

# The Law

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

Spring 2014

## Pensions: a ticking time-bomb?

We highlight some tips on reviewing your pension

## An interview with... Cees Zwaard of Law Management Plus

## Share and Share Alike

We discuss the option of EMI shares for family owned companies

## Benchmarking

We reveal the latest trends from our benchmarking database

**ArmstrongWatson<sup>®</sup>**

Accountants & Financial Advisers

A track record of providing solutions to the legal profession



Welcome to the Spring 2014 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.

One of the articles in this edition of The LAW is part of our series of 'good ideas' for the legal profession. We've teamed up with Cees Zwaard of Active Management Plus to help to improve the business of law. Another 'good idea' that we've recently circulated is a solution that we're involved with for law firms looking to pull out of personal injury in the wake of LASPO and the Jackson reforms. If you are looking to re-evaluate your position, please do get in touch.

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 Director

@AW\_AndyPoole

## In this edition:

Valuation case study: referral from a law firm

Catherine Briggs looks at a business valuation undertaken for the purpose of a divorce case.

[catherine.briggs@armstrongwatson.co.uk](mailto:catherine.briggs@armstrongwatson.co.uk)

Capital allowances changes on commercial property deals

David Robinson advises on the capital allowances claim changes on commercial property.

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

Pensions: a ticking time-bomb?

Matthew Slessor highlights some tips on reviewing your pension.

[Matthew.slessor@armstrongwatson.co.uk](mailto:Matthew.slessor@armstrongwatson.co.uk)

Share and share alike

Nigel Holmes discusses the option of EMI shares for family owned companies.

[nigel.holmes@armstrongwatson.co.uk](mailto:nigel.holmes@armstrongwatson.co.uk)

What results should my law firm be achieving in the current climate?

Richard Andrew explains our benchmarking report for law firms.

[richard.andrew@armstrongwatson.co.uk](mailto:richard.andrew@armstrongwatson.co.uk)

An interview with... Cees Zwaard of Law Management Plus

Andy Poole interviews Cees Zwaard of Law Management Plus.

[andy.poole@armstrongwatson.co.uk](mailto:andy.poole@armstrongwatson.co.uk)

## How We Help Law Firms

- Strategy Planning Workshops
- Business Plans
- Benchmarking
- Trading Structure Reviews
- Mergers & Acquisitions of Law Firms
- Law Firm Valuations
- Forecasts
- Raising Finance
- Lock-up Reviews
- Partnership Disputes
- Pro-active Tax Planning
- Tax Compliance
- Audits
- Accounts Rules Reporting
- Accounts Rules Training
- Accounts Preparation

Call 0808 144 5575 to be connected to your local office, or visit [www.armstrongwatson.co.uk/legalsector](http://www.armstrongwatson.co.uk/legalsector)

Armstrong Watson Accountants and Financial Advisers is a trading style

Armstrong Watson is a partnership under English law. A list of partners is available at the principal place of business, 15 Victoria Place, Carlisle, CA1 1EW

Armstrong Watson is regulated by the Institute of Chartered Accountants in England and Wales for a range of investment business activities

Armstrong Watson Audit Limited is registered to carry on audit work in the UK and Ireland by the Institute of Chartered Accountants in England and Wales. Registered as a limited company in England and Wales No. 8800970. Registered office: 15 Victoria Place, Carlisle, CA1 1EW

This newsletter is a general guide to issues facing the legal sector. It is not a substitute for professional advice which takes account of your specific circumstances. Subjects covered change constantly and develop. No responsibility can be accepted by the firm or the authors for any loss occasioned by any person acting or refraining from acting on the basis of this publication.



# Valuation Case Study: referral from a law firm

Catherine Briggs,  
Corporate Finance Assistant Manager

In the Winter 2013/14 edition of The LAW Douglas Russell introduced the Armstrong Watson Valuations Faculty. Leading on from this we look at a business valuation recently undertaken by the team for the purpose of a divorce case.

Is the valuation of the business a science or an art? It is a difficult question to answer. Valuations are subjective and the only real way of establishing the value of a business is to put it on the open market.

Taking a methodical and robust approach will ensure a defensible valuation. An essential starting point is to be clear of the reason for the valuation. This will assist in establishing the basis.

The Armstrong Watson Corporate Finance team recently undertook the valuation of a partnership and corporate partner for a divorce case following our recommendation from a firm of solicitors. We weren't appointed as single joint experts but agreed a clear scope with the solicitors and their clients on both sides.

The purpose of the valuation was to assist in establishing the valuation of all the matrimonial assets as part of the negotiation of a settlement. The husband and wife were both partners in the partnership and shareholders in the corporate partner through which the hospitality sector business operated.

In our opinion the most appropriate basis for the valuation was the capitalised earnings method as the business was profitable and was continuing as a going concern. With this method the underlying maintainable earnings of the business are calculated and then a multiple applied to the weighted average maintainable earnings to arrive at a valuation.

In order to establish the maintainable earnings of the business we looked in detail at the trading history. A key part to this was to identify and adjust for any non recurring income and expenses reported in the business' financial results.

Determining an appropriate multiple (also referred to as a price/earnings ratio or PE ratio) can be subjective. The choice of PE ratio for private businesses is affected by factors including:

- the size of the business
- whether its profits are reliable, predictable, high margin and well spread over a relatively large number of customers
- its track record of growth and prospects for future growth

The members of the Armstrong Watson Valuations Faculty are involved in the buying and selling of businesses and therefore have up to date experience of the multiples being paid in the market.

In this case the business owned a valuable property so we worked closely with a chartered surveyor to establish whether the value on the balance sheet for the property reflected the market value. If any material assets owned by a business are significantly undervalued in the balance sheet then the amount by which they are undervalued is added to the earnings valuation.

For robustness we always have another member of the Armstrong Watson Valuation Faculty review the assumptions we have made.

The valuation formed part of the negotiations between the two sides and stopped the case proceeding to court.



# Capital allowances changes on commercial property deals

## - key points for commercial lawyers

David Robinson, Corporate Tax Consultant

Whilst most accountants and many business owners understand about claiming capital allowances on loose plant items such as tables, chairs and fridges; capital allowances are often overlooked on "fixed plant" such as electrical and heating systems.

From 6 April 2014 (1 April for companies), if all available allowances haven't been "pooled", i.e. identified before a commercial property is sold, included in a capital allowances computation and notified to HMRC; all allowances are lost forever - for the seller, the buyer and any future buyer. Commercial properties that are sold without capital allowances will be less attractive to a future buyer and will therefore have a depressed value as a result.

The rules in operation between April 2012 and April 2014 have in a sense been a half way house between the rather relaxed regime before April 2012 and the situation post April 2014. Since April 2012, the buyer and the seller have been required to agree between themselves the amount attributed to fixtures, usually via a Section 198 election, with the option for either the buyer or seller going to a First-tier Tribunal within two years of the sale where they are unable to agree. Where neither the buyer nor a previous buyer has made a claim, the buyer has been able to claim capital allowances under the just and reasonable apportionment rules.

From April 2014 onwards there is a major sea change. Where there has been a previous claim then a Section 198 election should still be agreed between the parties, still with the option of The First-tier Tribunal if they cannot agree. However, where it is established that the seller could have claimed capital allowances but did not do so,

it is now imperative for the seller to formally notify the expenditure qualifying for capital allowances in a tax return to HMRC before sale, before entering into a Section 198 Agreement to agree the capital allowances on sale.

**This really needs to be agreed as part of the negotiations on the sale of the property and it is imperative that solicitors provide the right advice at the right time.**

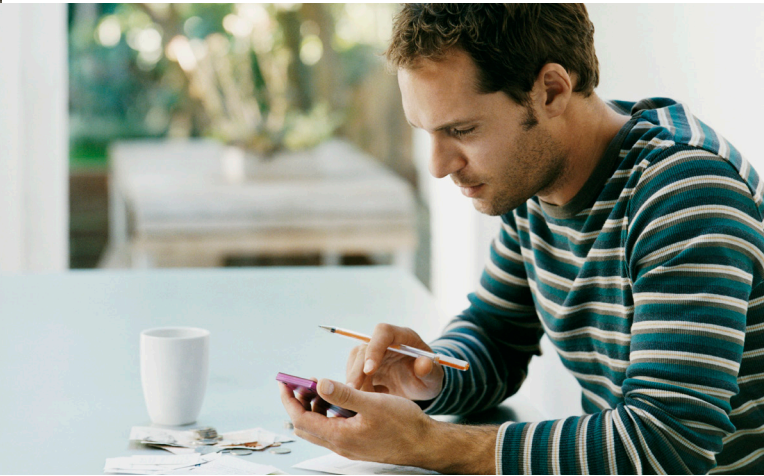
If the above is missed as part of the property sale and purchase, the new owner will not have the right to take it to the First-tier Tribunal (because the seller must first have claimed). If the buyer wants to receive the benefit of any capital allowances they will need to persuade the seller, after the event, to allow a capital allowances claim to be made. In order to do that, the seller would need to agree for the capital allowances to be pooled into their tax computations and then enter into a retrospective Section 198 election with the buyer within two years of the sale. The problem is that the seller is unlikely to agree to do so without some financial incentive provided by the new owner, if they agree at all.

If agreement cannot be established then any future right to claim capital allowances will be lost to the buyer and future purchasers.

In this last scenario one can see both a) the potential for those who do not have access to the correct professional advice losing the right to claim capital allowances altogether and b) disgruntled buyers who find out they have lost the right to claim capital allowances being prepared to sue their solicitors for not providing the correct advice at the point of sale.

# Pensions: A ticking time-bomb?

Matthew Slessor, Financial Planning Consultant



A recent study by think tank Policy Exchange identified that 11 million people are at risk of entering pensioner poverty when they retire.

Latest figures highlight the need to act swiftly when considering the following:

- 1 in 7 people who retired in 2013 intended to rely entirely on the state pension.
- 1 in 5 pensioners will be below the poverty line.

We have probably yet to fully witness the failure to diffuse the pensions 'time-bomb', given that we have an ageing population (the proportion of people aged 65 and over is projected to increase from 17% to 24% over the next 50 years); an apparent lack of career prospects for the young; and changing demographics – all of which may consign today's children to be poorer than their parents.

There are, however, many individuals out there who have amassed significant pension funds over the years and who do need professional financial advice. There are pension plans with access to guaranteed annuity rates, which is a good thing, but others with many layers of charges and underperforming funds, which isn't good at all. Worryingly, a lot of these people are completely unaware of whether their arrangements are good or bad.

For example, I recently met with a client with significant funds in a pension that he hadn't reviewed for some time. Having examined his arrangements in detail it turned out that we were able to provide him with access to a fund within his existing contract that would effectively double his income when he retires in five years' time. He had no idea that this arrangement existed.

It's not just people approaching retirement who need professional advice though. Those who have reached the point where they have decided to secure their retirement benefits often purchase an annuity with their existing provider without considering the alternatives.

There is currently no compulsion to seek financial advice, yet in many cases value can be added at one of the most crucial times of an individual's life.

An independent, whole of market adviser can provide the following:

- Only whole of market advisers have access to all the annuity providers in the market.
- They will help assess whether there is actually a need to buy an annuity in the first place - there are other retirement options which may be more suitable and just because the scheme's pension age has been attained, this does not necessarily mean the client has to take an income straight away.
- They will examine the terms to ensure that they are appropriate for their client's circumstances. If guarantees exist they could easily be overlooked and as purchase of annuity is an irrevocable decision and can't be reversed, the impacts of making the wrong decision can have an effect for the rest of the client's lifetime.
- If there are health issues, a fully independent adviser can ensure that these are properly taken into account when buying an annuity. On-line services generally only include generic health questions and proper underwriting can make a significant difference to the annuity income.
- The adviser will check all the documentation and liaise with the product provider to make sure the application is processed correctly.

Finally, perhaps the most important consideration of all is timing. Whatever plans are in place, they should be reviewed regularly and those approaching retirement shouldn't leave it until the last minute to start planning.

Source: <http://www.policyexchange.org.uk/publications/category/item/help-to-save-defusing-the-pensions-time-bomb>

Armstrong Watson Financial Planning Limited is authorised and regulated by the Financial Conduct Authority. Firm reference number 542122. Registered as a Limited company in England and Wales No. 7208672. Registered Office: 15 Victoria Place, Carlisle, CA1 1EW. Armstrong Watson Financial Planning & Wealth Management is a trading name of Armstrong Watson Financial Planning Limited.



# Share and Share Alike

Nigel Holmes, Corporate Tax Director



Recent research shows that 30% of family companies pass to the second generation, and 13% pass to the third generation. It is my experience that family owned and family run companies show a resistance to dilute shareholdings by bringing in non-family members.

However, what happens when there is no obvious family succession route? In such instances the exit strategy will be either liquidation or a sale. Many business owners will prefer a sale, which will leave a legacy, keep people in employment and maximise the exit proceeds.

It is in this situation that I foresee Enterprise Management Incentive (EMI) share options becoming more and more popular.

EMI share options are a government approved share option scheme which brings about tax advantages.

Companies with no obvious succession route may employ some key non-family members who they need to retain, up to the point of sale, to maximise the value of the company but they do not wish to dilute the family control in the meantime.

In such circumstances, if the trade qualifies, the key employee could be granted EMI share options that are only exercised on the company sale. Such options will, of course, lapse should the employee leave.

## How it works:

The employee has the right to acquire a small portion of shares in the event of a company sale; the price to be paid is set now, usually at today's market value for a minority holding. This will be within an EMI wrapper.

On sale, the employee exercises the right and pays the amount for the shares set, as above. The employee pays no income tax or NIC on the growth in value over the time the option is held yet the company obtains corporation tax relief for the growth.

The employee receives a proportion of the sale proceeds upon the sale which is subject to Capital Gains Tax (CGT) on the difference between proceeds received and the amount paid for the shares.

Recent changes to the tax rules have improved the CGT position. The 10% entrepreneurs relief rate of CGT will now be applicable even if the holding is less than 5% (usually a shareholder needs at least 5% to qualify for the 10% rate). Furthermore, the employee only needs to have held the option for at least a year, (not the actual shares unlike the normal 10% CGT rules).

In order to implement such schemes the accountant or tax adviser will work with a solicitor who will be responsible for drafting the option agreement and the scheme rules. The accountant will ensure the trade and the individuals qualify, agree a share valuation with HMRC and register the options.

In summary, family owned companies, where the exit plan is a third party sale as opposed to family succession, will need to consider retaining their key employees. If dilution of ownership is not an option then an EMI share scheme could tick all your boxes.



# What results should my law firm be achieving in the current climate?

Richard Andrew, Legal Sector Manager

At Armstrong Watson we maintain a database of financial key performance indicators for all of the law firms we advise. We supply a bespoke individual report to all of our legal sector clients as part of our normal accounts service when discussing their annual accounts. Those individual discussions allow us to take more of a strategic stance with our legal clients. We have produced an annual benchmarking report for the legal sector which can be downloaded from our website.

The highlights from the report are set out below and you can compare your own firm with these benchmarks:

- The average fee income per equity partner was £286,000 which is 33% higher than in 2012.
- The average fee income per fee earner was £112,000 which is 15% higher than in 2012.
- The average net profit per equity partner was £75,000 which represents 26% of fee income. Law firms with 11+ partners performed above this benchmark with average net profit per partner of £131,000.
- On average there are 2 fee earners for every equity partner. Firms with 11+ partners show a higher ratio nearer to 3 fee earners for every equity partner.
- Staff costs have reduced by between 1% and 3% as a proportion of fee income.
- Equity partner charge out rates have increased by a couple of percentage points for law firms with 1-10 partners. Law firms with 11+ partners show an uplift to equity partner charge out rates of 9%.
- The average number of chargeable hours per fee earner has reduced from 1,015 per annum for 2012 to 997 per annum for 2013.
- The average time taken to bill work in progress has reduced from 99 days to 92 days. The average time taken to collect debts has increased from 69 days to 72 days.
- The average partner's capital account has increased by 19% from £91,000 to £108,000.

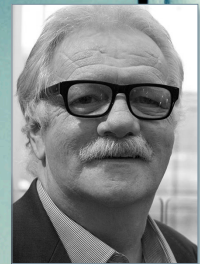
In general, 2013 showed growth in fee income and profits are showing signs of improvement. However, that is not necessarily being reflected in cash. Working capital continues to be a significant concern for many firms, especially those that are highly geared. Firms need to continue to monitor their work in progress days and debtor days and take proactive steps to reduce these where possible.

If you are interested in seeing how your firm compares with all of the KPIs that we benchmark, or want to investigate variances with your own firm's performance then please contact us.



# An interview with...

## Cees Zwaard of Law Management Plus



As part of our series of good ideas for the legal profession, we're working with Law Management Plus to improve the business of law. Andy Poole recently caught up with Cees Zwaard, the man behind Law Management Plus to find out more about Cees and the concept.

**Q:** You've had high profile positions within Columbia Pictures, Sony and Sky – what were your roles for those well known businesses?

**A:** As Managing Director of Columbia Pictures I was responsible for running the day-to-day business as well as introducing new products and extending the pictures line up with products from other producers. As part of the team at Sony Computer Entertainment, I reported directly to the President and was involved in launching the PlayStation 1 to the international market. This included marketing, customer care and every aspect of developing a new product. As a consultant to the SKY organisation I was involved in integrating technology to look after marketing and customer care.

**Q:** What are you now doing with UK law firms?

**A:** I have launched a low cost management support service called Law Management Plus. It is a service that assists law firms in becoming more efficient and competitive by analysing a wide range of business management factors. It is not a consultancy, but support in a management capacity. This is done by way of a free introductory meeting followed by a fixed fee £995 diagnostic interview and tailor made presentation and report in the form of a practical to do list.

**Q:** Why the Law? Why do you think there is a need to introduce this service and type of approach?

**A:** I have recently completed a two year stint as CEO of a small but progressive and growing law firm and I was struck by how law firms in general are not run as businesses. The legal sector is currently under increasing pressure from various angles and the law firms of the future will need to be more competitive and adopt a 'business' strategy. Many firms will not be in a position to employ a full time 'manager' and this low cost approach enables firms to take advantage of my experience in key business roles in order

to identify what needs to be changed in their businesses. Firms with fee income between £0.5m and £5m tend to benefit the most from my support.

I am not saying that firms necessarily need to move to factory outlets or dumb down on service levels, but they do need to have a commercial awareness.

**Q:** How will your experience help law firms?

**A:** My business management, marketing and client care experience allows me to help law firms to review their day to day management, their marketing and client acquisition strategy; their customer care and client follow ups; their legal and financial structure; and their services and service provision amongst other things.

**Q:** Why are you working with Armstrong Watson?

**A:** I work closely with Andy Poole and it is clear that Armstrong Watson are clearly specialists in the legal sector. They believe not only in assisting law firms with their compliance requirements, but also in improving their businesses – that fits in perfectly with my ethos.

**ArmstrongWatson<sup>®</sup>**  
Accountants & Financial Advisers

A track record of providing solutions to the legal profession

[www.armstrongwatson.co.uk/legalsector](http://www.armstrongwatson.co.uk/legalsector)