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WASTING ASSETS AND CAPITAL GAINS TAX EXEMPTION

The legislation relating to wasting assets and the capital gains exemptions has remained unchanged since 1992. While legal precedents have been set in recent years, none has received the level of press coverage that resulted in a recent Upper Tribunal case. In this article we will revisit the rules as we understand them based on current legislation, Revenue guidance and case law and explore how the recent Upper Tribunal case could impact on the sale of heritage assets.

So what exactly is a 'wasting asset'? The answer lies in Taxation of Chargeable Gains Act 1992 (TCGA 1992) section 44 as follows:

44 MEANING OF 'WASTING ASSET'

1. In this chapter, 'wasting asset' means an asset with a predictable life not exceeding 50 years but so that-
   a. freehold land shall not be a wasting asset whatever its nature, and whatever the nature of the buildings or works on it;
   b. 'life', in relation to any tangible moveable property, means useful life, having regard to the purpose for which the tangible assets were acquired or provided by the person making the disposal;
   c. plant and machinery shall in every case be regarded as having a predictable life of less than 50 years, and in estimating that life it shall be assumed that its life will end when it is finally put out of use as being unfit for further use, and that it is going to be used in the normal manner and to the normal extent and is going to be so used throughout its life as so estimated;
   d. a life interest in settled property shall not be a wasting asset until the predictable expectation of life of the life tenant is 50 years or less, and the predictable life of life interests in settled property and of annuities shall be ascertained from actuarial tables approved by the Board. [1]

As the name suggests, a wasting asset is likely to reduce in value over its predictable life and at the end of that life it will have scrap or residual value only. HMRC Capital Gains Tax Manual CG76700 details the various types of wasting assets and the special rules attributable to each. While section (1)(a) above excludes freehold land, leases do qualify as wasting assets, as do options and futures contracts, copyrights, livestock, chattels, plant and machinery. The most common assets which are wasting assets will involve plant and machinery of some description, and for the purpose of this article I will focus on the rules for fine wines and plant and machinery only.

When assessing if an asset other than plant or machinery has a predictable life of less than 50 years, regard should be had to section 44 (1)(b) above which defines 'life' as a predictable useful life ascertained at the time the asset is purchased and not on its eventual disposal. An example would be the purchase of a bottle of fine wine. The wine would usually have a predictable useful life of less than 50 years but may in fact still be drinkable some 60 years on. A disposal of the very drinkable wine 60 years after its purchase will not retrospectively alter its status as a wasting asset.

Section 44 (1)(c) is a particularly important part of the legislation as it confirms that plant and machinery are always regarded as having a predictable useful life of less than 50 years. The definitions of both plant and machinery for CGT purposes are considered below.

Having identified that a tangible moveable asset is a wasting asset under section 44, we need to refer to TCGA 1992 s 45 to determine if an exemption from CGT is available. The relevant provisions are as follows:

45 EXEMPTION FOR CERTAIN WASTING ASSETS

1. Subject to the provisions of this section, no chargeable gain shall accrue on the disposal of, or an interest in, an asset which is tangible moveable property and which is a wasting asset.
2. Subsection (1) above shall not apply to a disposal of, or an interest in, an asset-
   a. if, from the beginning of the period of ownership of the person making the disposal to the time when the disposal is made, the asset has been used and used solely for the purpose of a trade, profession or vocation and if that person

1. See Taxation of Chargeable Gains Act 1992 for section 44 in full.
2. See Taxation of Chargeable Gains Act 1992 for section 45 in full.
3. Richard Curtis, 'Deus ex machina' 4359 Taxation magazine 27 June 2012
4. 'Selling your Olympic Torch' (6 June 2012), HMRC Games news and updates (http://www.hmrc.gov.uk/news/olympic-torch.htm).
5. *Yarmouth v France* (1887) 19 Q.B.D. 647.
6. Edward Manisty 'Exemption from capital gains tax on the sale of chattels' (1994) 1 *Christie's Bulletin for Professional Advisers Summer 1994 Volume I, No. I.*
7. *The Executors of Lord Howard of Henderskelfe (Deceased) v CRC (2013)*
8. *CIR v Scottish & Newcastle Breweries Ltd HL* 1982, 55 TC 252

has claimed or could have claimed any capital allowances in respect of any expenditure attributable to the asset or interest under s 38(1)(a) or s 38(1)(b); or

b. if the person making the disposal has incurred any expenditure on the asset or interest which has otherwise qualified in full for any capital allowance. [2]

The above provisions generously provide a complete exemption for gains accruing on wasting assets provided the asset has (a) not been used solely in a business and has been eligible for capital allowances or (b) no expenditure on the asset has qualified for capital allowances.

The provisions of s 44 and s 45 are most valuable for our private clients holding assets personally and not carrying on a trade. I will now examine the definition of fine wine and plant and machinery further in order to demonstrate circumstances where the relief may or may not be available.

WINE

In most circumstances, any gain on the disposal of wine will be exempt from CGT as the relevant criteria under s 44 can be met; i.e. the asset is a tangible moveable asset and it is an asset with a predictable life at the time of acquisition not exceeding 50 years.

HMRC's general agreement that the wasting asset exemption is in point is set out in their Capital Gains Tax Manual CG76901. In the manual, HMRC acknowledges that cheap table wine will definitely be a wasting asset as it is likely that it will, in its words, turn to 'vinegar' within a relatively short period even if unopened. HMRC states that in the case of a port and other fortified wines such as Madeira and Cognac, which can have a very long storage life, the wasting asset exemption will not apply. Between the extremes of table wines and fortified wines there are fine wines which generally mature rather than deteriorate over time but are usually ready to drink in less than 50 years.

It must be borne in mind that TCGA 1992 s 44(1)(b) states that the point at which the predictable life of a wine is tested is at the time the wine is acquired by the person disposing of it. As an example, if we consider the imperial bottle of 1947 Cheval-Blanc sold by Christie's in 2010 for a staggering £192,000, we can assume that on a subsequent sale, the owner could claim the exemption under TCGA 1992 s 45(1) on the basis that, at the time of acquisition in 2010, the wine did not have an expected further useful life of 50 years or more. It remains to be seen if this 1947 vintage remains drinkable beyond 2060!

HMRC contends that where the facts justify it, the exemption will not apply to fine wines which are not unusually kept for substantial periods. But in reality, most fine wines, even the top end Bordeaux vintages, will be ready to drink in 20 to 40 years and should therefore qualify for the exemption. But as noted above, should the wine remain drinkable some 60 years later this should not jeopardise the availability of complete exemption from CGT. Fine wines have been known to outperform the FTSE100 and Dow Jones, offering significant returns for investors, and under current legislation these returns can be enjoyed free from CGT.

MACHINERY

There is no statutory definition of the word 'machinery' for CGT purposes but HMRC Capital Gains Tax Manual CG76905 Wasting assets: shotguns, states that its ordinary meaning should be taken. The definition of machine, according to the Oxford English Dictionary is 'an apparatus for applying mechanical power, consisting of a number of interrelated parts, each having a definite function'.

Helpfully, HMRC sets out in 'Machinery and plant fixtures' (1994) vol. 13 *Inland Revenue Tax Bulletin* its views on the various types of asset it regards as 'machinery' and thus tangible moveable assets which will be exempt under TCGA 1992 s45, provided of course that the asset is owned privately and not used in a business:

1. Antique clocks and watches.
2. Motor vehicles not commonly used as a passenger vehicle such as taxi cabs, racing cars, vans, lorries and motorcycles.
3. Boats. This will not usually include yachts, barges or boats that have been used as a residence.
4. Guns.

In the Manual CG76905, HMRC sought to distinguish between antique clocks and shotguns, as while they both fall to be machinery there are very real differences in their mechanical workings. HMRC made the distinction that once a clock is wound up its mechanical parts will continue to work independently until it requires winding again while a shotgun will work only once when the trigger is pulled. HMRC considered the differences between a shotgun and an automatic weapon or machine gun, which once the trigger is pulled, has the capacity for continuous fire.

While HMRC acknowledges that although there may be some doubt that a shotgun is machinery, it generally accepts that all types of gun should be treated together under the general description of 'machinery' and thus within the definition under s 44(1)(c) TCGA 1992. For example, a fine pair of Purdy shotguns can be gifted down through the generations without any CGT being paid on a lifetime gift or the eventual sale. According to the specialists, the market for sporting guns remains buoyant with record prices being achieved and the investment in such assets continues to be tax efficient and therefore attractive to private investors.

In their *Bulletin* HMRC acknowledges that whether a particular asset should be classified as machinery is a question of fact and can only be answered by looking at the state and nature of each individual asset. For this reason it is not possible for HMRC to issue an exhaustive list of those assets that would qualify for the relief under s 45 TCGA 1992. In addition to the above list, other assets generally acknowledged to be machinery include barometers and other scientific equipment, model railways and other antique toys with mechanical parts.

An interesting article by Richard Curtis recently put forward an argument that the capital gains tax exemption under s45 TCGA could be available on the sale of Olympics torches.[3] Richard's article looked at the state and nature of an Olympic Torch following an HMRC press release issued in response to reports that runners were selling their torches on well-known auction sites for astronomical sums of money.[4] The HMRC press release did not mention the availability of a CGT exemption, other than chattels relief, but Richard presents a reasonable argument that the mechanics of the torch is not so different from that of a gun and could equally qualify for exemption under s 45.

PLANT

As with the term 'machinery', there is no statutory definition of 'plant' but it has been considered in some well-known cases. 'Plant' can include apparatus kept for permanent employment in the trade but there is a distinction between that which performs a function in the business operation which may be plant and that which provides the place or setting in which the business operations are performed which is not plant.

In the case of *Yarmouth v France* (1887) the ordinary meaning of the word plant was referred to as follows:

There is no definition of plant in the Act: but, in its ordinary sense, it includes whatever apparatus is used by a business man for carrying on his business, not his stock-in-trade which he buys or makes for sale: but all goods and chattels, fixed or moveable, live or dead, which he keeps for permanent employment in his business.[5]

Case law has over the years extended the natural definition of plant to include, among other things, a horse, a swimming pool and a dry dock. The notion that 'plant' can include works of art and antiques used in a house open to the public is nothing new and indeed was covered in detail in this very Bulletin back in the summer of 1994.[6]

A recent decision by the Upper Tribunal has, however, propelled this particular interpretation into the spotlight. The case making the headlines involved the executors of Lord Howard of Henderskelfe, who claimed that Sir Joshua Reynolds's masterpiece *Omai*, which was sold in 2001, should be treated as plant and therefore exempt from CGT under TCGA 1992 s 45.

By way of background to the case, the painting was owned by the late Lord Howard and was on loan to Castle Howard Estates Limited who ran the business of opening Castle Howard to the public. The painting was sold at Sotheby's in 2001 for a hammer price of £9.4 million.

The executors contended that as the painting was one of the main draws for visitors to Castle Howard, it should be viewed as plant used in running the house and therefore a 'wasting asset' within TCGA 1992 s 44 (1)(c). HMRC opened an enquiry into the trust and estate tax return for 2001—02 stating that the chargeable gain accruing on the sale was not exempted by s 45 because the painting was not 'plant'. The case came before the First-tier Tribunal (FTT) and in July 2011 they held that the painting was not plant and machinery within s 44(1)(c) and was not therefore a wasting asset and the gain was not exempt under s 45.

HMRC argued that the painting was not plant and stated three reasons:

1. The use of the painting did not satisfy the test as to function;
2. The use of the painting by the company did not satisfy the test as to permanence;
3. The trade in which the painting was used was not the trade of the owners who sold the painting.

The executors appealed to the Upper Tribunal (UT) who, in March this year, found in their favour.[7]

In arriving at their decision, the UT addressed in turn the arguments raised by the FTT.

1. In considering the relevant test in relation to function the UT referred to the test described in the Scottish & Newcastle case.[8] The nature of the trade being carried out by Castle Howard Estates Ltd was considered and the UT concluded that the painting was being used for the promotion of the trade being carried on by the company.
2. With regard to the test of permanence, the UT noted that although the painting was not owned by the company, it was used in the business from 1952 to 2001. The painting was loaned to the company by the late Lord Howard from 1952 to 1984 and by the executors between 1984 and 2001.

   It was further noted that the painting was displayed in an established setting in the house and there was an understanding that the painting would be available for a considerable albeit indefinite period.
3. The principal challenge was based on the fact that the trade in which the painting was used was the trade of Castle Howard Estates Ltd whereas the painting was owned by the executors. The UT agreed that it was wrong to suggest that an object could be plant in the hands of the person using the object in its trade but not plant in the hands of the owner of that object. As a consequence, if having applied the established test to the object, then it should be regarded as plant whether one is considering the position of the trader or the position of the owner and there should be no distinction between the two.

In his closing statement, Mr Justice Morgan agreed that it was surprising that an asset of high value and likely to appreciate in value and with a predictable life in excess of 50 years should be a wasting asset. However, the painting was only a wasting asset for the purpose of s 44 because it satisfied the test as to plant which deems an asset to be a wasting asset even if it would not otherwise be thought a wasting asset.

It seems likely that HMRC will take this case to the Court of Appeal and it would be premature for clients to take action in reliance on the decision at this stage. However, if the decision is upheld on appeal it could prove significant for the owners of heritage property who rely on valuable works of art such as paintings, tapestries and furniture to boost visitor numbers in the course of their business.

So what, I hear you ask, has become of Sir Joshua Reynolds's masterpiece which has caused such a stir? Following its loan to the National Gallery of Ireland, *Omai* is rumoured to be back on British soil, but it is not as yet back on public display. We have to hope that this national treasure does not remain hidden from the viewing public for too much longer.

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