

Examining HMRC's refusal to allow capital allowances

09/08/2016

Property analysis: What were the most important elements of the judgment in *Wellstead v HMRC*? Rory Mullan, junior tax barrister at Old Square Tax Chambers, explores the outcome of the judgment and looks at the developing trends around this area of law.

Original news

Wellstead v HMRC [2016] UKFTT 0492 (TC)

A company was entitled to capital allowances on acquiring an interest in a property. The tribunal decided that it had acquired a 'relevant interest' in the property in order to qualify under the legislation, despite the fact that it had only been granted an underlease.

What is the significance of this decision for property lawyers?

The facts contain an important lesson—the manner in which a property transaction is carried out can have important knock-on implications for tax purposes. In this case the dispute (which took some 12 years to resolve) only arose because a factory was purchased by way of underlease rather than a partition and assignment of a head lease.

Thankfully, the tribunal took a common sense approach and decided that the issue should not turn on conveyancing niceties, but this very much depended on the construction of the legislation which appeared to allow for such an approach.

Briefly, what was the background to this decision?

The appellant acquired a factory by way of underlease from a connected company. That underlease largely exhausted the interest of the company in the property. The transaction was carried out this way rather than an assignment largely because the company held a headlease relating to two properties whereas the interest the appellant was purchasing related to only one of them. An assignment was not a straightforward matter and would have required a partition of the headlease. From a conveyancing point of view, the approach taken was cheaper and simpler.

It did have a significant tax consequence, however. It was agreed by all that if the appellant had taken the interest by way of assignment there would have been no question that he was entitled to capital allowances in respect of his purchase. Since he had taken an underlease from a connected company, however, HMRC argued that he was not entitled to capital allowances and denied his claim to them.

This had potentially huge significance for the taxpayer who had only entered into the transaction in the belief that the allowances would have been available.

What were the key legal issues before the court?

The key issue was whether the appellant had acquired 'the relevant interest' in the property. This was effectively the interest originally owned by the company. However, when that interest is split by way of granting a lease out of it, the legislation provides that the lessor's interest 'does not cease to be the relevant interest merely because of the creation of

a lease or other interest to which that interest is subject' (section 288(1) of the Capital Allowances Act 2001(CAA 2001)). It also provides for an election to treat certain leases as the relevant interest, but that it is not open where the transaction concerns connected persons.

The issue for the tribunal was whether this meant that, absent a valid election, the grant of a lease could never be the sale of a relevant interest. The tribunal accepted in this case that the result would be somewhat odd if that were correct, as the underlease effectively represented all of the valuable interest. It was not clear how denying allowances in those circumstances was in line with the purpose of the legislation.

Ultimately, the tribunal accepted the argument that the legislation contemplated the possibility that the grant of a lease could be the sale of a relevant interest in suitable circumstances. In particular the use of the word 'merely' in CAA 2001, s 288(1) left open the possibility that the grant of a lease could be the sale of a relevant interest. Looking at what happened in context, the tribunal accepted that there had in fact been the sale of such a relevant interest for the purposes of the legislation.

Does this case leave any unresolved issues?

The decision acknowledges a degree of flexibility in the operation of the legislation which is obviously to be welcomed. There may be a question as to how far it goes in terms of identifying when the grant of a lease will be the sale of a relevant interest. That will always be a question of fact, but it is likely that in any scenario where the lessor retains a leasehold interest of any value, there will not have been a sale of the relevant interest absent a suitable election.

Are there any trends developing in this area of law?

This is the latest in a series of cases where the courts and tribunals have acknowledged that principles of purposive construction apply not only to impose a charge to tax in cases of avoidance, but also to give a sensible construction of the legislation to allow a relief to be obtained or to prevent a tax charge applying unfairly.

It can only be hoped that this in turn persuades HMRC not to relentlessly pursue technical arguments at the expense of the obvious merits of the case. The appellant here had dealt with the dispute over 12 years. He clearly fell within the intendment of the legislation and there was no suggestion of tax avoidance. Despite this, and the tribunal having previously urged HMRC to reconsider their decision, they persisted all the way to a hearing based on a very technical reading of the legislation which is at odds with a more modern approach of purposive construction.

Rory Mullan is a junior tax barrister with Old Square Tax Chambers and successfully represented Mr Wellstead in his appeal against HMRC's refusal to allow capital allowances. He is co-author of The Interaction of EU Treaty Freedoms and the UK tax code and is a member of the Revenue Bar Association, the Chancery Bar Association and the Stamp Taxes Practitioners Group. He is also qualified as a chartered tax Adviser and sits on the CIOT EU and Human Rights sub-committee.

Interviewed by Janine Isenegger.

The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor



CLICK HERE FOR
A FREE TRIAL OF
LEXIS®PSL

[About LexisNexis](#) | [Terms & Conditions](#) | [Privacy & Cookies Policy](#)

Copyright © 2015 LexisNexis. All rights reserved.