Briefing note for MSPs

Scottish Tenant Farmers Action Group (STFAG)

STFAG propose an amendment to the Agricultural Holdings Bill to change the secure tenant's proposed pre-emptive right to buy to an absolute right to buy. The pre-emptive right to buy in the Bill reflects the understanding that reform in this area is required. However, the right will in reality mean little or nothing, most secure tenancies being on estates which have been in the same hands for hundreds of years and are not likely to change hands in the next hundred years.

Two issues have been raised by objectors to the proposed right to buy:

1. The pre-emptive right to buy can be made to work, and
2. If right to buy is implemented then, should there be a loss in the value of land held by landlords, the Scottish Parliament will be obligated to compensate landowners under the European Convention for Human Rights.

This short paper highlights how simple it is to avoid a pre-emptive right and how the judgements from the European Court of Human Rights support an absolute right to buy.

Background

One of the key objectives of the Agricultural Holdings (Scotland) Bill is to help produce a viable, thriving agricultural and rural sector. That necessitates a measured transfer of land from the hands of the few to the hands of the many, closely involved and making their livelihood from the rural community.

At present the draft Agricultural Holdings (Scotland) Bill provides secure tenants (those whose families have often farmed the same land for generations) with a pre-emptive right to buy that land when it is offered up for sale by the landowner. Whilst this may on the surface appear to be a practical and genuine reform, the reality is quite the reverse. A right of pre-emption may be easily circumvented and even should it be watertight (and this paper will demonstrate that it will never be watertight) the right may arise once in the course of a century or more. If the landlords' current practice of removing tenants wherever possible continues, and there is nothing in the Bill to suggest otherwise, the pre-emption right will never be seen to operate in Scotland.

Land ownership

It is worthwhile setting out diagrammatically, some of the various means through

which land may be held:

Individual (**A**)

Company / Trustees of a trust (**B**)

Company (**C**)

The land

<u>The Individual (A)</u>

A may be the sole shareholder in company **B**
A may be the sole beneficiary of the trust **B**
A may be one of the shareholders in company **B** or one of the beneficiaries of trust **B**

A may be UK or foreign resident

The Company / the Trustees (B)

B may be UK or foreign resident (ie an "offshore" company or an "offshore" trust)
The trustees **B** may have the ability to alter who shall be the beneficiaries, ie change **A**

The Company (C)

C may be a wholly owned subsidiary of Company **B** or wholly owned by trustees **B**
C may be UK or foreign resident

<u>Right of pre-emption</u>

The relevant Clauses in the draft Bill are Clauses 25 and 26. Clause 25, which triggers the consideration of a right of pre-emption (subject to clause 26) operates where "the owner of land …proposes to transfer any of the land to another person" (Clause 25) Who is the owner of the land? In the diagram, it is Company **C**. How might land be transferred avoiding a right of pre-emption? Sell the company.

If the land was not held in a company then the landowner (trustees **B** or individual **A**) would set up a company in which all the shares were held by **B** or **A**, respectively, and then gift the land to the company. (Clause 26 (1)(a))

If the land is to be sold in part, then the land would be gifted to a company, and the company would transfer the land which was to be transferred to a new group company, then that new group company would be sold. (Clause 26(1)(e))

If a trust is involved (**B**), the addition of a company may not be required. Clause 26 (1)(b) treats as trust as a family member in certain circumstances, (Clause 26(3)) and a transfer between family members does not trigger a pre-emption right. Most trusts have a wide class of beneficiaries, and many have the ability to appoint additional beneficiaries, if desired. Here are two examples of how to avoid the pre-emptive right using a trust:

1. Appoint a new class of beneficiaries (ultimately the new owners) and remove the existing beneficiaries. In return for the change of trustees the new beneficiaries would have paid the trustees in advance, and the trustees have ring-fenced the funds for the "old" beneficiaries, or transferred the funds at the same time as changing the beneficiaries.

2. A sole beneficiary **A** could sell his interest (as beneficiary) to a third party. **A** would then hold that interest on trust for the third party.

It is shown in Clause 26(3) that a company can also be a family member. The same types of operation apply to transfer the ownership of a single company. An individual **A**, can transfer land to a company which he owns as a gift under Clause 26(1)(a) or as a transfer to a family member under 26(1)(b). Clause 26(3) looks at the company ownership as a snapshot in time. If the company is wholly owned by **A** then there is no trigger for a pre-emptive right. **A** is then free to transfer the ownership of the company without triggering a pre-emptive right.

A form of anti-avoidance clause is inserted in Clause 26(2) which mimics clauses 137(1) of the Transfer of Chargeable Gains Act 1992 and 703(1) of the Income and Corporation Taxes Act 1988. Any tax lawyer will point out to a landlord that all that is required at present is to transfer the land into a company (as the company may well pay a lower rate of tax on profits at present), and to effect the transfer now. When the land comes to be sold sometime in the next 100 years the land is already in the right vehicle to effect a transfer without any pre-emption applying and the anti-avoidance clause is avoided. It is also of note that the anti-avoidance clause only attaches to certain types of transfer. Why is that? Has it not been simply shown that Clause 26(1)(b) can equally well be used for avoidance purposes? This paper does not propose to run through the remaining types of permitted transfer, other than to point out that land can be removed from a company and assets from a trust in accordance with a court order – see Clause 26(1)(c) – as part of a winding up or reorganisation of the company or trust.

On the more practical operation side, where A and/or B or C are offshore, how is the legislation to operate?

A great deal of land is owned by offshore companies, reflecting the nature of the owners of Scottish land. The company shareholders are not known, because the company is not in the UK and the register of shareholders is not open to the public, so the transfer of these shares is not transparent. In addition, even where the register of shareholders is public, the shares may be held by the parties which originally incorporated the company and not reflect the true owners. Once a trust becomes a shareholder, the process becomes even more nebulous.

There is no ability to find out if there has been a change in ownership which has infringed the provisions of Clause 26 unless the land in question is registered under a new owner's name. That will not happen where land is held by a company. The Scottish courts have no jurisdiction in Jersey or the Isle of Mann, let alone the British Virgin Inlands, all suitable tax havens for foreign owners of Scottish land. Companies and trusts in these jurisdictions have no obligations to the Scottish parliament, the Keeper or Scottish tenants and will never come under the Scottish jurisdiction. Even if the Scottish parliament were to provide a right to compel someone to reveal the information, it is of no value because the relevant parties are offshore- there is no sanction.

Land may be held by a company. This simple device completely circumvents a pre-emptive right to buy. The company will never offer up the land for sale, but instead the owners of the company will sell their shares in the company. [1]A similar position exists with trusts. Many estates are "owned" by trustees who hold the title to land in accordance with the terms of a trust. A trust deed will have an enormous range of potential beneficiaries for whom, in reality, the land is held. The beneficiaries are in the same position as shareholders. They may sell their interest in the trust to another party. In addition, they may also be changed by the trustees and new beneficiaries selected in accordance with the trust document. At the point of change of shareholders or beneficiaries, the legal ownership of the land does not change, but the parties who to all extents and purposes "own" the land are changed. .

Thus the pre-emptive right to buy is simple to circumvent, leaving these secure tenants "stuck", as Ross Finnie put it in his evidence to the Rural Development Committee. In fact the position of a secure tenant may be made even more difficult as a landlord may then try to avoid a pre-emptive right (should he ever see that as an issue) by doing his utmost to hound a tenant from the land. The reform which the Bill intends to effect will at best take place over the next 100 years if they are pursued through a right of pre-emption, but the issues to be addressed by this legislation are

[1] This has been used as a means to avoid stamp duty on the transfer of land for very many years. If an owner was to sell land then stamp duty may apply at up to 4% of the value of the land. If land is in a company then the shareholder owner sells the shares in the company, suffering stamp duty at only 0.5%.

those existing here, and now.

Precedents

There are a number of precedents both international and national that allow tenants to purchase from the landowner. The most current and obvious one is the Land Reform Act 2003. Prior to that, the other obvious example was the purchase of council houses by their tenants. However it was argued that these tenants were purchasing from the state and not from a private individual and that this was a relevant distinction.

The best parallel where an individual tenant exercises a right to purchase property from another private individual is in England, under the Leasehold Reform Acts of 1967 and its refinement under various Conservative and Labour governments in 1974, 1993 and 2002.

These acts allow tenants who are the leaseholders under long leases (originally for more than 21 years – although they can be for 99 years or even up to 999 years) to purchase the landlord's interest in the property. The value paid for the landlord's interest in the property is based on the length of time remaining on the lease, the level of investment in that property by the tenant and the comparable value of unimproved properties on the open market.

The valuation method is broadly what is proposed under the pre-emptive right to buy for secure tenants, with a right of appeal to the Scottish Land Court by either party. The appeal procedure mirrors that which already exists under the Leasehold Reform Acts, where an appeal is made to the Leasehold Valuation Tribunal.

The 1967 Leasehold Reform Act was introduced by a Labour government and subsequently amended by both Conservative and Labour governments to its current state. These governments have for some 35 years upheld the view that this transfer of property is in the public interest and socially just, and that the private owner is properly recompensed for the value of the property. The European Court of Human Rights has also upheld this view under challenge on grounds of infringement of human rights by the Duke of Westminster (see below, under the European Convention for Human Rights), stating that the legislation had an objective and reasonable justification.

The Leasehold Reform Act 1967 raised very similar issues to those put forward

by landlords now, with one exception. [2]

Hansard reports from the time, particularly at [742] 1271-398 prove enlightening. It was highlighted that:

1. the Landlord and Tenant Act 1954, introduced by the Conservative party, had significantly reduced the value of the landlord's interest in the land because it gave tenants the right to continue in occupation of the land after the term of the lease came to an end, as a statutory tenant at a rack rent. In this way a leaseholder became a secure tenant.
2. the landlord under the existing position would legally confiscate all of the tenant's improvements and all of the maintenance costs.
3. the maintenance costs exceeded the original value of the property.
4. the freeholder has little incentive to upkeep the property, and none to improve.
5. there was no question but that the legislation should be passed, merely that the only issue was one of value.
6. the value which should be paid to take on the land should be that which compensated the landlord for the value of the land which he had held, increased by the value to which society had given that land. Thus, land in central London had increased due to pressure for housing and that rise would be taken into account.
7. that the legislation would change the basis of a private contract, although it was also noted that the contract entered into by the parties was not a contract between parties of equal strength, quite the contrary, it was a contract where a tenant had terms dictated to him.
8. that it would be unfair to allow individuals to buy up "fag end" leases and then obtain a windfall by buying the land under the Act. Accordingly limits were placed on the parties who would be allowed to buy, being those who lived in the property for 5 years as their principle residence.
9. Of particular note, and commended throughout the debate, was the speech by the Liberal member, Mr Emlyn Hooson (Montgomery), reported at [742] 1333 where he said "it is astonishing how the landed interests find means of attacking any Bill, whatever its nature and however moderate, to reform the law.

   It is said it is difficult to reform leasehold law. Of course it is. Whatever principles of reform one adopts, when one starts interfering with land law one runs into difficulty, but this is no reason of running away from the problem. Basically, we are dealing with an injustice which has been embedded into the law. Land law particularly is a reflection of the social structure of the time." He went on to say "[one] need only read the judgements of Lords Wright or Atkin in which the sanctity of contract was set aside or modified in the interests of the community at large" and emphasised that the contract entered into was not an open and free bargain, that the landlords had a monopoly on

[2] At present it is said that if a right to buy of any variety goes through the Scottish Parliament then the ECHR may rule against the legislation and oblige the Scottish Parliament to pay sums to landlords from whom land has been acquired, a point to which this paper returns.

the land and would call the tune, and although any change would never be fair to all parties now (1967), that had to be accepted.

The European Convention for Human Rights

After the Leasehold Reform Act came into effect and some properties had been acquired under its provisions, the Duke of Westminster's case was taken to the European Court of Human Rights ("ECHR") to contest the purchases as a breach of landlords' rights.

The case was called James and others v United Kingdom (App. no. 8793/79) [1986] ECHR 8793/79. The case was taken to the ECHR on the basis that obligation under the Leasehold Reform Act 1967 to sell an interest in land was contrary to Article 1 of the First Protocol (to the convention), whether or not in connection with Articles 6, 13 and 14 of the European Convention of Human Rights.

The case was dismissed. There was no breach as the legislation was in the public interest and represented a legitimate social policy exercised through reasonable, regulated means. Provisions were in place to prevent tenants buying land where they had not stayed on and used the land for residential purposes throughout a set period. Lastly, and importantly, there was an objective and reasonable justification for the legislation and although it only affected some landlords (and therefore discriminated on a number of issues) it was not a breach of the Articles.

Recent ECHR cases have upheld the principles from the James case.

The most recent case in the ECHR relating to land was Wallbank v Ashton Cantlow & Wilmcote [2001] EWCA Civ 713, and [2002] Ch 51, reported last year. It again considered and approved the James case. It said that where the legislation (in this case a codification of the common law into a statute) operated to impose an arbitrary, indeterminate liability on a landowner as a form of tax, at any time, this was unjustifiably discriminatory and represented a breach of the terms of Article 14 (and some landowners have latched on to that point without considering the rest of the case). The facts of the case were that a purchaser of land was obliged to maintain the local church, in accordance with the terms of the title to the property. The church had sued for the costs of upkeep, some £96,000. The facts were highly unusual and (and this is a point stressed by the court) the purchaser of the land paid the same price for his land as any other purchaser of a freehold – i.e . there was no reduction in the price despite the burden placed on the land.

In the James case, and in every case where there is a secure tenancy, the value of the land does reflect that there is a secure tenant in place. The court approved the James case and the principles used. It used the same principles but distinguished this particular case on its highly unusual facts (the penal sum involved when owning such

a small piece of land; the fact that the land cost the same as other freehold land without the same burden).

It was noted in the judgement that:

1. if there was no reasonable and objective justification for parties in a similar position being treated in a different way, the underlying legislation might be discriminatory, *but only if*
2. the legislation does not pursue a legitimate aim or show a reasonable degree of proportionality between the means employed and the aim pursued.

It was also stressed that the legislature in each contracting state has a margin of discretion to apply in assessing whether and to what extent differences in otherwise similar situations justify different treatments.

The proposed right to buy has a reasonable and objective justification founded in social and economic reform, considered in depth by the Scottish Parliament and in consultation. There is proper compensation for the loss of land value, but even if someone considered that they had not been properly compensated and this was not addressed to their satisfaction by the UK courts, the ECHR reports indicate that (a) a legitimate aim has been pursued and (b) there is a reasonable degree of proportionality between the means employed and the aim pursued. These are exactly the same principles which will have been considered and approved when looking at the Land Reform Act and the right to buy enshrined there – there is no difference, except that, in Mr Emlyn Hooston's words, "it is astonishing how the landed interests find means of attacking any Bill, whatever its nature and however moderate, to reform the law."

Conclusion

The Agricultural Holdings Bill needs to be read alongside the Land Reform Act 2003 – this Bill and the Act, although about land, are also about social reform. They are about giving the public greater access to the countryside, giving communities a pre-emptive right to purchase land, giving crofting communities an absolute right to purchase salmon fishings as well as common land, thereby providing opportunities to make best economic use of their resources.

Thus these bills are about social change and empowerment. We feel these tenant farmers, for whom their farms are their cultural heritage, should be given the opportunity to redress the power balance with landlords in the same way that crofters have enjoyed. It is worth highlighting the difference in confidence in the crofting community compared to the tenant farming community, many of whom are intimidated to the point of not speaking out. Finally, there will always be members of

society who do not want to see social change but change should be in the interests of Scottish society as a whole and by the democratic process.