



**TC06631**

**Appeal number: TC/2015/05077**

*INCOME TAX – sideways relief for farming losses – application of sections 67 and 68 Income Tax Act 2007 – reasonable expectation of profits test – appeal allowed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**ARDESHIR NAGHSHINEH**

**Appellant**

**- and -**

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

**TRIBUNAL: JUDGE PHILIP GILLETT  
CAROLINE DE ALBUQUERQUE**

**Sitting in public at Taylor House, London on 11 June 2018**

**Edward Waldegrave, counsel, for the Appellant**

**Iona Stevenson, Officer of HM Revenue and Customs, for the Respondents**

## DECISION

5 1. This was an appeal against closure notices issued by HMRC on 7 May 2014 in respect of the accounting periods ended 31 March 2008 to 31 March 2012 inclusive and concerns the correct interpretation and application of the farming loss relief rules contained in ss67 and 68 Income Tax Act 2007.

2. The losses in the years under appeal, according to HMRC records, were:

	31 March 2008	£422,244
10	31 March 2009	£521,680
	31 March 2010	£390,174
	31 March 2011	£101,697
	31 March 2012	£28,529

15 3. The figures provided by Mr Waldegrave were slightly different but we were informed that this was due to computational differences and that we were only being asked to determine the matters of principle raised by this appeal.

20 4. The closure notices issued on 7 May 2014 notified the appellant (“Mr Naghshineh”) that the enquiries into his tax returns for these years had been completed and that HMRC had concluded that the sideways loss relief claimed for those years should be denied. This resulted in additional tax payable, in comparison with the original self-assessments, totalling £597,140.21.

25 5. Mr Naghshineh appealed against the closure notices on 21 May 2014 and, after further correspondence and a meeting with HMRC, Mr Naghshineh asked for the decision to be reviewed. This was done and HMRC issued a decision review letter on 31 July 2015, which upheld the original decision.

6. Mr Naghshineh lodged an appeal to the tribunal on 24 August 2015.

### **The Facts**

7. We received a witness statement and heard oral evidence from Mr Naghshineh, whom we found to be a credible and reliable witness.

30 8. We also received an expert report and heard oral evidence from William Waterfield, who was accepted by both parties to be a credible expert in this field. We found him to be a credible expert and none of his evidence was effectively challenged by HMRC when he was cross-examined.

35 9. The facts are not in general in dispute between the parties but we find the following as matters of fact:

5 (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.

10 (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.

15 (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.

20 (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.

25 (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

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

35 (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.

40 (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.

5 (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.

15 (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.

20 (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.

30 (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.

40 (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.

## 5 The Law

10. The relevant legislation is set out in ss 67 and 68 Income Tax Act 2007 as below:

### “67 Restriction on relief in case of farming or market gardening

- 10 (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—
- 15 (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
- 20 (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

- 25 (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—
- 30 (d) a competent person carrying on the activities in the current tax year would reasonably expect future profits (see subsection (4)), but
- (e) 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.
- 35 (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

5 (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. We were also referred to a number of cases:

10 *French v HMRC* [2014] UKFTT 940

*Erridge v HMRC* [2015] UKFTT 89

*Scambler v HMRC* [2017] STC 2108

### Discussion

12. It was accepted by HMRC that the appellant was carrying on the trade of farming on a commercial basis and with a view to profit such that the potentially restricting provisions of s66 Income Tax Act 2007 did not come into play. We were therefore solely concerned with the provisions of ss67 and 68 Income Tax Act 2007 which are set out above.

13. Section 67 denies the use of farming losses against other income of the taxpayer, often referred to as sideways loss relief, where losses have been incurred in each of the previous five tax years, unless the taxpayer can meet the reasonable expectation of profits test as set out in s67(3), and as further defined in s68.

14. It is accepted that the taxpayer incurred farming losses in every period from 31 March 1995 until 31 March 2012 and therefore, when considering the use of the losses for the year ended 31 March 2008 and the subsequent years, it is clear that s67(2) prevents the sideways relief of those losses unless the taxpayer can meet the reasonable expectation of profits tests set out in s67(3) and s68.

15. Sections 67(3) and 68 operate so as to deny the sideways use of farming losses by reference to the expectations of a competent farmer. Specifically s68(3) sets out two tests:

(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.

16. This second test is somewhat cumbersome but what it effectively does is to consider the expectations of a competent farmer, as they would have been at the

beginning of the period of losses, and only permits sideways loss relief for the years in which that competent farmer could also have expected losses.

17. It is accepted between the parties, and has been established in previous cases, that both tests are objective tests, in which we must consider the reasonable expectations of a hypothetical competent farmer, and not the actual farmer. Nor are we expected to judge whether or not the actual farmer is competent.

18. Importantly, the expression “the prior period of loss” is defined in s68(5) and requires us to consider the reasonable expectations of the competent farmer as they would have been at the beginning of the period when the losses commenced. Normally this test would be applied by reference to the period of five years referred to in s67(2) but, if there have been successive losses in the immediately preceding years, then s68(5)(b) requires us to go back to the beginning of the period when those losses commenced. Mr Waldegrave encouraged us to consider the position with effect from 1998, when Mr Naghshineh bought an additional 220 acres, which, Mr Waldegrave argued, was the real commencement of the trade. In our view however, the legislation is quite clear on this point. Losses were realised and, we assume, offset against Mr Naghshineh’s other income, from the year ending 31 March 1995 onwards. There is no ambiguity in this provision and we therefore consider that the reasonable expectation of profits test set out in s68(3)(b) must be considered with effect from 31 March 1995, as contended by HMRC.

#### *First Test*

19. We will first address the test set out in s68(3)(a), which requires us to consider whether or not the competent farmer had, in the year under consideration, a reasonable expectation of profits in the future. HMRC had accepted that this test was met for 2010-11 and 2011-12 but argued that in the preceding three years, prior to the departure of Mr Blatchford, costs had been allowed to get out of control and there was too much diversity as regards the activities of the Farm. Therefore, Miss Stevenson argued, a competent farmer could not have expected to make profits in the future because of the high level of those costs.

20. It is clear that the high level of costs in those years would have contributed to the losses but we received no evidence to suggest that this precluded the prospect of profits in the future, or that the diverse activities then being carried on also removed any prospect of future profits.

21. In contrast, Mr Waterfield’s expert report had stated that for each of the years under consideration a competent farmer would have had a reasonable expectation of future profits.

22. The underlying premise behind Miss Stevenson’s submission, on behalf of HMRC, was that a competent farmer would still have been unable to make a profit, because of the high cost structure of the farm as it was then being operated, and, in the hypothetical parallel world which we are required to consider, could not have made any changes to this high cost base. We do not accept this.

23. The reference in s68(3)(a) to “**the** activities” clearly means that we must restrict ourselves to considering how a competent farmer would carry on the actual activities being carried on by Mr Naghshineh in the year under consideration. However, s68(4) then states that in making our judgement regard must be had to “the nature of the whole of the activities” and “the way in which the whole of the activities were carried on in the current tax year”, and it is not clear to us how these two requirements should be read together, nor what the precise impact of the words “regard must be had to” is.

24. The Income Tax Act 2007 was part of the Tax Law Rewrite project and it is accepted that when tribunals encounter difficulties with the correct interpretation of legislation which was created as part of this project then it is legitimate for them to consider the predecessor legislation. In this case the predecessor legislation was contained in s397(3) Income and Corporation Taxes Act 1988 as follows:

“Subsections (1) and (2) above shall not restrict relief for any loss or for any capital allowance, if it is shown by the claimant –

(a) That the whole of the farming or market gardening activities in the year next following the prior five years are of such a nature, and carried on in such a way, as would have justified a reasonable expectation of the realisation of profits in the future if they had been undertaken by a competent farmer or market gardener, ...”

25. This is indeed helpful, but we do not consider that this means that when we examine the position of the hypothetical competent farmer we must assume that he could not make any changes at all in the way in which the farm was being run, as was contended by HMRC. Indeed that would be illogical, since there must be some differences between a competent farmer and an incompetent farmer since otherwise the legislation might as well ask if the actual farmer, Mr Naghshineh, had a reasonable expectation of profits in that year, but that is not the question which the legislation poses.

26. In our view therefore, even if we accept that the high level of overheads meant that the farming activities could never be profitable, a proposition for which we had no evidence, the hypothetical farmer could have reduced costs, in the same way that Mr Naghshineh did subsequently, such that he would have had a reasonable expectation of profits in the future.

27. We therefore consider that the first test, as set out in s68(3)(a) is met in all the years under consideration, in line with the opinion of Mr Waterfield as set out in his expert report.

*The second test*

28. The second test is set out in s68(3)(b) and is a somewhat cumbersome test in its construction. The wording in this section also causes some difficulties as to which activities it is referring to. Again therefore it may be worth referring to the predecessor legislation, as contained in s397(3) Income and Corporation Taxes Act 1988, for clarification. In that legislation the second test is set out as:



“(b) that, if the farmer or market gardener had undertaken **those** activities at the beginning of the prior period of loss, he could not reasonably have expected the activities to become profitable until after the end of the year next following the prior period of loss.”

5 29. This makes it clear that the activities which we must consider are those activities which are referred to in the first test, ie the activities which are being carried on in the year under consideration.

30. As stated above, the second test is somewhat cumbersome but helpfully, in *Scambler*, at [64], the Upper Tribunal set out a useful formulation encapsulating both  
10 tests, as follows:

“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 after the prior period of losses the competent farmer would need to be able to make the following statement in the circumstances of this case:

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

31. A further issue before the Upper Tribunal in *Scambler* was the extent to which a tribunal can take into account subsequent unforeseen, and unforeseeable events. In other words, when considering the reasonable expectations of the competent farmer at  
25 the beginning of the prior period of losses, can the tribunal take into account events which might have thrown the venture off course, such as the avian flu epidemic which had destroyed the poultry part of Mr Naghshineh’s business, or, more importantly, the financial crisis of 2007-08, which severely damaged the market for organic produce and had also left Mr Naghshineh in a position where he was no longer able to access  
30 additional funds to invest further in the business.

32. The clear answer to this question given by the Upper Tribunal in *Scambler* is that we cannot take such specific events into consideration. They are simply a normal part of farming life. They are unforeseeable and the hypothetical competent farmer could not therefore have foreseen them when he considered his plans at the beginning  
35 of the prior period of losses. There is no mechanism in the legislation for the long term strategy envisaged by s68(3)(b) to be adjusted in the light of subsequent events.

33. We do think it reasonable, as was confirmed by Mr Waterfield, that a competent farmer could and would have allowed a contingency for such events when drawing up his long term plans, because that is the nature of farming. This would have had the  
40 effect of deferring the time at which the venture became profitable, and we assume

that such a contingency was built into Mr Waterfield's profitability projections as contained in his report.

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.

### **Decision**

43. For the above reasons therefore we decided that Mr Naghshineh's appeal in respect of all years from 2007-08 to 2011-12 inclusive should be ALLOWED.

44. 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.

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**PHILIP GILLETT**

**TRIBUNAL JUDGE**

**RELEASE DATE: 22 June 2018**

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