Neutral Citation Number: [2022] EWCA Civ 19

Case No: A3/2020/0614

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM
THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
TROWER J AND JUDGE THOMAS SCOTT
[2020] UKUT 0030 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 13th January 2022

Before :

LORD JUSTICE GREEN
LORD JUSTICE BIRSS
and
LADY JUSTICE WHIPPLE

- -

Between :

ARDESHIR NAGHSHINEH	**Appellant**
- and -	
THE COMMISSIONERS FOR HM REVENUE AND CUSTOMS	**Respondent**

- -
- -

David Southern QC and Denis Edwards (instructed by **Ewen Cameron, Solicitor, Targetfollow Estates Ltd**) for the Appellant
Marika Lemos and Hitesh Dhorajiwala (instructed by **The Solicitor for HM Revenue and Customs**) for the Respondent

Hearing dates: 15 and 16 December 2021

- -

Approved Judgment

Lady Justice Whipple:

Introduction

1. This appeal is brought by Mr Naghshineh against the decision of the Upper Tribunal (Mr Justice Trower and Judge Thomas Scott). The UT allowed an appeal against the decision of the First-tier Tribunal (Judge Philip Gillett and Caroline de Albuquerque), allowing an appeal against the decision of HMRC to deny Mr Naghshineh "sideways relief" for losses deriving from his farming business at Salle Moor Hall in Norfolk (the "Farm") for the years 2007/08 to 2011/12. By this appeal, Mr Naghshineh seeks to restore the decision of the FTT and to secure sideways relief for some or all of those years. The total amount of tax at stake for those years is £587,140.21.

2. Permission to appeal was granted by Asplin LJ on a single ground of appeal, namely that the UT incorrectly construed the word "activities" as it is used in section 68(3)(b) of the Income Tax Act 2007 ("ITA 2007"). In short terms, it is the Appellant's case that he is entitled to sideways relief because he meets the test in section 68(3)(b), as the FTT held. HMRC's argument, upheld by the UT, is that on a proper construction of section 68(3)(b), the Appellant is not entitled to sideways relief for the years in question. The single overarching issue in this appeal is therefore one of construction of that provision.

3. HMRC filed a Respondents' Notice submitting that the UT's decision should be upheld on further or different grounds arising out of the evidence which was before the FTT.

4. Before us, Mr Naghshineh was represented by David Southern QC and Denis Edwards who did not appear in the FTT or the UT below. HMRC were represented by Marika Lemos who did appear below in the UT (but not the FTT) and Hitesh Dhorajiwala who did not appear below. We are very grateful to all counsel and their respective legal teams for the assistance they have given us.

Facts

5. In January 1995 the Appellant purchased the Farm together with 75 acres of surrounding agricultural land. This was a working farm at the time of purchase managed on a conventional (as opposed to organic) basis. Mr Naghshineh realised that he could obtain premium prices for organic farm produce compared to conventional produce and he therefore decided to convert the Farm to organic production. He also decided that the Farm was unlikely to be economically viable without increasing its size substantially and so he planned to increase the Farm's size by purchasing other land. Further, he decided to work towards ways of direct selling to the public, which he thought would enable him to achieve significantly higher prices than conventional routes.

6. In 1998 Mr Naghshineh acquired a further 221 acres of land and in 2000 he acquired a further 89 acres. In 2007 he acquired a further 25 acres of agricultural land as well as a 28-acre apple orchard. In the years with which this appeal is concerned, therefore, the Farm extended to 438 acres.

7. Over the years, Mr Naghshineh made significant changes to the way in which the Farm was run. He operated on an organic basis until 2009/10, but the market for organic produce deteriorated in 2008/09 and at that time the Farm required additional investment to continue to operate in its current form and, because of the financial crisis, Mr Naghshineh was unable to access additional funds. He therefore took the decision to revert to farming on a conventional basis.

8. Over the years Mr Naghshineh has carried on various different agricultural and non-agricultural activities on the Farm, with the activities in question often changing from year to year. The agricultural activities fell into three main categories: (a) arable, comprising crop, vegetable, and fruit production; (b) livestock, comprising the rearing of cattle and sheep; and (c) egg production. Additional business ventures associated with the Farm were his direct delivery box scheme, a farm shop, renting out of property on his land, a micro-brewery and a mustard business.

9. At all material times Mr Naghshineh intended that the Farm should operate on a commercial basis and should realise profits.

10. The Farm's losses were continuous from January 1995 to 2011/12. Mr Naghshineh's purchase of the Farm fell in the tax year 1994/5, which was therefore the first tax period in issue, starting from 6 April 1994. It took 18 tax years for the Farm to come into profit which it did in 2012/13.

11. It is now common ground, although it was not common ground before the UT, that the prior period of loss (a term which appears in section 68(3)(b), see paragraph 20 below) commenced on 6 April 1994.

Legislation

12. Chapter 2 of Part 4 ITA 2007 makes provision for trade losses. Section 60 gives an overview of the Chapter. It signposts sections 64 to 70 as the relevant provisions providing for trade loss relief against general income, commonly known as sideways relief.

13. Section 64 permits a person to make a claim for sideways relief if that person is carrying on a trade in a tax year and makes a loss in the trade in the tax year (section 64(1)). That loss can be deducted in calculating the person's net income for the loss-making year or for the previous tax year, or both (section 64(2)). The right of deduction is subject to restrictions specified, including those set out at sections 66 to 70 (section 64(8)(b)).

14. The first restriction appears at section 66, which is introduced by a sub-heading "restriction on relief for uncommercial trades". The section itself is headed "Restriction on relief unless trade is commercial" and is in the following terms:

> "(1) Trade loss relief against general income for a loss made in a trade in a tax year is not available unless the trade is commercial.
>
> (2) The trade is commercial if it is carried on throughout the basis period for the tax year–

> (a) on a commercial basis, and
>
> (b) with a view to the realisation of profits of the trade.
>
> (3) If at any time a trade is carried on so as to afford a reasonable expectation of profit, it is treated as carried on at that time with a view to the realisation of profits.
>
> (4) If the trade forms part of a larger undertaking, references to profits of the trade are to be read as references to profits of the undertaking as a whole.
>
> (5) If there is a change in the basis period in the way in which the trade is carried on, the trade is treated as carried on throughout the basis period in the way in which it is carried on by the end of the basis period.
>
> […]"

15. The test of commerciality now contained in section 66 has been considered in previous cases. In *Wannell v Rothwell* [1996] STC 450 Robert Walker J said:

> "The distinction is between the serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante" (at p 461c-d).

16. As to the words now in section 66(2)(b), in *Seven Individuals v HMRC* [2017] STC 874, Nugee J said:

> "35. … That requirement is looking at the aim or purpose of the relevant person, which is (primarily at least) a subjective question, rather than whether profits could reasonably be expected, which is an objective question"

17. Sections 67-70 contain a further restriction. Those sections are introduced by a sub-heading "Restriction on relief for 'hobby' farming or market gardening". There was some debate about the relevance of that sub-heading which I shall address at paragraphs 39-43 below.

18. Section 67 is headed "Restriction on relief in case of farming or market gardening" and provides:

> "(1) This section applies if a loss is made in a trade of farming or market gardening in a tax year ("the current tax year").
>
> (2) Trade loss relief against general income is not available for the loss if a loss, calculated without regard to capital allowances, was made in the trade in each of the previous 5 tax years (see section 70)
>
> (3) This section does not prevent relief for the loss from being given if–

> (a) the carrying on of the trade forms part of, and is ancillary to, a larger trading undertaking,
>
> (b) the farming or market gardening activities meet the reasonable expectation of profit test (see section 68), or
>
> (c) the trade was started, or treated as started, at any time within the 5 tax years before the current tax year (see section 69 below, as well as section 17 of ITTOIA 2005)."

19. This section therefore establishes the "five-year rule" precluding sideways relief for losses in farming or market gardening trades beyond five consecutive years (sub-sections 1 and 2, both of which refer to a "trade" of farming or market gardening). But the section also disapplies the five-year rule in certain circumstances (sub-section 3), including where the farming or market gardening "activities" meet the reasonable expectation of profit test, by reference to section 68 (section 67(3)(b)).

20. Section 68 contains the reasonable expectation of profit test presaged by section 67(3)(b). It is headed "Reasonable expectation of profit" and provides as follows:

> "(1) This section explains how the farming or market gardening activities ("the activities") meet the reasonable expectation of profit test for the purposes of section 67.
>
> (2) The test is decided by reference to the expectations of a competent farmer or market gardener (a "competent person") carrying on the activities.
>
> (3) The test is met if–
>
> (a) a competent person carrying on the activities in the current tax year would reasonably expect future profits (see subsection (4)), but
>
> (b) a competent person carrying on the activities at the beginning of the prior period of loss (see subsection (5)) could not reasonably have expected the activities to become profitable until after the end of the current tax year.
>
> (4) In determining whether a competent person carrying on the activities in the current tax year would reasonably expect future profits regard must be had to–
>
> (a) the nature of the whole of the activities, and
>
> (b) the way in which the whole of the activities were carried on in the current tax year.
>
> (5) *"The prior period of loss"* means–
>
> (a) the 5 tax years before the current tax year, or

> (b) if losses in the trade, calculated without regard to capital allowances, were also made in successive tax years before those 5 tax years (see section 70), the period comprising both the successive tax years and the 5 tax years."

21. There are a number of observations to be made about section 68. First, the section uses the words "the activities" in contrast to the use of the term "a trade" or "the trade" used elsewhere in Chapter 2 (notably sections 66 and 67). I will consider the significance of these words at paragraphs 47ff below. Secondly, the test imposed by section 68 depends on the expectations of a competent farmer or market gardener, and is therefore wholly objective, in contrast with the test of commerciality at section 66 which contains both objective and subjective elements. Thirdly, the test is only met if both limbs of section 68(3) are met, they can be referred to as limb (a) and limb (b). Limb (a) applies to "the activities in the current tax year", noting the definition of current tax year in section 67(1) and the references to the nature of the activities and the way they are carried on in section 68(4); limb (a) tests whether a competent person carrying on the activities in that year would reasonably expect future profits. Limb (b) applies to "the activities at the beginning of the prior period of loss" and tests whether a competent person carrying on the activities could not reasonably have expected the activities to become profitable until after the end of the current tax year. Thus, each limb is distinct from the other. Fourthly, however, limb (a) is connected to limb (b) by the word "but". Fifthly, the prior period of loss is defined at section 68(5) as the greater of five years before the current tax year (picking up the five-year rule in 67(2)) and the period comprising the five years and any successive tax years before that in which there were losses in the trade so that there is no limit put on the length of the prior period of loss which could extend back indefinitely so long as the trade has remained loss-making.

22. Section 69 defines the circumstances where a trade ceases and a new trade is carried on. Section 70 sets out how losses in previous tax years are to be determined.

23. Section 996(1) ITA defines "farming" as "the occupation of land wholly or mainly for the purposes of husbandry" but does not include "market gardening" which is separately defined at section 996(5) as "the occupation of land as a garden or nursery for the purpose of growing produce for sale". Both farming and market gardening are therefore defined as trades dependent on the land which is occupied for that purpose.

The Issue

24. The issue which divides the parties is the meaning of the words "the activities at the beginning of the prior period of loss" in section 68(3)(b). The Appellant, Mr Naghshineh, by his counsel, says that the words mean the farming or market gardening activities which were *in fact* being carried on at the beginning of the prior period of loss and up to the current tax year, and that the test relates to the reasonable competence of the farmer or market gardener who has carried on those activities since that date. HMRC say that the words mean the farming or market gardening activities *in the current tax year*, taking account of the nature of the whole of the activities and the way in which they were carried out in the current tax year, and the test is one of expectation of when those activities might reasonably be expected to come into profit.

25. On the Appellant's case, he is entitled to sideways relief for all tax years up to and including 2011/12, because the farming and market gardening activities at the Farm were competently managed throughout. He says he is supported by findings of fact in the FTT and by the general principle that trading losses should be permitted to be offset against other profits in the same year, citing *R v IRC ex p Unilever plc* [1996] STC 681 at 690. HMRC do not dispute the principle, at a high level of generality, but they dispute Mr Naghshineh's entitlement to sideways relief for the years in issue, because they say he fails limb (b) of the reasonable expectation of profits test in each of those years. The test requires evidence to show that if the activities in the current tax year had been carried on at the beginning of the prior period of loss (from 6 April 1994, in Mr Naghshineh's case), they could not reasonably have been expected to be profitable until after the end of the current tax year; but, they say, no finding to that effect was made by the FTT, in relation to any one of the years in dispute, and so the claim for sideways relief must fail.

26. I turn to consider what was decided in the two tribunals below. Because the UT commented on some parts of the FTT's decision, I shall start with the FTT.

First-tier Tribunal

27. The FTT heard evidence from Mr Naghshineh and from Mr William Waterfield, an expert in farming, particularly organic farming, and farm management. Mr Waterfield's evidence was not significantly challenged under cross examination. The FTT approached the limb (b) test in the following way (emphasis added):

> "18. Importantly, the expression 'the prior period of loss' is defined in s68(5) and requires us to consider **the reasonable expectations of the competent farmer** as they would have been at the beginning **of the period when the losses commenced**."

28. The FTT quoted Mr Waterfield's report at [34] with some additions inserted by the FTT in square brackets:

> "… Having established the business in 1995 the farm area increased with land purchase in 1998 and in 2000 when the business was fully established with 153 hectares being farmed. The conversion to organic production delayed the establishment of a stable business until December 2002 resulting in the first [saleable organic] harvest being 2003 and [the first] income accruing [from that harvest] in the year ending 2004.
>
> In my opinion a competent operation running a simple system of production, with sales to stable wholesale markets, and economies of scale being employed, could reasonably expect to be making a profit from conventional crop production and livestock rearing within 3-5 years.
>
> A more complex farming system such as organic farming with the establishment of a diverse portfolio of enterprises, combined with the development of short supply chains direct to end consumers and limited opportunities for economies of scale, where diversification and continual expansion are combined with retailing, a competent farmer could reasonably expect to be making a profit in 10 years.

> Where markets become unstable through forces beyond the control of the business, which necessitate production realignment and enterprise simplification and re-organization, a competent farmer could reasonably expect to be making a profit within 3 years from enterprises after restructuring."

29. They noted that Mr Waterfield had clarified this timescale in his oral evidence:

> "35. He had said that starting in 1998, when the additional 220 acres were acquired, it would take two years to achieve the conversion to organic status and a further two years to obtain full organic certification. The first fully organic harvest from this land would then be in 2003, with the profit from that harvest accruing in 2004. It would then take until the end of 2012 before he would expect a profit to accrue from the farming activities as a whole. He also clarified that his use of the words "within 10 years" in his report should be taken to read that he would not expect profits until after the end of that period."

30. Reconciling the evidence with the limb (b) test as the FTT had construed it, they concluded:

> "39. We must therefore consider the thinking of the competent farmer as at 31 March 1995. We are required by the legislation to work on the basis that the competent farmer was planning to carry on the same activities as were carried on by Mr Naghshineh in the years under consideration. In summary these plans must therefore have included:
>
> (1) The acquisition of more land in order to achieve the scale necessary for profitability,
> (2) The conversion of all the land to organic status,
> (3) Producing a wide range of farming produce, and
> (4) Selling farm produce directly to the consumer.
>
> 40. Applying Mr Waterfield's timescales to these activities we consider it reasonable to assume that the competent farmer's timescales would have included:
>
> (1) Finding and acquiring the necessary land; three to five years,
> (2) Conversion of the land to organic status; four years,
> (3) Producing a wide range of farming produce; four to ten years,
> (4) Selling farm produce directly to the consumer; four to ten years, and
> (5) Achieving profitability; ten years after the land had been converted to organic status.

> 41. This would mean that profits would not have been expected until after the end of 2012.
>
> 42. We therefore find that Mr Naghshineh did indeed fulfil the second test in all years up to and including 2012."

31. Accordingly, the FTT allowed the appeal on the basis that for all periods in question the Appellant had a reasonable expectation of profit. HMRC appealed.

Upper Tribunal

32. The UT noted that there was some lack of clarity about the timeline to profitability as found by the FTT at [40] and [41] of the FTT's decision (see paragraph 30 above). They approached the FTT's timeline in this way:

> "32. The parties suggested that paragraph [40] should be read as a finding that as at the beginning of the prior period of loss the competent farmer would not have forecast profits for at least 17 years. That figure results if one assumes that:
>
> > (1) The total minimum forecast period is three years for acquiring land, plus four years for conversion to organic status, plus ten further years for achieving profitability.
> >
> > (2) Items (3) and (4) run concurrently with item (2).
> >
> > (3) Where a range is specified, one takes the lower figure.
>
> 33. We agree that that is the most plausible interpretation of paragraph [40], and one which supports the conclusion reached by the FTT. We have therefore assumed in our decision that this is indeed how the FTT's decision should be interpreted. It is, however, unfortunate that both the parties and this Tribunal should have to unpick and deduce the essential reasoning in this way."

33. On the issue of law, the UT recited the parties' rival submissions, considered the earlier UT case of *Scambler v HMRC* [2017] UKUT 0001 (TCC), [2017] STC 2108 (which I will deal with at paragraphs 68-69 below), and described the drafting of section 68 as "dense and difficult". The UT concluded that section 68 should be construed in the following way:

> "39. In our opinion, the test operates as follows. First, the activities actually carried on in each year of loss—in this appeal each of the five tax years from 2007/08 to 2011/12 inclusive—must be determined. Second, one must then assume that *those activities* were being carried on at the beginning of the loss period (discussed below but found by the FTT to be 31 March 1995). Having made that assumption, one must ask how long a competent farmer *at 31 March 1995* would have expected it would take for *those activities* to become profitable. In answering that question, the competent farmer must "have regard to" the factors mentioned in section 68(4). Only if the competent farmer can say "it would have taken until

> after the end of the relevant loss year", and only if he could not reasonably have reached a contrary view, is the test in section 68(3)(b) satisfied. While applying the test of expectation as at 1995 may seem harsh, we note that section 68(3) refers specifically not to a competent person at that time but to "a competent person *carrying on the activities at the beginning of the prior period of loss*" (our emphasis).
>
> 40. With this approach in mind, our conclusions in relation to the competing submissions of the parties are as follows. First, the question of whether it is right or wrong to take account of preparatory or planning steps in relation to the trade is the wrong question. The operative question is "what were the activities as actually carried on in a particular loss year?" If, for instance, by a particular loss year as a matter of fact insufficient land had been acquired to operate the activities in that year profitably, that would inform any assessment to be made under section 68(3)(b), and if as a matter of fact the contrary was the case, that would similarly inform any assessment. But that would be so not because of a principle that planning or preparatory steps are or are not relevant, but because of the activities in fact carried out in that year. Second, it is essential in applying the test not to adopt a general categorisation of the activity carried out over a period of several years, such as "organic farming", "stud farming" or "conventional farming", but to consider the activities actually carried out in each tax year of loss. Not only may the activities change radically in nature (as they did in this appeal when the farm was eventually converted from mixed-use organic to conventional farming), they may well change more gradually. If, for instance, one takes HMRC's practice of generally accepting that stud farming takes 11 years to become profitable from the start of trading, then the answer to the question posited by section 68(3)(b) is likely to differ if the loss year occurs 10 years after the trade begins rather than 1 year after. Put another way, the test is dynamic and not static in nature."

34. On the purpose of the legislation, the UT stated

> "41. … The legislative code in this area seeks to reconcile a number of objectives, including a 'longer period of grace' than 5 years for sideways loss relief in respect of farming activities which by their nature or structure can reasonably be expected to take longer than normal to come to profit".

35. They allowed HMRC's appeal and denied sideways relief to Mr Naghshineh for the years in dispute:

> "44. According to the expert evidence on which the FTT based its decision, the four-year process of converting the land to organic status by 2002 would have led to the first fully organic harvest in 2003, with profit from the harvest in 2004. It would then take at least 10 years following conversion to organic status for the venture to become profitable: [34], [35], [40] of the decision. On the basis of these facts, by 2007/08 the activities *actually carried on* in that year were (mixed-use) organic farming, the process of conversion having been completed some years previously. So, if the competent farmer had been assumed to be carrying

> on *those activities* in 1995, he would reasonably have expected them to become profitable (accepting for this purpose the expert evidence) by the early 2000s, being 10 years after a conversion to organic status which had occurred some years previously. Even if the competent farmer could reasonably have expected the profitability not to arise until 10 years after 1995, that would still have been before the first period of loss under appeal."

36. The UT went on to correct two errors, as it perceived them, in the FTT's decision. The first was the "conversion" issue, whereby the UT considered the FTT had failed to recognise that in the last two years of loss (i.e. 2010/11, and 2011/12) the Appellant was not carrying on organic farming at all but had converted back to conventional farming. That being so, the question for the FTT was when a competent farmer carrying on those activities in 1995 would have expected them to become profitable, as to which there had been no evidence before the FTT (see [22] and [45]). Permission to appeal this finding was sought by the Appellant but refused, and the matter does not form part of this appeal. The second was the "tax year" issue, whereby the UT concluded that the beginning of the prior period of loss was 6 April 1994, the date when the relevant tax year commenced, and noted that the Appellant had accepted that point in written submissions (see [23] and [46]). This latter point is now common ground.

The Matters for Determination

37. The following issues or matters fall to be determined in this appeal:

    i) What is the proper construction of the section 68(3)(b)? Within that overarching issue, there are a number of sub-issues:

        a) Is the sub-heading to sections 66-70 which refers to "hobby" farmers relevant to construction?

        b) How should section 68(3)(b) be construed, based on its language, context and statutory purpose?

        c) What are the circumstances in which reference to the predecessor legislation may be made and do those circumstances exist here?

        d) If reference is permitted to the predecessor legislation, what, if anything, does that reveal?

        e) What does previous tribunal authority on the issue of construction of section 68(3)(b) show?

38. Once the issue of statutory construction is determined, what is the outcome of this appeal? This issue will encompass the points raised by HMRC in their Respondents' Notice.

Construction of Section 68(3)(b)

The "hobby farmers" sub-heading

39. Sections 67-70 are introduced by a sub-heading "Restriction on relief for 'hobby' farming or market gardening". A question arises as to whether the heading is relevant to the construction of the provisions which follow it, with Mr Southern suggesting that the heading describes the scope of the restrictions contained in these sections, a proposition with which Ms Lemos disagrees. Further, Mr Southern says his client is not a hobby farmer because he had farmed with commercial intention throughout and was not indifferent to the losses which had accumulated on the Farm. Ms Lemos sought, by submissions and by her Respondents' Notice, to suggest that Mr Naghshineh's decisions in relation to the farming business lacked commerciality and in some respects he was indifferent to the losses incurred.

40. The phrase "hobby farming" was used by the Royal Commission on the Taxation of Profits and Income (June 1955) which considered farming losses at paragraphs 489 to 497. At paragraph 489 it refers to the "hobby farmer" who was "the man who, enjoying substantial income from other sources, engages in farming as a part-time activity" and who may have reasons for being "indifferent to losses" incurred in the farming business, such as "the supply of agricultural produce for his home consumption, the prospect of ultimately realising a capital profit on the sale of his farm, the value of which he has improved by liberal expenditure, the amusement that he derives from indulgence in his hobby, the attraction of a 'hedge' against inflation" (see [489]). The Royal Commission did not consider there was a particular problem with hobby farmers but recommended a small amendment to the existing tax code to make it more difficult for abuses to be maintained (by strengthening the term "husbandry" as it then appeared in the tax legislation by defining it as "carried on on a commercial basis and with a view to the realisation of profits" - see [494]).

41. On the issue of statutory construction, we were taken to Bennion, Bailey and Norbury on Statutory Interpretation (8th Ed) which suggests that a heading is part of an Act and may be considered in construing an Act, provided that due account is taken of the fact that its function is merely to serve as a brief guide to the material to which it relates and that it may not be entirely accurate (see paragraph 16.7). The parties both accepted that general proposition, as do I.

42. I conclude that in the context of Chapter 2 of the ITA 2007, the sub-heading in question is not an accurate guide to the content of the sections which follow. It is a way-marker, pointing to hobby farmers and market gardeners as persons likely to fall within Chapter 2, but by no means limiting the application of those sections to those persons. I reach that conclusion because the word "hobby" is included in the heading in quotation marks, but is nowhere defined or used in the sections which follow. If the term "hobby farmer" was key to the functioning or scope of the restriction it would have been defined. There is no indication in the statute that the term hobby farmer is intended to define the type of farmer caught by these provisions and the better view is that its inclusion in the heading is merely indicative of one type of farmer who would fall within these provisions. That interpretation makes sense of the following sections which are precise, and where key terms (such as "farming and market gardening activities") are defined. A similar conclusion was reached in *Wannell,* in relation to section 170(1) of the Income and Corporation Taxes Act 1970 (now section 66(1) and (2) ITA 2007), where Robert

Walker J said: "that section was no doubt primarily aimed at hobby farming, but if that was intended to be its only aim, Parliament would have had a much easier and clearer means of achieving its aim …".

43. Regardless of the significance of the sub-heading, I would accept Mr Southern's submission on the facts that Mr Naghshineh was not a "hobby farmer", applying the Royal Commission's definition. The FTT made a finding that Mr Naghshineh intended that the Farm should operate on a commercial basis and should realise profits (at [9(17)]). I agree that HMRC is not entitled to go behind that finding by the FTT.

Language, Context and Purpose

44. The approach to construction is uncontroversial. The Court should have regard to the purpose of a particular provision and interpret its language so far as possible in a way which best gives effect to that purpose: see, as an example, *Barclays Mercantile Business Finance v Mawson (Inspector of Taxes)* [2005] 1 AC 684 at [28] and [32].

45. Chapter 2 provides for sideways relief, subject to restrictions. There are two restrictions in sections 66 to 70. One is general, restricting sideways relief in respect of all trades that are not commercial (section 66), the other is specific to farming or market gardening (section 67-70). These restrictions are cumulative so that claims for sideways relief for farming losses can only be made where the trade which has generated the losses is commercial, and then only if the criteria specific to losses from farming or market gardening are met. Within the second restriction specific to farming or market gardening, there are two layers. The first is the five-year rule which restricts sideways relief to a maximum period of 5 years of consecutive loss; the second is a 'relaxation' of that rule where section 67(3) applies. Section 67(3) sets out three scenarios where the relaxation applies. Section 68 addresses one of them, namely where the reasonable expectation of profits test is met (section 67(3)(b)).

46. Mr Southern disputed the description of section 67(3) as a 'relaxation' of the five-year rule. He described it as a 'disapplication' based on evidence or as a 'derogation'. Nothing turns on the particular description of the measure. To describe it as a relaxation of the five-year rule seems to me to be appropriate, on either party's case, and I shall use that term.

47. At paragraph 21 above, I made a number of observations about sections 67 and 68. I return to those now as part of the search for the correct construction of section 68(3)(b). First, the shift in language from "a trade" in sections 66 and 67 to "the activities" in section 68 suggests a narrowing of focus. A trade is a general term, encompassing all the trading activities; the reference to "activities" is more specific. "Activities" must be referring to the different strands of farming activity within a single compendious trade. This case provides an illustration, with different activities undertaken over time of arable, livestock, egg production and so on.

48. Section 68(1) defines "the activities". This definition emphasises that it is the activities of farming or market gardening which are in issue. So here too there is an increased focus on the specifics of the farming or market gardening business.

49. Section 68(4) requires regard to be had to the "whole" of the activities, both as to their nature and the way they are carried on in the current year. The legislation is here

emphasising that unless all the farming or market gardening activities pass the reasonable expectation of profits test, the relief will be denied.

50. The limb (a) test appears at section 68(3)(a). The activities in question are undoubtedly the current year activities, as specified within the provision. But in applying the test, regard "must" be had to the features described at section 68(4) (nature of the activities and the way they are carried on in the current tax year). There is no time limit built into limb (a). It is a test of likely profitability at some future point. It is different from and more stringent than the test of commerciality at section 66(1) because it refers to the whole of the activities (and not to the "trade"), and it has no subjective element to it, it is an objective test applied from the point of view of a competent farmer or market gardener (section 68(2)).

51. Limb (b) is introduced by the word "but". That connector indicates that limb (b) qualifies limb (a). Limb (b) is focussed on when, reasonably, the activities in question will become profitable. Only if profit could not reasonably be expected until after the end of the current tax year is the test met. Put the other way around, if the activities could reasonably have been expected to be profitable by the end of the current year, the limb (b) test is failed. It is a test of time, of how long to profit, objectively measured according to reasonable expectation.

52. I come then to the key issue which divides the parties. Mr Southern argues that the activities referred to in limb (b) are the activities as they were carried on at the beginning of the prior period of loss. Taken literally, in Mr Naghshineh's case, that would mean the farming activities undertaken from January 1995, before further land was purchased and before the conversion to organic was undertaken. There are obvious difficulties with fixing the activities at this point: it would mean that subsequent changes in the farming activities could not be taken into account. So, for example, in this case, Mr Naghshineh's entitlement to sideways relief would be forever more measured by whether and when his first-year activities were likely to be profitable. But Mr Southern does not apply the test quite so literally. He says that limb (b) operates as a prospective test. The competent person is required to look forward from the first year of the prior period of loss and predict, on the basis of the activities *then* carried on, whether those activities, as they might develop, would be unlikely to be profitable until a time after the current year (this is the formulation in the Appellant's skeleton at [101]). Mr Southern says that the application of this test is a matter of evidence, and that the point to which that evidence should go, in any given case, is this (as put in oral submissions): "how might this business undertake changes in the forthcoming years to become profitable, and what would be the timescale for such changes before they become profitable, in relation to all the alternatives?" So, he says, the early years when Mr Naghshineh built up the farm to the size it is today, and invested in the conversion to organic status, can be taken into account, and as long as they are within the bounds of what a competent person would have done, they meet the limb (b) test. Thus, he argues, Mr Waterfield's evidence that Mr Naghshineh reasonably undertook various changes which were predictable at the outset and reasonably took 17 years to bring this business into profit, answers the limb (b) test in Mr Naghshineh's favour. He argues that HMRC's alternative analysis is artificial and unworkable; and to the extent that it is built on a statutory hypothesis, it stretches the statute too far, citing *Fowler v R&C Commissioners* [2020] STC 1476.

53. There are a number of problems with Mr Southern's formulation. The most obvious is that it does not fit the words of section 68(3)(b). There is nothing there to suggest that the test operates on the basis of a rolling review of the activities during the intervening years, whether that is prospective or retrospective or some combination of both. Rather, "the activities" referred to in section 68(3)(b) appear to be an anchor for the test of expectation which follows: when would *those activities* be expected, reasonably, to become profitable? Secondly, on his analysis, the relief would be potentially open-ended. The only temporal limit to the relaxation would be when one of two things happened: either the farmer was not competent, or the farmer came into profit (in which case there would be no issue over loss relief anyway). Thirdly, that open-endedness would appear to defeat the object of limb (b) which appears, from its language and context, to be the imposition of a time limit on the relaxation of the five-year rule. Fourthly, and in any event, Mr Southern's reading would open up a wide exception to the five-year rule, which would be surprising because it would undermine the strictness and clarity of the five-year rule in any case where losses had reasonably been incurred for a longer period. Fifthly, as a matter of language, the use of the word "but" as the connector would seem misplaced on Mr Southern's analysis which treats limb (a) and limb (b) as independent tests, each with a different subject matter.

54. The contrary case put by Ms Lemos is that limb (a) and limb (b) examine the same activities, in other words, the current year activities which have given rise to the losses in issue. This, she says, is why the word "but" connects the two tests; that word is a clear indication that limb (b) refines limb (a). On her analysis, the considerations in section 68(4) which must be taken into account for the purposes of limb (a) are also read into limb (b). This, she says, makes sense because the reasonable expectation of profit test is focussed on those precise activities, that term being used throughout section 68. The purpose of the provision is to apply a time limit to the narrow relaxation of the five-year rule.

55. She says this is not artificial or strained. This approach involves a statutory hypothesis, that the current year activities were carried on at the beginning of the prior period of loss. This is not a deeming provision (so *Fowler* is not in point). She accepts that earlier loss-making years when the taxpayer was conducting different activities, or even activities which are preliminary to and in preparation for the current year's business activities, will be counted as part of the prior period of loss and so the taxpayer may find that the entitlement to sideways relief ends before they have brought their current year's activities to profit; but that, she says, is how the legislation works and that represents the balance drawn by Parliament. Such an approach promotes the purpose of the measure which is to permit sideways relief beyond five years for farming and market gardening businesses which, because of their nature or the specific way that they are carried on, are reasonably expected to take more than five years to become profitable, while barring sideways relief for those businesses which have taken longer than could reasonably have been expected to come to profit, or where profit is not being seriously pursued. The time to profit is tested not by reference to when the farmer first commenced those activities, but by when the farmer first started incurring losses, counting all the successive loss-making years within the prior period of loss.

56. My view is that Ms Lemos' construction of section 68(3)(b) is right, as the UT held. It makes sense of the statutory purpose which can be drawn from the language and context of the provisions themselves (and abiding by the principle in *R v Barnet LBC, ex p Shah*

[1982] 2 AC 302 on which Mr Southern relies, not to impose my own view of the policy but rather to adopt a purposive interpretation found in the statute). The purpose of section 68(3)(a) and (b), read together, is to permit a relaxation of the five-year rule where farming or market-gardening activities are expected reasonably to be profitable, but to cap that relaxation at the number of years which it would reasonably take for the activities (the same activities as in limb (a)) to come to profit. The words "activities" as they are used in limb (a) and limb (b) mean the same thing, namely the farming or market gardening activities as defined at section 68(1), carried out in the current year pursuant to section 68(3)(a), and having regard to the nature of the whole of the activities and the way in which they are carried out in the current tax year pursuant to section 68(4). Limb (b) complements and refines limb (a) (connected by the "but" between them) and operates to impose a time limit on the relaxation. The purpose of limb (b) is to impose a "long-stop" date beyond which relief is not available.

Predecessor legislation

57. I turn to consider whether it is permissible to seek assistance on the issue of statutory construction from the historic legislation, and if so, whether that legislation does assist. ITA 2007 is part of the Tax Law Rewrite Project. The Explanatory Notes to ITA 2007 confirm that the main purpose of the Act is to rewrite the income tax legislation to make it clearer and easier to use. Further, it is stated that the Act does not generally change the meaning of the law when rewriting it, and that the minor changes which it does make are within the remit of the Tax Law Rewrite project and the Parliamentary process for the Act: "in the main, such minor changes are intended to clarify the existing provisions, make them consistent or bring the law into line with established practice". So far as section 68 is concerned, the Explanatory Notes do not point to any change of substance at all, simply saying that this section set out the "reasonable expectation of profit test" which, if met, prevents relief being restricted under section 67, and that the section is based on section 397(3) and (5) of ICTA 1988 (paragraph 264 of the Explanatory Notes).

58. In *Eclipse Film Partners (No 35) LLP v HMRC* [2013] UKUT 639 (TC), [2014] STC 1114 Sales J (as he then was) considered the approach to construction of a consolidating statute such as ITA 2007:

> "96. … An important part of the objective of a consolidating statute or a project like the Tax Law Rewrite Project is to gather disparate provisions into a single, easily accessible code. That objective would be undermined if, in order to interpret the consolidating legislation, there was a constant need to refer back to the previous disparate provisions and construe them. … However, where, after undertaking such an exercise, a provision which falls to be applied is found to be ambiguous, a subordinate presumption comes into play, namely that it is presumed that there was no intention to change the meaning of the provision which has been repeated in the same language in the consolidated code. In such circumstances, it may be relevant to try to determine the meaning of the relevant provision by looking to see what it meant when it was previously enacted: see [*Farrell v Alexander*][1977] AC 59 at 73B (Lord Wilberforce), 84D-H (Lord Simon of Glaisdale) and 97B (Lord Edmund-Davies)."

59. This passage was cited with approval by the Supreme Court in *R (on the application of Derry) v HMRC* [2019] 1 WLR 2745 at [9]. The parties agree that it represents the approach this Court should take to the issue now raised: it is necessary to identify an ambiguity before the earlier legislation can be considered.

60. Mr Southern seeks to persuade us that there is no ambiguity in section 68(3)(b), which, he says, is clear in his favour. I have already rejected his arguments on construction. I agree with him that there is no real ambiguity in the legislation, but in my judgment it is clear the other way. But others may disagree and for the purposes of this part of my judgment, I assume against my earlier conclusions that there is an ambiguity in the wording of section 68(3)(b), so that regard can be had to the predecessor legislation.

61. Section 397(3) of ICTA 1988 provided (with emphasis added):

> "(3) [This section] shall not restrict relief for any loss or for any capital allowance, [in any case] —
>
> > (a) [where] the whole of the farming or market gardening activities in the year next following the prior five years are of such a nature, and carried on in such a way, as would have justified a reasonable expectation of the realisation of profits in the future if they had been undertaken by a competent farmer or market gardener, but
> >
> > (b) [where], if that farmer or market gardener had undertaken **those activities** at the beginning of the prior period of loss, [that farmer or market gardener] could not reasonably have expected the activities to become profitable until after the end of the year next following the prior period of loss."

62. Section 397(3) contains a test containing two limbs, just as section 68(3) does. The content and purpose of each limb appears to be identical to the current legislation, as would be expected given that ITA 2007 is a rewrite. There are differences: the activities are now defined separately by section 68(1); the requirement to take into account the nature of the whole of the activities and the way they are carried on is now set out separately in section 68(4); and the reference to "the" activities in section 68(3)(b) replaces the words "those activities" in section 397(3)(b).

63. Mr Southern says that the predecessor legislation should be read in the same way as he proposes for the current legislation, that the current year activities are not transposed to limb (b), and the words "those activities" in limb (b) are a reference to the real activities carried on from the start of the prior period of loss up to the current tax year and not to the same activities as appear in limb (a).

64. I am unable to accept Mr Southern's reading of section 397(3)(b). The language clearly indicates that the current year activities referred to in section 397(3)(a) are transposed back to the beginning of the prior period of loss for the purposes of section 397(3)(b). That is what "those activities" in section 397(3)(b) means. Section 397(3) works in a materially identical way to section 68(3). It poses the same hypothetical question under limb (b), namely: *if* that competent farmer or market gardener had undertaken *those* activities at the beginning of the prior period of loss, could he or she not reasonably

have expected those activities to become profitable until after the end of the current tax year?

65. The restriction of sideways relief for farming or market gardening losses first appeared in section 22 of the Finance Act 1967. It then appeared in section 180 ICTA 1970, before being re-enacted in section 397 of ICTA 1988. We were shown the two earlier iterations of the legislation (1967 and 1970) as well as the 1988 Act. It is clear that the two-limb test has remained the same in its essentials since 1967. All three earlier iterations contained the words "those activities" in limb (b), referring back to the activities defined as current year activities in limb (a).

66. The predecessor legislation aligns the limb (b) activities with the limb (a) activities. This confirms the view I had already reached in favour of HMRC's construction of the statute.

67. Further, my view of the meaning of the predecessor legislation accords not only with the UT in this case, but also, as I am about to come onto, the UT in *Scambler*. The UT in both cases had regard to the predecessor legislation and considered it to be conclusive of any doubt they had entertained.

Previous Tribunal Cases

68. The Upper Tribunal has considered the construction of section 68(3)(b) on one previous occasion other than in this case, in *Scambler* (Judge Timothy Herrington and Judge Thomas Scott). Faced with divergent FTT cases on the issue, the UT found that there was a "real difficulty" in interpreting the words of section 68(3)(b) which it thought were ambiguous so that it had regard to section 397(3) ICTA, which it considered resolved the ambiguity. At paragraph 64, the UT said that in order to obtain sideways relief beyond the five-year rule and in reliance on the reasonable expectation of profits test, the competent farmer would need to be able to make the following statement, with which I agree and which I gratefully adopt with slight adjustment as a helpful encapsulation of the issue:

> "Looking at the activities in [the current year], and taking account of the nature of the activities and the way they are carried on, I would reasonably have expected them to become profitable at some stage, but if you had asked me [at the beginning of the prior period of loss] to look at those [current year activities] in the same way, I could not reasonably have expected them to become profitable until after the end of [the current year]."

69. The UT rejected the taxpayer's submission that the purpose of the legislation was to ensure that competent farmers doing everything they could within their control to address profitability were entitled to sideways relief indefinitely; rather, the UT held that the purpose of the legislation reflected a policy that unless there was something in the nature of the farming business (or, I would add, the way it is carried on) which meant that the competent farmer could not reasonably expect that business to become profitable except in the long-term, then the period of sideways relief should be limited by time in normal circumstances (see [72]).

70. Previous to *Scambler*, there were three FTT decisions on the point. One of them, *Erridge v HMRC* [2015] UKFTT 0089 (TC), arrived at the same conclusion on the meaning of the provision as I have done, and as did the UT in this case and in *Scambler*, leading to the outcome in that case that sideways relief was denied for the year in question. One feature of that case was the FTT's recognition that farming involves occupation of land. This finds a statutory echo in section 996 which defines farming and market gardening by reference to occupation of the land (see paragraph 23 above).

71. The FTT in *Silvester v HMRC* [2015] UKFTT 0532 (TC) rejected HMRC's submissions that "activities" referred to activities in the year of claim, and instead held that the word meant the trade of farming in respect of which the losses were claimed. It nonetheless went on to dismiss the appeal on the basis that at the beginning of the prior period of loss in 2000 the competent farmer would have expected profits before 2009/10 or 2010/11, the years of claim. With respect, it seems to me that this disposal was correct, even if the reasoning was different from the route I have taken through the statute.

72. The third case is *French v HMRC* [2014] UKFTT 940 (TC). The FTT said at [49] (as *obiter dicta* given that the FTT had already determined the appeal on different grounds) that the word "activities" meant the activities that the actual farmer was conducting at the start of the period of losses and that HMRC's interpretation produced an incoherent result. It labelled as "extraordinarily far-fetched" HMRC's concern that the alternative interpretation could lead to abuse by hobby farmers changing farming activities every few years so that the relief became open-ended (see [51]). There are two points to make here. First, in their analysis of the statutory wording, the FTT said in terms that "it is not as if paragraph (b) referred to "*those activities",* which would clearly have been a reference back to the activities referred to in paragraph (a)…" I venture that if that Tribunal had been referred to the predecessor legislation which did contain the words "those activities" that they would have come to a different (and correct) conclusion on the law. Secondly, the logical consequence of the FTT's construction of section 68(3)(b) is that sideways relief could become open-ended, because the test could be satisfied indefinitely; it is not right to suppose that relief would be blocked by the commerciality test in section 66 or any other provision in the legislation; there would be the possibility of abuse.

73. Accordingly, there is support for the view that I have arrived at on the meaning of the statute, in the UT decision in this case, as well as in the earlier case of *Scambler*. The one FTT decision which clearly adopted the approach advanced by Mr Southern in this appeal (*French*) would probably have gone the other way if that tribunal had been shown the predecessor legislation.

Conclusion on Statutory Construction

74. I conclude that the reference in section 68(3)(b) to "the activities" is a reference to the same activities as are the subject of section 68(3)(a), namely the farming and market gardening activities undertaken in the current year, with regard to their nature and the way they are carried on. Section 68(3)(b) works by testing *those* activities on the hypothetical basis that they were carried on at the beginning of the prior period of loss and then asking the relevant question, which is whether a competent person could not reasonably have expected them to become profitable until after the end of the current year (see the *Scambler* question posed at paragraph 68 above).

Disposal on the Facts

75. The UT said it found the FTT's findings of fact opaque (see [29]). But the UT nonetheless summarised Mr Waterfield's evidence, based on submissions by both parties about what Mr Waterfield had meant, at [33] of its Decision, see paragraph 32 above. The UT was satisfied that the FTT had made a finding, based on Mr Waterfield's evidence, that at the beginning of the prior period of loss, the competent farmer would not have forecast profits for at least 17 years, given the various steps that were built into that timeframe, including the purchase of land and its conversion to organic conditions.

76. Ms Lemos says that Mr Waterfield's evidence was addressing the wrong issue. It was nothing to the point that a competent farmer might have expected to take 17 years to bring the Farm to profitability, adopting the various strategies adopted by Mr Naghshineh over time. That is to test the competence of Mr Naghshineh as a farmer, which is not what limb (b) does. Mr Waterfield should have been asked to confirm whether the current year activities, taking account of the nature and the way they were carried on in the current year, (a) would have been expected to be profitable at some stage; and if so (b) if they had been carried on at 6 April 1994, they could not reasonably have been expected to become profitable until after the end of the current year. The FTT, and in turn the UT, did not have this evidence before them and it follows that the appeal should have been dismissed for lack of evidence to satisfy the statutory test. This is the central submission advanced in HMRC's Respondents' Notice.

77. Mr Southern says that the FTT's findings cannot now be disturbed. The FTT found that Mr Naghshineh reasonably endured losses for 17 years before becoming profitable. He argues that the UT was not permitted to substitute 10 years, or to conclude that for some years there was no evidence at all as to the reasonable timeframe in which to expect profit. The years in question are wholly or mainly within the 17-year timeframe envisaged and Mr Naghshineh should have relief for those years.

78. I was initially troubled by the UT's disregard of the FTT's finding based on Mr Waterfield's evidence that there was a 17-year track to profitability for this farm. Even if the UT had taken a different tack on the law (one which I have in the event agreed with), that would not entitle them to depart from clear findings of fact by the FTT. But having examined the basis of Mr Waterfield's instructions, the content of his report and noting the way the FTT approached his evidence, I am satisfied that the 17-year track reflected the FTT's understanding of the legal test applied to the evidence of Mr Waterfield, and was a finding of mixed fact and law. The FTT was wrong in law, and the finding was therefore based on a false legal premise. As such, it was not binding on the UT.

79. Given the absence of any finding which was specific to the issue in the case (answering the *Scambler* question, see paragraph 68 above), the UT looked afresh at Mr Waterfield's evidence to see if it could pick out any part of it to answer the statutory test (hence resorting to his evidence that 10 years was the appropriate time to measure the reasonable expectation of profit for an organic farming business, but noting that it had no evidence at all to address the last two years of claimed losses when the Farm had reverted to conventional farming).

80. The UT was entitled to adopt that approach, as a matter of its discretion. Whether the UT could, or even should, have simply rejected Mr Naghshineh's claims for sideways

relief on the basis of a lack of relevant findings by the FTT (and in turn because of a lack of relevant evidence adduced by the Appellant), does not matter on the facts of this appeal, because either way Mr Naghshineh's claims were doomed to failure. The matters raised in the Respondents' Notice do not need to be determined.

Conclusion

81. The UT was correct in its construction of section 68(3)(b) ITA 2007. The FTT had misconstrued that test. Section 68(3)(b) does not test the competence of the individual farmer, but rather it tests the reasonable expectation of the length of time for farming activities, as they are carried on in the year of loss, to come into profit, taken from the beginning of the prior period of loss. The purpose of that test is to cap the length of time, beyond the five-year rule, that sideways relief is available for loss-making farming or market gardening activities which may otherwise be commercial (by reference to section 66) and may otherwise be likely to make a profit in time (section 68(3)(a)). The cap will vary in each case and will depend on evidence, that evidence focussing on the amount of time reasonably expected for those activities, i.e. the ones which are being carried on in the current year, to come to profit, taking their hypothetical start date at the beginning of the prior period of loss.

82. Applying the test in that way, Mr Naghshineh was not entitled to sideways relief for any of the five years of claimed losses.

83. I would dismiss this appeal.

Lord Justice Birss:

84. I agree.

Lord Justice Green:

85. I also agree.