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Practical And Professional Commercial Property Comment
From The Culshaw Partnership

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# *Landlord and Tenant (Covenants) Act 1995*

Contents



**STOP TINKERING, START REFORMING...**

In the same way that patch repairing is no solution to the need for necessary works of reconstruction… The approach of the court to the Landlord and Tenant (Covenants) Act 1995 ("the Act") is akin to a patch repair. In this case, the judiciary is not the appropriate tradesman to deal with the failings of the legislature. Yet, owing to the now patent structural defects in the Act, the court has been left with the unenviable task of dealing with its own construction and the fallout arising from this.
The sorry saga that is the recent case law history concerning the Act demonstrates that the judiciary is not the appropriate body to create or amend law in respect of the Act.
The legislature is instead the relevant body with the ability to reconstruct the Act in such a way as to untie the knots created by the judiciary and actually deliver an Act that is fit for commercial purpose. The need for reform is pressing.

**Purpose**
The key purpose of the Act is to release tenants and their guarantors from continuing liability upon assignment of leases granted on or after 1 January 1996. The exception to this is where the tenant provides an authorised guarantee agreement ("AGA") (section 16). The AGA allows the assignor to guarantee the lease liabilities of the assignee following assignment. There is no specific AGA provision concerning guarantors. Section 25 contains a wide anti-avoidance provision preventing any activity that offends the purpose and provisions of the Act.
When the groundwork for the Act was undertaken, the rationale for this was to avoid the unpleasant situation arising of a former tenant of a long lease suddenly being revisited by the landlord many years after assignment seeking payment for rent and other liabilities from the former tenant as a result of the current tenant's default. This was a particular problem in the desolation that was the early 1990s recession.
This purpose has been achieved by virtue of section 5 of the Act (though it should be noted that lease term lengths have reduced since 1990s). While the requirement for an AGA can be absolute or qualified in some way, it is not mandatory upon assignment and is a matter for negotiation between landlord and tenant prior to the granting of a lease. Similarly, upon a second assignment, the original tenant will be released from its AGA obligations and owe no further liability to the landlord.
In terms of its stated aim of making "provision for persons bound by covenants of a tenancy to be released from such covenants on the assignment of the tenancy", the Act has achieved its purpose. However, in other respects, the act is not fit for purpose.

**Problem**
The fundamental problem with the Act (as interpreted) is that it is hostile to the concept of freedom of contract. There is commercial logic in a lease guarantor offering to guarantee the assignee or indeed offering to become the assignee.
However, the Act contentiously offends this logic and prevents such action from taking place. What is striking is that the judiciary recognises this flaw, but has left it as a weeping sore. It is neither "here nor there" if the consequence of the operation of the act is "unattractively limiting and commercially unrealistic" (*Good Harvest Partnership LLP v Centaur Services Ltd [2010]* EWHC 330 (Ch); [2010] 1 EGLR 29). Lord Neuberger noted that "even where it suited the assignor, the assignee and the guarantor that the assignee should have the same guarantor as the assignor. They could not offer that guarantor. It would also appear to mean that the lease could not be assigned to the

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# Land Registry Sell-Off

Sir,
It is deeply concerning that the government is again proposing to sell off the Land Registry to raise an estimated £1.2 billion.
The UK attracts billions in foreign investment because our legal and financial systems are respected, trusted and admired in so many countries that seem incapable of replicating them. Much of that investment is in property and the government owned Land Registry, established in 1862, is a fundamental element in reassuring both foreign and domestic investors.
As a chartered surveyor I am frequently asked for advice about potential property purchases abroad. My first response is always to ask whether the country in question has a Land Registry. If not do not buy there, no matter how cheap the property may seem.
The government must be persuaded to think again.

ANTHONY RATCLIFFE
London W1
*Letter in The Times - 4th June 2016*

**C.P. Comment:**

There is so much rumour and uncertainty in buying property abroad that simply does not exist in this country.
This is surely a very bad idea of the Chancellor's.
*Justin Fowler*

# Landlord and Tenant (Covenants) Act 1995 - continued

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guarantor, even where both tenant and guarantor wanted it" (*K/S Victoria Street v House of Fraser (Stores Management) Ltd [2012]* Ch 497; *[2011] 2 EGLR 11).*
Similar comment is made in the other recent decisions concerning the Act. As well as vexing freedom of contract, the Act defies commercial rationale. Where a tenant has a guarantor, the covenant strength is likely held by that guarantor.
An AGA from a special purpose vehicle ("SPV") tenant is about as much use as a house built on sand if the financial strength rests with the SPV's guarantor.
The judiciary has tried to grapple with the Act, but legal evolution by way of case law is not satisfactory. This is exposed by the differences of opinion between the various judges involved in the cases - all of whom are highly respected in the property litigation world.
The defect is in the drafting of the Act. This is the legislature's business. The recent cases serve not merely to emphasise the defect but also the imperative for reform.

**Reform**
The Property Litigation Association ("PLA") has proposed reform of the Act. The proposed amendments are short, simple and address the devilment caused by the Act.
The amendments will:
*****clarify that an assignor's guarantor can provide a sub-guarantee of the assignor's AGA;
*****allow the assignor's guarantor to provide a group company repeat guarantee;
*****clarify that the assignor's guarantor may take an assignment from the assignor; and
***** address the risk of a void assignment situation where joint tenants A, B, C and D assign to A, B, C and E.
The PLA's proposals have industry and professional body support.

*Estates Gazette - 28th May 2016*

**C.P. Comment :**

It is clear that the position of the guarantor (via an AGA) has caused plenty of confusion. It is logical that proper legislative steps need to be taken, so that the legislation can work as surely it was intended.
*Justin Fowler*

# No Surrender

The surrender of a lease may be implied from the conduct of the parties. If the landlord and tenant have acted unequivocally in a manner that is inconsistent with the continuation of a tenancy, the parties will be treated as having effected a surrender by operation of law. Abandonment of a property will not suffice. The tenant must convince the court that the lease has terminated.

**Cases in point**
In *Padwick Properties Ltd v Punj Lloyd Ltd* [2016] EWHC 502 (Ch); [2016] PLSCS 81, and *Artworld Financial Corporation v Safaryan and others* [2009] EWCA Civ 303; [2009] 2 EGLR27, the court was asked whether a landlord had accepted a surrender of a lease from a company that had gone into administration, because as in the first case the landlord had accepted the keys, boarded up the property and marketed it for sale with vacant possession. The court said that accepting the keys to premises will, in itself, always be equivocal. Someone has to hold the keys to prevent them being passed backwards and forwards because neither party wants to risk it being suggested that it has made an admission by holding on to them. Furthermore, actions of a landlord that are consistent with its rights under the lease, such as inspecting or repairing, will not,

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# *Transfer of Going Concerns*

Nobody likes paying VAT and at 20% it can be a significant liability on property transactions.
If certain conditions are met, property can be acquired by way of a transfer of a going concern (TOGC). TOGC treatment is mandatory and where there is a TOGC this means that the transfer falls outside the scope of VAT and VAT is not therefore chargeable.
The main UK law concerning TOGC is the Value Added Tax (Special Provisions) Order 1995, which is derived from articles 19 and 29 of the Principal VAT Directive (Directive 2006/112/EC).

**Property transactions**
TOGCs are relevant to various property transactions, including:
***** occupiers disposing of property as part of a business sale;
***** investors disposing of property held for letting; and
***** developers disposing of a site in the course of development.
Following *Robinson Family Ltd v Commissioners for HM Revenue and Customs [2012]* UKFTT 360 (TC); *[2012]* PLSCS 159, HM Revenue and Customs (HMRC) confirmed that the grant of a lease can, in certain circumstances, be a TOGC, as can the surrender of a lease.

**What are the TOGC conditions?**
For transaction to comprise a TOGC a number of conditions need to be met. HMRC considers the main conditions to be:
***** the assets must be sold as part of the transfer of a "business" as "going concern";
***** the assets are to be used by the purchaser with the intention of carrying on the same kind of "business" as the seller (but not necessarily identical);
***** where the seller is a taxable person, the purchaser must be a taxable person already or become one as a result of the transfer;
***** in respect of land which would be automatically standard rated or which the seller has opted to tax, the purchaser must notify HMRC that it has opted to tax the land by the relevant date (see below), and that the option will not be disapplied;
***** where only part of the "business" is sold it must be capable of operating separately;
***** there must not be a series of immediately consecutive transfers of the "business".
On the grant of a lease, the grantor must also dispose of at least 99% of the value of the property if the grant is to be a TOGC. The grantor needs to compare the value of the property immediately before and after the grant to determine this.
When an investor sells a property, HMRC accepts that the letting business does need to have actually commenced, or be in respect of the entirety of the property for sale to be a TOGC. HMRC accepts that the following can be TOGCs:
***** the sale of a building where the tenants are currently enjoying a rent-free period;
***** the sale of a property subject to contractual agreement for lease;
***** the sale of a partially let property.

**Option to tax**
Any option to tax made by the purchaser must be made and submitted to HMRC prior to the date of any taxable supply by the seller. If there is a deposit payable then, unless this goes into a stakeholder account, the purchaser must make an option to tax and submit it to HMRC prior to the date of payment of the deposit. If the deposit is paid into a stakeholder account, the purchaser will have up to immediately before completion to make and submit its option to tax to HMRC.

**VAT registration of the purchaser**
Many property purchases are undertaken by new companies (Newco) that are set up specifically for the relevant acquisition. Often these companies are not registered for VAT on completion. This will not prevent there being a TOGC if the company is liable to be registered for VAT. In these circumstances if the purchaser is a UK company it will be treated as liable to be registered if:
***** the seller's taxable supplies (in respect of the business being transferred) in the previous 12 months exceeded the VAT

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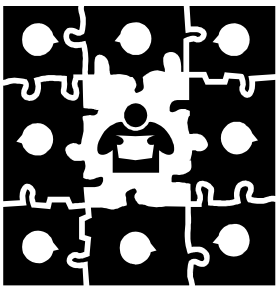
# *How We Can Help You*



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**See page 4 for all our contact details .**

# No Surrender - Continued

*(Continued from page 2)*
of themselves, be fatal to the continuation of the lease. Nor will actions to protect or preserve the value of, or even to re-let, property, since these are actions that a landlord might be expected to take in order to protect its own interests.

**No resumption of possession**
The judge ruled that the lease would have determined had the landlord taken possession of the premises or re-let them. However, this had not happened here. The landlord had accepted the keys because there had been no alternative and had informed the administrators why it was doing so. Landlords whose tenants abscond are entitled to protect the security of their premises, maintain their rights against their tenant until a fresh one is found, and then to forfeit.
Finally, attempting to re-let did not give rise to an estoppel, even though the property was advertised with vacant possession.

*Estates Gazette - 7th April 2016*

**C.P. Comment :**
The fear of inadvertently agreeing the surrender of a lease looms large in most landlords minds, however it is evident from the cases profiled that it is a fear largely overstated. A tenant cannot surrender a lease in isolation and if push comes to shove a tenant alleging successful surrender would have persuade a judge that the landlord took steps/acted in such a way that explicitly implied that his lease had ended e.g. by physically taking possession (and by that I assume possession means actual occupation) or re-letting.
Accepting keys by and in itself does not signify a surrender, nor it seems is offering the property to let, with vacant possession.
The landlord is entitled to take reasonable steps to safeguard his investment in the face of a tenant attempting to evade responsibility and those steps may include preparing the ground in the event of a forfeiture towards finding a replacement tenant.
*John Tookey*

# Transfer of Going Concerns - continued

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registration threshold; or
***** there are reasonable grounds for believing the purchaser's taxable supplies in the 30 days immediately after completion will exceed the current VAT registration threshold (£83,000).
As regards non-UK purchasers, the position on when they are liable to be registered for VAT is less clear, but it is still possible for these purchasers, if not VAT-registered at completion of the relevant transaction, to be liable for VAT registration and to acquire property as a TOGC. If the purchaser is not liable to be registered for VAT and is not registered for VAT at completion then the relevant sale will not be a TOGC. The fact that the purchaser may have applied to be registered for VAT prior to completion is not enough and the transfer will not be a TOGC even if the purchaser's VAT registration is, when received, backdated to a date prior to completion.

*Estates Gazette - 7th May 2016*

**C. P. Comment :**

The golden rule is to get good advice - not paying an extra 20%, even if you will get it back makes a huge difference to cash flow. However getting it wrong could be expensive!
*Justin Fowler*

# Market Indicators

The commercial property investment market is strong. The London auction houses are selling a high percentage of their lots and the returns, although sharper than they have been, are still positive when compared to other investment sectors.
However we will have to see if there is a dramatic change following the surprising outcome of the EU Referendum.

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