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The Law Society

# theLaw

*Armstrong Watson's specialist publication for the legal profession*

Winter 2016/17

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Helping to boost value in your clients business

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Welcome to the Winter 2016/17 edition of The LAW, the specialist publication for the legal profession from the legal sector team at Armstrong Watson.

In this edition, we focus on:

- Capital allowances – an area in which we often work alongside lawyers
- Business sales – another area where we work alongside lawyers
- Planning opportunities on the new residence nil rate band
- The impact of auto enrolment on members of LLPs
- Document production outsourcing

I have recently had the honour to have been invited by the SRA to sit on their SRA Accounts Rules reference group. This group will be used to test their ideas and assist with development of a support toolkit for law firms. This is to be welcomed as it is an indication that the SRA is reaching out to specialists for input before they implement changes.

Specialists are available from all of our 16 offices to provide pro-active support and advice to lawyers in compliance and business improvement matters. This publication is designed to allow us to share our collective experience in acting for lawyers throughout the UK.

In addition to providing comment via The LAW, we share up to date views via our monthly Legal News, our bi-monthly legal M&A opportunities and via twitter. If you would like to follow me, I am @AW\_AndyPoole

Please contact me if you would like to discuss how we can help you, or if you would like any further information on anything referred to in this publication.



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# Working with Lawyers on business sales

Lawyers and accountants working together on an exit strategy for business owners - helping to boost the value in your clients business

**A key decision for business owners is how they exit their business and maximise the return for all their hard work over the years. Selling the business on the open market is often the best route. Many business owners who know that major business decisions require careful thought, planning and preparation do not always prepare for the sale of their business. What bigger decision is there than opting to sell their business?**

It is not just the case of putting up a for sale sign, marketing the business and inviting interested parties to bid. Experience shows that planning and preparing for the sale of a business helps achieve the highest possible value and allows a smoother transition process. Planning should start at least three to five years before the sale is anticipated.

There are a lot of matters to consider.

Key points include:

- Put in place a strong supporting management team – the business needs to continue successfully once the business owner is out of the picture – effectively the business owner needs to “be made redundant”
- Demonstrate trading that shows growth and sustainable earning
- Look at cost efficiencies – focus on spending and expense control
- Prepare a realistic and supportable forecast model
- Have strong financial controls and processes
- Have reliable and accurate financial reporting
- Reduce customer concentration
- Separate family issues from business issues – “restructure shareholder expenses habit”
- Tidy/clean up the balance sheet – remove non business assets

Reflecting back over a number of company sales we have advised on, there have been instances where involving a commercial solicitor in the preparation and planning stage has benefitted the client in the final deal. This has reduced issues coming out of the legal due diligence stage and avoided price chipping and last minute negotiations. Also it has avoided “deal creep” - when extended timescales allow both sides to think too much about small minor issues and uncertainty creeps in.

This results in the parties losing sight of the bigger picture and the overall objective, and a deal that felt and looked right becomes too risky and falls over on the back of minor issues.

Normally we would engage with solicitors at Heads of Terms stage when the deal structure and price has been agreed. So if issues arise after Heads of Terms, there is often a price renegotiation or change in deal structure such as an introduction of a deferred / contingent consideration element.

Working together with a client’s commercial solicitor at an earlier stage and having additional legal input at the preparation and planning stage could avoid those pitfalls.

This may entail undertaking some legal due diligence on the business at the planning stage and areas to consider and review, include:

- Property – leasehold / freehold property contracts
- Employees’ contracts
- Compliance with employment legislation and pensions
- Securing the key people – share options, robust service contracts
- “Auditing” the statutory books, previous share changes, reconstructions and any company purchases of own shares
- Customer contracts - change of ownership clauses
- Supplier contracts - change of ownership clauses
- Health and safety
- Protecting IP
- Legal dispute settlement
- Tidying up the share holding - buy back of minority shareholders
- Accreditations and licences

Lawyers and accountants working together can provide a package of advice to support business owners in preparing for a sale, and maximising the value they secure.



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# What is the Residence Nil Rate Band (RNRB) and what opportunities does it present?



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An additional Inheritance Tax (IHT) free allowance, the Residence Nil Rate Band available to use against a property (or assets representing it) that has at some point been occupied as the family home, will be introduced in April 2017.

An additional Inheritance Tax (IHT) free allowance, the Residence Nil Rate Band available to use against a property (or assets representing it) that has at some point been occupied as the family home, will be introduced in April 2017.

Where a property (or assets representing it) is inherited on death of the owner by direct descendants, RNRB could result in a £140,000 IHT saving once fully implemented.

The RNRB only applies to deaths on or after 6th April 2017 and it will be transferable between spouses and civil partners, but larger estates may lose RNRB entitlement due to tapering.

The RNRB will be phased in over the next four years as follows:

Tax Year	RNRB
2017-18	£100,000
2018-19	£125,000
2019-20	£150,000
2020-21	£175,000
Onwards	Consumer Prices Index (CPI)

The legislation received Royal Assent on 18th November 2015 and has been one of the most talked about changes in recent years. Solicitors, accountants and financial advisors alike have speculated over the detail and proposed changes.

Why is it so emotive?

- In 2009/10 2.6% of deaths in the UK resulted in £2.4bn of IHT becoming payable.
- In 2015/16 7.1% of deaths in the UK resulted in £4.4bn IHT being payable.
- In 2020/21 it is forecast that 6% of deaths will result in £5.6bn of IHT being payable.  
(Source: Office for Budget Responsibility).

Whilst we have become used to low inflation in recent times, these figures illustrate just how both the number of deaths resulting in IHT being payable and the revenue receipts from IHT are growing year on year. This is particularly emotive given the role of the family home in so many of these cases.

As with all legislation, the key is understanding the finer detail:

What is a qualifying residential interest?

- An interest in a dwelling or house which has at any time been the deceased's residence and which forms part of their estate.
- No unused element can be carried forward against another property.

Closely Inherited:

- Inherited on death (by will, intestacy or some other means) by one or more of the deceased's children, grandchildren or other lineal descendants.
- The above includes the following trusts: Absolute/Bare, Immediate Post Death Interest, Bereaved Minors.
- But not discretionary trusts.

The Taper Threshold:

- Where the deceased's estate exceeds £2m (the taper threshold) the appropriate RNRB will be reduced by £1 for every £2 by which the taper threshold is exceeded to provide an 'adjusted allowance'.
- The £2m threshold is the net estate value after deducting liabilities, but before applying any relief or exemptions (including the current nil rate band, business property relief and agricultural property relief). The RNRB is lost entirely on an estate valued at £2.4m or more.

What are the planning opportunities?

- Lifetime gifting
- Using standard NRB on first death
- Using RNRB on first death (switch ownership to tenants in common)
- Avoiding BPR qualifying assets being passed to providing spouse/civil partner
- Gifting BPR qualifying assets prior to death.

New ideas? Not really, and many clients will fall directly into the group who will benefit from the RNRB without making any changes at all, but this does nonetheless present planning opportunities for many professional firms and the legislation will allow for specialists to showcase their knowledge and provide genuine savings for their clients and their families.

Planning opportunities will vary with each client circumstance, but now may be the time to challenge conventional thinking. Should the standard NRB be used on first death, thereby ensuring the full RNRB is used on property? Should RNRB be used on first death with ownership switched to tenancy in common? Should the gifted assets be BPR qualifying assets to reduce the estate value below £2.4m, or even £2m?

This is an area that legal professionals simply cannot afford to ignore.

# Capital Allowances Back to Basics

I spend a lot of my time speaking to solicitors about capital allowances; typically this has been in respect of the recent changes involving commercial property transactions. However it has become clear that a lot of solicitors are uncomfortable exactly how capital allowances work, so are effectively being asked to run before they can walk. I therefore thought it worth writing an article that was effectively a back to basics for capital allowances.

What are capital allowances?

This is a difficult thing to describe succinctly. If you capitalise assets on a company balance sheet you are not entitled to tax relief on the depreciation charged to the profit and loss account on those assets. Instead, capital allowances are permitted as a means of obtaining tax relief on some of those assets.

The tax relief means that depending on the item in question, it will qualify for a certain rate of tax relief, typically 18% or 8% of the cost each year until all of the expenditure has been written off. This figure is deducted from the taxable profits of the business.

Not all assets are eligible to claim capital allowances and there are quite a few grey areas. An experienced capital allowances specialist can look at the items a business has purchased and maximise the amount you can claim and maximise the speed in which you receive the relief.

What is the Annual Investment Allowance ("AIA")?

This is another question I get asked frequently.

Receiving tax relief at 18% or 8% each year is a slow process, therefore the government introduced the AIA to stimulate spending on enduring assets. The first £200,000 (apportioned for short or long periods) a business spends on assets is entitled to tax relief at 100% in year one; this is obviously much better from a cash flow point of view and a great help to a large number of businesses. As well as helping cashflow it eases the administration burden of companies as well.

To make a complicated matter more complex, the government has constantly tweaked the level of AIA available:

- £200,000 for expenditure incurred from 1 January 2016
- £500,000 for expenditure incurred from 1 April 2014
- £250,000 for expenditure incurred from 1 January 2013



- £25,000 for expenditure incurred from 1 April 2012
- £100,000 for expenditure incurred from 1 April 2010
- £50,000 for expenditure incurred from 1 April 2008

This is frustrating as it means that our clients who spend a lot on assets have little certainty as to the tax relief they will receive. The transitional rules are complex too, which further increases the administration burden on businesses, so we hope that the figure will remain the same for the foreseeable future.

There is a surprisingly large amount of planning that can be done around the AIA:

- There are a lot of items excluded from the AIA
- If you exceed the AIA you need to best allocate which items are set against it and which are not around
- Time your expenditure around the fluctuating rates
- Groups – allocate the allowances efficiently around the group, or even structure the group differently in some scenarios
- Short life asset elections

This is a tricky area for all concerned and something that often needs to be run past your client's tax advisers.



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# Automatic Enrolment legislation - Limited Liability Partnership exceptions

Since the introduction of Auto Enrolment (AE) in 2012, millions of people have been enrolled into a workplace pension scheme, with many larger firms now involved in re-enrolling their workforce.

The legislation applies to those who are employed and classed as 'workers' but not to all staff. Instead, there are different categories of workers determined by age and earnings.

Some time ago, we wrote an article in *The LAW* referring to members of LLPs and the circumstances under which they were deemed to be a worker under AE legislation. This situation appears to have since developed further.

In a 'Detailed guidance for employers no. 1' document published by The Pensions Regulator (TPR), page 22 highlights a list of exceptions from employer duties. Section (e) specifically relates to Limited Liability Partnerships and provides the following definition:

- A worker who is a member (partner) of a Limited Liability Partnership (LLP) and is not treated for income tax purposes as being employed by that LLP under section 863A of the Income Tax (Trading and other Income) Act 2005

In our previous article we highlighted the Supreme Court ruling of *Clyde & Co v Bates van Winkelhof*, whereby a member in an LLP was deemed to be a worker under the Employment Rights Act 1996 and TPR's view is that an LLP should assume that this decision by the Supreme Court's in

2014 is still equally applicable to the Pensions Act 2008 for AE purposes.

This is not to say that every member in an LLP is a worker for AE purposes, but instead that they could be. Where this exception applies, TPR have stated that the employer can choose whether to apply the AE rules (including automatic re-enrolment) to the worker(s) concerned.

This may represent a good time to review the guidance, to ensure that the impacts can be addressed in order to prevent the possibility of AE fines, which become payable by failing to comply with the legislation.

If you need help, please contact our Financial Planning Team on 0808 144 5575.



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# An interview with... Martyn Best, Chief Executive at Document Direct



Document Direct are specialists in document production, typing, and transcription for the legal sector

## 1. What are the key challenges that law firms are facing today?

Law firms are a business, and they face the challenges that every business faces every day. These include the need to retain and gain new customers, seek to improve profitability, become more efficient, adapt and adopt new technologies, keep staff happy and motivated, and do all of this whilst hopefully retaining the correct work/life balance that we all seek.

Specific to the legal sector, they are also facing the challenges that we come across in an increasingly fast-moving world including increasing use of social media; the threats of cyber security; the uncertain impact of Brexit; the changing face of finance and funding issues; new entrants following the Legal Services Act; and the clear impact that technology is having on their ability to deliver their advice.

## 2. What risks do those challenges present to law firms?

I would say that these challenges present opportunities for law firms and those managing them to positively react to each of these issues. How they react will depend on their own particular situation, size, partner demographic and the recognition that they do need to be proactive.

Each element of the above, and many other challenges present their own individual risk, but the fundamental risk lies in the failure to recognise the need to react.

If there is any complacency that may govern the management style of any law firm, this will not help them take positive steps to address these challenges, and ensure their long term success and survival.

These risks and challenges are not issues to be afraid of – they are just part of the many elements that face us all as business people, and lawyers are no different.

## 3. What trends are you seeing in the legal sector right now?

My vision of the legal sector is governed by my own perspective as a provider of support services, and placing my business at their disposal to help them become more efficient, more profitable, and better able to continue to deliver the best possible service for their own clients.

So those trends do show an increasing, albeit slower than it should be, acceptance of the need to bring in specialist skills in areas other than the delivery of legal opinion.

These will include my own services in the world of typing and transcription which helps reduce their fixed costs of secretaries, and provides a quicker and more accessible service truly when it is required. Being governed by the previous need to employ and house people is not what 2016 technologies allow us to do.

These trends will also include the better use of proven technologies such as cloud-based servers, the ability to deliver their opinions away from their traditional office base, and at times that better suits them and their clients.

The benefits of flexibility, mobility, agility, and better delivery vehicles are all permitted by those recent developments.

## 4. How and why did you obtain an endorsement from the Law Society and what does that mean for your legal clients?

The Law Society has clearly been effective at recognising some of those developments and last year there was the formal recognition that outsourcing typing and transcription was a growing trend. As a consequence, they issued a very complex review process upon which to base their endorsement of just one supplier of this service.

Document Direct was delighted to be chosen as the exclusive endorsed typing partner of the Law Society, and I consider that this helps underpin the credibility of this service generally, and I like to think that the choice of us speaks for itself.

I believe it adds a very high level of credibility to our service and provides any law firm who is considering engaging us with a level of comfort that we can deliver high levels of security, confidentiality and cost savings to them, and help law firms deliver a better, faster and more cost-effective service to their clients.

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