the law

SPRING 2022

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WELCOME

Welcome to the Spring 2022 edition of The LAW, the specialist publication for the legal profession from the legal sector team at Armstrong Watson.

Our latest quarterly legal sector pulse confidence survey shows that there is still a great deal of concern amongst law firm owners relating to recruitment/retention/development of people. Following on from our piece on the 'great resignation' in the last edition of The LAW, this edition covers getting the best out of your top team – with reference both to a Law Firm Ambition article on ***Is your top team performing?*** and an interview with Peter Scott to obtain his thoughts on the same topic.

This edition also covers:

- The forthcoming change of basis periods that will impact on all law firm partnerships/ LLPs that do not have a 31 March/5 April year end
- Support for Court of Protection Deputies
- What to do with Residual Balances
- New requirements for trusts to be registered

Specialists are available from all of our 17 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.

To find out more on any of the above, including how we can work with you to help you and your clients, please do get in touch with me.

Andy Poole

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THE REQUIREMENT FOR YOU TO REGISTER TRUSTS – AND HOW WE CAN HELP

The Trust Registration (TRS) came into existence in 2017 as part of the adoption by the UK Government of EU Money Laundering legislation. Broadly, the regulations required any existing or newly created trusts that incurred a "relevant UK tax liability" to enter certain data into a Trust Register administered by HMRC. The definition of "relevant UK tax liability" for these purposes includes income tax, capital gains tax, inheritance tax, stamp duty reserve tax and stamp duty land tax (or devolved administration equivalents).

The Fifth EU Money Laundering Directive, commonly known as 5MLD, took effect for trusts from 6 October 2020, resulting in the requirement to register being extended to the vast majority of trusts (even non-taxable trusts), unless specifically excluded.

The ability to **add non-taxable trusts to the Trust Register was made available by HMRC on 1 September 2021 and a 12-month deadline was set to meet the registration requirements.**

Changes to the current TRS regime as a result of the 5MLD regulations include:

- The requirement for non-taxable trusts in existence on or after 6 October 2020 to be registered by 1 September 2022 (even where those trusts have subsequently terminated).
- The requirement for both non-taxable AND taxable trusts created after 5 June 2022 to be registered within 90 days.
- Necessary updates to the trust information held on the Trust Register for both non-taxable AND taxable trusts to be made within 90 days of the change.

There are potential penalties for not undertaking the relevant actions within the necessary timescales although HMRC have advised that they will take a soft landing in this regard.

The process for registration is not entirely straightforward and there are many trustees who remain unaware of this additional compliance obligation and upcoming deadlines.

As a law firm, it is likely that you have clients that will be caught by the change in rules or your partners may be trustees of trusts that now meet the registration requirement. **We are assisting trustees and law firms in the process of reviewing whether a trust falls within the exclusions and providing assistance with registrations** – if you need support in this area or would like to understand more about the process, please contact me.

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IS YOUR TOP TEAM PERFORMING?

As law firms grow, and there is a need for key people to work 'on the business' rather than 'in the business', the roles of service line heads become more important and should be viewed as mini managing directors of their parts of the business.

Andy Poole -
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Those managing any part of or any function within a firm should:

- 'Lift their heads from their desks' and think strategically about their roles, as well as just day to day operationally;
- Focus on the steps they will need to take in practice if they are to grow and lead their teams so as to build their competitive edge over rival firms;
- Prioritise their thinking around 'innovating' when planning how they work and use their people and the technology available to them, to steal a march on their rivals;
- Be encouraged to lead and to understand that it is they who must drive change if their firm is to stay ahead of the game;
- Step out of their comfort zones to drive out complacency and to encourage ambition;
- Understand and put into practice how to be 'accountable'; and
- In relation to all or any of the above, undertake whatever coaching, training or other development may be required on their part to enable them to better carry out their roles so as to add more value to the business

My Law Firm Ambition article, which can be found at: www.lawfirmambition.co.uk/blog/your-top-team-performing, sets out certain challenges that law firms should look to satisfy themselves on if they are to have the right people leading the firm and then empower them to facilitate success.

Those challenges, all of which are expanded in the link mentioned, include:

1. Do you currently have the management structures, the decision-making processes and the right people in place?
2. Do you have service line heads in place, where each member of which is the best person for the job rather than the most senior? If not, what options do you have?
3. Do those people have the right mix of autonomy and responsibility?
4. Are your people prepared to be managed by those service line heads, regardless of their seniority?
5. Are the internal functions of finance, business development, training and development, IT, knowledge management and innovation, risk, compliance and HR all led and working as effectively as they can?
6. Are the leaders of your internal functions given the respect they need in order to perform most effectively?
7. Are your key people provided with effective learning, support and development to allow them to achieve their full potential?
8. Do the rewards packages for your key people incentivise them to succeed?

There are, of course, many other aspects of a law firm which will always need attention, but if a firm can ensure that it is effectively dealing with the above, then it is likely to make progress towards becoming fit for purpose to achieve its ambitions.

Editor's note – Peter Scott also shares his thoughts on developing an effective Top Team, in the interview piece at the end of this publication.

Law Firm *Ambition*

CHANGING HOW LAW FIRMS ARE TAXED

Currently individuals operating unincorporated businesses (including Limited Liability Partnerships ("LLPs") as well as Partnerships and Sole Practitioners) are subject to tax in a tax year on the profits of the business based on the accounts having a year end in that tax year – this is known as the 'current year basis'. For example, if the accounting year end was 31 May 2021 this would be taxable in the 2021/22 tax year as the year end is within the period 6 April 2021 to 5 April 2022.

However, to coincide with Making Tax Digital, from the 2024/25 tax year, business profits will be calculated for the tax year rather than the accounting year end – this is known as the 'tax year basis'. As a result, every business that does not have a 31 March (or 5 April) accounting year end, will have a change the way in which its profits are taxed.

How will this affect your business

In order to ensure the new tax year basis period is implemented from 2024/25, there will be a transitional year in 2023/24. In that tax year, businesses that do not have an accounting year end aligned with the tax year end will not only be taxable on the profits based on the 'current year basis' for that tax year, they will also be taxed on a proportion of the following year's accounts to take them to the 'tax year basis'.

For example, if we assume a business has a year end of 31 May with annual profits of £75,000 in the transitional year (2023/24), the business is actually taxable on the accounts to 31 May 2023 (£75,000) plus a further 10 months profits from 1 June 2023 to 31 March 2024 (being pro-rata £62,500). Essentially in that tax year the business will be taxable on 22 months of profits, in this case being £137,500.

However, individual business owners impacted by this change will be able to deduct any personal 'overlap profits' which are available to them. Overlap profits originate when an individual starts a business, or joins a partnership, that has an accounting year end other than 31 March/5 April. In those circumstances, because of the treatment of the opening years under the current year basis, individuals would have been taxed on a proportion of the same profits twice, therefore, creating 'overlap profits'.

In theory, if a business year end changes, following the deduction of any available overlap relief, the taxable period should still remain only 12 months as follows:

Accounting Year End	Accounting Period	Available Overlap	Taxable Period
30 April 2023	23 months	11 months	12 months
31 May 2023	22 months	10 months	12 months
30 June 2023	21 months	9 months	12 months...and so on

However, in practice, as overlap profits were created at the beginning of a business, which could have been many years ago, then it is unlikely that those profits will be sufficient to cover profits during the year of transition.

Continuing from the example above, if the business commenced 20 years ago with smaller profits, for example £12,000 per annum, the total overlap relief available based on the 10 month overlap period for the 31 May year end, would be £10,000. In the change to a tax year basis, this £10,000 of overlap profits could be deducted from the 22 months profit of £137,500 resulting in a total taxable profit in the one tax year of £127,500.

As a result, the individual will be taxable on an additional £52,500 profits in the one tax year – The £127,500 above less the £75,000 normal one year profit. This will not only significantly increase an individuals income tax liabilities but, if profits exceed £100,000 individuals will lose their personal allowances and it will also create potential cash flow issues for the business.

There are anticipated provisions which may allow this additional profit to be taxed over 5 tax years.

In addition to the income tax liabilities, from 6 April 2022 profits will be subject to a further 1.25% due to the planned tax increases to raise extra funding for the NHS as a result of the COVID pandemic.

Opportunities

There are some planning opportunities available to you which may to minimise the impact these changes may have on your tax liabilities. This could include advancing your tax year end to 31 March 2022 so the increased liability is paid when the tax rates are lower, or making the change in tax year in which you anticipate profits to be less, if this is likely before the 2023/24 tax year. This can be particularly useful if there is a risk your profits will exceed £100,000 which would result in the loss of your personal allowance and effective tax rates of 60% on the profits just above that level.

Care should be taken in changing your year end, as it may preclude you from the 5 year spreading of the additional liability.

You may also want to make increased pension contributions in order to ensure you pay less income tax at higher rates but we would suggest seeking financial planning advice prior to doing so.

If you would like support in making decisions for your firm, or would like to see the likely impact modelled so that you can prepare for the cash flow implications, please contact me.

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INVESTING FOR SOMEONE AS THEIR PROFESSIONAL DEPUTY OR TRUSTEE

The Office of the Public Guardian (OPG) published guidance in May 2019 about making investments for someone who does not have mental capacity. Visit www.gov.uk/guidance/investing-for-someone-as-their-attorney-or-deputy

This guide was aimed at:

- attorneys appointed under a lasting power of attorney (LPA) for property and affairs, or an enduring power of attorney (EPA)
- professional deputies appointed by the Court of Protection to manage the property and affairs of someone who lacks capacity to make decisions

As a deputy you will need to manage a protected person's money and assets in a manner which reflects their best interests. The guidance from the website noted specifically states:

- you cannot do whatever you like with the person's money
- you must support the person to make decisions themselves where possible
- you must make your decisions based on what is now in the person's best interests, while trying to balance their wishes
- your decisions should be based on the person's preferences and beliefs

Investment experience and knowledge

The guidance also states that it is the responsibility of the deputy to have the relevant investment experience and knowledge. Ascertaining what is sufficient relevant experience and knowledge can be difficult, as can understanding where the responsibility for each element of the decision making lies.

It is also, of course, important when acting in this capacity to assess whether a personal injury trust should be established. If a trust is not established, this could affect your client in respect of benefits they are in receipt of - either being reduced or even stopping altogether. In addition, your client's future entitlement to benefit support could be affected as well.

Investing lump sums awarded needs careful consideration, as often the claimant might not have the ability to work again and an award may be vital to their future wellbeing. The OPG clearly sets out what is expected of professional and public authority deputies and provides an important checklist of actions and behaviours every deputy should follow across the four standards. (www.gov.uk/government/publications/office-of-the-public-guardian-deputy-standards/sd5-office-of-the-public-guardian-professional-deputy-standards-web-version),

In the section - Standard 1 - Secure the client's finances and assets, in 1a(5) it states:

"Seek independent financial advice, where appropriate, to maximise the return on the client's savings, investments and any other assets."

It also goes on to state in 1b(3):

"Carry out reviews of savings and investment portfolios at least once a year. Seek expert and independent advice when necessary."

The OPG also says that you should work with a financial adviser when:

- you feel you do not have relevant experience or knowledge
- you need to show that you've taken advice
- you need to diversify or review the person's investments
- you need advice from a specialist adviser on specific investment types, such as faith-based (for example Shariah compliant) or ethical investments

Of course you could still act on behalf of someone without seeking financial advice. If you choose to take this this route, the OPG guidance covers a wide range of topics and you are required to consider.

The risk and understanding the principles of investing

Risk is the chance of losing some of the person's money. Generally, the greater the possible returns, the higher the risk an investor will have to take. All investments involve some degree of risk, but by making an informed decision to accept risk creates the opportunity for greater returns, known as the risk/reward trade-off.

If you act as a deputy and you do not feel your expertise and knowledge satisfy each of these areas set out by the OPG, their recommendation is that you seek financial advice.

Under those circumstances, any financial advice will be tailored to your individual client's needs. It will consider the sum of money, the objectives and the time-frames applicable to that individual. Good financial advice will be reviewed, as a minimum, once a year and documented to provide a strong audit trail for court deputies.

Tax

In Standard 4 - Have the skills and knowledge to carry out the duties of a deputy, in 4 (11) it states:

"Ensure the deputy and all members of staff delegated with deputyship responsibilities have access to appropriate advice and expertise on personal tax returns."

This is especially important to demonstrate that you have consulted and made decisions based on appropriate advice and supply you with proper and correct accounts which record all investments to submit to The Office of Public Guardian (OPG). Also, to ensure tax bills are minimised, tax returns are completed accurately and submitted on time.

At Armstrong Watson we help manage vulnerable clients on behalf professional deputies and trustees whether it be simple or complex needs. By offering this range of services "under one roof" we can take the burden of administration away allowing you to deal with the day to day matters for your clients.

Please note, some of the areas within this article such as advice on investing monies are provided by our Financial Planning Consultants, whereas, other areas such as completing tax returns are services offered by our Tax Consultants.

Armstrong Watson Financial Planning Limited is authorised and regulated by the Financial Conduct Authority. Firm reference number 542122.

Contact Justin Rourke – Senior Financial Planning Manager - for information on the services we can provide to you.

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WHEN IS ENOUGH, ENOUGH? RESIDUAL BALANCES AND THE "PRESCRIBED CIRCUMSTANCES"

I'm sure we all understand the overarching requirement for Solicitors to safeguard money on behalf of their clients, to use it appropriately and ultimately to send it back to the client if they don't need it anymore. Indeed the SRA helpfully provide us with plenty of rules and guidance that stem from that overarching principle. Yet sometimes at the end of the matter we find ourselves with a balance left over, which we still want to safe guard, that we know isn't ours (it never has been!) and yet we don't seem to be able to return. The dreaded 'Residual Balance' and the curse of many fee earner's and cashier's lives!

What are my options?

1. Do nothing – whilst this "option" seems to be many peoples default (particularly recently with so many fee earners working from home) you are only going to cause yourself two problems. Firstly if you don't jump on the balance quickly and get it sorted its much more likely that you will find it hard to trace the client and it becomes a much larger chore to chase down multiple of these balances once a year than to do it there and then. Secondly, ultimately the SRA has thought of this and rule 2.5 of the Accounts Rules is very clear – you cannot hold onto this money for any length of time as it must be returned "promptly" and if the volume of these balances builds up you could find yourself with a reportable breach of Rules.

2. Trace the client – The Rules ask us to consider "reasonable steps" to trace the client if they are not responding to correspondence we are sending to their most recent address. Whilst that threshold might be unclear what the SRA have said is that any tracing activity should be "proportionate to the amount of money held". There are plenty of free (or very nearly free) options such as social media, the DWP letter forwarding service or perhaps local adverts. If the amount of money is significant, or more recent, then by extension the reasonable steps should also be more significant and undertaken quicker. So its not unheard of for considerable expense to be incurred in (for one example) hiring a tracing agent or investigator to find the client. It is also important to note that only in exceptional cases can any such costs cannot be deducted from the residual balance itself, and SRA approval would be required for that.

3. Send the money to charity – Assuming the amount is under £500 (per client matter) and you are confident that "reasonable steps" have taken place (that have been recorded) then then Rule 5.1(c) allows you to send the balance to Charity without further, or undue, effort. This route is very common in residential conveyancing where often a small residual search fee remains, but often (by definition!) the client has moved and you may not always be sure where. If this is the option you go for please be aware you are still obliged to have records of where the money went and if the client does reappear you still owe them the money; although in some cases Firms get an indemnity from the Charity concerned and so recoup the balance from the charity.

4. Speak to the SRA – For those balances over £500, or for any where you are unclear of your obligations (the most frequent example here is where you can trace the client, but they refuse to accept the money) it is best to engage with the SRA. They will usually want to satisfy themselves that you have taken reasonable steps and that you do have an indemnity in place with your chosen charity. But assuming you have and you do then they will most likely give specific permission for the balance to go to charity – so you end up in 3 above, just via a longer route. It might be pertinent to note that when making such a decision it is more common for the SRA to allow you to recoup out of pocket expenses (e.g. an agent's fees) as it is more likely you have taken more in-depth steps with larger balances – but even if they do give such an authority they would never allow you to recoup your own time or internal costs (e.g. postage).

If you do meet the criteria to send the balances to charity then the question becomes which one(s)? Many firms have nominated charities of the year or causes that are close to your hearts. Certainly from the Accounts Rule's perspective the only requirement is that it's a genuine charity (i.e. registered with the Charity commission) and that there is no recompense back to the Firm. Depending on the amount, the Firm may want to be sure it has an indemnity in place back from the charity so that the money can be reclaimed should the client reappear. So, adding all those things together two charities that you might want to consider are below, not least because thy are both tangential to the legal sector and so they are more willing than some to provide the necessary indemnities:

www.atjf.org.uk/unclaimed-client-accounts

www.thesolicitorscharity.org/support-our-work/unclaimed-balances/

Editor's note – there are many other worthy charities that also provide the indemnities, the above have only been included here because of their direct link with the legal profession – either providing access to justice for those without means, or looking after solicitors in need.

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AN INTERVIEW WITH...

Andy Poole interviews renowned legal sector consultant Peter Scott, former managing partner of Eversheds London and European offices

As summarised in the Top Team article earlier in this edition, experience demonstrates that firms with outstanding people running their teams outperform the market. Andy Poole interviews Peter Scott to explore his thoughts.

1. What management structures and 'Top Team' roles are needed by a law firm if it is to achieve optimum effectiveness?

Law firms need to be agile if they are to successfully identify and respond quickly to threats to their businesses and to take advantage of opportunities. And to be agile, firms need to focus strongly on managing change, have streamlined decision-making processes and have capable people who are open-minded, flexible, and are prepared to learn new skills and ways of operating.

At the same time, a law firm's people need to be supported by organisational structures designed to help and not hinder the efficient and effective management and development of the firm. The two need to be aligned and operate in tandem if a firm is to successfully achieve its goals.

To do this, critical issues to be addressed will include:

- The future needs of the business;
- The effectiveness of decision-making; and
- The roles and abilities required of those in management.

2. What should those in a 'Top Team' be doing if they are to build 'competitive advantage' for a firm?

The level of people performance within a 'Top Team' should constantly improve to achieve optimum effectiveness. In particular they should adapt their roles to add most value to a firm by:

- 'Lifting their heads from their desks' and thinking strategically about their roles, as well as just day to day operationally;
- Identifying the key issues and challenges their teams face, and focusing on the steps they will need to take if they are to grow their teams;
- Prioritising their thinking around 'innovating', and encouraging their people to more effectively use the technology available to them;
- Understanding that it is they who must drive change if their firm is to be competitive; and
- Building, and managing the performance of, teams who are open-minded, flexible, and prepared to learn new skills and ways of operating.

3. What obstacles to achieving this do you come across in law firms?

A particular issue I constantly come across is where those who are managing the component parts of a firm, such as heads of departments, are not part of an executive group making the decisions. This disconnect can mean that decision-making is not always as good as it ought to be and, because those heads of departments then feel disenfranchised, too often there is a failure to implement, which is where many law firms could do better.

One tried and tested structure, particularly in mid-size firms, is to bring for example, heads of departments, into a decision-making executive group. In this way they will feel part of decision-making and be more willing to implement in their teams. The result will be joined-up decision-making and implementation.

In addition, there is always the fundamental question of whether there are people within a firm capable of carrying out required roles. An essential role of leaders of law firms should be to bring-on new leaders as part of 'future-proofing' a Top Team.

4. How should the performance of members of a 'Top Team' be measured and rewarded?

A law firm which is willing to place its future in the hands of a Top Team should be prepared to fairly and competitively match their remuneration to their contribution to the advancement of the firm, because reward is strategic – the objective being to drive a firm's competitiveness.

Ideally for this purpose, the remuneration of a Top Team should be performance-related, and a firm should put in place broad performance criteria designed to help it grow its competitive edge, as outlined my answer to Question 2. Depending upon the precise role of each Top Team member, performance objectives should be agreed, feedback obtained using a form of 360° process, and remuneration awards made by a remuneration committee in which there is trust and confidence.

To achieve this, those in the Top Team will need to know:

In which areas their performance will be measured;

- Their performance goals;
- How their performance rates against those goals; and
- How their performance will be rewarded.

Working with The Law Society

Peter Scott -
Peter Scott Consulting

Andy and Peter jointly facilitate workshops to help Heads of Department to achieve success – further details can be found at: www.armstrongwatson.co.uk/sectors/legal-sector/achieving-success-head-department

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