinery.

25. The provision of pipelines or underground ducts or tunnels with a primary purpose of carrying utility conduits.
26. The provision of towers to support floodlights.
27. The provision of–
    a. any reservoir incorporated into a water treatment works, or
    b. any service reservoir of treated water for supply within any housing estate or other particular locality.
28. The provision of–
    a. silos provided for temporary storage, or
    b. storage tanks.
29. The provision of slurry pits or silage clamps.
30. The provision of fish tanks or fish ponds.
31. The provision of rails, sleepers and ballast for a railway or tramway.
32. The provision of structures and other assets for providing the setting for any ride at an amusement park or exhibition.
33. The provision of fixed zoo cages.

In item 19 of the above list, the term "caravan" is defined to include, in relation to a holiday caravan site, anything that is treated as a caravan for the purposes of–

a. the *Caravan Sites and Control of Development Act* 1960, or
b. the *Caravans Act (Northern Ireland)* 1963.

To illustrate all this with a practical example, take the question of a hut put up by a builder to provide canteen and toilet facilities for workers at particular sites. The reasoning to follow will be:

- Assuming that the hut is to be kept in use for at least two years, it should be clear that the cost is capital expenditure.
- The cost of the hut is potentially caught by either s. 21 (as a building) or by s. 22 (as a structure).

- There is nothing relevant at s. 23(2), but item 21 at list C refers to "moveable buildings intended to be moved in the course of the qualifying activity".
- That does not of itself mean that the hut can qualify for allowances, but it can at least be considered using case law principles.
- Case law coverage of moveable buildings is not always helpful, but HMRC guidance does in this case come to the rescue, as allowances are specifically permitted for such buildings.

If, instead, the huts in question were used for some other trade – perhaps for selling items at trade fairs around the country – the HMRC guidance is less favourable. It would then be necessary to apply general principles to determine the correct outcome. In this case, it may be appropriate to question the HMRC view, so as to see if it can stand up to scrutiny.

Poor HMRC reasoning

In the *Telfer* case, HMRC sought to argue that an implicit restriction must apply if an item within List C removes that restriction. More specifically, HMRC were arguing that as item 19 removes a restriction on claiming for certain caravans, it must follow that caravans generally are within the restrictions for buildings and structures in the first place. This, in the view of the authors, was an inexcusable stance from HMRC: if they wished to bring sections 21 or 22 into play, the onus was entirely on HMRC to demonstrate that the caravans in question were either buildings or fixed structures. In reality, of course, they were clearly neither.

In rejecting the HMRC stance on this point the Tribunal commented as follows:

> "This is an argument from redundancy – that is, an argument that it would be redundant for a class of caravans to be excluded from the application of sections 21 and 22 by section 23 CAA, if section 21 or section 22 did not apply to caravans. Lord Hoffmann famously said that he seldom thought that an argument from redundancy carried great weight (*Walker v Centaur Clothes Group Ltd* [2000] 1 WLR 799 at 805D), and we respectfully agree. Further, it seems to us that section 21 or

section 22 CAA could only apply to fixed caravans and plainly Mr Telfer's caravans were not fixed."

Case: *Telfer v HMRC* [2016] UKFTT 614 (TC)
Guidance: CA 22110

4.2.5 Interests in land

Expenditure on land does not constitute expenditure on plant or machinery.

For these purposes, the term "land" is defined to exclude buildings, structures or any asset that is "so installed or otherwise fixed to any description of land as to become, in law, part of the land".

Subject to these points, "land" is defined to include "land covered with water, and any estate, interest, easement, servitude or right in or over land".

Again subject to the exclusion of buildings etc. (as above), an "interest in land" has the meaning applied to it for the purposes of the fixtures legislation (s. 175: see **10.1.4**).

Law: CAA 2001, s. 24; *Interpretation Act* 1978, Sch. 1 (re "land")

4.3 The meaning of "plant"

4.3.1 Introduction

Before allowances can be given for "plant or machinery" it is obviously necessary to know what that term encompasses, yet this is often far from clear. Certainly, not all capital expenditure qualifies for plant and machinery allowances. This point is well established but was confirmed in the *Bowman* case, where certain consultancy payments were held to be capital in nature but did not qualify for allowances.

Statutory rules introduced in the 1990s went some way towards creating a firmer definition, but those rules, now starting at s. 21 of CAA 2001 (see **4.2** above), are limited in their scope and still leave many questions unanswered. In essence, the distinction is drawn between the premises or setting within which a qualifying activity is conducted, and the apparatus used in the course of that activity. In practice, the setting and the apparatus can overlap and there are many grey areas. Dozens of cases have been taken to court where it

has not been possible for a business to reach agreement with the tax authorities about where the line should be drawn.

One complication is that the correct capital allowances treatment of a particular asset is coloured by its context. A ship, for example, will normally qualify quite clearly as an item or plant or machinery, yet the best known capital allowances case concerning a ship determined that it did not so qualify in the particular circumstances of the case (as it was functioning only as the premises for the business in question).

There has been some judicial disagreement over whether the term "plant" is still used in its natural sense, or whether it has developed its own meaning in the tax context. On the whole, the prevailing view is that the term has now gained a specialist meaning. Oliver LJ, in *Cole Bros* opined that:

> "it is now beyond doubt that [the term 'plant'] is used in the relevant section in an artificial and largely judge-made sense."

Cases: *Cole Brothers Ltd v Phillips* [1982] BTC 208; *Grant Bowman t/a The Janitor Cleaning Company v HMRC* [2012] UKFTT 607 (TC)

4.3.2 Illogical distinctions

Case law shows that it is notoriously difficult to pin down the meaning of "plant". As Stephenson LJ commented in his judgment in *Cole Bros*:

> "The more definitions multiply, the less enviable grows the task of H.M. Inspectors of Taxes. If they 'traverse the whole gamut of reported cases' crossing the border into Scotland and the seas to Australia in their search for guidance, they find plant in the most unlikely objects, from a horse to a swimming pool, from a dry dock to a mural decoration. Faced with such applications of the word, all supported by cogent reasoning, they may be pardoned for finding anything, or almost anything, to be or not to be plant and may be justified in making any number, or almost any number, of inconsistent concessions and illogical distinctions. It all depends on the circumstances, especially the work of the particular taxpayer, and (I feel bound to add) on how it strikes the particular

> judges of the question, whether in tax administration or on the judicial bench."

It is unfortunate that such a fundamental concept, affecting all businesses and often involving substantial amounts of expenditure, should have been left so open to the whims of individual interpretation. The comments quoted above pre-date the legislation now beginning at s. 21 (and indeed the concept of "integral features") but in reality that legislation has been of limited help in defining the slippery notion of "plant". In the end, the Courts have on occasion been ready to admit that the term is not clearly defined, and to fall back on more fundamental principles, as stated by Lord Wilberforce in the *Scottish & Newcastle* case:

> "I do not think that the courts should shrink, as a backstop, from asking whether it can really be supposed that Parliament desired to encourage a particular expenditure out of, in effect, taxpayers' money and perhaps ultimately, in extreme cases, to say that this is too much to stomach."

At least the 2008 legislation, whereby certain assets are categorised as "integral features", brought a greater degree of certainty to some common types of expenditure, including electrical work and cold water systems. These developments are very welcome, though they are limited and, even here, the precise scope of the legislation is at times unclear.

Case: *Cole Brothers Ltd v Phillips* [1982] BTC 208

4.3.3 All goods and chattels

Given that the capital allowances legislation contains no positive definition of "plant or machinery" it has fallen to the courts to develop an interpretation over the years.

The meaning of "machinery" has caused relatively few problems in practice. Defining "plant" has been a far greater challenge, but at least the starting point is agreed by all parties. Lindley LJ attempted a definition in a case, *Yarmouth v France*, heard back in 1887 on a matter that had nothing to do with taxation:

> "There is no definition of plant in the Act: but, in its ordinary sense, it includes whatever apparatus is used by a businessman for carrying on his business – not his stock-in-