TC02580

Appeal number: TC/11/08444

Income Tax – trading expenditure – repairs and renewals – grass surface on part of caravan park replaced by hard-core surface – whether deductible as revenue expenditure and repair – Yes – IT (TOI) A 2005, Section 33; ICTA 1988, Section 74

FIRST-TIER TRIBUNAL
TAX CHAMBER

CAIRNSMILL CARAVAN PARK **Appellant**

- and -

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

TRIBUNAL: JUDGE KENNETH MURE, QC
EILEEN A SUMPTER, WS

Sitting in public at George House, 126 George Street, Edinburgh on 30 and 31 January 2013

Philip Simpson, Advocate, with Ian McLeish, CA for the Appellant

Ms Ros Shields, HMRC Officer, for the Respondents

DECISION

Preliminary

1. The issue in this appeal is whether £89,210, being the cost of resurfacing part of the area occupied by the Appellants' business, is deductible as a trading expense for the Year to 5 April 2009. An area covered with grass was resurfaced with hard-core materials. HMRC argues that it represents an improvement and as such is capital and not deductible.

The law

Income Tax (Trading and Other Income) Act 2005 ("IT (TOI) A")
Income and Corporation Taxes Act 1988 ("ICTA")

Case law

Rhodesia Railways Ltd v Collector of Income Tax [1933] AC 368
Highland Railway Co v Balderston 2 TC485
Transco plc v Dyall [2002] STC (SCD) 199
Samuel Jones & Co (Devondale) Ltd v CIR 17 TC93
Conn v Robins Bros Ltd (1966) Ch 266
Lawrie v IRC (1952) SC 39
Lurcott v Wakely & Wheeler [1911] IKB 905
J B Vale v Martin Mahony & Bros Ltd [1947] IR 30
Margrett v The Lowestoft Water & Gas Co [1935] 19 TC 481
Hodgins v Plunder & Pollak (Ir) Ltd [1957] IR 58
Wynne-Jones v Bedale Auction Ltd 51 TC 426
Phillips v Whieldon Sanitary Potteries Ltd 33 TC 213

The Evidence

2. The only witness was Mr John Dalrymple Kirkcaldy. He is senior partner of the Appellant firm which is a family business. He confirmed the terms of his Witness Statement (produced as Appel/1) and elaborated on it in evidence-in-chief and cross-examination. He explained that 70% of the customers of the Park were families with children. The rest were largely older couples. He identified an aerial photograph of the Park (Resp/5/24). The two grey strips on the right are the resurfaced area. The work had been completed in a short "window" of opportunity between October 2008 and March 2009. This avoided disruption of the business as the touring caravan area was in use only from March to October annually. Resurfacing with grass would have proved a longer process with some disruption of lettings to touring caravans. The site is licensed for 300 units, both permanent (or static) and touring caravans. There are 60 pitches for touring caravans, the rest being for static ones. 25% of pitch fees are derived from touring caravans. The photograph shows also the Appellants' administrative office, the shop, the indoor swimming pool, a toilet and shower block, and a recreational area of woodland and open ground. Of a total area of 51 acres, 14

are woodland and open ground. Over the years the proportion of static caravans has increased relatively. Customarily their owners have had touring caravans and have developed an association as customers of the Appellants. They then have "progressed" to a static caravan, customarily bought via the Appellants. Mr Kirkcaldy spoke proudly of various environmental awards which have been won by the Park – one sponsored by the naturalist, David Bellamy. Later in re-examination Mr Kirkcaldy acknowledged certain unfavourable customer reviews of the new hard surface covering the area for touring vans.

3. In cross-examination Mr Kirkcaldy explained that the local authority and Tourist Board were anxious to maintain the proportion of sites for touring caravans. He indicated that the static caravan business was preferable from the Appellants' viewpoint. There was no need for communal toilet provisions. While the shop was used more by the touring caravans, it was not a source of profit, rather a "necessary evil". There was a greater need for office staff resources to manage bookings for touring caravans. These required also a 24 hour warden service. Mr Kirkcaldy explained too in cross-examination the very favourable costs and the immediate availability as at Autumn 2008 of the materials which were used for the resurfacing works.

4. We considered Mr Kirkcaldy to be a credible and reliable witness and, indeed his evidence was not controversial. On the basis of it and the correspondence and other documents to which we were referred, we make the following

Findings-in-Fact

1. The Appellants are a partnership constituted by Deed of Agreement dated 3 June 1998. John Dalrymple Kirkcaldy is the senior partner of this family firm. Its business is that of a caravan park conducted at Cairnsmill Farm, Largo Road, St Andrews. It rents sites for static caravans and also on a short-term basis for touring caravans.

2. The area occupied by the Appellants extends to about 51 acres. There is an undeveloped area of about 14 acres, accessible to all patrons for recreational use. Of the remaining area at the material time about 27 acres were devoted to providing sites for static caravans. These are plumbed in for water and sewage facilities. They are in use throughout the Year. The remaining five acres were occupied by touring caravans, which the Appellants allowed to park there from March to October each Year. These are brief lets although some touring caravans are, by arrangement, parked there over the winter too. Many of their owners decide to acquire a static caravan and to lease long-term a site for it at the Park. It is the practice of the Appellants to select long-term lessees on the basis of an extended relationship with them over several seasons as owners of touring caravans. They will buy their static caravan via the Appellants. 25% of total pitch fees come from the touring caravans. A disproportionate amount of expenditure is required in servicing the touring caravans, including staff engaged in booking and general service facilities.

3. The Appellants provide also shop facilities, which are used mainly by the occupants of the touring caravans. There is a toilet block with lavatory and shower facilities, provided primarily for the occupants of the touring caravans. There are play areas for children on the site which are used generally, irrespective of whether they are staying at a static or touring caravan. There is a 24 hour warden service provided for the touring caravans.

4. Commercially the caravan park is run as one business, and all its sources of income are inter-related in that one entirety.

5. In Autumn 2008 the Appellants decided to restore the surface of the pitches let out short-term to touring caravan customers. These extend to about three acres and are shown as two grey strips on the copy photograph (Resp/5/24). There is an area of grass remaining between each strip but there is no grass between the individual pitches. The grass surface had deteriorated with use over about a 50 year period before. To restore the grass surface would have required the area to be left largely vacant for about two holiday seasons to allow the grass surface to become re-stabilised. Instead the Appellants replaced it with a hard-core surface, consisting of a foundation made up from a former airport runway surface (conveniently nearby for transport purposes and which had become available at a relatively cheap cost at that time) and a top surface of loose gravel.

6. These works were completed well before March 2009. This enabled the Appellants to let out the area restored from that date for touring caravans. While the pattern of business was maintained, it was not improved. However, the surface now resembles a car park and is much less aesthetically and environmentally pleasing. It is less suitable as a recreational area for children. Annual maintenance costs are marginally more than those incurred on the previous grass surface. Erection of caravan awnings on the hard-core surface is problematical as securing pins cannot be readily located on hard-core. Unfavourable customer reviews have been generated as a result of the change of surface.

7. The cost of the surface restoration work amounted to £89,210, the deduction of which for tax purposes from the partnership's profit has been refused by HMRC.

8. The value of the Appellants' business at about 2008/2009 was in the region of £4m. It was not materially affected by the carrying out of the re-surfacing works. Two valuations are produced, one about one year before and the other three and a half years later (Appel/11-14). No reference is made to the state of the touring pitch (either before or after the carrying out of the works) as contributing to the value of the business.

9. The decision to carry out the resurfacing works was prompted by a coincidence of factors, viz the unsatisfactory state of the grass surface; the availability of suitable materials for re-surfacing at a relatively cheap price and

nearby; and the avoidance of an extended period for the re-stabilisation of the top surface.

Submissions

5. While the factual background to the dispute was largely not controversial, Parties differed materially in their interpretations of the applicable law in determining whether the expenditure was of a capital or revenue nature.

6. On behalf of the Appellants Mr Simpson submitted that the question for the Tribunal to determine was whether the expenditure on the replacement hard-core surface was capital or revenue in nature. If it were capital, then it is not allowable: Section 33 IT (TOI) Act 2005. In distinguishing capital and revenue, he argued, one should identify the *entirety* of the subject involved. If a whole or substantial part of the *entirety* is replaced, that would represent a renewal and hence capital expenditure. But if the replacement is of less than the whole or a substantial part of the *entirety*, then the next question is whether an improvement has resulted. If the *entirety* has been improved as a whole, the expenditure is capital in nature. Otherwise, it is revenue expenditure and should be allowed for business tax purposes.

7. Had the existing grass surface been replaced by grass, then the revenue nature of the expenditure would have passed unchallenged, Mr Simpson continued. Clearly, where no new asset has been created, expenditure would ordinarily be revenue in nature.

8. Mr Simpson referred extensively to the leading case-law distinguishing repairs and renewals. He noted the criteria formulated by Buckley LJ in *Lurcott v Wakely & Wheeler* at p924, viz:-

> "Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject-matter under discussion. ……. the test is whether the act to be done is one which in substance is the renewal or replacement of defective parts, or the renewal or replacement of substantially the whole."

He noted an Irish case (consistent with UK law) viz *Hodgins v Plunder & Pollak*, in which expenditure on renovating a weigh-house at a factory was allowed as revenue. The reasoning was that no new asset had been created. He relied also on the decision in *Samuel Jones & Co (Devonvale) Ltd v CIR*. There the replacement of a factory chimney by a new chimney was allowed as a repair: the chimney was only part of the factory, which itself was the *entirety* (see p99-100). That decision contrasted with *Lawrie v CIR*, in which an extended roof was erected to cover an extended building. This represented capital expenditure, which, moreover, could not be apportioned to allow as a deductible expense a fraction proportionate to the size of the original dilapidated roof. Mr Simpson then referred to the recent decision in *Transco plc v Dyall*, a Special Commissioners' decision, not appealed further. The taxpayers operated a gas transportation system across Great Britain. The original cast iron pipes

were liable to fracture. Expenditure was incurred in inserting plastic piping into the cast iron pipes to avoid the risk of gas leakages. The Commissioners considered that the character of the asset was not changed by the work. It fell therefore to be regarded as a repair, and revenue in nature, rather than a renewal which would have been capital in nature. The expenditure accordingly was allowed. He then referred us to the decision in *Highland Railway v Balderston*, the case of a railway company where heavier rails were substituted in the permanent way, resulting in an improvement of a section of the line, bringing it up to mainline standards. While in a sense one kind of rail had been replaced for another, viz steel for iron rails, it resulted in a much more valuable railway and a transformation in its nature. That accordingly was held to be capital expenditure and not deductible. He then distinguished from the circumstances of the present case the nature of the expenditure in *Vale v Martin Mahony & Bros Ltd.* There a woollen mill replaced its sanitary accommodation. While the original provision was satisfactory, the new provision was an improvement. It therefore fell to be disallowed. Finally, Mr Simpson noted *Margrett v The Lowestoft Water & Gas Co*, where the replacement of an old reservoir with a new one which was an improvement, was considered to be capital expenditure and disallowable.

9. The *entirety* in the present case, Mr Simpson submitted, was the caravan park, extending to the entire 51 acres, including the 14 acres used as a recreational area. The two strips affected were only a minor part. The five acres used for touring caravans was not a separate, divisible part of the caravan park. The business should be viewed, he submitted, as embracing its whole activities, both the static and the touring caravans. The static caravan side of the business was a development arising from the touring caravans. The shop and recreational facilities served both categories of campers. Indeed, the common facilities indicated that the *entirety* was the whole park.

10. A replacement of a subsidiary part is a repair, not a renewal. The costs of the works should, Mr Simpson argued, be compared with the value of the whole undertaking. On these criteria the caravan park as a whole had not been improved. There had been no significant change overall, Mr Simpson suggested.

11. By way of a reserve argument Mr Simpson suggested that even if the *entirety* were restricted to the five acres occupied by touring caravans, the three resurfaced acres were not a substantial part. A significant grass-covered area remained. Additionally the block containing the lavatories and shower facilities should be added, as it served only the touring caravans.

12. Mr Simpson then considered whether the re-surfacing had improved the park as a whole. The re-surfacing was not a "like for like" replacement. HMRC had argued in correspondence (Respondents 5/40 and 50) that there was a greater durability and climatic resistance and lower maintenance costs resulting. That was questionable. The previous surface had lasted for about 50 years. Indeed, maintenance costs now were slightly increased. But while the hard-core re-surfacing avoided disruption of business activities, it detracted from the ambience and aesthetic appearance of the Park. Grass better fitted the business' ecological ethos. It was a preferable surface

for children to use. Furthermore, there was no evidence of an increase in the overall value of the Park.

13. In short the hard-core re-surfacing was the cheapest and quickest solution for the business, but it did not produce an improvement. Accordingly Mr Simpson invited us to allow the Appeal.

14. In reply on behalf of HMRC Ms Shields submitted that the expenditure should be disallowed for tax purposes. She agreed with Mr Simpson that the first consideration was to determine what was the *entirety*. Thereafter, she argued (differing somewhat from Mr Simpson) that we should consider whether there had been the replacement of the whole or a substantial part of the business. Here the touring pitches generated 25% of the business' income, and the Appellants had decided to ensure its continuance by replacing the grass with a hard surface. They could not afford to lose income by a delay in the availability of the pitches. Accordingly, the touring area represented the entirety and the works were not a repair but an overhaul. In any event the entirety had to be judged by reference to what produces income. Here the recreational land, the swimming pool, and (for practical purposes) the shop did not yield income.

15. In the present case the works undertaken created a permanent and enduring advantage for the business, Ms Shields argued. This accrued to its fixed capital. Accordingly the works represented more than a repair in that the land or surface had to be excavated, replaced by entirely different material, viz hard-core, and then surfaced with gravel. In effect a new asset had been acquired.

16. Ms Shields then reviewed the relevant case-law which, she argued, supported her contentions. In *Phillips v Whieldon* the new barrier constructed to protect the pottery factory from flooding from the nearby canal, represented capital expenditure. There Donovan J concluded that the importance of the new barrier was such that it represented the premises (*or entirety*) for tax purposes. Somewhat similarly in *Wynne Jones v Bedale Auction Limited* Foster J considered that expenditure in reconstructing the cattle ring in the taxpayer's auction mart was on the facts of that case, capital expenditure on the basis that the premises (*or entirety*) were the ring itself. Ms Shields sought to derive further support from *Margrett v The Lowestoft Water & Gas Co* where expenditure on a water-tower and the construction of a new reservoir, of twice the size and with other improvements on the previous one, was held to be capital in nature. At p488 it is observed that while repair involves renewal, it is renewal of a part, of a subordinate part.

17. Ms Shields made reference also to the decisions in *Rhodesia Railways Ltd, Conn v Robins Bros Ltd, Lurcott v Wakely & Wheeler* and *Vale v Martin Mahony & Bros Ltd*. The decisions there, she submitted, were consistent with her argument that the expenditure in this case brought into being a new improved capital asset. Accordingly the expenditure should be disallowed for tax purposes and the Appeal should be refused.

Conclusion

18. Both Ms Shields and Mr Simpson addressed us helpfully on the case-law cited. The distinction between capital and revenue in the context of expenditure on repairs and renewals is essentially a question of fact. The inference to be drawn depends on each individual case. We have recorded Parties' arguments on the case-law in the preceding section of our Decision. In the abstract these summaries did not seem controversial, and we do not propose to rehearse the substance of them again. However, we would note the following observations in *Transco*:-

> [79] "… we derive the principle that the replacement of part of an asset is repair, that that is not altered by the fact that the replacement of part is by a new component of different materials, and that a test to decide whether there is a repair or an improvement is whether the character of the asset is changed by the work. Repair occurs when part of a complex whole is renewed or replaced and renewal occurs when substantially the whole is reconstructed or when the character of the subject-matter changes. In the present appeal the evidence supports the conclusion that it was only small parts of the complex whole of the network which were renewed each year and that it could not be said that substantially the whole was reconstructed nor did the character of the subject-matter change. It remained a pipeline throughout which gas was transported; neither the pressure nor the capacity was materially increased."

19. The first aspect to be determined is identifying the *entirety* of the subject which has been repaired. In our view the *entirety* is the whole caravan park. The enterprise is integrated physically and commercially. There is no physical barrier within the area of the Park, segregating the types of custom. Commercially there are certainly two categories of customer – the owners of fixed caravans and those owning touring caravans. However, the touring caravan custom is the source of the sales by the Appellant of fixed caravans and of the leases of permanent sites. Indeed, it provides a means of filtering suitable long-term tenants from the Appellants' point of view.

20. Apart from the shower and toilet block which is used primarily by the touring caravan custom, the other facilities at the Park are used, albeit to varying degrees, by both categories of custom. The shop, recreational areas, and the open land extending to some 14 acres or so are used by both groups.

21. On that view the area of the Park which has been resurfaced is only a very small part of the *entirety*. It extends to three acres out of a total area of 51 acres.

22. The next aspect to decide is whether there has been an *improvement* and, further, whether that affects the *entirety* as a whole. That was the somewhat technical approach which Mr Simpson invited us to follow. We think that this is sound-in-law, and we would refer to the observations of Lord Carmont in *Lawrie* at p401:-

> "The importance of considering an entirety is, of course, with a view to determining the character of the work done, because what might at first look

like a renewal may, when applying the matter to a larger unit, be shown to be only a repair."

23. In the correspondence between HMRC and the taxpayers' accountants the former suggested that the hard-core surface is more durable than grass and consequently and quite simply is thus an *improvement*. That inference may have a superficial attraction. However, as the evidence emerged, other considerations arose. Durability seems questionable as the original grass surface had been in existence for about 50 years (para 10 of Mr Kirkcaldy's Witness Statement – and not challenged in cross-examination). Maintenance costs of the new hard-core surface are, if anything, marginally higher. The hard-core has less aesthetic appeal: it is like any hard-surfaced car park. It is not suitable as a recreational area for children. Securing a typical camping awning on a hard surface is problematical inasmuch as fixing pins cannot easily be located. This, in fact, has generated customer complaints.

24. We do not consider that that part of the Park ie the area allocated to touring caravans, has been enhanced or improved as a result. Also in the broader context of the Park as an *entirety* we do not consider that it gives rise to an improvement. In the valuations produced before and after the works were undertaken, there is no suggestion of an improvement or resulting enhanced value.

25. The most obvious advantage to the Appellants of re-surfacing in this manner was that it avoided a serious disruption of their lettings for touring caravans over an extended period. A "like for like" re-surfacing with grass would not have stabilised and been suitable for use for up to two years. An immediate contributing incentive was the availability of suitable materials (the surface of a runway at nearby Leuchars Air-base) as a hard-core foundation, at an attractive price, and with minimal carriage costs.

26. For all of these reasons we consider that the expenditure of £89,210 on re-surfacing with hard-core is a revenue expense, deductible for tax purposes. The Appeal is accordingly allowed.

27. Finally, we would record our thanks to both Ms Shields and Mr Simpson for their presentation of their respective arguments and their analyses of the authorities cited.

28. 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

29. 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.

KENNETH MURE, QC
TRIBUNAL JUDGE

RELEASE DATE: 5 March 2013