[2015] UKFTT 0532 (TC)

TC04682

Appeal number: TC/2014/05306

INCOME TAX - loss relief for farming losses - whether restriction on loss relief in section 67 Income Tax Act 2007 only applies to 'hobby' farming - no - whether Appellant's farming activities met the 'reasonable expectation of profit' test in section 68 Income Tax Act 2007 - no - discovery assessment under section 29 Taxes Management Act 1970 - whether officer of HMRC could reasonably have been expected to be aware of information in previous years' tax returns - no - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PETER SILVESTER

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: JUDGE GREG SINFIELD
MR TYM MARSH MA MBA

Sitting in public at Fox Court, 30 Brooke Street, London EC1N 7RS on 9 September 2015

Mrs Pam Ling of P Rainsbury & Co, accountants, for the Appellant

Mr Matthew Mason, officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The Appellant ('Mr Silvester') appeals against two assessments issued by HM Revenue and Customs ('HMRC') disallowing trade loss relief claimed by Mr Silvester, under section 64 of the Income Tax Act 2007 ('ITA') in respect of his farming losses during the tax years 2008-09 and 2009-10.

2. The issue in relation to both assessments is whether section 67 ITA applies to prevent Mr Silvester from claiming a deduction for his farming losses against his general income. Section 67 provides that relief for a loss made in farming is not available if a loss, calculated without regard to capital allowances, was made in the trade in each of the previous five tax years. Section 67 does not apply, however, where the farming activities meet the 'reasonable expectation of profit' test in section 68. In making the assessments, HMRC took the view that, as Mr Silvester's farming trade had made losses in each year since 2000-01, section 67 applied and trade loss relief was not available against Mr Silvester's general income for the farming losses in 2008-09 and 2009-10. Mr Silvester contends that, as the heading to section 67 refers to 'hobby' farming and he is not a hobby farmer, the section does not apply to him and, even if it does, his farming activities pass the reasonable expectation of profit test in section 68.

3. In relation to the assessment for the tax year 2008-09, there is a further issue of whether there was a valid discovery under section 29 of the Taxes Management Act 1970 ('TMA'). This turns on whether, when the time limit for opening an enquiry into Mr Silvester's tax return for 2008-09 expired on 29 January 2011, an officer of HMRC could have been reasonably expected to be aware, on the basis of the information made available to him or her before that time, that Mr Silvester's farming activities had made losses in each of the previous five tax years. Mr Silvester contends that HMRC were fully aware that the farming business had made losses since 2000-01 because he had filed tax returns with accounts and tax computations each year. HMRC maintain that information included in tax returns for earlier years or any documents accompanying them is not 'information made available to [HMRC]' as defined by section 29(6) TMA and that the return for 2008-09 (or accompanying documents) must make HMRC aware of an actual insufficiency in the Self-Assessment for that year to be complete enough to prevent the making of a discovery assessment.

4. For the reasons set out below, we have decided that section 67 ITA applied to Mr Silvester's farming activities and they did not meet the reasonable expectation of profit test in section 68. It follows that Mr Silvester was not entitled to deduct the farming losses incurred in 2008-09 and 2009-10 from his general income. We have also concluded that an officer of HMRC could not reasonably have been expected to be aware on 29 January 2011 that Mr Silvester's farming activities had made losses in each of the previous five tax years and, therefore, the assessment for 2008-09 is valid. Accordingly, Mr Silvester's appeal is dismissed.

Evidence

5. HMRC produced a bundle of documents for the hearing. There were no witness statements. Mr Silvester submitted a note on the history of the farming business and explained the background to and facts of the case. There was no dispute between the parties as to the factual background which we summarise below.

Facts

6. Mr Silvester is an experienced sheep farmer and a member of the National Sheep Council. He is a partner in a farming partnership which owns and operates one of the largest sheep farms in Cornwall. For many years, Mr Silvester was a successful businessman outside farming and, as a result, he has a substantial pension income. It was against that general income that Mr Silvester sought to claim relief for his share of the losses suffered by the farming partnership.

7. Mr Silvester described the history of the farming business in a written submission and orally at the hearing. In 2001, the farm had 33 ha with 244 breeding ewes and six rams. The ewes were a mix of Suffolks, Dorsets and crossbreds. The partnership's objective was to breed purebred animals, especially Suffolks and Dorsets, supplemented with lambs for slaughter. By 2004, the partnership had increased the total to 290 ewes, being 10 Suffolks and 30 Dorsets with the rest being crossbreds. At that point the business was making losses. In 2004, the partnership paid significant money for five Suffolk ewes to be fertilised by a ram at the AI centre in Devon which produced only three, not particularly special, lambs. In 2005, the partnership concluded that its attempts to breed pure stock were not working and the business was unlikely to become profitable as the fixed costs were too high relative to the turnover which was insufficient because the flock's lambing percentage and the price obtained for lambs sold were both too low. The partnership had to choose whether to close the operation down or make a radical change. In late 2005, the partnership decided to change its business model by changing the type of sheep to breeds suitable for the meat market and expanding the flock. The partnership required more land to accommodate a larger flock and produce the hay that would be needed to feed them in winter. The partnership rented further land but it had to be re-fenced in order to make it stock proof and could not be used until 2006. At that point, the partnership started to sell the old flock and to buy in new ewes and rams. The new ewes did not produce lambs to sell until autumn 2006. The partnership also purchased some special Beltex/Texel cross rams which it believed would give good results in terms of numbers of lambs and their conformation. Unfortunately, the partnership suffered two thefts in successive years of approximately 100 lambs on each occasion. The partnership gave up the land from which the lambs had been stolen and acquired further land which was closer to the farm and less vulnerable to theft of livestock. Consequently, the partnership incurred further costs. The partnership continued to buy more stock in 2009 and 2010 which brought its total number of ewes to just over its target of 600. Since 2010, the partnership's land and numbers of sheep have remained stable and it is now profitable.

8. Mr Silvester explained that, throughout the period 2001 to 2010, a number of factors had affected the partnership's profitability such as the level of subsidy payments (eg under the Single Farm Payment and Entry Level Stewardship schemes) available to farmers and one-off events (an example was wild boar invading two fields which had to be completely re-sown). Mr Silvester said that the most important factor for profitability was probably the price of lambs sold which was £30 to £35 in 2001 rising to £55 to £75 in 2012. He also referred us to an analysis of lowland sheep farming produced by EBLEX which showed that, on average, no-one made any profits in the years 2003 to 2012. Mr Silvester said that the sideways loss relief that was received each year was always ploughed back into the farming business and, without it, the partnership would have had to borrow to expand.

9. The accounts of the farming partnership for the year ended 30 June 2000 showed a profit before capital allowances of £5,661. Subsequent accounts showed losses as follows:

Year Ended	Loss before Capital Allowances £	Capital Allowances £	Loss £
30/06/2001	(8,752)	9,652	(18,404)
30/06/2002	(12,508)	8,463	(20,971)
30/06/2003	(6,789)	7,166	(13,955)
30/06/2004	(8,449)	8,639	(17,088)
30/06/2005	(18,849)	7,464	(26,310)
30/06/2006	(13,513)	6,571	(20,084)
30/06/2007	(23,490)	5,812	(29,302)
30/06/2008	(35,724)	4,789	(40,513)
30/06/2009	(21,042)	10,088	(31,130)

10. On a fiscal year basis, the figures gave the following results

Year Ended	Loss before Capital Allowances £
05/04/2001	(5,360)
05/04/2002	(11,623)
05/04/2003	(8,136)
05/04/2004	(8,063)
05/04/2005	(16,391)
05/04/2006	(14,770)
05/04/2007	(21,139)
05/04/2008	(32,864)
05/04/2009	(24,478)
05/04/2010	(4,958)

11. The time limit for opening an enquiry into Mr Silvester's tax return for 2008-09 expired on 29 January 2011. On the same day, Mr Silvester submitted his Self-Assessment tax return for 2009-10 to HMRC. The return included a claim for sideways relief on his share of the farming losses suffered.

12. On 29 November 2011, HMRC wrote a letter to Mr Silvester informing him that they would open an enquiry under section 9A TMA into his Self-Assessment tax return for 2009-10. In the letter, HMRC stated that they only intended to look at Mr Silvester's claim for relief for farming losses against other income but would let him know if they needed to extend the check. On the same day, HMRC wrote to Mr Silvester's accountant, P Rainsbury & Co ('PRC'), advising them that

> "Your client's Farming and Consultancy trade has produced losses for each of the 5 preceding years. Please either confirm that trade losses for the year of £31,130 should be relieved by carry-forward against future profits or explain why the loss is not caught by s.67 ITA 2007."

13. PRC responded in a letter dated 6 January 2012 setting out some of the background to the farming business and stating that Mr Silvester was an extremely competent farmer and would not have become involved in farming, with the associated hard work and stress, if he did not reasonably expect to make profits and so satisfied the tests in section 68 ITA.

14. In a letter dated 6 February 2012, HMRC stated that they were aware that the farming business had not returned a profit since 30 June 2000. HMRC did not accept that the conditions in section 68 ITA had been met.

15. Between February 2012 and March 2013, the parties engaged in protracted correspondence. It is not necessary to recite the correspondence or record the shifting positions of the parties. We note, however, that HMRC first stated that the loss relief claim for 2008-09 was, on their view, restricted by section 67 in a letter dated 5 September 2012.

16. On 26 March 2013, HMRC issued a Notice of Further assessment (the discovery assessment) for 2008-09 under section 29 TMA, disallowing the sideways relief claim. Mr Silvester appealed against the discovery assessment for 2008-09 on 15 April 2013. HMRC accepted the appeal in a letter dated 30 April 2013. In that letter, HMRC referred to *Langham v Veltema* [2004] EWCA Civ 193, [2004] STC 544 and stated:

> "… the information made available in a Return must make HMRC aware of an actual insufficiency in the Self Assessment for that information to be complete enough to prevent the making of a discovery assessment. In the event of any doubt or uncertainty about the interpretation of figures entered in the Return, the taxpayer should fully alert HMRC to the circumstances of the particular entries in the Self Assessment. Reference is made to the use of the 'Additional Information' field in the Self Assessment for this purpose.
>
> I accept that a discovery assessment would have been prevented had the 2009 Return contained additional information specifically drawing attention to the fact that Farm losses were being claimed against general income for a period well beyond the normal five years, and the basis upon which the continuing claim was being made."

17. Further correspondence and also a meeting in London took place in July 2013 but without reaching any agreement. HMRC issued a closure notice, under section 28A TMA, to Mr Silvester on 1 April 2014 amending his Self Assessment tax return for 2009-10 to disallow the sideways relief of his farming losses. Mr Silvester appealed against the closure notice on 17 April. On 25 April, HMRC wrote to Mr Silvester setting out a full explanation of their reasons for disallowing the loss relief claimed and offering a statutory review. On 11 June, Mr Silvester requested a review of the decision. In a letter dated 1 August 2014, HMRC notified Mr Silvester that the review had concluded that HMRC's decisions should be upheld. Mr Silvester appealed to this Tribunal on 29 September 2014.

Legislation

18. The relevant legislation is set out in an appendix to this decision but may be summarised as follows.

Farming losses

19. Section 64 ITA allows a person to make a claim for loss relief against general income in the year the loss is made or for the year preceding the year of loss or both. Section 64(8)(b) ITA states that section 64 needs to be read with sections 66 to 70 ITA (restrictions on the relief).

20. Section 66 ITA precludes loss relief if the trade is not conducted on a commercial basis with a view to a realisation of profits. It applies to losses arising in any type of trade and not just farming. HMRC did not rely on section 66 in this case and made no attempt to suggest that the partnership's farming business was not conducted on a commercial basis and with a reasonable expectation of profit.

21. Sections 67 to 70 ITA are headed "Restriction on relief for 'hobby' farming or market gardening". Section 67 is the provision on which HMRC has challenged Mr Silvester's claim for loss relief in this case. The section only applies to losses arising in farming and market-gardening trades. Section 67(2) provides that trade loss relief is not available where there has been a loss, calculated without regard to capital allowances, in such a trade in each of the previous five tax years. Section 67(3) provides that relief for losses is not prevented where one of three exceptions applies. It was common ground that the first and third of the exceptions in section 67(3) do not apply in this case and nothing further need be said about them. As far as this appeal is concerned, the relevant exception is in section 67(3)(b) which reads:-

> "the farming … activities meet the reasonable expectation of profit test (see section 68),"

22. Section 68 ITA explains how the farming activities meet the reasonable expectation of profit test for the purposes of the exception in section 67(3)(b). Section 68(3) provides that the reasonable expectation of profit test is met if the farming activities fulfil two conditions. Applying the section to the facts of this case, the first condition is met if a competent farmer carrying on the farming activities in the 2009-09 and 2009-10 tax years would, having regard to the nature of the activities and the way in which they were carried on in those tax years, reasonably expect future profits. It was accepted by HMRC that the partnership's sheep farming activity was potentially profitable in 2009-09 and 2009-10 and so satisfied the first condition. The second condition, as relevant to this case, is that a competent farmer carrying on the activities at the beginning of the period of losses, ie on 1 July 2000, could not reasonably have expected the activities to become profitable until after the end of the 2008-09 and 2009-10 tax years. The appeal turns on whether the partnership satisfies this condition.

Discovery

23. Where an officer of HMRC discovers that an assessment is, or has become, insufficient, or that a relief claimed is, or has become, excessive, resulting in a loss of tax, section 29(1) TMA permits the officer to issue an assessment to correct the situation. Where, as in this case, the taxpayer has submitted a tax return for the year in question, section 29(3) states that he cannot be assessed unless one of two conditions is satisfied. The first condition, set out in section 29(4) TMA, is that the situation was brought about either carelessly or deliberately by the taxpayer or a person acting on his behalf. In this case, HMRC accept that neither Mr Silvester nor PRC, acting on his behalf, claimed the relief from losses carelessly or deliberately sought to claim (what

HMRC regard as) excessive relief. Accordingly, HMRC rely on the second condition contained in in section 29(5) which is that, at the time when HMRC ceased to be entitled to open an enquiry into the return, "the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation". Section 29(6) provides that information is made available for the purposes of section 29(5), so far as relevant to this case, if:

> "(a) it is contained in the taxpayer's return … in respect of the relevant year of assessment (the return) or in any accounts, statements or documents accompanying the return;
>
> (b) …
>
> (c) … or
>
> (d)it is information the existence of which, and the relevance of which as regards the [fact that the relief given is excessive]-
>
> (i) could reasonably be expected to be inferred by an officer … from information falling within paragraphs (a) to (c) above; or
>
> (ii) are notified in writing by the taxpayer to an officer of the Board."

24. Section 29(7) TMA provides that "the taxpayer's return … in respect of the relevant year of assessment" in section 29(6) includes:

> "(i) a reference to any return of his under that section for either of the two immediately preceding chargeable periods; and
>
> (ii) where the return is under section 8 and the taxpayer carries on a trade, profession or business in partnership, a reference to any partnership return with respect to the partnership for the relevant year of assessment or either of those periods."

Issues

25. In relation to the assessments for 2008-09 and 2009-10, the issue is whether, having sustained more than five consecutive years of losses, section 67 ITA applies to prevent Mr Silvester from claiming loss relief for his farming losses against his other income. In order to determine whether loss relief is available, there are two questions for us to decide, namely:

(1) Does section 67 apply to Mr Silvester's farming activities?

(2) If section 67 applies to Mr Silvester's farming activities, is it disapplied by section 68, ie could a competent person carrying on the farming activities on 1 July 2000 not reasonably have expected the activities to become profitable until after the end of the two tax years in respect of which loss relief was claimed, ie 2009-10 and 2010-11?

The first question raises the issue of whether section 67 should be construed as only applying to hobby farming and not to farming activities carried out on a commercial basis with an expectation of profit. The second question requires us to determine what is meant by "the farming activities" and whether the hypothetical competent farmer carrying on such activities in July 2000 could not reasonably have expected them to become profitable until 2010 0r 2011.

26. In relation to the assessment for tax year 2008-09, there is the additional issue of whether HMRC were entitled to issue a notice of further assessment for 2008-09 under section 29 TMA. That turns on whether a hypothetical officer of HMRC could reasonably have been expected to be aware on 29 January 2011, on the basis of the information made available to him before that time, that the partnership's farming activities had made losses in five tax years prior to 2008-09.

Discussion

Does section 67 apply only to hobby farming?

27. Mr Silvester contends that as the cross-heading to sections 67 to 70 ITA refers to hobby farming and he is not a hobby farmer, the section does not apply to him and, even if it does, his farming activities pass the reasonable expectation of profit test in section 68. Mr Silvester submitted that section 67 is immediately preceded by the heading "Restriction on relief for 'hobby' farming or market gardening". Mr Silvester argued that this is clearly not applicable to his farming activities. Mr Silvester submitted that, from the outset, HMRC's website stated quite clearly that the legislation in sections 67 to 70 relates to hobby farming and, as such, it did not apply to him at the time of submitting his tax returns. HMRC's website now says that the sections apply to all farmers but Mr Silvester was unaware of this until the dispute that led to this appeal.

28. Mr Mason, for HMRC, contended that the mention of hobby farming in the cross-heading does not of itself mean that the legislation is restricted to hobby farmers. He submitted that headings in statutes are not relevant to the construction of legislative provisions and the wording of section 67 is clear; it refers to "carrying on a trade of farming or market gardening" and makes no reference to the trade being a hobby. In support of this view, Mr Mason relied on the decision of the First-tier Tribunal (Tax Chamber) ('the FTT') in *French and French v HMRC* [2014] UKFTT 940 (TC) ('*French*'). In *French*, the appellants contended that section 67 ITA did not apply at all to the professional or commercial farmer. The FTT did not accept this submission and, at [21], stated as follows:

> 'We agree, however, with HMRC that, while that may be the broad thrust of the 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.'

29. We respectfully agree with the views of the Tribunal in *French*. Support for this approach can be found in *Bennion on Statutory Interpretation* (6th edition, 2013) at page 694 in section 255 of the Code which states:

> "A heading within an Act, whether contained in the body of the Act or a Schedule, is part of the Act. It may be considered in construing any provision of the Act, provided due account is taken of the fact that its function is merely to serve as a brief, and therefore necessarily inaccurate, guide to the material to which it is attached."

30. In the comment on section 255 of the Code, the learned author of *Bennion* states

> "… a heading is of very limited use in interpretation because of its necessarily brief and inaccurate nature. Any heading can only be an approximation, and may not cover all the detailed matters falling within the provision to which it is attached. Furthermore it may fail to get altered when some amendments made in Parliament to those provisions would justify this. Lord Reid said:
>
> > 'A cross-heading ought to indicate the scope of the sections which follow it but there is always a possibility that the scope of one of the sections may have been widened by amendment'.[1]
>
> …
>
> Where a heading differs from the material it describes, this puts the court on enquiry. However it is most unlikely to be right to allow the plain literal meaning of the words to be overridden purely by reason of a heading."

31. In our view, the heading can be an aid to the construction of the sections that follow it but it is no more than that and cannot govern the language used in the sections. The reference to hobby farming in the cross-heading to section 67 to 70 ITA is clearly only meant as a shorthand term for or brief description of the contents of the sections that follow and does not restrict the scope of those sections. We consider that the limited role of the word 'hobby' is made clear by the fact that the Parliamentary draftsman has placed it in single quotation marks within the heading, the term is nowhere defined and it is not used in the sections that follow the heading. Accordingly, we consider that we must apply the words of section 67 using their ordinary meaning considered in the context of the relevant statutory provisions taken as a whole and with regard to their general purpose.

32. Mr Silvester relied on statements in earlier and current versions of the Business Income Manual ('the BIM') published by HMRC. The BIM is an internal manual containing guidance for HMRC staff but it has for many years been made available to the public generally (and is now readily available online).

33. Mr Silvester referred to BIM75615 and said that it made clear that the legislation was originally enacted to catch hobby farming. It is now BIM85615 which is headed "Farming losses: test of commerciality" and states as follows:

> "Trade loss relief against general income (see BIM85605) is denied unless the taxpayer can show that, during the period when the loss was sustained, the trade was being carried on on a commercial basis and with a view to the realisation of profit. For guidance on the meaning of 'not on a commercial basis', see BIM85705; and with a view to the realisation of profits, see BIM85710.
>
> The provision was first introduced in 1960. The Chancellor of the day stated in the course of a Parliamentary debate on the clause:
>
> > 'we are after the extreme cases in which expenditure very greatly exceeds income or any possible income which can ever be made and in which, however long the period, no degree of profitability can ever be reached'.

[1] *DPP v Schildkamp* [1971] AC 1 at page 10

> These words should be borne in mind when considering the application of the restriction to farming cases. The small farmer and the farmer farming marginal land genuinely trying to make a living from their farms in difficult circumstances are not caught.
>
> Nor does the restriction operate to deny relief to a farmer who incurs temporary losses while establishing an enterprise, for instance by building up a production herd or bringing land back into fertility, provided the enterprise in which he or she is engaged is likely in due course to become an economic undertaking. For example, it may take a farmer five years to clear and work land infested with bracken before there can be an expectation of profit. Trade loss relief against general income should not be refused on the initial losses in such a case."

Mr Silvester said that the legislation should be interpreted in accordance with the words of the Chancellor when the provision was introduced and the guidance in BIM85615. Mr Silvester maintained that he was not one of the extreme cases that the legislation was intended to catch.

34. In fact, BIM85615 deals with section 66 ITA, the general restriction on trade loss relief against general income unless the loss arises from a trade carried on a commercial basis with a view to profit. As BIM75620, which is headed "Farming losses: restriction of relief after 5 years of losses", explains, what is now section 67 ITA was introduced in 1967 to complement what is now section 66. Accordingly, the Chancellor's words quoted in BIM85615 refer to the restriction on relief where the trade is not commercial rather than the specific rule where losses are made in six or more years consecutively. The Chancellor's words do not refer to the provision under consideration in this appeal.

35. BIM75620, which provides guidance on the application of section 67, was re-worded and now, as BIM85620, states as follows:

> "The five year rule only applies to trading losses arising from farming or market gardening activities. The rule denies trade loss relief against general income etc (see BIM85605) where a loss computed without regard to capital allowances was incurred in each of the five tax years preceding that in which the claimed loss was incurred (see BIM85625).
>
> The rule operates according to an objective test and should be applied, subject to BIM85640 and BIM85645, in all cases where the conditions are satisfied."

36. In our view, the BIM does not assist Mr Silvester. Section 67 ITA is clearly intended to do something more than section 66 otherwise there would have been no point in introducing it to the statute book. Section 66 removes trade loss relief against general income where the trade is not carried on on a commercial basis with a view to the realisation of the profits of the trade (ie so as to afford a reasonable expectation of profit). A person who engaged in a farming activity, even a consistently loss-making one, would not fall within section 66 if it was carried on on a commercial basis with a view to the realisation of profits at some point. HMRC accepted that Mr Silvester carried on his farming activities on a commercial with a view to the eventual realisation of profits (as happened in 2010-11) and that section 66 did not apply to him. Unlike section 66, which contains a subjective element, section 67 applies a purely objective test: was a loss made in the trade in each of the previous five tax years? Section 67 makes no reference to and its application does not depend on whether the trade is carried on on a commercial basis or the person carrying it on had a view to the

realisation of profits. We conclude that section 67 is not restricted to hobby farming but can apply to farming activities carried on on a commercial basis where there have been losses in each of the previous five tax years, subject to the exceptions in section 67(3) which include the reasonable expectation of profit test to which we now turn.

Application of the reasonable expectation of profit test

37. Whether section 67 ITA applies to Mr Silvester turns on whether the partnership satisfies the condition in section 68(3)(b). That condition is that a competent farmer carrying on the activities at the beginning of the period of losses, ie on 1 July 2000, could not reasonably have expected the activities to become profitable until after the end of the 2008-09 and 2009-10 tax years.

38. Mr Mason submitted that the reasonable expectation of profit test required us to consider whether a competent farmer in July 2000, carrying on the same farming activities that the partnership carried on in the tax years 2008-09 and 2009-10, could not reasonably have expected the activities to become profitable until after the end of those years. He contended that the test is not concerned with the actual activities carried on by partnership in July 2000. He said that this followed from the language of sections 67 and 68 ITA. Section 67 is only concerned with the tax year in respect of which relief for losses was claimed ('the current tax year') and the reference in section 67(3)(b) to farming activities was to farming activities carried out in that year. Section 68 explains how the farming activities meet the reasonable expectation of profit test for the purposes of section 67. Mr Mason contended that this showed that the activities must be those of the current tax year as they were the only activities mentioned in section 67. Accordingly, the term 'the activities' in section 68(3)(a) and (b) refers to activities of the current tax year. Mr Mason also relied on section 68(4) which provides that, in determining whether a competent person carrying on the activities in the current tax year would reasonably expect future profits (ie the section 68(3)(a) test), regard must be had to the nature of the whole of the activities. Applying that interpretation, Mr Mason submitted that Mr Silvester does not the meet the reasonable expectation of profit test in section 68(3)(b) because the competent farmer carrying on, in July 2000, the same farming activities as the partnership carried on in 2008-09 and 2009-10, could not reasonably have expected that they would not become profitable until 2009-10 or 2010-11. Mr Mason said that Mr Silvester had made a small profit in 2010-11 and that showed that those activities were capable of becoming profitable within three years. It followed, he submitted, that a competent farmer carrying on the same activities as the partnership carried on in 2008-09 and 2009-10 in July 2000 could not reasonably have expected that they would not become profitable for nine or ten years. Accordingly, Mr Silvester was not able to claim relief against his general income for the losses arising from the farming trade in the 2008-09 and 2009-10 tax years.

39. Mrs Ling submitted that it would be illogical if section 68(3)(b) ITA deemed the hypothetical competent farmer in July 2000 to be carrying on the same farming activities as the partnership carried on in 2008. The hypothetical competent farmer would have the advantage of not having to go through the difficulties experienced by the partnership between 2000 and 2010. The competent farmer in 2000 would not have been able to foresee events such as the thefts of 200 lambs or the foot and mouth outbreak in 2007. Further, the increased subsidies available in 2008 and the higher price of lambs could not have been foreseen in 2000. Mr Silvester said that he realised in 2004-05 that, if things did not change, the partnership would not make a profit. Mr

Silvester contended that the reasonable expectation of profit test was met in that the competent farmer carrying on the same farming activities as the partnership in 2000 would not have made a profit any sooner than the partnership in the circumstances. Mr Silvester also relied on the EBLEX study which showed that the average lowland sheep farmer did not make any profit until 2010.

40. In order to determine whether the partnership satisfies the condition in section 68(3)(b) ITA, we must decide whether "the activities" in that subsection means the activities actually carried on by the partnership in July 2000 or the activities that it carried on in 2008-09 and 2009-10. Having decided which activities are the subject of the condition, we must decide whether the hypothetical competent farmer carrying on such activities in July 2000 could not reasonably have expected them to become profitable until 2009-10 or 2010-11.

41. We were referred to two recent decisions of the FTT which considered section 68(3)(b) ITA. The first was *French*, which we have already referred to, and the second was *Erridge v HMRC* [2015] UKFTT 89 (TC) ('*Erridge'*).

42. In *French*, Mr and Mrs French carried on a dairy farming business in partnership. From 1998, the business ceased to be profitable due to the fall in milk prices. In 2000, the couple sold their cattle and subsequently let the farm to a neighbouring farmer who began arable farming on the land. Mr and Mrs French resumed operating the farm in 2004, but continued to make losses although they were reducing. In the tax years 2008-09 to 2010-11, Mr and Mrs French claimed relief for these losses against their other income (derived from letting buildings on the farm). HMRC rejected the claim on the basis that relief was precluded by section 67 ITA and the exceptions in section 68 did not apply. Specifically, HMRC contended that "the activities" in section 68(3)(b) referred to arable farming conducted by Mr and Mrs French in 2008-09 to 2010-11 and the reasonable expectation of profit condition fell to be applied by considering whether a competent farmer carrying on such activities in 1998 could not reasonably have expected them to become profitable until after the years in which loss relief was claimed. The FTT (Judge Nowlan and Mr Thomas) found that there was a cessation of trade when Mr and Mrs French let the land. Accordingly, the relevant years of losses only started when Mr and Mrs French started trading again in 2004 and HMRC appear to have accepted that the competent farm seven years for the new farming operation to become profitable (and there had not been five years of losses preceding 2008-09 anyway). The FTT allowed Mr and Mrs French's appeal on that ground. In case they were wrong on that point, they also considered HMRC's submission that the competent farmer in 1998 must be regarded as carrying on the same farming activities as were actually carried on by Mr and Mrs French in in 2008-09 to 2010-11, ie arable farming, notwithstanding the fact that Mr and Mrs French had been engaged in dairy farming at that time. The FTT rejected this submission. As they had already concluded that the appeal should be allowed, the FTT's reasons on this point at [49] of their decision are obiter but we consider they are worth setting out in full.

> "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 [section 68(3)(b)] referred to 'those activities', which would clearly have been a reference back to the activities referred to in [section 68(3)(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 three 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."

43. In *Erridge*, Mr Erridge was a dentist who also farmed in partnership with his wife. Mr and Mrs Erridge enlarged their existing farming business by buying other farms. The purchases were financed by bank loans. The partnership made losses in every tax year from 2005-06 to 2012-13. Mr Erridge claimed sideways loss relief in his self-assessment for 2010-11 which HMRC disallowed. On appeal, Mr Erridge contended that the farming activities met the reasonable expectation of profit test. He submitted that, among other reasons, the losses were caused by the bank which made the loans subject to a punitive breakage fee and the banking crisis in 2008 which made proposed sales of land for housing unfeasible. After the banking crisis, in 2010, Mr Erridge commissioned a farm review and the business was projected to become profitable within a short time, which it did. He argued that the 'activities' in section 68(3)(b) ITA should include the expansion of the business and the increase in borrowing to fund that expansion. The FTT (Judge Scott and Mr Sheppard) concluded that section 68(3)(b) required them "to look at the 2010/11 current activities but in the context of the beginning of the period of loss, namely 5 April 2005." The FTT, while expressing sympathy for Mr and Mrs Erridge's situation, held that, in April 2005, the competent farmer could not possibly have predicted the banking crisis and alleged miss-selling by the lending bank as they were unforeseeable. They found that, if the partnership had had the same land bank in April 2005 as in the 2010-11, Mr Erridge (and, by implication, the competent farmer) would have expected to make a profit within a short timescale as he did following the farm review. The FTT dismissed Mr and Mrs Erridge's appeal.

44. The tribunals in *French* and *Erridge* might appear to have taken different views on how the reasonable expectation of profit test in section 68(3)(b) ITA is to be applied. In *French*, the FTT decided that they should consider the relevant farming activities were those that Mr and Mrs French were actually carrying on at the start of the period of losses. The FTT in *Erridge* considered what expectations of profit the competent farmer would have had at the start of the period of losses if the business had been in the same position as it was in the tax year when the loss relief was claimed. The facts of the two cases were, however, very different. In *French*, the farming activities changed dramatically from a failing dairy farming business at the beginning of the period of losses to an improving arable farm in the years when the relief was claimed. In *Erridge*,

as in this case, the farming activities, although expanding, remained the same throughout the relevant period albeit subject to unforeseeable external events.

45. We consider that "activities" has the same meaning in paragraphs (a) and (b) of section 68(3) ITA. We do not agree with HMRC's view that "activities" means the farming activities carried on by the person claiming the loss in the year of the claim. In our view, "activities" in section 68(3) refers to the activities that constitute the trade of farming in respect of which the loss relief is claimed. We reach this view because section 67(1) refers to the trade of farming in relation to which the loss was made. Section 67(3)(b) applies the reasonable expectation of profit test not to the trade of farming but to the farming activities which must mean the activities of the trade of farming. Section 68(3)(a) explicitly refers to the farming activities carried on in the current tax year, ie the year in which the loss relief is claimed. Section 68(3)(b) refers to "the activities at the beginning of the prior period of loss" but does not explicitly state that "the activities" are those that the person claiming loss relief carried on in the year of the claim. In our view, "the activities" does not have a special meaning, ie does not mean the farming activities in the current tax year, because the legislation does not define it as having that meaning and we do not consider that it can be read as having it without being so defined. We consider that "the activities" should have its normal meaning which, in the context, is the activities that constitute the trade of farming in respect of which the loss relief is claimed. Reading section 68(3)(b) in that way means that the competent farmer condition is less artificial and more straightforward to apply because it is applied to known rather than assumed facts. The known facts are the nature of the farming activities at the beginning of the prior period of loss and the circumstances in which they were carried on. Even though known in the year in which the loss relief is claimed, the competent farmer cannot be assumed to have been aware of unforeseeable events in the intervening years.

46. In this case, section 68(3)(b) requires us to assume that the competent farmer in July 2000 carried on the same activities in the course of a trade of farming, namely sheep farming, as the partnership actually carried on in 2000.

47. On the basis of that assumption, we consider it is clear that the competent farmer could not reasonably have expected the sheep farming activities to become profitable until 2009-10 or 2010-11. We consider that the competent farmer could not reasonably have expected them not to become profitable until 2009-10 or 2010-11.

48. What expectations of profit would the competent farmer, carrying on the same sheep farming activities as the partnership actually carried on, have in July 2000? We regard Mr Silvester as a proxy for the competent farmer. On the basis of the evidence presented to us, we find that Mr Silvester is a highly competent sheep farmer and HMRC have never suggested otherwise. Mr Silvester told us (and we accept) that it would not have been possible for anyone else to get into profit sooner than he did but that is not the test. Mr Silvester was an experienced and successful businessman as well as a competent sheep farmer. We find that he did not farm sheep as a hobby but sought to do so as a profitable, commercial business. From his evidence, we conclude that, in 2000, Mr Silvester considered that the sheep farming activities carried on at that time could become profitable as, in fact, they had been in the year ending 30 June 2000. It was only in 2005 that Mr Silvester accepted that the business was unlikely to make a profit without radical change. The test is not, however, what expectations Mr Silvester or the competent farmer had in 2005 but what those expectations were in July 2000.

Given his commercial background, experience and commitment to sheep farming, we consider that Mr Silvester did not expect (and could not reasonably have expected) in 2000 that the sheep farming activities would not become profitable until after the end of the tax years 2009-10 or 2010-11. That would require Mr Silvester to have predicted unforeseeable events such as the foot and mouth outbreak, two episodes of lamb rustling and land being despoiled by wild boars. Had Mr Silvester, in July 2000, expected the activities to be loss making for the next nine or ten years, we have no doubt that he would have changed the business model with a view to making it profitable, as he did in 2005 when he accepted that the existing business was unlikely to become profitable. From that, we infer that, in July 2000, Mr Silvester, and thus the competent farmer for whom he is a proxy, could not reasonably have expected (and did not expect) that the sheep farming activities would not make a profit until 2009-10 or 2010-11. Accordingly, we conclude that Mr Silvester did not meet the reasonable expectation of profit test in section 68(3)(b) ITA.

Discovery

49. In relation to the assessment for tax year 2008-09, there is a further issue of whether there was a valid discovery under section 29 TMA. As HMRC accept that the understatement of liability was not made carelessly or deliberately and thus section 29(4) is not in point, Mr Silvester can only be assessed if the condition in section 29(5) is fulfilled. This turns on whether, when the time limit for opening an enquiry into Mr Silvester's tax return for 2008-09 expired on 29 January 2011, an officer of HMRC could not have been reasonably expected to be aware, on the basis of the information made available to him or her before that time, that the partnership's farming activities had made losses in each of the previous five tax years. If that is the case then HMRC meet the condition in section 29(5) and may make the assessment. Mr Silvester contends that HMRC were fully aware that the farming business had made losses since 2000-01 because he had filed tax returns with accounts and tax computations each year. HMRC maintain that information included in tax returns for earlier years or any documents accompanying them is not 'information made available to [HMRC]' as defined by section 29(6). HMRC's position is that the return for 2008-09 (or accompanying documents) must make HMRC aware of an actual insufficiency in the Self-Assessment for that year to be complete enough to prevent the making of a discovery assessment.

50. It was established in *HMRC v Lansdowne Partners Ltd Partnership* [2011] EWCA Civ 1578, and confirmed in *HMRC v Charlton Corfield and Corfield* [2012] UKUT 770, [2013] STC 866, that it is not the officer actually dealing with the matter who has to be aware of the insufficiency, but rather a hypothetical tax officer. The officer is assumed to be of reasonable knowledge and understanding, but there is no uniform standard. In *Langham v Veltema*, Auld LJ observed, in [33], that the awareness in section 29(5) TMA is "an inspector's objective awareness, from the information made available to him by the taxpayer, of … an actual insufficiency in the assessment" rather than an awareness that he should do something to check whether there is an insufficiency. He further observed, at [36], that the taxpayer must have clearly alerted the inspector to the insufficiency and the draftsman of section 29(6) could have but did not provide that the categories of information specified in section 29(6) should not be an exhaustive list.

51. We consider that the points to be derived from *Lansdowne Partners*, *Charlton* and *Langham v Veltema* can be summarised as follows:

(1) the awareness required by section 29(5) is an objective awareness of a hypothetical officer of HMRC of an actual insufficiency in the assessment in question;

(2) whether an officer could reasonably have been expected to be aware of an actual insufficiency must be determined on the basis of the information made available to him by the taxpayer;

(3) only information described in section 29(6), as extended by section 29(7), can be taken into account in determining whether an officer could reasonably have been expected to be aware of the actual insufficiency; and

(4) the information in question must clearly alert the officer to the insufficiency in the assessment.

52. The "information made available" for the purposes of section 29(5) TMA is defined by section 29(6) and (7). Section 29(6)(a) clearly provides that Mr Silvester's return for 2008-09, together with any accompanying accounts, statements or documents, is information made available. Section 29(7)(a) states that a return of Mr Silvester for either 2006-07 or 2007-08 also falls within the definition of information made available and extends the definition to cover returns of the partnership for the same periods as those of Mr Silvester. Section 29(6) and (7) provide an exhaustive definition and items not within that definition cannot be considered to be "information made available".

53. As section 29(6)(a), as extended by section 29(7), creates an exhaustive category which does not encompass returns of Mr Silvester or the partnership for any earlier years than 2006-07, we conclude that Mr Silvester's submission that HMRC could reasonably have been expected to be aware, on the basis of the information made available, of the partnership's farming losses must be determined on the basis of the returns for 2008-09 and for either 2006-07 or 2007-08. In our view, there was nothing in the return for 2008-09 or either of the returns for 2006-07 and 2007-08 which would have alerted HMRC to the fact that the farming activities had generated losses in every year between 2003-04 and 2007-08 so that there was an excessive claim for loss relief. It was not suggested by Mr Silvester or Mrs Ling that the returns for 2008-09 and for either 2006-07 or 2007-08 revealed losses throughout the relevant five-year period. The returns for those years showed losses in those years. In our opinion, HMRC could not reasonably be expected to be aware, from the fact that a return for a particular year showed a loss, that the partnership had made losses in each of the five tax years prior to 2008-09. Accordingly, we conclude that HMRC could not reasonably have been expected to be aware of the five years of losses on the basis of the information made available, as that term is defined in section 29(6)(a) as extended by section 29(7)(a).

54. In section 29(6)(d)(i), the issue is whether information can reasonably be inferred from the returns which fall within section 29(6)(a), ie the returns of Mr Silvester or the partnership for 2008-09 or either of 2006-07 and 2007-08. In our view, the returns for earlier years cannot be regarded as information from which HMRC should have inferred that there had been a series of losses extending over five years before 2008-09. The relevant information to be inferred is that there had been losses for a continuous period of five years. It was not suggested that the returns individually made clear that there had been an extended period of losses and we do not consider that a series of losses

extending over five years could reasonably have been inferred from the fact that individual returns for one or two years showed a loss. Section 29(6)(d)(ii) includes information about the insufficiency, the existence and relevance of which are notified in writing to HMRC by the taxpayer. We considered whether the tax returns for the years prior to 2008-09 were notifications in writing of the existence and relevance of information from which HMRC could reasonably be expected to be aware of the excessive loss relief claimed. In our view, section 29(6)(d)(ii) does not apply to the earlier returns for two reasons. First, those returns did not notify HMRC of the existence or relevance of any information about the series of losses over five years. They only notified losses for individual years (or, we speculate, the current year and, by reference in the accompanying accounts, the immediately preceding year). Secondly, we do not consider that it would be right to take account of the returns for earlier years because to do so would make the limitation in section 29(6)(a) and (7)(a) to the returns for the year of assessment and one of the two preceding years meaningless.

55. For the reasons given above, Mr Silvester's submission that HMRC could reasonably have been expected to be aware that there had been losses in each of the previous five years must be rejected. Accordingly, the condition in section 29(5) TMA is fulfilled and the assessment for 2008-09 is valid.

Decision

56. For the reasons given above, Mr Silvester's appeal is dismissed.

Right to apply for permission to appeal

57. 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.

GREG SINFIELD
TRIBUNAL JUDGE

RELEASE DATE: **30 October 2015**

Appendix

Deduction of losses from general income and restrictions on relief in certain cases

Income Tax Act 2007

64 Deduction of losses from general income

(1) A person may make a claim for trade loss relief against general income if the person-

(a) carries on a trade in a tax year, and
(b) makes a loss in the trade in the tax year ("the loss-making year").

(2) The claim is for the loss to be deducted in calculating the person's net income-

(a) for the loss-making year,
(b) for the previous tax year, or
(c) for both tax years.

…

(8) This section needs to be read with-

…
(b) sections 66 to 70 (restrictions on the relief),

…

Restriction on relief for uncommercial trades

66 Restriction on relief unless trade is commercial

(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.

…

Restriction on relief for "hobby" farming or market gardening

67 Restriction on relief in case of farming or market gardening

(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).

68 Reasonable expectation of profit

(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.

Discovery

Taxes Management Act 1970

29 Assessment where loss of tax discovered

(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment -

(a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or
(b) that an assessment to tax is or has become insufficient, or
(c) that any relief which has been given is or has become excessive,

the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.

…

(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above-

(a) in respect of the year of assessment mentioned in that subsection; and
(b) in the same capacity as that in which he made and delivered the return,

unless one of the two conditions mentioned below is fulfilled.

(4) The first condition is that the situation mentioned in subsection (1) above is attributable to fraudulent or negligent conduct on the part of the taxpayer or a person acting on his behalf.

(5) The second condition is that at the time when an officer of the Board -

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or
(b) informed the taxpayer that he had completed his enquiries into that return,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if -

(a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;

(b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;

(c) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer; or

(d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above-

(i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or

(ii) are notified in writing by the taxpayer to an officer of the Board.

(7) In subsection (6) above-

(a) any reference to the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment includes -

(i) a reference to any return of his under that section for either of the two immediately preceding chargeable periods; and

(ii) where the return is under section 8 and the taxpayer carries on a trade, profession or business in partnership, a reference to any partnership return with respect to the partnership for the relevant year of assessment or either of those periods; and

(b) any reference in paragraphs (b) to (d) to the taxpayer includes a reference to a person acting on his behalf.

…

(8) An objection to the making of an assessment under this section on the ground that neither of the two conditions mentioned above is fulfilled shall not be made otherwise than on an appeal against the assessment.

(9) Any reference in this section to the relevant year of assessment is a reference to-

(a) in the case of the situation mentioned in paragraph (a) or (b) of subsection (1) above, the year of assessment mentioned in that subsection; and

(b) in the case of the situation mentioned in paragraph (c) of that subsection, the year of assessment in respect of which the claim was made.

Section 118 defines "chargeable period" as a year of assessment or a company's accounting period.