



TC01874

Appeal number: TC/2010/5431

INCOME TAX – losses incurred in farming – succession to farming trade – restrictions in offsetting farming losses against employment income – section 397 ICTA – liability of employee to account to HMRC for tax on employment income – Regulation 72 Income Tax (PAYE) Regulations 2003

**FIRST-TIER TRIBUNAL
TAX**

MICHAEL HOWES

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS**

Respondents

**TRIBUNAL: JUDGE ALEKSANDER
LESLEY STALKER**

Sitting in public in Sutton on 17 November 2011

The Appellant in person

Colin Williams, an officer of HM Revenue and Customs, for the Respondents

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DECISION

1. This decision relates to the tax affairs of the Appellant, Mr Michael Howes, for the tax years 1999-2000 to 2004-05 inclusive. In essence the appeals relate to Mr Howes's ability to set off losses incurred in deer farming against other taxable income. HMRC argue that section 397(1) Income and Corporation Taxes Act 1988 ("ICTA") restricts the ability of Mr Howes to set-off his farming losses against his employment income. HMRC contend that in any event for the years 2001-02 to 2004-05 Mr Howes's claim for "sideways" relief was made out of time and that there are no statutory provisions which would allow a late claim.

2. Mr Howes appeared in person. HMRC were represented by Mr Williams. We heard evidence from Mr Howes. Bundles of documents were presented to us by way of written evidence. Because of some confusion in the mind of Mr Howes that the hearing on 17 November was going to be limited in its scope, he did not bring to the hearing copies of all relevant documents. We therefore gave leave for Mr Howes to produce further documents following the hearing, and for both Mr Howes and HMRC to make written submissions relating to such documents. We also gave directions relating to production by HMRC of any directions made under Regulation 72 of the Income Tax (PAYE) Regulations 2003 in respect of employment income earned by Mr Howes in the years under appeal.

Background facts

3. The background facts are not in dispute, and we find them to be as follows:

4. Mr Howes is a surveyor by profession. In the 1990s he proposed to supplement his income from surveying through deer farming, with the intention that over time the deer farming would generate sufficient income so that he could wind down his surveying activities. He purchased Buckholt Park in 1990 with a view to self-building a house for his family and the necessary farm buildings. The property comprised woodland and orchard without any buildings on site. Between 1990 and 1993 the fruit trees were grubbed out and land seeded for grass. Fences were erected and two deer handling barns and access roads constructed. Planning consent was sought for the construction of a farmhouse. A herd of 40 hinds was purchased in 1990, and stags were purchased separately. They were retained within two temporary fields ready for release when the structural work had been completed. Equipment to run the farm was also purchased.

5. On 30 April 1993, the Planning Inspectorate allowed Mr Howes's planning appeal, and granted planning consent to construct a farm dwelling, subject to various conditions being satisfied before construction commenced.

6. Buckholt Park Limited ("BPL") was incorporated to manage the deer farm at Buckholt Park and operate Mr Howes's surveying business. BPL was incorporated in March 1992, but did not commence business activities until 1 April 1993. At that point the company started to breed deer, with a view to retaining hinds (for further breeding) and selling stags.

7. Mr Howes and his family were living in a caravan on Buckholt Park whilst Mr Howes started construction work on the house. This took its toll on the family, and in December 1993 a decision was made to halt commercial deer farming activities and for Mr Howes to focus on completing the construction of the house. BPL became dormant, and the herd was acquired by Mr Howes to allow him to restart commercial farming once the house had been completed. At the point when BPL became dormant, it had not sold any deer. Apart from some limited equipment that Mr Howes acquired from BPL, all of its other assets were left to rot, and BPL was eventually struck-off. The field division gates on the farm were opened and the deer herd was allowed to roam and forage freely over the whole farm and to have unrestricted access to a substantial natural pond. A field was selected where all the stags were herded during the rutting season – so ceasing all breeding, the core activity of a deer farm. Stock was slaughtered for the table only or where an animal was sick and needed to be destroyed. In addition there were a few farm gate sales of small joints of less than a few pounds value to friends, but the amounts involved were small and insufficient to generate any profit.

8. The house was completed by Mr Howes in summer 1996 leaving only a garage to be built. At that point he and his family moved into the house. He considered restarting deer farming at that time (and incorporated Buckholt Park Deer Ltd to undertake the business), but because of the BSE crisis (and the fact that BSE had been shown to have been transmitted to deer), the business was not restarted, and Buckholt Park Deer Ltd remained a dormant company, and was eventually struck off.

9. In order to meet his commitments to servicing bank loans taken out to finance the construction of the house, Mr Howes returned to surveying, and was employed as a surveyor in the tax years 1999/2000 and 2000/2001. He was employed by companies owned by his brother – by Nirex UK Limited in 1999/2000 and by CS Building Services Limited in 2000/01. Both companies became insolvent and were eventually struck off.

10. In September 1999, as the BSE crisis had abated, Mr Howes checked the fence lines and water butts on the farm. He broke the herd down into two groups and put a stag with each during the rutting season until November 1999. He expected between 20 and 30 calves to be born between May and July 2000. The calves would be allowed to grow. The intention was that the stags would be sold, but the hinds would be retained to augment the herd. Mr Howes expected to have a herd of between 160 and 170 deer by 2004.

11. In order to operate sales on a commercial basis, Mr Howes told us that a deer farm needs to sell in excess of 30 deer – it therefore takes between three and four years before a deer farm generates income. In the period between 1999 and 2004, there were only a few farm gate sales of small joints of less than a few pounds value to friends, and in quantities insufficient to generate any profit. It is not in dispute, and we find, that at no time did either BPL or Mr Howes generate any profits from deer farming (whether before or after taking into account any available capital allowances). He therefore continued as a surveyor, intending to give up surveying once the deer farm became sufficiently profitable.

12. In 2004 maintenance work was required on overhead power lines running across the farm. Contractors employed by EDF (the electricity utility) came onto the farm to undertake the work. They left farm gates open, allowing much of the deer herd to escape into nearby woodland, and they could not be recovered. The deer that escaped
5 were a nuisance to the community, and Mr and Mrs Howes received threatening letters from neighbours. Mr Howes closed his farming business in 2004 and gave what was left of his deer herd to a zoo. Those deer that could not be given to the zoo were shot and disposed of. Mr and Mrs Howes moved out of the house in 2005 and put the property on the market. The farm was finally sold in 2006 to an equestrian
10 vet. Litigation against EDF for compensation has only recently been settled.

13. Mr Howes filed his tax return for 1999/2000 on 21 August 2001. The return showed £35,000 income from employment with Nirex UK Ltd, and that the employment terminated on 30 March 2000. Mr Howes ticked the box stating that he was not self-employed and that therefore he did not need to complete the
15 supplementary pages dealing with income from self-employment.

14. Mr Howes filed his tax return for 2000/01 on 12 March 2002. The return showed that he was employed by CS Building Services Limited, but did not specify the amount of income earned from the employment. Mr Howes ticked the box stating that he was not self-employed and that therefore he did not need to complete the
20 supplementary pages dealing with income from self-employment.

15. On 27 December HMRC opened an enquiry into Mr Howes's 1999-2000 tax return relating to benefits in kind (which were not included in the tax return, but which had been included in his PAYE coding notice). As no response had been received by HMRC despite several reminders, the enquiry was closed on 18 April
25 2002 by amending the return to include £3525 additional benefit in kind income.

16. On 29 April 2002 Mr Howes appealed against the closure notice on the basis that his employer (Nirex UK Ltd) was no longer trading, and it had proved impossible to substantiate the amount of benefits received. Mr Howes noted that he was now self-employed, and asked for time to prepare accounts which would show losses sustained
30 through farming, which he wished to offset against his employment income. On 13 June 2002 Mr Howes wrote to HMRC giving some details of the deer farm, and including a schedule of plant purchased for use in the farming business and a schedule of estimated expenses incurred. Protracted correspondence then followed culminating in the closure notices and assessments now under appeal.

35 **Issues before the Tribunal**

17. There are a number of issues before the Tribunal.

18. The first two issues relate to farming losses. The first is whether Mr Howes succeeded to BPL's farming trade when that company became dormant and Mr Howes acquired the deer herd. Interlinked with the first issue is the question of
40 whether Mr Howes was undertaking a farming trade between December 1993 (when

the company became dormant and Mr Howes acquired the herd) and 1999 when deer farming recommenced on a commercial basis.

19. The second is whether the provisions of section 397 ICTA 1988 apply to restrict the ability of Mr Howes to offset losses incurred by him in the course of deer farming against non-farming income, and in particular his income from employment.

20. The third issue only arises if s397 does not apply to restrict the use of his farming losses. It is whether Mr Howes applied to offset his farming losses in the years 2001-02 to 2004-05 against other income ("sideways relief") within the relevant time limit prescribed by law.

21. The final issue is whether Mr Howes is liable to account for income tax on his employment income in 1999-2000 and 2000-01, as his employer had not accounted for any PAYE in respect of that income.

Farming losses

22. The appeal has to be understood in the context of the provisions of s397 ICTA. People with income from other sources sometimes take up farming for the sake of recreation or the lifestyle or status which it offers rather than for genuinely commercial reasons. Because of this, Parliament has enacted rules which prevent some farming losses being offset against non-farming income.

23. s384 ICTA restricts relief where a trade is not run on a commercial basis and with a view to the realisation of commercial profits. Although initially HMRC did not accept that deer farming was being carried on commercially by Mr Howes, by the time this case reached the Tribunal, HMRC had accepted that deer farming was being carried on commercially, and that BPL had commenced trading in the tax year 1990/91.

24. s397 ICTA, often known as the five year rule, restricts relief where tax adjusted losses before capital allowances were incurred in each of the five previous years of assessment. s397 is set out below (minor amendments were subsequently made consequential on the enactment of the Capital Allowances Act 2001 – but the changes made are not material to this appeal):

397 Restriction of relief in case of farming and market gardening

(1) Any loss incurred in a trade of farming or market gardening shall be excluded from section 380 if in each of the prior five years a loss, computed without regard to capital allowances, was incurred in carrying on that trade;

(2) Any loss incurred in any accounting period by a company in carrying on a trade of farming or market gardening shall be excluded from section 393A(1) if a loss, computed without regard to capital allowances, was incurred in carrying on that trade in that accounting period, and in each of the chargeable periods wholly or partly comprised in the prior five years.

(3) Subsections (1) and (2) above shall not restrict relief for any loss or for any capital allowance, in any case—

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

10 (b) where, if that 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.

15 (4) Subsections (1) and (2) above shall not restrict relief where the carrying on of the trade forms part of, and is ancillary to, a larger trading undertaking.

(5) In this section—

20 “basis year”, in relation to any capital allowance, shall be construed in accordance with section 383(5)(a);

“chargeable period”, in relation to a company, means any accounting period,

“prior five years”—

25 (a) in relation to a loss incurred in a year of assessment, means the last five years of assessment before that year, and

(b) in relation to a loss incurred in a company's accounting period, means the last five years before the beginning of the accounting period;

30 “prior period of loss” means the prior five years, except that, if losses were incurred in the trade in successive years of assessment or chargeable periods amounting in all to a period longer than five years (and ending when the prior five years end), it means that longer period, and in applying this definition to a chargeable period of a company “losses” means losses computed without regard to capital allowances; and

35 “farming” and “market gardening” shall be construed in accordance with the definitions of those terms in section 832, but as if those definitions were not restricted to activities in the United Kingdom.

40 (6) For the purposes of this section, a capital allowance is related to a loss incurred in a trade if it falls to be made in taxing that trade and its basis year is the year of assessment in which the loss was incurred.

45 (7) In ascertaining for the purposes of this section whether a loss was incurred in any part of the prior five years or earlier, the rules applicable to Case I of Schedule D shall be applied; and in this section “loss computed without regard to capital allowances” means, in

relation to a chargeable period of a company, a loss so ascertained, but so that, notwithstanding section 73(2) of the 1968 Act, no account shall be taken of any allowance or charge under any of the Capital Allowances Acts.

5 (8) Subsections (1) and (2) above shall not restrict relief for any loss or capital allowance if the trade was set up and commenced within the prior five years, and, for the purposes of this subsection, a trade shall be treated as discontinued, and a new trade set up, in any event which
10 under any of the provisions of the Tax Acts is to be treated as equivalent to the permanent discontinuance or setting up of a trade.

(9) For the purposes of subsection (8) above a trade shall not be treated as discontinued if, under section 343(2), it is not to be treated as discontinued for the purpose of capital allowances and charges.

15 (10) Where at any time there has been a change in the persons engaged in carrying on a trade, this section shall, notwithstanding subsection (8) above, apply to any person who was engaged in carrying on the trade immediately before and immediately after the change as if the trade were the same before and after without any discontinuance, and as if—

- (a) a husband and his wife were the same person, and
- 20 (b) a husband or his wife were the same person as any company of which either the husband or the wife has control, or of which the two of them have control;

25 and accordingly relief from income tax or from corporation tax may be restricted under this section by reference to losses some of which are incurred in years of assessment and some, computed without regard to capital allowances, are incurred in a company's chargeable periods.

In this subsection "control" has the same meaning as in Part XI.

25. HMRC submit that BPL's trade commenced in the tax year 1990-91. Mr Howes succeeded to BPL's trade in December 1993 for the purposes of s397(10) (it is not in
30 dispute (and we find) that BPL was at all material times under the control of Mr Howes for the purposes of s397(10)). The trade continued in the hands of Mr Howes from December 1993 until the farming business was closed in 2004. The losses incurred by Mr Howes in 1996-97 are therefore restricted by s397, and sideways relief cannot be claimed for the tax year 1996-97 and subsequent tax years.

35 26. Mr Howes submits that BPL ceased trading in December 1993. At that point Mr Howes merely acquired some of BPL's assets without acquiring its trade. The farming trade did not commence until September 1999 (during the 1999-2000 tax year). s397 could therefore only apply to restrict the use of farming losses at the earliest for the tax year 2005-06, which was after the trade ceased.

40 27. Unlike most trades, farming is statutorily defined for tax purposes, and the usual "badges of trade" do not apply. s53(1) ICTA provides that :

All farming and market gardening in the United Kingdom shall be treated as the carrying on of a trade or, as the case may be, of a part of

a trade, and the profits thereof shall be charged to tax under Case I of Schedule D accordingly.

28. "Farming" is defined in s832(1) ICTA as follows:

5 "farm land" means land in the United Kingdom wholly or mainly occupied for the purposes of husbandry, but excluding any dwelling or domestic offices, and excluding any market garden land, and "farming" shall be construed accordingly.

29. Thus, "farming" for tax purposes is the occupation of land in the United Kingdom wholly or mainly for the purposes of husbandry. "Husbandry" is not statutorily defined and one of its ordinary meanings is "farming". The statutory definition of "farming" thus has a degree of circularity and has to be given a common-sense interpretation to include activities normally recognisable as farming including the management of livestock (such as deer).

30. We have found that on BPL ceasing business, Mr Howes acquired its herd of deer, expressly with a view to being able to recommence deer farming on a commercial basis in due course. Although the deer were allowed to roam freely over Mr Howes's land from December 1993 until September 1999, they were managed and were not allowed to become wild. During that period, Mr Howes managed the herd (for example, during the rutting season, the stags were segregated from the hinds, and Mr Howes destroyed sick deer). He also made some (albeit modest) farm gate sales. We therefore find that Mr Howes was carrying on "husbandry" of his deer on his own account since December 1993, and therefore undertaking the trade of farming on his own account since that date. As Mr Howes purchased the deer herd and some farming machinery from BPL, we also find that Mr Howes succeeded to the farming trade previously carried on by BPL. Therefore for the purposes of s397, Mr Howes is deemed to have commenced trading in 1990-91. As the farming trade was never profitable (before taking account of capital allowances) both when carried on by BPL and subsequently by Mr Howes, the restrictions on the use of farming losses therefore apply for the tax year 1996-97 and subsequent years.

31. We would note, parenthetically, that our finding that Mr Howes's trade was deemed to have commenced in 1990-91 is predicated on the statutory definition of a farming trade in s53(1) ICTA. If this deeming provision did not apply, and trading was to be analysed using the normal tests, we would have great difficulty finding that either BPL or Mr Howes had actually commenced trading, in view of the fact that neither had sold any deer (other than immaterial quantities to friends). We would have found that the activities of both BPL and Mr Howes (although carried on commercially) were essentially preparatory in nature, and that therefore no trading losses had ever arisen.

Loss Relief Claim

32. In view of our decision on the restriction of farming losses under s397, we have not needed to consider whether Mr Howes ever submitted a valid claim to set-off his farming losses against his other income.

Employment Income

33. Income from employment is subject to deduction of tax under PAYE, and it is the employer who has the primary obligation to account to HMRC for the tax withheld (or the tax that ought to have been withheld).

5 34. However Regulation 72 of the Income Tax (PAYE) Regulations 2003 ("PAYE
Regulations") applies if the employer has failed to deduct the correct amount of
income tax, and certain conditions are met. In such circumstances, HMRC can issue a
direction that the employer is not liable to account for the tax due, and instead the tax
can be recovered from the employee. Following directions given by the Tribunal at
10 the hearing, HMRC reviewed whether directions under Regulation 72 (or its
predecessors) were given. They acknowledged in a letter to the Tribunal after the
hearing that no direction was given in respect of Mr Howes employment by Nirex UK
Limited in 1999-2000 but that a direction was given in respect of his employment by
CS Building Services Limited in 2000-01. Accordingly, Mr Howes should not be
15 assessed to income tax in respect of his earnings from his employment with Nirex UK
Limited in 1999-2000 to the extent that such tax should have been deducted under
PAYE.

Conclusions

20 35. We hold that s 397 ICTA operates to prevent Mr Howes from claiming sideways
loss relief. He therefore cannot set losses arising from his farming trade against his
employment and other income.

36. We hold that as no direction was issued by HMRC under Regulation 72 of the
PAYE Regulations, HMRC cannot assess Mr Howes to income tax in respect of
earnings from his employment with Nirex UK Limited, to the extent that such tax
25 should have been deducted from such earnings.

37. This is a decision in principle only, and we have not determined the amount of
income tax payable by Mr Howes for the years under appeal. We leave it to Mr
Howes and HMRC to reach agreement on the amount of tax payable. In the event
that they are unable to agree the amount of tax payable, we give leave for them to
30 apply to the Tribunal to determine the amounts due.

38. 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
35 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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NICHOLAS ALEKSANDER

TRIBUNAL JUDGE

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RELEASE DATE: 7 March 2012

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