



JD Wetherspoon plc Case Review

Background

In the accounting period ended 31 July 1999, J D Wetherspoon plc undertook significant work fitting out and refurbishing some 288 public houses under their ownership. The subsequent capital allowances claim prepared thereon was queried by H M Inspector of Taxes and an amended assessment was issued in 2003 restricting the tax relief available to the company by nearly 50%. An appeal was lodged and originally dealt with by the General Commissioners.

The case reached the Special Commissioners in 2005 who released an original decision in principle (referred to as the First Decision) following a hearing in June 2007. The parties were expected to retire to consider the decision and reach agreement. J D Wetherspoon has appealed to the High Court regarding the first decision.

No agreement could be reached and the Special Commissioners (sitting as the First-Tier Tribunal) were required to revisit the case in June 2009. The parties accepted a pre-determined list of 'clear' and 'unclear' items which would require further analysis following the First Decision.

The First Decision (June 2007)

The appeal concerns the application of sections 24 and 66 of the Capital Allowances Act 1990 with respect to fitting out and refurbishing public houses. The three main issues subject to the appeal were the definition of plant in premises, building alterations incidental to the installation of plant and the allocation of overheads (such as professional fees and preliminaries).

Plant in premises (Section 24 CAA 1990 now Section 23 CAA 2001)

Further to submissions on behalf of H M Revenue and Customs ('HMRC') and the appellant, the Special Commissioners held the opinion that an asset may be plant upon consideration of 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. Specifically in the hospitality sector, an embellishment to a property to create ambience may be plant provided it has not become part of the premises.

In the example considered, some of the walls of a public house were covered with wood panelling. The Special Commissioners considered whether the structure of the rooms would be complete without the panels, whether the panels were removable and whether the panelling visually retained a separate entity. The Special Commissioners concluded that the panels had become part of the premises and would not qualify as plant.

Cross referenced cases include:

Inland Revenue Commissioners vs Scottish and Newcastle Breweries Ltd (1982)

Wimpey International Ltd vs Warland (1987)

Alterations incidental to the installation of plant (s.66 CAA 1990, s.25 CAA 2001)

Capital allowances are generally available on work required to install items of plant and machinery for the purposes of a trade. The query raised is whether expenditure on all alterations was required so that the plant may serve a purpose qualifies for allowances or simply the alterations specific to the installation of certain qualifying items.

There were several key themes from the Special Commissioners deliberations – 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.

In considering the application of s.66 CAA 1990, the Special Commissioners refer to the nexus of the expenditure in relation to the installation of the plant items. For example, the wipe-clean kitchen tiles were required to ensure prudent health and safety operation but were not required for the cookers to function properly. In a similar fashion, alterations to the kitchen walls to install the cookers also do not have sufficient nexus to qualify though partitions and doors to toilets and cubicles do.



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Cross referenced case include:

Inland Revenue Commissioners vs Barclay, Curle and Co. (1969)

Attribution of overheads and preliminaries

Preliminaries or overheads generally refer to contractor's costs which are not reflected in finished work costing. In capital allowances claims, these items are usually apportioned among measured work items.

HMRC argued that any apportionment should be performed on a much more specific basis and certain items should be excluded before any apportionment. The Special Commissioners agree that some costs are properly attributable to one item, 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. In fact, the Special Commissioners agreed that items may be apportioned under section 24 or section 66 CAA 1990, though HMRC argued otherwise.

The appellant argued that non-negligent insurance costs relating to the building works should be included in the capital allowances claim. The Special Commissioners agreed on the basis the insurance was clearly part of the works including the plant within section 66.

Indirect site costs (such as security, logistics, building regulations compliance and utilities) were apportioned equally amongst measured work items and included within the claim, though HMRC did not accept this apportionment, again the Special Commissioners agreed with the appellant.

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.

HMRC stated that they utilised various cost models to determine what percentages of preliminaries should be allowable. On a broad brush approach, 50% would be allowable. The Special Commissioners noted that where preliminaries are to be apportioned to a number of small value items, a pro-rata apportionment is reasonable in principle. A detailed assessment of such an apportionment should not be expected to occur.

The Second Decision (December 2009)

The second hearing was undertaken to agree many items (referred to as 'unclear items') included in the client's capital allowances claim that were not agreed by the parties prior or post the First Decision.

Items under section 66 CAA 1990

Floors and walls

The Special Commissioners concluded that tiles did not qualify under s.66 apart from splashbacks to sinks and immediate surrounds of lavatory basins. HMRC indicated that they accepted this judgement. The appellant wished for further clarification on whether the splashback functioning walls or floors and those installed for other items such as cookers would qualify for capital allowances under s.66.

The Special Commissioners agreed with the appellant that allowances will be due for splashbacks installed for other items (such as cookers or cold stores) but did not accept notional splashback or wipe-clean surfaces as they cannot be concluded to be a specific splashback function themselves. In this particular case, the Special Commissioners excluded the wipe clean floors and walls. Plastering to receive tiles or paint would also not qualify, neither would non-slip vinyl and latex cement on the basis that these alterations were not required to enable installation of plant and machinery. The floors and their provision did not have sufficient nexus with the installation of equipment.

The Special Commissioners view a dividing line between alterations which are incidental but specific to the installation of plant and machinery and surfaces which form parts of walls or floors. The latter do not qualify for allowances under any basis.



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In the cold store floor example, HMRC accepted that costs to provide an incline in a cold store for drainage purposes would qualify but not the remainder of the costs relating to the floor itself (the appellant had claimed the floor in entirety).

The Special Commissioners applied the same logic to that of the tiled walls and floors but reached the opposite decision, whereby *all* of the costs in relation to provision of the inclined floor must qualify, not a portion as HMRC determined. The building was altered to allow the cold store to function, therefore it is a qualifying cost.

Lighting

HMRC contested that expenditure on lighting in toilets and kitchen (altering the roof, provision of a drop ceiling, fittings and rewiring) could not provide ambience and therefore could not qualify for allowances. The appellant argued that the lighting in the building was originally found to be insufficient and was altered to maximise the ambient effect.

HMRC will only accept trade-specific lighting as qualifying for capital allowances and the physical type and usage of the lighting are relevant factors. The Special Commissioners agreed with the appellant that lighting (including alterations to the ceiling) in the toilets was trade-specific (to create ambience) and would qualify for capital allowances. Likewise, the elusive concept of trade specific lighting may apply to the kitchen area and the Special Commissioners allowed the appellant the 'benefit of the doubt' in this case.

Lifts and hoists

The appellant had claimed specific alterations incidental to installing a hoist between the kitchen and dining area. HMRC agreed on studwork, though contested the tiling upon the studwork in front of the hoist. The appellant again argued that these areas must perform the splashback function. The Special Commissioners agreed with HMRC on this point.

Toilets and cubicles

The original capital allowances claim included brick and block works incurred in constructing the toilet dividers and cubicles. In the First Decision, the Commissioners accepted that timber used to create partitions and doors would qualify for allowances but did not comment on the brick or block work. The Special Commissioners did not intend to overlook these items and as such, all costs in connection with cubicles and partitions will qualify, this includes back and side walls works to cover cisterns and pipe-work (as these do not form part of the room itself).

Reinforcement of floors and partitions

The claim included items to reinforce the kitchen floor (removal of old timbers and relaying concrete screed) to take the load of equipment on the basis that the alterations were necessary to install the plant and machinery. The Special Commissioners accepted that this 'special floor' was required for the trade and allowances would be available.

Similarly, costs to enable the fitting of sanitary-ware to toilet partitions would be eligible for allowances. Installation of a waterproof coating (to minimise risk of leakage) was a preventative measure and not eligible, though a special PVC floor coating for the disabled toilets (to ease movement of wheelchairs) is eligible for allowances.

Cross referenced case include:

J.Lyons and Co. Ltd vs Attorney General (1944).

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Conclusion and application

Obviously the change to the capital allowances legislation through the inception of 'integral features' will have significant bearing to claims involving items such as electrical and mechanical installations in a building. Though for historical application, the judgements remain valid.

The concept regarding the application of s.66 and s.24 CAA 1990 (now s.23 and s.25 CAA 2001) will continue to prove relevant for past and future capital allowances claims. In particular, the theme regarding a 'sufficient nexus' to plant item will have a positive influence in determining capital allowances claims, as will the important concept of ambience within a trading premises.

Although circumstances may vary per capital allowances claim, it is important to always consider the application of sound judgement for each and every claim, regardless of historical or widely accepted practice. Tax legislation is far from clear, so interpretation and application is of utmost importance.