



KEY CONTACTS



Tim Beresford
0121 710 1333
tim.beresford@
davislangdon.com



Rachel Sanders
020 7061 7141
rachel.sanders@
davislangdon.com



Michael Murray
0131 550 9473
michael.murray@
davislangdon.com



David Rees
023 8068 2801
david.rees@
davislangdon.com



John Goldrick
0161 819 7646
john.goldrick@
davislangdon.com

B&E SECURITY SYSTEMS LTD -v- HMRC

Introduction

This is a recent capital allowances case concerning a claim for the construction of a control room as plant and machinery on the basis that it was incidental to the security equipment for which it was built to house. The case was heard by the Tax Chamber (First-Tier Tribunal) in 2nd November 2009 and the decision of the Tribunal Judge, Alistair F W Devlin, was released on 26th March 2010.

Background

The appellant company, B&E Systems Ltd, was primarily engaged in the installation, maintenance and monitoring of intruder alarm systems from a business address in Northern Ireland. In addition, the company also carried out sensitive surveillance type work and the control room in question was constructed as part of these latter services carried out by the company. In order to obtain two contracts for the provision of surveillance work, the company needed to create a custom built control room within an existing building. We are not told the precise nature of the security equipment, or the exact location of the control room in Northern Ireland, presumably for security reasons.

The control room had to be constructed in such a way as to satisfy the requirements of the relevant British Standard Code of Practice governing the construction of control rooms. It was constructed within premises already occupied by the company and involved substantial alterations to the existing building. The control room had reinforced walls, floor and ceiling, an interlock, fire doors, its own power supply and kitchen and toilet facilities. The Tribunal accepted that had the control room not been constructed, then the company would not have been able to obtain or perform either of the two contracts; the first for two public sector security related organisations and the second for a large town in Northern Ireland.

The company maintained that had it not been for the requirements of the client it would not have constructed the control room. Instead, it would have been content to have operated from its existing building, or from a temporary building, without there having been any need for a control room to be constructed.

The control room took six months to construct at a total cost of £63,050 and was built before the security equipment was purchased. The total cost of the security equipment housed by the control room was £78,658. The claim for the cost of both the security equipment and the control room was made for the company's financial years ending 31 August 2001 and 31 August 2002. There was no dispute concerning the security equipment, only the control room.

The relevant legislation

Whilst there is no definition of plant or machinery within the capital allowances legislation, Section 21 of the Capital Allowances Act 2001 (CAA 2001) states that plant or machinery does not include a building and that a building includes an asset which is incorporated in a building. Specifically, walls, floors, ceilings and doors are all treated as a building.

Notwithstanding the above, CAA 2001, Section 25 provides as follows:

If a person carrying on a qualifying activity incurs capital expenditure on alterations to an existing building incidental to the installation of plant or machinery for the purposes of the qualifying activity, this Part applies as if -

- the expenditure were expenditure on the provision of plant or machinery; and
- the works representing the expenditure formed part of the plant or machinery.

Plant and machinery that is installed in an existing building has a much wider legislative meaning than in the case of plant and machinery forming part of a new development, or the acquisition of an existing building.

Case law

In the House of Lords case of Inland Revenue Commissioners -v- Barclay Curle & Co Limited (1969), Lord Reid made the following statement concerning the meaning of 'incidental to the installation of machinery or plant' for the purposes of the Income Tax Act 1952:

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

In the case of JD Wetherspoon plc -v- HMRC (2007), the Special Commissioners had to consider the correct interpretation and applicability of Section 66 of the Capital Allowances Act 1990, the immediate predecessor of Section 25 of the 2001 Act. The Special Commissioners in the Wetherspoon case made the following statement concerning the passage of Lord Reid set out above:

"We do not understand Lord Reid in the passage cited from Barclay, Curle to be saying more than that expenditure on alterations to a building (over and above expenditure necessary to install it) was allowable to the extent that such expenditure is incidental to the installation of the plant in order that the plant can function

properly by reference to the purpose for which it was installed. Thus, for example, if a cooker is installed, expenditure incidental to the installation may be incurred on the removal of a wall (or part of a wall) in the existing building in which the cooker is installed, to allow proper access to the cooker to make it useful for the purposes for which it was installed. Such expenditure would qualify under Section 66. In our view, it would be stretching Section 66 beyond its evident purpose to allow expenditure on the construction of kitchen walls to qualify, on the basis that the exigencies of the Appellant's trade, including statutory or regulatory requirements, require that kitchen walls themselves must be constructed so that the cooker may serve its proper purpose. The construction of the kitchen walls was not incidental to the installation of the cookers (or other kitchen equipment). It was part of the creation of a kitchen, in which the cookers and other kitchen equipment could function properly....."

The Special Commissioners in the Wetherspoon case went on to state the following:

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

The case of Bradley (Inspector of Taxes) -v- London Electricity plc (1996) was also referred to by the Respondents; where a substation was found not to be plant by the High Court despite that fact that parts of its construction may have been specifically designed to house the transformer equipment. The question as to whether the substation was 'incidental' to the equipment was not an issue, as the substation did not represent alterations to an existing building.

The decision of the Tribunal

The Tribunal decided that there was sufficient nexus between the security equipment and the control room so as to make the construction of the control room properly incidental to the installation of the security equipment. The Tribunal gave four reasons for reaching its decision as follows:

- The control room would not have been constructed if it were not for the company seeking to obtain the two contracts for surveillance work. In order to carry out the contracts the company had to acquire specialist security equipment and then the construction of the control room became inevitable in order to provide a secure enclosure for the equipment.
- The company had very little, if any, discretion concerning the specification of the control room, which had to comply with a specific British Standard Code of Practice.

- It was irrelevant that the security equipment was purchased after the control room was constructed. The Tribunal rejected the assertion by the Respondents that the timing of the work was an issue when deciding if such work was incidental to the installation of plant or machinery.
- The cost of the control room was not disproportionate to the cost of the security equipment.

The Tribunal made it quite clear that its decision had been reached based on the 'particular and somewhat singular facts and circumstances of this case'. It was also interesting to note that both parties had agreed not to seek an order for costs in the event that either party was successful.

Conclusions

On the face of it, this decision might be viewed as widening the scope for building alterations to qualify for capital allowances as 'incidental' to the provision of plant or machinery. In circumstances where regulations require that certain works must be carried out as a natural consequence of installing plant or machinery, then the B&E Systems case could provide the dicta for including such expenditure together with the cost of plant or machinery for capital allowances. We are not convinced that the decision by the Tribunal is supported by existing case law.

Looking firstly at the Barclay Curle case and the words of Lord Reid, we accept that the expenditure on the control room was required by the 'exigencies of the trade'. Without the control room the company would not have obtained the surveillance contracts. We do not believe that the control room was constructed 'in order that the new plant or machinery may serve its proper purpose'.

Rather, we believe that the control room was constructed in order to obtain the contracts. That, in our opinion, is not the same thing. The proper purpose of the security equipment was to carry out the surveillance required under the contracts. As the company itself conceded, the control room would not have been built if it was not required by the client. We contend that the requirements of the client are not sufficient to make the alterations 'incidental' to the installation of the security equipment.

From the Wetherspoon case we can see that in order for works of alteration to an existing building to be properly regarded as 'incidental' to the installation of the plant or machinery, there must be 'sufficient nexus' between such works and the plant or machinery. The Special Commissioners found that toilet partitions have sufficient nexus with sanitary appliances, whereas kitchen walls do not have sufficient nexus with kitchen equipment. In our opinion, the control room has more in common with the kitchen walls, than it does with the toilet partitions.

The control room was not necessary for the function of the security equipment, although it must be true that the security equipment would not have been required if the company had not agreed to construct the control room. It was, therefore, regulatory and client requirements that resulted in the construction of the control room, not the installation of the security equipment.

So where does the Tribunal's decision in the B&E Systems case leave us? As neither party asked for costs, it may indicate that this case is not going to proceed to the High Court. This may be due to the unique circumstances in this case and the fact that there is an issue of national security involved. Whilst we believe that this decision would in all probability be reversed by the High Court, it is unlikely that this decision will be appealed. For these reasons, the decision may well be of limited significance as far as the definition of 'incidental' for capital allowances is concerned. Of far more significance will be the forthcoming appeal to the High Court in respect to the previous decisions in the Wetherspoon case.

For further advice concerning any of the issues raised in this briefing, please contact one of our key individuals detailed overpage, or alternatively call our helpline on 0800 526262. Information on other property tax related topics can also be found on our website at <http://bankingtaxfinance.davislangdon.com>.