Predevelopment expenditure: the cost of uncertainty

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The *Ørsted* judgment and the government's subsequent consultation on predevelopment expenditure raise important questions about the availability of capital allowances relief.

Key Points

What is the issue?

The Supreme Court's decision in *Ørsted* has clarified the treatment of certain predevelopment costs for capital allowances purposes, but uncertainty remains over design, engineering and other expenditure associated with major infrastructure projects.

What does it mean to me?
Advisers preparing capital allowances claims must consider how the judgment affects qualifying expenditure, particularly on complex projects involving substantial early-stage costs, and the potential implications of increased HMRC scrutiny.

What can I take away?
The government's consultation may lead to clearer guidance or legislative changes. Meanwhile, advisers should carefully identify, document and apportion predevelopment costs, while considering the potential time and expense of HMRC reviews.

The Supreme Court's decision in *Ørsted West of Duddon Sands (UK) Ltd and others v HMRC* [2026] UKSC 12 has raised important questions about the availability of capital allowances on predevelopment expenditure. While the judgment clarified the treatment of certain studies and surveys undertaken before construction, uncertainty remains over other costs associated with major infrastructure projects.

The government's subsequent consultation has provided an opportunity to consider how the rules might be clarified, and to establish a consistent approach for businesses and their advisers. With substantial sums potentially at stake, the treatment of these costs has implications for investment decisions and the preparation of capital allowances claims.

The Ørsted decision

The Ørsted litigation concerned capital allowances claimed on pre-construction expenditure relating to offshore wind farms developed between 2009 and 2014, at a total cost of approximately £2.23 billion. The dispute centred on expenditure on studies and surveys undertaken during the planning and development phases of the projects, including assessments of environmental conditions and potential suitability of the windfarm locations.

Under the Capital Allowances Act (CAA) 2001 s 11(4)(a), qualifying expenditure must be capital expenditure 'on the provision of plant or machinery'. HMRC accepted that the wind farm generation assets constituted plant, but challenged whether the costs of the preparatory studies and surveys were sufficiently closely connected with their provision to qualify for relief.

The case progressed through the tribunals and the Court of Appeal, which found in Ørsted's favour, before reaching the Supreme Court in February 2026. In its judgment delivered in April, the Supreme Court unanimously allowed HMRC's appeal.

Lady Rose, supported by the other four judges, concluded that the statutory wording required a close connection between the expenditure and the provision of the plant. Although the studies and surveys informed decisions about the design and construction of the wind farms, their costs were not sufficiently closely connected with the provision of the assets themselves to qualify for capital allowances. The fact that expenditure was necessary for a project to proceed did not automatically make it qualifying expenditure.

The judgment clarified the treatment of the disputed studies and surveys, but did not establish a comprehensive test for every category of predevelopment expenditure. In my view, the precise location of the dividing line between eligible and ineligible costs remains unclear, particularly in relation to design and engineering expenditure. These unresolved questions were central to the government's subsequent consultation.

Government consultation

The consultation ran between 13 July and 21 September 2026. HM Treasury emphasised the importance of capital allowances in encouraging business investment, reaffirming the government's commitment to permanent full expensing, the £1 million annual investment allowance and other fundamental features of the capital allowances system for the duration of this Parliament. However, without certainty over the availability of relief, investors may be less inclined to undertake major projects.

According to the government's summary of responses, respondents generally considered that the April 2026 judgment in *Ørsted* had clarified the treatment of the specific studies and surveys examined by the Supreme Court. However, uncertainty remained over other expenditure, particularly design and engineering costs, professional fees and expenditure serving more than one purpose.

I question whether this accurately reflects the balance of opinion among respondents. In the interests of transparency, the government should provide

figures to support its conclusions. With 47 organisations identified as respondents, excluding confidential and individual responses, it should be possible to indicate the proportion expressing different views.

The government acknowledged in para 4.15 of its consultation response that stakeholders had consistently identified the treatment of predevelopment costs as an area of uncertainty and administrative burden. It therefore prioritised this area to explore how the ‘existing rules could be made clearer and easier to apply without changing their underlying boundaries’. This could involve improvements to guidance, such as clearer principles, more worked examples and more practical approaches to apportionment. HM Treasury also indicated that targeted legislative changes may be necessary to simplify the operation of the rules and support more consistent treatment.

Impact on capital allowance claims

Although the *Ørsted* judgment has prolonged uncertainty, it does not necessarily represent a major concern for all capital allowances claims. Many tax advisers deal with more modest asset expenditure and relatively straightforward construction projects. The consultation responses suggested that predevelopment costs typically represented between 1% and 10% of total project expenditure, with one energy sector respondent citing 5% to 6%. These costs may arise from regulatory requirements or studies undertaken for engineering, environmental, risk-management or financial purposes. Smaller, less complex projects are generally less likely to involve such extensive predevelopment design fees.

In my view, the greatest uncertainty arising from *Ørsted* concerns major infrastructure projects, such as data centres, ports, transport schemes and energy developments, rather than more conventional projects such as production lines, factory extensions, hotels, care homes or car dealerships.

Smaller projects will also incur design fees, but these are often more directly linked to the specific requirements of the site and the construction of the assets, potentially bringing them within the definition of qualifying expenditure on the provision of plant or machinery under CAA 2001 s 11(4)(a).

Should taxpayers and their advisers be concerned? Much will depend on how HMRC applies the judgment when examining individual claims. Amended legislation or

clearer guidance would reduce uncertainty, particularly for complex projects involving extensive surveys, engineering studies and design work, where expenditure may be considered ‘too remote’ from the provision of plant or machinery to be eligible for relief.

The consultation responses also revealed considerable support for extending relief to predevelopment expenditure. Many respondents considered that such costs should qualify, arguing that expenditure required by regulation or essential to responsible development should not become permanently unrelieved. This suggests that, regardless of the Supreme Court’s interpretation of the existing legislation, there is support for adopting a more accommodating approach to relief for these costs.

HMRC guidance and scrutiny

One concern is that the updated HMRC Capital Allowances Manual (CA20070) includes preliminaries (site and project establishment costs) alongside design fees, despite the Supreme Court making it clear in *Ørsted* (para 58) that the treatment of preliminaries was not being challenged.

This raises questions about whether HMRC is reconsidering the approach to fees and preliminaries following the earlier decision in *JD Wetherspoon plc v HMRC* [2012] UKUT 42 (TCC). It could represent a significant change in approach, potentially taking us back to the disputes over fees and preliminaries that characterised capital allowances claims in the 1990s.

Additionally, HMRC has introduced a £5 million threshold for distinguishing between ‘small’ and ‘large’ construction projects, with larger projects subject to mandatory Valuation Office scrutiny of apportioned costs.

However, given construction cost inflation of approximately 40% over the past decade, the £5 million threshold may be too low, with £20 million potentially a more appropriate figure. E³ Consulting has questioned the basis for the threshold, which could result in more claims being referred to the Valuation Office, increasing the time and costs involved in securing relief.

The government’s Advance Tax Certainty Service also aims to provide greater certainty for major investment projects by allowing businesses to establish how

HMRC will apply tax legislation to specified aspects of a project before significant investment decisions are made. Following limited take-up, the government is reducing the qualifying investment threshold from £1 billion to £300 million to broaden access to the service. While this is a welcome development, clearer guidance on predevelopment expenditure would also help businesses and their advisers assess the availability of capital allowances relief.

In conclusion

The *Ørsted* judgment has provided some clarification on the treatment of predevelopment expenditure, but it has also highlighted the difficulties of distinguishing between costs that qualify for capital allowances and those considered too remote from the provision of plant or machinery. The government's consultation acknowledges these uncertainties, although it remains to be seen how far revised guidance or targeted legislative changes will resolve them.

For advisers, the immediate challenge is to assess how the judgment may affect existing and future claims, particularly where substantial expenditure has been incurred on studies, surveys and design work. Careful identification and apportionment of these costs will remain important, alongside consideration of how HMRC's updated guidance may affect the preparation and scrutiny of claims.