Building savings

Large Corporate OMB

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William Sweeney and Natasha Spicer ask whether you are claiming enough tax relief on your construction costs

Key Points

What is the issue?

Plant and machinery expenditure attracts the Annual Investment Allowance (currently £1m a year) and an 18% writing down allowance for expenditure over this limit.

What does it mean for me?

In practice, it is not always clear whether an item will qualify as plant, as the legislation does not specifically define the term but merely states that buildings and structures are not plant or machinery.

What can I take away?

It is important to analyse any costs of construction by paying particular att enti on to CAA 2001 s 21 to 23. There may be fewer items disqualified than you would expect, which could provide valuable tax relief.

The recent introduction of the Structures and Buildings Allowance (SBA) has focused considerable attention on the neglected area of buildings and structures. The promise of an annual 2% tax relief on construction expenditure was an attractive prospect to companies carrying out such work.
Regrettably, many advisers have noted that all does not shine as brightly as it might with SBAs, even at the increased 3% rate expected from April. It may therefore be in a client's interest to identify whether all or part of their building or structure qualifies for capital allowances by other means.

On the surface, expenditure on buildings, structures, assets and land works will not be regarded as plant or machinery and so won't qualify for capital allowances. In truth, however, the rules are considerably more nuanced. With plant and machinery expenditure attracting the generous Annual Investment Allowance (currently £1m per annum) and an 18% writing down allowance for expenditure over this limit, significant savings may be realised by ensuring you understand what may be claimed.

Plant vs premises: does the expenditure qualify as plant?

The first question to ask is whether the building or structure should be regarded as the 'provision of plant or machinery wholly or partly for the purposes of the qualifying activity' (Capital Allowances Act (CAA) 2001 s 11), the prerequisite for claiming plant and machinery allowances.

In practice, it is not always clear whether an item will qualify as plant, as the legislation does not specifically define the term but merely states that buildings and structures are not plant or machinery (CAA 2001 ss 21 and 22). For this, we must refer back to case law.

In Yarmouth v France (1887) 19 QDB 647, plant was held to include 'whatever apparatus is used by a businessman for carrying on his business – not his stock in trade, which he buys or makes for sale – but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business'.

In J Lyons [1944] CH 281, the principle of ‘setting vs function’ emerged, with the court ruling that ‘a distinction has to be drawn between property which is part of the setting in which the business is carried on (in which case it is not plant) or as part of the apparatus used for carrying on the business’.

These two cases have formed the basis for many subsequent judgments, codifying the requirement for an enduring benefit (taken to be two years) and use in the activities of the business. Setting vs function may prove contradictory where the setting has a function (Fitch’s Garage [1975] STC 480)). This was clarified by Jarrold v John Good [1963] 40 TC 681, which ruled that plant and setting are not mutually exclusive, but the reasons for the expenditure can determine if it is more than mere setting.

This was elaborated by Wimpy International Ltd v Warland [1987] BTC 591, which created three tests to distinguish the nature of assets:

- Is the item stock in trade?
- Is the item the business premises or part of the premises?
- Is the item used for carrying on the business?

While the latter is broadly the same as the ‘function test’, HMRC considers passing this to be insufficient on its own. If an item is permanently attached to the premises, such that it is unlikely to be replaced or moved in the short term, and the premises would not appear complete without it, then it will not be plant.

To forestall this question, Anduff Car Wash [1997] EWCA Civ 2128 attempted to claim that an entire building containing plant for car washing was plant. The Court of Appeal disagreed, finding that a ‘piecemeal approach’ was more appropriate. This approach is the default position and is preferred by HMRC.

Finally, certain specific items, such as integral features (CAA 2001 s 33A) are automatically regarded as plant or machinery. This article does not, however, go into any more detail on this topic.

Having established that an item is plant (or machinery), one can consider capital allowances. The next question is whether the expenditure would be disqualified by CAA 2001 ss 21 to 23.

Buildings

Expenditure on plant does not include buildings. For this purpose, ‘building’ includes any item that is incorporated into the building, inside the building and of a type that is normally incorporated; or an item that is in or connected with the building and is within the categories of asset in List A in CAA 2001 s 21. These include, but are not limited to:

- walls, floors, ceilings, doors, gates, shutters, windows and stairs; and
- mains services and systems for water, electricity and gas.

Expenditure on these items will be disqualified from claiming capital allowances unless saved by s 23, which includes categories such as integral features.

Structures

CAA 2001 s 22 states that expenditure on the provision of plant or machinery does not include expenditure on:

a) the provision of a structure or other asset in List B; and

b) any works involving the alteration of land.

List B includes expenditure on:

1. tunnels, bridges, viaducts, aqueducts, etc.;
2. pavements, roads, railways, etc.;
3. canals, basins, rivers;
4. dams, reservoir or barrages;
5. docks, harbours, wharfs, etc.;
6. dikes, sea walls, weirs or drainage ditches; and
7. any structure not within items 1 to 6, except for structures within the meaning of 'industrial buildings' and those in use for industries including gas extraction and distribution, telecom

As with those items of expenditure in List A, these will not qualify as plant unless included within the exceptions in s 23 and so no allowances would be available.

The Upper Tribunal recently ruled in SSE Generation that ss 22 (1)(a) and 22(1)(b) are mutually exclusive, such that any structures or assets dealt with under List B may not also be considered under s 22(1)(b) even if their construction involves the alteration of land. The logical conclusion of this line of reasoning is that works involving the alteration of land may only be taken to consider works whose primary objective is the alteration of that land, rather than the incidental result of any other construction.

Expenditure unaffected by the above exclusions

The exclusions in ss 21 and 22 do not apply to certain items for which plant and machinery allowances are provided by specific provisions (CAA 2001 s 23(2)). These include integral features and thermal insulation of buildings.

In addition, s 23(4) contains List C, a comprehensive list of items drawn from historical case law to which the above exclusions do not apply. Note that inclusion on this list is not a guarantee that an item of that type will qualify for capital allowances, merely that it will not be disqualified by ss 21 and 22. Thus, it remains of primary importance to establish whether a building or structure should be treated as plant.

Examples of expenditure in List C include:

- cookers, washing machines, dishwashers, refrigerators and similar equipment;
- washbasins, sinks, baths, showers, sanitary ware and similar equipment;
- furniture and furnishings;
- partition walls, where movable and intended to be moved in the course of the qualifying activity; and
- advertising hoardings, signs, display and similar assets.

As mentioned, the list is long and covers many specific types of expenditure. Of particular interest in many cases is 'the alteration of land for the purpose only of installing plant or machinery' (List C item 22). For claims made before 29 October 2018, this enabled capital allowances to be claimed regardless of whether the plant was excluded by Lists A or B. References in List C to plant have now been changed to exclude any expenditure disqualified by ss 21 and 22 but the scope of this item remains broad.

The case of SSE Generation

SSE Generation undertook a £300m hydroelectric power generation project in Scotland. The company claimed capital allowances on £260m; however, while not disputing that that the expenditure was plant HMRC accepted only £34m of this claim, stating that the majority of costs were not allowed under CAA 2001 ss 21 and 22.

As would be expected with a project of this nature, a large portion of the work related to civil engineering works which were necessary to adjust the landscape and allow the water to be routed to and from the turbine and generation equipment.

Initially, in HMRC v SSE Generation [2018] UKFTT 416, the FTT ruled that while there was little question that the pipes were plant, much of the remaining expenditure fell under List B item 1. Where this case was remarkable, however, was that the judge stretched the definition of ‘install’ in List C item 22 to include manufacture or assembly onsite, so that the alteration of land involved in the creation of an item of plant may be regarded as having been done for the purpose of installing the plant.

Unsurprisingly, HMRC appealed and the Upper Tribunal did not support this construction. However, in an interesting twist, it reviewed List B item 1 and decided on a far narrower interpretation of tunnel and aqueduct, which excluded the underground water conduits and structures. All of the works were therefore considered under item 7, where they were excluded as the definition of industrial buildings includes those for carrying on a trade of electrical generation. Hence, none of the appealed expenditure was disqualified under s 22 and was held to be allowable.

Although no longer required, the Upper Tribunal also clarified that installation means the setting in place of an item rather than its creation in situ.

Summary

In summary, it is important to analyse out any costs of construction by paying particular attention to CAA 2001 ss 21 to 23. There may be fewer items disqualified than you would expect, which could provide valuable tax relief, particularly when you take into account the £1m Annual Investment Allowance that will be in place until 31 December 2020.

The case of SSE Generation is significant as it demonstrates the potential value of ‘alterations of land’ and provides further clarity on its scope. This could have application where we carry out capital allowance analyses and see costs such as ‘ground works’, etc. In this case, it could well be worth ‘digging’ deeper to see if this involves a structure relating to plant.