TC03851

Appeal number: TC/2013/03336

Income Tax –Self Assessment Tax Return – Appeal against Closure Notice - loss relief – section 66 Income Tax Act 2007 - was trade carried on with a view to the realisation of profits – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

JUDITH THORNE **Appellant**

- and -

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

TRIBUNAL: JUDGE ALISON MCKENNA
MRS GILL HUNTER

Sitting in public at Bedford Square on 13 June 2014

Iain Bottrill of Kent and Sussex Accountancy Services for the Appellant

Anthony O'Grady, HMRC Officer, for the Respondents

DECISION

1. This appeal concerns the Appellant's self assessment tax return for the year 2008-9 and her claim to "sideways" loss relief under s.64 (1) and (2) of the Income Tax Act 2007 ("ITA").

2. In her 2008-9 return, the Appellant reported her remuneration from her employment with tax deducted at source, but also submitted a self employment income page covering the twelve month period ended 5 April 2009. Her self employment was described as *'Equestrian Breeder and Farming'*, and she reported losses (including capital allowances) of £79,424.00. She made an election to set off these losses against the other income reported for 2008-2009, giving rise to overpaid tax of £31767.60.

3. The Appellant had first reported her self employment income as an '*Equestrian Breeder*' on her 2004-2005 return. Similar information appeared in her returns for 2005-2006 and 2006-2007. In 2004-5 and 2005-6 capital losses were reported but no claim for sideways relief was made against her other income. On the Appellant's 2007-2008 return, the self employment was described differently, as '*Equestrian Breeder & Farming*'. This description was also given in 2008 -2009.

4. The claim to "sideways" loss relief in the 2008-9 return was made under s.64(1) and (2) of ITA, which is subject to the restrictions imposed by ss. 66 (1), (2) and (3). HMRC opened an enquiry into the Appellant's 2008-2009 tax return and refused the claim to sideways relief on the basis that the conditions in s. 66 ITA had not been satisfied. HMRC issued a Closure Notice and amended the return, resulting in the losses being disallowed and tax of £2.00 being due. The Appellant appealed against the conclusions set out in the Closure Notice and the consequential amendment to the 2008-2009 return.

5. HMRC extended its enquiry to cover the years 2006-2007 and 2007-2008 and assessments were made which disallowed the losses and resulted in further tax being due. The Appellant appealed against the discovery assessments made for 2006-2007 and 2007-2008 but HMRC then decided to withdraw them, so the only matter before the Tribunal now is the appeal against the 2008-2009 Closure Notice.

6. HMRC has not challenged the quantum of the losses claimed, so the only issue for the Tribunal is whether the sideways relief was properly due.

The Facts

7. The Appellant has lived at Yew Tree Farm since December 1995. The property comprises a farm house, outbuildings and 38 acres of land.

8. The Appellant has always used much of the land as pasture for her horses. Five and a half acres of land were dedicated to growing asparagus in April 2009. The

Appellant was unsure of the precise date in April when the asparagus crowns were planted.

9. The Appellant has carried out a substantial amount of work on the outbuildings, which now comprise stables, a feed room, a tack room and foaling boxes. The evidence was that this work was completed prior to April 2004, which is when the Appellant states that she started to trade as an equestrian breeder. No claim to tax relief has been made in respect of these works and, although it is understood that the works were funded in part by mortgage finance, mortgage interest has never been claimed as a business expense. The Appellant told the Tribunal that she had registered for VAT in relation to the asparagus business but that she had never registered for VAT in respect of her equestrian business.

10. The Appellant's evidence was that she was an experienced horse-woman and had competed at an amateur level for many years. When she purchased Yew Tree Farm in 1995 she owned two horses, one of which was a mare in foal. These horses were for the Appellant's private use and she told the Tribunal she had no thought of starting an equestrian business at that time. In 1998 the mare had a second foal, named Regal Red. This horse started his competitive career in 2004, at which time the Appellant took expert advice and was told that he had potential as a top eventing horse, possibly even at Olympic level. At this point, the Appellant told the Tribunal, she decided to set up an equestrian business with Regal Red and his mother Opium II as the business assets. In 2007 Opium II had another foal, she was named Corn Rosa.

11. Regal Red was trained and competed by professional riders, and was stabled at his rider's yard. By 2010 he was competing at international level and was invited onto the official training programme for the London Olympics in 2012. In the event, he did not compete.

12. In 2007 Regal Red suffered an injury which meant that he had no resale value because he could not have passed the five-stage veterinary examination which was required for a sale. The Appellant continued to enter him into top level competitions and she told the Tribunal this was with a view to increasing the value of the foals of Corn Rosa. It does not appear that Regal Red won any prize money in this period.

13. In 2004 at the commencement of the equestrian business, Opium II was given a sale value of £3,500 and Regal Red was given a sale value of £12,000. Opium II's value remained constant in 2006 and 2007, but Regal Red's value was given as £25,000 then £45 – 50,000. Corn Rosa's value was given as £2,500 in April 2007 and raised to £4,500 in April 2009. By April 2009 Opium II was 25 years old, so retired as a brood mare. Consequently at April 2009 the business' stock consisted of Regal Red, who could no longer be sold and Corn Rosa, a two year old filly with a value of £4,500.

14. The Appellant told the Tribunal that Corn Rosa's performance when ridden had been unexpectedly poor and that she had required spinal surgery in 2013. In 2009 she was only two and her potential was unknown. The Appellant did not give any evidence in relation to her own assessment, nor did she refer to anyone else's

estimation, of the future value of Corn Rosa as at 2008–2009. Her evidence was that if Regal Red did well in competition then Corn Rosa's offspring would be more valuable, but the anticipated value of her foals was not quantified.

15. The Appellant told the Tribunal that her business model had involved selling Regal Red as a top competition horse. She estimated that his value would have risen to somewhere between £250,000 and £400,000 if he had continued to compete at the highest level and had not been injured. She told the Tribunal that there are other sport horse owners who have adopted the model of breeding a foal, having it professionally produced and then selling it once it has reached a high level of competition. In answer to questions from the Tribunal she said that Regal Red had not had medical insurance because it was too expensive for an event horse. She accepted that the business model was one involving a high level of risk.

16. The Appellant told the Tribunal that in 2008 she had embarked upon a new trade of asparagus farming. She explained that it takes three years to obtain the first crop but that she had anticipated that it would return a substantial profit after that period.

17. In answer to a question from the Tribunal, the Appellant stated that she had relied on professional advice and had not been advised to separate the equestrian and asparagus trades into separate business entities.

The Law

18. Section 64(1) and (2) ITA provide that a person may make a claim for trade loss relief against general income if that person carries on a trade in a tax year, and makes a loss in the trade in the tax year (the loss making year). The claim is for the loss to be deducted in calculating the person's net income for the loss making year, for the previous tax year, or for both years.

19. Section 66(1) and (2) ITA provide that trade loss relief is not available unless the trade is commercial. It is further provided that the trade is commercial if it is carried on throughout the basis period for the tax year on a commercial basis, and with a view to the realisation of profits of the trade.

20. Section 66(3) ITA provides that, 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.

21. Section 66 (5) ITA provides that if there is a change in the basis period in the way in which the trade is carried on, the trade is treated as carried on throughout the basis period in the way in which it is carried on by the end of the basis period.

22. Section 67 ITA applies a restriction to relief in cases of farming and market gardening. S. 67(2) provides that trade loss relief against general income is not available if the loss calculated without regard to capital allowances, was made in the trade in each of the previous five tax years. However, s. 67(3) (b) provides that relief

for losses will not be prevented if the farming or market gardening activities meet the reasonable expectation of profit test in s. 68 ITA.

23. Section 996 ITA defines "farming" as the occupation of land wholly or mainly for the purposes of husbandry, and "husbandry" includes the breeding and rearing of horses and the grazing of horses in connection with those activities.

24. In *Wannell v Rothwell* [1996] STC 450, Robert Walker J considered the meaning of 'commercial basis' and concluded (at page 462) that:

> "…the best guide is to view 'commercial' as the antithesis of 'uncommercial', and I do find that a useful approach. A trade may be conducted in an uncommercial way either because the terms of the trade are uncommercial (for instance the hobby market gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable cost of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance the hobby art gallery or antique shop where the opening hours are unpredictable and depend simply on the owner's convenience). The distinction is between a serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante. There may well be many borderline cases for the commissioners to decide, and such borderline cases could as well occur in Bond Street as at a car boot sale".

25. In *Macdonald (Inspector of Taxes) v Dextra Accessories Limited* [2005] UKHL 47, the House of Lords interpreted the phrase 'with a view to' in a different statutory context and held that funds would be held with a view to becoming relevant emoluments if they were held on terms which allowed a "realistic possibility" that they would become relevant emoluments.

26. We were referred to three recent decisions of the First-tier Tribunal in which there has been consideration of whether the test 'with a view to the realisation of profits' is an objective or a subjective test. In *Walls v Livesey* [1995] STC (SCD) 12, Special Commissioner Shirley held that 'with a view to the realisation of profits' was a subjective test on the part of the taxpayer. In *Charles Atkinson v HMRC* [2013] UKFTT 191 (TC), Judge Tildesley disagreed with the decision in *Walls v Livesey*, and concluded that the structure of s. 66 ITA suggests that a reasonable expectation of profit in Section 66(3) imports an objective quality to the profit element of the commercial test. In *Stephen Kitching v HMRC* [2013] UKFTT 384 (TC) Judge Cannon disagreed with Judge Tildesley's analysis. We are not bound by decisions of the First-tier Tribunal, which do not establish precedent but turn on their own facts.

Submissions

27. Mr O'Grady told the Tribunal that the Appellant's declared income from equestrian breeding for the tax years 2004–2005 to 2008–2009 inclusive was nil. He submitted that, whilst no cessation date had been given for the business, no self

employment pages for the years 2009 – 2010 and 2010-2011 had been returned for the equestrian business. There had been no self employment pages for 2009-10 and the 2010–2011 return had related to asparagus farming only.

28. He further submitted that HMRC's analysis of the tax returns shows that none of the Appellant's declared income for the years 2004 to 2009 inclusive relate to equestrian breeding or farming and only some of the expenditure claimed for those years relate to those activities. All of the income and some of the expenditure relate to the Appellant's consultancy work for The Ice Organisation Limited.

29. Mr O'Grady explained that HMRC's analysis indicates that the Appellant's losses from the equestrian trade escalated rapidly from 2006 to 2009, with losses after the deduction of capital allowances increasing from £34,452 to £43,769 to £91,780 against a background of no income.

30. HMRC's case was that the equestrian and the asparagus trades should be assessed together. They are not legally separate businesses and both were included in one self employment return, with an amalgamated claim to sideways relief. Mr O'Grady referred the Tribunal to s. 9 of the Income Tax (Trading and Other Income) Act 2005 which provides that all farming carried on by a person is to be treated for income tax purposes as one trade.

31. HMRC does not dispute the existence of a trade in this case, but Mr O'Grady submitted that the trade had not, during the 2008-9 tax year, been carried out on a commercial basis with a view to the realisation of profits. In response to Mr Bottrill's submission with regard to the long-term nature of horse breeding (see paragraph 34 below), he submitted that the Appellant's business was clearly not a thoroughbred stud farm in relation to which industry- specific concessions had been made, and these could not be applied more widely.

32. Mr O'Grady referred the Tribunal to the decision in *Wannell v Rothwell* (referred to at 24 above) and to the distinction between the trader who is seriously interested in profit and the amateur or *dilettante*. HMRC's case was that the Appellant was shown by the evidence to fall into the latter category. Mr O'Grady submitted that the Appellant's business model could only have been viable if she had purchased more brood mares and produced more foals. If Regal Red was the only asset of value then the business model was too precarious to regard there as being a commercial basis for the trade. By April 2009, Regal Red had no sale value and Corn Rosa was only two, so her potential as a competition horse or a brood mare was unknown. Mr O'Grady pointed to the pattern of losses over the five years to 2009 and the fact that the equestrian trade produced no income and asked the Tribunal to find that there was no "realistic possibility of profit" for the equestrian trade, applying the objective test.

33. With regard to the asparagus trade, Mr O'Grady submitted that if the first crowns were planted in 2009 and no crop was expected for three years, it is difficult to see how the commencement of the asparagus venture could, in the 2008-2009 year, have influenced the Appellant's expectation of profit.

34. Mr Bottrill submitted that s. 68 ITA could be relied upon by the Appellant to defeat s. 67 because the reasonable expectation of profit test has been met. He referred the Tribunal to HMRC guidance in relation to the breeding of thoroughbred horses, which states that HMRC has recognised the long-term nature of such a business and would not usually seek to invoke the s. 67 provisions until 11 years after the start of the business.

35. It was submitted on behalf of the Appellant that the majority of the losses claimed in the 2008-9 tax return related to the start up costs of the asparagus trade. Mr Bottrill submitted that HMRC had ignored the growing of asparagus as a commercial concern and wrongly concentrated on the equestrian trade losses. He submitted that the asparagus business fell under the heading of market gardening for tax purposes and should be treated differently from the farming trade, which falls under the heading of farming. He submitted that the Appellant is excluded from the ambit of s. 996 for this reason and that sideways loss relief should properly be split into two categories for the 2008-2009 tax year.

36. In his closing submissions, Mr Bottrill submitted that if Corn Rosa had competed then her value would have increased and that the Appellant had an expectation of profit from the sale of Corn Rosa.

Conclusion

37. This appeal concerns the question of whether the claim for losses relief in the 2008-2009 tax return was correctly made. We note that the Appellant's three trades (consultancy, equestrian breeding and asparagus farming) were included in one tax return. She is a sole trader and has not established any of her trades as legally separate entities. As an amalgamated claim to tax relief was made in respect of the equestrian and asparagus trades, we conclude that HMRC was correct to consider the Appellant's claim to relate to one composite trade for the purposes of applying s. 66 ITA. We also conclude that this analysis requires us to apply the statutory test across both businesses as a composite whole. We reject Mr Bottrill's submissions that the asparagus and equestrian businesses qualify for separate tax treatment in this case. It seems to us that it is now too late to present those arguments, having submitted a composite return for the year in question, although there may be ways to establish that the trades should be treated separately in future returns.

38. We understand the statutory scheme as follows. There are two conditions which must be satisfied if sideways relief is to be available. The first is that the trade must be carried on on a commercial basis. The second is that the trade must be carried on with a view to the realisation of profits. We understand the statutory test to be that if it is established that there is a reasonable expectation of profit, then the trade is to be treated as though carried on with a view to the realisation of profit. If it is not established that there is a reasonable expectation of profit then it is still open to the taxpayer to seek to establish that she carried on the trade with a subjective view to the realisation of profit. We do not consider that the Appellant has to establish that she expected a profit to occur in the tax year in question, and that it is open to her to show that the profit was expected to occur at some time in the future. We reject Mr

Bottrill's submissions with regard to s. 68 as we consider that the provisions to which he referred relate only to thoroughbred horse stud farms. He did not address us as to how s. 68 might apply in any other circumstances.

39. Applying this test, we do not find that the Appellant's trade (comprising both elements) was carried on on a commercial basis in the relevant period. We note that in the five years up to the tax return in this appeal, the equestrian breeding business had made a nil profit and faced escalating costs. We accept that Regal Red had a good prospective sale price prior to 2007, however after that time he was said to have no sale value at all. The Appellant referred us to the possibility that Regal Red might have won prize money even after 2007, but we note that the Appellant's trade was stated to be that of an "equestrian breeder" so income from competition does not seem to us to be relevant to the question of whether her trade was conducted on a commercial basis. Even if we are wrong about that, and Regal Red's successes could increase the value of Corn Rosa's foals, there was no evidence of any winnings from Regal Red. It was accepted that the Appellant's other horses had minimal value in the year in question. We consider that an equestrian breeding business which made no money but bore the costs of keeping three horses, namely a mare past her breeding age, a gelding, and filly whose future was then uncertain, cannot reasonably be described as a venture being run on a commercial basis. We find that during the period in question the Appellant's equestrian breeding trade bore the characteristic hallmarks of an amateur or *dilettante* venture, run by someone who clearly loved her horses but who was not seriously interested in profit. The asparagus venture appears to have the hallmarks of a more professional enterprise and we accept, from the little that is known about its operation in 2008-2009, that it was run on a commercial basis. However, as we have found above, we are required to assess the two ventures as a composite whole and we find that, taken as a whole, the Appellant's trade was not run on a commercial basis because it included the uncommercial element that we have described above.

40. Turning to the question of whether the trade was made with a view to the realisation of profits, we find that this was not so in the period in question. Whether we take a subjective or an objective view of the situation, the evidence was that in relation to the equestrian breeding business the stock consisted of a mare past her breeding age, a filly whose potential was unknown and a gelding with no sale value. The Appellant's evidence was unsatisfactory as to how she had thought that her trade could make a profit in the future, except to point to Corn Rosa's potential as a brood mare if Regal Red did well in competition. Mr Bottrill's submission at [36] above was unsupported by evidence. Unlike Regal Red, in relation to whom there was evidence other than that of the Appellant's own opinion that he was (prior to 2007) a horse with extremely high potential, there was no such evidence produced in relation to Corn Rosa. We find that that in 2008-2009 there was no reasonable expectation of profit from Corn Rosa and there was no evidence, other than from the Appellant herself, from which we could conclude that the Appellant expected her equestrian business to realise a future profit as a result of Corn Rosa's prospects. Having heard from the Appellant on this point, we were not satisfied on the balance of probabilities that even she held this view at the relevant time.

41. We find on the basis of the evidence that the Appellant did have a view to the realisation of profits in relation to the asparagus venture, albeit that it was at a very early stage in the year in question. However, looking at the composite return, it is difficult to see how she could have had a view to the realisation of profits for the two businesses taken together, in view of the escalating losses of the equestrian venture and taking into account the anticipated delay before any asparagus crop could be sold.

42. For all the reasons given above, we have concluded that the Closure Notice and amended return should stand and that the Appellant's appeal should be dismissed.

43. 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.

ALISON MCKENNA
TRIBUNAL JUDGE

RELEASE DATE: 30 July 2014