



[2021] UKFTT 0193 (TC)

**TC08143**

*INCOME TAX – partnership return – enquiry and closure notice – ss 33 and 34 of ITTOIA 2005 – deductibility of renovation costs to buildings –farmhouse listed building of historical significance – whether expenditure capital in nature – whether ‘wholly and exclusively’ for the purposes of the trade – the trade in question – the implications of the dissolution of partnership on the legal tests – appeal dismissed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**Appeal number: TC/2016/03298**

**BETWEEN**

**MESSRS ELLIOT BALNAKEIL**

**Appellant**

**-and-**

**THE COMMISSIONERS FOR  
HER MAJESTY’S REVENUE AND CUSTOMS**

**Respondents**

**TRIBUNAL: JUDGE HEIDI POON**

**Sitting in public at George House, George Street, Edinburgh on 4 December 2017 and 12, 13, and 14 November 2019**

**Gordon Watt, Advocate, instructed by Independent Tax LLP, for the Appellant**

**Matthew Mason, Litigator of HM Revenue and Customs’ Solicitor’s Office, for the Respondents**

## DECISION

### INTRODUCTION

1. The appellant, Messrs Elliot Balnakeil was a partnership, now dissolved. This appeal concerns the deductibility of items of expenditure in the partnership accounts for the year to 28 May 2011, which formed the basis of assessment for the tax year 2011-12.

2. By closure notice dated 9 February 2015, the respondents ('HMRC') disallowed a total of £273,001 claimed as deductible expenses in the accounts, of which £6,980 has been agreed, leaving the disputed items for determination as follows:

(a) £206,407 as expenditure on repairs to Balnakeil House;

(b) £23,213 as expenditure on repairs to the Bothy;

(c) £36,401 as legal and professional fees related thereto.

3. Parties are agreed that the two legal issues for determining the appeal are:

(1) Issue 1 – whether the disputed expenditure was capital or revenue in nature;

(2) Issue 2 – whether the disputed expenditure was incurred wholly and exclusively for the purposes of the partnership trade.

### LEGISLATION AND CASE LAW

4. The provisions under the Taxes Management Act 1970 ('TMA') relevant to the procedural aspects of the appealable decision are under s 12AC, s 28B, s 49C.

5. The onus of proof in this appeal is governed by s 50(6) TMA, which provides that the closure notice assessment shall stand good unless the appellant discharges the burden that it has been overcharged.

6. For the substantive issues, the relevant provisions from the Income Tax (Trading and Other Income) Act 2005 ('ITTOIA') are:

#### **33 Capital expenditure**

In calculating the profits of a trade, no deduction is allowed for items of a capital nature.

#### **34 Expenses not wholly and exclusively for trade and unconnected losses**

(1) In calculating the profits of a trade, no deduction is allowed for –

(a) expenses not incurred wholly and exclusively for the purposes of the trade, or

(b) losses not connected with or arising out of the trade.

(2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade.

7. Parties referred to the following authorities:

(1) *Lurcott v Wakely and Others* [1911] 1 KB 905 ('*Lurcott v Wakely*')

(2) *Ushers Wiltshire Brewery Ltd v Bruce* [1914] 6 TC 399 ('*Ushers Brewer v Bruce*')

(3) *Whimster & Co v Comrs of Inland Revenue* [1924] 12 TC 813 ('*Whimster v IRC*')

(4) *Copeman v Flood (William) and Sons Ltd* [1941] 1 KB 202 ('*Copeman v Flood*')

- (5) *Bentley, Stokes and Lowless v Beeson* [1952] 33 TC 4914 (*'Bentley and Ors'*)
- (6) *Conn v Robin Brothers Ltd* [1966] 34 TC 266 (*'Robin Brothers'*)
- (7) *Tucker v Granada Motorway Services Ltd* [1979] 53 TC 92 (*'Tucker v Granada Motorway Services'* or *'Tucker'*)
- (8) *Robinson v Scott Bader Co Ltd* [1981] 54 TC757 (*'Scott Bader'*)
- (9) *Vodafone Cellular Ltd v Shaw* [1997] 69 TC 376 (*'Vodafone v Shaw'*)
- (10) *Christopher Wills v HMRC* [2010] UKFTT 174 (*'Wills v HMRC'*)
- (11) *G Pratt & Sons v HMRC* [2011] UKFTT 416 (TC) (*'Pratt v HMRC'*)

#### **THE WITNESS EVIDENCE**

8. The appellant called three witnesses. Mr David Main, a partner of the accountancy firm Whitelaw Wells CA, which has acted for the appellant and the Elliot family since at least 1971. The other witnesses were David Elliot and Andrew Elliot, who were partners of the appellant at the material times. I find all three witnesses to be credible, and accept their evidence as to matters of fact, but have set aside their opinions on the facts at issue.

#### **THE FACTS**

##### ***Background to the partnership***

9. The Elliot Balnakeil partnership had existed for over 100 years as the trading medium of the Elliot family for generations. Its main activity had been in the farming of sheep and cattle as breeding livestock (Lairg Ewe and Tup, Dignwall Store Calf) to be sold on to other farmers. The farm is in Durness, Lairg in Sutherland, in the north-west Highlands of Scotland.

10. Andrew Elliot is a farmer by trade; he joined Messrs Elliot Balnakeil in 1986, and took over the management of the farm in 1992, for which he received a salary as a first charge on the profits. He was the nominated partner of the partnership prior to its dissolution. Andrew Elliot lives in the Scottish Borders, where another family farm is based. He joined the Borders farming partnership in 1980, and became the sole owner from 1989.

11. David Elliot had been a partner of the appellant since 1967, when his father was then actively managing the farm. Being a surgeon living in south-east of England, he was not involved in the day-to-day running of the Balnakeil farm, but was 'regularly consulted' and was 'actively engaged' in major business decisions for the Balnakeil partnership.

12. Andrew and David Elliot are cousins, and from 1998 onwards, they were equal partners in terms of share ownership. There had been a deterioration in the relationship between the partners from around 2006, when Andrew Elliot was unwell for a period of seven months. The partnership was eventually dissolved on 8 October 2014.

##### ***Assets used in the partnership business***

13. The Balnakeil partnership had a hill farm of some 35,000 acres originally, some of which was sold off over the years, reduced to 25,500 acres in 1986, and further to 13,000 acres in 1999. The terrain of the extreme north means that it takes 15 acres to keep one sheep, as distinct from the normal two to three sheep per acre. Both partners spoke of the financial challenges in running an upland and hill sheep farming in a remote location.

14. Other assets in the partnership included a number of farm buildings and houses to provide 'tied accommodation' for staff working on the farm, since there are 'really no options' given the 'outlying situation' of the farm with no alternative housing in and around 100 miles.

15. The Balnakeil House is the biggest farm property, and was used until 1992 to provide accommodation for the general manager, who was then responsible for managing and running the farm with around eight employees. The last general manager died in 1992, at a time when upland and hill sheep farming business had been suffering financially through several difficult

years. Instead of appointing a new general manager, a decision was taken that Andrew Elliot would take over the management of the farm by making regular visits from the Borders.

16. The House has nine bedrooms and public rooms, a farm house kitchen with a long oak table, and a courtyard. Before the expenditure in question, the House was furnished and serviced by water and electricity, with the interior and the furnishings remained as it had been since the last farm manager moved out in the 1990s. From 1992 onwards, the House was used annually for a month between mid-April and mid-May by a shepherd at lambing time, and occasionally by casual workers (e.g. silage contractors and fencers) and farm employees, or when Andrew Elliot visited the farm, though he would be staying in one of the farm cottages as the House became increasingly uninhabitable.

17. The Beach Bothy is a small outbuilding of one bedroom, and was historically used as a shepherd's cottage. It was last used in the 1970s for accommodation purposes, but became uninhabitable due to disrepair, and was used for storage of sheep feed boxes and nets.

### ***The significance of the House***

18. The Balnekeil House is dated 1744, and built by the Mackay chiefs as a family mansion on the site of an earlier building, which had at one time been the summer palace of the medieval Bishops of Caithness. As the Mackay chiefs' main residence in Sutherland, it is considered to have importance for the Mackay clan worldwide. It was in the early 1800s that the House came to be occupied by tenant sheep farmers, and has been owned by the Elliot family since 1918.

19. In 1971, Historic Scotland listed Balnakeil House as a 'category A' building, meaning that it is of 'national importance', and being in the top 7.5% of listed buildings. Its interior is a mixture of original features, and alterations and decoration from the 1860s such as wood panelling; the walled garden is dated 1863. The exterior is described in the listing as:

'Two storey and attic, symmetrical U-plan house; four centre bays, projecting outer wings with 3-bay inner faces to small paved court; two first-floor and small attic windows only in south facing outer gabled wings. All harled, with polished ashlar margins and dressings.'

20. In 1972, the House was 'Grade 1 listed' by the Highland Council, which enables the Council to enforce statutory maintenance. In October 2002, and House (together with the Old Corn Mill) was included in the Buildings at Risk Register by the Council. An Urgent Works Notice was served under s 49 of the Planning (Listed Buildings and Conservations Areas) Act 1997, which would empower the Council to execute any works considered to be urgently necessary for the preservation of a listed building, and to recover (under s 50) from the owner the expenses of any works carried out. The letter requested access for inspection of the property, after stating the following:

'In view of the apparent condition of this building ... we are actively considering the use of the above powers, in order to safeguard the building and to arrest any further deterioration. However, I am sure you will agree that it is in the interest of all concerned that statutory proceedings are avoided.'

### ***The scope of works***

21. Andrew Elliot stated that Urgent Works Notice was the trigger that brought about the renovation project. The initial estimates to carry out the statutory repairs were from £250,000 to £300,000, and would not have qualified for grant aid. Even after that expenditure, the House would remain 'barely fit for modern use' with 'no improvement in value'. A solution would have been to sell the house, and agents were alerted that the House was potentially for sale. several groups showed interest (including Clan Mackay, local enterprise, overseas groups, an

entrepreneur), but no offer was ever received due to the costs and difficulties in renovating a listed building.

22. Andrew Elliot described the House as an ‘albatross’ for the partners; it was not in full time use, but could not be ‘got rid of by sale or scrappage’ because of its listed status. The only way was to try to secure external funding for the House to be refurbished to be fit for use all year round, which meant going beyond the required scope of the statutory notice. He said that the partners therefore agreed that the House should be used for a fixed period of five years as a furnished holiday let so as to be eligible for funding for improvements.

23. It was a long process from the service of Urgent Works Notice in 2002 to securing two external funding sources in 2009; namely (i) Scotland Rural Development Programme (SRDP), and (ii) Historic Scotland. A few survey reports were produced in the process, and the three significant reports relevant to the substantive issues were respectively by: (a) Historic Scotland; (ii) Anta Architecture (‘Anta’); and (c) Scottish Agricultural College for the SRDP application.

#### *Report by Historic Scotland*

24. A report dated 22 December 2005 by Historic Scotland District Architect was commissioned for the purpose of the *Historic Buildings Repair Grant* scheme. The report listed areas of work which should form the core of a grant-eligible repair scheme, to be read in conjunction with the Advisory Standards of Repair which offer guidance on grant eligibility, tradition materials and workmanship. The items considered to be grant eligible are summarised.

(1) Roof: likely areas of rot in the roof structure, sarking, trusses and wall plates and likely insect infestations; slating suffering from nail sickness; replacement leadwork for valleys and chimney aprons; historic cast iron skylights to be refurbished and retained.

(2) Rainwater goods: all cast-iron rainwater goods to be overhauled, and to provide rodding access at the base of each down pipe and check the underground drainage flows.

(3) Masonry (harling alone): harl failures and previous repairs e.g. bossing, cracks, friable patches, lost patches; modern non-porous masonry paint to be removed and algae growth treated prior to lime washing; three coats of pure lime wash after harl repair and another three coats 12 months later.

(4) Masonry (others): repointing all loose beds and joints in the dressed margin masonry, quoins and window surrounds; clear chimney flues of debris; re-profile raised ground levels; repair fallen masonry stair with substantial crack for beach access and the access plinth to the east wing door; repairs for boundary wall; reset courtyard flagstones to working falls to avoid ponding; remove all plant growth hard to the masonry, especially woody growth, moss and lichen on the crow steps and chimney copes.

(5) Joinery and plastering: overall existing structural joinery for the roof; all repairs must use traditional techniques in boiled linseed oil / burned sand mastic; lime plaster repairs to rooms; internal joinery repairs on the timber panelling and mouldings.

25. The Historic Scotland report concluded with an executive summary as follows:

‘The first priority lies in repairing the roof, undertaking rot eradication measures and, if advised by civil engineer, stabilising/ protecting the seaward footings. This should be followed by masonry and harl repairs. Other works can follow.’

#### *Statement of Significance by Anta Architecture*

26. Anta Architecture was appointed by the partnership to conduct a survey as to the scope of works that should be undertaken. There was a delay in proceeding with matters after the Historic Scotland report in 2005 due to Andrew Elliot’s illness in 2006. In June 2007, Anta

produced a ‘Statement of Significance’, which opened by setting out the client’s brief and objectives, followed by a short summary assessment as follows.

‘(i) Create a holiday house for the Elliot family, with 9 bedrooms and 6 bathrooms, with the required reception rooms, kitchen etc., this to be created with the existing envelope of the house and with the minimum alteration.

(ii) To carry out repairs to the wall and roof structures and finishes to prevent the ingress of water of dampness.

(iii) Create a heating system for the house, which will keep the building heated at all times to help maintain the internal fabric of the building by keeping dampness out of the fabric. This heating system to be ground source heat pump, connected to underfloor heating system on the ground floor and radiators on the upper floors.

(iv) Carry out repairs to all windows and external doors, leaving original fabric in place where ever possible.

In general, the building is in better condition than would be anticipated, fortunately the family have repaired the fabric over the years adopting a minimal intervention [approach] where ever possible, this has resulted in many of the original windows and doors retaining in place, and it would be the intention to carry this repair philosophy forward into the proposed work.’

27. The report addressed different elements referential to the ‘Zones’ of the House: Zones 1 to 4 being external, and Zones 5 to 8 being internal. For each zone, an assessment was carried out for the roof, the harling, the floor timber, the windows and doors. The overall recommendations accorded closely with the Historic Scotland’s report. Anta’s report was produced some 18 months after the Historic Scotland’s report, and it singled out two areas for immediate attention, being the roof and timber woodworm infestation, in the following terms.

‘To bring the roof up to standard there is no option but to strip the roof completely, carry out sarking repairs as required, lay under-slating felt and relay the slates with replacement as required for breakage. ... We would not recommend patching the existing roof as this is merely postponing the work needed to do the job properly ...’

[Woodworm in timber rafters and floor timber] –

‘to stop the woodworm problem getting any worse we recommend the building be treated for woodworm from top to bottom ... as soon as possible...’

28. The conclusion to the report emphasised water ingress and dampness as problems that would require a long-term solution, and recommended improvement by way of a heating and ventilation system, which the House as a listed building would be eligible for zero-rated supply.

‘... the proposed works should secure the building from further deterioration as a result of water ingress and dampness, however they are not a long-term solution for the well-being of the building which must include an overall heating and ventilation strategy. ...’

The majority of the works are essentially repairs/maintenance but some of them will still require listed building consent, ... currently any work which requires listed building consent can be zero-rated for VAT purposes. ...’

*Specialist Business Plan by the Scottish Agricultural College*

29. The report prepared by SAC in February 2009 was to assess the business prospect of the proposed refurbishment of the A-listed historic Balnakeil House and Beach Bothy for

residential holiday let usage for the self-catering holiday let with the view of applying to SRDP for improvement funding. The 27-page report has four sections:

(1) Description of the existing business – ownership, structure, operation and markets; its income streams (including subsidies and grants); assets and recent financial performance; landscape features; significant issues; environmental performance; review of skills level and areas of weakness. Under assets, the two properties Balnakeil House was described as with 20 rooms; being ‘Empty Uninhabitable in present condition’; and the Bothy as a ‘1 room empty shell’ used for storage.

(2) Assessment of the business and options for improvement – SWOT analysis (strengths, weaknesses, opportunities and threats faced by the business). Among the strengths identified for the proposed business plan were: (a) owner-occupier status provides scope for diversification; (b) recognises need to restructure and make changes to secure future for farm; (c) experience in letting properties. Among the weaknesses of and threats to the business being highlighted by the SWOT analysis were: (i) high reliance on subsidies; (ii) limitations of land as majority being rough terrain; (iii) gradual reduction in single farm payment; (iv) change in subsidy regime.

(3) Action plan – in terms of advice and costs for renovating the properties; investigate and confirm holiday accommodation market (signpost: tourist board, letting agencies, local businesses, and RSPB); draw up budget and cash flow; make application to SRDP.

(4) Justification of regional priorities – in terms of scale of contribution to regional priorities and national targets, value for money, and management of risk.

30. The executive summary of the SAC report stated as follows:

‘The creation of the two holiday-let units will provide a managed income stream: to support and develop farming at Balnakeil and to support and develop continued countryside stewardship measures. More widely the scheme would revitalise this historic building; enhances the Balnakeil beach and Old Church are, which is popular with tourists; ...

... we believe, a strong case for supporting a well-conceived, required diversification measure.’

### ***The business prospect of holiday lets***

31. Andrew Elliot wrote to the various organisations being signposted by the SAC report to confirm the viability of a holiday let market for the two properties. The responses included:

(1) From Tourism Development of the Highland Council dated 1 February 2009:

‘I am glad ... that you are aiming for 4 star +. The national occupancy statistics for self catering indicate that 4/5 star properties generate higher occupancy levels which should lead to greater profitability.’

(2) From RSPB Scotland, Conversation Officer on 1 February 2009:

‘We believe the above investment would compliment and support the present farming business at Balnakeil ... maintaining the viability of the farming enterprise will help ensure appropriate management of these UKBAP species in the long term.’

32. In the ‘Statement of Intent’ as part of the SRDP application, Andrew Elliot stated:

‘The total cost of converting the redundant farm house and buildings (including a renewable heating system based on ground heat) into houses will be around £400,000 of which a grant of 50% is sought. Planning permission has been passed for the A-listed Balnakeil House and building warrant will be

applied for shortly. Plans have been drawn up for the Beach Bothy and planning permission and building warrant will be applied for shortly. The 2 houses could be completed and all grant monies claimed by 31 March 2010.'

*Planning applications*

33. There were several planning applications made. One planning permission and listed building consent were granted on 14 July 2008 for installing a new sewage treatment plant with outfall to water course for Balnakeil House.

34. In support of another planning application, Anta prepared a Design Statement dated 30 April 2010 on Balnakeil House with Andrew Elliot as the applicant, with details of note being:

[The proposal]: Restoration and upgrade of Balnakeil House for holiday lettings, aiming for 4-star VISIT SCOTLAND rating, also for occasional family use by client's family and friends.

[The design concept]: the creation of a Classic Big House. ... the restored house will lose none of its grandeur but does gain a modern usability and reduced running costs.'

*The funding of the renovation*

35. On 3 June 2009 a contract was awarded under the Rural Development Contracts (Rural Priorities) Scotland Regulations 2008. The named parties to the contract were the Scottish Ministers and Messrs Elliot Balnakeil; the value of the contract was 50% of the 'Improvement in the value' of named 'Item', being '2 self-catering holiday homes' with a 'unit cost' of £714,577; the actual cost maximum value available was capped at £357,288.50. The claim year was 2010 for 'both the annual recurrent and capital work' as detailed on the Schedule of Works. Among the terms and conditions was a fixed-term commitment which required that 'for a period of five years, no modifications or changes will be made that substantially affect the nature, usage or location of the item purchased, including any change of ownership'.

36. On 16 November 2009, Historic Scotland made the formal offer under s 4 of the Historic Building and Monuments Act 1953 to Andrew Elliot as the 'Grantee'. The offer included a Schedule of works on Balnakeil House, which corresponded closely to the Historic Scotland report of December 2005 for roof works, overhaul of rainwater goods, masonry and harl repairs, joinery repairs to windows, doors, panelling and so on.

37. The costs and works were as per the agreed tender from O'Brien Construction Ltd in Thurso, with the split between eligible and non-eligible for the overall project cost as follows:

Eligible works (inc allocated prelims and contingencies)	£326,079.52
VAT on eligible costs	£57,063.92
[Professional] Fees at 15.05% of works costs	£49,074.97
VAT on fees	<u>£8,588.12</u>
<b>Total eligible costs</b>	<b>£440,806.53</b>
Non-eligible costs	<u>£488,671.36</u>
Total Project Cost	<u>£929,477.89</u>

38. The Historic Scotland grant offer was to fund one-third of the eligible costs, and undertakings for funding the overall project were stated in the offer as follows:

<b>Scheme Funding</b>	
Historic Scotland	£145,466 (being 1/3 of the project cost)
SRDP	£174,000 (for improvement on House)
Contribution from Owner	<u>£610,012</u>
Total Project Cost	<u>£929,478</u>



39. The balance in funding requirement had come from a bank loan of £700,000 made to Messrs Elliot Balnakeil, and £200,000 from David Elliot's own funds on 10 April 2011 as contribution to the overall cash flow by settling one of the O'Brien invoices.

#### ***Accounting of the renovation costs***

40. Mr Main explained the renovation costs were treated in the partnership accounts for the year to 28 May 2011 by adopting the categorisation of expenditure for VAT purposes on the invoices rendered by O'Brien Construction Ltd, under the following headings:

- (1) *fixture and fittings* for all expenditure charged at the standard-rate of 17.5%;
- (2) *repairs* for expenditure at the reduced rate of 5%;
- (3) *improvements* for zero-rated expenditure.

41. Other accounting entries relevant to the appeal are as follows.

(1) Costs related to the Bothy were allocated 50:50 to repair and improvement based on discussions with Andrew Elliot. There was no preferential treatment of zero-rating costs relating to improvements in the case of The Bothy, as it is not a listed building.

(2) Mr Main said the two funding sources broadly supported the split between capital and repair expenditure, with funding from SRDP allocated against improvements, and grant offer from Historic Scotland against repairs.

(3) Total expenditure on improvements (i.e. capital) was £437,712, and the grant from SRDP was £174,755, giving the *net* additions to Land and Buildings as £262,957.

(4) Total repairs were stated at £257,208 in the accounts, with £206,408 being for the House (£337,327, less Historic Scotland funding of £130,919); repairs to the Bothy at £23,212; and other general repairs of £27,588 (not in dispute).

(5) Legal and professional fees were allocated to repairs of £36,401 were same proportion as the overall split between improvements and repairs for the two properties.

#### ***Dissolution of the partnership***

42. The renovation which commenced in early 2010 was mostly complete by late 2012. The witness evidence concurred that when the project was being considered, it was already apparent that the partnership would dissolve.

43. Andrew Elliot spoke of the lengthy discussions regarding the project as being 'hugely stressful', partly due to the likelihood that there would be a dissolution of the partnership with his 'sole surviving partner'; but there were 'irreconcilable differences' between them; and that David Elliot's 'belief that no benefit would accrue to him [had led] to considerable resentment but he accepted, albeit reluctantly, that Blanakeil House was an asset owned by the farming partnership and thus the obligation lay jointly with both partners.'

44. In relation to the capital injection of £200,000 to settle an O'Brien invoice, David Elliot said: 'I was obligated to fund half of the eventual renovation, which absorbed the profit of the farm overall several years and required payment of £200,000 of my own money in 2011 to provide extra funds for the renovation.'

45. In a letter dated 14 August 2014, Whitelaw Wells set out 'some more background' to the operation of the partnership leading up to, and during the period of renovation.

'At the time the project was being considered, the two partners ... agreed that in the longer term it was better that they went their separate ways. The partnership is in the process of being divided, where each partner will take a

share of the farm. For various reasons, and it is a legally complex area, the dissolution has not yet taken place.

In the meantime, it was agreed that the two partners would farm their parts of the farm separately, but under licence to the partnership, and with some shared costs still flowing through the partnership. These licences commenced on 1 January 2012.

Balnakeil House fell into Andrew Elliot's share, although it should be noted that this part of the business is being operated through a partnership consisting of Andrew Elliot and his wife ... It is this partnership that will be running the letting business at Balnakeil House.

The agreement was therefore that the value attributed to Balnakeil House for the purpose of the dissolution would be as complete, and having been returned to a habitable condition.'

46. In an earlier letter dated 30 May 2014, Whitelaw Wells replied to HMRC's query as regards the use of the House in the following terms:

'... the situation [of the House] deteriorated to such an extent that ... the partners were effectively forced to carry out the necessary "statutory" repairs.

At that point, which was broadly 2008 or 2009, the decision was taken (working with Historic Scotland) that the farmhouse would need to be both repaired and improved. It was also recognised that in the future it was unlikely it would ever be needed as a farmhouse in the traditional sense, so a commercial decision was made that the best use of the property in the longer-term would be as a furnished holiday let.'

47. The Dissolution Agreement between David Elliot and Andrew Elliot took effect from 8 October 2014, and Andrew Elliot received and retained sole and exclusive ownership of Balnakeil House, the Beach Bothy, among other farm buildings and lands, while David Elliot received other parts lands and buildings thereon as designated in the agreement. Andrew Elliot was to pay David Elliot the sum of £365,000 to achieve equalisation in relation to the division of heritable properties. The Stamp Duty Land Tax arising on the transfer of the heritable properties was provided at £120,171.

#### ***The business of Furnished Holiday Lets ('FHL')***

48. A new partnership 'Andrew & Elizabeth Elliot (Balnakeil)' was formed on 1 January 2012, and was the entity that marketed the House and Bothy as furnished holiday lets and received the first letting income.

49. Whitelaw Wells stated that the first letting income was received in January 2013 and returned in Andrew Elliot's 2012-13 return; that there were no let property expenses in the partnership accounts to 28 May 2011.

50. HMRC produced website printouts as at September 2012 from the 'Elliot Houses' for 'Luxury Self-catering Houses in Scottish Borders & Sutherland'. The website included the picture and booking link for Balnakeil House with a note saying: 'Almost Finished – work on the Balnakeil House is nearing completion. We would envisage the House being available in September.' The 'Elliot Houses' website would appear to be a advertising vehicle for two Borders cottages which are linked to Andrew Elliot's farm based in the Borders. Balnakeil House and the Bothy were added to these two Borders cottages on the website as a collection of properties situated near farms for holiday lets to the public. These four properties are collectively known as Elliot Houses, run and managed by Andrew Elliot and his wife.

### ***Enquiry, closure notice and appeal***

51. The chronology of the procedural events behind the appeal is as follows.
- (1) On 13 January 2014, HMRC opened enquiry into the Partnership Tax Return for the year ended 5 April 2012 under s 12AC TMA, and issued a closure notice under s 28B(1) and (2) TMA on 2 February 2015.
  - (2) On 24 February 2014 the agent appealed against the closure notice. HMRC rejected the appeal and offered a statutory review under s 49C TMA on 19 March 2015.
  - (3) After the offer of review, HMRC requested further information from the appellant. The letters from Whitelaw Wells of 30 May 2014 and 14 August 2014 were responses in during this period before the review conclusion decision, which upheld the closure notice.
  - (4) On 23 December 2015, the appellant appealed to the Tribunal.
  - (5) In July 2016, the appellant applied for Alternative Dispute Resolution ('ADR'), which was accepted, but concluded on 22 November 2016 with no resolution reached.

### **HMRC's case**

52. On the first issue, HMRC's position is that the expenditure so claimed is capital in nature.
- (1) Around 2008 when working with Historic Scotland, the decision was taken that the farmhouse would need to be 'repaired and improved', and that it was unlikely to be needed as a farmhouse; a commercial decision was taken to use the property as a FHL.
  - (2) Renovation commenced in 2010 and was mostly complete by late 2012, but it was done to an extent more than required to comply with the Works Order. Rather than do the minimum required, the appellant chose to repair fully and improve the House.
  - (3) The decision by the partnership to change the purpose of House and Bothy into FHLs changed the character of the assets, and not merely restored them. As such any expenditure is considered to be of a capital nature: *Vodafone v Shaw*. Millet LJ held that the nature of the payment and the nature of the advantage obtained by the payment are of particular importance in characterising the expenditure.
  - (4) Properties were modified and improved as part of the undertaking of the overall dissolution agreement to bring the farming partnership to an end. Any recurring expenditure in respect of maintenance or repairs was brought to an end by the disposal of the House and Bothy so therefore all expenditure should be treated as capital costs: *Tucker v Granada Motorway Services*. The lump sums expended in this case were to modify and improve fixed assets immediately before disposal and were therefore capital in nature.
  - (5) The sums expended were to improve and modify the assets, and no costs were incurred to extinguish future maintenance or upkeep costs in respect of the properties. On both counts the expenditure must be regarded as capital.
53. On the second issue, HMRC contend that the purpose of the expenditure, or at least one of the purposes, was to benefit Andrew Elliot personally, or the new partnership with his wife.
- (1) The consequences of incurring the expenditure were to comply with a works order, to qualify for grant aid, and to bring the buildings to an expected standard so that they could be let as FHLs, and to make the buildings complete and habitable as required by the dissolution agreement.

(2) The Bothy may have been used for storage purposes, but HMRC submit that there is no evidence that it was used as accommodation in respect of the farming partnership for almost 20 years.

(3) The expenditure incurred in restoring the farmhouse and bothy was not expended therefore to serve the purposes of the farming partnership, as it had already been decided prior to the commencement of the work that the properties would be used in a completely new trade of FHL accommodation.

(4) The expenditure was therefore not exclusively laid out for the business purpose of the farming partnership. Clearly the other motives and objects were to meet the requirements of the partnership dissolution agreement, and also to provide one of the partners with an asset that could be used immediately, or almost immediately, in a new business venture of furnished holiday lettings.

(5) Furthermore, the costs in respect of the farmhouse and bothy were not incurred in order to allow the farming partnership to earn any receipts as a consequence of the expenditure. Therefore it is not incurred wholly and exclusively for the purposes of the farming partnership: *Usher's Brewery v Bruce* and *Whimster v IRC*.

(6) There is no evidence that the expenditure related specifically to earning any receipts, or directly related to receipts earned during the years in which the expenditure was incurred. As such it cannot be allowed as a deduction against the trade of the farming partnership in the measure of profits of the tax year as required by s 7(1) ITTOIA 2005.

(7) Section 34(2) ITTOIA cannot apply as no identifiable part or proportion of the expenses can be shown to be incurred wholly and exclusively for the purposes of the trade of the farming partnership.

### **The appellant's case**

54. On the first issue, the appellant avers that the expenditure claimed is revenue in nature.

(1) There is no statutory definition of 'capital'. The starting point is to consider the nature of the liability where a sum is paid to commute or extinguish a contractual provision to make recurring revenue payment, then the payment is *prima facie* a revenue payment: *Vodafone v Shaw*.

(2) The respondents' position that the repairs conferred an 'advantage' to furnish Andrew Elliot and his wife with improved properties on dissolution of the partnership is misconceived. This is fundamentally to misunderstand the impact of the renovations and repairs on dissolution, which is that the partnership assets had a higher value when divided; hence the balancing payment by Andrew Elliot to David Elliot.

(3) It is more accurate to regard the proportion of the expenditure readily apportioned to and properly attributable to revenue type repairs, as being in the nature of a payment by the partners to settle accrued repairs liabilities associated with the use of the properties in the business for business purposes over many years.

(4) The evidence does not support the application of *Tucker v Granada Motorway Services* to conclude that the partners were spending the repair element of the overall budget in order that an improved property portfolio could be transferred to Andrew Elliot.

(5) All that happened on dissolution as a result of the works is that the renovated properties carried a higher value than they would otherwise have done for the purposes of the partners accounting for their liabilities to each other.

(6) The grant funding applications, and the terms of the grants, are not consistent with that interpretation, in view of the fact that the funding had been in place some 5 years before the partnership dissolved.

(7) Repair is ‘restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety’: *Lurcott v Wakely*. The starting point is to establish ‘the whole’. Where the works do not reconstruct substantially ‘the whole’ or change the overall character of an asset, they are usually works of repair: *Wills v HMRC*.

55. For the ‘wholly and exclusively’ issue, Mr Watt addressed the chief contention from the respondents that the expenditure served multiple purposes as follows.

(1) It is well established that when a larger amount is spent, a discrete portion may be so incurred even if the balance of the whole is not: *Copeman v Flood*.

(2) HMRC’s Property Income Manual PIM 2030 advises that in relation to capital work and revenue repairs carried out at the same time, some expenditure may relate to repairs, and remains allowable if apportioned on a reasonable basis, as in the present case where professional input from quantity surveyor, architect, and contractor to apportion the repairs element.

(3) The apportionment of the expenditure on the Bothy was in effect ‘on the basis of a reasonable estimate influenced by the detailed work to apportion costs for the house’.

(4) The contention that the repairs element served multiple purposes (to comply with a Works Order, qualify for grant aid, bring the buildings to an expected standard for FHL) is to confuse effects, or incidental benefits, with the partners’ clear over-riding purpose in incurring this portion of the expenditure.

(5) In *Bentley and Ors* the client lunches were ‘primarily and principally but not purely for business purposes’ with the cost of lunches being ‘indivisible’ or ‘unapportionable’. To that extent the case must be applied with care and directed to only that element of the total expenditure treated as ‘repairs’ to the fabric by the construction professionals.

(6) The purpose of the partners in expending that part of the budget was to settle the accrued liabilities that the farm trade had incurred in relation to heritable assets it had used and benefitted from over many years. It is the subjective intention at the time of the expenditure that is relevant: *Robinson v Scott Bader*.

(7) As to the ‘exclusively’ test, the guidance is from *Vodafone v Shaw*. The subjective intentions of the partners were to serve the purpose of the farm trade – because quite simply – they were setting out to find a way to settle substantial revenue type repairing obligations albeit one which had accrued over a very long time.

56. As to the respondents’ alternative argument that the expenditure was not being incurred to generate an income receipt for the farming partnership, Mr Watt submitted this amounts to saying that repairs type expenditure is only a deductible revenue expense when it is spent on assets used *directly* to generate business receipts, which is not supported by *Whimster v CIR*. In *Pratt v HMRC* repairs to the farm drive were a revenue expense despite the fact that the outlay was to rectify deterioration attributable to a period of 30 years’ use. Similarly, the House was in use as accommodation for those working on the farm, but use was restricted, not least because of the need to carry out substantial repairs, while the Bothy had been in use in the farming business as accommodation and then storage.

## DISCUSSION

### ***Burden of proof: issues conjoined or separate***

57. Parties have stated that they are agreed that the two legal issues for determining the appeal concern separate tests, which are ‘entirely independent of each other’. HMRC’s submissions addressed the ‘capital or revenue’ issue before the ‘wholly and exclusively’ issue, while Mr Watt’s submissions were in the reverse order, though not related above as such. When asked for clarification, parties confirmed their agreement that the two issues are to be treated as ‘either/or’ and not as ‘(a) *and* (b)’, and that each party can win or lose on either issue.

58. While the two issues concern separate and distinct tests, in the sense that the ‘capital or revenue’ test is completely different from the ‘wholly and exclusively’ test, for the appellant to succeed in this appeal, it is not enough to win on either issue. For the disputed expenditure to qualify as a deduction in computing profits, the appellant has to win on both issues.

59. Although the tests are distinct, the legal issues behind the tests are not distinct and separate. Expenditure found to be revenue in nature may still fail the wholly and exclusively test, and rendered non-deductible in computing profits. Furthermore, the order of the two provisions in ITTOIA under s 33 for the ‘capital or revenue’ test, and under s 34 for the ‘wholly and exclusively’ test is an indicator of the primacy of one criterion over the other. That is to say, capital expenditure is not deductible in computing profits, even if the expenditure is found to have been wholly and exclusively incurred for business purposes: such capital expenditure may qualify for capital allowances, but is not a revenue deduction in computing profits.

60. The burden of proof on both issues rests with the appellant, and the standard of proof is on the balance of probabilities. For present purposes, the ‘capital or revenue’ issue has primacy over the ‘wholly and exclusively’ issue, and is the first issue to be determined.

### ***Issue 1: whether capital or revenue***

61. The leading authority for the first issue is the majority decision by the House of Lords (Lord Salmon dissenting) in *Tucker v Granada Motorway Services Ltd*, wherein the taxpayer (G Ltd) paid a lump sum to procure a more favourable lease and claimed revenue deduction. The Crown did not deny that the payment of over £122,000 had the ultimate effect of reducing the burden on revenue of G Ltd, or argue that the sum created a new capital asset, but that the sum *effected* an improvement in a fixed capital asset; namely, the lease, and as such is capital expenditure. In agreeing with the Revenue’s analysis, Lord Templeman stated:

‘... payment of a lump sum which reduced a burden on revenue, albeit a burden which would otherwise extend over a long period, is an income expense if the reduction is the *direct and only* consequence of the payment. But where a lump sum is paid to acquire, dispose of, improve or modify a fixed capital asset, the lump sum payment is capital expenditure although, as a result of dealing with the capital asset, the future revenue expense of the taxpayer is reduced. In the present case, the revenue expense of the taxpayers has been lower because the rent payable under the lease is lower. The lower rent is a characteristic of the modified fixed capital asset – namely, the lease – and enures for the benefit of the tenant under the lease irrespective of his trade and for the benefit of any mortgagee, liquidator, assignee or other person who at any time takes an interest under the lease.’ (italics added)

62. The approach in *Tucker* requires the fact-finding tribunal to: (i) isolate the asset on which the expenditure has been incurred; (ii) if the asset is capital nature, to consider the nature of the particular expense; (iii) sums spent on acquiring the capital asset will be capital while sums spent maintaining or repairing will be revenue.

63. The Privy Council in *Auckland Gas v CIR* [2000] STC 527, PC followed the approach set out in *Tucker* and found that the expenditure incurred to fix gas leak from old iron pipes by installing a network of polyethylene pipes was capital, and not revenue (as would have been the case if the iron pipes were repaired). However, in *Transco plc v Dyall* [2002] STC (SCD) 199, the Special Commissioner found that the character of the pipeline had not been altered by installing polyethylene piping (which replaced the metal pipes previously in place), and that the expenditure was therefore revenue, not capital. Juxtaposing these two similar cases on the replacement of pipelines indicates that the approach in *Tucker* is not without difficulties.

64. In *Vodafone v Shaw*, it is observed that:

‘Two matters are of particular importance: the nature of the payment; and the nature of the advantage obtained by the payment. The fact that the payment is a lump sum payment is relevant but not determinative. In a case such as the present, where the payment is made in order to get rid of a liability, a useful starting point is to inquire into the nature of the liability which is brought to an end by the payment. Where a lump sum payment is made in order to commute or extinguish a contractual obligation to make recurring revenue payments then the payment is *prima facie* a revenue payment.’

65. In *Commissioner of Taxes v Nchanga Consolidated Copper Mines* [1964] 1 All ER 208, [1964] AC 948 (*‘Nchanga’*), the Privy Council held that the disputed expenditure was not capital, for it was wholly related to the production of the output of the company’s mine for the year and was analogous to an operating cost, and allowable against income. Lord Radcliffe’s observations are pertinent to my consideration of the facts in the present case:

‘Again courts have stressed the importance of observing a demarcation between the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which the income is to be the produce or fruit and the cost of earning that income itself or performing the income earning operations. Probably this is as illuminating a line of distinction as the law by itself is likely to achieve ... the functions of business are capable of great complexity and the line of demarcation is sometimes difficult indeed to draw and leads to distinction of some subtlety between profit that is made “out of” assets and profit that is made “upon” assets or “with” assets. It does not settle the question, for instance, to say merely that an expenditure has been made to acquire a “source of income”, as the appellant says here, unless one is clear that some forms of circulating capital itself, e.g. labour, raw material, stock in trade, are not themselves to be regarded as such a source.’

66. The respondents rely on *Tucker*, and though not citing *Nchanga* as an authority, also make the submission that the expenditure in question was not put to use to generate income receipts for the farming partnership. The appellant relies on *Vodafone v Shaw* in making the case that the disputed expenditure was to extinguish an accrued liability for repair obligations as evidenced by the statutory works notice. Secondly, the appellant seems to assert that the disputed expenditure was revenue in nature (historically speaking) in a manner reliant on the principles enunciated in *Nchanga* that the properties had been used in the farming operations of the partnership. Lord Radcliffe’s observations in *Nchanga* highlight the nuanced consideration of the relevant facts that a court or tribunal is required to undertake to determine whether the disputed expenditure is capital. Lord Macmillan likewise observed in *Van den Berghs Ltd v Clark* [1935] AC 431: ‘There is no single test or infallible criterion for distinguishing between capital and revenue payments.’

67. With these authorities in mind, and having considered the relevant facts in the context of the partnership business of the appellant before its dissolution, I come to the conclusion that the disputed expenditure was capital in nature for the following reasons.

(1) As a foundation of its assertion that the expenditure was revenue in nature, the appellant has relied heavily on the classification by the contractor O'Brien as proof of the nature of the expenditure being 'revenue' repairs. It is true that for VAT purposes, the contractor had set out clearly in the invoices the three categories of expenditure: (a) at zero-rate for improvements of a listed building; (b) at 5% for repairs applicable to a listed building; and (c) at the then applicable standard rate of 17.5% for items that were neither repairs nor improvements. The accuracy and faithfulness in following the VAT categorisation on the O'Brien invoices to make the accounting entries is not in doubt. However, a sum eligible for the reduced rate of VAT at 5% does not commute, without more, into eligibility as a revenue deduction for income tax purposes. No legislative provision exists to deem the proof for s 33 ITTOIA purposes as met simply by virtue of the treatment of the same expense for VAT purposes. Nor is there any noted authority that supports repairs for VAT purposes commute into repairs for income tax purposes.

(2) Looking at the project as a whole, the overall 'eligible' costs being considered by Historic Scotland amounted to £440,806 per O'Brien tender, which represented around 47% of the total project cost for the House under tender, with the balance being non-eligible expenditure in relation to improvements (the new heating and ventilation systems as set out in Anta's Statement of Significance). The substance and scale of the 'eligible' works considered for repairs grant funding were detailed in the Historic Scotland report of 2005, which led to the grant offer in 2009, with the quantum being set with reference to the O'Brien tender. Anta's Statement of Significance was the basis for the O'Brien tender, and reiterated that the extent of the works on the roof to be 'no option but to strip the roof completely'. Similarly, in relation to timber infestation (of the roof and the floors), it was to be treated 'from top to bottom' and 'as soon as possible'. The works on the roof, while classified as 'eligible' repairs for VAT purposes, and for Historic Scotland's repairs grant, represented a complete overhaul of the roof structure, from sarking, to felting, to re-slating. While maintenance expenditure for replacing missing or broken slates is undoubtedly revenue, when the roof is completely overhauled as to become a replacement roof, the expenditure is capital: *Lurcott v Wakely* per Buckley LJ.

'Repair is restoration by renewal or replacement of subsidiary parts of the whole. Renewal as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole, but substantially the whole ... it follows that the question of repair is in every case one of degree, and the test is whether the act be done is one which in substance is the renewal or replacement of defective parts or the renewal or replacement of substantially the whole.'

(3) In terms of quantum, the appellant does not argue for an alternative basis of apportionment between capital and revenue. In any event, my conclusion that the costs of 'repairs' (as classified in the partnership accounts) on both the House and Bothy were of the nature of 'replacement of substantially the whole', s 34(2) ITTOIA cannot be applied, as explained by Lord Carmont in *William P Lawrie v CIR* [1952] 34TC20.

'Any sum claimed by the taxpayer as having been actually spent on repair can be analysed by the Inspector or by the Commissioners, with a view to determining whether or not it is a repair or renewal, but once it is determined that the matter is a renewal the whole of the sum must be treated as capital outlay and it is not allowable to split up the cost of the renewal so determined with a view to showing that a certain part of it should be debited to income because that amount would have been expended if the necessary work had been done as a repair, because that course would be going back on the decision



that has already been arrived at, viz., that the work done should be charged as a renewal.’

(4) The appellant submits that if the expenditure claimed was to commute or extinguish a contractual provision to make recurring revenue payment, then the payment is *prima facie* a revenue payment: *Vodafone v Shaw*. It has been emphasised in evidence, and in submission, that the expenditure was incurred to discharge the appellant’s contractual obligation under the Urgent Works Order, which was a liability for recurring revenue payment; and the lump sum nature merely pointed to the fact that the liability had accrued over some twenty years, and that the underlying nature of the expenditure as revenue repair had not changed. Contrary to this analysis, Anta in the Statement of Significance had referred to the fact that ‘fortunately, the family have repaired the fabric over the years adopting a minimal intervention [approach]’. Even if I were to take the appellant’s submission in this respect at the highest, it is of no avail in altering the characterisation of the expenditure, since I have concluded that the nature of the expenditure was replacement of substantially the whole, it ‘would be going back on the decision that has already been arrived at’ per Lord Carmont. Any necessary work that could have been done as repairs, and eligible for revenue deduction over the span of two decades if done at the time, had become *renewal* when it had to be done at once through neglect of some eighteen years in the case of the House, and some forty years in the case of the Bothy.

(5) The appellant submits that if the works do not change the overall character of an asset, then they are the works of repair: *Wills v HMRC*, which would seem to be the reasoning behind *Transco v Dyll* as well. However, as a matter of fact, the House was transformed from being a farmhouse of minimal facilities and not fit for modern living, and by 2010 uninhabitable when the works commenced, to being a luxury holiday home that would obtain 4-star Visit Scotland rating with the grandeur of a Classic Big House. The Bothy was transformed from an uninhabitable empty shell into a luxury self-catering cottage with the command of easy access to a popular beach. I find as a fact therefore that both the House and the Bothy have changed their overall character, and the expenditure was of a capital nature therefore in bringing about this transformation.

(6) The appellant rebuts the respondents’ submission that the result of the works was to confer a benefit on Andrew Elliot on dissolution by averring that all that happened on dissolution was that a higher value was carried by the partnership assets consequent to the completion of the project. I cannot see how this argument assists the appellant’s case. On the contrary, it seems to concur with the analysis that it was a *capital* benefit if the works resulted in an uplift in the capital value of the assets held by the partnership on dissolution. More importantly, the respondents’ position is that the expenditure was to confer a capital benefit on Andrew Elliot on dissolution in the form of two enhanced properties. I agree with the respondents’ analysis, and find that the assets in the form of the House and the Bothy had an enhanced value, and for which Andrew Elliot had to pay David Elliot £365,000 to equalise the asset division between them as equal partners.

(7) As to the argument put forward by the respondents that the expenditure was not related to an income receipt earned by the appellant as a farming partnership, Mr Watt has not put forward any effective submission in reply. In *Nchanga* the Privy Council found in favour of the taxpayer company that a capital sum of expenditure can be of a revenue nature if it is expended as a cost to procure the earning in question. Lord Radcliffe’s remark is that there has to be some nexus between the earning operation and the expenditure eligible as a revenue deduction in computing profits: *the income is to be the produce or fruit and the cost of earning that income itself or performing the income earning operations*. Turning to the facts of the case, the income of the partnership had

derived from livestock farming. The disputed expenditure did not represent a cost of earning that farming income. While historically the properties had played its part in the income earning operations, albeit in diminishing terms and significance as they became uninhabitable, the disputed expenditure had not been incurred for the sake of the income earning operations in relation to the livestock farming. The expenditure was incurred for a *new* income earning operation of furnishing holiday letting, which had never been, and never was, and never became, a part of the appellant's 'produce or fruit'.

68. In relation to first issue for determination, I conclude that the disputed expenditure in its entirety is capital in nature, and is not eligible for deduction in computing profits by virtue of s 33 ITTOIA. The appeal is accordingly dismissed. It is unnecessary for me to go on to consider the issue of 'wholly and exclusively', but for completeness, I will address issue 2 briefly.

***Issue 2: whether 'wholly and exclusively'***

69. The test under s 34 ITTOIA is a matter of fact and degree. It is for the appellant to establish the purpose for which the expenditure was incurred, and the decision as to the purpose is entirely a question of fact. The fact-finding tribunal needs to find the fact in relation to the questions: (a) What was the object or purpose of the expenditure? (b) Was it to benefit or further the trade carried on by the taxpayer in question or for some other purpose?

70. In *Scott Bader Waller LJ* stated the test to be a subjective test. In other words, it is *not* an objective test of asking whether the reasonable or prudent businessman would have incurred the expenditure, or whether, on the assumption that he would, that he had done so for the purposes of the trade or for some other reasons. The subjective test of purpose is as follows.

'The phrase with which the case is concerned is "for the purposes of". In my judgment "purpose" contains an ingredient of "intention". It is very difficult, but perhaps not impossible, to determine this without some element of subjectivity. Indeed, in many cases the test will be wholly subjective. ... The court has to decide the real purpose, if it is for the trade, vocation or profession, and whether it is independent, ie independent of the business purposes to be served ... It would be impossible in such a case to do other than make the decision subjectively. In considering the purposes of a company there may be room for some objectivity, but it will normally be to assist in making the subjective decision.'

71. The 'wholly and exclusively' test is predicated on there being an alignment between the purpose of the expenditure being incurred and the trade in question. While parties have made submissions on duality or multiplicity of purposes, the appellant's case falls on the first hurdle in relation to s 34 ITTOIA. The trade in question was the one being carried on by Messrs Elliot Balnakeil, which was in livestock farming. However, as I have found, the disputed expenditure was for a *new* trade in furnished holiday letting. Consequently, there was no alignment between the trade in question and the purpose of the expenditure under appeal for the test of 'wholly and exclusively' to be relevant.

72. In relation to finding the subjective purpose in incurring the expenditure, I have accorded more weight to earlier evidence (such as Anta's survey report and its Design Statement for planning permission, and the letters from Whitelaw Wells to HMRC in May and August 2014) than to the witness evidence. My findings of fact as concerns the subjective purpose are:

(1) Andrew Elliot was the driving force of the renovation project. It was clear that his intention was to *improve* and not just to repair the properties, so that the repair expenditure would contribute to the overall enhancement of the properties fit for a new business of furnishing holiday letting at a high standard. David Elliot was of the view that no benefit would accrue to him for incurring the expenditure (§43).

(2) When the project was being considered by the partners, it was already apparent that the House was unlikely to be used as a farmhouse again; nor would there be any reason to use the Bothy for the purposes of the partnership trade. The subjective intention was stated in writing in the ‘Statement of Intent’ for the SRDP application, where Andrew Elliot stated the cost is for ‘converting the redundant farm house and buildings’ (§32). The operative word here is ‘redundant’, and the SAC business plan gave substance to Andrew Elliot’s intention in exploring the business prospect for such conversion of redundant farm buildings into FHL properties.

(3) By the time the project commenced in 2010, the partners were in the knowledge that the partnership would soon dissolve. From 1 January 2012, the two partners were farming under separate licences. It would seem one of the reasons why the partnership was not dissolved until October 2014 was to comply with the fixed-term commitment for the contract with SRDP, which stipulated that there should be no change in ownership for 5 years. The SRDP contract was for converting the redundant farm buildings to FHL properties, but the letting income was never intended to come into the appellant.

(4) Instead, the expenditure was incurred to convert the redundant farm buildings to be used as assets in a different partnership of Andrew Elliot and his wife, which received the first income from the new trade. The trade of FHL had never been part of the trade of Messrs Elliot Balnakeil. It follows that the expenditure could not have been incurred for the trade of the appellant, which had no component of furnished holiday letting.

(5) It is true that the partnership could have diversified its trade by developing its assets for furnishing holiday letting, but the fact is that the FHL trade did not happen within the trade of the partnership that claimed the revenue expenditure. No case can be made that the repair expenditure had been incurred for the purposes of the partnership trade.

73. I find as a fact that the purpose of the expenditure was to convert the redundant farmhouse and bothy into suitable properties to carry on a new trade of furnished holiday letting, and by a new entity which is not the appellant. The renovation expenditure, while being incurred under the name of the appellant, was never intended for the trade of the appellant. It follows that the expenditure was *not* incurred for the purposes of the appellant’s trade, and there is no basis to consider the ‘wholly and exclusively’ criterion, since there had never been a component of furnished holiday letting, before, during, or after the said expenditure.

#### **DISPOSITION**

74. The appeal is accordingly dismissed. The closure notice amendments to the partnership return for the year 2011-12 are confirmed in full.

#### **RIGHT TO APPLY FOR PERMISSION TO APPEAL**

75. 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.

**DR HEIDI POON  
TRIBUNAL JUDGE**

**RELEASE DATE: 25 MAY 2021**