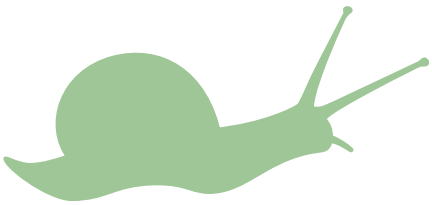
Clive Moys

Clive Moys reflects upon a recent High Court decision and its possible ramifications ■

Shams, snails and empty property rates



Overview

The purpose of this article is to bring to the attention of readers an important recent High Court decision concerning the application of the common law doctrine of **"sham"** to a series of leases of office premises in Leeds. The upshot of the decision was that a significant liability order made by District Judge Holland, in Leeds Magistrates' Court in April 2020, was found – on the hearing of a case stated – to be correct and the appeal dismissed.

The article is in three parts: Part 1 Introduction: sets the scene and context; Part 2 considers and discusses the case as it appears from the law report; Part 3 looks at some possible implications of the decision.

Part 1: Introduction

1966 was a momentous year which saw England win the World Cup. Far less well-known is that 1966 marked the beginning of a new chapter in the history of rating law, with the introduction of empty property rates[1]. Rating as a UK tax based upon the occupation of land and buildings has, as is well-known, a very long provenance[2]. Such longevity may be explained by the relative ease of imposing the tax, together with the inherent equity of taxing part of the wealth generated from the activity and enterprise which the occupation of land and buildings facilitates to fund local services[3]. By contrast, the levying of rates upon empty property – which will not generate a rental income to the owner – has been described, typically by those in the business of devising rates avoidance schemes, as **"a tax on failure"**.

Milestones on the journey to where we are today were reached in 2007[4] and 2008[5] with non-domestic rates (**"NDR"** or **"rates"**) being levied using the same multiplier (poundage in the pre-1990 rating world)[6] irrespective of whether the hereditament was occupied or unoccupied. The 2008 financial crisis helped create the conditions in which owners of empty property would soon begin to cast around for, and adopt, NDR mitigation or rates avoidance arrangements.

The 2013 advent of billing authorities retaining 50% of the NDR which each is able to collect has incentivised local councils in their administration, collection, and enforcement of NDR[7].

As was noted by the judge in *Makro*[8]: *"It has been recognised for a considerable amount of time that ratepayers can and do organise their affairs so as to avoid paying rates."*

The purpose of this article is not to consider the various rates avoidance schemes currently on offer in the marketplace which have been the subject of reported case law – of which there is now a reasonable body – but rather to reflect upon the interesting recently reported decision in *Isle Investments Ltd. v. Leeds City Council*[9], together with its possible ramifications.

Part 2: What was decided in Isle?

The essence of the decision in Isle was that the rates avoidance arrangements entered into were ineffective because the leases involved were held to be "shams". The arrangements concerned office premises at Units 2, 4 and 7 Airedale House, Beeston, Leeds which Isle Investments Limited (**"Isle"**) had acquired. As the offices looked set to be empty and unoccupied for the immediately foreseeable future, meaning that Isle would be faced with an NDR liability for the property as **"the Owner"**[10], it contacted Crusader[11] (EPRA) Limited (**"Crusader"**)[12], a firm specialising in empty property rates mitigation.

How much NDR was at stake and how was the scheme supposed to work?

Between 24th May 2018 and 31st March 2020, the potential NDR liability for the three

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office premises totalled £105,728. Crusader agreed to "implement a scheme designed to achieve Isle's NDR avoidance objective"[13], in return for Isle paying Crusader a fee of 20% of Isle's prospective liability. Crusader's legal team prepared a series of leases entered into between Isle and various newly formed off-the-shelf companies. The key lease terms were: term length, 21-weeks; user, heliciculture (aka snail-farming); rent, £1; tenant covenant, tenant liable to pay all business rates due.

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Each 21-week lease identified Isle as the landlord, and a newly formed off-the-shelf company, Property Alliance (9) Ltd. – or with the same name – but a different number in parenthesis, as the tenant. These newly formed companies – each sharing the same registered office as Crusader and with a common director in Mr Terence Ball – may well not have had any assets from which to meet NDR demands which the billing authority might have tried to collect[14].

Leeds City Council in fact applied for and obtained a liability order against Isle on the basis that the leases were **"shams"**; hence they were void, or of no legal effect. The leases created the impression that the tenant was entitled to exclusive occupation of the respective office premises – and hence liable for the NDR – but that was, in truth, merely a **"pretence"**. In other words, an act or a document created or designed and intended to give a false impression to a third party or the court of the actual rights and obligations which the parties created *inter se*.

The consequences of a legal finding of "sham" were significant in this case. A £105,728 liability order was made and upheld. Isle was ordered to pay the billing authority's legal costs of £23,107.36 on the appeal, and £15,772.62 in the magistrates' court.

As to the future, it is important to look closely at Isle to try and identify why the billing authority succeeded.

What is a sham?

A sham has been judicially described as a **"very simple"** concept[15]. Essentially, it means acts done or documents created by the parties to "the sham" which are intended to give to third parties or the court the appearance of creating legal rights and obligations which are different to the actual legal rights and obligations they really intended to create.

As it is necessary to carefully analyse the facts of any given case so as to be able to rebut the presumption of regularity – and to find a "sham" – which encompasses an element of dishonesty, it is worth considering the specific factual circumstances in Isle which led the district judge to conclude that the leases were "shams" – and the High Court to agree and dismiss the appeal.

It is also important to consider those facts with the legal concept of, or test for, a "sham" well in mind.

As to the law, Fordham J. in Isle said this[16]:

"A sham is an arrangement involving an intentional mismatch between the apparent nature of the relationship and the true nature of the relationship, so as to give a false impression to third parties or a Court. As Arden LJ explained in Hitch[17]: the "essence" is that the parties to the transaction intend to create one set of rights and obligations but do acts or enter into documents which they intend should give third parties … or the court, the appearance of creating different rights or obligations …".

The facts of Isle as found by the judge, may be viewed from two separate perspectives. First, those relating to the rights and obligations which the parties – i.e., Isle, together with the various tenant companies, and Crusader – appeared to create by the lease arrangements, as contrasted with the actual rights and obligations which the parties really or truly intended to create between themselves.

Apparent rights and obligations created by and between the parties

Evidence was given by a director of Isle, Mr Jonathan Ainsworth-Jackson. Isle wished to avoid having to pay NDR on the empty offices – hence it made contact with Crusader – entering into an arrangement pursuant to which Isle paid Crusader 20% of the NDR due on the offices. In return, Crusader would implement a scheme designed to achieve Isle's rates avoidance objective.

On the face of it, the scheme involved a series of short (21-week) leases made between Isle, as landlord, and newly created off-the-shelf companies named Property Alliance (9) [or various other numerals]

Ltd., as the tenant on the principal terms identified above.

The essential rights and obligations were the grant by Isle of the right of exclusive occupation of the office to each of the various companies named in each lease, subject to the terms and conditions as there set out. Additionally, the concomitant obligation of each company to pay the NDR due to the billing authority based on their occupation.

Eyebrows raised

The features of the apparent nature of the relationship which appear to have aroused the billing authority's suspicion – and also weighed with the judge – are as follows: first, the snail-farming user restriction in leases of office premises was, to put it mildly, **very strange**. The judge found this would have meant that the premises could not have been used for the purpose prescribed under the lease. Secondly, a rent of £1 was, plainly, not a market rent. Thirdly, why would a "genuine tenant" take on a contractual (pursuant to the lease), as well as a statutory obligation (as the rateable occupier), to pay NDR when it was not apparent how its occupation would generate any income to meet such a liability?

It is settled law that in the case of a document, such as a lease, the court is not restricted to examining the four corners of it but may also examine external evidence – including explanations given by the parties and circumstantial evidence, such as evidence of subsequent conduct[18]. In sum, courts are required to pay attention to what people do as well as what they say. The factual enquiry can, and should, include questions of practical reality.

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Council officers inspected, or attempted to inspect, on three occasions. They observed that: the water supply was turned off, there was no caretaker and the key holders who let them in appeared to have very little knowledge of on behalf of whom they acted or represented.

Actual rights and obligations created by and between the parties

The judge found, importantly, that the actual user was a practical impossibility. In other words, snail-farming could not have been carried out from office premises.

Inferences

The judge inferred that the parties never intended that:

(a) the various tenants would actually occupy the premises;

(b) they would use the premises for snail farming in accordance with the user restriction in the leases;

(c) or pay any NDR, because if the billing authority were to seek to collect NDR on the basis of the tenants' rateable occupation, then the respective newly formed company would be placed into administration so as to defeat such a claim and could then be replaced by another off-the-shelf company with the same name but a different numeral.

Dishonesty

A necessary ingredient of the legal concept of a sham is that there is some degree of dishonest intention. Having heard his verbal evidence, which was tested by cross-examination, the judge was satisfied that Mr Ainsworth-Jackson was dishonest in the sense of having an intention (in common with the moving spirit behind Crusader) to pretend that the leases were genuine when, in truth, he knew how the scheme would really work, and that the parties would not be honouring their primary rights and obligations. In other words, the various companies formed by Mr Bull would never occupy the offices for snail farming purposes; nor did they really intend that such companies would ever pay NDR.

Presumption of regularity

The question of whether a document is effective to achieve its purpose arises in many different legal contexts. In the context of rating the aim, typically, of NDR mitigation (e.g., occupation or ownership by charities) or NDR avoidance – e.g.,

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shifting liability from a person who would be the liable ratepayer, but for the avoidance arrangement/mechanism – onto a party who, typically, is **"a man of straw"** who cannot, or never will, pay any NDR demanded.

The courts are slow to find that an agreement is a sham. The presumption that what parties say on the face of their documents is what they truly mean and intend to be their respective rights and obligations, has been explained as follows[19]:

"Both principle and authorities indicate that the court is slow to find that an agreement is a sham, and that before the court can reach such a conclusion it must be satisfied that the purported agreement is no more than a piece of paper which the parties have signed, with no intention of it having any effect save that of deceiving a third party and/or the court into believing that the purported agreement is genuine."

In the end it is for a judge who, having heard all the evidence adduced by the parties and observed the witnesses give their testimony, and seen that evidence tested by cross-examination, to find the facts and resolve the issue. **Genuine or sham?** As with any judicial determination, in practice judges attach significant importance to the sheer likelihood, or unlikelihood, of an event having happened as a witness testifies[20].

Part 3: Ramifications

It is not unreasonable to suppose that those who design rates avoidance schemes may look again at the documentation which they use, perhaps astute to try and make good any deficiencies so that a sham looks more convincing. For example, the snail-farming user restriction in Isle could be regarded as something of an own goal, not to be repeated.

From the perspective of hard-pressed billing authorities there is much to think about if they find themselves faced with a similar situation in which the landlord and tenant arrangements bear the hallmarks of a sham, created so as to avoid an owner being liable for NDR due on its unoccupied property once the three- or six-month (qualifying industrial hereditaments) void period has elapsed.

Best practice: Inspection

Whilst there are only 24 hours in a billing authority's revenue and benefits department's day, with many demands upon officers' time and resources, the value of physically inspecting premises should be stressed. What is seen (or, in some cases, not there to be seen) can be contemporaneously recorded by photographs, notebook entries and so forth, and provide valuable evidence to supplement the recollection of inspecting officers who undertake such visits. In Isle the evidence and information gathered from the three visits carried out by council officers was important in the judge's decision-making.

Publicly available records and information

HM Land Registry provides office copy entries and filed plans of registered freehold and leasehold titles for a modest charge. The Companies House website also provides important information – freely available to download and print – concerning companies formed and registered in England and Wales e.g., the date of incorporation; names of directors and secretary; address of registered office; financial statements and accounts, and so forth. The Charity Commission's website contains important information about registered charities which is freely available. The Valuation Office Agency website also provides important publicly available information about individual hereditaments – including the premises address; their description; rateable value; and effective date of compiled list alterations. Additionally, a Google search can, depending upon the search terms used, generate information which may be relevant.

Billing authority records

In addition to a billing authority's own rating records, its own planning, building control and street naming departments may, depending upon the nature of the case, hold information of relevance.

Hallmarks of a sham

Actual conduct may be telling in the search for evidence of a common intention to perpetrate a pretence or sham. For example, in Isle, as part of its investigations the council had written to Property Alliance (9) Ltd. – the tenant of one of the units according to the lease – which elicited a written response in March 2019 denying that they operated any sort of snail breeding or snail production scheme; disavowing any connection with snails in any capacity – it asserted that:

"… being a property letting company … we have not used or placed snail boxes in this or any other property that we are associated with."

And yet the leases imposed a heliciculture user restriction which had been drafted by Crusader. This, together with the failure by Isle to carry out any due diligence upon its tenant, clearly weighed with the judge.

In the wake of COVID-19

As we cautiously emerge from the pandemic and lockdown, coming to terms with the **"new normal"**, it seems inevitable that a considerable amount of retail and office space will either remain, or become, vacant. **"Grey space"** or **"tenant release space"** is again on the rise[21] and the surplus of unoccupied property may well create a situation where more owners seek to avoid NDR otherwise due on their empty property.

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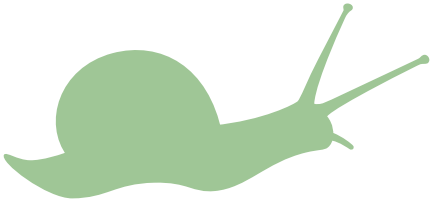
Keeping the bigger picture in mind, it is, of course, possible for owners to take action (e.g., strip back to a bare shell) so as to ensure that their hereditament is incapable of beneficial occupation, and so not liable for NDR because there is no hereditament capable of being valued[22]. There will, inevitably, be difficult borderline cases.

The right to occupy

It is also important to keep in mind that liability for empty property rates is placed upon the owner of the vacant hereditament. Because "the owner" is defined as "the person entitled to possession"[23] this may not be the freeholder. Hence it may be necessary to consider derivative leasehold interests,



which could include under-leases carved out of a head lease. There may also be the terms of a licence to consider when asking: Who is entitled to possession of this hereditament?

Regulation 4 exemptions

The legislative scheme of liability for unoccupied property rates sets out conditions, at (a) – (m) which, where satisfied, will take the property out of the ambit of empty property rates[24]. For example, regulation (k) "whose owner is a company which is subject to a winding-up order made under the Insolvency Act 1986, or which is being wound-up voluntarily under that Act." Regulation (l) provides a similar exemption for companies in administration. At the time of writing the decision of the Supreme Court in the appeal in Rossendale is awaited[25].

Takeaways

The important points for readers to take-away are as follows: first, the common law (i.e., judge made) legal concept of "sham" is alive and kicking with rates avoidance schemes within its reach. Secondly, where a sham is proved the court sees through the pretence resulting in the "offending documents" being of no effect. Thirdly, as there is a presumption of regularity, careful thought and presentational clarity is needed to make good an allegation of sham. Fourthly, as it is also necessary to show dishonest common intention it is prudent to make plain what the billing authority suspect, inviting comment/explanation about the documents and arrangements which arouse suspicion. Fifthly, effective rates avoidance intent does not, of itself, equate to a "sham". Lastly, the acid test is to ask: Is this lease or licence, and/or other relevant part of these **"arrangements"** which arouse suspicion, really intended to be genuinely acted upon by the parties? Or is it nothing more than a mask to conceal the reality? If it is the latter, then behind the mask is a sham.

FOOTNOTES:

1 Local Government Finance Act 1966
2 Poor Relief Act 1601 – often cited as the beginning of rating
3 Efficiency of collection, high level of revenue raised and relative difficulty of evasion – summary of responses Business Rates Review: Interim Report, March 2021
4 Rating (Empty Properties) Act 2007
5 The Non-Domestic Rating (Unoccupied Property) (England) Regulations 2008 (SI 2008/386)
6 Local Government Finance Act 1988
7 Local Government Finance Act 2012
8 *R (Makro Properties Ltd.) v. Nuneaton & Bedworth B.C.* [2012] EWHC 2250 (Admin) HHJ Jarman QC
9 [2021] EWHC 345 (Admin)
10 LGFA 1988, s. 45(1)
11 Person entitled to possession LGFA 1988, s. 65(1)
12 Company incorporated on 17 July 2019 with a registered office at residential premises in Preston
13 Judgment, para. 2, p. 2
14 Companies House website
15 Mostyn J in *Broxfield Limited v. Sheffield City Council* [2019] EWHC 1946 (Admin)
16 Para. 8, p. 6
17 *Hitch v. Stone* [2001] EWCA Civ 6
18 *Hitch* op cit. para. 64
19 *National Westminster Bank plc v. Jones* [2001] 1 BCLC 98, Neuberger J
20 The Business of Judging 2002, Thomas Bingham LJ
21 Savills, Markets in Minutes: City Office Market Watch March 2021
22 *Monk v. Newbigin* [2017] 1 WLR 851
23 LGFA 1988, s. 65(1)
24 SI 2008 No. 386, regulation 4
25 *Rossendale BC and others v. Hurstwood Properties (A) Ltd. and others* UKSC 2019/0071.

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