Relief for the owners of empty properties

Dean Monk examines the case of Rossendale, *a Court of Appeal decision approving steps taken by property owners to mitigate their business rates liability*

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'While the Supreme Court was unanimous on the "evasion" principle, it was divided on whether the principle could be expanded in the future. The billing authorities sought to exploit this by arguing that the principle ought to be expanded on account of the owners having sought to divest themselves of an anticipated liability via the SPV.'

Once a property becomes vacant and the property owner becomes 'entitled to possession', the owner becomes eligible for 'empty rates relief', reprieving the owner from paying national non-domestic rates, or more commonly known as business rates, for the first three months. However, after the initial three months' relief, an owner is liable to pay full rates.

In the absence of any official statistics, some commentators estimate that 10-20% of the total rates revenue (estimated to be £25bn in 2019-20) derives from owners paying rates on empty premises (despite billing authorities estimating that they will grant £4.9bn in rates relief in 2019-20; £880m of which will be empty rates relief).

Given the sums involved, it is therefore not surprising that many owners seek to mitigate their liability. One such example is the case of *Rossendale Borough Council v Hurstwood Properties* [2019], concerning mitigation schemes whereby an owner sought to avoid its rates liability by granting a lease to a newly incorporated special purpose vehicle (SPV), which then either entered into voluntary liquidation, or allowed itself to be struck off at Companies House. The letting arrangement had no commercial purpose, other than to shield the owner from rates.

The issues for the court were:

- could the corporate veil of the SPVs be pierced in order to defeat the mitigation scheme; and
- could the leases be disregarded by virtue of the '*Ramsay* principle' (ie should the court adopt a purposive approach by holding that the rates legislation prohibited this type of mitigation scheme)?

The billing authorities only needed to succeed on one of these two issues to prevail overall.

The court decided against the billing authorities on both issues, holding that the leases – which were properly executed, albeit only executed in order to avoid tax – successfully passed the liability for rates to the SPVs.

Ramifications of the decision

There are various ways that an owner can mitigate its empty rates liability. One option is to take advantage of the cyclical nature of empty rates relief, which is re-triggered every time the premises is occupied for six weeks (the owner can therefore cycle relief on-and-off by occupying the property for six weeks, then vacating for three months). However, this can be a logistical burden and the owner is still obligated to pay rates during the period of occupation.

In an attempt to receive a full reprieve from rates some owners, such as those in this case, have sought to operate slightly riskier mitigation schemes.

By upholding the legality of these schemes and refusing to bring morality into its decision, the Court of Appeal has provided ratepayers with a big win. However, now that rates collection has been devolved to

billing authorities who get to 'eat what they kill', it seems likely that billing authorities and ratepayers will continue to clash.

The facts

This is an appeal of a High Court decision. At first instance, there were 55 cases involving similar mitigation schemes due to be heard in the Liverpool branch of the Chancery Division (the total rates liability across all 55 cases was c.£10m, though it is unclear how many cases outside of Liverpool eagerly awaited the decision).

Two out of the 55 cases were chosen to be heard as a test case, the facts of which are as follows:

- The owner granted a lease to an SPV.
- The lease had no commercial benefit (the lease was for a peppercorn rent never collected; it could be terminated on short notice; it could not be terminated due to an insolvency event; the SPVs did not carry on business, nor was it intended that they would).
- In one of the two cases, the SPV entered into voluntary liquidation days after the lease was granted. In the other, the SPV effectively allowed itself to be struck off at Companies House through inaction.
- The owners' view was that granting the leases would shield them from rates liability.
- The billing authorities took the view that the schemes were unlawful and pursued the owners.

Issues

The issues to be decided by the Court of Appeal were:

(1) in these circumstances, could/should the court pierce the corporate veil of the SPVs; and/or

(2) in these circumstances, could/should the court disregard the lease by virtue of the principle in *WT Ramsay Ltd v Inland Revenue Commissioners* [1981].

If the billing authorities were successful on issue one and the corporate veil of the SPV was indeed pierced, the SPV's separate legal personality would be disregarded and the owner would be deemed to have granted the lease to itself, thus making the lease a nullity and placing liability on the owner.

If successful on issue two by convincing the court that it should interpret the rates legislation purposively, the leases would be disregarded and the owner would again be liable.

Partial success at first instance

The High Court held that the leases were genuine and not a 'sham' (ie they had been created lawfully, notwithstanding the morality of the motivation to execute them). On issue one, the High Court held that the law relating to piercing the corporate veil was developing and the billing authorities had a reasonable prospect of success at trial. On issue two, the High Court was unconvinced that it could or should utilise the *Ramsay* principle and struck out those elements of the billing authorities' particulars of claim.

The parties both appealed on the respective parts of the case that they lost and it was consequently left to the Court of Appeal to determine the first and second issues. It is important to note that the finding that the leases were genuine and not a sham was not in issue.

Background law

Before we delve into the arguments, it's helpful to be aware of the following provisions in the rates legislation:

- Where premises are occupied, rates are payable on a day-by-day basis by the person in occupation of the property on any given day (the relevant legislation is set out in s43(1)-(3) of the Local Government Finance Act 1988).
- For empty premises, the statutory regime is different and s45(1)-(3) applies (the key provisions are emphasised):

  (1) A person (the ratepayer) shall as regards a hereditament be subject to a non-domestic rate in respect of a chargeable financial year if the following conditions are fulfilled in respect of any day in the year –

  (a) on the day none of the hereditament is occupied,

  (b) *on the day the ratepayer is the owner of the whole of the hereditament*,

  (c) the hereditament is shown for the day in a local non-domestic rating list in force for the year, and

  (d) *on the day the hereditament falls within a description prescribed by the Secretary of State by regulations.*

  (2) In such a case the ratepayer shall be liable to pay an amount calculated by –

  (a) finding the chargeable amount for each chargeable day, and

  (b) aggregating the amounts found under paragraph (a) above.

  (3) A chargeable day is one which falls within the financial year and in respect of which the conditions mentioned in subsection (1) above are fulfilled.

- On the expiry of empty rates relief (which, as stated earlier, expires three months after the property becomes vacant), the owner becomes liable for full rates for each day that the property is unoccupied (NB – it is worth noting that up until 1 April 2008, the owners of unoccupied properties were entitled to 50% relief on rates, before this was removed by the Rating (Empty Properties) Act 2007).
- To elaborate on s45(1) of the Act, a ratepayer is liable if four conditions are met:

  (1) On the given day, the property must be unoccupied

  This was not in issue between the parties.

  (2) To be liable, a person must be the 'owner' of the property

  This is defined in s65(1) of the Act as 'the person entitled to possession of it' and it is trite

law that a tenant under a lease is the 'owner' for the purposes of rates (*Brown v City of London Corporation* [1996]).

(3) The property must be shown on the rating listing

Again, this was not in issue between the parties.

(4) On the given day, the property must fall within a class prescribed by regulations

The owners were seeking to rely on an exemption which provides that any property whose owner is a company 'which is being wound up voluntarily' is exempt from paying rates (through a combination of Regs 3 and 4 of the Non-Domestic Rating (Unoccupied Property) (England) Regulations 2008 and Reg 4(k) of the Insolvency Act 1986).

- In one of the schemes, reliance was placed on the exemption set out in the fourth condition set out above (ie that the company was exempt from rates as it was being voluntarily wound up); while in the other scheme the reliance was on the lease having passed *bona vacantia* to the Crown following the dissolution of the company (taking with it the rates liability, although it was not explored whether the Crown would instead be liable for rates).

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Everything therefore turned on whether the leases granted to the SPVs were lawful and would survive interrogation from the court. If the corporate veil of the SPVs could be pierced, or the leases disregarded by applying the purposive approach of the *Ramsay* principle, the mitigation schemes would fail.

Judgment

The appeal was heard by David Richards LJ, Henderson LJ, and Baker LJ. Interestingly, presumably due to their differing technical backgrounds/expertise, the Lord Justices divided the issues between them – Richards LJ dealt with issue one in his judgment, and Henderson LJ dealt with issue two in his (albeit the Lord Justices all concurred with one another and gave a unanimous decision).

Issue one: Piercing the corporate veil

The billing authorities predominantly based their case for piercing the

corporate veil on *Prest v Petrodel Resources Ltd* [2013], where the Supreme Court unanimously agreed that the corporate veil could be pierced where:

> ... a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control.

However, while the Supreme Court was unanimous on this 'evasion' principle, it was divided on whether the principle could be expanded in the future. The billing authorities sought to exploit this by arguing that the principle ought to be expanded on account of the owners having sought to divest themselves of an anticipated liability via the SPV.

The Court of Appeal held that the evasion principle did not apply to the current set of facts, on the basis that liability for rates is not an existing liability. Once the leases (which were genuine and not a sham) were granted, the liability to pay rates day-to-day passed to the SPV.

In refusing to extend the evasion principle, the court was influenced by its findings that the SPVs had not been used as an engine of fraud or to take an unconscionable advantage, and that it was open for ratepayers to organise their affairs so as to avoid tax. Provided that those affairs were organised lawfully, the morality of the ratepayer's motivation was irrelevant.

Issue two: *Ramsay* principle

The *Ramsay* principle is the doctrine of purposively interpreting statute so as to give effect to what it is trying to achieve. While there is no general fetter on a party entering into a transaction which includes elements which are bereft of any commercial benefit other than to avoid tax liability, the *Ramsay* principle may thwart such a transaction if the purpose of the applicable tax regime is that liability should not be avoided in such a way.

It was decided that the wording of the Act (as set out above) was sufficiently straightforward and there was no scope for an alternative interpretation of s45(1)(b), which must logically be read as meaning 'on the day the ratepayer is the person entitled to possession of the whole of the hereditament'. As it is trite law that a tenant under a lease is the person entitled to possession, the lawful execution of the lease meant that both the right to legal possession of the property and the obligation to pay rates passed to the SPV.

The motivation of the owner was irrelevant and the court was not persuaded by the billing authorities' arguments that 'Parliament cannot have intended to allow this sort of thing'.

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Conclusion

While the decision may be appealed (permission was denied by the Court of Appeal, though it is unknown whether permission has been sought from the Supreme Court), the key take-home points as it stands are as follows:

- Given the recent spate of retail tenants entering into insolvency, the survival of this brand of mitigation scheme will be welcome news for landlords who can soften the sting of any voids.
- The decision offers practical guidance for owners wishing to operate this form of mitigation scheme (ie owners should take care to ensure that their letting arrangements are properly documented).
- The Court of Appeal has effectively signalled to Parliament that it is for them to prevent any perceived 'abuse' of the rates legislation as it applies to empty rates. While it would seem unlikely that this is a priority for Parliament given the ongoing Brexit saga, the Treasury Committee has in fact launched an inquiry into rates reform and the public consultation stage ended on 5 April 2019. In the British Property Federation's submission (which will no doubt be one of the largest and more influential groups to make a submission), it was advocated that empty rates should be reduced to 25% of the normal rate and the rate-free period after a tenant vacates extended from three to six months.
- This case furthers the trend of rating becoming an increasingly litigious world and follows a raft of recent decisions in the higher courts which have had mixed results for ratepayers: *Newbigin v SJ & J Monk* [2017] (owners carrying out significant work or refurbishment are exempt from rates during the works); *Woolway v Mazars* [2015] (ratepayers occupying different floors of a building where those floors can only be accessed via lifts or shared staircases will have their floors rated separately, thus increasing liability); *Cardtronics Europe Ltd v Sykes* [2018] (ATMs in supermarkets should not be assessed separately for rates purposes, thus decreasing liability). ■

Brown v City of London Corporation
[1996] 1 WLR 1070

Cardtronics Europe Ltd & ors v Sykes & ors
[2018] EWCA Civ 2472

Newbigin v SJ & J Monk
[2017] UKSC 14

Prest v Petrodel Resources Ltd & ors
[2013] WTLR 1249

Rossendale Borough Council v Hurstwood Properties & ors
[2019] EWCA Civ 364

WT Ramsay Ltd v Inland Revenue Commissioners
[1981] UKHL 1

Woolway v Mazars
[2015] UKSC 53