

JD Wetherspoon plc v HMRC

The decision in *JD Wetherspoon plc v HMRC* SpC 657, which was published just before Christmas, related to an appeal in connection with the tax return for the company's accounting year to 31 July 1999. It is surprising that such a fundamental issue as the scope of the term 'plant' in such a commonplace context should be so unclear as to give rise to an uncertainty which was yet to be resolved eight or nine years after the incurring of the expenditure concerned. Nor, one suspects, is it yet resolved, for the decision is a questionable one, probably leaving both parties discontented and in all likelihood heading for the Courts.

It would be unfair, however, to criticise the Commissioners too harshly, as it seems that there were just too many individual areas of dispute referred to them. The taxpayer and HMRC failed to agree on the treatment of more than 120 items of expenditure, and the Commissioners acknowledged that 'the case involved a mass of detail most of which was not covered in the time which the parties had agreed for the hearing'.

The decision focused on sample pub premises in Cardiff (converted from a theatre) and Cosham (converted from two high street shops). The Commissioners decided to address points of principle, using only a small number of disputed items as examples to illustrate their reasoning. They addressed three issues:

- whether expenditure on certain assets was properly regarded as expenditure on plant and machinery;
- the meaning and scope of CAA 1990, s 66 (now CAA 2001, s 25), dealing with expenditure on building alterations incidental to the installation of plant and machinery; and
- whether and how the project 'on costs' of preliminaries and professional fees could be allocated to the cost of plant and machinery.

PLANT OR PREMISES?

The first issue boiled down to a reconsideration of the 'premises test'. The Commissioners took just one asset of

Martin Wilson of The Capital Allowances Partnership LLP provides us with his analysis of the Special Commissioner's decision in JD Wetherspoon plc v HMRC

the many in dispute and sought to use it to illustrate the impact of applying general principles. In the circumstances, this was the only practical approach. The asset they chose to consider was wood panelling fixed to the walls and used by the taxpayer to create a richer and more inviting atmosphere than traditional painted walls; or to put it in terms of the celebrated case *IRC v Scottish & Newcastle Breweries Ltd* [1992] STC 296, to create an 'ambience'. In that case, it was claimed that one element of the company's trade was the provision of a certain type of atmosphere, or ambience, conducive to attracting custom. This argument proved attractive to the courts and consequently allowances

Newcastle, it is accepted that hospitality premises are an exceptional case.

- Secondly, they failed to consider fully how higher courts have expanded Lord Lowry's interpretation of the term 'premises'.

Thus in *Wimpy International Ltd v Warland* [1989] STC 273 (the first port of call for any discussion of the meaning of 'premises') Glidewell LJ commented:

'when Lord Lowry referred to "something which becomes part of the premises", he cannot have meant simply something which is affixed to the premises. He must have been expressing in other words the point made by Oliver LJ in *Cole*

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were given in respect of fixed items used to create this 'ambience', such as decor, murals and sculptures.

The Commissioners in *JD Wetherspoon* referred to this case and accepted 'that the panelling was an embellishment to create ambience', but then, in my opinion, made two mistakes.

- Firstly, they did not adequately consider whether the panelling could be *both* premises and plant – although they acknowledged Lord Lowry's comment in *Scottish & Newcastle* that an asset could be both plant *and* premises in exceptional cases, they merely concluded 'This, of course, is not one of those cases'. This conclusion was ill-considered – following *Scottish &*

Brothers v Phillips about something which "performs *simply and solely* the function of housing the business"?

So, having accepted that the panelling did not *simply and solely* perform the function of housing the business (because it created ambience), the Commissioners were bound to accept the decision of the higher courts and find that the panelling was not premises and therefore not barred from being plant. This they did not do, and thus appear to have erred in point of law.

Key factors

The Commissioners recognised, following Mr Justice Hoffmann in *Wimpy v Warland* [1988] STC 149, that the key issue was

whether it was 'more appropriate' to regard the panels as part of the premises, rather than having retained a separate identity. However, their decision was flawed at the outset by their failure to consider what was meant by the term 'premises', as discussed above.

They ran through the four factors (not absolute hurdles) set out by Mr Justice Hoffmann, as follows:

- whether the disputed 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 it was intended to be permanent or whether it was likely to be replaced within a relatively short period.

The Commissioners' individual decisions were as follow:

- the panelling 'did appear visually to retain a separate identity';
- the panelling was 'clearly capable of being removed; indeed similar panelling had been removed ... and reused. There is no reason to believe that removal ... would cause more than surface damage to the plaster';
- 'The structure of the rooms was clearly not incomplete without the panelling' (that is, the structure was complete without the panelling); and
- 'The panelling was not likely to be removed after only a short period'.

Let us consider these conclusions. The first three point to the panelling being plant, rather than premises. So even at that point it would seem 'more appropriate' on balance to regard the panelling as having retained a separate identity, rather than as being part of the premises, following Mr Justice Hoffmann's principles.

The fourth finding seems to be based on surmisal rather than evidence (at least, none is referred to in the published decision) and is in any case a misunderstanding of what Mr Justice Hoffman's fourth consideration intended. It has never been considered that an asset failed to be regarded as plant simply because it had a relatively lengthy period of use. Case law has always been clear on the point. Indeed the *locus classicus* for plant, *Yarmouth v France*, spoke of plant including 'whatever apparatus is used by a businessman for carrying on his business ... which he keeps for permanent employment in his business'.

By way of illustration, the dry dock in *CIR v Barclay Curle & Co Ltd* was held to be plant despite the fact that it was agreed it might last for 80 to 100 years. Against this background the most logical

interpretation of Mr Justice Hoffman's fourth consideration is that it aimed simply to suggest that a relatively short period of use would indicate that an asset has *prima facie* not become part of the premises.

An alternative test

The Hoffman 'tests' clearly point to the panelling *not* being part of the premises. And yet the Commissioners appear to have erred in law by ignoring this result and substituting a new test of their own. This appears only in the Commissioners' published decision. It was not put forward by the taxpayer or HMRC and had not been debated.

This test was whether the panels were 'an unexceptional component which would not be an unusual feature of premises of [this] type'. In other words, it is apparently not unusual to find wall panelling in pubs, so they must be part of the premises.

This 'test' seems wholly inappropriate. Among other fixed assets which are 'unexceptional components which would not be an unusual feature of premises of [this] type' would be heating systems and sanitary ware, not to mention bar counters, and carpets – by this test, they would all be part of the premises. The same would apply to a lift in an office building. And yet they are all accepted as plant; indeed proposed changes to the Capital Allowances Act from April will put this on a statutory basis for assets such as electrics, central heating and lifts.

Put another way, the test is proposed as embodying a general principle to be applied to a range of assets but when applied to many common assets gives results which are unequivocally wrong. One assumes an appeal is pending.

ALTERATIONS INCIDENTAL TO THE INSTALLATION OF PLANT AND MACHINERY

The second matter under consideration related to building alterations 'incidental to the installation of plant and machinery'. Both in its present form and under earlier Acts this phrase has been open to differing interpretations. The narrow definition (argued by HMRC) is that the alterations must be incidental to the physical act of installation; the wider definition is that they must merely be consequential, or related to that installation.

Intention of legislation

This provision was introduced in the Income Tax Act 1945 and the *Hansard* debate from the time makes clear that it was aimed at works such as modernising

hotels, which required the installation of hot and cold water, bathrooms, lifts, and air-conditioning, etc. The provision was intended to allow incidental works to qualify, such as partitioning larger rooms to install bathrooms, or fitting double-glazed windows to make air-conditioning effective. The intention was therefore for the legislation to apply quite widely.

In *Barclay Curle* Lord Reid said in the House of Lords when considering ICTA 1952, s 300 (a predecessor to CAA 1990, s 66 and CAA 2001, s 25) "Incidental" is a wider word than necessary ... 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 of plant may serve its proper purpose. Where that is the case this section enables the cost of the additional alterations to be included.'

Application in this case

The Commissioners took the example of wipe-clean wall tiling in a kitchen, which the taxpayer argued was required due to the volume of steam, etc, produced by cookers, but which the Commissioners held did not have a sufficient *nexus* with the installation of those cookers. A cooker could be used perfectly well ('serve its proper purpose', in the words of Lord Reid) without the tiling.

The other assets considered were drainage (which was held to be obviously plant due to the substantial capacity required – just like the cold water tanks and pipework in *Wimpy*) and toilet cubicles. It has long been a source of amazement and indeed humour that HMRC believed surrounding partitions or cubicles were not needed in order for toilets to serve their proper purpose – there are stories, probably apocryphal, of clients plying inspectors with tea, then seeing how keen they were to use an 'open plan' toilet! The Commissioners on this occasion found that the erection of cubicles was incidental to the installation of plant. It is perhaps a matter of degree – without tiles in the kitchen, the cookers could still have been used, whereas without cubicles, the toilets would probably have been left untouched. It is not wholly clear, however, that the precepts of *Barclay Curle* regarding the 'exigencies of the trade', and the guidance of *Hansard*, have been followed, and this remains a grey area.

PRELIMINARIES AND PROFESSIONAL FEES

HMRC's Valuation Office has for many years sought to arbitrarily disallow a

proportion (typically 50%) of preliminaries (for example, site management, security or plant hire) and professional fees, before any allocation to the constituent parts of a project, including plant – the so-called ‘Newstead formula’. Such an approach has had no basis in law and has generally been disputed by taxpayers, and a compromise reached.

The Commissioners recommended an eminently sensible approach. Insofar as items claimed as preliminaries or fees can be properly attributed to or apportioned to a qualifying or non-qualifying item, they are part of the cost of that item. Any allocation should be as accurate as possible, but where (as in *JD Wetherspoon*) there is a multiplicity of items, a *pro-rata* apportionment is reasonable in principle.

SUMMARY

The question of expenditure ‘incidental to the installation of plant’ was decided largely, but not entirely, in favour of HMRC. Nonetheless, many advisers will have sympathy with the approach outlined, which is to allow the expenditure only where the relationship between the expenditure and the installation of plant is

sufficiently close. The problem is that this is a question of degree, and consequently a large grey area remains. It is to be hoped that any appeal would consider more fully the original intention and scope of the legislation, as shown by *Hansard*.

On preliminaries, the decision will be a blow to HMRC. Again, however, the decision appears sensible, and one would hope it marks the end of HMRC seeking to arbitrarily disallow a proportion of such costs.

The Commissioners are to be applauded for the way they dealt with the matters above. However, on the remaining question, essentially a consideration of the ‘premises test’, it is hard to conclude other than that they appear to have come to a wrong decision as a result of erring in law.

This was in part due to not attaching sufficient importance to a key comment in *Wimpy* that ‘when Lord Lowry referred to “something which becomes part of the premises”, he ... must have been expressing in other words the point made by Oliver LJ in *Cole Brothers v Phillips* about something which “performs *simply and solely* the function of housing the business”.’

The resultant misunderstanding of the term ‘premises’ meant that the Commissioners’ deliberations were inherently flawed. Having answered the appropriate questions from case law (which, in this case, clearly suggested that wood panelling was plant), they ignored those answers and substituted instead a wholly inappropriate test of their own, one which when applied to other assets gives answers which are not only unexpected but which are at variance with statute.

One has every sympathy for the Commissioners, who appear to have been given wholly inadequate time for dealing with such complex issues. Nonetheless, this part of the decision, which of course does not form binding precedent and is merely persuasive, seemingly fails to apply House of Lords and Court of Appeal decisions and is therefore unlikely to carry much weight.

Neither party will have been wholly satisfied with the decision and one suspects an appeal (or two) may be made.

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