

An interview with... Professor Stephen Mayson

Are you
considering
incorporating
your practice?

We look at the benefits
and complexities.

What's the fuss
about FATCA?

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Welcome

to the Autumn 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 is on law firm incorporations. At the moment, we're working with a lot of law firms throughout the country on incorporating their practices. If you'd like to find out the advantages for you, please do get in touch.

We're also working with law firms to improve their businesses. The Law Society has asked me to write a Financial Stability Toolkit and that will be published shortly – watch this space!

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

Andy Poole
Legal Sector Partner

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In this edition:

Considering incorporating your practice?

Steve Holmes looks at the benefits and complexities of incorporating a legal practice to help you reach a more informed decision on whether it is right for your firm.

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Renewables - The need for a joined up approach from professional advisors

Keith Johnston discusses the options for clients considering renewable energy and the tax issues that are likely to be encountered.

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What's the fuss about FACTA?

Helen Thornley shares the things anyone involved with trusts needs to know - regardless of whether or not anyone connected with the trust has even set foot on US soil.

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An interview with... Professor Stephen Mayson

Andy Poole interviews possibly the best known thought leader and strategist in the legal sector, Stephen Mayson.

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Considering incorporating your practice?

Steve Holmes, Corporate Tax Consultant

In general it seems that people are vaguely aware of the benefits of incorporating a legal practice, but they often don't fully appreciate all of the benefits of incorporation. Conversely people also don't fully understand the complexity with incorporating law firms. This article aims to discuss both of these in greater detail so you can reach a more informed decision on whether incorporation is right for your firm.

Legal practices have been able to incorporate for a long time now, but in the last couple of years this option has become more and more popular. The main reasons for this are - opening up of the legal market to non-lawyers; the increasing number of insolvent law firms; the need to retain more working capital; and the changes in the taxation status of fixed profit partners. Lastly, the decreasing rates of corporation make it ever more tax efficient to incorporate.

The main driving reason behind incorporating your practice is often the tax savings, which come from two key areas. Firstly, you can sell the goodwill of the partnership to the company and pay capital gains tax at only 10%. This amount can then simply sit in your director's loan account with the newly incorporated company and be drawn down tax free whenever you want, or your cash flow allows.

Secondly, a corporate practice can generate significant ongoing tax savings. What really helps the tax savings of a company is that in a partnership you pay tax on all of your profits, whether withdrawn or not - whereas in a company you simply pay a much lower level of corporation tax on your profits and then personal tax is only taxed on the amount withdrawn. This allows for much more flexible tax planning. A shareholder will typically receive a salary set at a level where no National Insurance or income tax is paid, and receive a dividend on top of this which is effectively tax free up to the top of an individual's basic rate band.

Unfortunately incorporating your business isn't that straightforward and consideration must be given to some of the complexities which will arise; these should be considered against the tax savings.

- Partners (shareholders) joining and leaving the business will need to be considered – for example who will the shares be acquired by and at what value? A well thought out shareholders agreement is vital.
- The goodwill in the business will also need to be valued.
- The owners of the business will become employees and therefore covered by employment law.
- Such things as the partners' cars will need to be considered, accounting for these was previously straightforward, now any cars left in the company will be considered company cars and will generate a benefit in kind.

One of the larger, often unconsidered, aspects of incorporating a legal practice is the SRA administration. There are two different types of form to be completed, one of which requires completing twice (for the COLP and the COFA). Alongside these you must also submit such things as forecasts, business plans, continuity plans and shareholders' agreements. This can be quite a large administration burden and can increase costs on a legal practice incorporation compared to incorporation of a non SRA regulated business; these complexities must be considered from the outset.

Law firms should not just look at the potential tax savings and immediately jump into incorporating. All of the above issues need to be considered. I would always recommend speaking to somebody with specific legal sector experience in this regard, as that can be vital in reaching the correct decision for your firm.



Keith Johnston,
Tax and Agriculture Director

Renewables:

The need for a joined up approach from professional advisors

It is not many years ago that renewable energy was the preserve of committed environmentalists as the technology was largely unreliable and the financial returns mediocre. However, following the introduction of government support as a key part of their commitment to reducing greenhouse gas emissions, renewable energy projects of all sizes have become part of the mainstream business scene and more importantly, the returns can be attractive.

Businesses of all sizes are therefore looking at a multitude of technologies – wind; solar photovoltaic (PV); biomass; and anaerobic digestion (AD), to mention only a few – to either reduce the operating costs of their existing operations or as a separate business venture. In order to choose the most appropriate technology, identify the most suitable supplier, agree the legal terms, arrange the finance, and avoid the tax pitfalls, will require the services of several professionals with experience of the renewables sector.

The key is to consider all the legal, practical and taxation issues at an early stage in order to decide on the most appropriate structure for the new venture. In particular the use of a limited company could provide the benefit of limited liability as well as lower rates of tax on the income. In other cases the transfer of the ownership of the underlying land to other family members, family company, or trust, should also be considered.

Armstrong Watson acts for a vast number of agricultural clients, many of which are currently undertaking renewable activity. Talk to us to ensure the necessary joined up approach.



There are two distinct options open to clients when thinking about renewable energy:

- Operator - to purchase the equipment and generate energy to either use in the business or to sell into the national grid.
- Landlord - to lease the site to a third party and receive regular rental income.

Clearly there is a trade-off between risk and return here. The client can take the safe option of receiving a regular rent or alternatively commit a large amount of capital in the hope of receiving a much higher return.

I will conclude this article with a brief description of some of the tax issues that are likely to be encountered:

- An Inheritance Tax liability may be created if a lease is entered into as this is likely to be an investment activity rather than a trading activity.
- Similarly, there may be a higher Capital Gains Tax liability on a future sale if part of the property has been subject to a lease.
- Where some of the energy generated is used for private purposes, this has several consequences – part of the VAT cannot be reclaimed; tax relief on the cost of the equipment is restricted; but on the positive side not all of the Feed-in Tariffs or Renewable Heat Incentives are taxable.
- Where energy is sold to nearby properties, VAT will need to be charged and paid to HMRC – in the case of supplies to domestic properties this will be at a rate of 5% while supplies to commercial properties will be 20%.

What's the fuss about FATCA?

Helen Thornley, Tax Consultant



Do you deal with trusts or act as a trustee? Have you considered your responsibilities under a series of US originated anti-avoidance laws known as FATCA?

It might be very tempting to assume that if you have no or very few US clients it's not going to be an issue for you. But this legislation is now part of UK law. All UK resident trusts are going to need to consider their position – regardless of whether or not anyone connected with the trust has even set foot on US soil.

1. Where has this come from?

FATCA stands for the Foreign Account Tax Compliance Act. It is part of a US drive to tackle tax avoidance. Concerned that their taxpayers may be evading tax by using foreign accounts, the US has enacted legislation to require non-US financial institutions to report information on payments made to US citizens to the IRS. If foreign institutions do not comply, withholding taxes will be applied.

In 2012 the UK government entered into an agreement with the US to help manage the difficulties UK financial institutions would encounter in complying with FATCA. This new legislation is so broad that it catches not just financial institutions but also trusts.

2. Who does this affect?

The new rules will affect all UK-resident trusts – even if they have absolutely no US connections. All UK trusts will need to determine what their status is under FATCA. In future trusts will be asked their status by the UK financial institutions they deal with, e.g. when opening bank accounts or investment portfolios.

Trustees will also need to monitor if they acquire any US connections – for example if a beneficiary moves to the US, or marries a US citizen.

3. What is the status of our trust under FATCA?

A trust can be either a Foreign Institution (FI) or a Non-Financial Foreign Entity (NFFE). A NFFE does not need to report. An FI may, depending on the assets it has and how it is managed. These FIs will need to register with the IRS by 25 October 2014. Annual reporting starts from the end of 2014.

The major professional bodies in the area - the Law Society, the Society of Trust and Estate Practitioners and the Institute of Chartered Accountants have all got together to produce guidance to help trustees identify the status of their trust. This guidance is currently being updated following a further statement on FATCA on 27 June from HMRC.

Examples of trusts that may be FIs include those who employ discretionary fund managers or have a corporate trustee.

4. What do we need to do as a law firm?

The joint guidance above recommends a number of actions including reviewing how you will identify any US clients and any payments to them and record that information. Engagement letters will need to be updated to allocate responsibilities for FATCA compliance and reporting. Clients too need to be informed of the new rules.

If you've not drawn up your summer reading plans yet, you might want to put FACTA guidance at the top of your list.

An interview with... Professor Stephen Mayson



Armstrong Watson works with a number of well known advisors to the legal profession. In this edition, Andy Poole our Legal Sector Partner talks with possibly the best known thought leader and strategist in the legal sector, Stephen Mayson.

Two years on from ABS, how do you think the legal landscape is shaping up?

ABSs have tended to be as I would have expected: either law firms converting to allow ownership for people who are not qualified lawyers, or new entrants. As the number grows (currently approaching 350), their different approach to structure, ownership and operations will increasingly shape clients' expectations of how legal services can be delivered, and staff expectations of how 'law firms' can be capitalised and run. And not all of this new activity is in the high street or private client markets. The ones to watch, in my view, are Slater & Gordon and Riverview Law.

What do you think the key questions are that law firms should be asking themselves?

The must-ask questions relate to the firm's strategy and business

model. On strategy: are we clear what services or products we do (or do not) want to offer clients, who those clients are (or are not), and where we must be (physically or virtually) to succeed? Also, are we clear about where our competitive advantage (a difference that is meaningful to clients) will come from? On the business model: how do we seek to create value for clients, how we must resource the firm to create that value (appropriate people, processes and technology), how best to structure and finance the firm to access and retain those resources, and how we deliver an acceptable return to our staff, investors and owners?

What are you doing to help UK law firms?

My work these days focuses mainly on being a non-executive director on the boards of law and law-related businesses. I still take on a limited amount of advisory work (usually on strategy), as well as working with the Legal Services Board as a strategic adviser until April 2015 as they form their 2015-18 strategic plan and examine the cost of regulation.

Have your own views changed in the past two years?

No, not really. The developments that I was hoping to see in 'law

as a business' after the Legal Services Act have largely been set in train. There have been some early surprises (Slater & Gordon, as the world's first publicly listed law firm, making an early entry into the market here), and some disappointments (Co-operative Legal Services stumbling because of challenges elsewhere in the Co-op's structure). There is more change still to come. As long as we can support good business practice alongside maintaining the professional and ethical underpinnings set out in the Act, I think there is a very good future for legal services in this country.

How valuable is the advice of a sector specialist such as Armstrong Watson?

The commercial and regulatory world in which law is now practised is more complex than ever before. The value of independent sector insight and experience should never be underestimated. 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. Even confirmation of one's existing views is valuable; gaining an insight or experience that stops a firm making a mistake is invaluable.

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