[2012] UKFTT 739 (TC)

TC02399

Appeal number: TC/2011/08453

CORPORATION TAX – capital allowances – plant and machinery – excavation support equipment hired out – design service – whether first year allowances available under Capital Allowances Act 2001 – yes – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MGF (TRENCH CONSTRUCTION SYSTEMS) LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN CANNAN
JUDGE JOHN N. DENT
MR ALAN P. SPIER

Sitting in public at Manchester on 25 September 2012

Mr Grant Summers of Grant Thornton UK LLP Chartered Accountants for the Appellant

Mr Gary Griffin of HM Revenue and Customs for the Respondents

DECISION

Background

1. This appeal concerns a decision made by HMRC that capital expenditure on the cost of excavation support equipment used by the appellant in its business does not qualify for first year allowances ("FYAs"). The decision resulted in amendments to the appellant's company tax returns for accounting periods ending 30 June 2006, 30 June 2007 and 30 June 2008. The amendments were made on 28 February 2011. The total amount of additional corporation tax charged by virtue of the amendments is £550,713. There is no issue as to quantum.

2. Put briefly the issue on this appeal is whether the expenditure incurred by the appellant was expenditure for the provision of plant and machinery for leasing. HMRC contend that the equipment was used for leasing and the appellant was not entitled to FYAs at 40%. Instead it was only entitled to writing down allowances at 25% per annum. The appellant contends the equipment was not provided for leasing and that it was entitled to FYAs. There is a cashflow advantage to the appellant if the expenditure qualifies for FYAs.

Evidence

3. Oral evidence at the hearing was given by Dr Ian Jones who is the operations director of the appellant. He is a Chartered Civil Engineer and gave a description of the company's operations and of the engineering design service and excavation support solutions which it provides to the construction industry. We also heard oral evidence from Ms Elizabeth Marshall, the officer of HMRC who made the amendments to the appellant's company tax returns. Both witnesses provided witness statements upon which they were cross-examined.

4. We also had documentary evidence including:

(1) Correspondence between HMRC, the appellant and its accountants Grant Thornton.

(2) Documentation generated by HMRC's enquiry into the appellant's company tax returns.

(3) Contract documentation including design request forms and site visit reports in relation to a sample of contracts carried out by the appellant

(4) The appellant's marketing brochure.

5. We briefly set out the law below, and then set out our findings of fact based on the evidence before us.

The Law

6. The *Capital Allowances Act 2001* ("*CAA 2001*") provides for allowances in respect of certain capital expenditure by taxpayers. Allowances are available for qualifying expenditure on plant and machinery by a taxpayer carrying on a qualifying activity.

7. *Section 39 CAA 2001* states that FYAs are not available unless the qualifying expenditure is first year qualifying expenditure under specific provisions of the Act. Those provisions include *Section 44* which states that expenditure is first year qualifying expenditure if it is incurred by a small or medium-sized enterprise and it is not excluded by *Section 46*. It was common ground between the parties that the appellant is a small or medium-sized enterprise and also that it had incurred capital expenditure on plant and machinery.

8. *Section 46(2) CAA 2001* sets out the general exclusions to *section 44*. In particular "*General Exclusion 6*" states as follows:

> "*The expenditure is on the provision of plant or machinery for leasing (whether in the course of a trade or otherwise).*
>
> *For this purpose, the letting of a ship on charter, or of any other asset on hire, is to be regarded as leasing (whether or not it would otherwise be so regarded.*"

9. We were not referred to any authority as to the meaning or scope of General Exclusion 6.

Findings of Fact

10. The appellant is a trading subsidiary of MGF Limited. It was formed in 1981 to provide temporary works excavation support equipment to the construction industry. Temporary works in this context includes anything required to support or allow construction of permanent works. The appellant has grown to become a leading provider of excavation support solutions and satisfies approximately one third of the UK demand for shoring. Design solutions for temporary excavation works are an important part of ensuring a safe working environment on construction sites.

11. Customers of the Appellant benefit from a design service as well as the provision of equipment. At least 70% of the appellant's turnover comes from designed projects and the vast majority of this business would not be won or retained if a design service was not available. In 2006 the appellant fulfilled some 2,100 design projects. These range from quite small contracts to extremely large projects such as temporary works schemes for major motorway upgrades. The remaining turnover is from plant and equipment hired out with little or no design.

12. The plant and equipment with which we are concerned in this appeal includes hydraulic struts, beams, piles and panels. It is used in both designed projects and non-

designed projects. Much of this is modular equipment which can be assembled by the appellant on its own premises according to a design plan and then transported to the construction site. It is then installed by the contractor.

13. Most contractors, including household names, do not have an in-house capability to design their own temporary excavation works solutions. They outsource this requirement to specialist shoring providers such as the appellant. The appellant and a related company, MGF Design Services Limited ("Design Services"), between them employ 22 technical sales representatives and 20 graduate engineers, both civil engineers and structural engineers.

14. We were taken through the sales and design process. Following the intial inquiry a technical sales representative will visit the site and complete a design request form. This will include various supporting documentation including site plans, geotechnical information, ground investigation reports and photographs. The design request form is signed off by the customer and submitted to the design team. Design engineers will often visit the site as part of the design process. They may also visit to provide advice on correct assembly and installation. It is the engineers who design the solution based on data and assumptions provided by the customer. The engineers produce detailed design calculations and drawings and a design check certificate.

15. The appellant holds an extensive stock of modular shoring equipment. It is also often necessary for the appellant to design and assemble bespoke units which are incorporated into the design solution. For example certain types of supporting frames.

16. Each design is specific to the individual excavation project and will depend on various factors including:

(1) size and depth of excavation,

(2) ground conditions,

(3) ground water,

(4) loads from adjacent buildings, roads and railway lines and other construction plant on site,

(5) contractors preferences for certain types of equipment and certain methods of installation,

(6) the relationship between the excavation and the permanent construction works.

17. The design takes into account not only the type of equipment to be provided but also the excavation method and the process of installation. All designs are required to be in accordance with various formal industry standards and guidance. It is clear from the documentation we have seen and the evidence we have heard that this is a very technical process, in terms of identifying possible solutions, the plant and equipment to be used and the process of implementing the solutions.

18. It is not uncommon when excavation works are carried out and the solution is being implemented that something unforeseen arises, such as an uncharted pipe in the ground. In those circumstances the contractor will require further advice and it may be necessary to redesign the works. Further advice may also be required if the contractor makes an error when implementing the solution. Failure to follow the design and installation plan could lead to serious health and safety issues. Indeed unsupported excavations on construction sites can lead to fatalities.

19. The design service is provided by Design Services. Originally, the corporate structure was set up to ring fence any potential design liabilities. One issue which we have to resolve is whether Design Services provides services directly to the customers or whether it acts as a sub-contractor on behalf of the appellant. We deal with this issue in our decision below

20. The design request form is a standard form in the name of "MGF" and is signed by the customer. It is in the nature of a design brief and is addressed to Design Services. It includes extremely brief terms and conditions, including a term that "*MGF Design Services Limited exercise reasonable skill and care in the performance of their services. Liability for these services is restricted to the value of these services only*". The face of this documentation would suggest that Design Services provides the design service directly to the customer.

21. The evidence included correspondence from Design Services to customers setting out their services and also referring to "*Standard Terms and Conditions for Hire and Sale*". This correspondence referred to the "*design and supply*" of equipment but there was no evidence that Design Services supplied equipment. All equipment was supplied by the appellant.

22. Dr Jones maintained under cross-examination that it was the appellant which was the contracting party, and that Design Services was its sub-contractor.

23. We were provided with "*Model Conditions for the Hiring of Plant*" and "*Supplementary Conditions for Shoring Technology and Piling*" to be read in conjunction with the model conditions. The purpose of the latter was to define the responsibilities of the "*hirer*" and the "*owner*". It provides in standard form that all designs supplied by the owner are based on information provided by the hirer and do not form part of the contract between the hirer and the owner. We note that this anticipates that the designs have been provided by the appellant as owner of the equipment rather than Design Services.

24. There are also separate "*Conditions of Hire*" in standard form which relate only to the hire of equipment and make no mention of designs. It was not at all clear to us on the basis of the evidence whether all or only some of these documents would be incorporated into the terms on which customers dealt with the appellant.

25. We were provided with a marketing brochure for the appellant which had a separate page for Design Services. This stated in an introductory paragraph that "*MGF Design Services Ltd offer a design service to support the hire of MGF*

excavation support equipment. All customers are encouraged to utilise this service in order to obtain the most economical safe shoring solution for their particular needs".

26. There is no contract in place until the customer has chosen the appropriate design solution after which an estimate and quotation are prepared. There is no separate invoice to the customer for the design service.

27. During the course of the hearing the appellant applied to adduce invoices to customers for a sample of contracts. Given the circumstances in which the issue as to the separate entity arose, mentioned below, we permitted the appellant to adduce the invoices. All invoices for plant hire are issued in the name of the appellant. They expressly include haulage of plant to site and for each type of plant a hire charge over a specified period. Dr Jones stated in evidence and we accept that the hire charge included design services. An enhanced rate for hire is charged, which includes the design element. The prices charged are inclusive of all costs, including design, and are in excess of the hire only charges that would be made by a plant hire business. All payments are made to the appellant.

28. Dr Jones also stated that quotations were sent to customers in the name of the appellant. Unfortunately we were not provided with copies of quotations. We put this down to the fact that the issue as to which entity provided the design service only arose shortly before the appeal hearing. In any event Mr Griffin did not challenge Dr Jones' evidence on this point.

29. A professional indemnity policy is in place, which covers both the appellant and Design Services. It applies in general terms to liabilities arising from the design, specification and supervision of construction works with up to £10 million of cover. If the appellant were simply hiring out plant and equipment it would not require such indemnity insurance.

30. The equipment provided to customers is delivered by the appellant to the relevant construction site. As much pre-assembly work as possible is carried out by the appellant at its own premises. The equipment is then transported to the construction site by the appellant and installed by the customer during the construction operations. Where a design service has been provided the equipment is installed to the detailed design specification. Detailed plans and elevations are provided, along with calculations of the engineering loads involved. These are produced on the basis of underlying data supplied by the customer. Technical support and assistance is provided by Design Services. If there is additional cost during the construction phase, or damage to the equipment, it is invoiced by the appellant to the customer.

31. Design Services does not charge the customers for its services. Rather it charges sums to the appellant, albeit without any profit element. The sums charged represent wage costs to Design Services. The following table shows the turnover of the appellant and the sums charged by Design Services to the appellant for the 3 years under consideration:

Accounting Period	Sums Paid to Design Services	Appellant's Turnover
30 June 2006	£ 556,350	£ 15,561,745
30 June 2007	£ 528,675	£ 20,803,558
30 June 2008	£ 658,600	£ 28,556,014

32. We should point out that the appellant's turnover includes capital sales of plant and machinery and also the 30% of contracts which do not involve any design service.

33. Some equipment is sold rather than hired because it can be used and re-used by customers without any design. For example excavations less than 1m in depth do not require design, and the equipment that might be used in such works can be re-used. We are not concerned in this appeal with plant which is the subject of capital sales. Part of the design service will involve the construction of frames. In some cases the appellant has a stock of such frames which it constructs. The frames are then available to use "*off the shelf*" but as part of a designed scheme. The frames would not generally be sold as capital items because potential customers would not have the necessary design capability to re-use them.

34. Some equipment owned by the appellant is of a standard specification which can be hired out on several occasions to different customers.

35. Design Services issues a "*Design and Check Certificate*" to certify that the design has been carried out with reasonable skill and care by suitably qualified and experienced personnel and that the design complies with current standards and design guidance. It also supplies a calculations and drawings package together with technical support during the course of the project

36. The design engineers regularly visit sites during the construction process to ensure the correct assembly of equipment and installation. They also conduct routine audits and will sometimes visit for the purpose of providing remedial solutions and/or re-designing where issues arise during the course of a contract. The appellant separately invoices customers for such services.

The Issues

37. The issue before us can be stated quite shortly – was the appellant merely providing plant for leasing, or did the appellant provide something more in the nature of a package comprising use of the equipment together with design and support services.

38. Having defined the issue in those terms, it is necessary to record that both parties relied upon the HMRC guidance contained in its *Capital Allowances Manual* at CA23115 which we set out in full:

*"**Assets used for leasing and those used in the course of providing a service***

There is a distinction between the leasing or hiring of an asset and the provision of services that involve the use of an asset. Each case must be decided on it's own facts.

In the construction industry, you should accept that plant provided predominantly with an operative is more than mere hire and an article was issued in TB66 on 28 August 2003 to this effect. This means that such plant is not excluded from FYA by the leasing exclusion CA23110.

We changed our view after the judgment in the case of Baldwins Industrial Services PLC and Barr Ltd. That case considered whether the hire of a crane with an operative constituted a construction operation, and as such amounted to more than mere hire. Baldwins hired a 50 tonne crane to Barr to be used in the building of the new Southampton football stadium. An incident arose which led to a dispute as to which party was responsible for repairs to the crane. An essential element of the claim was whether the provision of the crane and driver was part of a construction contract within the ambit of Housing Grants, Construction and Regeneration Act 1996. A construction contract is one under which construction operations are carried out and it was accepted that a contract for mere plant hire is not a construction contract. The labour element was held to be crucial.

The hire of the crane plus driver was held to be a contract for supply of plant and labour to be used as part of the operation to build the stadium. The contract for supply of the crane and driver was for an operation that formed an integral part of, was preparatory to, or was for rendering complete a work of construction. Following the judgment we accept that the supply of plant or machinery with an operator, by a business, is the provision of a service and not mere hire.

The supply of plant or machinery with an operator means that the operator remains with the equipment during its use and that he or she will operate it alone save for exceptional circumstances. It is not sufficient for the plant or machinery to be delivered or installed by the hire company. For example, the delivery and installation of a generator would not be regarded as the provision of a service but the supply of a digger with driver would be so regarded.

Plant or machinery may be provided with an operator on some occasions and without on others. Where, at the time the expenditure is incurred, it is intended that the asset will be predominantly provided with an operator, the precise facts and use of the asset will have to be considered, but generally we accept that FYAs are due.

We also accept that the provision of building access services by the scaffolding industry amounts to a construction operation and is therefore more than mere hire. This does not apply to businesses that simply supply scaffolding poles etc for use by others.

Each case must be considered on its own facts …"

39. HMRC argued that the Appellant merely hired out excavation support equipment. The fact that a design service was available through a separate company, Design Services, did not constitute the provision of services by the Appellant. This was a new argument by HMRC raised for the first time shortly before the hearing in Mr Griffin's skeleton argument. Mr Summers did not object to Mr Griffin pursuing the argument on this appeal and we have therefore considered it.

40. Mr Griffin submitted that the design service was not an integral part of the hire of assets, as it was provided by a separate company. He said it was clear from the documentation that the customer was responsible for providing information upon which the design was based, and that the appellant had no responsibility for the design. He submitted that the appellant merely provided plant hire, and that the design service simply supported the hire and was not integral to it. In any event it was provided by a separate company directly to the customer.

41. Mr Griffin further argued that once the plant was offloaded from the appellant's vehicles, installation was the responsibility of the contractor. There was no requirement for labour to be provided by the Appellant to operate or install the equipment. There was no composite service provided by the appellant, and the charging of a single price to customers was merely an administrative convenience. Further that the turnover of Design Service was so small in comparison to that of the appellant that it could only be an adjunct to the hire business, and not integral to it.

42. HMRC did accept that if at the time the plant is purchased by the appellant it is intended that it will be used predominantly as part of a supply involving something more than the hire of an asset, and it is so used, then FYAs are available. They do not contend on the facts of this case that any apportionment is necessary to reflect the fact that up to 30% of the appellant's turnover relates to contracts without any design element.

43. There were effectively two limbs to HMRC's submissions:

(1) The design services were not integral to the hire of the equipment. The substance of what was provided to customers was leased equipment and the capital expenditure on such equipment was therefore excluded from FYAs.

(2) Even if the design services could be viewed as integral to the leasing of equipment, those services were provided to customers by Design Services and not by the appellant.

44. Mr Summers on behalf of the Appellant contended that its temporary works excavation support solutions amount to "construction operations" as defined in the *Housing Grants, Construction and Regeneration Act 1996* ("*the 1996 Act*"). As such he argued that they do not fall within General Exclusion 6. He contended that the majority of site works cannot be undertaken without a design, and that the design is

integral to the contract and to the excavation process. In the circumstances the design is not severable from the hire.

45. In this regard the Appellant referred to the case of *Fence Gate Limited v James R. Knowles Limited*, and in particular the judgment of His Honour Judge Gilliland QC were he stated at [7]: "*It seems to me that…where a contract relates both to construction operations and to other activities, … the contract is to be treated as severable between those parts which relate to construction operations and those parts which relate to other activities…*". The appellant contended that in their case only a single contract and a single composite service is provided to the customer. The design element is not severable from that contract. It therefore follows that the entirety of the agreement with the customer should be treated as construction operations under the 1996 Act.

46. The appellant maintained that despite the name of Design Services appearing on the documentation as set out above, Design Services was not contracting with the customers. The appellant was contracting with the customers to provide a design solution.

47. The Appellant argued that although the relative cost of design might be small in proportion to the overall price charged to the customers, the value to the business was 70% of turnover. This demonstrated that the design was not an adjunct, but integral to the business.

Decision

48. Both parties adopted the approach in the HMRC Capital Allowances Manual and made submissions as to whether what the appellant was providing amounted to "*construction operations*" for the purposes of the 1996 Act. We were referred to two authorities dealing with the meaning of that term in the 1996 Act, namely *Baldwins Industrial Services plc v Barr Limited [2002] EWHC 2915 (TCC)* and *Fence Gate Limited v James Knowles Limited [2002] All E.R (D) 34.*

49. It should be noted that HMRC guidance does not have the force of law. The cases referred to in the guidance and by the parties are illustrative of the types of issues that can arise when considering the nature of services provided during the course of construction projects. However we did not find these cases or the 1996 Act helpful in construing the *CAA 2001*. They deal with different terminology used in a different context to that of the *CAA 2001*. There is no reference in the *CAA 2001* to construction operations. General Exclusion 6 is of general application and not limited to the construction industry. It simply refers to the provision of plant and machinery for leasing.

50. The provisions of the *CAA 2001* itself are wide and at first sight appear to cover plant and machinery for leasing whether or not the leasing takes place together with other services. However we accept that where the leasing is provided together with something else the circumstances may be such that what is being provided can no longer be described simply as the leasing of plant.

51. We agree with HMRC's guidance to the extent that there is a distinction to be drawn between leasing of assets and the provision of services which include the use of assets. HMRC accept that the exclusion will not apply where assets are provided for use together with the provision of further services, unless those further services are merely subsidiary to the hiring of the asset. The appellant did not take issue with the test stated in those terms, but contended that the services in the present case were more than merely subsidiary. They were a key element of what the customer was purchasing.

52. The application of such a test inevitably involves a question of degree. In particular whether the service provided with the leasing makes the overall package something more than merely leasing assets. The paradigm case in a construction context may be that referred to in the HMRC guidance. The supply of plant or machinery such as a crane with an operator. However, whilst that supply may be at one end of a spectrum there will be other cases, not necessarily involving supplies of operators or labour, that amount to more than the leasing of assets for these purposes.

53. In the light of our findings of fact we are satisfied that the design service was supplied by the appellant. The contract with the customer was with the appellant and although the design was provided by a separate company it was charged for by the appellant. The design was carried out by Design Services acting as a subcontractor, and the cost was absorbed into the charge made by the appellant.

54. At the time contracts are entered into the design solution has already been produced. It is specific to the equipment that will be supplied by the appellant. On entering into contracts with customers the appellant assumes responsibility for the design and is paid by customers to assume such responsibility through enhanced hire rates. The design service is integral to 70% of the contracts, and without it customers would not hire assets from the appellant.

55. HMRC accept that where plant and machinery is provided with labour, for example a crane provided with a driver or scaffolding provided with scaffolders, then that is an indicator that what is being supplied is more than simply the hiring of an asset. In the present case however they point to the fact that none of the equipment supplied requires an operator or indeed any labour to be supplied by the appellant to install it. That is undoubtedly the case and the appellant does not suggest otherwise.

56. In our view however there can be circumstances where plant is supplied without labour but with other services and benefits such that the expenditure on such plant falls outside General Exclusion 6. Each case must be looked at on the basis of its own facts.

57. The provision by the appellant of temporary works excavation solutions includes a package of services comprising:

(1) designing the solution and taking responsibility for the design,

(2) assembling plant prior to being transported to the construction site,

(3) providing plant for the contractor to implement the solution, and

(4) dealing with any issues during the course of the construction project

58. In our view such services cannot fairly be described merely as the leasing of plant. The appellant is providing an overall service beyond the leasing of assets referred to in General Exclusion 6. It is analogous to a scaffolding firm hiring scaffolding but also providing something more, namely the labour to erect and dismantle the scaffolding.

59. In the circumstances we find that the Appellant was entitled to FYAs for the accounting periods ending 30 June 2006, 30 June 2007 and 30 June 2008. Its appeal against the amendments issued on 28 February 2011 is allowed.

60. 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.

JONATHAN CANNAN
TRIBUNAL JUDGE

RELEASE DATE: 30 November 2012