TC04053

Appeal number: TC/2013/04836 & TC/2013/04834

Income Tax - Loss relief for farming losses - Correct application of sections 67 and 68 Income Tax Act 2007 - Appeals allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

CHRISTOPHER JOHN FRENCH & MARGARET ALEXANDER FRENCH **Appellants**

- and -

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

TRIBUNAL: JUDGE HOWARD M. NOWLAN
MR RICHARD THOMAS

Sitting in public on 15 September 2014 at 45 Bedford Square in London

Roger Lugg of Roger Lugg & Co, accountants, on behalf of the Appellants

Paul O'Reilly of HMRC on behalf of the Respondents

DECISION

Introduction

1. This was an interesting case, dealing with the very considerable difficulties encountered by a life-long farmer, in trying to change his farm from a dairy farm when it became completely uneconomic to continue producing milk, and his struggle to make a profit out of arable farming when his land and the soil were relatively unsuitable for crop production. This was particularly the case when the land had been covered by grass for at least 30 years. More specifically, it very much related to the proper interpretation and application of the somewhat badly-worded provision of section 68(3) Income Tax Act 2007, and the objective test that that provision imposes to restrict the sideways offset of farming losses against other income of the same year and the previous year.

2. The dispute resulted from an enquiry challenge of the Appellants' claim to set farming losses against other income in the tax year 2010/2011, coupled with discovery assessments to deny similar offset for the two previous years, 2008/2009 and 2009/2010. The Appellant was disputing all the challenges, but raising no issue to the effect that HMRC might be precluded from raising discovery assessments as such. Correspondingly, HMRC had conceded that they could not and would not raise discovery assessments for any years prior to 2008/2009.

3. The Appeal raises two basic issues. One is whether the Appellants, husband and wife operating the farm in partnership on a 50/50 basis, actually ceased the trade of farming altogether between early 2001 and 2004. If the right analysis is that they did, then it almost certainly follows that HMRC themselves would accept that the provisions of sections 67 and 68 Income Tax Act 2007 would not preclude the offset of the losses in questions against other income.

4. The second main issue assumes that there was no break in the farming trade. The result of this would be that the Appellants would have incurred farming losses for 13 years, from about 1998 to 2011. The basic and objective test of section 67 is to preclude the sideways offset of farming losses once losses have been incurred for a period of 5 years, with that period potentially being extended to a longer period if the taxpayer can satisfy the rather involved tests set out in section 68(3) Income Tax Act 2007. Very broadly, those continue to permit sideways and carry-back loss relief where losses have been incurred for more than 5 years if, in the relevant later year, a notional competent farmer, conducting the same activity as the taxpayer, would still in that period be anticipating making profits at some time in the future, and the same notional farmer, commencing activity when the taxpayer's run of losses commenced, would not by the relevant year have anticipated breaking into profit until after the relevant later year.

5. The objective of that provision can readily be seen. It serves a dual purpose. It first precludes sideways and carry-back loss relief after year 5 unless the farm, in the right hands, is one capable of generating profit and is not an everlasting loss-maker. Secondly, it precludes the additional loss reliefs where there might be a suspicion of casual or hobby-farming, because the competent farmer would already have made profits, or at any rate expected to realise profits, before the next year, whilst self-evidently the taxpayer has not done so.

6. Our decision on the first main point is that in fact there was a cessation of trade between 2001 and 2004 such that the involved point under sections 67 and 68(3) actually drops away. Failing that our decision is in any event that section 68(3) does not in this case preclude the sideways and carry-back offset of the losses, even with the 13-year run of tax losses.

The facts

7. In all periods when the farming trade was being conducted, and when the land was leased or licensed to a neighbouring farmer, Mr. Colebrook, (ignoring the analysis of the tax treatment of that licence at this stage) the activities and income were divided on a 50/50 basis between Mr. and Mrs. French. Since Mr. French alone gave evidence before us, and he had clearly been the life-long farmer on this particular farm, we will refer to him as "the Appellant" throughout this decision, particularly when referring to what he said or to his personal farming experience.

8. The Appellant's father had farmed this particular farm, initially as tenant and then as owner, from 1920 until his death in 1961. With a short break at agricultural college, the Appellant took over the farm on his father's death. During the Appellant's ownership more land was acquired, though the farm always remained relatively small, never exceeding 465 acres. In 1968, the Appellant changed the activity on the farm from market gardening and vegetable production to dairy farming. At the time, the government and the Milk Marketing Board were encouraging farmers to do this, and for many years the farm made good profits. We understand that at its peak, there was a herd of 140 dairy cows on the farm. As is very well known, price pressure from the supermarkets led towards the end of the 1990s to countless dairy farmers finding that it was costing more to produce milk than the milk fetched when sold, and many dairy farmers thus made losses and many abandoned dairy farming. The Appellant was no exception and from the tax year 1998/1999 he started making losses.

9. Having been a dairy farmer for over 30 years, the Appellant described the way in which, in July 2000 he sold the bulk of his cattle, with the remainder being sold in December 2000. He described the sale of the cattle as having been highly emotional, which is hardly surprising. He also said that he chose to abandon dairy farming before many other dairy farmers bowed to the inevitable. He appeared not to have been slow in realising that the price pressure from supermarkets, and presumably the cheaper cost of imported milk, meant that it was essential for the farm to change its type of farming.

10. The farm is located below the North Downs near Redhill in Surrey just south of the M25, and the Appellant sought to explain to us that because of the extreme sandy soil (known as Fyfield 2) which lies on the "Lower Green sand geological formation", and the inability of the land to retain water, the land was unfortunately poor land for arable farming. He explained to us that the vast bulk of the country's arable crops came from Lincolnshire and East Anglia, and that farms in that area generally expected to achieve two to three times the yields that the Appellant could hope to achieve on the relatively poor soil on his farm. Having had, however, to abandon dairy farming, the Appellant had no alternative but to change activity, even if his particular farm was bound to remain one on which he, or indeed any farmer, would have something of a struggle to make good profits.

11. A very telling point in this Appeal was that HMRC never challenged the competence of the Appellant. The impression that we gained indeed was that, having worked this farm for

so many years and being intensely familiar with the soil conditions, he was almost uniquely qualified, amongst farmers, to have the best chance of making the new activity a success.

12. When the dairy herd was sold in July and December 2000, the Appellant freed up acreage on those two occasions, and let or licenced first 75 acres and then the residue of the farm to a neighbouring farmer, Roger Colebrook. From those dates until some time in 2004, Roger Colebrook commenced arable farming on the land, and the Appellant's only activity appears to have been to continue the employ one of the previous farm workers. This individual apparently attended to hedging and ditching, but he also worked in relation to modifying some of the now vacant farm cottages so that they could be let out, and doing the same in relation to some of the now redundant farm buildings.

13. Roger Colebrook was clearly a farmer on a very much larger farm, and while the Appellant said that he had one tractor, it was obvious that Roger Colebrook had much more equipment in terms of tractors and harvesters, suitable for arable farming. In this period from 2001 to 2004, the farming activity was conducted entirely by Roger Colebrook. He doubtless ploughed up the grass, took the required steps to enrich the soil and planted, and then harvested, the crops. The Appellant simply received a rental return, and out of that rent (or possibly out of both the rent from Roger Colebrook, and the rent from the farm cottages and buildings that had also been let out) paid the wages of the individual doing the various tasks mentioned in the previous paragraph. Without quoting the exact figures of losses incurred in the period 2001 to 2004, they were entirely consistent with simply a portion of the wages of the one man in question.

14. It never emerged during the hearing quite why the Appellant leased or licensed the land to Roger Colebrook in the period from 2001 to 2004, particularly when we note that in 2004, the arrangements were again changed. In 2004, the licence to Roger Colebrook was terminated, but Roger Colebrook continued to farm the land on a contract basis. In other words, instead of merely receiving fixed rent (as in the period from 2001 to 2004, with Roger Colebrook then taking all the risks and rewards of sowing the crops and harvesting them), from 2004 onwards (until the present day, it seems) the Appellant clearly resumed the role of farmer, deciding which crops to try, and paying for the sowing and harvesting the crops, and Roger Colebrook's role was to undertake the work on the farm for a fee. We rather imagine that the explanation for the fact that the farm had been leased or licensed to Roger Colebrook in the period from 2001 to 2004 may well have been that the work in ploughing up the grass, and commencing the task of trying to enrich the soil, and reduce the way in which the land was so reluctant to retain water, may have been that it was best to let the experienced arable farmer get on with the conversion job in the first three years. While Roger Colebrook's much more extensive heavy equipment could perhaps have been used in this early period on the contract basis, as it was used after 2004, it was perfectly obvious that the Appellant himself, without such equipment, would have faced far more of a struggle in adapting the land to arable farming had he not had the cooperation of Roger Colebrook.

15. The detail is not particularly relevant, but there continued to be losses until the tax year 2011/2012. In that year there was a profit of £15,000 and a profit in the following year of £7,680. In contrast, for the three years in relation to which HMRC has challenged the sideways offset of losses (i.e. the years 2008/2009, 2009/2010 and 2010/2011), there had been declining losses of £50,000, £35,000 and £24,000 respectively. The Appellant described how pigeons had eaten the bulk of a rape crop in one year and how difficulties had been encountered in others. Nevertheless the pattern was gradually improving, and not

only could it be said that in 2010/2011, profits were then anticipated, but indeed in the next two years there were profits.

16. There is one other factual point that we should mention, albeit that it has no definite technical relevance in this case. There is bound to be a suspicion with a challenge by HMRC for the offset of farming losses, that the taxpayer is something of a hobby-farmer with the profits against which he wishes to offset the farming losses being vast profits made in the city, or vast amounts of investment income. It is notable that in this case, the income against which the Appellant sought to set the losses was the income derived from letting out the redundant farm cottages and farm buildings. Of course we accept that such income was rental income and not farming income, such that the right analysis was that the Appellant was seeking to set farming losses against non-trading income, rather than just pooling the two and declaring reduced net income, but it is interesting to see that everything, even the rental income, derived in some way from the farm. Again there is no strict relevance to the following point, but the Appellant said that even when he was sustaining losses, he never contemplated "walking away" from the farm, and letting it go to rack and ruin like many of the hop fields in Kent. He said that he could not bear see that happen, and thus willingly ploughed the ancillary income derived from the old farm buildings into re-working the land and keeping it in good condition, even though he could have ignored the farm, and used the ancillary income as free spending money. In any event, he anticipated making profits in the long run, but it has to be said that it was somewhat commendable for the Appellant to be ploughing money back into the farm, rather than spend the ancillary income and let the farm deteriorate at the end of his life's work on the farm.

The law and the challenge by HMRC

17. Two provisions restrict the sideways and carry-back relief for trading losses, namely sections 66 and 67 Income Tax Act, 2007.

18. Section 66 can apply to losses in any type of trade, rather than just farming trades, and it precludes the additional reliefs if the trade is not conducted on a commercial basis with a view to a realisation of profits. This is a subjective test.

19. HMRC never contended that section 66 was of any relevance in this case. In other words, it was effectively conceded that the trade was always conducted (when it was conducted, one of the points to which we will have to turn) on a commercial basis and with a reasonable expectation of profit being created.

20. Section 67 is the provision on which HMRC has challenged the sideways offset of losses in this case. This section introduced an objective test, designed to deal only with farming and market-gardening trades, and provided that, subject to various exceptions, the additional reliefs for losses were denied for a loss if there had been losses, calculated without regard to capital allowances, in the previous five tax years.

21. The Appellant contended that section 67 did not apply at all to the professional or commercial farmer. In very broad terms that is correct in the sense that when we have explored the one potentially relevant exception (i.e. the provision that permits sideways offset of losses when there have been more years of loss than the 5 years), it does become evident that the prohibition of sideways loss relief is not to apply if the farmer has operated "competently". We agree, however, with HMRC that, while that may be the broad thrust

of section 67, and the accompanying exception in section 68(3), we have clearly got to apply the provisions by reference to their strict wording. Once, therefore, there have been 5 years of losses, section 67 is potentially engaged, and it is impossible to contend that section 67 is totally inapplicable to some commercial category of farmer. The only saving provision that is potentially available is that in section 68(3). While the general thrust of that provision is to distinguish between the competent farmer, and either the incompetent farmer or the casual or hobby-farmer, we must still address the specific wording of section 68(3) if the present Appellant is to escape the ban of offsetting farming losses against other income once there have been 5 years of losses.

22. Subsection 68(3) provides effectively that where the taxpayer has incurred losses in a current year, and there have been more than five years of losses, sideways offset is still permitted where the two conditions met in the subsection are both satisfied. It is worded as follows:

> *"68(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."*

23. The subsection is slightly oddly worded, in that the linking word between the two paragraphs would make rather more sense if it was the word "and", rather than "but", and the point addressed by the second paragraph may also not be instantly obvious. As we summarised in paragraphs 4 and 5 above, the circumstance in which the test in the second paragraph will not be satisfied is where the competent farmer would have expected profits by either the current year, or indeed quite possibly some past year. Whilst everything is expressed in terms of "expectations", the two paragraphs do not lie terribly happily together because, in the case where the notional competent farmer would have anticipated profits, say, two years ago, this does not tie in particularly comfortably with the notion in the first paragraph that the competent farmer "is reasonably expecting future profits". In terms of expectation, he may well be, but when he expected profits two years ago, the likelihood is that the notional competent farmer probably had profits in the current year, and probably the two previous years as well, so that the phrasing of the first paragraph, suggesting merely an expectation of future profits, is slightly inappropriate. The meaning, however, must be that given in paragraphs 4 and 5 above, and paragraph 5 indicates the perfectly sensible two objectives doubtless sought to be achieved by the relevant test.

24. The other key feature of the subsection (3) test is the meaning of the expression "the prior period of loss". Subsection (5) indicates that this means the five-year period plus any earlier years in which there has been an unbroken chain of losses. In the present case, if the farming trade ceased between 2001 and 2004, the prior period of loss in relation to the claim for the 2010/2011 loss will run back from 2009/2010 to 2004/2005 (a total of 6 years), in relation to the claim for 2009/2010 from 2008/2009 (a total of 5 years) and in relation to 2008/2009 from 2007/2008 a total of 4 years (in which case section 67 is not relevant at all). If there was never a break in the farming trade, and there were thus losses in all the years back to 1998/1999, the period of unbroken losses will be 12, 11 or 10 years, and in each case

the second test in section 68(3) will consider the notional competent farmer as at 6 April 1998.

25. HMRC's contention is simple, and certainly intelligible on one construction of the legislation, if HMRC is right to say that there was never a break in trading. Their contention is then that it has taken the present Appellant 7 years (from 2004 to 2011) to conduct arable farming on the land, so as to end up "anticipating profit". He is plainly competent, and HMRC never challenged this, and so they take as the period that it should take a competent farmer to anticipate profits on conducting arable farming activities on this farm, the same period of seven years. By the end of that period, the Appellant was anticipating future profits, and indeed he was right because there were profits in the next period, and so that period is treated as the period that it would also take the competent farmer to anticipate profits.

26. HMRC then say that, if the period that the competent farmer would expect to make profits in arable farming from this land is seven years, then it would have taken the competent farmer in the spring of 1998 seven years, i.e. up to spring 2005, to anticipate profits. This results from the way in which section 68(3)(b) deems the notional competent farmer's farming activity to have commenced at the beginning of the prior period of loss, and the way in which section 68(5) defines the "prior period of loss" (see paragraphs 22 and 24 above). Accordingly the actual farmer, the Appellant, who is not anticipating profits until 2011/2012, is way behind the notional competent farmer in achieving an expectation of profit, and so he cannot offset losses for any of those periods on and after 2005. For present purposes, as we mentioned above, HMRC are accepting that they cannot make discovery assessments before 2008/2009, so that the challenge is made only for that and the following two years. To repeat it, however, the basis of the challenge in this case is to calculate how long the competent farmer would take to anticipate profits by looking entirely to the experience of the presently competent Appellant, counting the period then as seven years from 2004 onwards, and then carry back that 7-year period to the start of the run of losses and implicitly assert that the Appellant should have anticipated profits by 2005 (i.e. seven years after the start of the run of losses) in order to avoid the bar on offsetting farming losses against other income.

The points of dispute

27. Whilst the Appellant did not specifically raise either of the following objections to HMRC's contention, there are obviously two bases on which HMRC's analysis may be faulted. In fairness to HMRC, they seemed not to have fully appreciated before the hearing what had happened in the period from 2001 to 2004, and in other words that there may well have been a cessation of any farming trade at all in that period. If, however, there has been such a cessation, then the unbroken run of farming losses would only have run from 2004 to 2011 and, since HMRC were anyway happy to take the period that the competent farmer would have taken to anticipate profits to be measured precisely by reference to the period that the Appellant took to anticipate future profits when re-commencing the farming trade in 2004, there would be no bar on sideways offset of the losses (and we have seen that on this basis there was no prior five-year period before 2008/2009 anyway). HMRC seemed to accept this inevitable conclusion, but it does of course itself depend on whether there was a cessation of any farming activity in the period 2001 to 2004. We will deal with that below.

28. The second challenge, relevant in the case where the farming trade and the losses had run continuously for 13 years since 1998, is to consider the purpose and presumed intended operation of section 68(3). The question then, is whether it can conceivably have been intended to preclude the sideways offset of losses if the overall reality was that the Appellant farmer had been completely competent at all times, and the notional competent farmer could only be treated as having anticipated profits before the Appellant because of some quirk in the legislation. We will also address that question below.

The cessation of trading question

29. The Appellants' tax returns were made on the basis that there was a farming trade in all material years, which is why, quite understandably, HMRC calculated that there had been 13 years of losses, so that when applying section 68(3)(b), it was necessary to calculate from the beginning of that run of losses in 1998 when the notional competent farmer might first have anticipated making profit, and whether critically that would have been before the year 2011.

30. In the light of the evidence given, however, we conclude that there was a break in the farming trade by the Appellants between 2001 and 2004. When the final cattle had been sold in December 2000, the Appellants had no stock or produce to sell at all. The farm was then leased or licensed to Roger Colebrook, who was to commence arable farming activities on his own account, for between three and four years. The Appellants then received modest rent for the lease or licence. When the Appellants terminated the licence to Roger Colebrook in 2004, the Appellants clearly re-commenced their farming trade (albeit still using Roger Colebrook as the contract farmer). They were then directly involved in planting the crops, attending to the fertilisation of the land and harvesting the crops, and a farming trade had plainly re-commenced. We would expect the trade to have commenced when the Appellants were able to market their produce or, at the very earliest, when seed had been sown with a view to crops being harvested and sold.

31. The only basis on which HMRC were able still to mount a contention that the farming trade continued throughout the whole period, including the years 2001 to 2004, was by reliance on a supposed proposition that, if a farmer let or licensed a farm to someone else for less than a year, the rental income charged for the licence was to be taken to be the gross receipts of the continuing farming trade. A further factor in support of the proposition that the farming trade continued throughout was the admitted feature that, in all those years, the Appellants retained the services of one farm worker, who, as we said above, worked on keeping the hedges and ditches in good order, and also did some repair or maintenance work in relation to redundant farm cottages and buildings, enabling them to be leased to tenants.

32. While the Respondents advanced the proposition just indicated largely in reliance on internal guidance Manuals produced by HMRC, we have considered the cases of *CIR v. Forsyth Grant*, 25 TC 369, *Bennion v. Roper*, 46 TC 613, *Donald v. Thomson*, 8 TC 272, *Mitchell v. CIR*, 25 TC 380 and *Drummond v. CIR*, 32 TC 263 and have reached a quite different conclusion. None of the cases indicate that there is anything decisive about the period of any lease or licence. The more dominant factor is what the licensee or user is to do with the land, and whether that amounts to the occupation of land by the user, a question seen as decisive by the Courts in the cases mentioned. If the licensee is merely to graze horses, sheep or cattle on the grass for the summer period, and the owner remains responsible for maintaining the hedges and fences, and in the case of *Forsyth Grant* manures the parks to keep the pasture in condition, the owner is understandably treated as continuing to act as

farmer. The explanation may not quite lie in the proposition that the owner is still selling the grass, by letting the animals eat the fresh grass, just as he would be selling the grass, clearly as a farmer, if he cut the grass and then sold it, but the relatively passive activity of grazing is still highly significant in leading to the conclusion that relatively short-term grazing licences are consistent with continuing farming activity.

33. A factor that was particularly significant in leading to the reverse conclusion (i.e. that the licence generated rental income from land, rather than farming profit) was the feature in *Bennion v. Roper* that the licence included not just pasture land but 110 acres of arable land, on which the tenant or licensee's activity was inevitably going to be far from passive.

34. In the present case, although we were never given the detail of whether the arrangements involved a lease or licence, or indeed whether each formal term was for just short of 365 days, the arrangements did extend for a period of three to four years. While the Appellants continued to employ one doubtless faithful farm worker, who spent part of his time attending to the hedges and fences, it was obvious that the farm had been leased or licensed to Roger Colebrook because he, with his extensive equipment, would be better able to convert the farm to arable production. Equally obviously Roger Colebrook would be farming the land very actively, adding fertiliser, sowing the seed, endeavouring to get the land to retain more moisture, and of course harvesting and selling the crops. The Appellants did not know whether Roger Colebrook made profits or losses, though suspected that he made losses. The Appellants' receipts were simply of rent, and so what they had was property income for income tax purposes, not farming income. In addition the Appellant himself declared that in this period, he was not farming. He said to us "I was not a farmer".

35. One other factor of some relevance is that the Appellants' activity in this period from 2001 to 2004 has to be judged solely by reference to the licence to Roger Colebrook. The balance might have been influenced or tipped had it remained clear that the Appellants were continuing other farming activities. They were not. They had no milk, no animals, and no produce of any description to sell. They received rents, indeed some from redundant farm buildings and, in the period 2001 to 2004 some from temporarily redundant farm land. We conclude that for the three or four year period, no farm trade was conducted by the Appellants on any of the land, and the land let to Roger Colebrook was occupied by him and that he was farming it, not the Appellants.

36. The year 2004 is too distant for it to be permissible to change or correct any tax calculations in the light of the conclusion that we have reached. In any event, save for the implications of the break in trading, and thus the break in continuous farming losses on the application of section 68(3), it rather appears that the conclusion just reached does not otherwise affect the fact that the wages of the remaining farm worker should anyway have remained deductible. It is of course the case that in calculating the net income from rents derived from either the buildings or the land, legitimate non-capital expenses of maintaining or repairing the buildings and of maintaining the land (in the sense of hedging and ditching) would all anyway be deductible. Insofar as any of the wages of the farm worker were perhaps solely dedicated to the Appellants' future commencement of the arable farming activity, then the expenses would have ranked as pre-trading expenses of that trade, deductible when trading commenced in 2004. The more realistic expectation is that they would have been deductible from one or another category of the rents received.

37. As we have already indicated, once we conclude that the farming losses in 2010/2011 spanned back for only seven years, not 13 years, it follows that section 68(3)(b) did not preclude the sideways offset of the losses. This is because HMRC has already calculated the time that the notional competent farmer, commencing the arable farming trade in 2004, would have taken to anticipate profit by the period that it took the present competent Appellant to anticipate profit (seven years in both cases, or rather in one and the same case), and so the Appellant satisfies the tests in both paragraphs of subsection 68(3).

The alternative conclusion

38. Were we wrong to conclude that there had been a 4-year break in the farming trade, it would naturally follow that there had then been 13 years of losses, and we must then address the question of how to apply the test in the second paragraph of subsection 68(3) in that situation.

39. Our conclusion is that the Appellants would still satisfy both limbs of the test in subsection 68(3), such that sideways offset of losses would still be permissible. We start with the proposition that this conclusion should be seen as obvious and not remotely surprising. This is of course because HMRC has already accepted that the Appellant was a competent farmer and indeed HMRC effectively emphasised this by calculating the time by which they suggested that the notional competent farmer would have anticipated making profits solely by reference to the facts applicable to the Appellant himself. We consider that the Appellant was not only a competent farmer, but rather that he was almost uniquely qualified to tailor his farming plans to the Greensand soil on which the farm was located, and which he understood so well. We will not recite the details, but the Appellant did recount two events that illustrated his unique understanding of the problems that anyone would face, attempting arable farming on the land. On one occasion a tragedy would have been averted, during the construction of the M25, had his advice about the unstable and dangerous soil conditions been heeded and, on the other occasion, 6 miles of land drainage along the M25 would not have had to be re-built after merely three months, had the expert engineers not ignored his advice that the original drainage being installed was bound to fail.

40. The problem in this case is that if the period during which the actual farmer took to anticipate profit is treated as commencing only in 2004, with that period of 7 years then being attributed to the notional competent farmer as the requisite period for him to anticipate profits, and if subsection 68(5) treats the notional competent farmer as commencing his seven year run up to the point of anticipating profits as commencing in 1998, the notional competent farmer obviously achieves his expectation of profit 7 years later, i.e. in 2004 or 2005. Accordingly he beats the actual farmer to achieving an expectation of profit by 6 years. This conclusion is, we suggest, completely unrealistic for two reasons. Firstly, it is wrong to count the period that the notional competent farmer would have taken to anticipate profit as being 7 years, since it would plainly be realistic to add the three or four year period when Roger Colebrook was working the land to the 7-year period. Roger Colebrook's period of activity must have considerably improved the land, and the assumption that the state of the land would have sprung from grass-covered pasture to arable land in an instant such that the period of progression to anticipated profit should run from 2004, rather than July 2000 and January 2001, cannot be right. Secondly the further oddity is that the extra delay in achieving profit on the part of the actual Appellant (i.e. from 1998 to 2000) resulted in no way from any lack of competence. HMRC never suggested that the Appellants had been slow in acknowledging that they needed to abandon dairy farming. If therefore the

notional farmer beats the actual farmer to anticipate profit by 3 years, because he starts his progression to profit from 1998, while the actual Appellant struggles with dairy losses for a further three years, with no challenge to his competence in so persisting by anybody, it becomes obvious that if this Appellant fails the subsection 68(3)(b) test it is only because the subsection is worded inappropriately, and not because this Appellant wanted or lacked competence in contrast to the notional farmer.

41. Once, thus, we reach the two conclusions that:

- the objective of section 68(3) is to preclude a farmer from enjoying the sideways and carry-back offset for farming losses, only if the actual farmer has been slower in anticipating profit than "the notional competent farmer", so denying relief to the incompetent farmer, and that
- the present Appellant has shown no want of competence in any of his actions since 1998 (indeed he has probably been almost uniquely competent),

it follows that we must either conclude that the strict application of the wording in section 68(3) compels us to deny the additional reliefs for losses, and thus compels us to reach an incoherent decision, or we must see whether there is a tenable interpretation to give to subsection 68(3) that achieves a coherent result. In terms of interpreting statutory provisions, we are meant, when this is feasible, to interpret provisions in a purposive manner, consistent with the obvious intent of the provision, and the question in this Appeal is whether an interpretation that achieves a coherent result, consistent with the obvious purpose of section 68(3), is tenable.

42. Before addressing the wording of subsection 68(3) and how we suggest that it should be interpreted, we need to consider why both paragraphs refer to *"the competent farmer **carrying on the activities".*** It is not expressly stated but it is clearly obvious that *"the activities"* referred to in the first paragraph of subsection 68(3) are the activities conducted by the actual farmer in the "period of loss". This is made abundantly clear by section 68(4) which directs one to base the competent farmer's profit expectations on *"the way in which the whole of the activities were carried on in the current year."* The purpose of this is doubtless to preclude there from being a far wider-ranging enquiry as to whether, instead of undertaking, for instance, arable farming, the competent farmer might have embarked on some other branch of farming, say ostrich farming, in which he might have anticipated profit after a shorter interval. That enquiry is intended to be irrelevant. We consider that this explanation to why there is this reference to *"the activities"* is relatively important. By locking the actual activity of the actual farmer to that of the notional competent farmer, it ensures that there is then a level playing field comparison between their respective progressions to profitability. We suggest that that principle will ultimately make it far more coherent to retain that linkage in activity so that if in the early period of the actual farmer's run of losses, the actual farmer was conducting a different activity, it makes more sense in terms of the coherent comparison to treat the notional farmer as undertaking those other activities in that period, rather than to breach the "like for like" comparison. The alternative, we will see, is to treat the notional competent farming as having a head-start in the run up to profitability by deeming him to commence arable farming when in fact the actual farmer was still, and understandably, struggling with losses in the dairy business, such that by commencing the arable farming three years before the actual farmer of identical

competence, the notional farmer will naturally, and ridiculously, achieve profitability three years before the actual farmer.

43. The other factor that is obvious and not disputed is that the comparison to be made between the profit expectations of the actual farmer and the notional competent farmer are all to be based on the actual facts and circumstances of the farm. In other words, it is completely irrelevant that even a moderately competent farmer could probably make a profit in arable farming in the first year of farming in, say, Cambridgeshire.

44. It accordingly follows that the subsection is endeavouring to provide a level playing field test. The competent farmer is to be assumed to be conducting the same type of farming, and to be doing that on the actual farm, and that is how the comparison should be made. That presumably is undisputed.

45. The next observation that we make is that, while it supports the Appellant's case that HMRC has calculated the period that they consider the competent farmer would have taken to achieve profit expectations by the period that they suggest that the Appellant himself took from 2004, we consider that it is wrong not to have added the three or four years during which Roger Colebrook was farming the land. The reason he was farming the land, and the Appellant was not farming the land, appears to have been that, in the early period of converting land that had been pasture land for over 30 years to satisfactory arable farming land, Roger Colebrook's equipment was vital, and he was presumably able to make quicker progress than the Appellant could have done. It is arguable that the same could have been achieved had the Appellant farmed the land, using Roger Colebrook as the contract farmer, as he did from 2004 onwards, but that has no bearing on the fact that on either approach, the farming activity in the period from 2001 to 2004 appears to have been essential in enabling a profit to be anticipated by 2011. In itself that approach would mean that 2008/2009 would be a year in which the losses could validly be set sideways, but not the losses in the later two tax years.

46. That now takes us to the critical point of interpretation in relation to subsection 68(3) which is whether, as the Respondents assume, the reference to "*the activities*" in both paragraphs of subsection 68(3) must refer to "arable farming activities".

47. The Respondents' contention is as follows. They assert that "*the activities*" in paragraph (a) must be a reference to the activities then conducted by the Appellant, i.e. arable farming, and we agree. This is simply the point that nobody must consider ostrich farming.

48. The Respondents then suggest that "*the activities*" referred to in paragraph (b) must also be a reference to arable farming. If this is right, and we are right in paragraph 45 to say that Roger Colebrook's period of farming the land should be added to the 7 years of arable farming by the Appellant since 2004, there are still only 10 years during which it took to build up the arable farming. If then the notional farmer counts that period from the start of the Appellant's run of losses in 1998, while the actual Appellant struggled on for three years with dairy farming, HMRC say that the Appellant is bound to fail the subsection (3)(b) test. The notional farmer is bound to start the 10-year period three years earlier than the actual Appellant, and so bound to finish it three years earlier, and so the actual farmer, the Appellant, is bound to have three years of "trapped" losses.

49. Our conclusion is that the reference to *"the activities"* in paragraph (b) of section 68(3) can be read to refer not just to arable farming activities in the present context, but to the activities that the actual farmer was conducting at the start of the period of losses. It refers to *"a competent person carrying on the activities at the beginning of the prior period of loss"*, and the activities then conducted were the dairy farming activities. 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), namely arable farming activities. The more sensible interpretation is therefore to treat the reference to *"the activities"* as being a reference, at any relevant time, to the activities conducted at that time by the actual farmer. In the "later period of loss", those activities happen indeed to be "arable farming activities" so that that is what must be attributed to the notional competent farmer. At the start of the run of losses, however, *"the activities"* sensibly refer again to whatever the actual farmer was doing at that time. In terms then of achieving the realistic level playing field between the actual farmer and the notional farmer, the notional farmer would then be treated as facing 3 remaining years as a dairy farmer, making losses, to be followed by 10 years in building up to anticipation of profits in arable farming, exactly as the actual farmer. Accordingly, consistent with the fact that the notional farmer was no more competent than the actual Appellant, both would start at the same point [undertaking the same activity], and both would finish at the same point, and a coherent result would be achieved.

50. There is a second reference in subsection 68(3)(b) to *"the activities"* and it is clear that on the facts of this case, the second reference refers to "the activities" conducted at the time when profits might reasonably be anticipated by the notional competent farmer. At that point, of course, the activities in 2010 were the arable farming activities. We see no inconsistency in reading the reference to the activities treated as conducted by the notional competent farmer always to be to the activities conducted at each relevant time by the actual farmer. Since that precisely tallies with the surely obvious conclusion reached in paragraph 44 as to how the expectations of the notional competent farmer should be divined, this interpretation of the phrase *"the activities"* seems to accord more naturally with the obvious statutory purpose of the test, than the Respondents' contended interpretation. We accordingly consider that our interpretation is a perfectly natural interpretation, and not just a slightly strained interpretation, still justified because it avoids what we would regard as an unjust and ridiculous result.

51. We made it clear during the hearing that we considered that HMRC's interpretation was understandable as a matter of representing one possible reading of the subsection, but that in this case it would produce an incoherent result. The HMRC representative and officers who were present may or may not have had some sympathy with that proposition. One of the observations that was made, however, was that our interpretation could not be correct, because it would enable hobby farmers to change farming activity, say, every 8 years, and if they managed to find successive activities in which profits could ultimately be anticipated, but never within the time frame of 8 years however competent the farmer, then section 68 would fail to bar the offset of the losses against other income. Beyond out finding this proposition extraordinarily far-fetched, it would seem fairly obvious that any actual hobby-farmer operating in this way would fall foul of the "non-commercial" activities test of section 66.

52. Our decision is that on both grounds, namely cessation of the farming trade between 2001 and 2004 and the proper coherent interpretation of subsection 68(3), this Appeal is allowed.

Right of Appeal

53. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

HOWARD M. NOWLAN

TRIBUNAL JUDGE

RELEASE DATE: 7 October 2014