

# The Law

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

Spring 2015

An interview with...  
**Chrissie Lightfoot**  
Entrepreneur Lawyer and author  
of *The Naked Lawyer*

## Salary Exchange to Pension

We explore how this  
could be beneficial for  
both employer and  
employee

**Law Firm Valuations**  
How we value law firms

## Mortgages for partners in law firms

Special offer

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## Welcome

to the Spring 2015 edition of The LAW, the specialist publication for the legal profession from the legal sector team at Armstrong Watson.

Specialists are available from all of our 15 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.

Thank you for all of your positive feedback on our **endorsement by the Law Society**. Those that experience our service have said "we know why the Law Society would be happy to endorse you".

We've jointly written a **toolkit for the Law Society on Financial Stability in law firms**. It is now **available for pre order** at <http://ow.ly/LhhNM>.

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.

**Andy Poole**  
Legal Sector Partner  
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## In this edition:

### Law Firm Valuations

Rosy Ware looks into the circumstances when law firms should be valued.

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### VAT & Commercial Property – issues for solicitors when advising clients

David Graham explores this important area of VAT which needs to be carefully considered before advising clients on their property.

[david.graham@armstrongwatson.co.uk](mailto:david.graham@armstrongwatson.co.uk)

### Salary Exchange to Pension – A Win Win Solution for many

Brian Stenhouse advises on the benefits of a salary sacrifice pension scheme for both the employer and employee.

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### Mortgages for partners in law firms

Andy Kilby talks about the challenges in arranging mortgages for partners in law firms and how we can help.

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### An interview with...

Andy Poole chats with Chrissie Lightfoot, legal futurist and author of best-seller 'The Naked Lawyer'.

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## The Law Society has exclusively endorsed Armstrong Watson for the provision of the following services to law firms throughout the North of England:



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# Law Firm Valuations

Rosy Ware, Legal Sector Manager

It would be easy to assume that a law firm valuation is only required when it comes to selling your business.

However, there are actually numerous instances which may require a need for the firm to be valued. This could be the sale of the firm, but also for any of the following reasons:

- A change in structure or incorporation
- Admitting new partners, or the retirement of existing partners
- For acquisition or merger purposes
- Disputes with exiting partners

The examples above occur regularly within law firms, whatever their size or location.

The financials of the business, its turnover, gross and net profit margins and its size, are a good place to start when valuing a law firm but there are many more things to consider which can affect its value.

Put simply, there isn't one universal method that can be used when it comes to valuing a law firm. When we undertake a valuation, we produce a formal detailed report concluding the most appropriate open market value of that firm.

Our report identifies the potential valuation methodologies which could be used. We consider changes in the legal market which have, or may, directly affect the firm. We also take into account the firm's own unique factors including the reason for the valuation; the location; key people; work types; market; and prospects. The conclusion of the report selects the most appropriate valuation methodology, and this is applied to our analysis of the most

recent financial position and results to generate our valuation.

A recent example of a law firm valuation we have undertaken concerned a dispute over the value of shares. The shares belonged to an individual who had left a law firm that he had initially established. The valuation of the shares that had been offered by the other party was virtually Enil, whereas our client was expecting significantly more.

The terms of the shareholders' agreement stated that an independent valuation was to be carried out following an appointment of an arbitrator by the President of the ICAEW. We were instructed to fully value the law firm for submission to the independent arbitrator. The report we prepared was on an independent basis and took into account all the relevant factors, as outlined above.

The approach that we take to all valuations is one of independence. We do not artificially inflate the valuation as part of any negotiation process, and would not provide a valuation that we could not defend in court.

Our report mentioned above, valued the individual's shares in excess of £100,000. The report was submitted on this basis, and the independent arbitrator's valuation was in line with our calculation, and provided a fair valuation for all concerned.

More importantly, it was a result that our client was delighted with.





# VAT & Commercial Property – issues for solicitors when advising clients

David Graham, Assistant VAT Consultant

When solicitors advise clients on property related transactions, there are numerous considerations that need to be taken into account. One consideration that can often be overlooked is the potential VAT impact of the transaction.

This article looks to provide an overview of the key factors that solicitors should bear in mind when advising on a transaction involving commercial property.

## Construction and sale of a new commercial property

Any costs associated with the construction of a new commercial property will be standard rated for VAT. Commercial property construction does not share the same VAT reliefs that benefit the construction of residential properties.

The sale of a 'new' freehold commercial property is a standard rated supply for VAT purposes and therefore if the intention of the developer is to sell the property on completion, then they can recover the input VAT that they incur on its construction.

'New' is considered to be any property that is less than three years old.

## Rental income and the sale of an 'old' commercial property

Any rental income obtained from a commercial property has a default position of being exempt from VAT.

If the intention is to construct a commercial property to rent out, then due to this VAT liability the input VAT incurred on the development would be non-recoverable.

The sale of a commercial building over three years old also has a default position of being exempt from VAT. Therefore if, for example, a client owns a commercial property and incurs costs renovating the property with a view to a sale, then the input VAT would be non-recoverable as being in relation to a VAT exempt sale.

However, in both of these cases the default exempt position can be overridden by making an Option to Tax on the property.

## Option to Tax

By making an Option to Tax on their property, your client would change the VAT liability of supplies of the property from being exempt to standard rated.

The effect of this is that any input VAT incurred in relation to the property would become recoverable; however it must also be made clear that this also means that output VAT would need to be charged on any future rent or sale of the property.

A key consideration would also be the Stamp Duty Land Tax effect – SDLT is payable on the VAT inclusive price of a land or property sale, therefore an Option to Tax on the property will increase the amount of SDLT payable by the purchaser.

### **Transfer of a Going Concern**

The sale of a business is a transaction that will be seen regularly in the legal profession and many such sales are structured as a transfer of a going concern. Transfers of a going concern allow the sale to be treated as outside the scope of VAT.

If the business includes commercial property with an option to tax on it by the seller, it is a qualifying condition of the transfer of a going concern rules that the purchaser also opts to tax the property to enable the whole purchase to be outside the scope of VAT.

This is only one of the rules that must be met for a transfer of a going concern to occur – advice should be sought to ensure all other conditions are also met.

This can be beneficial especially where SDLT is payable - no VAT means less SDLT.

### **Capital Goods Scheme**

It should also be noted that if a building is a capital goods scheme asset and a transfer of a going concern is made, the responsibility for future capital goods scheme adjustments transfers to the purchaser.

A property falls within the rules of the capital goods scheme if the owner incurs VAT bearing capital expenditure on its acquisition, construction, refurbishment, fitting out, or alteration or extension with a value of at least £250,000.

VAT should always be considered in a property transaction, and we always advise that specialist VAT advice is sought to confirm the position prior to exchange of contracts. It can often be too late to correct the VAT position once this point has been reached.





# Salary Exchange to Pension – A Win Win Solution for many

By Brian Stenhouse, Director of Payroll

With Auto-Enrolment now affecting more and more SME's, businesses are increasingly looking to find ways to minimise the costs involved. For those who have not had pension schemes in place they have the added cost of employer pension contributions in addition to the costs associated with implementing and managing the ongoing Auto-Enrolment process. One measure that is worth consideration is 'Salary Exchange to Pension'.

This option has been available for many years and a significant number of companies have already taken advantage of it; some have saved a considerable amount of money.

The majority of businesses will have, or will introduce, AE compliant 'Personal Pensions' for their workforce. This type of pension involves deducting the employee contribution from their net pay.

Under a 'Salary Exchange' scheme, the employee agrees to 'exchange' a percentage of their gross salary to cover the pension contribution. The employer is then responsible for paying this contribution to the pension provider in addition to their original employer contribution.

Because the employee contribution has been deducted from gross pay, the employee reduces both their income tax and NIC liability and if done correctly, will see an increase in their net pay. The employer will have a reduced NIC liability. So, both employee and employer make savings with the employee receiving higher take home pay. Some employers also increase the employee pension contribution by paying across a percentage of the employer NIC savings.

As an example, an employee earning £20,000 per annum with a tax code of 1000L and contributing 3% net into a personal pension would see a monthly increase of around £7.40 in net pay and the employer would reduce NIC by £8.63 per month. For someone

earning £40,000 per annum, their monthly net pay would increase by £15 and the employer would save £17.25 each month.

Salary Exchange is a contractual change, therefore Contracts of Employment need to be amended to reflect this. Employees cannot be forced to accept the change, and for some, it would not be advantageous.

For example, those below the NIC threshold would not benefit, or those considering maternity leave in the near future as the SMP earnings would be calculated on their reduced salary.

The payroll software needs to be able to process the Exchange correctly; the Notional Salary (Contractual Salary), should ideally be shown on the payslip, and overtime rates etc. will need to be calculated using the Notional Salary, not the Salary after Exchange. There are also considerations when setting up the Auto-Enrolment details with the Pension Provider. Most require a separate 'group' to be set up within the pension fields to distinguish between non 'Salary Exchange' and 'Salary Exchange' employees. The payroll software will also need to be able to split these types in the pension export file.

To establish the Salary Exchange, a few before and after payslips should be produced and a letter explaining the scheme should be sent to HMRC together with the payslips for clearance.

The scheme rules and the process will need to be communicated to employees and advice given as regards individual suitability for the scheme in advance of implementation.

Companies have used this facility as an employee benefit and it has been helpful in attracting and retaining staff as well as saving the company money. Armstrong Watson ourselves have operated such a scheme for several years and have advised and implemented schemes with a number of our clients.



# Mortgages for partners in law firms

By Andy Kilby, Managing Director,  
Armstrong Watson Financial Planning Limited

The Financial Conduct Authority (FCA) introduced new rules for mortgage lenders last year (known as the Mortgage Market Review). One of the primary aims is to ensure that lenders only approve mortgages that they have confirmed borrowers can afford, both now and in the future, and in the event that mortgage interest rates rise.

Mortgage lenders are now expected to obtain much more detailed information about a borrower's income and expenditure (and see documentary evidence of this), along with understanding the impact that future changes in borrowers' circumstances may have.



For potential borrowers with the most straightforward finances, such as salaried employees, the process of obtaining a mortgage can now be considerably more onerous than it used to be, but for legal professionals it can be more challenging still. Many within the legal sector are self employed, often with fluctuating profit share, and in firms with more complex structures it can be difficult to clearly substantiate earnings levels.

This is often where additional help is invaluable, as some lenders can prove difficult to deal with where applications are not straightforward.

**Editors Note:  
Special offer -  
Partners in full recurring  
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clients will receive a £100  
credit against their personal  
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Financial Planning**

As part of the specialist services Armstrong Watson provide to the legal sector, we are able to offer independent mortgage advice via our financial advisory division, Armstrong Watson Financial Planning & Wealth Management.

Our process is to firstly establish your specific requirements, after which we are able to examine the whole of the mortgage market to source the most suitable solution. We are able to consider all lenders as we aren't tied to a specific provider or panel of lenders.

We are also able to draw on our experience of the market to approach the lenders who are most likely to be able to assist.

For existing legal sector clients, we usually have a good understanding of their remuneration structure, which makes it easier for us to clarify earnings. This can help speed up the application process, increasing the prospect of a mortgage being approved and, importantly, saving time and hassle.

If you would like us to help with your property finance, please contact Andy Poole, Legal Sector Partner, in the first instance and he will liaise directly with our mortgage specialist.

# An interview with ...Chrissie Lightfoot



Andy Poole chats with Chrissie Lightfoot, legal futurist and author of best-seller 'The Naked Lawyer' and 'Tomorrow's Naked Lawyer: NewTech, NewHuman, NewLaw – How to be successful 2015 to 2045'.

## What changes do you think law firms will be facing over the next five years?

We have only felt the first fluttering of the butterfly wings of climatic change that the legal ecosystem is about to experience. Technology is progressing at an exponential rate. Accordingly, the way in which lawyers go about their daily work and their role (who, what, where, why, when and how) – research, due-diligence, drafting, process, advising, delivery, rainmaking etc - will change incrementally (and somewhat dramatically in some areas of law) over the next few years.

The impact of NewTech, a term I coined for cloud-based systems software and artificially intelligent machine systems, at the cutting-edge of what was once deemed 'futuristic', cannot be under-estimated or understated in bringing about legal efficiency. Discerning clients and prospects, from GC to the layman, expect and demand efficiency. Law firms will certainly need to face the challenges and changes with regard to the modernisation of the courts, innovative pricing, big data capture and new analytic tech, psycholinguistics in audio-analysis, and balancing the legal risk and business advantage of social media.

Artificial Intelligence (AI) in law is here now. Law firms are going to come under increasing competition from 'new entrants' and entrepreneurs as well as deal with bold moves from the 'traditional' law firms that have already deployed and/or begun developing (or have already developed) smart AI systems to help their lawyers be more efficient and productive; for example, Hodge Jones & Allen, A&O, DAS and Riverview Law. Student lawyers have recently designed an app called Ross, that they claim is the first "artificially intelligent attorney", able to conduct legal searches in answer to natural language queries, based on IBM's cognitive computer, Watson.

## What changes do you think law firms will be facing over the next twenty years?

The relentless march of industrialisation, wearable technology, AI and robotics will push the boundaries of what it means to be human, social and a lawyer in the next 20 years.

By 2020, avatars will be mainstream. By 2025, robots will have entered every aspect of human life and will be performing a wide range of functions, from complex surgery to policing and security. It's highly probable that robots will be performing complex legal services too within the next 20 years; AI (and robots) by that time will possess iterative AI.

Ultimately, greater use of both cognitive and iterative AI in a range of legal roles, tasks and delivery will ensue and we will witness the rise of iCyborg Lawyer and Robot Lawyer in the legal ecosystem; there will be blue-collar and white-collar robot legal staff working alongside 'pure blood' human lawyers and 'hybrid humans' (NewHuman).

## What should law firms be doing about those changes now?

The new arms race is all about AI. NewTech and NewHuman in the legal industry are to be embraced immediately for the age of AI and robotics is here, albeit not prolific, yet.

The evolution is inevitable and lawyers will need to future-proof their careers and livelihoods as law firms in turn will be challenged to future-proof its business. Steps which can be taken include:

- Embracing the new breed of consumer/customer/client;
- Being SocialHuman and embracing social networking, relationship building, rainmaking,
- Creativity, innovation, intrapreneurialism and entrepreneurialism;
- Embracing the role that technology and AI can play for law firms, and clients – in particular, marketing automation to support SocialHuman activity;
- Embracing the full spectrum of choice and opportunity to provide low-cost commoditised services juxtaposed with high-cost, high-end, intellectually and emotionally intelligent services,
- Creating competitive new practice areas and
- business offshoots.

## Does engaging with legal sector specialist advisers make a difference to law firms?

I share Stephen Mayson's view in a previous edition of The Law when he said "even if law firm owners and managers think they understand themselves, their markets and their clients, they can always benefit from a reality check and a helping hand." The dawn of robot law is upon us. Realise the future or ignore it, prepare or watch from the sidelines: it's your choice.