Case Name: *The Secretary of State for Business, Energy and Industrial Strategy v PAG Asset Preservation Ltd and MB Vacant Property Solutions Ltd* [2019] EWHC 2890 (Ch) (30 October 2019)

Topic: Rates mitigation – use of insolvency regime

Full case: click here

Summary: In a rates mitigation scheme, taking advantage of the exemption from business rates of companies which are in the process of being wound up, the High Court decided that it was not able to accept the Secretary of State's argument that the activity "lacks commercial probity and is contrary to the public interest". Accordingly, it was unable to order the winding up of corporate entities created for the express purpose of avoiding payment of rates. This was the opposite conclusion to that reached in a 2015 case, which related to another PAG company operating a slightly different scheme. The main difference was that the later scheme created an asset of the corporate entities, which postponed completion of winding-up until realisation and, therefore, prolonged the period of exemption from rates.

Commentary: This case involved the grant of 3-year leases of empty properties (owned by third party landlords) to SPVs owned by PAG Asset Preservation Ltd, "PAG" (and latterly by MB Vacant Property Solutions Ltd, "MBV"), entered into in consideration of payment of a modest sum by the landlord (in practice, although not described as such, being slightly more than the rates liability from the date of grant to the intended date of commencement of winding up of the SPV) and for the express purpose of claiming exemption from rates. The leases were contracted out of the Landlord and Tenant Act 1954 and were determinable by the landlord on 7 days' notice (e.g. if possession should be required for letting on an open market basis or for some other purpose). Properties were introduced to PAG/MBV by third party commercial property agents, who were said to have been paid a substantial commission.

Each SPV was placed into Members' Voluntary Liquidation ("MVL") seven days after the lease was granted and the billing authority was duly notified of the lease grant. There was no intention that the SPV would ever occupy the property, but the lease contained an obligation for the tenant to pay the rates, which (by reason of the insolvency exemption) were chargeable only in respect of the short period before the SPV went into MVL. The landlord's payment on lease grant pre-funded the SPV's full anticipated exposure to rates for that short period.

There were separate fee agreements between the landlord and PAG/MBV under which the landlord paid a monthly fee for so long as the leases subsisted, being either 30% of the rates saved or a fixed fee in a similar amount. If the landlord exercised the right to break the lease it was also required to pay a "determination premium" to the SPV as its tenant under the lease, being an amount increasing over time (until lease expiry when no premium would be due). Most of the fee arrangements with PAG also contained a requirement for PAG to repay to the landlord between 90% and 99% of the determination premium. This repayment by PAG (being a further incentive for landlords to enter into the arrangement) was not carried forward into the leases granted to the MBV SPVs, but this did not affect the outcome of the case.

The determination premium was the key factor that distinguished this scheme from that which had been determined in 2015 (in Secretary of State for Business, Innovation and Skills v PAG Management Services Ltd [2015] EWHC 2404 (Ch))to "subvert the purpose of liquidations, demonstrating a lack of commercial probity and making it just and equitable to wind up the companies operating the scheme". This was because the premium contingently payable under the new scheme (subject to the landlord exercising its option to break) represented an asset of the relevant SPV, which had to be collected by the liquidator before the company could be wound up. It was apparent from the witness statement provided by the liquidator (who acted in respect of a large number of the SPVs involved in the scheme) that in relation to three of the MVLs all of the leases held by the SPVs in question had been determined with premiums being paid and in the remaining MVLs at least some determination premiums were received.

Stephen Davies J. had no criticism of the conduct of the liquidators, who were obliged to maintain the SPVs in MVL due to the existence of the leases. The question before the court was whether it was possible to show that the activity lacked commercial probity and was contrary to the public interest.

The judge found that the incorporation/acquisition of the SPVs, the entering into of the leases and the putting of the SPVs into MVL were all legally-effective transactions, although pre-arranged, non-commercial and having no purpose other than to avoid liability for rates. The liquidators were genuinely entitled to decide that because of the existence of the determination premiums it was appropriate to continue the MVLs until all of the leases were either determined or expired.

He further found that there can be no proper objection, whether under the business rates or insolvency legislation or by reference to specific statutory provisions or the Ramsay principle (noting that the taxation General Anti-Avoidance Rule ("GAAR") adopted by HMRC in 2013 does not apply to business rates), to the members of a company putting it into MVL for the purpose of avoiding business rates, after creating an artificial asset within the "tax shelter" arising from the MVL. This will remain the case for each SPV until expiry or determination of the last of the leases held by that corporate entity provided that putting the company into MVL and maintaining it in that state is (considered objectively in law and in fact) for the purpose of collecting, realising and distributing the assets of the company.

The court was unsympathetic to the position of the billing authorities and the consequent loss of income. Stephen Davies J. was clear that he could not rule on the extent of the loss suffered as it would require an investigation as to (a) whether the landlords may turn to other insolvency-based schemes if the companies were wound up; (b) whether the landlords may use alternative mitigation schemes if the judgment ruled out insolvency-based schemes entirely in this context; and (c) what wider losses may result if one way in which landlords could avoid payment of rates on empty property was removed.

There will inevitably be criticism of this judgment, but it remains to be seen whether it results in an amendment to the Regulations to disapply the exemption, where (as here) artificial arrangements are used to create notional assets for the purpose of prolonging the MVL process. Such legislative measures are already being considered by the Scottish and Welsh Assemblies. A simple way to achieve this may be to extend GAAR to include business rates and this judgement (effectively endorsing use of the PAG scheme) may well accelerate such action, which would have much wider implications than merely outlawing schemes making use of the insolvency exemption.

Town Legal LLP