



TC02734

Appeal number: TC/2012/04653

Corporation Tax – deduction of expenditure – whether expenditure revenue or capital- revenue – whether scheme of works – no – whether relevant asset an entirety – yes – appeal allowed.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

HOPEGAR PROPERTIES LIMITED

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE & CUSTOMS**

Respondents

TRIBUNAL: DR K KHAN

Sitting in public at Bedford Square, London on 31 January 2013

Laurent Sykes, Counsel for the Appellant, instructed by Carpenter Box LLP

Jake Hillier of Local Compliance – Appeals & Reviews for the Respondents

DECISION

Introduction

5 1. The Appeal is against a Closure Notice issued by the Respondents on 15 December 2011 under Paragraph 32F to Schedule 18 of the Finance Act 1998.

2. The Closure Notice amended the Appellant's Corporation Tax return for the accounting period ended 31 August 2008. The effect was to increase the Appellant's profits chargeable to Corporation Tax from £170,789 by £187,203 to £357,992. This
10 resulted in additional tax payable of £58,688.90. Part of the additional profits is an amount of £820 Value Added Tax which was claimed in error by the Appellant in their Corporation Tax return. This addition to profits chargeable to Corporation Tax is not in dispute and the additional tax that results is £257.07.

3. The Statutory Review of the HMRC Decision was undertaken on 9 March 2012
15 which concluded that the assessment was correct subject to a minor adjustment (£187,163 as opposed to £187,203)

Matters at issue

4. The core issue is whether or not the amount of £240,992.60 expended by the
20 Appellant is capital expenditure prohibited by Section 74(1)(f) and Section 74(1)(g) of the Income and Corporation Taxes Act 1988 ("ICTA") from being deducted and calculated in the profits chargeable to Corporation Tax.

Background and Facts

5. The Appellant is a limited liability company, Registration Number 471372 with
25 a registered office at Bankside House, Henfield Road, Small Dole, Henfield, West Sussex BN5 9XQ. Its principal activity is buying, developing, managing and letting of land and buildings. The Directors are members of the Mackley family. For the years 2007 and 2008 the Company's turnover was £1,102,968 and £1,163,702
30 respectively showing a profit in each year.

6. The works in dispute were carried out on land and buildings on the Mackley Industrial Estate in West Sussex ("Industrial Estate"). The works were undertaken by J T Mackley & Co Limited, an affiliated company.

7. On 1 June 2010 pursuant to Paragraph 24(1) Schedule 18 to the Finance Act
35 1998, Mr Iain Stannard, an Inspector of Taxes, wrote to the Appellant to conduct a check on the Company's Tax return for the period ending 31 August 2008. There followed various correspondence between the Respondents and the Appellant's representative and auditors, Carpenter Box LLP, regarding expenditure at the Mackley Industrial Estate. To understand the nature of the works, the Respondents
40 had paid a visit to the site and reviewed various documentation including plans, drawings and leases used to contract with the tenants at the Industrial Estate.

8. The Appellant's representative provided a schedule of works undertaken on the Industrial Estate which was agreed with HMRC. The breakdown is as follows:

(a)	Diversion of BT capital and other fibre-optic cables	£31,469.54
(b)	Main carriageway temporary diversion to allow the road to be broken up	£23,226.88
(c)	Main carriageway re-laying and re-surfacing	£135,141.25
(d)	Re-site main car park and avoid a steep entrance	£26,777.13
(e)	Additional resurfacing, to road outside original scope of works, but which were breaking up	£9,299.40
(f)	Additional resurfacing works to road outside timber sawmills which were breaking up	£27,796.00
(g)	Reinstating footpath to main office and estate	£24,377.80
	Total	£278,088.00

9. The Respondents agreed that two of the items listed above in paragraphs (e) and (f) are revenue items and therefore allowable deductions. The total of these is
5 £37,095.40.

10. The remaining five items of expenditure (items (a) (b) (c) (d) & (g)) totalling £240,992.60 are the disputed amounts. The Respondents submit that they are capital not revenue payments.

10 11. There is an issue relating to tenants' contributions. The tenants at the Industrial Estate contributed amounts to the cost of works totalling £54,649 during the accounting period ending 31 August 2008. This amount has been included in the Appellant's profits chargeable to Corporation Tax on its Corporation Tax return. All adjustments to figures after the decision of the Tribunal would be made by the parties.

The Works in Summary

15 12. The works relate to the main entrance road to the estate, which was built some 40 years previously. It was in need of repair and widening with the increase in traffic to the estate of heavier lorries, transporters and other vehicles, which was substantially in excess of the original weight expectations when the road was built.

20 13. In addition to the main road, the footpaths were beginning to break up. As a result of road damage, there was a risk to under-laid fibre optic cables belonging to British Telecom, and these had to be re-laid. The landlord felt that tenants should contribute to the repairs given the size and budget for the work. The tenants agreed and contribution payments were made over three instalments.

14. As a result of the road widening, there was attendant landscaping required. Trees had to be removed and fencing and railings installed to comply with local authority and safety requirements. The existing car park was re-sited, enlarged and repaired. The total works took approximately 15 weeks to complete. During that time, access to the estate was via a temporary access road, which was constructed for that purpose.

Evidence

15. The Tribunal was provided with a core bundle of documents which included three Witness Statements and a bundle of Authorities. The core bundle included detailed plans of the work undertaken, invoices from contractors and correspondence between the parties. Each party provided a ring-binder of Authorities.

Witness Statements

- (1) John Mackley
- (2) Tony Mackley
- (3) Stephen Kitchener

(1) Witness Statement of John Mackley

16. The Witness Statement of John Mackley together with the Supplemental Witness Statement is dated 19 October 2012 and comprises approximately 28 pages.

17. He is a director and chairman of JT Mackley & Co Limited, the contractor, who carried out the works in dispute. He is also director and shareholder in Hopegar Properties Limited.

18. The Witness Statement provided a comprehensive review of the works and expenditure.

19. The breakdown of the expenditure and works were on the following:

- (1) Main carriageway and temporary carriageway;
- (2) Work on the front car park;
- (3) Re-instating footpaths to the main office ;
- (4) Work on the BT cable and fibre optic diversion.

20. The Witness Statement was comprehensive in its analysis of the figures and together with his oral evidence explained the actual expenditure in detail with costs incurred on the individual heads of expenditure.

(2) Witness Statement of Mr Tony Mackley

21. Mr T Mackley is a director of Hopegar Properties Limited and shareholder in JT Mackley & Co Limited.

22. He provided evidence on the general Industrial Estate maintenance expenses which included grass cutting, hedge trimming, road sweeping, clearing of rubbish, minor repairs, and general upkeep of the pond and clearing drains.

5 23. He specifically commented on why the expenditure in dispute was reflected as an expense in the accounts. He said he took the advice of Hopegar's accountant, Howard Pope, who confirmed that no material capital items were included in these maintenance items and all expenditure was of a revenue nature.

(3) Witness Statement of Stephen Kitchener

10 24. Mr Kitchener was employed from 1974 until his retirement in 2010 as a technical designer specialising in design calculations and drawings for civil engineering projects and temporary work.

15 25. He explained that the main carriageway to the estate was breaking up and the base below the road was becoming saturated causing the concrete slabs to move when passed over by heavy vehicles.

20 26. He agreed with John Mackley's statement on the technical aspect of the works. He disagrees that there was no greater functionality as a result of the road improvements. He does agree that the road has been brought up to modern standards.

Findings of Fact

27. The estate has land and buildings which is serviced by a road network connected to the highway.

25 28. The estate has 67 rental units and comprises approximately 309,500 square feet. There is 1,130 metres of road. The total length of fibre optic cable on the whole estate is 285 metres and the total length of telephone cable is 2,100 metres. The length of diverted fibre optic and telephone cable was 143 metres.

30 29. There was no written contract between the Appellant and the contractor. They were connected companies and the work was done on a cost plus basis. Some incidental work was undertaken by independent contractors. The works were invoiced.

30. The works, under five itemised heads (relating to road works, cable works and Bankside House), are not disputed.

35 31. The works were the subject of planning permission.

32. The main carriageway was widened but this was a small percentage of the road network.

33. The original access road was built in the 1960s and there was a need to update, widen and repair the current main carriageway.

40 34. The Appellant received tenant contributions towards the works.

Legislation and Case Law

The Respondents' list of cases:

- 5 (a) *Atherton v British Insulated and Helsby Cables Limited* (10 TC 155)
- (b) *Auckland Gas Co. Ltd v Commissioner of Inland Revenue* (73 TC 266)
- (d) *Moonlight Textiles Limited v HMRC* ([2010] UKFTT 500 (TC))
- (e) *Southern v Borax Consolidated Limited* (23 TC 597)
- (f) *Texas Land and Mortgage Company v Holtham* (3 TC255)
- 10 (g) *Tucker v Granada Motorway Services Ltd* (53 TC 92)
- (h) *William P Lawrie v Commissioners of Inland Revenue* (34 TC 20)

Appellant's list of cases:

- 15 (1) *Highland Railway Co v Balderstone (Surveyor of Taxes)* 2 TC 485
- (2) *Lurcott v. Wakely & Wheeler* [1911] 1 KB 905
- (3) *Anglo-Persian Oil Company Ltd v Dale; Anglo Persian Oil Company v the Commissioners of Inland Revenue* [1932] 1 KB 124
- 20 (4) *O'Grady (HM Inspector of Taxes) v Bullcroft Main Collieries; Bullcroft Main Collieries Ltd v O'Grady (HM Inspector of Taxes; O'Grady (HM Inspector of Taxes) v Markham Main Colliery Ltd* 17 TC 93
- 25 (5) *Samuel Jones & Co (Devonshire) Ltd v Commissioners of Inland Revenue* 32 TC 513
- (6) *Phillips (HM Inspector of Taxes) v Whieldon Sanitary Potteries Ltd* 33 TC 213
- 30 (7) *J T Hodgins (Inspector of Taxes) v Plunder & Pollak (Ireland) Ltd* 1957 IR 58
- (8) *Conn (HM Inspector of Taxes) v Robins Bros Ltd* 43 TC 266
- 35 (9) *Tucker (Inspector of Taxes) v Granada Motorway Services Ltd* [1979]STC 393
- (10) *Brown (Inspector of Taxes) v Burnley Football and Athletic Co Ltd* [1980] STC 424
- 40 (11) *Transco plc v Dyall (Inspector of Taxes)* [2012] STC 199
- (12) *Christopher Willis and The Commissioners for Her Majesty's Revenue and Customs* TC 00479

The Appellant's submissions

5 35. The Appellant's main submission is that the expenditure is revenue and not capital. The Courts have used the concept of "entirety" to distinguish between revenue repairs and capital expenditure and it is appropriate to look at the relevant asset which is being repaired. If the entirety is replaced then the expenditure is capital but if less than the entirety is replaced then the expenditure is likely to be a repair. The Appellant looks at the individual items of expenditure rather than the scheme of works or expenditure as a whole.

36. They make the following main points:

15 (1) HMRC have accepted certain expenditures as revenue and it must follow that either the "scheme of works" is of a capital nature or none of the expenditure is deductible or the expenditure is revenue in nature and is deductible.

20 (2) The works undertaken and claimed as repairs are repairs. It does not matter if they are undertaken at the same time as improvements or as part of a project. The Appellant says that it "is not understood why a repair is any less of a repair simply because it was undertaken at the same time as an improvement and as part of the same project".

25 (3) The taking of the "works" collectively as a starting point is wrong. The correct starting point is to look at why the expenditure was incurred. First, the entirety has to be identified and the expenditure examined in relation to the asset. Most of the expenditure incurred relates to the main carriageway not the whole network of roads on the estate. Secondly, the nature and extent of the work done to the asset must be examined.

37. In undertaking works there is no requirement for works to be considered repairs only if the same material as the original material is used. The fact that tarmac has been used instead of concrete does not change the character of the expenditure.

30 38. In looking at apportionment, the Appellants say that the concept of "notional repairs" (when instead of simply repairing an asset the taxpayer may take the opportunity to buy an improved asset) does not apply on the facts.

Respondents' Submissions

35 39. The Respondents say all of the expenditure in dispute is of a capital nature. The plans and documentation show that there has been a scheme of alteration to the Industrial Estate and the works should be seen as a whole rather than as a piecemeal series of individual jobs.

40. The contention is that there is a clear scheme of alteration and the expenses are capital in nature.

41. The Respondents make the following point:

5 “That the Appellant had a desire to solve a maintenance problem. The access road could be repaired with patch repairs but this did not take place. The existing concrete access road was dug up and replaced with a tarmac road. The Appellant has discharged a future recurring revenue expenditure that would be required to patch/repair the road, by modification of a capital asset.”

10 42. That :

- (a) There has been a scheme of alterations and improvements which should be taken as a whole.
- (b) Where a capital asset is altered or improved, the expenditure incurred is capital.
- 15 (c) There is no need for an acquisition or disposal of a capital asset for capital expenditure to exist.
- (d) If the result of the expenditure is the alteration and improvement of a capital asset then the expenditure is capital despite the motive for incurring the expenditure.

20 **Discussion**

43. For the purposes of this decision we shall divide the works and the corresponding expenditure under three main headings. These are:

- (1) Road works
- (2) Cable works
- 25 (3) Bankside House works

This is in accordance with the way the evidence and submissions were made.

Entirety

30 43. The Appellant’s main argument focuses on the entirety of the assets. To understand this submission, it is required that the Tribunal look to identify the relevant asset and to consider the nature and extent of the work undertaken. On the other hand, the Respondents say that there is a scheme of works and the expenditure was not on repairs. The work formed part of one overall project. To find an entirety
35 the Tribunal would look to see if the asset is complete in itself, physically and functionally distinct and capable of separate operation. The work done must not result in a replacement or renewal and must not change the character of the asset. There are other relevant considerations to distinguish revenue from capital and these are explored below.

(1) **Road works**

44. The road works relates to the main carriageway and the expenditure incurred was £135,141. There was work undertaken on the additional carriageway leading to the timber yard entrance and the expenditure of £9,299 was allowed. The evidence
5 shows that the main carriageway had been damaged and was in need of repair and widening. Various plans, diagrams, drawings and photographs showing the entire Industrial Estate, road work, site of building and other works undertaken, were provided as part of the evidence. This gave a helpful overview of both the estate and the works.

10 45. The work to the main carriageway involved widening and repair. It was required because the road was old and breaking due to the impact of heavy lorries over a period of years. The expenditure on the road can be broken down to show money was spent on labour, plant and material (£73k) and road surfacing (£32k). There was additional expenditure to muck away (£18k), road planing or smoothing (£400), road
15 markings (£1,950), landscaping (£6,000) and footpath resurfacing (£2,300).

46. In his Witness Statement (Paras. 24 and 25) Mr John Mackley explained that the reason repairs were needed was because “the concrete slabs had become loose from the sub-base in part. This caused the slabs to tilt as lorries were driven over them”. It is this breaking up of the concrete which seems to be the main reason why the road
20 was in need of repair and was dangerous. The widening of the road itself was intended to make greater room for larger, modern lorries. The widening reflected the fact that modern lorries were longer and heavier and Horsham District Council in August 2006 required a wider turning radius for articulated lorries. In short, the road needed to be repaired and updated.

25 47. The entire road system on the estate is approximately 1,130 metres. The part of the road which was involved with the works was 120 metres. The road has been widened in parts from 6 metres to 8.6 metres. Evidence was presented to show that the increase in the area of road was some 3% of the road network on the Industrial Estate. The actual widened part of the road increased from 613 square metres to 816
30 square metres.

48. The way the road was originally constructed meant that there was sub-base and more concrete over the top. The concrete was in the form of slabs and therefore lay in sections. This concrete was replaced with tarmac. In order to lay the tarmac, it was necessary to re-lay thicker sub-base for greater load bearing. It was decided that
35 tarmac could be laid more easily and quickly since concrete required a 28 day setting period and this would facilitate an earlier completion of the work. The tenants on the estate required 24 hour access to their properties with a minimum of disruption. A temporary access road was needed while the work was being undertaken. It was necessary to provide safe passage for vehicles while workers were repairing the main
40 carriageway and the temporary road allowed the estate to function normally while repairs were being undertaken.

49. The actual work which was undertaken on the main carriageway involved several phases. First, the area which was to form the temporary road and that part

which was to be the widened part of the main carriageway were dug up and new sub-base was laid. Secondly, the temporary road was built. This road was tarmacked. Thirdly, the base of the widened part of the main road was installed. Fourthly, a stretch of access road was dug up, sub-base laid, the kerb was repaired and then a base course followed by a layer of binder course was laid. This would have been done to an area which covered more than half of the existing road surface area as one lorry would require approximately 5 or 6 metres width of road. At this point all the sub-base was being put in place for the widened permanent road. Fifthly, the temporary road was removed in part and then what remained of the temporary road was turned into the widened part of the permanent road and the remainder of the surfacing was completed. New kerbs were laid to part of the road. The work was done in stages and sequentially and this allowed the estate to function normally during the period of work.

50. After the permanent road was completed, as a result of the widening, some trees had to be cut down to comply with local authority and general safety requirements. Consequently, some landscaping work, fencing and railings were required. These were done in the final stages of the project.

51. The technical advice indicated that when the road works were being undertaken there was a risk of damage to certain fibre-optic utility cables. These had to be removed to avoid problems arising from the widening of the road and the re-laying of the footpaths. The cables were below the part of the road which was being repaired.

52. There were different cost categories for the work undertaken. There was muck away cost (£18,671) which represents carting the excavated material from the existing road and the area of temporary road to an offsite landfill. The substantial cost on the labour, plant and materials (£72,245), is self-explanatory. The road planing costs (£400) which is the grinding down of the sub-base where it was uneven prior to the laying of the tarmac. The road surfacing costs (£32,519) relates to the cost of laying the base binder course and sub-base courses which gives the road stability and load bearing capability.

53. In terms of contracting, the arrangements were different. It is normal to have a written contract. However, there was no written contract between the parties since the two companies involved were connected by family and ownership. The contractor was therefore on a cost plus basis which is total cost plus a mark-up of 12%. We understand that this represented commercial terms and this has not been disputed. Time sheets and payment ledgers were kept to record the labour and payment for the works. There is no disagreement between the parties on the numbers involved. A breakdown of charges was provided to HMRC with an analysis of costs showing that the re-laying and re-surfacing of the main carriageway cost £135,141.

54. The Appellant, on who is placed the burden of proof and who must satisfy the standard of proof according to the ordinary civil standard on a balance of probabilities, says that the correct approach is to identify the relevant entirety. Once the entirety is established, the nature and extent of the work must be examined to determine whether the expenditure is revenue or capital. The Respondents say that the

Appellant had a desire to solve a maintenance problem. The access road could have been repaired with patch repairs but this did not take place. Rather, the existing concrete access road was dug up and replaced with a tarmac road. In doing so, the Appellant solved the patch repair problem of the road and what occurred was the modification of a capital asset. They rely on the authority of *Auckland Gas Limited v. Commissioners of Inland Revenue (New Zealand)* (“Auckland Gas”) and *Tucker v. Granada Motorway Services* (“Tucker”) to say that such expenditure falls to be treated as capital.

55. HMRC have accepted in their guidance the concept of “entirety” to distinguish revenue, repairs and capital expenditure. They accept that the replacement of an entire asset is capital but if less than the entire asset is replaced then it is likely to be revenue expenditure. Expenditure on repairs and maintenance of an asset would involve restoring the asset or part of it to its original state so it performs its original function in a manner similar to that which was intended; it is this question of degree which must be examined.

56. The starting point is to look to identify the relevant asset. A case which looks at the entirety is *O’Grady v. Bullcroft Main Collieries Limited* 17 TC 93 (“Bullcroft”). In this case, a colliery chimney became unsafe and needed to be replaced. It was a separate structure from the other buildings of the colliery but connected to the furnace by pipes. It was claimed that the cost of building a replacement chimney was revenue but the Commissioners decided it was capital. The chimney was held to be a separate entity and the expenditure on its replacement was therefore capital.

57. The judge in the case, Rowlatt J, said:

“Of course, every repair is a replacement. You repair a roof by putting on new slates instead of old ones, which you throw away. There is no doubt about that. But the critical matter is ... what is the entirety? The slate is not the entirety of the roof. You are repairing the roof by putting new slates. What is the entirety? If you replace in entirety, it is having a new one and it is not repairing an old one. I think that is very largely a question of degree, but it seems to me the Commissioners have taken the only possible view here.”

58. The Court seems to have been influenced by the fact that a new chimney was functionally a significant improvement on the existing chimney. It was taller with greater dimensions and constructed of engineering brick as opposed to the original built in common brick. It was in effect a new structure.

59. The concept of the new structure was explored in another case. In *Phillips v Whieldon Sanitary Potteries Ltd* [1952] 33 TC 213 the Court looked at the question of entirety. The company’s factory was adjacent to a canal and had been protected by an embankment. There was subsidence in the embankment and water seeped into the factory. Consequently the factory suffered subsidence. The old brick and earth embankment was removed and an iron and concrete barrier constructed. The Judge decided that the work was of a capital nature. Donovan J said:

5 “I am of the opinion that this is a clear case of capital expenditure. I reach this conclusion taking into account the extent of the work, the permanent nature of the new barrier, the enduring advantage it confers upon preserving part of the fixed capital of the business, and the contention of the Company that it was essential to enable the trade to be carried on. It is irrelevant, in my view, in the present case to consider whether the new barrier, in point of size or effectiveness, is or is not an improvement on the old, and there is no finding upon that point. There can be cases where the work done may result in no improvement, but merely reinstatement, and yet be work involving capital expenditure on account of its size and importance.”

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15 60. The case highlights the question of the “size and importance” of the work and concludes that because of those factors it cannot be an improvement but must be a reinstatement. In his view, the barrier itself was the entirety and since it was replaced with a new one, the work was not repair.

20 61. As in *Bullcroft*, it is possible for a repair which changes the function of the capital asset to be considered as capital. In the New Zealand case of *Auckland Gas* the company supplied its customers through a network of underground cast iron and steel pipes. There were several thousand joints within the system and the pipes were made in sections of 12 or 18 feet. The joints were fractured because of subsidence and other reasons. To deal with the problem of leaks arising as a result of fractures in the joints, the company adopted the technique of inserting polyethylene pipes into the existing cast iron and steel pipes. This meant that the leaking joints lay outside of the polyethylene pipes containing gas, which could be transmitted regardless of the old pipes. The company claimed the cost of inserting the pipes into the old metal pipes as revenue deduction. The Court considered it is a capital expenditure since it was not a restoration of the gas distribution system to its original state but rather the work changed the character of the existing gas distribution system. The Court was not convinced by the argument that because the overall functionality was the same that by itself is a guide for establishing whether something is revenue or not.

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35 62. Lord Nicholls summarised the argument as follows:

40 “The objective was not borne out of a desire to improve the distribution system or to add new or improved features. The objective was to restore the system to its original functional and reliable state. The method adopted, of inserting polyethylene piping, happened to be the most cost effective and cheapest way to achieve that goal... The nature and extent of the work carried out to the physical asset are what is determinative of the character of the work. The fact that the method chosen is the cheapest and most effective is neutral. It does not deprive expenditure of its capital character. Replacing an object may be cheaper and better than patching and minding.”

45 63. The Respondents also draw reference to *Tucker* where the taxpayer paid a lump sum to extinguish a recurring revenue expense. The lump sum payment was held to be capital. It seems that the court took the view that the expenditure was made to prevent future repairs. In this sense, the nature and extent of the work must be examined to see

if it results in a renewal, replacement or reconstruction of the asset. The Respondents say that the work was intended to resolve future patch repairs and therefore capital.

5 64. In the Respondents' view the main carriageway had been altered to make it wider to accommodate heavier goods vehicles accessing the premises. This involved the creation of a new improved carriageway. Further, the material used for the carriageway had been changed from concrete to tarmac which supports the view that the expenditure was capital. While this argument is understandable the analysis must start with the question, what is the entirety?

10 65. They drew reference to the case of *Moonlight Textiles Limited v. HMRC* [2010] UKFTT 500 ("Moonlight") where the Tribunal commented:

15 "From the plans and other documentations available it was clear that there had been a significant improvement of the premises through the repairs and alterations effected. The work had changed the character of the building as a whole. It is also clear that the Appellant Company had chosen to adapt its premises to its needs and failing compelling reasons to contrary this would be regarded as capital expenditure as an alteration."

66. The Tribunal commented:

20 "It was therefore clear that there had been a scheme of alteration of the Company's showroom and storeroom/warehouse areas and, as such, save for those items allowed by HMRC as referred to above, the expenditure was capital and therefore not an allowable deduction from profits."

25 67. In the *Moonlight* case, one point which influenced the court was that there was no breakdown of expenditure which could distinguish between repairs and improvements, which meant the project's expenditure was viewed as one undertaking. Similarly, the Respondents say that there had been a clear scheme of alterations of the Appellant's premises which should be taken as a whole and therefore the expenditure falls to be treated as capital. The work had changed the character and functionality of the road.

30 68. The fact that the repairs involved the replacement or renewal of some or part of the asset does not make the expenditure capital. This would include the alteration or improvement with new materials. In our case, itemised invoices were provided and show materials used and itemised the heads of work. The expenditure was analysed by both parties and the capital element was not allowed. The revenue expenditure was actually incurred and identifiable. On this basis there is no case for the notional repair argument.

35 69. The Tribunal finds that there was no scheme of works or expenditure as suggested by the Respondents. It would be incorrect to import an overall purpose of improving the site as the reason why the work was undertaken. There were individual heads of repair relating to particular assets. The capital portion of the expenditure was identifiable and could be separated out.

70. In the case of *Christopher Wills v The Commissioners for Her Majesty's Revenue and Customs* [2010] UKFTT 174 (“*Wills*”) the Court rejected the idea that works undertaken as part of the scheme of works has to be all capital. In that case, the court closely examined the repairs to convert an outbuilding into additional living space and decided that they were revenue in nature since there was not a replacement of the whole structure.

71. This approach is also found in the more recent case of *Transco v Dyll (Inspector of Tax)* [2012] STC (SCD) 199 (“*Transco*”). The Court had to consider whether there were repairs or improvements to a gas pipeline system. *Transco* operated an integrated gas transportation system across Great Britain. The cast iron pipes were liable to fracture so the company embarked on a process of replacement by polyethylene pipes which were inserted into the cast iron pipes. The Tribunal had to decide whether the expenditure was capital or revenue and whether it was deductible from the Company’s profits. The Special Commissioners decided that the expenditure was repairs, and therefore deductible. The expenditure involved was over £100 million. This contrasts with the Privy Council’s decision, based on not dissimilar facts, in the case of *Auckland Gas*. The Court here seems to have taken the view that there was a modernisation of the assets resulting from the improvements. The accepted argument was that there was a network of pipes which comprises a single asset and only parts of that network were being replaced.

72. The Appellant draws reference to the fact that HMRC accepted that expenditure relating to the additional carriageway and the additional resurfacing work to a road outside the timber sawmill (£9,299 and £27,799 respectively) were revenue in nature and deductible. They says that if HMRC are focusing on a “scheme of works” taken as a whole, then it must follow that either the “scheme of works” is of a capital nature and none of the expenditure is deductible, or it is revenue in nature and the expenditure is deductible. The Revenue’s approach in drawing a distinction between expenditure on individual items and a “scheme of works”, when all the expenditure relates to one project, is inherently flawed. The expenditure must be either capital or revenue, it cannot be both. HMRC’s approach may be understood if one accepts that expenditure on capital works may include an element of revenue expenditure. In such a case, as here, there will be a separation of the two types of expenditure.

73. The picture which emerges from the plans, diagrams, photographs and various correspondences between the parties is that the road was in need of repair and modernising. Whilst it is accepted that the widening of the road is a capital expenditure the work on the main carriageway was to provide, not a renewal of the entirety of the road network but the repair of part of that network. It was intended to provide a better surface and sub-base for heavy vehicles and a larger turning point which, after 40 years, had to be improved to deal with heavier lorries and more frequent usage. The re-laying and re-surfacing of the main carriageway was only part of the road network. There is no logical basis on which one stretch of road can be the entirety given the entire road network is joined up and forms a single whole for the entire estate. It is the replacement of part of the entirety.

74. The Tribunal finds that defective parts of the road were being repaired. The older material was dug up and replaced with a more modern equivalent which met current standards. It was a substantial repair but not if one starts with the entirety of 1,130 metres of road on the estate as a whole. The repaired part of the road is not meant to function separately; it is the access point for the estate and the other parts of the road network. By its nature it is not physically or functionally distinct; it is part of the aggregate of roads and access on the whole estate.

75. The Respondents have raised a question concerning the fact that different materials were used in undertaking the repair. The question is whether the works should be undertaken with the same material which was used in the original road. If the purpose of the repairs is to cater to heavier lorries and increased loads then it would be sensible to use available modern materials.

76. In the case of *Conn (HM Inspector of Taxes) v Robins Brothers Ltd* 43 TLC 266 (“Conn”), the repairs were treated as revenue even though different materials were used. The slate roof was replaced with one of corrugated asbestos, the floorings were replaced with concrete in the main shop, certain timbers were replaced with steel joist encased in oak and overall, modern materials had been used. The result was, in substance, to repair what was there before and the expenditure was treated as revenue. The case takes a common sense and practical approach to the issue of revenue expenditure. It cannot be expected that a contractor having modern and improved components would elect to use outdated and inferior materials to repair an asset especially where there is a legal obligation to observe current standard of safety and repair.

77. A similar observation was made in the case of *Transco*, where the Special Commissioners acknowledged that newer and better technology may not of itself change the character of the asset:

“The character and nature of the property possessed by *Transco* has not changed nor indeed has it been materially improved. The material used, polyethylene, is cheaper than cast iron. To adopt the words the Lord President, what was done was a mere insertion of polyethylene pipes into the old pipes, which were worn out or partially worn out, and renewing them in whole or in part along the whole network. This did not alter the character of the network.”

78. The roads network for the Industrial Estate was built in the 1960s when lorries were lighter and road traffic was much less frequent. Lorries now are much heavier being in excess of 40 tonnes when fully laden and their overall length between 16 to 18 metres. They must be able to legally operate on commercial roads and have adequate turning circles. The main carriageway was being repaired with modern, durable and easy to lay material which reduced the noise levels on the estate and enhanced the road infrastructure. As pointed out in the evidence, road building is not an exact science but the functionality of the main carriageway is very near the same as before the works. The Tribunal, on balance, can see no increased functionality of significance. The work was essentially to repair the road not to produce something

entirely new. The overall effect of the work was to give the estate back a functional carriageway at the start of the road network.

79. In the case of *Conn* the Court had to address the issue of modernising a 400 year old building. The Court observed:

5 “In the light of the circumstances it seems to me that this was
expenditure incurred by the Company with a view to enabling it to
continue to earn profits from its business, not by acquiring some asset
for that purpose but by putting the Company’s existing assets into a
state of repair which would enable it to continue to use that asset. No
10 doubt in the course of carrying out these works certain structural
alterations were made, as one would expect with any extensive repair
for a building over 400 years old, when repairs were being carried out
at a time when the building techniques have completely altered. But
the fact that there were alterations in the structural details of the
15 building does not seem to me to be a good ground for proceeding upon
the basis that the work produced something new. On the contrary, I
think it is implicit in the Commissioners’ findings that the result of this
work was not to produce something new but to repair something which
had previously existed. Upon that basis it seems to me that there is no
20 ground for regarding this expenditure as a capital expenditure. It was
expenditure incurred for the purpose of enabling the Company to
continue to earn profits, and was therefore in my judgment expenditure
which would properly be chargeable to income.”

25 80. The idea of a modern upgrade was also approved in *Auckland Gas* where the
Privy Council said:

 “It is often that, with improvements in technology, a replacement part
is better than the original and would last longer or function better. That
does not, of itself, change the character of the larger object or hence the
appropriate description of the work.”

30 81. The Tribunal finds that upholding modern standards of road repair, especially
when required by law and the local authority does not, of itself, make the expenditure
capital.

82. The Respondents say that using tarmac instead of concrete created a new
structure since “concrete was the material that remained available for installation”.
35 The important question is whether the repair results in an asset which is changed in
character. In his Witness Statement, John Mackley explained that the concrete slabs
had a tendency to become loose and broken and that the tarmac was a more suitable
option. The fact that tarmac surfacing was used or that it resulted in additional
expenditure on increased sub-base (£4,500) does not make the expenditure capital.
40 We know that a replacement can be of different modern materials and components
which are more suitable. The new main carriageway was better than the old but
physically, commercially and functionally was very similar to what existed before.

83. The Respondents have raised issue with the expenditure on the sub-bases. The
road originally had sub-base with concrete surfacing. Extra sub-base of thickness

(approximately 100-150 mm) was added. The temporary road also had an enhanced sub-base since part of that road was incorporated into the new improved carriageway. The Tribunal accepts the evidence of John Mackley that there was no increased functionality in having thicker sub-base. The new carriageway did allow heavier traffic and larger lorries. It was simply betterment to part of the road network which was not independent of the main and while that part may have had more operating capacity and a longer life it cannot be seen as an entirety in itself.

84. It is possible that the road could have been patched up using tarmac for a further 3 years but the Appellant chose not to go down that route and to modernise and upgrade part of the road instead. The idea of creating something better and to modern standards was also looked at in the case of *JT Hodgins (Inspector of Taxes) v Plunder & Pollak (Ireland) Ltd* [1957] IR 58 (“*Hodgins*”) where there was a weigh-house as part of a leather factory and where the building was damaged and pulled down and a new one constructed on the same site. The Court observed:

“The Company now has a weigh-house which is in good repair instead of a weigh-house which was in danger of becoming ruinous, but there is no suggestion that it is more convenient, more effective, or of greater capital value, than the weigh-house would have been if it was in thorough repair. I am unable to see that any new capital asset has been created.”

85. The road was repaired to standards required by the local highway authority in having modern safety and load bearing capabilities. The evidence supports the conclusion that the repairs were being carried out when road building techniques and specifications had been completely altered. As in *Hodgins*, there was a significant time period between when the road was built and when it was repaired. The parties have acknowledged that repairs and maintenance were necessary and the standard of road building had moved forward.

86. The Respondents made two further points with regard to the re-laying and re-surfacing of the main carriageway. The first point is that the alteration constitutes an improvement since there is greater room for larger lorries which are longer than those previously using the road and secondly, the Appellant had a desire to solve a maintenance problem and so paid a lump sum to extinguish a recurring revenue expense. The lump sum itself would be capital as indicated in *Tucker*. They say that the expenditure on the main carriageway is capital and all incidental expenditure is capital. They draw reference to *Auckland Gas* where Lord Nicholls explained:

“A maintenance problem such as existed here may be capable of being solved in more than one way. It may be solved by work which would be regarded as a repair of the existing structure or it may be solved by scrapping all or much of the existing structure and providing a new one. In overall functional terms the result may be much the same in the two cases, but that is not by itself a reliable guide. If the latter alternative is chosen, the expenditure may well be of a capital nature.”

87. While this observation is interesting, the purpose of the repair does not determine whether it is capital or revenue. By repairing the stretch of road they will

avoid patching-up repairs but that does not mean that the work undertaken would not be repairs. The Tribunal does not accept the Respondents' argument that the road could have been patch repaired and the fact that this was not done makes the expenditure capital. It is possible to have repairs which obviate the need for patching-up but that does not change the character of what was done. The character of the entirety has not been altered. A repair by its nature means that the work is being done on part of the whole, it is not a replacement. It would seem nonsensical if the tax system gave relief for patching-up but not for repairs which resulted in the taxpayer not having to do the patching up. It seems one and the same thing. It is sensible that the law treats both activities in the same way.

88. The Tribunal turns next to the temporary road. We understand from the witness evidence that a temporary diversion was necessary to allow access to the Industrial Estate. It seems to the Tribunal that the temporary road had two purposes. First, it provided temporary access to the tenants to the estate between January and February 2008 and secondly, it was constructed as part of the carriageway and was so used. The temporary road had to fit the specifications needed for the permanent road since it had to cater for 40 tonne articulated lorries having the same axle loads as would have used the permanent road.

89. The temporary diversion was built to be used while the main carriageway was being repaired. The main carriageway temporary diversion costs is put at £23,226 which is comprised of tree stump removal (£825), muck away (£6,224), sub-bases (£2,433), temporary surfacing (£8,545), labour (£2,156), plant (£1,918 + £1,125 = £3,043). We know that expenditure which is incidental to revenue expenditure is revenue. The Appellant has deducted a proportionate part of the sub-base (£2,433) and a proportionate part of the temporary surfacing cost (£4,718) and they have accepted that these amounts should be treated as capital. The remaining amounts are revenue expenditure which is incidental to the expenditure on the main carriageway.

(2) Cable works

90. The £31,469.54 for the diversion of the BT cables and fibre optic can be broken down into component parts. These are as follows: New cables (£6,764), Fibre optics (£8,350), JTM labour (£13,611.93), plant hire (£1,985), and material (£758). The cabling provides telephone and data transmission for the whole estate and it is run under the pathway which connects to other cabling for the rest of the Industrial Estate. It was felt that repair work on the road could damage the cables lying underneath. Further, the roots of trees which had to be removed to make access for the temporary road could also have damaged the cables. The appropriate way to deal with these dangers and potential problems would be to move the cables away from the site of the works and away from tree roots with some older fibre optic cables were replaced.

91. The plans and diagrams provided to the Tribunal show that there is a cable network which runs through the whole estate. The work which was done to a small part of that network and the functionality of the cable both before and after the work was exactly the same. The Tribunal accepts, like the road network, that the relevant

asset was the cable network for the estate as a whole. The cable network did not operate in parts but rather was part of one whole.

92. The witness evidence presented suggests that the movement of the cable was necessary for the road repairs. To the extent that it was necessary for the widening of the road, then those costs would have to be treated as capital. The widening of the road expenditure has been accepted as capital.

93. Let us look at the other expenditure. The first point is that the actual movement of part of the cable does not of itself give rise to a capital expenditure. The reason that this cannot be treated as a capital expenditure is because there is no increase in functionality both before and after the movement of the cable. In the case of *Samuel Jones & Co (Devonvale) Limited v Commissioners of Inland Revenue* 32 TC 513 (“*Samuel Jones*”) the Lord President looked at functionality. He said :

“It is found as a fact that the new chimney is not an appreciable improvement over the old chimney. So far as function is concerned its suitability for boiler draft is exactly the same as that of the old chimney. No additional steam – raising plants have been installed.”

94. The cable network provides internet and phone communication to tenants both before and after the work was done. The Respondents say that the addition of new fibre optic cables means that the cable network has been altered. It is correct to say it has been altered but it has been altered in that there has been replacement cable for existing cables. New for old. There is nothing to suggest that the new cable does anything different to the old cable.

95. The Appellant say that the cable was moved because it was in a vulnerable position and could have been damaged when the road works was being undertaken. The repairs were therefore precautionary. The Special Commissioner in *Transco* recognised that the cost of precautionary work could be revenue expenditure. He observed:

“Although some old cast iron pipes have had only polyethylene pipes inserted into them, that has been done only where necessary for the purpose of repair, or precautionary repair, and has not been done to the whole network. Those considerations would point to the conclusion that expenditure is properly chargeable as revenue expenditure.”

96. The fact that the new cable replaced an existing cable shows only that repairs were undertaken. New for old does not mean a capital expenditure. This was observed in *Lurcott v Wakely* by Molton LJ, who said:

“Many, and in fact most, repairs imply that same portion of the total fabric is renewed, the new is put in place of old. Therefore you have from time to time as things need repair to put new for old.”

97. The part of the cable which was removed and repaired did not change the character or functionality of the system as a whole. The repairs to the cable network were *de minimis* in the context of the cable network. In *Auckland Gas*, the Court observed that in order for there to be a capital expenditure the work “may readily go

beyond what would normally be regarded as repair of the entire system ... the work may be of such a nature and scale as to change the character of the existing system". There is no evidence that the operating capacity or the income-earning capacity of the cable network was changed.

5 98. It is clear that the work which was being done did not change the entire system but rather that part which was under or around the area of the main carriageway. The Tribunal does not agree with the Respondents' submission that a new asset has been created which replaced the old asset. The moving of the asset from one location to another does not of itself create a new asset. The installation of new cabling was of
10 such a minimal amount that it cannot be said that it created a new capital asset. A cable network must be seen as a whole over the whole estate and the part that has been repaired and/or replaced is *de minimis*. The expenditure therefore would be revenue and treated as a repair.

15 (3) **Bankside House work**

99. The work which is considered under this heading relates to the work on the front car park (£26,777), which is broken down into labour plant and material of (£17,236) and surfacing (£9,541). The second set of work under this heading is the
20 reinstatement footpaths to the main office and estate (£24,377).

100. The entrance to the car park at Bankside House was moved from the north side to the east side and the car park area was re-surfaced as it was in need of repair. The car park is used for visitors to the Industrial Estate. The re-surfacing was needed
25 because the surface had become worn and damaged. The relocation of the entrance was done for safety reasons because the entrance had a steep slope. During periods of icy conditions it was possible for cars to slide at the front entrance. Further, the steepness of the entrance would become even more pronounced during the road widening and it was felt appropriate that the entrance should be moved to a safer area.
30 In addition, the new entrance allowed greater visibility for drivers and pedestrians. It was decided that any car parking spaces which had been lost as a result of the road works should be replaced and this was confirmed by Horsham District Council in a letter dated 27 October 1997. The car park was also extended west and south. The Tribunal's understanding is that there was the repairing of part of the old car park and
35 the creation of a new additional car park. The expenditure should therefore be apportioned between the two undertakings.

101. It is not disputed that the old car park was in need of repair. The cost of labour, plant and materials relating to digging out concrete and sub-base and earth and preparation of the surface as well as the surfacing cost relating to the laying of the
40 sub-base and tarmac accounted for a substantial part of the expenditure. The new car park is larger at approximately 226 square metres. It is estimated that 75 square metres of this related to the area of the car park before the extension. Using this apportionment, the Witness Statement of John Mackley states that there is a cost to the Appellant of resurfacing which related to repairing the old car park of
45 approximately £3,166 ($\frac{75}{226} \times £9,541$). The balance of the £6,375 relates to the work consequential on widening.

102. The dug up area, including the entrances, is 311 square metres. On this basis Mr Mackley considered the cost to the Appellant of labour, plant and materials which related to repairing the old car park surface is £4,156 ($\frac{75}{311} \times £17,236$). The balance of £13,080 relates to work consequential on the widening. It is accepted that the widening of the car park is an improvement. The total amount for the widening which is to be treated as capital is £13,080 + £6,375 based on the figures provided. The cost attributable to repairing the car park (or a portion of it) should be considered a revenue item. The amount of £7,322 (£3,166 + £4,165) should therefore be treated as revenue.

103. In the case of *Brown v Burnley Football Club* 53 TC 357, Vinelott J looked at the concept of premises, he said:

“In my judgment, the test is equally artificial and remote from the facts. It may be that, for instance, a sports stadium designed and built as a single building would constitute separate “premises” and that replacement or renewal of part, more or less extensive, would be a repair of the premises as a whole, though it is not easy to see why, in such a case, a car park, baths and changing rooms forming an integral part of the structure should not be as much part of the stadium as the spectators’ seats and the ground itself.”

104. In the same way, the old car park is functionally and physically part of Bankside House as is the footpath. These are appendages of the property. The original footpath had deteriorated significantly over the years and was in need of repair. However, there was no need to carry out works to the footpath due to the widening of the road. It was incorporated into that project. New bollards and railings were installed for safety reasons to protect pedestrians on the footpath and to prevent cars jumping the kerb and running down the steep incline of the road. A new disabled ramp was built. The cost attributable to the railings and bollards and for the painting of these was £3,267 (marked up by 12% to £3,659) as shown by the documentary evidence. The balance of the £24,377 which is £20,717 (£24,377 - £3,659) relates to the repair of the footpath. The new railings, bollards and painting would be capital. The cost of repairing the footpath around the main office should be treated as revenue.

105. Similarly, the cost of repairing the car park which has been put at £7,322 should be treated as revenue expenditure. Regarding the repairs to the car park, there has been an allocation of an amount to capital for widening. The Respondents’ argument that a new asset has been created does not consider that the footpath and car park are integral to Bankside House and its functionality. The Tribunal accepts that that part of the car park which is new is capital and the cost is apportioned accordingly. The costs relating to the old car park which has been repaired are revenue deduction.

106. The Respondents say that the invoice provided with regard to the work on the car park is not sufficiently itemised and falls to be treated as capital. The Tribunal however is willing to accept the evidence of Mr John Mackley that because the parties were connected the work was done on the basis of a costs plus formula on commercial terms. There has been an apportionment of the capital expenditure. The cost of the

repair work on the footpath and the car park were clearly distinguishable from the works which could be treated as capital expenditure. It is accepted by HMRC that where work is undertaken of a capital and revenue nature and these are undertaken at the same time a deduction would be allowed for the repair element.

5 107. The work which was undertaken as repair can be distinguished from the work which was of a capital nature. There should have been no dispute as to deductibility of these costs and it is surprising that objections have been raised. The taxpayer is allowed to deduct an identifiable proportion of the expense which is revenue.

10 108. The costs of the repair of the footpath (around the main office) and repairs to the relevant part of the old car park are to be revenue deductions. This would allow for a subtraction from the total of the costs of the capital elements relating to the widening, new railings, bollards and painting.

Conclusion

15 109. The appeal is allowed.

110. The Tribunal finds as follows:

(1) There is no scheme of alteration. The expenditure, as itemised, can be considered individual pieces of work and are allowable as revenue deductions.

20 (2) The relevant entirety (the road network, cable network and Bankside House) is the asset being repaired. The nature and extent of the work shows that there has not been a reconstruction, replacement or renewal of the asset or substantially the whole of the asset. The character of the assets has not changed when the overall effect of the work is examined.

25 (3) The expenditure is clearly identifiable and sufficiently itemised. The concept of notional repairs is not a relevant consideration. It is accepted by the Tribunal that the widening work on the road is a capital expenditure and other expenditure directly relating to that widening would also be a capital expenditure. These have been indicated in the decision above.

30 (4) Accordingly the appeal is allowed.

35 111. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

DR K KHAN
TRIBUNAL JUDGE

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