

## 1. INTRODUCTION

- 1.1 We are instructed by Shropshire Council (the “Council”) in respect of the Council’s rationale for approving the establishment of a new company limited by guarantee (“Newco”) as a subsidiary of Cornovii Developments Ltd (“CDL”).
- 1.2 The proposal to establish Newco follows recommendations made by KPMG in their draft report to CDL: *Cornovii Developments Limited: Alternative land transaction structuring July 2023* (the “KPMG Draft Report”), and a related KPMG memorandum dated 16 Augst 2023: *Cornovii Developments Ltd – Tax Comments on land purchases from Shropshire County Council* (the “KPMG Memo”), and advice received from Shakespeare Martineau in consideration of the KPMG recommendations (the “SHM” Advice”).
- 1.3 We are asked to prepare a report which considers the Council’s rationale for approving CDL’s setting up of Newco.
- 1.4 We have received and reviewed the documents listed below and attended an initial meeting with Miranda Garrard, (our instructing officer), on 14 September 2023.
  - 1.4.1 The KPMG Draft Report;
  - 1.4.2 The KPMG Memo;
  - 1.4.3 The SHM Advice;
  - 1.4.4 The Housing Scrutiny Bord Report;
  - 1.4.5 The Housing Scrutiny Board Terms of Reference Review and Governance (5 November 2020);
  - 1.4.6 CDL’s Articles of Association;
  - 1.4.7 The Shareholder Agreement between CDL and the Council (11 December 2019);
  - 1.4.8. The Equity Subscription Agreement between CDL and the Council (19 March 2020).

## **2. THE CURRENT OPERATIONS AND GOVERNANCE ARRANGEMENTS OF CDL**

### **CDL's Operations**

- 2.1 CDL was established by the Council as a housing development company and acquires land from the Council (or potentially a third party) for the purpose of providing new, mixed tenure sustainable housing in Shropshire. The developments are designed and built of by third party contractors procured by CDL.
- 2.2 CDL is a private company limited by shares incorporated on 6 July 2019 under the Companies Act 2006 ("CA2006"). On 12 August 2019 CDL adopted bespoke articles of association (the "Articles"). On 11 December 2019 CDL entered into a shareholder agreement (the "Shareholder Agreement") with the Council. On 19 March 2020 CDL entered into an equity subscription agreement (the "ESA") with the Council.

### **CDL's Governance Arrangements**

- 2.3 Pursuant to CDL's Articles, the company's directors are responsible for the management of the company's business for which purposes they may exercise all the powers of the company. The Articles further provide the Council, as CDL's shareholder, with a 'reserve power' where by way of a special resolution, the Council may require the directors to take, or refrain from taking, a specified action.
- 2.4 The Articles are supplemented by the Shareholder Agreement between CDL and the Council. The Shareholder Agreement provides at schedule 1 for various corporate and operational 'shareholder consent matters'. These are matters which cannot be effected by the CDL directors without the Council (as shareholder) having first resolved to grant consent.
- 2.5 The Council's shareholder function is exercised by the Council's Housing Scrutiny Board. We are aware that the Council is currently undertaking a comprehensive governance review which will consider the Council's companies and the exercise of its shareholder / member function in respect of them.

## **3. THE KPMG RECOMMENDATIONS**

- 3.1 The KPMG Draft Report recommends that Newco is established as a company limited by guarantee, either as a subsidiary of CDL or in parallel with CDL, to purchase land from the Council and then onward sell the land to CDL. Being in the form of a company limited by guarantee will mean Newco is not in the same tax group

as the Council and CDL. This enables the base value of land transferred from the Council to Newco to be that determined as the point of appropriation by Newco as stock and not the value at the time the land was acquired by the Council, thereby reducing the corporation tax payable in respect of capital gains on the disposal of the land.

#### **4. THE SHM ADVICE**

- 4.1 It is our understanding that the SHM Advice was prepared for CDL in consideration of the KPMG Draft Report. In short, the SHM advice confirmed that Newco can be established as a subsidiary of CDL in the form of a private company limited by guarantee (“CLG”).

#### **5. THE COUNCIL’S FUNCTIONS AND POWERS TO ESTABLISH NEWCO**

- 5.1 The Council’s powers which it will have exercised in establishing CDL are:
- 5.1.1 The General Power of Competence (“GPOC Power”) – Sections 1 and 4, Localism Act 2011 (“LA2011”);
  - 5.1.2 The power to trade (“Trading Power”) – Section 95, Local Government Act 2003 (“LGA2003”) and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009/2393 (“2009 Order”);
  - 5.1.3 The power to borrow (“Borrowing Power”) – Section 1, LGA2003;
  - 5.1.4 The power to invest (“Investment Power”) – Section 12, LGA2003;
  - 5.1.6 The power to dispose of land (“Disposal Power”) – Section 123, LGA1972;
  - 5.1.7 The powers to provide housing accommodation under Part II, Housing Act 1985 (“HA1985”) including the power to provide housing accommodation (Section 9), the power to acquire land for housing purposes (Section 17) and the power to dispose of land held for housing purposes (Section 32) (“Housing Powers”).
- 5.2 In approving the establishment by CDL of Newco the Council will be using its GPOC Power but this will also be an arrangement for the continuous improvement in the Council’s exercise of its Disposal Power in accordance with its overarching ‘best value’ duty pursuant to section 3 (1) of the Local Government Act 1999 (“LGA1999”).
- 5.3 The Council will also have regard to its common law fiduciary duty to safeguard public money.



## **6. THE COUNCIL'S RATIONALE FOR ESTABLISHING NEWCO**

- 6.1 The officer reports which recommended establishing CDL will include the reasons and rationale as to why creating a subsidiary company was considered to be the most appropriate means through which to achieve the objectives for which CDL was set up – namely, the development of primarily Council owned land for the provision of housing.
- 6.2 To complete the picture, minimising or avoiding tax liabilities is entirely lawful (unlike tax evasion) to the extent possible within the law. The Council also has a fiduciary duty to safeguard public money, and this can be legitimately said to be an arrangement under the LGA1999 to secure 'best value' through continuous improvement in the discharge of its functions with regard to economy, efficiency and effectiveness.
- 6.3 Given the prevailing economic conditions and the increased cost of developing the land so far transferred to CDL, it may also be the case that the viability of CDL's proposed and future developments, and as such the continuation of CDL and its business, will be at risk if the tax efficiencies proposed in the KPMG Draft Report are not realised.

## **7. GOVERNANCE ARRANGEMENTS**

- 7.1 Newco will be incorporated as a private company limited by guarantee under the CA2006, and as such will be a distinct legal entity separate from CDL and the Council. Newco will be subject to regulation under the CA2006 and as a local authority company, also the requirements of Part V of the Local Government and Housing Act 1989 and the Local Authorities (Companies) Order 1995 Order.
- 7.2 We recommend that bespoke articles of association are prepared for Newco, supplemented by a bespoke member / governance agreement between Newco and CDL / the Council which provides for the exercise of the Council's member function in relation to Newco, and the company's reporting and provision of information to CDL and the Council.
- 7.3 To the extent possible, Newco's governance arrangements should be aligned with those of CDL.

## 8. SUMMARY

- 8.1 The group structure recommended by KPMG whereby Newco will sit outside of the tax group formed by the Council and CDL is the means by which CDL will reduce its exposure to corporation tax as advised by KPMG.
- 8.2 The Council's fiduciary and best value duties provide the rationale for approving the establishment by CDL of Newco which extends beyond merely mitigating tax liability.
- 8.3 Newco will be incorporated and regulated as a CLG under the CA2006, and as a local authority company, will be subject to the LGHA1989 and the 1995 Order.
- 8.4 Governance arrangements for Newco should be aligned with those for CDL, and bespoke articles of association and a bespoke member / governance agreement should be prepared for Newco, which provide for the exercise of the Newco member function and reporting arrangements from Newco to CDL and the Council.

We would be happy to advise and assist further subsequent to the consideration of this report. If there are any queries or any further information is required in the meantime, please do not hesitate to contact us.

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