CORPORATION TAX – whether industrial buildings within s18 CAA – On facts – No – appeal dismissed

[2014] UKUT 0227 (TCC)
FTC/94-96/2012

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

NEXT DISTRIBUTION LIMITED
NEXT GROUP PLC
THE PAIGE GROUP LIMITED **Appellants**

-and-

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

TRIBUNAL: Mr JUSTICE DAVID RICHARDS

Sitting in public in London on 24-25 March 2014

Timothy Brennan QC, instructed by PricewaterhouseCoopers Legal LLP, for the Appellants

Sam Grodzinski QC, instructed by the Solicitor to HM Revenue and Customs, for the Respondents

Introduction

1. This appeal is concerned with the meaning of "industrial buildings" as defined in section 18 of the Capital Allowances Act 1990 (CAA 1990).
2. The appellants are three companies in the Next group, which carries on clothing and household goods retailing on a large scale both in shops and online. They appeal, with permission granted by the First-tier Tribunal (FTT), against its decision that the relevant premises were not "industrial buildings" for the purposes of section 18.
3. The premises in question (the Buildings) are two buildings, called Elmsall Way and Stadium Two, near Doncaster. They were built in 1997-1999. The members of the

FTT (Judge Adrian Shipwright and Ruth Watts Davies FCIPD MIH) visited the Buildings, which they describe in their Decision at [58] as "enormous". Elmsall Way has a capacity to hold approximately 16.5 million individual items and Stadium Two, which primarily deals with items which are received hanging on rails rather than folded in boxes, can store up to 4.25 million hanging items.

4. Next Group plc (NGP) is the freehold owner of the land on which the Buildings stand. It granted a lease of the land to The Paige Group Limited (Paige) which in turn granted a sub-lease to the first appellant, Next Distribution Limited (NDL), during the course of construction. These companies are the appellants.

5. The warehousing and other activities at the Buildings, and at buildings elsewhere, are carried on by NDL. It provides warehousing and distribution services to companies in the Next group, mainly Next Retail Limited (NRL) which is the principal retailing company in the group. These services have since 2007 also been provided to third parties. It is common ground that NDL carried on the business of warehousing and distribution services, not as part of a larger trade but as a separate trade. NDL does not itself sell goods and, as the FTT found as a fact, its trade is the holding and distribution of goods in a group context. The FTT accepted the following as an accurate description of NDL's business:

> *"dedicated warehouse processing, quality control, rework and sorting services for goods acquired by NRL for resale in its business (principally fashion clothing and homewares) and arranging for the storage of and then the distribution of such goods to NRL stores, Directory customers and franchisee customers…"*

6. The total expenditure incurred by the appellants on the buildings was £19,264,856. The amounts incurred by each of the appellants were as follows: NDL (£42,754), NGP (£3,485,608) and Paige (£15,736,494). This expenditure covered land preparation and the construction of walls and roofs for both warehouses, an office block (costing less than 25% of the total building expenditure), car park and vehicle access areas, as well as other building works which were not incidental to the installation of plant and machinery. These figures are common ground.

7. HMRC refused the appellants' claim to allowances under section 3 CAA 1990, for the accounting periods ending 31 January 1998 to 31 January 2001. The FTT dismissed the appellants' appeal against that decision.

Legislation

8. The claims for allowances were made before the Capital Allowances Act 2001 came in to force and are to be determined under the capital allowances legislation as it then stood. Capital allowances on industrial buildings have since been abolished, with effect from 2011.

9. CAA 1990 was divided into a number of Parts, each providing allowances against income or corporation tax in respect of a wide range of capital expenditure. The provisions relevant to this appeal appear in Part I, headed "Industrial Buildings and Structures".

10. Section 3(1) provided:

> *"(1) Subject to the provisions of this Act, where –*
>
> *(a) any person is, at the end of a chargeable period or its basis period, entitled to an interest in a building or structure, and*
>
> *(b) at the end of that chargeable period or its basis period, the building or structure is an industrial building or structure, and*
>
> *(c) that interest is the relevant interest in relation to the capital expenditure incurred on the construction of that building or structure,*
>
> *an allowance ("a writing-down allowance") shall be made to him for that chargeable period."*

The allowance in respect of such expenditure was 4% of the relevant expenditure spread over 25 years on a straight-line basis: section 3(2).

11. It is common ground that each of the appellants had at the relevant time an interest in the buildings which was a "relevant interest" as defined.

12. Section 18 CAA 1990 provided an exhaustive definition of "industrial building or structure" for the purposes of Part I. Section 18(1) provided:

> *"(1) Subject to the provisions of this section, in this Part "industrial building or structure" means a building or structure in use—*

(a) for the purposes of a trade carried on in a mill, factory or other similar premises; or
(b) for the purposes of a transport, dock, inland navigation, water, sewerage, electricity or hydraulic power undertaking; or
(c) subject to subsection (11) below, for the purposes of a tunnel undertaking; or
(d) subject to subsection (12) below, for the purposes of a bridge undertaking; or
(da) for the purposes of a highway undertaking; or
(e) for the purposes of a trade which consists in the manufacture of goods or materials or the subjection of goods or materials to any process; or
(f) for the purposes of a trade which consists in the storage—

(i) of goods or materials which are to be used in the manufacture of other goods or materials; or

(ii) of goods or materials which are to be subjected, in course of a trade, to any process; or

(iii) of goods or materials which, having been manufactured or produced or subjected, in the course of a trade, to any process, have not yet been delivered to any purchaser; or

(iv) of goods or materials on their arrival in any part of the United Kingdom from a place outside the United Kingdom; or

(g) for the purposes of a trade which consists in the working of any mine, oil well or other source of mineral deposits, or of a foreign plantation; or
(h) for the purposes of a trade consisting in all or any of the following activities, that is to say, ploughing or cultivating land (other than land in the occupation of the person carrying on the trade) or doing any other agricultural operation on such land, or threshing the crops of another person; or
(j) for the purposes of a trade which consists in the catching or taking of fish or shellfish;
and, in particular, the expression "industrial building or structure" includes any building or structure provided by the person carrying on such a trade or undertaking for the welfare of workers employed in that trade or undertaking and in use for that purpose."

13. The legislative policy behind capital allowances, and specifically allowances for industrial buildings, was described by Lord Walker of Gestingthorpe in *Maco Door and Window Hardware (UK) Ltd v HMRC* [2008] UKHL 54, [2008] 1 WLR 1790, (2008) 79 TC 287, at [18]-[19]:

> *"18. Capital allowances have a long and complex history. They are a relief afforded by Parliament partly as compensation for the non-allowance of depreciation as a deduction in computing trading profits for tax purposes, and partly as a policy of providing differential tax incentives in order to encourage particular forms of economic activity. Parliament's perception of the need for incentive changes from time to time and there is not therefore*

> *any very regular or coherent pattern in the way that capital allowances have been granted over the years. Allowances for industrial buildings were first introduced by the Income Tax Act 1945. The legislation was consolidated, as amended, by the Capital Allowances Act 1968, and reconsolidated, with further amendments, by CAA 1990, which (with a few further amendments) was in force in 1999 and 2000. Since then Parliament has enacted the Capital Allowances Act 2001 ("An Act to restate, with minor changes, certain enactments relating to capital allowances") as part of the tax law re-write programme.*
>
> *19. Despite repeated amendment and consolidation the provisions enacted in 1945 remain essentially intact. They reflect a general legislative policy, formed in the very difficult economic conditions at the end of the Second World War but still continuing half a century later, to encourage industrial activity by according to industrial buildings advantages not accorded to shops and offices. But the precise extent of the advantages depends on the correct construction of the legislation, and in particular the terms of s 18 of CAA 1990 (definition of "industrial building or structure").*"

14. It is the appellants' case that each of the Buildings constituted an industrial building or structure because it fell within one or more of the limbs of paragraphs (e) and (f) of section 18(1) as follows:

> *"(1) Subject to the provisions of this section, in this Part 'industrial building or structure' means a building or structure in use –*
> *…*
> *(e) for the purposes of a trade which consists in the manufacture of goods or materials or the subjection of goods or materials to any process; or*
>
> *(f) for the purposes of a trade which consists in the storage –*
>
> > *…*
> > *(ii) of goods or materials which are to be subjected, in course of a trade, to any process; or*
> > *…*
> > *(iv) of goods or materials on their arrival in the United Kingdom from a place outside the United Kingdom;"*

15. This raises essentially three issues. The first issue is whether the goods in question were (or were to be) subjected to any "process". If so, the Buildings qualify as industrial buildings by virtue of paragraph (e) and may also do so by virtue of paragraph (f)(ii). The second issue is whether the Buildings were used for the purposes of a trade consisting in the storage of goods. This condition must be satisfied before either paragraph (f)(ii) or (f)(iv) can apply. The third issue is whether the Buildings were used for the storage of goods on their arrival in the United

Kingdom from a place outside the United Kingdom. If so, the Buildings qualify as industrial buildings by virtue of paragraph (f)(iv).

Facts

16. The Decision of the FTT contains a very full account of the operations at the Buildings, based on comprehensive written and oral evidence and on a site visit.

17. Very helpfully, for the purposes of this appeal, the parties agreed a summary description of the operations at the Buildings. This is not a substitute for the description and findings set out in the Decision but it is I think sufficient for the general purposes of this judgment. I set it out in the following paragraphs, subject only to a few editorial changes which do not alter its sense.

18. At all material times, the Buildings were used by NDL in providing warehousing and distribution services to another member of the group, NRL.

19. A range of clothing, footwear, accessories and home products were delivered in bulk to the buildings. Most of the goods came from suppliers abroad, using sea, air freight and overland means of transportation. The goods were transferred by road transport in containers or trailers from the point of entry into the UK to the Buildings.

20. The goods were generally either contained in Bulk Delivery Cartons (BDCs) of standard size, or were delivered on hangers. Multiple items of the same specification were delivered together.

21. The BDCs and hanging items were unloaded and taken into the Buildings. Their arrival was recorded on a stock control system.

22. Apart from a single sample which would be used for quality control, the goods in sealed BDCs or on hangers were then moved into the large storage areas of the Buildings, using highly automated systems.

23. The goods were held in these storage areas for up to 6 months, but on average for 6 weeks, until NRL needed them to be sent either to their retail stores or to “Next

Directory" online customers. Stores would need a particular allocation of items, of varying models, colours, and size, at particular times depending on the season and the timing of "phase" launches. Stores needed regular replenishments of stock.

24. NDL carried out quality control on the incoming goods, examining a sample of the delivered goods against a detailed specification. If a defect was identified, the whole batch could be returned to the supplier, or NDL might remedy the defect itself, although most goods did not require such remedial work and this work did not form a major component of the activities in the Buildings.

25. Once stock was needed for onward distribution, the goods were retrieved from the storage areas, largely through automated systems. Goods required for onward transmission to NRL stores were put into totes or kept on hangers and were sent to dispatch areas in the buildings. The totes would be loaded onto pallets, wrapped in plastic for protection, and then manually loaded onto HGV trailers for onward distribution. For customers who had placed an order with Next Directory, individual items were taken out of the BDCs, conveyed to "picking" stations and parcelled up with other items before transfer to dispatch areas. There were separate picking and despatching procedures for hanging goods.

26. At various points, labels might be placed on the boxes or totes or bags containing the goods, to facilitate their arrival at the correct destination, whether inside the Buildings or for onward distribution.

27. The Buildings also received and dealt with goods that were returned by NRL retail stores and by Next Directory customers (via a different warehouse facility in Bradford). These were again stored until needed for onward distribution, generally to "Next to Nothing" clearance shops or staff shops. Returned hanging goods were dealt with at a separate building ("Stadium Way") not forming part of this appeal.

The Decision of the FTT

28. The FTT set out in its Decision at [261] the questions which it considered needed to be answered for the purposes of this case:

> *"(1) Although the legislation refers to "goods" there is no helpful definition so the question therefore arises what are the "goods" for the purposes of the IBA legislation? Are they the individual items or the bulk? Can the meaning change as the items progress through the buildings?*
>
> *(2) What are the goods in the case before us for the purposes of the section?*
>
> *(3) Were the Buildings used for a trade which consisted in subjecting goods or materials to any process?*
>
> *(4) Were the Buildings used for a trade which consisted in the storage of goods or materials:*
>
> *(a) which were to be subjected to any process; or*
>
> *(b) on their arrival in the United Kingdom from a place outside the United Kingdom."*

29. The answer given by the FTT to the first and second questions was that the goods in the present case were not the goods in bulk but were the individual items which comprised the bulk. It rejected the submission on behalf of the appellants that the goods on arrival at the Buildings were the goods in bulk which were then broken down by mechanical processes to smaller parcels of goods or to individual goods for the purposes of making them more merchantable.

30. In dealing with the issue of "process", the FTT described what was done to the goods at [270]-[271]:

> *"270. The goods in the sense of the individual items came into the buildings as part of a bulk load. The individual item was unloaded, checked, held until "picked" and then labelled on its packaging or hanger or other matter associated with the item so that it could be transported and then despatched. There was generally no physical change to the individual item. Although the label could well be attached to the packaging there was, in general, no change to the individual item. If a defect was detected on checking then the item might be returned to the supplier or in some cases have something done to it such as pressing or cleaning. This would not necessarily be done at the Buildings. The items could be sent out or to another building for what was required to be done.*
>
> *271. Overall nothing was physically done to most of the goods in question. As we said before at most a label or further packaging was attached to the packaging of the goods in question where work was not required following the quality control. We were not provided with any figures as to the proportion of goods which required work. However, it did seem to us that most of the goods did not require such work and commercially one would expect this to be the case as the suppliers would not want to bear the cost or*

> *suffer the returns and Next would wish to deal with matters as expeditiously and economically as possible. On that basis we find that the work that was done was not a major component in the activities in the buildings. It was essentially ancillary."*

31. The Tribunal found as a fact that the goods arriving in bulk were broken down and held until picked for distribution. It considered, however, that it should look at the individual items and see what was done to them, and, on that basis, the goods were not subjected to any process as they remained unchanged. Attaching a physical or electronic address label was not sufficient to meet the requirements of a process. They accepted the submission made on behalf of HMRC that:

> *"There was no subjection of goods to a process here. Subjection to a process involves the treatment of goods in some way. There must be a method of manufacture or adaption of the goods towards a particular use. Moving of goods from one part of a building to another or taking items out of one box and putting them in to another does not constitute a subjection of those goods to a process."*

The Tribunal also concluded that the individual products were not subjected to a sufficiently substantial measure of uniformity of treatment or system of treatment to cause the system of operations conducted in the Buildings to be a "process" in the relevant sense.

32. As to storage, the FTT accepted the appellants' case that there was storage of goods in the Buildings as part of NDL's trade.

33. As to whether the Buildings were used for "the storage of goods on their arrival in any part of the United Kingdom", the FTT noted that the distances from Felixstowe and Southampton, the ports at which most of the goods arrived, were more than 180 miles and 210 miles respectively by road or rail. At [295] it expressed the view that arrival connoted the act or instance of reaching a place, in this case the United Kingdom. The reasons for their conclusion that the Buildings were not used for the storage of goods on arrival in the United Kingdom were as follows:

> *"297. We consider that the phrase has to be given a pragmatic meaning in the context of each case rather than a literal one. We do not consider that the meaning is fulfilled solely when goods come in to territorial waters or UK airspace. It is a more flexible concept which depends to some extent on the*

context of the factual matrix which has to be considered.

298. We consider that the goods had arrived in the UK before arrival at the Buildings. For the purposes of this case it does not matter when they arrived in the UK if they had arrived before reaching the Buildings. It is unnecessary for us to determine the precise point of arrival. We find that the point of arrival was before coming to the Buildings.

299. We do not consider that Parliament intended that the holding goods in a large warehouses after they have been unloaded from a ship or aircraft, loaded on to railway wagons and then downloaded on to lorries and then to deliver to buildings or within the UK and then stored can in the particular circumstances be storage on arrival in the UK from outside on the facts of this case."

The subjection of goods to a process

34. The appellants relied on this appeal on the same arguments as they had put to the FTT. The goods, whether boxed or hanging, were bought and delivered in bulk. The boxes containing non-hanging goods were required by the appellants to be in one of five standard sizes. What were bought, and delivered, were goods in specified containers. This latter point was made only in closing before the FTT and none of the contracts of sale with the suppliers to the appellants were in evidence. Whether the appellants bought the goods or the goods in specified containers is not therefore clear, but I do not think that HMRC disputed, and I am prepared to accept, that it was a contractual requirement that the clothing and other goods should be supplied in containers of specified sizes. The significance of the size of boxes was that the automated handling machinery in the Buildings was designed to operate only with boxes of those sizes.

35. The appellants' case is that the process involved the delivery of goods in bulk, their storage, their extraction from storage and the breaking down of the goods in bulk into parcels for dispatch to retail outlets or to online customers, in each case in the precise required mix of goods, sizes and colours. This process led to more readily merchantable goods. The appellants submitted that the FTT was wrong to conclude that the "goods" for the purposes of the application of section 18(1) were the individual items rather than the boxed goods. However, even if the goods were for

these purposes the individual items, they were nonetheless subject to a "process", including recording, sorting, transporting, movement into and out of storage, picking, collating with other goods, packing, labelling and dispatch. A "process" need not involve a change in the goods themselves, whether of their size or nature. A process of selection through a course of operations was sufficient. If, as the appellants submitted, the "goods" were the boxed goods, there was in fact a relevant change to the goods because the boxes were opened, goods were removed and they were repackaged in different configurations and in new packaging.

36. The appellants relied on the wide meaning given to the phrase "the subjection of goods or materials to any process" in the authorities and in particular on the judgments in *Kilmarnock Equitable Co-operative Society v IRC* (1966) 42 TC 675, *Buckingham v Securitas Properties Ltd* [1980] 1 WLR 380, (1979) 53 TC 292 and *Girobank plc v Clarke* [1998] 1 WLR 942, (1998) 70 TC 387.

37. The untutored reader of section 18(1) might think that, in view of the association of the word "process" with "manufacture" in each of paragraphs (e) and (f) in section 18(1) that the processes envisaged were of a familiar, industrial-like character. The significance of this association has, for more than one purpose, been referred to and relied on in a number of the authorities: see *Buckingham v Securitas Properties Ltd* [1980] 1 WLR 380 at 388C, *Girobank plc v Clarke* [1998] 1 WLR 942 at 945F-946A and *Bestway (Holdings) Ltd v Luff* (1998) 70 TC 512 at 541I. Clearly processes of that character fall or are very likely to fall within those paragraphs, but it is certainly the case that in the authorities the courts have given a much wider meaning to the subjection of goods to a process.

38. *Kilmarnock Equitable Co-operative Society v IRC* concerned a claim for capital allowances in respect of expenditure on a building used for the purposes of its trade in coal. The precise operation at the building is important and was set out in the facts found by the General Commissioners at p. 676 of the report:

> *"(g) What happens in the building is that the coal, which is bagged from wagons in the coal yard or depot, is conveyed by conveyor belt and is deposited in a hopper near the roof of the building. It is then fed down a shute through a vibratory screen where dross is removed. The coal is then passed by conveyor belt to the weighing point where it is filled into paper packets. Immediately the set weight of 28 lbs is registered on the weighing machine the machinery is cut off and the filled packet is removed from the machine and is closed by stitching. The packet is then placed on a gravity conveyor to floor level where it awaits disposal."*

39. The First Division of the Court of Session allowed the taxpayer's appeal from the decision of the General Commissioners. The four judges of the Court were unanimous in their decision. In concluding that the coal was subjected to a process for relevant purposes, each of the judges stressed the breaking of the bulk, the cleaning and separating out of dross and the packaging of the clean coal in to paper bags of a standard size: see the Lord President (Lord Clyde) at p. 679, Lord Guthrie at p. 681, Lord Migdale at p. 683 and Lord Cameron at pp 684-685.

40. It should be noted that the Crown conceded on the appeal that a process as envisaged by the equivalent of section 18(1)(e) was in fact occurring in the premises. The Crown's submission was that goods were not "subjected to" a process within the meaning of the provision unless it resulted in some alteration to the goods: see Lord Migdale at p. 683.

41. Mr Brennan QC, appearing for the appellants in the present appeal, laid stress on what was said by Lord Clyde at p. 679:

> *"Goods in the form of bulk coal are brought to this building and are subjected to a process which involves the separating of the dross from the coal and the packaging in 28-lb paper bags of the coal only. The material supplied to the building was altered by the time the coal left the building in these paper bags. Indeed in my view any such alteration is not essential to involve subjecting the goods to a process. To bring the coal under the operation of a process is enough, and in the present case, where the activities in this building do admittedly constitute a process, it seems to me clear that the goods which pass through that process were subjected to it."*

Mr Brennan relied in particular on the statement that *alteration* of the goods was not essential to a process.

42. All the judges agreed that *alteration* was not essential, but each of them regarded the

separation of the dross and the cleaning of the coal as an essential ingredient of the "process". For example at p. 683, Lord Migdale said:

> *"Now I am unable to find any warrant in the Sub-section for requiring that the nature or size of the material must be altered before one can say that it has been subjected to a process. In my opinion, when the coal was cleaned and then packed into containers of a convenient size it was subjected to a process. "Subjected to" means that it went through a process, and "process" means some course of operations. It started this operation or series of operations as a stream of dirty coal but it ended up as clean coal in an attractive wrapping. The nature of the material remained the same but it had been made more marketable and will probably attract a higher price for the same weight than if it had been sold unscreened in a large and dirty sack."*

Lord Guthrie made much the same point at p. 681, adding that he did not think the mere conveyance of goods from one part of the building to another would be their subjection to a process. Process, he said, "involves the treatment of the goods in some way" such as occurred in that case. To similar effect was Lord Cameron at p. 684, and at p. 685 he added:

> *"The word "process" in its ordinary connotation seems to me to mean no more than the application of a method of manufacture or adaptation of goods or materials towards a particular use, purpose or end, while "to subject" means no more than to treat in some manner or other."*

43. The basis of the decision in the *Kilmarnock Equitable* case was that the subjection of goods to a process, for the purposes of section 18(1)(e), need not involve any alteration in the nature of the goods but it must involve their treatment or adaptation.

44. I do not think that the appellants can get any support for their case from the judgments in the *Kilmarnock Equitable* case. The treatment of the coal in that case was significantly different from the operations involving the items of clothing, or indeed the boxes in which they arrived, in the present case. The coal arrived in a single mass. It was screened and dross was removed, and the clean coal was then packaged in relatively small bags of identical size. The judges were unanimous in stressing the cleaning of the coal and the removal of dross. This clearly involved the treatment or adaptation of the goods which had first arrived at the building. There is in my view no analogous process in the present case.

45. *Buckingham v Securitas Properties Ltd* involved a claim for capital allowances in respect of expenditure on the construction of a building which included a secure area occupied for the purposes, among others, of storage and wage-packeting of large sums of cash. The building was owned by the taxpayer and let to another company (Group 4). Group 4 provided wage-packeting services to employers, who supplied Group 4 with a cheque for the total payroll and individual payslips for each employee. Group 4 would present the cheque and transport the cash to the secure premises. At the secure premises, the cash was broken down into smaller amounts and then the exact amount required for each employee, together with the appropriate payslip, was put into a packet and sealed. Care was taken to put notes of varying denominations in each pay packet. Group 4 subsequently distributed the pay packets in a number of different ways.

46. Slade J, sitting in the Chancery Division, allowed the Crown's appeal against the decision of the General Commissioners. He did so on the grounds that cash and money were not "goods" within the contemplation of the relevant statutory provisions. He expressed the view, in slightly tentative terms, that the treatment of the cash at the secure depot would amount to subjection to a process for the purposes of those statutory provisions:

> *"I would be inclined to accept Mr. Pinson's submission that, if the subject-matter of Group 4's activities in the wage-packeting area constituted "goods", then such activities constituted a subjection of such goods to a process, within the meaning of the subsection. As he pointed out, the coins and notes came into the security area in bulk form and left it reduced to individual wage-packets, after being dealt with through the activities of a staff requiring numeracy and accuracy, who had to take care that each wage packet contained the right amount and selection of notes and coins, broken down according to the employer's specifications. I am inclined to think that these activities did involve the subjection of the coins and notes to a "process", within the ordinary meaning of words and within the meaning of the subsection, even though it could not be said that their texture, substance or value was altered by such activities. I derive some support from the Kilmarnock case, where Lord President Clyde, at page 679, specifically said that in his view alteration of the material in question (in that case, coal) was not essential to involve subjecting it to a process."* ([1980] 1 WLR at 386E-G)

47. *Girobank plc v Clarke* concerned a claim for capital expenditure in respect of a building which was used as the paper processing centre for its banking business. The operations conducted at the centre are summarised in the headnote in (1979) 70 TC 387 as follows:

> *"…receipt of paperwork, conversion into information on magnetic tape, sending that information by telephone link to a computer elsewhere, and sorting cheques for forwarding to clearing banks. Various machines were used in these processes, and manual operations were also involved."*

48. The taxpayer's appeal failed before the Special Commissioners, the High Court and the Court of Appeal, but on different grounds at each level. The Court of Appeal dismissed the appeal on the grounds that, applying the decision and reasoning of Slade J in *Buckingham v Securitas Properties Ltd*, the cheques and other documents which were dealt with at the processing centre were not "goods or materials" within section 18(1)(e).

49. The aspect of the case which is important in the present context is that at each stage the Crown submitted that the cheques and other documents were not subjected to "a process" at the centre. The submission was accepted by the Special Commissioners but rejected by Lindsay J in the High Court. The Court of Appeal considered this point, without reaching a concluded view on it.

50. Nourse LJ considered the question "though briefly": [1998] 1 WLR 942 at 947-948. He cited the view of Lindsay J on the requirements for a "process":

> *"… I find nothing [in the legislation and the authorities] that limits the very broad width of 'any process' to processes only of an 'industrial' character, if by that is meant that something has to be made by the process, or that the operations have to be carried out only or chiefly by machines. Nor is it required of a process that it alters the goods and materials subjected to it in any way but rather it may suffice of a process that it should clean, sort or package the goods or materials fed into it. I hold also that it is no requirement of a process that it should be done with a view to the sale or disposition of the goods or material processed but that 'a process' does connote a substantial measure of uniformity of treatment or system of treatment, in contrast (although doubtless the line will sometimes be difficult to draw) with individual treatments of the kind given, for example, to cars serviced in a garage or patients in a doctor's surgery."*

Commenting on this passage, Nourse LJ said at p. 948B-C:

> *"Having already held that the commissioner did not misdirect himself as to goods or materials, I do not find it necessary to express a concluded view as to subjection to a process. I think it is a difficult point. As at present advised, I rather prefer the view of the judge. But even if I was sure that he was right, I would, for the reasons already stated in relation to goods or materials, hold that s 18(1)(e) was not satisfied."*

Schiemann LJ agreed with the judgment of Nourse LJ.

51. Brooke LJ agreed that the appeal should be dismissed. As I read his judgment, he was clear in his view that the operations at the centre did not involve the subjection of the cheques and other documents to a "process" for the purposes of section 18(1)(e). He said at p. 950:

> *"Nourse L.J. has set out in his judgment the commissioner's description of the activities being carried out at the Wigan centre. Documents pour into the centre in their thousands where they are read by different means, varying from the use of human eyesight to the use of technological wizardry, before being sifted and sorted and tidied up. The information contained on the face of the documents is then converted into information recorded on magnetic disc or magnetic tape. Whatever the original method of conversion the information is ultimately all lodged on magnetic tape so that it can be sent by telephone link to a Girobank mainframe computer some miles away.*
>
> *It would, in my judgment, be an abuse of language to say that what was going on in those premises involved subjecting goods or materials to a process so as to constitute the building an industrial building for the purposes of Part 1 of the Capital Allowances Act 1990, and the commissioner was correct when he reached the conclusion that this was not what was happening there. I agree with Nourse L.J. in his approach to the judgment of Slade J. in Buckingham v Securitas Properties Ltd [1980] 1 WLR 380; 53 TC 292. The documents pouring into that centre for the purposes for which it was erected were not "goods or materials" being subjected to a process within the meaning of s 18(1)(e) of the 1990 Act, and the Judge was wrong to hold that they were."*

Mr Brennan suggested that in this passage Brooke LJ was referring, not to the process, but to the identification of the cheques and other documents as goods or materials as being the abuse of language. I do not accept this. The second half of the second paragraph cited above deals with the categorisation of the documents. The first half, referring to the abuse of language, follows the description of the process given by Brooke LJ in the preceding paragraph and appears to me to be expressing agreement with the conclusion of the Special Commissioner at p. 405 that what was being processed was not the documents but the information on the documents.

52. Mr Grodzinski QC, appearing for HMRC, referred me to the decisions of Dillon J and the Court of Appeal in *Vibroplant Ltd v Holland* (1981) 54 TC 658 and the decision of Lightman J in *Bestway (Holdings) Ltd v Luff* (1998) 70 TC 5112.

53. *Vibroplant Ltd v Holland* concerned a claim for capital allowances in respect of expenditure on buildings in which plant, used by the taxpayer in the course of its plant hire business, was cleaned, serviced and, as may be necessary, repaired after each hiring. Dillon J agreed with the Special Commissioners that the operations conducted within the building did not involve the subjection of goods to any "process". He said at p. 666:

> *"The essence of the treatment which is provided in these buildings is that it is individual for the particular defects or needs of a particular piece of plant; each item is treated individually. By contrast, in my view "process" connotes a substantial measure of uniformity of treatment or system of treatment."*

He considered that these operations were no different from those of an ordinary garage where cars are serviced and repaired according to their particular requirements or a doctor's surgery where patients are treated for their individual ailments. The Court of Appeal, in a judgment of the court delivered by Templeman LJ, agreed with Dillon J and specifically approved the passage cited above. This decision establishes that to constitute a "process" for the relevant purposes there must be a substantial measure of uniformity of treatment or system of treatment.

54. *Bestway (Holdings) Ltd v Luff* concerned a claim for capital allowances for a building in which goods, to be sold by subsidiaries of the taxpayer on a wholesale basis in a number of cash and carry supermarkets, were unpacked, checked and sorted, repackaged and labelled and their product codes read. Lightman J agreed with the Special Commissioners that no "process" as required by the relevant legislation was involved in these operations. At pp 539-541 he summarised in seven sub-paragraphs the "limited" guidance to be derived from the authorities, which by then included the decision of the Court of Appeal in the *Girobank* case. The guidance included that it was not sufficient that "anything is done to goods". Mere conveyance of goods was

not enough; some form of treatment was necessary. While it might fall short of manufacturing a new article or making any alteration to existing goods or materials, there must be at least adaptation of goods or materials towards a particular use, purpose or end. These propositions were derived from the judgments in the *Kilmarnock Equitable* case. Citing *Buckingham v Securitas Properties Ltd*, the process need not be industrial or complex and he noted that "the matter was perhaps taken a little further in *Girobank*." He highlighted that part of the exercise undertaken in the *Girobank* case, which might justify describing the operations as a process, was the conversion of information contained on the face of documents into information recorded on magnetic disc or magnetic tape.

55. The final proposition of Lightman J at p. 541 was as follows:

> *"(7) I would add as an inference from all the authorities cited and from a reference to the statutory language in its context, that not every treatment of goods or materials constitutes a subjection to a process. A uniform treatment or system of treatment of some real significance is postulated. This is only to be expected in legislation designed to encourage industry where the word "process" is used in conjunction with the words "manufacture" and "production". A judgment has to be reached whether the treatment is sufficient to meet the statutory criteria and for the statutory purpose to attract the allowances."*

56. In dismissing the challenge to the conclusion of the Special Commissioners that no "process" was involved in the operations at the building in question, Lightman J said at p. 542:

> *"I read the reference to "mere" preliminaries as reflecting their judgment that, fairly and properly viewed, the activities in question were limited, mundane and of no substantial significance and that they could not properly be elevated to the status of processing goods or materials. They decided that as a matter of language (but properly informed by the authorities cited to them) the carrying on of these activities did not amount to the use of the buildings or part of them for the purpose of the subjection of goods or materials to a process within the meaning the section. This is a view they were entitled to take. Intuitively this view has much to recommend it. Indeed, in my judgment, to recognise the activities in the buildings in this case (as claimed by Bestway) as use of the buildings for the subjection of goods or materials to a process is totally unreal and to extend the availability of the capital allowances far beyond what the legislature can conceivably have intended."*

57. Commenting on *Bestway*, Mr Brennan submitted that the decision was correct on the

grounds that the taxpayer was not carrying on *an identifiable trade* of processing the goods. This was certainly part of the judge's decision, confirmed as correct by the House of Lords in *Maco*. However, his conclusions on the meaning of "process" and his decision that the treatment of goods in that case did not involve their subjection to a "process" is a separate part of his reasoning.

58. It is not surprising that in circumstances where a word such as "process" is not defined by the legislation and is construed as bearing a wide meaning, there will be uncertainties as to what does or does not constitute a process. These uncertainties are reflected in the terms of the judgments in the Court of Appeal in the *Girobank* case and, to an extent, in the judgment of Slade J in *Buckingham v Securitas Properties Ltd*.

59. The operations at the Buildings in this case essentially involve the receipt of very large quantities of complete garments and other goods in bulk cases, their storage and the unpacking of the garments and other goods into smaller packages for delivery to retail outlets and online customers. This involves the selection of goods, by reference to size, quantity and colour, according to the requirements of the individual outlets and customers. The unpacking of goods received in large quantities, and their repackaging in parcels of smaller quantities, involving no treatment or adaptation of the goods in question, does not in my judgment constitute the subjection of those goods to a "process" for the purposes of section 18(1)(e). The fact that it is done on a very large scale, and to a great extent by automated mechanical means, does not affect the essential characteristics of the operation.

60. While the operations involve more than merely moving the goods from one part of the building to another, none of the cases cited to me suggests that they could amount to a "process" for the purposes of the legislation. In *Buckingham v Securitas Properties Ltd*, Slade J was "inclined to think" that a process involving a large unseparated mass of cash being divided into a large number of small pay packets,

each with its own payslip, was a "process". In my view, this is significantly different from unpacking bulk deliveries of garments and repackaging them in smaller packages for retail outlets and online customers. As regards the operations involved in the *Girobank* case, which clearly cannot with certainty be categorised as a process, there was, as Lightman J observed in *Bestway*, the significant feature that information contained on the face of each document was converted into information recorded on magnetic disc or magnetic tape. This, it can be fairly said, involved a degree of processing not present in the operations undertaken at the Buildings in this case.

Storage

61. As an alternative to the claim that the Buildings qualified as an "industrial building or structure" within section 18(1)(e), the appellants contend that they qualified under section 18(1)(f)(ii) or (iv). The appellants, however, accept that if the claim based on section 18(1)(e) fails, then the claim that the Buildings fell within section 18(1)(f)(ii) must also fail. Both provisions require that the goods or materials in question should be subjected to a "process".

62. The claim that the Buildings fell within section 18(1)(f)(iv) depends on establishing two elements. First, the buildings must be "in use… for the purposes of a trade which consists in the storage of goods or materials" and, secondly, the trade consists in the storage of goods or materials "on their arrival in the United Kingdom from a place outside the United Kingdom."

63. HMRC contend that neither of these elements is satisfied in relation to the Buildings. The FTT rejected their submissions as to the first element but accepted their case as to the second.

64. The FTT was able to deal shortly with HMRC's submissions on the question of storage. At [280]-[281], the FTT said:

> *"280 HMRC seem to accept that there was storage in the Buildings. It is hard to see how they could not. However, HMRC said that this storage was not an*

end in itself and so did not meet the statutory requirements.

281 We find that there was storage of goods in the Buildings and that it was part of NDL's trade. We find that it was a constituent of NDL's trade."

65. On this appeal, HMRC submit that the FTT made two errors of law. First, it conflated the fact of storage in the Buildings with NDL's trade in the Buildings consisting of storage. Secondly, it failed to deal properly with section 18(2), as explained in *Maco*.

66. HMRC accept that goods were stored at the Buildings but they contend that NDL did not use the Buildings for a trade consisting of storage. In order for the trade to consist in the storage of goods, storage must be an end in itself rather than being storage for some other purpose, such as storage pending sale.

67. Mr Grodzinski QC, appearing for HMRC, relied in support of this submission on the decision of Lightman J in *Bestway (Holdings) Ltd v Luff*. The buildings in that case were occupied and used by companies carrying on cash and carry wholesale businesses. They were wholesale supermarkets open to retail traders and caterers. Goods for sale were stored in the buildings, in particular in a building which also housed the group's head office, pending sale in the course of the cash and carry business. As and when goods were required which were not available in the parts of the buildings which were open to customers, they were drawn down from the storage areas. Lightman J accepted the submission of HMRC that the buildings were not used for the purposes of a trade consisting in the storage of goods, because stock was kept in the buildings not for the purposes of storage but for the purposes of sale. The business of the companies was that of a wholesale cash and carry supermarket, and all the goods stored in the buildings were available for sale and intended to be sold as part of their business. The storage of goods was not therefore an end in itself but was merely a necessary and transitory incident of the conduct of the business of a wholesale supermarket. In *Maco*, Lord Walker considered that *Bestway* was correctly decided because "you cannot trade by storing your own goods".

68. The position of NDL is very different from that of the companies carrying on the cash and carry business in *Bestway*. NDL does not carry on any business of buying and selling goods, whether wholesale or retail, nor does it store its own goods. Its business consists, so far as relevant, of taking into the Buildings goods imported and owned by other companies in the Next group, principally NRL, and retaining and dealing with those goods as previously described. Subject to HMRC's second submission, NDL's trade carried on at the Buildings consists in the storage of goods belonging to NRL and other companies. So far as NDL is concerned, as opposed to the Next group as a whole, storage at the buildings is an end in itself. It is its business.

69. HMRC's second submission was that the trade carried on by NDL at the buildings was not just storage but was, on its own case, a very sophisticated operation involving the unpacking of bulk containers of goods and their allocation to fulfil orders from individual shops or online customers. The business was not storage, but storage plus something else.

70. HMRC relied on section 18(2) which provides:

> *"The provisions of subsection (1) above shall apply in relation to a part of a trade or undertaking as they apply in relation to a trade or undertaking except that where part only of a trade or undertaking complies with the conditions set out in subsection (1), a building or structure shall not by virtue of this subsection be an industrial building or structure unless it is in use for the purposes of that part of that trade or undertaking."*

71. Mr Grodzinski relied on the majority decision in *Maco* that "a part of a trade" must be not simply one of the activities carried out in the course of a trade, but a viable section of a composite trade which would still be recognisable as a trade if separated from the composite whole: see Lord Walker at [25].

72. In my judgment, even if the unpacking and allocation procedures did not take place at the Buildings, the storage of goods belonging to NRL and other companies in the Next group by NDL would constitute a viable section of a trade which would be

recognisable as a separate trade. Quite simply, it would be the business of storage.

73. I do not consider, therefore, that HMRC's challenge to this part of the decision of the FTT can succeed.

Arrival in the United Kingdom

74. In order for the Buildings to qualify as industrial buildings or structures under section 18(1)(f)(iv), they must be in use for the purposes of a trade which consists in the storage of goods or materials on their arrival in any part of the United Kingdom from a place outside the United Kingdom. The critical question for this aspect of the claim is whether the goods were stored "on their arrival in any part of the United Kingdom from a place outside the United Kingdom".

75. I have earlier set out the reasons given by the FTT at [297]-[299] of its Decision for the conclusion that this requirement is not satisfied in the case of the Buildings. Essentially, the reason as stated at [299] was that, where goods have been unloaded from a ship or aircraft, and then transported by rail and road to a large warehouse, "and then stored… in the particular circumstances" of this case, the goods were not stored "on their arrival". They earlier noted, and were clearly influenced by, the distances of the Buildings from Felixstowe and Southampton, the principal ports to which the goods were shipped. They were of the view that the goods had arrived in the United Kingdom before their delivery to the Buildings, but they did not consider it necessary to identify the point at which they had arrived.

76. The appellants criticise the reasoning by which the FTT reached its conclusion. They submit that it failed to engage with principle and to identify the test that they were applying to determine the issue of arrival. The Decision contained no explanation of what, in the FTT's view, the expression "storage on arrival in any part of the United Kingdom from a place outside the United Kingdom" meant.

77. The appellants submit that this expression connotes a continuous process of transport into the United Kingdom from outside the United Kingdom. That process of arrival may culminate in storage in the course of a trade, and, they submit, it did so in the present case. At the point after arrival in the United Kingdom where goods are stored, there is "storage on arrival" within the meaning of the statute. In the present case there was no intermediate point of storage between unloading at the ports and delivery to the Buildings.

78. In response to these submissions, HMRC rely on the decision of the Court of Appeal in *Copol Clothing Ltd v Hindmarch* [1984] 1 WLR 411. In that case the taxpayer company, which carried on business as clothing wholesalers and distributors, let the first floor of a building to a wholly owned subsidiary which used it for the storage of goods. The great majority of the goods were imported. Most of the goods were landed at Southampton or other southern ports and transported by rail and/or road to the warehouse building in Manchester. The goods were purchased by the taxpayer for use in its trade but stored by its wholly owned subsidiary in that part of the premises leased from the taxpayer company. The taxpayer company's claim for capital allowances in respect of the building failed at each stage.

79. It is important to note that the wording of section 18(1)(f)(iv) was then different. It referred to the storage "of goods or materials on their arrival by sea or air into any part of the United Kingdom". The amendment to introduce its present form was made by section 101 of the Finance Act 1995. It was common ground on this appeal that this change was probably prompted by the opening of the Channel Tunnel. However, as Mr Brennan QC for the appellants noted, its application goes wider than simply including imports through the Channel Tunnel. It would extend to imports by rail or road from the Republic of Ireland to Northern Ireland.

80. The reasoned judgments in the Court of Appeal were given by Fox LJ and Dunn LJ.

Oliver LJ agreed with both judgments. There were however some differences in the two reasoned judgments.

81. Fox LJ, while accepting that the storage of goods at some distance from the point of landing would fall within the requirements of section 18(1)(f)(iv), considered that the words "on arrival" involved some degree of immediacy and could not be treated as if they merely meant "after". He considered that there must be imported a requirement that the warehouse can, having regard to its location, be reasonably regarded in the normal course of its trade as providing a storage service in relation to a particular port or ports, or airport or airports, in the United Kingdom for goods or materials on their arrival by sea or air into such port or airport: see p. 415 B-C. It would be difficult to regard facilities which were some hundreds of miles away from the port of entry as being used for the storage of goods on their arrival into the United Kingdom. He accepted that this conclusion could in particular circumstances require an investigation of the nature of the goods or materials being dealt with and the availability or absence of storage facilities of a suitable character close to the port or airport.

82. Fox LJ did not however need to reach a conclusion on that issue, because he was satisfied that the taxpayer company's claim failed on a separate ground on which he relied. He said at p. 415 E-G:

> *"It is necessary, it seems to me, to consider the reason for the storage. The words "goods or materials on their arrival by sea or air into any part of the United Kingdom" leave upon me the impression that what sub-paragraph (iv) of section 7(1)(f) is dealing with is goods in transit. Storage "on arrival" in the United Kingdom suggests some temporary storage before onwards transmission. The sub-paragraph, I think, is dealing with goods which have reached the United Kingdom but not their ultimate destination and are stored meanwhile. In the present case the goods, when they reach the warehouse in Manchester are not in transit at all. They have reached the consignee (the company) who is in fact the purchaser. I do not think it is the purpose of the statute to give the allowance merely in respect of a building which is used to store manufactured goods which have been purchased from outside the United Kingdom and delivered to the purchaser. Certainly, as the judge pointed out, no such allowance is given in respect of goods manufactured in*

> *the United Kingdom which have been delivered to the purchaser: section 7(1) paragraph (f)(iii).*
>
> *The allowance under sub-paragraph (iv) is given to encourage the provision of storage for goods which have just arrived in the United Kingdom and before their onward transit. The storage in the present case is not that at all – it is merely the storage that any wholesaler wants for his goods. That situation seems to me to be a far cry from the storage of goods "on their arrival by sea or air into the United Kingdom." The storage, at this point, really bears no relation to the arrival by sea or air into the United Kingdom. It is merely storage by an owner of goods until he disposes of them."*

83. Dunn LJ did not consider that the distance of the storage buildings from the port of entry would normally be a relevant factor: see p. 416E. He did, however, agree with the passage in the judgment of Fox LJ set out above. He said at p. 416F-G:

> *"I agree that the paragraph is concerned with a business which involves the storage of goods in transit before they are delivered to their final destination. It is necessary in a particular case to look at the nature of the business for which the building is used, and not to its location per se. If the building is used, for example, as a depot to which goods are sent straight from the port of arrival for storage pending their despatch to their ultimate consignee, then it would attract the allowance.*
>
> *But that is not the case at all here. Although Wharehouses was a separate legal entity from the company, the reality of the matter was that when they arrived in Manchester the goods had reached their final destination, and it could not be said that the business involved the storage of goods in transit.*
>
> *For those reasons and for the reasons given by Fox LJ I too would dismiss this appeal."*

84. Unless the change in the wording of section 18(1)(f)(iv) makes this reasoning inapplicable, it is binding on me if it applies to the facts of the present case. In my judgment, it does apply to the facts of the present case. The imported goods were purchased by NRL and delivered to the Buildings for storage by NDL, a company in the same group. The goods cannot be said to be in transit to their ultimate purchaser. They have been received by their ultimate purchaser. Goods which are purchased by online customers will be sent directly to those customers and goods destined for sale in retail shops will be extracted from the bulk containers and delivered to those shops. The fact that the storage is being undertaken by a separate company in the same group, just as it was in *Copol Clothing*, does not affect the position.

85. Mr Brennan submitted that the amendment to section 18(1)(f)(iv), and in particular the substitution of the word "in" for "into" in the expression "in any part of the United Kingdom", meant that this resulted in this reasoning being no longer applicable. While I would accept that the amendment makes it clearly inappropriate to consider whether a building could reasonably be regarded as providing a storage service in relation to a particular port or airport, I do not see that it has a similar effect on the ground on which both Fox LJ and Dunn LJ rejected the taxpayer's appeal. The qualification to which the Court of Appeal held that section 18(1)(f)(iv) was subject, namely that it applied to the storage of goods or materials in transit to their ultimate purchaser, continues in my view to apply. I can see no reason why the broadening of the means of import from sea and air transport to transport by land should remove that qualification. The substitution of "in" for "into" was no more than stylistic; with the removal of the words "by sea or air" the words "into" is not the natural or appropriate preposition.

86. For this reason, I consider that the appellants' claim for allowances under section 18(1)(f)(iv) must fail. My ground for this conclusion is different from that given by the FTT. I do not accept the view taken by them at [294] that the change in the legislation required them to consider the wording of the provision without regard to the case law.

Conclusion

87. For the reasons given above, I shall dismiss this appeal.

Mr Justice Dave Richards
Release Date: 23 May 2014