



A recent tax case has highlighted that farmers who are not hobby farmers but make continued losses can have sideways loss relief restricted under the tax legislation. **Julie Butler** examines the issues

**H**usbandry, or ‘real’ farming as it might be called, has been facing problems of commerciality and survival over recent years. Most farming enterprises tackle the problem of producing a commercial profit from husbandry operations by diversifying into alternative property use. The question has to be, does this give rise to income from property or trading income? HMRC has asked this question in the context both of income tax and inheritance tax (IHT).

**FACTS OF THE CASE**

In the recent case of *Henderson v HMRC* TCO4730, the taxpayer, Mr Henderson, was a farmer whose farming activities had run at a loss since 2002/03. His income was supplemented by rent from a tenancy agreement to excavate gravel

from a quarry on his farmland.

Mr Henderson claimed income tax relief for the three years ended 5 April 2012 in respect of his farming losses against his rental income and also against his capital gains tax (CGT) liability arising from the disposal of part of his farm.

HMRC refused Mr Henderson’s loss claim on the basis that s67(2), Income Tax Act 2007 (ITA 2007) applied because the taxpayer had made losses in the previous five years and there was no reasonable expectation of profits (s67(3)).

**INCOME FROM MINES AND QUARRIES**

There were two grounds for Mr Henderson’s claim: either that the farming losses could be claimed generally if the property income he received was part of his

farming/trade income, or if not, claimed ‘sideways’ against that property rental income under s64, ITA 2007.

The First-tier Tribunal (FTT) said that, under s12 and s335, Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005), profits arising from concerns such as mines and quarries were taxed as if they were from trades even though the source of the profits was the land. This is how the tenant would be taxed. However, the taxpayer’s rental income was instead chargeable to tax under s335, ITTOIA 2005 as property income and could not be part of his general trading income.

**REASONABLE EXPECTATION OF PROFIT FROM FARMING**

The FTT decided that on sideways loss relief, the taxpayer had provided no evidence that he intended to make a profit in future years. Mr Henderson had been living on his rental income and by selling parts of his land, and could not be regarded as having a reasonable expectation of profit. The judge accepted that he was not a hobby farmer, but said the restriction in s67(3), ITA 2007 applied.

**ACTION POINTS**

The case raises various interesting points. First, it highlights the lack of profitability of many traditional farming operations and the need to tax plan around this at a general and specific level. Identification of the farm loss is key; it is important for this not to be muddled up with the trading results of the diversification operation.

Second, it is crucial to have business plans that show the farming operation does have a reasonable expectation of making profits.

Third, if diversification profits are to be part of the general income of the farming business, it is important to trade from land, not receive rental income from land, eg in this case to undertake the quarry operation ‘in hand’. In practice this may be difficult, highlighting the tax plight of the farmer and the challenges of tax planning in 2016. This need to trade as opposed to receive rent has been highlighted in a number of recent business property relief cases for IHT: eg, *McCall (McCall and another v HMRC* [2009] NICA 12), *Zetland (The Trustees of David Zetland Settlement TCO2690)* and *Buller (John Best (executor of the estate of Alfred William Buller deceased) v HMRC* [2014] TCO3217). ■



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