

Capital or revenue expenditure

(Lecture B1147 – 9.40 minutes)

The recent cases of Turners (Soham) Ltd (“Turners”) provides a useful refresher of the distinction between capital and revenue expenditure for tax purposes.

Capital expenditure is expenditure that is intended to give an enduring benefit to the business. Normally, the purchase of a fixed asset would meet the definition of capital expenditure but there are specific tax rules that can treat it as revenue expenditure instead.

Development expenditure of a revenue nature is deductible, irrespective of whether it is charged to P&L as an expense or capitalised in the balance sheet

Rewiring (because electrical systems are fixtures integrated into a building) is more complicated. If the cost of works exceeds 50% of cost of replacing the whole system (judged over a rolling 12-month period), it is treated as capital expenditure. The expenditure is therefore included in the special rate pool if no AIA is available.

Some capital items do (or did) qualify for immediate deduction such as the replacement of trade tools. But what are (and are not) trade tools?

The Turners case involved discussion of many aspects of the capital versus revenue debate.

Turners was a road haulage company that in the years 2008-2011 purchased replacement trailer units, tractors and tank units totalling £33 million. In their accounts they capitalised the acquisitions and put a depreciation charge to profit and loss in each period. In their tax computation for 2008 they initially claimed capital allowances but then in 2011 they amended their tax computation for 2008 by disclaiming the capital allowances and claimed a full deduction for the cost against their trading profits. They also made an overpayment claim under FA 1998, Sch 18 para 51. A similar amendment was made to 2009 tax computation and no claims for capital allowances were made in subsequent years.

The company argued that the deduction claimed for the year to 2008 was based on ICTA s74(1)(d) ICTA 1988 which stated that:

‘Subject to the provisions of the Corporation Tax Acts, in computing the amount of profit to be charged under Case I or II of schedule D no sum shall be deducted in respect of ...

(d) any sum expended for repairs of premises occupied, or for the supply, repairs or alterations of any implements, utensils or articles employed for the purposes of the trade or profession beyond the sum actually expended for those purposes;’

The basis for the argument was that by denying a deduction for amounts beyond those actually expended, the section implicitly permits deduction for expenditure up to that point and that this would include capital expenditure.

The FTT noted that if a deduction is to be claimed for an item the first step is to see if it is deducted in the accounts of the trade; if it has been, the second step is to see if its deduction is prohibited and the third step, if the first two do not result in a deduction, is to see if there is any express provision under which deduction is required.

They concluded that, as there was no deduction in the accounts and that the deduction would be prohibited as capital, there should be no deductible amount for the replacement items. Section 74 was prohibitive to restrict a deduction for amounts expended but did not therefore allow provision for capital amounts up to the limit.

For the subsequent years, the company claimed relief under CTA 2009, s 68 which allowed a deduction for the expenses incurred on the replacement of trade tools which would otherwise not be allowable because they were capital in nature. The discussion centred around the meaning of 'expenses incurred' and the FTT took the view that this should mean there was a debit in the accounts of the company under GAAP. As this was not the case here there could be no deduction. They also noted that tractor and trailer units would not fall to be treated as tools as used in common language.

Lastly the FTT rejected the claim for overpayment made by the company because HMRC are not liable to give effect to such a claim where the liability was calculated in accordance with generally prevailing practice at the time. As there was a generally agreed practice of claiming capital allowances on such replacement items HMRC were not liable to meet the company's claims for an overpayment of tax.

It should be noted that s68 CTA 2009 was repealed in relation to expenditure incurred on or after 1 April 2016 for corporation tax purposes. Relief is now available for most items under the existing capital allowances regime or the relief for residential landlords for replacement of furnishings, appliances and kitchenware, which took effect from the same date.

There is a common application of the principle that capitalised costs of a revenue nature cannot be deductible as revenue expenditure unless or until they are charged as expenses in the profit and loss account.

Many companies and businesses capitalise the cost of an office refurbishment. This might consist of little more than redecoration in some cases but might be expensive.

If a refurbishment that is revenue in nature is capitalised, no immediate deduction will be available. However, when the company or business depreciates this expenditure it will be allowable as a revenue expense in each period.

Care must be taken not to disallow this depreciation, perhaps by referring to it in the profit and loss account as "deferred refurbishment costs".

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