More Than Just Hope! Property Repairs And Improvements – Maximising Tax Relief

Julie Butler looks at some practical issues to consider for businesses incurring expenditure on property repairs and improvements.

In the drive to achieve maximum income tax/corporation tax relief at the earliest possible point, the tax benefit of improvements made to property can sometimes be overlooked.

Firstly, the details and costs of the improvements made should be carefully recorded, as they will increase the base cost for capital gains tax (CGT), in the case of a future sale. However, they can also qualify as eligible expenditure for CGT rollover relief. For example, where business land or property is sold for development it can qualify for rollover relief, and likewise, the improvement to property can qualify as an asset for the gain to be rolled into.

Record full details, take copies of invoices, and ensure that the information is safely retained for future use.

Repairs – more than 'patch repairs' can still be a revenue expense!

Let's now consider when the property owner wants to achieve the maximum amount of relief as a revenue expense.

Following hot on the heels of the Cairnsmill Caravan Park case (Cairnsmill Caravan Park v HMRC [2013] UKFTT 164 (TC)), the taxpayer has enjoyed another victory in arguing that expenditure should be treated as a revenue expense, as opposed to a capital purchase.

The case in question, Hopegear Properties Ltd v HMRC [2013] UKFTT 331 (TC), concerned expenses on the repairs and widening of the main entrance road to an industrial estate. The expenses comprised the repairs to the entrance road itself, repairs to footpaths and re-laying of fibre optic cables, related landscaping costs, changes to an existing car park, and the construction of a temporary access road for the duration of the repairs. A small amount of the expenditure relating to the temporary diversion costs necessary to carry out the road works had already been capitalised by the taxpayer.

HMRC argued that the entire amount of the expenditure was capital in nature, being one overall scheme of alteration to the industrial estate. The tribunal, however, found HMRC's objections to be incorrect, going so far as to comment 'there should have been no dispute as to deductibility of these costs, and it is surprising that [the HMRC] objections have been raised'. In reaching their decision, the First-tier Tribunal (FTT) had separated the expenditure into three separate headings:

1. Road works

The FTT rejected the HMRC view that, "the road could have been 'patch' repaired, and the fact that this was not done makes the expenditure capital". Given that a small amount of the temporary diversion costs had already been capitalised, the tribunal accepted that the remaining amounts were revenue expenditure, which was incidental to expenditure on the main entrance road.

2. Cable works

The FTT found that the costs associated with the cable works were all revenue in nature, as the work only affected part of the cabling system on the site. The tribunal went on to say that, "the installation of new cabling was of such a minimal amount that it cannot be said that it created a new capital asset". The costs were therefore allowed as a revenue expense.

3. Work to car park and footpaths

The expenditure incurred under this heading comprised work on the front car park and the reinstatement of footpaths. Again, the tribunal found that the whole amount of these costs were revenue in nature. Accordingly, the FTT allowed the taxpayer's appeal and summarised its views with the following statements:

> "There is no scheme of alteration. The expenditure, as itemised, can be considered individual pieces of work and allowable as revenue deductions".

> "The relevant entirety (the road network, cable network and Bankside House) is the asset being repaired. The nature and extent of the work shows that there has not been a reconstruction, replacement or renewal of the asset or substantially the whole of the asset. The character of the assets has not changed when the overall effect of the work is examined".

> "The expenditure is clearly identifiable and sufficiently itemised. The concept of notional repairs is not a relevant consideration. It is accepted by the tribunal that the widening work on the road is a capital expenditure and other expenditure directly relating to that widening would also be a capital expenditure. These have been indicated in the decision above".

The work on the car park and footpath were thus deemed to be a repair.

With the success of Pratt v HMRC [2011] UKFTT 416 (TC), Cairnsmill and now Hopegear, there is every reason for property owners to be positive about the deductibility of the repair expenditure they incur. Each one of these cases offers the taxpayer a little more clarity as to what actually constitutes a revenue expense, and any repairs currently under consideration should be examined in context with the details and comment contained within the results of these recent decisions.

Points to consider

The key is to plan ahead and to consider the entirety of the planned works to the property, what was there before, and the valuation before and after the project has taken place. It will not be enough to take a broad-brush, general approach.

It is recommended that a complete review of proposed work relating to repairs and renewals be undertaken, to ensure these costs are analysed correctly and accurately split into capital or revenue headings.

Where larger scale work is planned or envisaged, contractors' 'tender or specification reports' can be of crucial importance in detailing and examining the precise scope of the work to be carried out. Reports of this nature tend to contain a 'nature of works' heading, which can be used to assist with pinpointing and analysing the various revenue and capital elements of the work.

This information can be viewed in context with the work that is ultimately completed, and by reference to the invoicing. By examining the work in this way, it is possible to ascertain how tightly a schedule of works has been adhered to, and maximise the potential for a robust repairs claim.

Consider what questions or queries HMRC could possibly raise, and formulate answers to these. Ensure that sufficient information and detail is held, so that a robust defence can be made in the event that the position is challenged. Anticipate that queries will be made and plan for the worst-case scenario.

By taking these steps, property owners can then be sure that the best tax position is achieved and valuable reliefs secured, particularly in light of the recent favourable rulings.

Not keeping good or sufficiently detailed records and/or making an automatic assumption that the work undertaken is a repair. The devil is in the detail!

Practical Tip :

The timing of the expenses is key to tax efficiency. If the expenditure creates a tax loss in the tax year it is essential to examine how the property owner can use this. Any property tax loss can be carried forward against profits of the same rental business only.