

Spc00657

Capital allowances – Plant – Conversion, fitting out and refurbishment of public houses – Wood panelling for ambiance – Whether panelling became part of premises – Alterations incidental to installation of plant – Barclay, Carle 45 TC 221 considered – Wipe-clean tiles in kitchen and toilets – Additional drainage – Attribution of overheads and preliminaries to expenditure on provision of plant and incidental alterations – CAA 1990 ss 24, 66, Sch AAI – Decision in principle on sample expenditure – Appellant succeeded in part

THE SPECIAL COMMISSIONERS

J D WETHERSPOON PLC

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY’S REVENUE & CUSTOMS Respondents

**Special Commissioner: THEODORE WALLACE
JOHN WALTERS QC**

Sitting in public in London on 14, 19 and 20 June 2007

Julian Ghosh QC and James Henderson, instructed by Deloitte and Touche LLP, for the Appellant Company

Rupert Baldry, instructed by the Solicitor for the Revenue and Customs, for the Respondents

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DECISION

1. This appeal concerns capital allowances under sections 24 and 66 of the
5 Capital Allowances Act 1990 (“CAA”) for expenditure on fitting out and refurbishing
public houses. Statutory references appearing below are, unless otherwise indicated,
references to CAA.

2. The appeal is against a closure notice dated 14 May 2003 amending the
10 Appellant’s revised corporation tax return for the accounting year to 31 July 1999.
The amendment adjusted the expenditure in the year on qualifying allowances in
respect of building costs, professional fees and head office costs from £33,740,007
down to £17,562,348. The appeal was originally before the General Commissioners.
The Special Commissioners accepted the transfer of jurisdiction on 28 November
15 2005. This hearing thus concerned work carried out eight or nine years ago.

3. This decision concerns expenditure on converting two public house premises
which were selected by the parties as samples: the Prince of Wales, Cardiff, which
was converted from a theatre, and the First Post, Cosham, which was converted from
20 two high street shops.

4. A schedule agreed by the parties showed £1,061,935 out of £1,585,598
expenditure in the year on Prince of Wales as being in dispute. There was no such
schedule for the First Post but it appears from the documents before us that £84,397
25 was in dispute.

5. There were three issues before us:

(1) Whether 37 items of expenditure on the Prince of Wales qualified as
30 plant under section 24 or, in the case of 23 of those, under section 66 and
whether 5 items of expenditure on the First Post qualified either under section
24 or section 66;

(2) Whether 60 items of expenditure on the Prince of Wales and 21 on the
35 First Post qualified as building alterations incidental to the installation of plant
within section 66;

(3) Whether certain site overhead expenditure or preliminaries, including
40 professional fees, such as structural engineers and planning supervisory fees,
is in part attributable to expenditure under section 24 or section 66, and if so
how it should be allocated.

6. The parties agreed to review the position in relation to other expenditure of the
45 same type on the Appellant’s other pubs in the year in question in the light of this
decision.

Statutory provisions

7. The relevant provisions in the Capital Allowances Act 1990, since replaced by the 2001 Act, were as follows:

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“s.24(1) Subject to the provisions of this Part, where –

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(a) a person carrying on a trade has incurred capital expenditure on the provision of machinery or plant wholly and exclusively for the purposes of the trade, and

(b) in consequence of his incurring that expenditure, the machinery or plant belonged to him,

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allowances and charges shall be made to and on him ...”

8. Schedule AA1 provided:

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“1(1) For the purposes of this Act, expenditure on the provision of plant and machinery does not include any expenditure on the provision of a building.

(2) For the purposes of this Schedule ‘building’ includes any asset in the building –

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(a) which is incorporated into the building, or

(b) which, by reason of being moveable or otherwise, is not so incorporated but is of a kind normally incorporated into buildings;

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and in particular includes any asset in or in connection with the building included in any of the items in column 1 or column 2 of the following Table (‘Table 1’).

(3) Sub-paragraph (1) above does not affect the question whether expenditure on the provision of –

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(a) any asset falling within column 2 of Table 1,

(b) any cold store,

...

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is for the purposes of this Act expenditure on the provision of machinery or plant.”

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Column 1 of Table 1 included walls, floors, ceilings, doors, windows, stairs, mains services and systems of water and electricity, waste disposal systems, sewerage and drainage systems and shafts in which lifts and hoists were installed. Column 2 included the following:

- “1. Electrical, cold water, gas and sewerage systems –
- 5 (a) provided mainly to meet the particular requirements of the trade, or
- (b) provided mainly to serve particular machinery or plant used for the purposes of the trade.
2. Space or water heating systems powered systems of ventilation, air cooling or air purification; and any ceiling or floor comprised in such systems.
- 10 ...
4. Cookers, washing machines, dishwashers, refrigerators and similar equipment; washbasins, sinks, baths, showers, sanitary ware and similar equipment; and furniture and furnishings.
- 15
5. Lifts, hoists.
- ...
20 8. Refrigeration or cooling equipment.
...
14. Decorative assets provided for the enjoyment of the public in the hotel, restaurant or similar trades.”

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The notes to Table 1 read as follows:

“1. An asset does not fall within column 2 if its principal purpose is to insulate or enclose the interior of the building or provide an interior wall, a floor or a ceiling which (in each case) is intended to remain permanently in place.

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2. ‘Electrical systems’ include lighting systems.”

35 9. Section 66 provided as follows:

“Where a person carrying on a trade incurs capital expenditure on alterations to an existing building incidental to the installation of machinery or plant for the purposes of the trade, the provisions of this Part shall have effect as if that expenditure were expenditure on the provision of that machinery or plant and as if the works representing that expenditure formed part of that machinery or plant.”

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10. The evidence was extensive. We visited both the Prince of Wales and the First Post after the first day of the hearing. There were 136 photographs and lengthy schedules of the items claimed and in dispute. There were seven ring-binders with supporting documentation, floor plans and original construction documentation for

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each of the two premises and another with supporting documentation for professional fees. Four witnesses gave evidence and were cross-examined: Christopher Large, who worked with the Appellant from 2001 in a number of senior roles and is currently a New Development Consultant; Timothy Martin, chairman of the Appellant; Peter Phillippo, LLM, MRICS, MCI Arb, ICI OB, Cert Adj, a partner at Tudor Rose Partnership LLP, Chartered Quantity Surveyors; and Ronald Heeley, MRICS, ICI OB, Quantity Surveyor, employed by the Inland Revenue since 1992 as a building surveyor and currently Head of National Assets and Building Surveyors.

10 11. The conversion of the Prince of Wales included the creation within the basement of a kitchen with new walls together with the provision of male and female toilets with all walls and partitions; a bar area and servery was created on the ground floor and new toilets were created on the first floor.

15 12. The work at the First Post included the creation of a bar area kitchen on the ground floor and male and female toilets on the first floor.

13. There was an agreed statement of facts which we summarise.

20 14. The Appellant owns, operates and develops pubs in strategic positions throughout the UK. Its stated priorities are to provide its customers with high quality, good value food and drink, served by well trained and friendly staff; it aims to create attractive surroundings that are clean, safe and excellently maintained.

25 15. In the year to July 1999 the Appellant operated 327 pubs in the UK and had a turnover of £270 million. It had expanded its business by acquiring buildings previously used for other purposes and converting them to pubs. These included banks, theatres, post offices and a range of other buildings. The projects entailed varying degrees of work, depending on the nature and state of the buildings acquired.

30 16. In the year in question, the Appellant incurred expenditure in relation to 288 fit out projects, however the greater part of the fit out expenditure related to 79 new pubs opened in the period. The Appellant also carried out 15 major refurbishments and 158 minor refurbishments. The Appellant incurred expenditure of £109,861,738 on land and buildings and in its revised tax return claimed plant and machinery allowances on expenditure totalling £52,045,614, out of which £18,513,787 on fixtures and fittings was not challenged. £26,698,853 of the balance was for building costs, £4,822,215 was for professional fees and £2,010,759 was for head office costs. As already stated the closure notice reduced the figure for expenditure allowed to
40 £17,562,348.

17. It is common ground between the parties that the expenditure was capital expenditure for the purposes of the 1990 Act and was incurred wholly and exclusively for the purposes of the Appellant's trade.

45 18. Mr Martin confirmed his witness statement and was cross-examined briefly. We accept his evidence in particular as to the Appellant's purposes. He stated that he

founded the business with the intention of creating pubs without music, specialising in a wide variety of traditional ales. Concentrating on real ale attracted a significant number of older people. A quarter of sales are of food which is available from 9.00am for breakfast until 11.00pm. There are substantial sales of coffee. The Appellant's pubs aim to be as attractive as possible to customers from a cross-section of society, to different age groups and families. It attracts many pensioners and also students. Newspapers are provided in 90% of pubs and books in around half. The pubs are often used as a venue for work-related meetings.

10 19. He stated that atmosphere is crucial to the appeal of pubs. He said that great efforts are made to achieve atmosphere through design. The aim is to create a "front room" atmosphere that is cosy, warm and interesting, even though the Appellant's pubs are considerably larger than average. Wood panelling is used to create a richer and more inviting atmosphere than traditional painted walls. Wood panelling was removed from a pub at Gatwick when BAA wanted a more modern image and was re-used at Heathrow Terminal 2. The Appellant has won many pub design awards, including one for the Prince of Wales.

20 20. He stated that decorative cornices and architraves are used to enhance the atmosphere of pubs, particularly in large rooms with high ceilings where they create a better visual impact by breaking up the ceiling. In the Prince of Wales decorative plaster was applied to the balcony frontage of the first floor balcony and parts of the existing balcony were touched up; gold decoration was applied to new demountable panelling on the first floor and decorative end plates were applied to the balustrades. A stage door lighting box enhanced the atmosphere by connecting with the past use as a theatre.

21. Mr Martin stated that particular attention was given to making toilets pleasant. In the Prince of Wales there is an ample ante-chamber to encourage female customers to take their time, often chatting to friends there. A book called "Pub Scene" had commented on the Appellant's fantastic "loos" often with sofas and chairs in the ladies.

22. He stated that special attention is given to lighting, attempting to create relatively low levels of background lighting, with pools of brighter light near the bar and some seating areas. Diffusers are used over spotlights.

23. Mr Martin said in cross-examination that a number of the premises developed were interesting or unusual buildings, but those were a minority. The Prince of Wales was an outstanding listed building. The work there had been extensive, adding a whole new floor with a bar and a whole new kitchen. The work took 18 months. Mr Baldry did not challenge any of the evidence summarised above.

24. Mr Large, who joined the Appellant after the work in question had been carried out, said that he had read through all the details of the construction and had met with all the consultants who took part in the conversion and development of the two premises under consideration.

25. He said that the Prince of Wales had been an amusement arcade and was in a state of disrepair when acquired. It was necessary to create a kitchen. He stated that kitchens had to be easily cleanable and capable of supporting the relevant kitchen equipment, whilst maintaining the correct temperature. To comply with modern legislation kitchens must be designed so as to deal with a high level of air extraction and ventilation. The kitchen at the Prince of Wales had to be created within the existing structure. Ovens, grilles, chargrilles, fryers, microwaves, toasting machines, fridges, freezers, food preparation benches, sinks and other equipment were installed. It was necessary to enclose the kitchen with walls to prevent the humid and greasy atmosphere caused by the equipment spilling from the kitchen into the main pub area. The kitchen and pub ventilation systems were also designed to prevent smoky air from the pub being sucked into the kitchen. The walls acted in conjunction with the two ventilation systems to maintain the different atmospheres within the pub. He said that a micro-climate was needed for the equipment required under the Building Regulations to provide and extract a given amount of air per square metre of floor space in the kitchen area. He stated that it was a statutory requirement to provide wipe clean surfaces including walls and ceilings within the kitchen environment in conformity with the Workplace (Health, Safety and Welfare) Regulations 1992 (“the 1992 Regulations”) and the Health and Safety at Work Act 1974.

26. He stated that it was necessary to create a number of cold store areas for different products. Bottled beer was brought into the storage areas and then put into a “Porka fridge” to reduce the temperature to 5°C before transfer to the fridges behind the bar. A refrigerated area at 12°C was necessary for draught beer. For the refrigeration equipment to work and to reduce the temperature of the cold store area to the required level, it was necessary to create insulated walls and partitions having the effect of fridge walls.

27. He said that the whole drainage system at the Prince of Wales had to be amended adding outlet points below ground level to take account of the plant installed in the toilets and kitchen, the existing drainage system being nowhere near adequate. This included drainage from the dosing system breaking down grease in the kitchen.

28. The items in dispute before us with the total costs for each item are listed below. The figures shown are before being marked down by some 10 per cent to reflect not expenditure attributable to the year in question.

29. The following items claimed were under section 24 alone.

Prince of Wales

Electrical Installations (£7,132)

ES 06	Stage door lighting box	£ 492.75
ES 11	Lighting grilles	300.00
ES 17a	Internal decoration lighting to public areas	6,060.80

	ES 41	Light fittings	68.00
	ES 59	Cut off duct around electric cable and fix to ceiling	210.19
	<i>Furniture and Furnishings (£37,726)</i>		
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	FF 02	Decorative wood panelling	£26,884.00
	FF 16	Decorative cornice and architraves	3,371.00
	FF 40	Decorative cornice	640.00
10	FF 55	Change specification of finishes to FF 02 to decorative timber panelling	4,940.00
	FF 66	Decorative panelling	500.00
	FF 74	Decorative panellings	750.00
	FF 78	Decorative bronze ends to hand-railing	493.00
15	FF 90	Decorative brass plates to balustrades	148.00
	<i>Sanitary Fittings (£3,616)</i>		
20	SA 48	Strip out installed island unit as too large for space and provide replacement fitting	3,616.00
30.	The following items were claimed under both sections 24 and 66.		
	Prince of Wales		
25	<i>Catering and Welfare equipment (£525)</i>		
	CA 18	Stud around and tiling to front of food hoists	£ 400.00
	CA 20	Wall access hatch adjacent to food hoists	125.00
30	<i>Electrical Installation (£10,957)</i>		
	ES 02	Cut holes for luminaire points and outlet points	£ 367.50
	ES 03	Lighting pelmet to WC cubicle partition	400.00
35	ES 04	Cut holes for luminaire point and outlet points	411.00
	ES 10	Access panel for electricians	120.00
	ES 20	Small power	6,780.00
	ES 31	WC light fittings	360.00
	ES 35	Rewire toilet lighting	144.00
40	ES 45	Electrical installations to manager's flat	2,375.00
	<i>Heating, Ventilation and Air Conditioning Installation (£531)</i>		
45	HV 57	Demolish wall incidental to plant room installation	£ 531.36
	<i>Sanitary Fittings (£23,957)</i>		
	SA 10	Excavating trenches for buried plumbing services	£ 701.95
50	SA 11	Below ground drainage incidental to cold store drainage channels	1,800.00
	SA 17	Overboard existing soffit incidental to air handling	

		equipment	1,562.15
	SA 33	Drainage incidental for cold store plant	500.00
	SA 34	Form drop ceiling incidental to toilets	300.00
5	SA 58	Below ground drainage for sanitary and kitchen installations - manholes	6,886.00
	SA 59	Testing and commissioning drainage system for sanitary and kitchen installations	1,700.00
	SA 61	Additional drainage runs for sanitary and kitchen installations	3,307.00
10	SA 63	Backdrops to manholes for toilets	1,192.00
	SA 64	Additional costs for drainage for sanitary and kitchen installations	400.00
	SA 65	Re-lay drains for sanitary and kitchen installations	5,214.00
15	SA 68	CCTV of drainage system for toilets	393.00
	First Post		
	<i>Electrical installations (£6,768)</i>		
20	ES 01	Cut holes and chases for luminaire and outlet points	£ 346.00
	ES 03)	Electrical installation to manager's flat	
	ES 14)		3,662.00
	ES 08	General power	2,760.00
25	<i>Residual building costs (£2,500)</i>		
	BZ 78	Roof access hatch and ladder to plant	£2,500.00
31.	The following items were claimed under section 66 alone		
30	Prince of Wales		
	<i>Catering and Welfare Equipment (£22,919)</i>		
35	CA 02	Plaster to walls for kitchen installation	£ 2,228.00
	CA 03	Ceramic tiles to walls for kitchen	6,718.00
	CA 04	PVC floor sheeting for kitchen	4,323.80
	CA 05	Painting walls for kitchen	624.76
	CA 06	Architraves and stops for kitchen installation	306.00
40	CA 07	Timber packing to door hinges in kitchen	169.20
	CA 08	Wipe clean suspended ceiling in kitchen	2,331.50
	CA 09	Doors and door frames in kitchen	1,550.00
	CA 11	Latex-cement for kitchen floor	444.50
	CA 17	Ceiling hatch in kitchen	125.00
45	CA 26	Tiling in toilets and kitchen of manager's flat	110.00
	CA 28	Drainage for kitchen	3,988.20
	<i>Cold stores (£27,937)</i>		
50	CS 01	Latex cement screeds for cold store and mechanical installations	£ 3,055.50

	CS 02	Timber packing around doors	122.20
	CS 03	Doors and door frames	2,263.00
	CS 05	Cement flooring	6,755.14
	CS 12	Concrete filling behind basement walls	390.00
5	CS 13	Break out existing slab in cellar	1,100.00
	CS 14	Remove doors	300.00
	CS 16	Remove concrete screed in basement, kitchen and toilets	3,837.50
	CS 17	Break out area around basement column	114.00
10		<i>Electrical Installations (£336)</i>	
	ES 52	Lighting including emergency lighting to plant room	£ 336.00
15		<i>Heating, Ventilation and Air Conditioning (£2,948)</i>	
	HV 05	Flat roof structure	£1,890.00
	HV 14	Roof incidental to plant room	865.16
	HV 56	Build wall in cellar over sump pump	192.42
20		<i>Lights and Hoists (£1,200)</i>	
	LI 06	Build roof incidental to lift shaft	£ 750.00
	LI 08	Form ceiling incidental to lift	450.00
25		<i>Sanitary Fittings (£123,787)</i>	
	SA 01	Drainage	£ 725.00
	SA 03	Brickwork and blockwork	9,091.00
30	SA 04	Straight joints in blockwork	152.40
	SA 07	Formation of stair for access to toilets	1,730.00
	SA 08	Removal of fittings and finishes to create new first floor toilets	2,300.00
	SA 09	Ceramic tiling splashbacks to sinks	214.50
35	SA 12	Internal doors and frames	2,139.90
	SA 13	Plastering	4,435.55
	SA 14	Rub down and paint surfaces	690.00
	SA 15	Raised floor area	1,764.00
	SA 18	Take up floor boards and prepare surface	2,463.00
40	SA 20	Timber stand partitions for toilets	11,212.50
	SA 22	Timber doors and door frames for toilets	6,660.00
	SA 23	Cement flooring for toilets	346.50
	SA 24	Plastering	5,369.50
	SA 25	Ceramic tiles	7,119.90
45	SA 26	Mosaic tiles	21,490.00
	SA 27	PVC sheet flooring	1,384.20
	SA 28	Painting and plastering	2,589.80
	SA 29	Architraves and doorstops	2,322.00
	SA 35	Plywood	250.00
50	SA 36	Studwork wall to rear of toilets to provide fire escape from plant room	550.00
	SA 40	Break up screed	150.00

	SA 41	Flooring	280.00
	SA 42	Door frames	225.00
	SA 49	Additional panelling for toilets	219.00
	SA 55	Remove raised timber flooring to basement	1,295.20
5	SA 56	Replace floor structure to first floor	14,154.25
	SA 57	Break out slab for underground drainage	3,010.00
	SA 60	Additional costs for SA 56	2,664.30
	SA 66	Screed and concrete	14,625.00
	SA 67	Walls in basement	400.00
10	SA 69	Opening first floor slab incidental to sanitary installation in existing building	1,964.25
	First Post		
15	<i>Catering and Welfare Equipment (£12,319)</i>		
	CA 01	Plastering	£1,215.00
	CA 02	Ceramic tiling	1,984.00
	CA 03	PVC floor sheeting	1,547.00
20	CA 04	Wipe clean suspended ceiling	3,866.00
	CA 05	Strip out, rebuild walls and fill in openings	1,732.50
	CA 06	Brick and block walling	1,039.50
	CA 07	Ceramic tiling to manager's flat	334.89
	CA 10	Ceiling	600.00
25	<i>Cold Stores (£649)</i>		
	CS 04	Demolition of existing cool store walls	£ 649.00
30	<i>Sanitary Fittings (£41,431)</i>		
	SA 01	Drains	£ 950.00
	SA 02	Cubicles	3,000.00
35	SA 03	Plastering and lining	2,061.50
	SA 04	Ceramic tiling	5,287.00
	SA 05	PVC floor sheeting	207.00
	SA 09	Excavate trenches and install below ground drainage	7,458.00
	SA 10	Strip out, rebuild walls and fill in openings	3,275.25
40	SA 11	Brick and block walling	1,732.50
	SA 13	Drainage survey – provisional	500.00
	SA 14	Additional toilet cubicles	150.00
	SA 15	Additional drainage works	16,000.00
45	SA 16	Drainage survey – final	810.00

32. The Tribunal had directed the exchange of any reports by experts and, failing agreement, discussions to identify the issues between them and a statement of the issues on which they agreed and on which they disagreed with a summary of reasons.

50 Mr Phillippo, who was instructed by the Appellant, and Mr Heeley, as expert on behalf of the Revenue, agreed a joint statement pursuant to the directions. This was

solely directed to preliminaries and professional fees in relation to the Prince of Wales.

33. They agreed that PR3, PR4 and PR17 were not preliminaries.

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34. They agreed that the following claimed preliminaries were trade specific overheads directly associated with differing categories of works and should be apportioned equally to the items of main contract expenditure relating to those works. These were as follows:

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	PR 02	Scaffolding and propping	£ 3,000
	PR 05	Scaffolding for roof works	500
	PR 06	Scaffolding to access lantern	2,860
	PR 07	Mobile tower for interior finishes	300
15	PR 08	Internal lift scaffolding	551
	PR 09	Additional tower for painters	160
	PR 13	Hoardings and Propping	6,000
	PR 15	Temporary propping	12,198
	PR 19	Localised removal of concrete	180
20	PR 20	Photographs as drainage work proceeds	100
	PR 21	Temporary protection of glass entrance dome	200
	ES 55	Additional costs for electrical installations – time overrun	4,032
25	HV 53	Additional costs for mechanical installations – time overrun	3,932

35. They agreed that PR 01 (site supervision and management £53,711) was a project overhead which should be apportioned equally to each and every item of main project expenditure. Mr Heeley agreed that site accommodation, power, telephone and site safety which were part of PR 12 should be so apportioned. At the hearing the Revenue agreed that PR 22 (temporary lighting on site £355) should be treated in the same way.

36. Mr Phillippo and Mr Heeley were in dispute as to the correct treatment of the following items which Mr Phillippo considered should be apportioned equally to each of the measured work items:

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	PR 10	Additional cost of labour due to extension of time (Final Account)	£7,897
	PR 11 and 14	Insurance	675
	PR 12	Preliminaries (part)	24,500
45	PR 16	Site supervision and management	4,886
	PR 18	Additional cost of labour due to extension of time to 23.12.98	12,000

The disputed items in PR 12 were site security, mechanical plant, contractors' general attendance, delivery of components, craneage, health and welfare and site cleaning (see paragraph 94 below).

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37. The joint statement recorded that it was the overriding position of Mr Phillippo that the total value of preliminaries should be apportioned to all the measured works. The agreement referred to at paragraph 34 above is therefore subject to this position. It was confirmed during the hearing that this applied to all the scheduled items not merely to PR 12.

38. The joint statement recorded that Mr Heeley's opinion was that in order to ascertain the amount of the preliminaries that were incurred on the provision of plant or machinery for capital allowances the preliminaries should be apportioned on an individual basis whenever possible rather than using the more general approach set out by Mr Phillippo.

39. In respect of professional fees they agreed that the structural engineer's fees should be proportionally allocated to those items of expenditure that related to the alterations and amendments to the existing building. They disagreed as to the planning supervisor's fees which Mr Heeley considered related to health and safety of the project as a whole and did not directly relate to specific items of plant and machinery.

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Submissions for the Appellant

40. Mr Ghosh said that expenditure on the provision of plant under section 24 could include expenditure on a building or on an asset incorporated into a building but that expenditure on the provision of a building or which becomes merged in a building was disallowed under Schedule AA1 unless it came under column 2 of Table 1 or was on provision of a cold store. There was a further restriction under Note 1. The application of Schedule AA1 was a question of fact. It was not enough that expenditure came within column 2, it must also be plant under general law. In order to succeed the Appellant must show that the expenditure was either not part of the provision of the building at all, or, if it was on an asset incorporated in the building, that it was within column 2 and was on plant.

41. He said that capital allowances are a form of relief for depreciation: some assets wear out more quickly than others. He said that we should bear this factor in mind when deciding the scope of allowable expenditure.

42. He said that in order to be plant an asset must be a tool of the specific trade by means of which profits are generated, see *J Lyons & Co v Attorney-General* [1944] Ch 281, 287. Ambience was part of the Appellant's trade as it was in *Inland Revenue Commissioners v. Scottish and Newcastle Breweries Ltd* (1982) 55 TC 252. Here toilets were plant for the Appellant's trade. Premises by contrast house the trade,

being distinct from the activity itself. In *Shove v Lingfield Park 1991 Ltd* [2004] STC 805 the artificial turf was the premises where the horses raced, whereas in *Inland Revenue Commissioners v Anchor International Ltd* [2005] TC 411 the artificial turf was plant because it was hired out. It is possible for an asset to be both premises and plant : the two are not mutually exclusive. In *Cole Bros Ltd v Phillips* (1982) 55 TC 188 Oliver LJ at page 212 distinguished between an asset “simply and solely” housing the business and an asset which performed some other distinct business purpose. Mr Ghosh accepted that in order to be plant an asset must retain a separate identity from the premises; examples were the decorative wood panelling here and the mural in *Scottish and Newcastle*. Affixation was not conclusive.

43. He said that the premises test was a negative formulation of the functional test, which was whether the expenditure was on tools of the trade, see *Anduff Carwash Ltd v Attwood* (1997) 69 TC 575, 596. Duality was irrelevant. If an item was both premises and plant, it qualified as plant. In *Inland Revenue Commissioners v Barclay, Curle & Co Ltd* (1969) 45 TC 221, Lord Reid said at 238 that buildings, structures, machinery and plant were not mutually exclusive, see also *Scottish and Newcastle* at 276A. The grain silos in *Schofield v R & H Hall* (1974) 49 TC 538 had a distinct separate purpose and were not merely the setting. There was no valid distinction between an active and a passive function, see *Cole Brothers* at 210. In *Wimpy International Ltd v Warland* (1988) 61 TC 51 Lloyd LJ said at 106-7 said that all of the items in dispute could have fallen on either side of the line. Mr Ghosh said that in order to come within column 2 of Table 1 drainage must be specific to the Appellant’s trade, see per Stamp LJ in *Bridge House (Reigate Hill) Ltd v Hinder* (1971) 47 TC 182; he submitted that the drainage in the present case was trade specific.

44. Mr Ghosh said section 24 and section 66 could overlap. The test in section 66 which merely required alterations to be incidental to the installation of plant was more relaxed. If section 66 applied, Schedule AA1 did not arise. In *Barclay, Curle* 45 TC 221 Lord Reid at 239-240 said that expenditure on provision of plant included the cost of installation to enable it to be used. Mr Ghosh said that “incidental” in section 66 was wider than “necessary” and covered alterations involving more “than mere installation in order that the new machinery or plant may serve its proper purpose.” Here Health and Safety requirements meant that there had to be wipe-clean surfaces for the cookers to be used; the installation of the cookers meant that the walls had to be put up with the tiles. Installation went beyond provision and involved installing something that can be used.

45. He said that alteration could include painting and repainting, see *Windsor and Maidenhead RBC v Secretary of State for the Environment* (1987) 86 LGR 402, citing Lord Diplock in *Customs and Excise Commissioners v Viva Gas Appliances Ltd* [1983] 1 WLR 1445 where he referred to any work upon the fabric of a building which is not de minimis. Here new walls were erected within the Prince of Wales for the kitchen as part of the process of installing the equipment. The walls and partitions in the ladies toilets were explained by the toilets: they had no independent purpose. It was irrelevant that the alterations also performed other functions.

46. Turning to the allocation of preliminaries and professional fees, Mr Ghosh said that such expenditure was allowable under section 24(1)(a) in so far as incurred on the provision of plant. Section 24 went beyond the purchase price. Preliminaries are global costs covering several different items which are not readily attributable to specific items; items which can readily be specifically attributed are not preliminaries. Mr Phillippo said that under normal business practice they should be allocated pro rata to all the measured works whereas Mr Heeley said that section 24 required a more detailed attribution exercise. If a detailed allocation was required, they had agreed the method for all but six items (see paragraph 36 above). Mr Ghosh said that at least in part all of the preliminaries claimed were by their nature attributable to plant; the next question was how to allocate. Once a cost was partially attributable to plant, a proportionate allocation was both sensible and permissible. The additional cost of labour due to the extended time on site was a preliminary; that was a residual cost which should be pro-rated. An apportionment approach was accepted by Kitto J in the Australian case, *B P Refinery (Kwinana) Ltd v Federal Commissioners of Taxation* [1961] ALR 52 at 57. Absolute accuracy is not possible. He said that the same approach should be applied to professional fees including the Planning Supervisor's fees and to preliminary expenditure apportionable to works coming within section 66.

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Submissions for the Revenue

47. Mr Baldry accepted that expenditure on items providing atmosphere or ambience for the Appellant's trade could satisfy the business test : thus, for example, the gantry lighting had been accepted as plant. The problem arose when drawing the line with respect to items which were put into premises. The issue under section 24 was whether the items had become part of the premises. If an item was part of the premises it did not matter that it provided atmosphere. He referred to Lord Lowry and *Scottish and Newcastle* 55 TC 252 at 277D where he said,

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“Something which becomes part of the premises, instead of merely embellishing them, is not plant ...”

Mr Baldry cited the judgment of Hoffman J in *Wimpy International Ltd v Warland* (1987) 61 TC 51 at 85D, which was approved by Lloyd LJ in the Court of Appeal, when he said that the question was whether it was appropriate to describe the item as having become part of the premises or, alternatively, as having retained a separate identity. That was not the same as being identifiable. An architrave or cornice did not retain a separate identity. He said that *Scottish and Newcastle* and *Wimpy* were really the only cases which need to be considered in this appeal.

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48. He said that relevant factors included whether an item visually retained a separate identity, the degree of permanence with which it was attached, the incompleteness of the structure without it and whether it was likely to be replaced within a relatively short period.

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49. Mr Baldry said that the business use test was of secondary importance in this case; it was accepted that the expenditure was for business purposes.

50. Turning to section 66, Mr Baldry said that “incidental to the installation” was narrower than “in connection with”. The work must be ancillary to the installation process. He submitted that the work must be incidental to the installation of specific items of plant. Lord Reid was not addressing this point in his observation at page 239 in *Barclay, Curle*. He said that the tiling and wipe-free ceilings in the kitchen were not incidental to the installation of the cooker. Health and Safety legislation required wipe-free ceilings in all work place kitchens. Section 66 was not intended to create a wholly new category of expenditure going beyond items truly incidental to the installation of plant. Section 66 covered work incidental to the installation rather than consequential Health and Safety requirements. Many of the alterations claimed were in reality alterations to the buildings. The cost of cubicle walls around the toilets was not incidental to the installation of toilets and making them work. It was sufficient that the plant functioned as plant. He said that building a new kitchen before installing equipment was the construction of a new kitchen rather than expenditure incidental to the installation of the equipment.

51. Mr Baldry said that the third question was how much of the preliminaries could properly be regarded as expenditure on the provision of plant within section 24. He referred to the speech of Lord Wilberforce in *Ben-Odeco Ltd v Powlson* [1978] 1 WLR 1093 where he said that the focus is on the expenditure on the plant. Mr Baldry said that where the costs of preliminaries could be specifically attributed either to items of plant and machinery or to items which were unrelated to plant and machinery that attribution should be made; an apportionment should then made of the residual items. This was inherently more accurate than the Appellant’s global approach. Part of the dispute was whether it was possible or meaningful to make an attribution of something which is a preliminary. He said that it was not enough that businessmen simply do a global apportionment; the attribution methodology was inherently more accurate. In *Kwinana* where the taxpayer did a global apportionment, the Revenue did not produce any evidence in response and it was decided that the taxpayer had discharged the burden of proof. In response to a question whether it is relevant that a method is properly workable without lengthy and detailed analysis, he said that models could be devised to produce a proxy of the right decision without going into the length of detail which Mr Phillippo had done.

Conclusions

52. This hearing concerned sample claims in respect of the Prince of Wales and the First Post covering 123 individual items involving total expenditure of £327,238 not including preliminaries. The sample covers under 1 per cent of the total expenditure in issue in the whole appeal.

53. 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 material in the seven ring-binders was scarcely referred to. Mr Large covered the individual items in his witness statement and his oral evidence, however, inevitably the level of detail varied. Mr Heeley's witness statement took the form of an expert report, however much of it was directed at whether individual items satisfied the statutory criteria which was not a matter for expert evidence. Further it appears that he was involved in making the decision under appeal. Most of his report consisted of contentions rather than evidence. This formed the basis of a schedule handed in by Mr Baldry, headed "Summary of Respondents' position."

54. The greater part of the submissions by counsel on both sides was taken up with submissions as to the law rather than the application of the law to the individual items. Consideration of the individual items would have involved a significantly longer hearing. In spite of the photographs and the site visits it was not easy to identify all items with any precision. We have concluded that to attempt to produce a decision covering all 123 items on the material before us would be both impractical and of limited use since, if we were to attempt that course, some at least of our conclusions might be based on incorrect assumptions.

55. We have decided instead to seek to address the points of principle arising on the statutory provisions which are in dispute between the parties, concentrating on a small number of items taken as examples to illustrate our reasoning, and to leave the parties to apply for a further hearing if the appeal as a whole cannot be resolved in the light of this decision. We start by considering section 24 alone, concentrating on the wood panelling.

Section 24 expenditure on plant

56. We have identified two issues of principle in dispute between the parties on the application of section 24. The first issue is: in the factual context relevant to this appeal what characteristics give an item a "retained separate identity", which results in it being plant provided for the purposes of a trade rather than part of the premises? The second issue is: if an item (which would otherwise rank as plant – before any consideration of Schedule AA1) is considered to be part of premises, is it for that reason not plant provided for the purposes of a trade? We consider these issues, taking the decorative panelling at the Prince of Wales as an example to illustrate our reasoning.

57. Decorative panelling is covered by four items at the Prince of Wales - FF02, FF55, FF66 and FF74, together totalling £33,074. The panelling consisted of plywood veneered to look like oak and had ogee planted panel mouldings, skirting and decorative friezes. The panelling only extended part of the way up to the ceiling, being 2050mm high in the ground floor bar whereas the ceiling was very much higher. It extended around the main sitting areas but not around all of the walls. There was no panelling behind the fruit machines. The panelling was attached to the walls and columns with softwood battens and was thus proud of the plaster on the

walls. It was designed for the Prince of Wales so as to fit the parts to be covered. It was clearly a feature of the premises.

58. It is clear from *Scottish and Newcastle Breweries* 55 TC 252 that an embellishment to a pub can be plant provided that it has not become part of the premises but has retained a separate identity. In *Wimpy International* 61 TC 51, Hoffman J. (as he then was) after reviewing the authorities said this at page 85,

10 “... the question seems to me to be whether it would be more appropriate to describe the item as having become part of the premises than as having retained a separate identity. This is a question of fact and degree, to which some of the relevant considerations will be : whether the item appears visually to retain a separate identity, the degree of permanence with which it has been attached, the incompleteness of the structure without it and the extent to which
15 it was intended to be permanent or whether it was likely to be replaced within a relatively short period.”

That passage was expressly approved by Lloyd LJ in the Court of Appeal.

20 59. We accept that the panelling was an embellishment to create ambience for the purposes of the Appellant’s trade; this was not in dispute. The Revenue’s case was that the panels were fixed to the wall and formed part of the premises.

25 60. We accept Mr Baldry’s submission that the question whether an item has retained a separate identity is not the same as the question whether it is identifiable. As Hoffman J said it is a question of fact and degree whether the panelling retained a separate identity and whether an item appears visually to retain a separate identity is one of a number of factors to be considered. In our view, in relation to the decorative panelling, some of the considerations referred to in *Wimpy International* point one
30 way and some point the other.

61. The structure of the rooms was clearly not incomplete without the panelling. A substantial part of the walls was not panelled and the panelling was fixed to the walls. The panelling was clearly capable of being removed; indeed similar panelling
35 had been removed from a pub at Gatwick Airport and reused. There is no reason to believe that removal of the battens would cause more than surface damage to the plaster. However we find that the panelling was not likely to be removed after only a short period since this would obviously involve substantial refurbishment during which period the pub would have to be closed, although periodic redecoration of the interior would clearly be needed from time to time and no doubt consideration would
40 be given to whether the panelling should remain. There was no suggestion that the panelling was a necessary embellishment to the pub, in view of the history of the premises as a theatre. Since the panelling only covered part of the walls we conclude that it did appear visually to retain a separate identity.

45 62. Although neither counsel suggested any considerations in the present case additional to those referred to in *Wimpy International*, we note that Hoffman J did not

intend his list of considerations to be exclusive of any others. The considerations he listed were factors to be taken into account in answering the question of fact and degree which is: would it be more appropriate to describe the item as having become part of the premises than as having retained a separate identity? This question, in turn, is posed as a means of deciding whether an item which “passes” the “business use test”, namely, an item which is used for carrying on the business, can nevertheless be excluded from the category of “plant” because it does not “pass” the “premises test”, that is, because it becomes part of the premises, instead of merely embellishing them. It is to be noted that this reasoning is subject to an exception in “the rare cases where the premises are themselves plant, like the dry dock in *Barclay Curle*, or the grain silo in *Schofield v Hall* – per Lord Lowry in *Scottish and Newcastle*, *ibid.* at p.277.”

63. In this context, it seems to us that we are being asked 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.

64. A factor not mentioned by Hoffman J in *Wimpey International*, but which seems to us to be helpful to consider in the context of the decorative panelling is the extent to which the panelling can be regarded as an unexceptional component which would not be an unusual feature of premises of the type to which the Appellant is inviting the public. If an item is or becomes such an unexceptional component of the premises into which it is introduced, that, in our view, is a factor tending to the conclusion that it does not retain a separate identity for relevant purposes. The relevance of this factor is, we consider, supported by the treatment in para. 1(2) of Schedule AA1 of any asset in a building which is not incorporated into the building but is of a kind normally incorporated into buildings, as effectively, part of the building, and also the exclusion from this treatment, by item 14 of Column 2 of Table 1 in Schedule AA1, of “decorative assets provided for the enjoyment of the public in the hotel, restaurant or similar trades”.

65. Because the decorative panelling in the Prince of Wales effectively turns the premises, or that part of them to which it is applied, from an unpanelled room into a room which is mainly panelled, we consider that it is an unexceptional component of the type of premises, in contradistinction, for example, to the fixed but not easily removable metal sculpture, which was held, in *Scottish & Newcastle Breweries*, to be plant.

66. Balancing all the above matters, we conclude that the panelling is more appropriately described as having become part of the premises than as having retained a separate identity. Therefore it does not qualify as plant.

67. By the above reasoning we have answered the first issue of principle which we identified at paragraph 56 above. We can answer shortly the second issue there identified. If an item is considered to be part of the premises, it is indeed for that reason not plant provided for the purposes of a trade, except in the rare cases

identified by Lord Lowry in *Scottish & Newcastle Breweries Ltd*, where the premises themselves are plant – see: paragraph 53 above. This, of course, is not one of those rare cases.

5 *Alterations incidental to installation of machinery or plant – s.66*

68. Section 66 enlarges the category of expenditure qualifying as expenditure on the provision of machinery or plant for the purposes of a trade, by specifically including in that category “capital expenditure on alterations to an existing building incidental to the installation of machinery or plant for the purposes of the trade”. The issue of principle in dispute between the parties on the application of section 66 is whether such capital expenditure on alterations to an existing building includes all expenditure on alterations to a building which are required so that the machinery or plant installed may serve the purpose intended for it in the carrying on of the trade (as Mr Ghosh submitted) or whether it must be confined (as Mr Baldry contended) to expenditure on alterations to a building which are incidental to the installation of specific items of plant. We start by considering the alteration to the Prince of Wales whereby kitchen walls, tiled so that they are wipe-clean, were constructed to enable the installed cookers to be used in carrying on the Appellant’s trade, as an example to illustrate our reasoning on this issue.

69. Mr Ghosh’s argument, in reliance on a dictum of Lord Reid in *Barclay, Curle*, 45 TC 221 at 239-40, was that all expenditure on alterations to the building carried out to enable the installed plant to be used for its intended purpose qualified under section 66. Mr Baldry drew a distinction between alteration expenditure which was incidental to the installation of plant, and was allowable, and alteration expenditure which was consequential to the installation of plant. He said that the construction of the kitchen walls should be regarded as the construction of a new kitchen (and, therefore, not plant) rather than an alteration of the building incidental to the installation of the cookers and other kitchen equipment.

70. Surprisingly there are no decided cases on section 66 or its predecessors. Its predecessor in the Income Tax Act 1952 was however considered by the House of Lords in *Barclay, Curle* which concerned capital allowances for building a dry dock. In that case the Revenue accepted that the dock gate, valves, pumps, electricity generators and other machinery for operating a dry dock, were plant but contended that the excavation of 200,000 tons of earth and rock and the expenditure on concrete-work did not qualify. The House of Lords decided by a majority of three to two that the concrete dry dock was plant and that the cost of excavation to make room for the plant was part of the cost of provision of the plant. Lord Reid who gave the leading speech said this at pages 239-240 in relation to section 279, the predecessor of section 24:

45 “... the question is whether, if the dock is plant, the cost of making room for it is expenditure on the provision of the plant for the purposes of the trade of the dock owner. In my view this can include more than the cost of the plant itself, because plant cannot be said to have been provided for the purposes of the

trade until it is installed: until then it is of no use for the purpose of the trade
.... If the cost of the provision of plant can include more than the cost of the
plant itself, I do not see how expenditure which must be incurred before the
plant can be provided can be too remote.”

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71. Lord Reid then considered a submission for the Revenue that “provision” in
section 279 could not have the meaning which he attributed to it because of section
300, which was the predecessor to section 66, and said this at page 240D,

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“Here the word used is ‘incidental’ to the installation of the plant. ‘Incidental’
is a wider word than ‘necessary’. In my view, the expenditure necessary for
the installation of the plant is already covered by section 279. But it may be
that the exigencies of the trade require that, when new machinery or plant is
installed in existing buildings, more shall be done than mere installation in
order that the new machinery or plant may serve its proper purpose. Where
that is the case this section enables the cost of the additional alterations to be
included.”

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Lord Upjohn at page 249 expressly agreed with the reasons given by Lord Reid in
respect of the cost of excavation.

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72. Although *Barclay, Curle* did not involve capital allowances under section 300,
Lord Reid’s observations as to section 300 clearly formed part of his reasoning on
section 279. Those observations are of the highest authority. They should not
however be treated as a substitute for the words of the statute.

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73. Mr Baldry was of course correct to emphasise that the statute refers to
alterations “incidental to the installation of machinery or plant.” However Lord Reid
said that the statute covers “more ... than mere installation in order that the new
machinery or plant may serve its proper purpose.” The ambit of section 66 is of
course confined to alterations to a building which in the context is an existing
building: building operations on a new building incidental to the installation of
machinery or plant would not be covered by section 66 although they might fall
within section 24. Due weight must also be given to the statutory requirement that the
alteration must be “incidental” to the installation of the plant albeit with Lord Reid’s
gloss. We do not consider that the alteration must be solely attributable to a specific
item of plant. It would be absurd if an alteration qualified if it was solely attributable
to one item of plant but not if the same alteration was attributable to two items of
plant.

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74. The word “incidental” suggests that the alteration should be subordinate or
secondary to the installation of the plant. The *New SOED* (1993) gives under 2b,

“Of an expense or charge : incurred apart from the main sum disbursed.”

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Here of course section 66 is directed to whether the alterations are incidental rather
than whether the expenditure is incidental, however we consider the principle to be no

different. This does not necessarily mean that the alterations must cost less than the installation or installations to which they are incidental, however in our view they cannot properly be described as incidental if their cost is disproportionately more.

5 75. The Appellant claimed under section 66 alone for a series of alterations on the
basis that they were required under various regulations if the plant was to be used in
compliance with those regulations. Although Mr Large referred to certain regulations
and the Health and Safety at Work Act 1974 neither counsel referred to any specific
provision. Regulation 9(2) of the Workplace (Health, Safety and Welfare) Regulations
10 1992 provides

“(2) The surfaces of the floors, walls and ceilings of all workplaces inside
buildings shall be capable of being kept sufficiently clean.”

15 Regulation 12(1) and (2) provides so far as is relevant,

“(1) Every floor in a workplace ... shall be of a construction such that the
floor ... is suitable for the purpose for which it is used.

(2) Without prejudice to the generality of paragraph (1), the requirements in
20 that paragraph shall include requirements that –

(a) the floor ... shall have no hole or slope, or be uneven or slippery so
as ... to expose any person to a risk of his health or safety; and

25 (b) every such floor shall have effective means of drainage where
necessary.”

30 Quite apart from Health and Safety legislation, there are of course food hygiene and
environmental health requirements.

76. The Appellant claimed a number of items, including CA 03, 05 and 09 in the
Prince of Wales and CA 02 and 04 at the First Post on the basis that wipe clean
surfaces had to be provided. There was no evidence of a specific requirement for tiles
35 by the regulatory authorities, however we do accept that tiles are reasonable for a
busy kitchen. We have no difficulty in concluding that the need for wipe clean walls
and ceilings in the kitchen arises from the steam and smoke generated by using the
fryers, cookers and other plant. These could not be used without generating steam
and smoke. If the Appellant could not use that plant without providing a wipe clean
40 surface, it is clearly arguable that alterations to provide a wipe clean surface were
needed if the plant was to serve its proper purpose. The question remains however
whether such alterations can properly be described as incidental to the installation of
any machinery or plant.

45 77. Although the cost of the tiles (and painting of the walls) was not
disproportionate to the cost of installing the plant, we consider that Mr Baldry is
correct in submitting that section 66 was not intended to create a wholly new category

of expenditure going beyond items truly incidental to the installation of plant, and that there is a real distinction between alterations to a building incidental to the installation of plant and alterations consequential on the installation of the plant.

5 78. We do not understand Lord Reid in the passage cited from *Barclay, Curle* to
be saying more than that expenditure on alterations to a building (over and above
expenditure necessary to install it) was allowable to the extent that such expenditure is
incidental to the installation of the plant in order that the plant can function properly
10 by reference to the purpose for which it was installed. Thus, for example, if a cooker
is installed, expenditure incidental to the installation may be incurred on the removal
of a wall (or part of a wall) in the existing building in which the cooker is installed, to
allow proper access to the cooker to make it useful for the purposes for which it was
installed. Such expenditure would qualify under section 66. In our view, it would be
15 stretching section 66 beyond its evident purpose to allow expenditure on the
construction of kitchen walls to qualify, on the basis that the exigencies of the
Appellant's trade, including statutory or regulatory requirements, require that kitchen
walls themselves must be constructed so that the cooker may serve its proper purpose.
The construction of the kitchen walls was not incidental to the installation of the
20 cookers (or other kitchen equipment). It was part of the creation of a kitchen, in
which the cookers and other kitchen equipment could function properly. The kitchen
walls were of course specifically excluded from section 24 by the Notes to Table 1 of
Schedule AA1. In our judgment the tiles did not have a sufficient nexus with the
installation of equipment such as cookers to be incidental thereto. The tiles were
25 fixed to facilitate cleaning of the walls. Apart possibly from splash backs to sinks and
the immediate surrounds of lavatory basins, we do not consider that wipe-clean tiling
qualifies under section 66.

79. Although we do not consider that the kitchen walls had a sufficient nexus to
the installation of the cookers to qualify, we do consider that the timber partitions and
30 doors to the individual toilets at the Prince of Wales and the cubicles at the First Post
did have sufficient nexus. We do not consider that Lord Reid's observation was
confined to mechanical functioning. The toilets could properly not be used without
partitions or cubicles.

80. We consider next the drainage items. The evidence of Mr Large that the
35 whole drainage system had to be amended because the existing drainage system was
inadequate for the toilets and the kitchen was not challenged. The drainage layout is
shown on one of the exhibited plans, 4619-PH-01A. In addition there was the
drainage connection from the new first floor toilets at the Prince of Wales. It is a
40 statement of the obvious that a large pub such as the Prince of Wales serving food
requires substantial additional drainage for the kitchen and toilets. In our judgment
the drainage items under SA 01, 10, 11, 33, 51, 58, 59, 61, 63 to 65, 68 and CA 28 at
the Prince of Wales and SA 01, 09, 13, 15 and 16 at The First Post either fell within
Column 2 of Schedule AA1 as being a trade specific sewerage system or were
45 incidental alterations within section 66. The schedule put in by Mr Baldry
summarising the Revenue's position merely went through the items asserting that they
were neither plant nor incidental to the installation of plant. He did not elaborate on

this orally. Not surprisingly there was no submission that the pipework and drainage connecting a toilet to the drains is not incidental to the installation of the toilets.

Attribution of overheads and preliminaries

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81. It was common ground that the capital expenditure on the provision of plant under section 24 could include preliminaries or professional fees attributable to such provision.

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82. It is convenient to take as a starting point the ambit of the expression “preliminaries”. The description and narrative in paragraphs 30 to 40 of Mr Phillippo’s report was agreed. Preliminaries generally refers to the building contractor’s necessary costs which are not usually tangibly reflected in the finished works as opposed to costs directly related to the quantity of items of work, i.e. materials, tradesmen and site labour, tools and small plant. Costs concerned with the works as a whole are preliminaries being commonly referred to as the contractor’s site-related overheads. Preliminaries costs are incurred on every construction contract although for a simple contract a lump sum may be agreed without identifying preliminaries. For more complex projects, such as the Prince of Wales refurbishment, the tender document usually requires preliminaries to be identified separately. Irrespective of the contractor’s pricing policy, the cost of preliminaries or overheads are integral parts of the construction costs.

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83. In spite of the agreed description of preliminaries as being concerned with the works as a whole and as being site-related overheads, both Mr Phillippo and Mr Heeley referred to the items listed at paragraph 34 above as preliminaries although all were agreed to be trade specific overheads being directly associated with demolition and alteration, drainage, roofing, lifts, surface finishing, electrical or mechanical works. None of the items in paragraph 34 was however exclusively related to any specific items of work. The issue in relation to the items in paragraph 34 was whether these should be attributed to those items of main contract expenditure to which they relate, being apportioned equally among such items, or whether they should, as the Appellant contended, be apportioned rateably to all the measured works. Mr Baldry did not suggest that no apportionment of those items should be made; the issue rather turned on how specific it should be.

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84. The issue in relation to the items listed in paragraph 36 was quite different. Mr Heeley considered that these did not relate directly to any item of plant so that no question of apportionment could arise. Mr Phillippo considered them to be general overheads to be apportioned equally among all measured work items.

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85. It is clear that the expression “preliminaries” is not a precise expression. Items which might be treated as preliminaries in one contract or tender might not be so treated in another. While some costs, such as portable toilets, are not capable of meaningful attribution to measured work, other costs may be capable of meaningful attribution, albeit with varying degrees of difficulty. All, however, will be integral parts of the construction costs of the measured work to the extent that they can be

properly apportioned to such work. A cost properly attributable to one item of work cannot properly be apportioned among the whole.

5 86. The entitlement to capital allowances under section 24 depends on the taxpayer having incurred expenditure on the provision of plant or machinery. Such expenditure includes site-related overheads, project overheads and other expenditure treated as preliminaries provided such expenditure can be properly attributed or apportioned to plant or machinery. The exclusion of preliminaries as being too general or on the ground that a preliminary item did not directly relate to specific items of plant or machinery would have the effect that capital allowances would not reflect the real expenditure incurred. In *Barday, Curle* Lord Reid said at 240B:

10 “... I do not see how expenditure which must be incurred before the plant can be provided can be too remote.”

15

87. Before considering the items listed in paragraphs 34 and 36 above, we address the issue of whether preliminaries can be apportioned to section 66 expenditure or whether (as the Revenue contend) they are confined to section 24 expenditure.

20 88. Mr Phillippo’s written statement as to preliminaries was addressed both to section 24 and section 66 (see his paragraph 13). The Schedule agreed by Mr Heeley on behalf of the Revenue with Mr Phillippo agreed PR 13 and 15 as a trade specific overhead to be apportioned equally between all items relating to demolition and alteration on the existing building. On Preliminaries under PR 12 Mr Heeley agreed site accommodation, power, telephone and site safety as pro-rata to the measured work but considered that all other items were related to the structure or not directly related to items of plant. We do not understand the relevance of his comments on PR 13 and 15 if preliminaries could only be apportioned under section 24, since demolition and alteration work could in this case only qualify under section 66.

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89. Paragraph 1 of the Appellant’s skeleton argument identified issue (iii) as:

35 “The extent to which the preliminaries costs and professional fees incurred by the Appellant (‘overheads expenditure’) constitute capital expenditure on ‘plant’ for the purposes of CAA 1990 section 24, or alternatively, CAA 1990, section 66.”

40 Paragraph 26 of the Respondent’s skeleton argument stated that the issue was the extent to which overheads expenditure can be said to have been incurred on the provision of plant and machinery within section 24 and continued,

45 “The suggestion (in paragraph 1(iii) of the Appellant’s skeleton) that the preliminaries constitute expenditure on plant for the purposes of section 66 as well is not developed by the Appellant, but for the avoidance of doubt the Commissioners submit they do not accept that section 66 is of any relevance here.”

Mr Baldry did not explain the basis of that submission in oral argument.

5 90. Section 66 has the effect that capital expenditure on alterations incidental to
the installation of plant is treated as expenditure on the provision of that plant. We
are wholly unable to understand why overheads and other preliminaries should not be
included in the capital expenditure on alterations. The description of the nature of
preliminaries contained at paragraph 30 onwards of Mr Phillippo's statement was
10 expressly agreed in paragraph 3(a) of the joint statement by himself and Mr Heeley.
At paragraph 39 Mr Phillippo stated,

15 "Irrespective of the contractor's pricing policy the cost of
preliminaries/overheads are integral parts of the construction cost."

In our judgment there is no basis in law for excluding preliminaries in arriving at
capital expenditure falling under section 66.

20 91. We now turn to the items listed at paragraph 36 above. It was common ground
that items which can be specifically attributed to measured work are not preliminaries.
Mr Ghosh submitted that in the present case all the preliminaries claimed were by
their nature attributable to plant in part. The Revenue however contended that the
items listed at paragraph 36 did not relate to plant. Neither counsel addressed us as to
25 whether the particular items were or were not in part attributable to plant.

92. PR 11 and 14 both related to insurance in the contractor's account. This
related to insurance under clause 6.2.4 of the contract (an IFC 84 contract) which
required the contractor to take out an indemnity policy:

30 "in respect of any expense, liability, loss, claim or proceedings which the
Employer may incur or sustain by reason of injury or damage to any property
caused by collapse, subsidence, heave, vibration, weakening or removal of
support or lowering of ground water arising out of or in the course of or by
35 reason of the works ..."

Mr Phillippo gave as an example a pipe bursting in the road under a crane resulting in
flooding. He described it as "non-negligent project insurance" by which he meant
40 cover for liability without proof of negligence. He said that the cost of this insurance
was a project overhead. Mr Heeley said that it covered damage to property other than
the Prince of Wales and not to any item of plant.

45 93. It is not in fact clear to us that Mr Heeley was correct in asserting that it
excludes damage to the Employer's property. In any event it is clearly part of the cost
of the works as a whole including plant and alterations within section 66 and in our
judgment is a general overhead falling to be apportioned.

94. PR 12 was described in the Bill of Quantities as,

“Preliminaries generally. Generally, 7 weeks at £3,500 item £24,500.”

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Mr Heeley accepted site accommodation, power, fuel, lighting and water, telephones and fax and site safety, health and welfare as overheads to be allocated pro-rata to the measured work. He considered that the following related to the structure or were not directly related to plant:

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PR 12

	c. Site Security	£ 705
	d. Mechanical plant	1,106
15	e. Contractor's general attendance	5,250
	f. Deliver Components	164
	g. Craneage	401
	j. Site clearing	4,370
	k. Other preliminaries	2,822

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These figures were assessed by Mr Phillippo and Mr Heeley.

95. Mr Phillippo gave evidence, which we accept, that site security was to protect site items from being stolen, that mechanical plant would include a mobile generator for use in the work, that craneage was for crane hire perhaps for lifting an item onto the roof. In his statement Mr Phillippo expressed the opinion that all the costs under PR 12 were a general site overhead and should be apportioned equally among all measured work items: this was not challenged in cross-examination and we accept it. In our judgment Mr Heeley's objection to PR 12 was misconceived because these items were of their nature general overheads of the whole project.

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96. PR 16 related to the fees of a building control officer attending the site during the works to check compliance with building regulations, including safety, ventilation, heating, appliances generating heat such as boilers and electrical works. Mr Heeley commented that this primarily related to the building structure although a small percentage might relate to plant. We consider that this is a general overhead to be apportioned equally among measured items.

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97. PR 18 was for the additional cost of labour due to a four week extension of time on site to 23 December 1998. There was a significant variation in the contract sum by reason of variations to works. Mr Phillippo expressed the opinion that this was an addition to the preliminaries at PR 12, being four weeks @ £3,000 on phase one of the work. He said that PR 10 was an addition to the sum at PR 01 for phase 2, again by reason of an extension. He said that those sums had been agreed and paid by the Appellant. In relation to both of those items Mr Heeley commented that no details were available as to the reason for the extension of time and that they were not

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directly related to an item of plant. It appears from the supporting documentation exhibited that there had been very considerable variations from the original contracted sum.

5 98. We regard it as unrealistic to require details of reasons for modest extensions of time on a contract of this size where there were substantial variations. Mr Phillippo's opinion appears to us to be logical. The fact that those items were not directly related to specific items of plant is inherent in their nature as preliminaries. We conclude that they should be apportioned rateably.

10 99. Having concluded that all the disputed items under paragraph 36 were project overheads to be apportioned rateably over all the measured work, we turn to consider the items which Mr Phillippo and Mr Heeley agreed to be trade specific overheads which were capable of being apportioned to relevant items of the main contract
15 expenditure in contrast to PR 01 which it was agreed should be apportioned among all items.

20 100. It is our understanding that when Mr Phillippo and Mr Heeley agreed that the 14 items listed at paragraph 34 above were trade specific overheads this was on the basis that each overhead related to a number of different items of main contract expenditure within a trade category and did not relate specifically to individual items of plant or alterations incidental to specific items. If they had related to individual items they would not have been described as overheads or preliminaries. They were overheads of parts only of the main contract. PR 05 and 06 related specifically to
25 roofing works. PR 07 and 09 related specifically to surface finishing works.

30 101. The expenditure which qualifies under section 24 is of course capital expenditure on the provision of plant and machinery. That qualifying under section 66 is capital expenditure on incidental alterations. The expenditure is not limited to the cost of the plant, see per Lord Reid in *Barclay, Curle* cited at paragraph 53 above. Contracts for building alterations of any size regularly include items for preliminaries. These are clearly part of the expenditure in question.

35 102. In an ideal world preliminaries could for the most part be specifically allocated to individual items. This would have involved the retention and analysis of the necessary detailed information. It was not suggested on behalf of the Revenue that all preliminaries could be accurately broken down. It was agreed that PR 01 (site supervision and management) should be apportioned rateably to all contract expenditure. There is not therefore, and could not be, any objection in principle to an
40 apportionment which is inherently an estimate rather than an exact measurement of the cost properly attributable.

45 103. Mr Heeley's calculations apportioned £19,317 out of total preliminary items of £112,315 to qualifying expenditure. He derived this figure by taking £56,966 out of the £112,315 as being allowed subject to apportionment and apportioning it between the £433,973 total allowable items and £846,338 items disallowed by him. He thus apportioned 33.9% of the £56,966 to qualifying expenditure. He said in

evidence that the only real difference between him and Mr Phillippo was that he (Mr Heeley) had looked at which of the claimed preliminaries should be correctly apportioned to plant, whereas Mr Phillippo had not gone that far.

5 104. Mr Heeley told us that the Revenue has various cost models for different types of buildings to see what percentages of preliminaries should be allocated to allowable and non-allowable expenditure for capital allowances. He said that normally a broad brush approach is taken for practical purposes allowing 50 per cent. He did not give any details or evidence of the cost model which would apply in the present case.

10 105. Mr Phillippo told us that his additional work to compare the result of a detailed assessment of the allocation of preliminaries to the result of a rateable apportionment of preliminaries across the board took him 20 to 25 days work on the Prince of Wales alone. We have some difficulty in understanding how the additional
15 work should have taken so long, however we do accept that a detailed assessment of the heads of work to which each preliminary relates is a time-consuming exercise and in any event cannot be more than an exercise of judgment.

20 106. Mr Phillippo produced calculations showing that on the Appellant's view of the ratio of qualifying to non-qualifying expenditure a detailed analysis would give a value for preliminaries of 3% less than a pro-rata basis but that on the Revenue's lower ratio of qualifying expenditure a detailed analysis would give a value for preliminaries of 7% higher than a pro-rata basis. This was not challenged.

25 107. Mr Ghosh accepted that in principle any preliminaries which did not relate to plant and machinery in any way should be excluded; we assume that he treated section 66 alterations as relating to plant and machinery. In the present case he said that at least part of all preliminaries were by their nature attributable to plant.

30 108. Clearly the allocation of preliminaries when arriving at the capital expenditure under section 24 and section 66 should be as accurate as is reasonably possible. Where a relatively small amount of work and record-keeping will result in substantially greater accuracy, it will be reasonable and proportionate that this should be done. However where a large amount of work will result in no great increase in
35 accuracy, the additional work will be disproportionate to any gain. This is not necessarily an all or nothing issue. If a substantial preliminary item can be reasonably allocated to a small number of works, it may be reasonable to do this rather than leave it in the pot. On the other hand where a smaller item would fall to be spread over a large number of works it may not be reasonable. This will particularly be so where
40 allocation would involve examining a substantial amount of material and where allocation would in any event be largely a matter of judgment.

45 109. In a case such as the present where the capital expenditure to which the preliminaries relate involves a multiplicity of items many of them relatively small we consider that a pro-rata apportionment is in principle reasonable and is justified as being in accordance with generally accepted accounting practice. It is clear that a detailed exercise such as that carried out by Mr Phillippo for comparison purposes

would take an inordinate amount of time. There was no indication that the Revenue have visited any of the sites apart from the Prince of Wales and the First Post, apart possibly from one airport site. It is already 8 years after the end of the year in question and a detailed allocation of all items on all sites would be likely to take years rather than months. We do not consider that this would be proportionate or reasonable.

110. Mr Baldry said in closing (p.166) that it would not be necessary for this kind of dispute to go into the length of detail that Mr Phillippo did because models could be arranged to produce a proxy of the right answer. However such model would have to be based on evidence and no model was produced. He did not suggest that in the absence of such model it would not be necessary to go into such detail.

111. We do not consider that it can have been the intention of Parliament that if a taxpayer is to be entitled to include preliminaries in capital expenditure claimed it should be necessary to enter into a detailed assessment in order to allocate the preliminaries.

112. No submissions were made by counsel contending that the approach to professional fees should differ from that for general project overheads.

Summary

113. We summarise our conclusions as follows.

114. The decorative panelling in the Prince of Wales which we have taken as an example of embellishment does not qualify as plant because it is more appropriately described as having become part of the premises than as having retained a separate identity.

115. The kitchen tiles did not have a sufficient nexus with the installation of equipment such as cookers to be incidental thereto for section 66. The partitions and doors to toilets and cubicles did however have sufficient nexus with the installation of the toilets. The drainage items listed at paragraph 80 either fell within column 2 of Schedule AA1 as being a trade specific sewerage system or were incidental alterations within section 66.

116. The expression “preliminaries” is not precise. In so far as items claimed as preliminaries can be properly attributed to or apportioned to a measured item they are part of the cost of such item. There is no basis in law for excluding preliminaries from the cost of section 66 expenditure. All of the items listed at paragraph 36 were project overheads to be measured rateably over all the measured work. The allocation of preliminaries should be as accurate as reasonably possible. The extent of attribution or allocation required instead of global apportionment depends on what is reasonable and proportionate, depending on the amount of money involved and the work necessary for a detailed exercise. Where as here there is a multiplicity of items many of them relatively small a pro-rata apportionment is reasonable in principle.

117. This decision only covers capital allowances on two sample premises and only considers some of the large number of items claimed in respect of those premises. A full consideration of all items in those premises is not possible because we do not have sufficient material. We have only been able to give a decision in principle on the main issues. We adjourn the appeal for the parties to consider whether the outstanding matters can be disposed of by agreement.

118. It is now over 8 years since the expenditure in dispute was incurred and several months since the site visit. We direct the parties to notify us if there are any issues in relation to the sample premises which are not agreed within 4 months so that the matter can be relisted if necessary. We allow a further year for issues arising out of the application of this decision to the other premises to be agreed.

THEODORE WALLACE

JOHN WALTERS

SPECIAL COMMISSIONERS

RELEASED: 21 December 2007