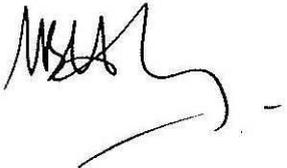


Report to:	Sutton Shareholdings Board	Date:	5 February 2019
Report title:	Creation of Design and Build Development Subsidiary		
Report from:	Mary Morrissey, Chief Executive (Interim)		
Ward/Areas affected:	Borough wide		
Chair of Committee/Lead Member:	Councillor Sunita Gordon		
Author(s)/Contact Number(s):	Simon Latham, Assistant Director, Housing, Planning and Regeneration, 020 8770 4006		
Corporate Plan Priorities:	<ul style="list-style-type: none"> • Being Active • Living Well Independently 		
Open/Exempt:	Open		
Signed:		Date:	29 January 2019

1. Summary

- 1.1 This report presents proposals for establishing a separate development subsidiary to enable the recovery of VAT by Sutton Living Limited. Establishing a subsidiary is a reserved matter for the Sutton Shareholdings Board.

2. Recommendations

The Sutton Shareholding Board is recommended to:

- 2.1 Agree that Sutton Living Limited establish a Design and Build Development Subsidiary ("Sutton Living Design and Build Limited") for the purposes of VAT recovery.
- 2.2 Delegate authority to finalise the appropriate company structure and put in place all necessary contractual and governance arrangements to the Shareholder Representative, or their nominee, in consultation with the Chair of the Shareholdings Board.

3. Background

- 3.1 Sutton Living, like other Council wholly owned subsidiaries, has to pay VAT on services on all professional fees and currently cannot recover all of this money due to the nature of some of its

supply. To provide a context, the estimated VAT likely to be payable on the Wallington Public Hall project alone amounts to nearly £80,000, and the project is not yet on site. This places Sutton Living Ltd, a wholly owned company of the Council, at a disadvantage when compared with projects delivered by the Council directly.

- 3.2 In discussing with Devonshires (solicitors acting on behalf of Sutton Living for Wallington Public Hall), they suggested that by setting up a Development Subsidiary (or DevCo) and letting all professional and build contracts through this body, VAT could be recovered.
- 3.3 Other local authority wholly owned development companies have set up development subsidiaries for VAT recovery purposes, and this advice was also given previously to the Council by EY in 2016 following their engagement on tax advice for the Council's wholly owned companies.
- 3.4 Consideration was given to the the option of the DevCo being a subsidiary of Opportunity Sutton Ltd to be able to used by the other OSL subsidiary, SDEN. This evaluation has been completed, and it has been concluded there is no financial advantage to this course of action.

4. Issues and Options

- 4.1 The process followed in pursuing the establishment of a Development Subsidiary is as follows:

- (1) **Framework Development Agreement**

- Sutton Living and the Design and Build Development Company (Sutton Living Design and Build Limited) will enter into a Framework Development Agreement (to allow multiple contracts to be set up and novated to it). The D&B Co (as developer) will undertake developments for Sutton Living (as employer). This allows the recovery of VAT.

- (2) **Governance**

- The Directors of D&B Co will be the same as those of Sutton Living Ltd. The internal governance arrangements between Sutton Living and D&B Co will be dealt with through an internal governance agreement to demonstrate to HMRC that the D&B is a proper company for tax purposes. The terms of reference for subsidiary boards, delegated authorities/financial regulations and a protocol setting out matters needing parent consent and who gives that consent internally, will be part of the governance agreement.

- (3) **Service Level Agreement (SLA)/Cost Share Arrangements**

- Sutton Living D&B Limited will require certain services e.g. staffing, and Sutton Living can provide services either under a SLA or Sutton Living can agree to share costs with Sutton Living Design & Build Ltd under a cost sharing agreement. Devonshires view is that tax accountants tend to favour cost sharing, though this requires further investigation.

- (4) Sutton Living D&B Limited will appoint the contractors and professionals to undertake development projects. If Sutton Living asks them to, Sutton Living D&B Limited will be required to accept a novation of existing scheme contracts (for schemes which have not reached practical completion).

(5) Sutton Living has already engaged consultants (e.g. Employer's Agents) for the Wallington Public Hall project and will, over coming months, procure a construction company to carry out the building works. When Sutton Living Design & Build Ltd is established, contracts will novate from Sutton Living to this subsidiary. Any warranties required by Sutton Living (and any other relevant third party) will be signed by the novated organisation in favour of these parties.

4.2 The most straightforward way to use DevCo is for new developments, where DevCo provides a design and build service from the outset. It is possible for DevCo to take on a scheme which has been commenced by another group member as long as it is transferred sufficiently ahead of practical completion of the scheme, and it may be possible for DevCo to recover VAT on professional fees on a retrospective basis. This would involve novating existing contracts and professional appointments. SLL's tax advisers would need to advise whether such retrospective VAT relief is available on each such scheme.

5. Impacts and Implications

Financial

5.1 The Council previously engaged EY to provide tax advice for the Council's wholly owned companies. EY advised that due to the nature of the services to be provided by Sutton Living, the company may not be able to fully recover all of the VAT that it incurs on supplies and services purchased by the company. For example, it would be able to recover VAT incurred on supplies connected with the provision of new build units if these units are being sold, but not if the units are being held for rental. VAT can not be recovered on supplies connected with the purchase of units which, for example, are being refurbished for onward sale. In practice this means that the company is likely to incur a significant level of VAT which it cannot recover. Advice from EY was to consider setting up a D&B development company to avoid irrecoverable VAT on land / unit acquisition costs and professional fees. Under this arrangement the subsidiary company purchases the land and engages with the building contractor, architect and other third parties and constructs the new dwellings which are sold to Sutton Living at zero rated VAT. VAT incurred by the D&B company is fully recoverable as it is attributed to an onward zero rated supply.

5.3 The above costs to which will need to be added VAT and disbursements (if any), will be paid for by Sutton Living Limited. These costs may vary if for example the D&B Co operates for more than one subsidiary.

5.4 Apart from the costs of setting up Sutton Living Design & Build there will be ongoing costs similar to those incurred for other Council owned companies, such as the provision of financial statements and the audit of those statements, provision of returns to companies house, financial and managerial oversight costs, tax planning and actual cost of relevant taxes such as corporation tax.

Legal

- 5.5 The principal reasons for setting up this sort of subsidiary is to ring fence liability and tax advantages including the reasons stated in paragraph 5.1 above. This is a commonly used vehicle and should ensure that Sutton Living is not placed at a disadvantage with regards VAT.
- 5.6 The governance arrangements between Sutton Living and its subsidiary would be governed by a shareholder/member agreement and articles of association as Sutton Living would be the owner of the subsidiary. Notwithstanding this, in effect the governance arrangements between the Council (as owner of the holding company) and Opportunity Sutton also cover the subsidiaries where decisions affect the shareholder’s rights.
- 5.7 As to the recommendation paragraph 2.2, under schedule 1, Part A of the Shareholders Agreement between the Council and Opportunity Sutton the creation of the subsidiary by Sutton Living would be a reserved matter for the Sutton Shareholdings Board.

6. Appendices and Background Documents

Appendix letter	
None	

Background documents
None

Audit Trail		
Version	Final	Date: 29 January 2019
Consultation with other officers		
Finance	Yes	Lyndsey Gamble
Legal	Yes	Fabiola Hickson
Equality Impact Assessment required?	No	N/A