30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E: technical@ciot.org.uk

Tax treatment of predevelopment costs consultation

Response by the Chartered Institute of Taxation

1. Executive Summary

The central issue following the Supreme Court decision in *Orsted West of Duddon Sands (UK) Limited and others v HMRC* earlier this year is the lack of tax relief for legitimate business expenses that are a pre-requisite of the development of renewable energy infrastructure and other infrastructure projects. The lack of relief for essential business costs undermines a rational business tax system and encourages investors to look elsewhere.

The application of the close connection test established by *Orsted West*, and the boundary line between what is eligible and what expenditure is ineligible for relief is very uncertain. Lack of certainty and predictability deters investment and adds complexity.

We urge the government to consider seriously the strong case for implementing legislative change in the short term to ensure there is both clarity and tax relief for legitimate business expenses.

2. About us

2.1. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2.2. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

2.3. The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

2.4. Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

3. Introduction

3.1. This consultation asks for views on the nature of 'pre-development costs', businesses' understanding of their tax treatment following the Supreme Court's judgment in *Orsted West of Duddon Sands (UK) Limited and others v HMRC* [2026][1] ('*Orsted West*') and how far the tax treatment affects business and investment decisions and therefore wider government goals. Immediately after the publication of the judgment, we gathered feedback from our specialist members and volunteers that was published on 2 June 2026[2]. Much of that feedback is relevant to the consultation and is developed or reiterated in this response.

3.2. The main question in *Orsted West* was whether costs associated with pre-construction studies such as environmental assessments, marine surveys and technical studies could be treated as spending incurred 'on' the provision of plant for capital allowances under CAA 2001 section 11(4)(a):

(a) It is capital expenditure <u>on the provision of plant or machinery</u> wholly or partly for the purposes of the qualifying activity carried on by the person incurring the expenditure [our underlining].

3.3. The Supreme Court held that the requirement for expenditure 'on' the provision of plant is a narrow test that requires a close connection with the plant. A 'limiting curve' of qualifying expenditure surrounds the plant and its provision. Expenditure on studies that inform the design of the plant or machinery fall well outside that curve.

3.4. The consultation notes that capital allowances are an important lever to help drive investment, as recognised in the Corporate Road Map. However, the leading judgment in *Orsted West*, points to the link between the concept of capital allowances as a proxy for depreciation charged in the accounts as militating against a broad interpretation of section 11 to include surveys and studies " …*which have only the most tangential connection with the diminishing value of the physical asset.*.". The court rejected a purposive argument for a broader interpretation based on the wider purpose of capital allowances being to incentivise investment.

3.5. On 10 July 2026, HMRC updated the Capital Allowances Manual to reflect their position following the Orsted judgment (CA20070, CA20060, CA95010) including a new section headed 'Design costs' at CA20070.

3.6. CIOT representatives attended two HM Treasury and HMRC consultation roundtables on 11 and 13 August 2026. This response reflects the discussions at those roundtables where appropriate.

---

[1] *Orsted West of Duddon Sands (UK) Limited and others v HMRC* [2026] UKSC 12 (referred to in the tribunals as Gunfleet Sands Ltd and others)

[2] https://www.tax.org.uk/ref1684

3.7. Our stated objective for the tax systems include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- Responsive and competent tax administration, with a minimum of bureaucracy.

For the reasons set out in this response, the current position following *Orsted West* does not meet these objectives due to greater complexity, lack of certainty and therefore no clarity of outcome.

3.8. Questions 5-8, 10-11 and 15 are largely outside our remit and expertise. We have not answered these questions.

4. Policy approach and scope of the consultation

4.1. The consultation is fairly limited in its scope focusing largely on the implementation of the Supreme Court decision. While that is important, the central issue, in our view, is that the outcome of the case has resulted in the absence of tax relief for legitimate business expenses in the form of environmental, engineering and regulatory studies that were a pre-requisite of the development of the offshore windfarms in Orsted.

4.2. The absence of tax relief for essential business costs (often required by law) runs counter to a rational business tax system that promotes and underpins investment, both domestically and internationally. Not allowing a deduction simply puts up the cost to business of developing long-term projects; adds to complexity as boundary lines need to be considered; and is internationally uncompetitive. The UK is competing for international investment in major projects, especially in renewable energy (although not only in that area) and refusing a deduction for essential business costs simply encourages investors to look elsewhere.

4.3. Against a backdrop of first year allowances aimed at promoting investment, disallowing upfront feasibility and groundwork investigation studies seems counter intuitive and is likely to be a puzzling signal to investors. Taken in isolation the ineligibility of essential costs for tax relief may not prevent a project going ahead but taken in conjunction with other commercial challenges such as connectivity, the change to what costs are eligible for relief makes the UK less attractive to investors. It also drives up the effective tax rate of the project and thereby counteracts to an extent the international competitiveness of the UK's low rate of corporation tax.

4.4. *Orsted West* established that costs incurred on environmental and geotechnical surveys were ineligible for capital allowances. These surveys mitigate construction and environmental impact risk and seek to ensure environmentally responsible development. In *Orsted West* the development was of windfarms, but the principle will apply to all development and critical national infrastructure, such as, for example, data centres. The fact that there is no tax relief for the costs of these surveys undermines the mitigation of those risks.

4.5. A lack of tax relief for essential business costs distorts economic choice. This can result in tax considerations driving how businesses structure their projects, rather than only the commercial factors. This can result in an unlevel playing field because the ability to structure a project to obtain tax relief may not be possible for all businesses. For example, structuring a project via an operating company /development company can give rise to materially different tax consequences (and risk allocation) when compared to a project undertaken by a single company. This is contrary to the principle that tax should not distort economic decisions. The detailed consideration required to try to accommodate a complicated tax position drives up costs for all.

4.6. There is a tension between the wider policy intent for capital allowances to support the government's growth mission and energy and net zero strategies, and the narrow interpretation of qualifying expenditure for large infrastructure and energy projects established by the Supreme Court's judgment in *Orsted West*. A reduced quantum of capital allowances for energy generation infrastructure ultimately feeds into higher consumer pricing.

4.7. We recognise that changing tax relief that is available to businesses undertaking development following the *Orsted West* decision would require new legislation, but we encourage the government to consider seriously the strong case for implementing a change. The precise nature and scope of a change to address the lack of relief for pre-development costs needs further consultation. Please see our response to question 10 at paragraphs 5.24-5.26 for initial comments on how this might be achieved bearing in mind the objectives of simplicity and consistency with the current capital allowances regime.

4.8. More broadly however, ensuring that all legitimate business costs are relieved (unless excluded for policy reasons) would restore certainty and promote investment by providing reassurance that business costs (whether capital or revenue) attract some form of relief and do not become permanent 'tax nothings'.

4.9. In any event, the application of the close connection test established by *Orsted West*, and the boundary line between what is eligible and what expenditure falls outside the 'limiting curve', remains very uncertain. Lack of certainty and predictability deters investment and adds complexity. Taxpayers with projects involving at least £1bn of qualifying expenditure may be able to use HMRC's advance certainty service but that is limited to the largest projects. The consequential complexity is explored in detail in our response to questions 1-4 at paragraph 5 below.

5. Existing tax treatment

5.1. **Question 1: How has the Supreme Court's judgment in Orsted West of Duddon Sands (UK) Ltd and others v HMRC [2026] affected your understanding of the tax treatment of predevelopment costs?**

Question 2: To what extent has the judgment clarified the treatment of these costs in practice?

Question 3: In light of the judgment and HMRC's updated guidance, are there specific aspects where uncertainty remains? Please provide examples and explain why.

5.2. **Question 4: What practical challenges do businesses face in applying the current rules to predevelopment costs?**

5.3. In terms of the current position, it has always been the case that not all costs that are capital in nature are eligible for capital allowances and these costs have largely been understood and accepted in practice, although the cliff edge between those costs that receive some relief and those that do not adds to the compliance burden. The Supreme Court judgment has pushed back the boundary - extending the nature/type of capital costs that are now not eligible for relief.

5.4. The precise boundary of the dividing line between eligible or ineligible 'pre-development' costs is now very unclear in its application and will need to be assessed on a project-by-project basis. Paragraph 85 of the *Orsted West* judgment confirms that 'on the provision' of the plant and machinery 'connotes a close connection between the expenditure and the plant'. This includes the purchase price, the costs of transporting the plant to the site and installing it. Other costs are subject to a 'limiting curve'. There was some discussion at paragraph 97 about the timing of the expenditure relative to the plant becoming operational with counsel for HMRC suggesting the plant must be 'in your sights' at the time the expenditure is incurred (although not necessarily when the plant is in existence given the difficulty this would present for advance payments made prior to fabrication). There is no clear temporal test; this matters in practice as developers may commission initial feasibility surveys years before any final investment decision. For most large infrastructure projects, we understand that a contractual commitment to purchase specific plant may only be possible after substantial preparatory expenditure has been incurred.

5.5. The 'in your sights' approach seems to some extent at odds with CAA 2001 section 5(1) that treats capital expenditure as incurred when there is an unconditional obligation to pay.

5.6. HMRC's updated guidance (post *Orsted West*) does not refer to the underlined terms from the judgment noted at 5.4 above.

5.7. The updated guidance confirms HMRC's acceptance of a pro-rata apportionment for both preliminaries and professional fees following the Upper-tier Tribunal decision in *JD Wetherspoon v HMRC* [2012][3]. The approach in the updated guidance is largely unchanged from the previous version of the guidance (pre-*Orsted West*) except to the extent that HMRC's new guidance now helpfully adds a monetary value to distinguish pro rata apportionment for smaller and larger projects and provides a rule of thumb for determining whether the apportioned amount is unusually high[4]. We note, however, that proportions will vary between sectors as well as depending on the method of procurement and consequential allocation of risk.

5.8. It was noted (at paragraph 58 of the *Orsted West* judgment) that HMRC say preliminaries were correctly dealt with by the First-tier Tribunal and therefore the question is not considered further by the upper courts. However, it is not entirely clear whether HMRC's acceptance of pro-rata preliminaries and professional fees is wholly consistent with the narrow test established by the Supreme Court creating ongoing uncertainty.

5.9. In terms of design fees, HMRC's updated guidance differentiates design fees carried out at a 'preparatory or early stage' (non-qualifying) and design costs that form 'an integral part of constructing or installing a specific item of plant' (qualifying). It is fundamentally uncertain where that line is drawn between conceptual design, detailed design and fabrication. Some costs may have more than one purpose being required for regulatory purposes at an early stage while also being essential for physical construction.

[3] UKUT 42 (TCC)

[4] More than 25% of total construction costs excluding the preliminaries and professional fees.

5.10. Professionals may work across the project stages, and invoice descriptions (if available at all to advisers - sometimes we understand these may be withheld due to commercial sensitivity) are not always sufficient to identify whether the costs meet the close connection test or not. Services of this nature evolve across the project and the point at which the service meets a close connection test will not be readily identifiable.

5.11. Depending on how the project is procured (eg a design and build contract/ engineering procurement contract/ in-house) design time and costs may be part of fixed lump sums or stage invoices with little detail to differentiate early design costs.

5.12. *Orsted West* confirms that studies (environmental, impact, metocean, geophysical and geotechnical) used to inform or feed into the design and development of offshore windfarms are ineligible as '<u>well outside the limiting curve</u>'. However, each case is fact dependent and the nature of a development project, such as a refurbishment of an office building, a data centre or even an onshore (as opposed to an offshore) windfarm, may give rise to markedly different costs to those of a large offshore windfarm making it difficult to draw analogies with *Orsted West*. It also means that the absence of tax relief for pre-development costs will adversely affect different infrastructure projects to different degrees. This means the fundamental principle of taxpayers in similar situations being treated in similar ways for tax purposes is undermined. For complex bespoke plant (for example, data centres involving power distribution systems, cooling infrastructure), the cost of detailed engineering design and technical drawings may be considerable compared to say, a refurbishment of an office building where design costs are relatively low. Very large infrastructure projects also require extensive and costly preparatory work. At the other end of the scale small alternative energy community projects may incur relatively high levels of design fees upfront depending on the technology and scale of the project.

5.13. *Orsted West* left open (and HMRC's reserved their position in the case) on the issue of whether the costs of producing final technical drawings and specifications which are then 'made real' by the manufacturer are eligible. HMRC's updated guidance at CA20070 states the following: *'…design costs that form an integral part of constructing or installing a specific item of plant, for example the cost of producing the final detailed engineering designs without which the plant could not be manufactured or installed, and which are incurred as part of the process of providing the plant, may qualify on the same basis as transport and installation costs. That is, where the design costs are inherent in the concept of the plant being "provided" (see CA20060).'*

5.14. In practice, this approach appears to require an analysis of the consequential impact of each element of design costs and a direct linkage with what is actually built, an exercise that simply does not fit well with the way projects are managed or the way costs are analysed for tax purposes, the analysis likely taking place two or three years after the invoice date. The question of whether the 'on the provision of' test is to be assessed prospectively at the time of the expenditure or retrospectively looking back from when the plant is acquired/fabricate, or some other basis, is also not clear.

5.15. The uncertainty is also challenging for HMRC officers to provide and ensure consistency of treatment of taxpayers. The level of detail available to identify costs will depend in part on commercial factors (the method of procurement for example a project delivered under a design and build contract or engineering procurement contract for a lump sum will design, build commission and deliver the project for a set sum with milestones) and on the accounting treatment.

5.16. The uncertainty has implications for other parts of the tax system where similar wording is used in statute, for example the test for Business Premises Renovation Allowance (BPRA) claims was for expenditure 'on or in connection' with the physical conversion of a property. Although BPRA was withdrawn in 2017, there are ongoing claims under HMRC enquiry.

Commercial uncertainty

5.17. The Supreme Court judgment in *Orsted West* reverses the Court of Appeal's decision. It is likely that some taxpayers have made claims based on the Court of Appeal's approach giving rise to:

- potentially complex and practical difficulties in considering filing positions, and
- affecting valuation of share sales and due diligence.

5.18. Purchasers conducting due diligence on sales of energy and infrastructure businesses will as part of due diligence exercises need to scrutinise claims made that may now be invalid affecting pricing and slowing deal activity. Members report nervousness in the renewables sector. There is a high level of acquisitions activity in the renewables sector including of sites under development and as part of consolidation of energy provision by corporate acquirers, including for example by private equity funds. However, members are concerned that the decision and uncertainties surrounding capital allowances are already beginning to influence this activity. There is concern that buyers will factor these uncertainties into pricing mechanisms potentially slowing deal activity with consequences for wider adoption of alternative energy. Management of this uncertainty is likely to become a key focus of the due diligence process. Overall, this creates a degree of commercial uncertainty that could affect transactional activity in the sector and will likely lead to increased insurance costs for business to mitigate the risks.

5.19. Uncertainties regarding the eligibility to capital allowances affect the financial modelling and commercial risk for Offshore Transmission Owners (OFTOs) bids and for merger and acquisition activity. The availability of capital allowances are key in establishing the commerciality of operating the assets because they free up cashflow for meeting funding costs. Uncertainty is potentially distortive if bidders are making different assumptions. It risks creating an unlevel playing field between those taking a more aggressive or a more prudent approach distorting the market.

5.20. **Question 9: If an investment project does not go ahead, can any of the predevelopment costs be recovered? For example, through sale of surveys to another business interested in pursuing a similar project.**

5.21. We understand that in practice most professional surveys are non-assignable under standard terms and conditions so cannot be transferred or monetarised unless incurred by a group company whose trade is to seek opportunities for development to be undertaken by group companies. In those circumstances the survey costs should be deductible as a trading expense.

5.22. A project risk is specific to a project so surveys for one project will not necessarily have value to a different project, for example a survey for a solar project would identify different risks to those for another form of energy project. Similarly, the geotechnical risks for one project site will differ from another, depending on location and groundworks, even if the nature of the infrastructure project is similar.

5.23. **Question 10: To what extent do you consider that predevelopment costs should qualify for capital allowances or other forms of tax relief? Please explain your reasoning and indicate which types of predevelopment costs you believe are most important to have tax relief.**

5.24. Please see paragraph 4 above. We encourage the government to consider seriously the strong case for a change in legislation to allow relief for pre-developments costs.

5.25. The way that change might be achieved would merit further consultation. Initial feedback from our members indicates support for evaluating a widening of the test in CAA 2001 section 11(4) on the basis that it would be a relatively simple solution to ensure relief for pre-development expenses that should be possible to achieve without undermining the integrity of the structure of the capital allowances regime.

5.26. Extending relief would be consistent with Structure and Building Allowances (see CA93110 Expenditure treated as incurred on the construction of a building includes professional fees relating to the design and construction of a building and costs incurred in preparing the site for construction) and the wider test for relief for Research and Development Allowances (CAA 2001 section 438).

5.27. **Question 12: Does the tax treatment of predevelopment costs impact business and investment decisions? If so, why is this and what are the impacts?**

Question 13: What is your impression of the tax treatment of predevelopment costs in other jurisdictions? Does this treatment impact whether to invest in those other jurisdictions rather than the UK?

As we note above, disallowing upfront feasibility and groundwork investigation studies associated with the government's investment strategy seems counter intuitive and likely to send an adverse signal to investors. Taken in isolation it may not prevent a project going ahead but viewed in conjunction with other commercial challenges such as connectivity, the change to what costs are eligible for relief makes the UK less attractive to investors. It also drives up the effective tax rate of the project to an extent and thereby counteracts the international competitiveness of the UK's low rate of corporation tax.

5.28. **Question 14: Are there other impacts that the government should be aware of, in relation to the tax treatment of predevelopment costs?**

5.29. As we note above, *Orsted West* established that costs incurred on environmental and geotechnical surveys were ineligible for capital allowances. These costs mitigate construction and environmental impact risk including for critical national infrastructure such as data centres. Therefore, the fact that these costs are non-qualifying may have unintended consequences if cost-cutting were to undermine the mitigation of those risks and responsible development.

5.30. A reduced quantum of capital allowances available to Offshore Transmission Owners (OFTOs) post *Orsted West* could result in a higher OFTO Tender Revenue Stream (TRS) with potential adverse effect on consumers as part of the OFTO TRS is directly consumer funded.

6. Acknowledgement of submission

6.1. We would be grateful if you could acknowledge safe receipt of this submission and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

14 September 2026