CHAPTER 9
CAPITAL ALLOWANCES – DEFINITIONS

In this chapter you will cover the rules for determining whether plant and machinery qualifies for capital allowances – the tax deduction available instead of depreciation. You will learn about:
- the definition of “plant and machinery”;
- exclusions for buildings and structures;
- qualifying expenditure within s.23 et seq CAA 2001;
- integral features.

9.1 Introduction

When a trader incurs expenditure of a capital nature, such costs are not deductible from trading profits because the expenditure will have an “enduring benefit” for the trade.

No deduction is usually available for the depreciation of capital assets.

Instead, where businesses employ capital assets for use in their business (for example machinery, motor vehicles etc) they receive a measure of relief in the form of “capital allowances”. Capital allowances compensate a business for the fall in value of capital assets used in the trade. Essentially capital allowances are a form of tax-approved depreciation.

Relief is given by treating the capital allowances as an expense to be deducted when arriving at the taxable trading profits for the accounting period.

Year ended 31 December 2015:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax adjusted profit before capital allowances</td>
<td>X</td>
</tr>
<tr>
<td>Less: Capital allowances</td>
<td>(X)</td>
</tr>
<tr>
<td>Taxable trading profit</td>
<td>X</td>
</tr>
</tbody>
</table>

Assuming that the trader has a year-end of (say) 31 December 2015, capital allowances are given for the accounting period to arrive at the taxable profit for the year ended 31 December 2015. These profits will then be taxed in 2015/16 under the current year basis.

Capital allowances are given at specific rates as laid down in the Capital Allowances Act 2001. The rates of relief depend on:

1. the type of capital expenditure incurred; and
2. the date the costs are incurred.

Capital allowances are given when a business incurs expenditure on plant and machinery.
9.2 Definition of “Plant and Machinery”

Before we look at how we calculate capital allowances, we first need to look at the definition of “plant and machinery”.

The definition of plant and machinery is found in the Capital Allowances Act 2001 (CAA 2001). There is also a significant body of case law discussing what is and what is not “plant”. CAA 2001, s.21–33A

Yarmouth v France (1887) defines “plant” as:

“…. 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 moveable, live or dead, which he keeps for permanent employment in the business.”

HMRC practice is to treat an asset that has an expected life of two years or more to be for “permanent employment” and to therefore be sufficiently durable to qualify as plant. If an asset has a useful life of less than one year, the costs will be directly deductible as allowable business expenses. Where the asset has an expected useful life of between one and two years the treatment of the asset is subjective and we must look at the specific facts of the case to determine if it is plant or a revenue expense.

The quotation also made it clear that the business premises are not plant because they are not “goods or chattels” employed in carrying on the business. Rather, they are the place or setting in which the business is conducted.

The test of whether an item is apparatus used in carrying on a business is the “functionality test”.

If the asset has a function, it will be plant and capital allowances can be claimed. However, if expenditure has been incurred by the trader on part of the setting within which he runs his business, it will not be plant and no allowances can be claimed. This was established in the case of J Lyons & Co v Attorney General (1944) where it was held that electrical lighting in a tearoom was part of the ‘general setting’ in which the business was carried on, and has been revisited many times by the Courts in deciding what is or is not “plant”.

Over the years, hundreds of cases have gone through the Courts to determine whether expenditure does or does not qualify as “plant” for the purposes of calculating capital allowances.

In 2001, HMRC consolidated the capital allowances legislation in a new Capital Allowances Act (CAA 2001). Within CAA 2001, HMRC took the opportunity to give statutory authority to some of the precedents previously established by case law. Therefore, for the first time, CAA 2001 attempted to define more precisely what is meant by plant and to differentiate between “qualifying” and “non-qualifying” expenditure.

The relevant legislation can be found at s.21 to s.38 CAA 2001.

9.3 Buildings – Section 21 CAA 2001

Buildings are part of the “setting” in which the business is carried on and will not qualify as “plant”. CAA 2001, s.21
List A in s.21 provides further clarification as to items included within the term “building”, specifically detailing the following:

1. Walls, floors, ceilings, doors, gates, shutters, windows, stairs.
2. Mains services and systems for water, electricity and gas.
3. Waste disposal systems.
4. Sewerage and drainage systems.
5. Shafts or other similar structures.
6. Fire safety systems.

Therefore expenditure on these particular items (unless later overwritten by List C in s.23), would be regarded as expenditure on “buildings” and therefore would not qualify as “plant”.

9.4 Structures and Land – Section 22 CAA 2001

Under s.22 plant and machinery does not include expenditure on the following:

CAA 2001, s.22

a. The provision of a structure or other asset in List B; or
b. Any works involving the alteration of land.

List B contains the following:

1. Tunnel, bridge, viaduct etc.
2. Pavement, road, car park.
3. Canal or basin.
4. Dam, reservoirs etc.
5. Docks, harbours, wharfs.
6. Dikes and sea walls.

Therefore expenditure on these particular items (unless later overwritten by List C in s.23), would not qualify as “plant”.

9.5 Override – Section 23 CAA 2001

S.23 tells us that that s.21 and s.22 do not apply to the following:

CAA 2001, s.23

a. Thermal insulation of buildings.
b. Personal security.
c. Integral features.
d. Software and rights to software.
e. “List C" items.

Therefore expenditure on any of the items above will be treated as expenditure on “plant” and will qualify for capital allowances.

List C is a long list of specific items, most of which have been derived from case law. Therefore we no longer need to refer to as much case law as case precedents have now been incorporated into the Capital Allowances Act. The Capital Allowances Act is very comprehensive and is a great help in determining whether a particular item is plant or not.

List C comprises 33 items. Here are some of the more common ones you may come across in practice:

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>13</td>
<td>“Partition walls where moveable and intended to be moved in the course of the qualifying activity”. Walls are part of the building and do not qualify as plant. However in the case of <em>Jarrold v John Good &amp; Sons</em>, the Court found that moveable partitions were “apparatus with which the company carried on its business” and hence qualified as plant. This decision has now been incorporated into s.23.</td>
</tr>
<tr>
<td>14</td>
<td>“Decorative assets provided for the enjoyment of the public in hotel, restaurant or similar trades”. In <em>CIR v Scottish &amp; Newcastle Breweries Ltd</em>, the company spent money on decorative items such as wall plaques, tapestries, murals, prints and sculptures within their pubs and restaurants. It claimed plant &amp; machinery allowances. The Court agreed with the company and allowed capital allowances to be claimed on the grounds that the expenditure went to create “atmosphere or ambience” and this was an important function of the company’s particular trade. This decision has again been incorporated into s.23.</td>
</tr>
<tr>
<td>16</td>
<td>“Swimming pools” (including diving boards, slides etc). In <em>Cooke v Beach Station Caravans Ltd</em>, a company operated a caravan park and claimed capital allowances on the construction costs of two swimming pools. HMRC denied the claim on the basis that the swimming pools were part of the setting. However the Court found in favour of the taxpayer and said that the pools were “part of the means whereby the trade is carried on, and not merely the place in which it is carried on”. Swimming pools have now been added as “plant” in List C.</td>
</tr>
</tbody>
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This is by no means a definitive list and only covers a handful of the types of expenditure listed in List C.
9.6 Plant and Machinery – Other Qualifying Expenditure

Expenditure on the following will also be “plant & machinery” qualifying for capital allowances:

- Altering a building for the purposes of installing plant & machinery: CAA 2001, s.25
  
  This means that if (say) a new floor has to be laid or strengthened in order to house some plant and machinery, the costs of laying the floor will qualify for capital allowances.

- Demolition costs (eg costs of removing / demolishing plant & machinery): CAA 2001, s.26

- Thermal insulation of buildings. CAA 2001, s.28

9.7 Plant and Machinery Used for Business Entertainment

Capital allowances are not given on plant and machinery used for business entertainment. “Hospitality of any kind” counts as business entertainment. CAA 2001, s.269

Plant and machinery provided by a business for its employees and directors does not count as provided for business entertainment. Capital allowances will therefore be available in this instance.

9.8 Integral Features

Finance Act 2008 introduced rules regarding “integral features”. Where an item is classified as an “integral feature” to a building, the expense will qualify for plant and machinery allowances. “Integral features” now include: CAA 2001, s.33A

- Lifts, escalators & moving walkways;
- Space heating systems;
- Air-conditioning and air cooling systems;
- Hot & cold water systems (excluding toilet & kitchen facilities);
- Electric lighting and power systems;
- External solar shading.

We will look at these rules in more detail in a later chapter.

9.9 Recent Case Law – J D Wetherspoon

Notwithstanding the detail in sections 21-23 CAA 2001 there can still be dispute between taxpayers and HMRC on the definition of plant versus setting or premises.
The recent case of JD Wetherspoon plc v Revenue and Customs Commissioners (2012) has given further guidance and practical advice from the courts in 3 key areas:

- Whether certain decorative items including panelling were plant or premises
- The extent to which building alterations were incidental to plant installation and so treated as expenditure on plant and machinery.
- The apportionment of preliminary costs between plant and buildings

The case involved a review of the capital allowances claim JD Wetherspoon made in respect of two sample public houses.

It was held that decorative panelling was part of the premises, merely turning an unpannelled room into a panelled room and was an unexceptional component of the type of premises. The panelling had become part of the premises and had not retained a separate identity. This is in contrast to CIR v Scottish & Newcastle Breweries Ltd where decorative items such as wall plaques, tapestries, murals etc within their pubs were held to be plant rather than part of the premises.

With regard to building alterations incidental to the provision of plant and machinery which are treated as plant under s.25 CAA 2001, it was held that broadly speaking if the work would be required in a new building then it would not be plant and only expenditure needed as a result of plant being installed into an existing building would qualify. For example, kitchen tiling and plastering to meet health and safety requirements would not qualify as plant, but strengthening the kitchen floor to take the weight of commercial cookers etc would. In the cold store, alterations to the floor for drainage were allowed as plant whereas block work walls and floor and wall tiling in the toilet areas was not.

The third issue related to the apportionment of preliminaries such as scaffolding, photography of work in progress, etc. HMRC have always contended that a prorating of all preliminaries, and also professional fees, between plant and premises overstates the qualifying expenditure as the majority of costs relate to the building. Studies have shown this is not always the case, but the time and costs in analysing the expenditure may make a detailed analysis impractical. The Tribunal stated that if preliminaries or fees, without too much extra analysis, can be properly attributed or apportioned to an item of measured work then they are part of that item's cost. Otherwise, a pro-rata apportionment offers a fair and pragmatic alternative.

9.10 Other Relevant Case Law

Over the years hundreds of cases have gone through the courts to determine whether an item qualifies as plant for capital allowance purposes. We have summarised below additional relevant cases not covered earlier in this chapter.

**Dixon v Fitch's Garage Ltd (1975)**

The taxpayer company ran a garage and petrol filling station. In 1971 it changed over to self-service pumps to meet competition from a nearby garage. The changeover included the construction of a metal canopy tailored to the company's requirements and designed to protect pumps, customers and employees from the effect of the weather. In addition, strip lighting was fixed to the canopy and this provided illumination for the whole pump area. The taxpayer
claimed that the canopy was plant on the grounds that it formed part of the apparatus for delivering petrol.

**Held**

The canopy was not plant qualifying for capital allowances. It did not help with the delivery of petrol but, by providing shelter and illumination, merely made its supply more comfortable for the staff of the petrol station and for motorists. Accordingly, the canopy could not be regarded as part of the apparatus by which petrol was supplied and, therefore, did not perform a function in carrying on the trade.

**Benson v Yard Arm Club (1979)**

The taxpayer company carried on a restaurant business. In 1962 it incurred expenditure on acquiring and converting an old ship and barge for use as a floating restaurant. The company claimed it was entitled to capital allowances in relation to that expenditure, on the grounds that the ship and barge were essential apparatus for carrying on a floating restaurant business and should, therefore, be treated as plant. The ship and barge were subject to movement by the tide and waves and this, according to the taxpayer, enhanced the atmosphere within the restaurant.

**Held**

The ship and barge were not plant. They merely provided the structure within which the business was carried on and were not part of the apparatus employed in the commercial activities of the business. The facts that the ship and barge were chattels and were not attached to the rail were held not to be relevant.

**Hampton v Fortes Autogrill Ltd (1980)**

A firm of caterers installed false ceilings in the parts of its premises which were open to the public. The ceilings were a permanent fixture and they provided support for pipes, electrical conduits, lighting apparatus, ventilation trunking, etc, which related to the services used by the company for carrying on its trade. HMRC refused a claim for capital allowances on the grounds that the ceilings were not plant.

**Held**

The ceilings were not plant. The ceilings acted as a covering and, therefore, provided the setting in which the trade was carried on. They were not necessary for the functioning of any apparatus and did not perform a function in the carrying on of the trade.

**Wimpy International Ltd v Warland (1989)**

A chain of fast food restaurants was refitted with removable items (such as pictures, carpets, screens, etc) and fixed items (such as staircases, raised ceilings and floors, shop fronts, tiling, etc). The items were installed to provide ambience and attract customers to enable profits rather than losses to be generated.

**Held**

The fixed items were not plant, whereas the removable items were. The fixed items formed part of the premises in which the trade was carried on, and were not items with which the trade was carried on.
EXAMPLES

Example 1

Which of the following types of expenditure qualifies as plant?

a. Decorative tapestries in a hotel
b. Ship used as a floating restaurant
c. Advertising hoardings
d. Suspended ceiling over a stairwell
e. Suspended ceiling over eating area
f. “Cold-room” in a restaurant kitchen to keep food cool before cooking
g. Shutters on shop windows to prevent break-ins
ANSWERS

✓ Answer 1

<table>
<thead>
<tr>
<th></th>
<th>Plant</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Decorative tapestries in a hotel</td>
<td>Y</td>
</tr>
<tr>
<td>b. Ship used as a floating restaurant</td>
<td>N</td>
</tr>
<tr>
<td>c. Advertising hoardings</td>
<td>Y</td>
</tr>
<tr>
<td>d. Suspended ceiling over a stairwell</td>
<td>N</td>
</tr>
<tr>
<td>e. Suspended ceiling over eating area</td>
<td>Y</td>
</tr>
<tr>
<td>f. “Cold-room” in a restaurant kitchen to keep food cool before cooking</td>
<td>Y</td>
</tr>
<tr>
<td>g. Shutters on shop windows to prevent break-ins</td>
<td>N</td>
</tr>
</tbody>
</table>

**Tutorial Notes:**

a. Decorative tapestries in a hotel are regarded as plant. In List C item 14, decorative assets provided for the enjoyment of the public in a hotel, restaurant or similar trade will be treated as plant. This was established in the case of CIR v Scottish & Newcastle Breweries Ltd where tapestries and murals fitted to the walls of pubs and hotels created an “ambience and atmosphere” with which to attract customers. Therefore such expenditure had a function rather than being part of the setting.

b. A ship used as a floating restaurant was not regarded as having a function, it was actually the setting in which the trade was carried on (Benson v Yard Arm Club Limited (1979)).

c. Advertising hoardings are specifically within List C, item number 15. Therefore they qualify as plant.

d. A suspended ceiling over a stairwell is not regarded as plant. It does not fulfil a function, but instead is merely part of the setting. Hampton v Fortes Autogrill Ltd (1980).

e. A suspended ceiling over an eating area however could be regarded as plant as it fulfils a function in the trade creating a general atmosphere. Exposed wiring over an eating area is not attractive for customers!

f. Cold-stores can be found at List C, item number 18. Therefore they qualify as plant.

g. Shutters are part of a building under List A Item 1. They will not qualify as plant.