[2020] UKUT 0030 (TCC)

Appeal number: UT/2018/0129

INCOME TAX – sideways loss relief for farming losses –application of test in s68(3)(b) Income Tax Act 2007 regarding period for expectation of profitability – appeal allowed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Appellants**
- and -	
ARDESHIR NAGHSHINEH	**Respondent**

TRIBUNAL: MR JUSTICE TROWER
JUDGE THOMAS SCOTT

Sitting in public at The Rolls Building, Fetter Lane, London EC4 on 10 October 2019 and following further written submissions received on 24 October 2019 and 8 November 2019

Marika Lemos, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Edward Waldegrave, instructed by Targetfollow Estates Ltd, for the Respondent

DECISION

1. This is the decision on the appeal by HMRC against the decision of the First-tier Tax Tribunal ("FTT") reported at [2018] UKFTT 453 (TC).

2. The FTT allowed an appeal by Mr Naghshineh against closure notices issued by HMRC in respect of the tax years 2007/08 to 2011/12 inclusive which denied him sideways loss relief for those years. The losses amounted in aggregate to almost £1.5 million, and had been claimed by Mr Naghshineh in respect of farming activities. The FTT decided that the losses were not restricted by the provisions of section 67 and 68 of the Income Tax Act 2007 ("ITA 2007").

3. The FTT granted HMRC permission to appeal two aspects of the decision. As will be seen below, in the event only one question was before us in the appeal.

The facts

4. The primary facts are not in dispute. The FTT stated as follows at paragraph [9] of its decision:

> "The facts are not in general in dispute between the parties but we find the following as matters of fact:
>
> (1) In January 1995 the Appellant purchased Salle Moor Hall in Norfolk ("The Farm"), together with about 75 acres of surrounding agricultural land. This was a working farm, and was at the time of the purchase being managed on a conventional (as opposed to an organic) basis. The land purchased in 1995 formed the core of the Farm, although, as set out below, it was significantly expanded by subsequent acquisitions of land.
>
> (2) Prior to his acquisition of the Farm, Mr Naghshineh had no previous experience of running a farm. He was a general businessman with a wide range of other activities, and he approached his acquisition of the Farm in a similar business-like manner.
>
> (3) At an early stage in his ownership of the Farm 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.
>
> (4) He also decided that the Farm was unlikely to be economically viable without increasing its size substantially, in order to obtain the benefits of scale.
>
> (5) He also realised that the prices which farmers were able to realise by selling into conventional marketing channels were considerably less than those payable by customers in a supermarket. He therefore decided that he would work towards ways of selling directly to the public, which he believed would enable him to achieve significantly higher prices than could be achieved by conventional

routes to market, but which would still be cheaper than supermarket prices, by "cutting out the middle men".

(6) Mr Naghshineh never lived in the farmhouse.

(7) In 1998 Mr Naghshineh acquired a further 221 acres of agricultural land.

(8) In 2000 he acquired a further 89 acres of agricultural land.

(9) In 2007 he acquired:

(a) a further 25 acres of agricultural land, and

(b) a 28 acre apple orchard

(10) In the years with which this appeal is concerned, therefore, the Farm extended to 438 acres.

(11) Initially Mr Naghshineh employed a farm manager, Colin Pratt, whose family had previously worked the Farm. Later, in 2007, he employed a General Manager, Giles Blatchford, to oversee the whole operation, including the expansion into the "box scheme", which required considerable marketing effort in order to identify new ways to market.

(12) Unfortunately Mr Blatchford did not prove to be a great success. In 2010 Mr Naghshineh came to the conclusion, supported by a report from a Ms Annette Peters, a retail consultant, that costs were out of control under Mr Blatchford and eventually Mr Blatchford was made redundant. Mr Naghshineh blamed himself for this and acknowledged that he had not perhaps communicated his ideas and wishes sufficiently well to Mr Blatchford, and that he should perhaps have let Mr Blatchford go sooner.

(13) Over the years, Mr Naghshineh made significant changes to the way in which the Farm was run. As stated above, he decided to run the Farm on organic, rather than conventional, principles and continued to operate the Farm on an organic basis until 2009 – 2010. Following the financial crisis of 2007-08 however the market for organic produce deteriorated. In addition the Farm required additional investment if it were to continue to operate in its current form and, because of the financial crisis, he was unable to access additional funds to continue supporting a loss-making enterprise. He therefore took the decision to revert to farming on a conventional basis and the Farm became profitable in the year to 31 March 2013 and subsequent years.

(14) 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. In summary the agricultural activities (the "Agricultural Activities") fall 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.

(15) In addition to the Agricultural Activities, Mr Naghshineh carried on various other activities on, or in connection with, the Farm. For example, in 2004 the Appellant started operating a "box scheme", by which members of the public could order deliveries of produce from the Farm. Cottages which formed part of the Farm premises were renovated and made available as holiday lets. A farm shop was established and the products sold in the shop included food prepared in a new kitchen on the Farm.

(16) There is now a micro-brewery on the site and a toy-maker who uses wood from the Farm. There is also a mustard business, using Norfolk mustard seed as used by the now closed Colman's Mustard factory.

(17) At all material times Mr Naghshineh intended that the Farm should operate on a commercial basis and should realise profits. In particular, he contends that he has at all times operated the Farm in the manner which would be expected of a competent farmer carrying on the relevant type of farming. He rejects any suggestion that his farming activities amounted to "hobby" or "lifestyle" farming.

(18) The Farm generated losses in all years since Mr Naghshineh acquired it until 2012 – 2013, when a profit was realised. It has been profitable in every year since then, and continues to generate profits.

(19) As mentioned above, the losses were in part attributable to a downturn in the market for organic food which followed the financial crisis, and to Mr Naghshineh's generous remuneration of workers on the Farm. In relation to the latter point, Mr Naghshineh carried on other business activities in the relevant years and felt that it was fair that, where success was achieved in relation to those other activities, workers on the Farm should be rewarded in a manner commensurate with the treatment of those employed by his other enterprises. This generous policy resulted in higher remuneration costs in relation to the Farm than might otherwise have been the case, and contributed to the losses."

Legislation

5. Chapter 2 of Part 4 ITA 2007 makes provision for trade loss relief against general income. The relief is known as sideways relief and operates by permitting a claim for trade loss relief against general income which may be deducted in calculating a person's net income for the loss-making year, for the previous tax year or for both tax years: see s 64 ITA 2007.

6. Section 66 ITA 2007, however, provides that trade loss relief against general income from a loss made in a trade in a tax year is not available unless the trade is commercial. This section provides that the trade is commercial if it is carried on throughout the basis period for the tax year on a commercial basis and with a view to the realisation of profits of the trade. HMRC accepted that Mr Naghshineh satisfied this test.

7. There is a further restriction on sideways relief in the case of farming or market gardening. This is set out in s 67 ITA 2007 which provides as follows:

> "(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…"

8. Section 68 ITA 2007 explains how the reasonable expectation of profit test is to be met. Section 68(2) states that the test is decided by reference to the expectations of a competent farmer carrying on the activities. Section 68(3) then provides:

> "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."

9. Section 68(4) makes it clear that regard must be had to the nature of the activities carried on. It provides:

> "(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."

10. Section 68(5) defines the "prior period of loss" as

> "(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".

11. Although sections 67 to 70 ITA 2007 are set out under the heading "restriction on relief for "hobby" farming or market gardening", there is no reference to "hobby farming" in any of the relevant provisions.

The FTT's decision

12. The FTT relied on witness evidence from Mr Naghshineh, whom it found to be a credible and reliable witness. It also relied on an expert report and oral evidence from William Waterfield, who was accepted by both parties, and the FTT, to be a credible expert in the field, the FTT recording that none of his evidence was effectively challenged by HMRC when he was cross-examined: [8].

13. The FTT considered the relevant case law in relation to sections 67 and 68, which we discuss below. It noted that section 67(2) would prevent sideways loss relief for the relevant losses unless Mr Naghshineh could meet the "reasonable expectation of profit" tests in sections 67(3) and 68. It described the two tests within section 68(3) as follows, at [15]:

> "(1) Would a competent farmer carrying on the activities being carried on by the actual farmer reasonably expect future profits, and
>
> (2) Could a competent farmer carrying on those activities **at the beginning of the prior period of loss** not reasonably have expected the activities to have become profitable until after the end of the tax year under consideration."

14. It was common ground that both of these tests were objective, and that the issue was not whether Mr Naghshineh was a competent farmer: [17].

15. The FTT considered the first test set out in Section 68(3), namely the requirement for a reasonable expectation of future profits. It determined that this test was met. Although HMRC were granted permission to appeal this conclusion, Ms Lemos confirmed to us that HMRC no longer wished to pursue this point, and we consider it no further in this decision.

16. It is the FTT's conclusion in relation to the second test which is the subject of this appeal. The FTT referred to the guidance set out by this Tribunal in *Scambler v Revenue & Customs Commissioners* [2017] UKUT 1 (TCC) ("*Scambler*") in interpreting that test. The FTT then set out its reasoning and conclusions as follows:

> "34. In making the assessment required under s68(3)(b) we must now turn to the expert report of Mr Waterfield. He summarised his findings as regards the time taken for a venture such as that undertaken by Mr Naghshineh to achieve profitability as follows:
>
> "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 operator 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 within 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."

35. In his oral evidence, Mr Waterfield clarified this timescale, and 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.

36. HMRC did not present any evidence which questioned this timescale or undermined Mr Waterfield's evidence in any way and we therefore accept it as our starting point for assessing the reasonable expectations of a competent farmer undertaking the venture undertaken by Mr Naghshineh.

37. Mr Waldegrave urged us, on behalf of Mr Naghshineh to treat the starting point of this venture, at which time the hypothetical competent farmer's reasonable expectations were formulated, as being 1998, when the additional 220 acres were purchased. This was the date when the venture effectively began and he submitted that using 1998 would be the result of taking a sensible purposive construction of s68(3)(b) and s68(5).

38. We cannot follow this approach. The legislation on this subject is totally clear that the time at which we must consider the competent farmer's expectations to have been formulated is the beginning of the prior period of losses, ie 31 March 1995. The legislation does not leave us any room for using anything other than a simple reading of the clear words.

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."

Applying the test in section 68(3)

17. It was common ground that in considering whether sideways loss relief is restricted by section 68(3)(b) it is necessary to determine the following questions:

(1) For each tax year in which a loss was made in the farming or marketing gardening trade ("the current tax year"), what were the activities carried out by the taxpayer in that year?

(2) When did "the prior period of loss" begin?

(3) Could a competent farmer carrying on the activities carried on in the current tax year at the beginning of the prior period of loss not reasonably have expected "those activities" to become profitable until after the end of the current tax year?

18. If one takes as an example one of the tax years in this appeal, the tax year 2007/8, and assumes (which we discuss below) that the prior period of loss began in 1994/5, the Upper Tribunal in *Scambler* explained the combined effect of both limbs of Section 68(3) as follows, at paragraph 64:

> "64. In our view, bearing in mind our analysis as to the activities which are to be taken into account in applying the test, in order to obtain the relief…the competent farmer would need to be able to make the following statement…:
>
> "Looking at the activities in [2007/08], 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 on [6 April 1994] to look at those [2007/08] activities in the same way, I could not reasonably have expected them to become profitable until after [5 April 2008]." "

19. In this appeal, as we have explained, HMRC no longer challenge the FTT's conclusion that the first part of this question (expected profitability at some stage) could be answered in the affirmative. However, they appeal against the FTT's conclusion that the second part of the statement in *Scambler* could also be satisfied for all years under appeal. HMRC do not challenge the FTT's findings of fact, but argue that the FTT wrongly directed itself as to how that test operates, and as a result took into account irrelevant factors in reaching its conclusion.

HMRC's grounds of appeal

20. In summary, HMRC's grounds of appeal and skeleton argument asserted the following errors in the FTT's decision:

(1) The FTT misdirected itself as to the application of section 68(3)(b) and thereby erred in law.

(2) Instead of looking at the nature of the activities carried on in the current tax year, and the way in which those activities were carried on, the FTT erred in taking into account a period during which Mr Naghshineh was planning to carry on activities.

(3) What the FTT was required to do was to determine the point in time at which a competent farmer could reasonably expect the activities actually carried out in the year the loss relief is claimed to become profitable had those same activities carried out in the same way been carried out at the beginning of the prior period of loss. Instead, the FTT erred in law by effectively inserting the words "planning to" into the statute, thereby substantively altering the requirements to be satisfied and the outcome of applying the test. By considering how the competent farmer was planning to carry out the activities, the FTT erred in relying on expert evidence to construct a timescale which took into account the requirement to purchase land and then to convert the land to organic status. This led it to find that profits would not reasonably have been expected until after the end of the tax year ending 5 April 2012.

(4) On the correct construction of section 68(3)(b), it is only necessary to consider when the competent farmer would expect profit if the activities *as actually carried out* in the loss year had been carried out at the beginning of the prior period of loss. It was wrong to take into account prior or preparatory activities such as searching for and acquiring land and converting that land to

organic status because that was not part of the way those activities were being carried on in the current tax year.

Two further issues

21. Before we consider these grounds of appeal, we should mention two further issues which concern possible errors of law by the FTT in its interpretation and application of section 68(3)(b).

22. The first ("the Conversion Issue") flows from the requirement in the legislation, which was not in dispute, to consider the activities carried on in each separate year of loss in applying the test. The FTT's reasoning and conclusions appear to construct a timeline for the expected profitability of organic farming. However, in sub-paragraph (13) of its findings of fact, set out at [4] above, the FTT found as a fact that the farm was operated on an organic basis only until 2009/10, and thereafter was converted to operate on a conventional basis. The question is therefore whether the FTT took this into account in its determination of the activities carried on during the last two years under appeal ie 2010/11 and 2011/12, and, if it did not, whether this had a material effect on its conclusion in relation to those two years.

23. The second ("the Tax Year Issue") relates to the FTT's conclusion (at [38] of its decision) that the beginning of the prior period of loss was 31 March 1995. 31 March was indeed the date on which the accounting periods for the taxpayer's trade ended. However, section 68(5) defines the prior period of loss by reference to tax years. In ITA 2007 section 4(3) a tax year is defined, as one might expect, as beginning on 6 April and ending on the following 5 April. The question is therefore whether the beginning of the prior period of loss should have been taken by the FTT to have been 6 April 1994 or 1995, and, if so, whether the failure to do so was material to its decision.

24. We raised both of these issues with Ms Lemos and Mr Waldegrave at an early stage in the hearing. In the course of our preparation for the hearing, they had seemed to us to be potential errors of law on the face of the FTT's decision, going to HMRC's appeal in respect of the FTT's reasoning and conclusions in relation to section 68(3)(b). Since these issues were raised by the Tribunal, and had not been addressed in terms in either party's skeleton argument, we considered it fair and proportionate to direct that both counsel could make further written submissions to the Tribunal. We stated that those submissions could, if the parties wished, address both the substantive issues and the question of whether procedurally these points could and should be taken into account by us in reaching our decision, to the extent that they were not points already made explicitly or implicitly in HMRC's pleadings. We subsequently received written submissions from each of Ms Lemos and Mr Waldegrave.

25. We discuss both issues below. As to the question of whether procedurally we could and should consider these points if we concluded that they had not been raised expressly by HMRC, having taken into account the submissions of the parties we have concluded that it would be both fair and appropriate to do so. We have reached this conclusion even though, in the light of our views on the second ground of appeal,

the answers to the two further issues do not affect the outcome of the appeal. We see no jurisdictional bar to this, since this Tribunal's powers in relation to an appeal from the FTT apply if, in deciding the appeal, we find that the making of the FTT decision involved the making of an error on a point of law: section 12(1) of the Tribunals, Court and Enforcement Act 2007. HMRC's pleaded case is that the FTT made an error of law in relation to section 68(3)(b), and the two additional issues relate directly to that question.

26. We accept that in an adversarial system of litigation, it is not generally incumbent on a court or tribunal to make either party's case for them. We are not persuaded by Ms Lemos' submissions that HMRC identified either point with sufficient clarity in their pleadings, although we note that both points are in fact identified in the document dated 9 October 2019 titled "Examples to illustrate operation of ss. 67 and 68 ITA 2007" prepared by Ms Lemos before the hearing and handed up to us during the hearing. In any event, it is clear that that the points relate directly to HMRC's overall ground of appeal, namely an error of law in the application of section 68(3)(b). In that circumstance, given that this Tribunal is given the general power, subject to the 2007 Act and any other enactment, to regulate its own procedure (Rule 5(1) of the Upper Tribunal Rules), and that the overriding objective requires us to deal with cases fairly and justly and to seek flexibility in the proceedings, we have nevertheless concluded that we should consider the two additional issues. That conclusion was made with the need for procedural fairness and the avoidance of prejudice to the parties very much in mind, which is why we directed that counsel for each party should have an appropriate period in which to make further submissions, which we have taken into account in reaching our decision to consider the issues. In reaching that conclusion, we take particular account of the fact that both issues raise pure points of law in relation to which it is not suggested by Mr Waldegrave that all necessary findings of fact had not been made.

27. We should add that Mr Waldegrave referred us to authorities dealing with appeals from an employment tribunal and an asylum and immigration tribunal, which he submitted supported the view that a court or tribunal should never raise points of its own volition. We do not agree that there is a principle of such wide application and consider that those authorities are not on all fours with the procedural question in this appeal.

Discussion

28. In the hearing, Ms Lemos criticised a number of the FTT's findings of fact. However, HMRC do not have permission, on the basis of an *Edwards v Bairstow* challenge or otherwise, to appeal any findings of fact so we have proceeded on the basis that those findings must be accepted.

What did the FTT decide?

29. It must be said that the critical reasoning of the FTT in relation to the issue in this appeal was opaque. As set out above, at [40] and [41] of its decision, the FTT stated as follows:

> "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."

30. The FTT had taken 31 March 1995 as the start of the prior period of loss. It is not clear whether "the end of 2012" in paragraph [41] means 31 March 2012 (the end of the last accounting period in the appeal), 5 April 2012 (the end of that tax year) or 31 December 2012 (the end of the calendar year).

31. More importantly, it is necessary to reverse engineer the timeline in paragraph [40] to deduce the basis on which it supports the conclusion in paragraph [41]. There is no indication of which, if any, of the first four items included in the timescale are assumed to run consecutively and which concurrently, or whether in the case of a stated range the FTT has assumed the lower or higher figure.

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.

Submissions of the parties

34. HMRC submitted that the FTT made fundamental errors in applying the test in section 68(3)(b). That test requires in the first place a determination of the activities *actually* carried on in each year in which a loss is in dispute—so, in this appeal, for each of the years 2007/08 to 2011/12. One then assumes that a competent farmer is carrying on *those* activities (being the activities actually carried on in the particular

loss year) not in the loss year but as at 31 March 1995. In then testing whether a competent farmer as at 31 March 1995 could not reasonably have expected those activities to become profitable until after the end of the particular loss year, section 68(4) requires that account be taken of the nature of the activities and the way they were carried on in that loss year. The FTT erred in not adopting a "year by year" approach, and in taking account of irrelevant preparatory or planning steps.

35. For Mr Naghshineh, Mr Waldegrave submitted that the FTT's approach was entirely correct. Section 68(4) applies only to section 68(3)(a), and not to sub-paragraph (b), which is the subject of this appeal. HMRC's approach would require the test to assume that the competent farmer was carrying on a fully mature business in final form in each loss year. Such an approach was not warranted by the legislation, and it would run contrary to the policy of the legislation, which is to protect businesses in their start-up period.

Our conclusions in relation to section 68(3)(b)

36. It is helpful to begin by briefly discussing the decision of the Upper Tribunal in *Scambler*. The background to that decision was that there had been conflicting decisions by the FTT in relation to whether the reference in section 68(3)(b) to "the activities" was a reference to the activities carried on in the year of loss (the "current year") or in the prior period of loss (broadly, the year the trade commenced). The Tribunal acknowledged that either interpretation was feasible on the wording of the legislation. Applying a purposive construction to the legislation, and taking into account the predecessor legislation which section 68 purported to codify, it reached the conclusion that the reference was to the activities carried on in the year of loss. The predecessor legislation had referred not to "the activities", but to "those activities", which was a clearer reference back to the activities in sub-paragraph (a), being those in the year of loss. That interpretation, and indeed the contrary interpretation, could admittedly give rise to anomalies, but it was consistent with the aims of the code.

37. Turning to the questions of interpretation in this appeal, we are not persuaded by Mr Waldegrave that section 68(4) applies only to the "reasonable expectation of profits" test in section 68(3)(a). He made the valid points that subsection (4) is referred to specifically (in parentheses) in (a) but not (b), and that (4) tracks the wording of (a) rather than (b). However, we consider that this point is just one more example of what the Tribunal in *Scambler* found to be the dense and difficult drafting of the section. In our opinion, it would be illogical and inconsistent if section 68(4) applied in relation to the loss year activities, but not when applying the test in (b) to activities which (per *Scambler*) are the same activities. Section 68(4) (a) requires that regard must be had to "the nature of the whole of the activities", which is what the Tribunal in *Scambler* clearly had in mind at paragraph 57 of its decision:

> "57. In our view the ambiguity is resolved by reference to the predecessor legislation and accordingly it must be construed by applying the test to the activities as they were carried on in the current tax year and not as they were carried on at the start of the prior loss

> period. That inevitably means that the question as to whether the nature of the activities carried on was such that the competent farmer could not reasonably have expected those activities to become profitable until the end of the current tax year must be determined by reference to the nature of the activities as they were carried on in that current tax year, so that if there was a change in the nature of those activities it is the nature of those activities as they are carried on in that final year to which the test must be applied."

38. The parties, and the FTT, were agreed that section 68(3)(b) requires a "year by year" approach. Where the parties differ sharply is in what this approach requires in practice.

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.

41. We do not accept Mr Waldegrave's submission that such an interpretation would frustrate the policy objective of the legislation to protect businesses in their start-up period. 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. We respectfully agree with the observations in *Scambler* at paragraph 72, as follows:

> "…It follows from our analysis that we do not accept 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 loss relief indefinitely. We should stress that normal loss relief against future losses of the trading question are still available for farming trades in the same way as they are for any other trade. There are a number of instances in the tax legislation where farming has its own special tax rules, some of which are relatively generous when compared to other businesses. It is also the case that farming is sometimes carried on as more of a hobby than a trade and the provisions reflect that. However, in our view, it is clear that the purpose of the legislation reflects a policy that unless there is something in the nature of the farming activities concerned that means that they cannot reasonably be expected to become profitable except in the long-term then the period of sideways loss relief should be limited by time in normal circumstances."

The FTT's decision

42. Applying these principles to the FTT's reasoning and decision, we have concluded that it contained material errors of law.

43. The periods under appeal were 2007/08 to 2011/12 inclusive. We remind ourselves that the facts as found by the FTT are not challenged.

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.

45. That is sufficient to dispose of the appeal in favour of HMRC. However, we consider that in any event the FTT adopted the wrong approach in relation to the Conversion Issue. The FTT found as a fact that the activities carried on for the last

two years in the appeal were not organic farming but conventional farming: [9] (13) of the decision. In order to satisfy the requirements of section 68(3)(b), the FTT should have applied those conventional farming activities to the reasonable expectations of the deemed competent farmer at the beginning of the prior period of loss. It did not do so. There was no evidence before the FTT as to when a competent farmer carrying on the activities actually carried on in those two years in 1995 would have expected them to become profitable, and no consideration by the FTT of that question.

46. Although it does not affect our decision, we also conclude that the beginning of the prior period of loss was not 31 March 1995, but 6 April 1994, because the prior period of loss must be a tax year, and the beginning of the prior period of loss must be the beginning of a tax year, for the reasons explained above. Mr Waldegrave accepted this point in his written submissions subsequent to the hearing.

Disposition

47. Having found that the decision contained errors of law, we may set it aside but are not obliged to do so. If we do set it aside, we may remit it to the FTT or remake it. We set aside the decision and consider that we can remake the decision on the basis of the unchallenged findings of fact made by the FTT. We accordingly remake the decision and, for the reasons given, refuse Mr Naghshineh's appeal for the years 2007/08 to 2011/12 inclusive. HMRC's appeal in this case is therefore allowed.

MR JUSTICE TROWER
JUDGE THOMAS SCOTT

RELEASE DATE: 31 January 2020