

Welcome

Welcome to the first issue of WK Law, a newsletter designed by the Professional Services Team at Wilkins Kennedy specifically for Solicitors. Our aim is to bring you updates on new rule changes by the Law Society, provide useful tax planning tips and also to keep you informed of any events we will be holding which we think will be of interest to you.

Tax Planning for the new 50% income tax rate

This year, 2010, will see the introduction of a 50% tax rate. With only months to go it is worth considering how partners and members can reduce their liability for those earning over £150,000.

New highest rate of income tax

From 6 April 2010, the top rate of income tax is increased to 50% for individuals with income over £150,000. Taking into account National Insurance, the effective top rate on earned income will be 51% for those with income over £150,000; for those with income in the region of £100,000 to £112,950, the rate will be 61%, as the personal allowance is clawed back for those with income over £100,000.

For those affected it is key to consider the opportunities available to partners or members of partnerships to avoid the 50% income tax rate after 5 April 2010. Opportunities generally consist of reducing income for tax purposes so that the 50% tax rate is avoided or minimised.

A general election is due to take place by June 2010. It has been assumed for the purpose of this article that whichever Party comes into power, no changes will be made to the rules as presently drafted. It has also been assumed that any Budget measures which may be announced between now and 5 April 2010 will not change the present rules.

The following methods may be ones by which total taxable income can be reduced below

£150,000 for these purposes, to enable you to avoid paying the new 50% rate of income tax.

Change of year end

Sole traders and partnerships are taxed on the profits they make in their accounting period which ends in a tax year. For example, a business which has a year end of 30th April will pay tax on the profits of the year ended 30 April 2010 in the tax year ended 5 April 2011.

It may be worthwhile for such businesses considering whether to change the annual accounting year end. If a business is expecting future profits to be lower than current profits, a change of year end from say, 30 April to say, 31 March may result in lower taxable profits (at 50%) for the year ending 5 April 2011 because the business will be taxed on its profits for the year ending 31 March 2011 instead of the profits of the year ending 30 April 2010. This may also utilise some overlap profits that partners or members may have. It is important to note however that a change of year end must be for a valid business reason and not just for tax purposes!

Incorporation of partnerships

Where an unincorporated business makes profits in excess of £150,000 per annum, some of those profits will be taxable at the 50% rate.

If that business were to be incorporated, the business profits will become subject to corporation tax at between 21% and 28%. Income tax will only

become payable to the extent that profits are paid out by way of salary or dividend.

In that situation, shareholders/directors have control over the amount of income they take from their company and can therefore avoid taking income which brings them into the 50% tax rate.

Incorporation of a business has commercial and other tax consequences which need to be taken into account before a decision is made to operate through a limited company, but the tax savings could be significant.

For further information please speak to your usual WK contact or email Roger Williams, roger.williams@wilkinskennedy.com.



In this issue New Solicitors' Accounts Rules on residual client balances and requirements to report client funds held; Legal Services Act 2007; Should we be interested in Legal Disciplinary Practices?; To LLP or not to LLP, that is the question...

New Solicitors' Accounts Rules on residual client balances and requirements to report client funds held

Whilst the 'new rules' are perhaps not so new they are nonetheless often the subject of a query eighteen months after they were introduced.

New rules came into effect from 14 July 2008 on residual client balances such as the obligation:

- > **to return them to clients promptly.**
- > **to report to clients if client funds are held at the end of a matter.**

Practices will need to implement procedures and systems to ensure the rules are being complied with.

Rule 22 amended – residual balances

The previous rules on leftover balances for clients that could not be traced, required practices to obtain written authorisation from the Solicitors Regulatory Authority (SRA) before the monies could be withdrawn and donated to a charity.

Under the amended rule 22, where the leftover balances are £50 or less, they can be donated to charity without prior authorisation from the SRA, subject to certain conditions set out in rule 22 (2a).

For balances exceeding £50, the practice will have to apply for SRA authorisation. However, Solicitors may, if they prefer, apply to the SRA for prior authorisation in all cases.

- > **Practices must continue to take steps to trace and return the money to the client and maintain records of the work undertaken.**
- > **Keep a central register of all withdrawals made under the new rules, detailing the name of the client, amount of the donation, name of the charity and date paid.**

The reporting accountant will be required to review the central register and record of steps taken to trace the client. It could also be inspected by the SRA.

Rule 15(3) to (4) – reporting of residual client funds held

- > **Practices are required to return leftover client balances to the client promptly as soon as there is no longer any proper reason to retain the funds.**
- > **The Solicitor is required to inform the client in writing of the amounts held at the end of the matter, and the reason for retaining it.**
- > **The client should be informed in writing on an annual basis if funds continue to be retained and the reason for doing so.**

New procedures and systems will need to be established to ensure the rules are complied with, such as:

- > **Files to be closed on a more timely basis. The fee earner or cashier should check the client balance remaining when the final bill has been raised. If the residual balance is to be retained, this could be reported to the client in the letter sending out the bill.**
- > **Create a new report that shows the last date there was movement on the client ledger. The cashier would review it every month to identify any client balances that are old or have not moved for some time to make sure the funds should still be held. A copy could be sent to the appropriate fee earner to follow up.**

The new rules apply to balances arising on or after 14 July 2008.

For further information please speak to your usual WK contact or email [Sylvia Tse, sylvia.tse@wilkinskennedy.com](mailto:sylvia.tse@wilkinskennedy.com).



London

Bridge House, London Bridge, London SE1 9QR
Tel: 020 7403 1877 Fax: 020 7403 1605 Email: london@wilkinskennedy.com

Amersham

Anglo House, Bell Lane, Office Village, Bell Lane, Amersham, Buckinghamshire HP6 6FA
Tel: 01494 545 570 Fax: 01494 764 351 Email: amersham@wilkinskennedy.com

Ashford

Stourside Place, Station Road, Ashford, Kent TN23 1PP
Tel: 01233 629 255 Fax: 01233 643 901 Email: ashford@wilkinskennedy.com

Egham (Heathrow)

Gladstone House, 77-79 High Street, Egham, Surrey TW20 9HY
Tel: 01784 435 561 Fax: 01784 430 584 Email: egham@wilkinskennedy.com

Guildford

Mount Manor House, 16 The Mount, Guildford, Surrey GU2 4HN
Tel: 01483 306 318 Fax: 01483 565 384 Email: guildford@wilkinskennedy.com

Hertford

Cecil House, 52 St. Andrew Street, Hertford, Hertfordshire SG14 1JA
Tel: 01992 550 847 Fax: 01992 554 515 Email: hertford@wilkinskennedy.com

Legal Services Act 2007

Unquestionably the Legal Services Act 2007 marks the biggest change in the legal profession, providing opportunities and challenges.

Whilst parts of the Act have already been implemented it may be 2011 or 2012 before the final ramifications of the Act are realised.

We have seen the introduction of dual regulation for the Firm and individuals working within it. The SRA can impose a fine of up to £2,000 to an employee and, in extreme cases, an employee can be disciplined by the Solicitors' Disciplinary

Tribunal. Are employees of legal practices now aware of their potential liability for any breaches they are directly responsible for?

Legal Disciplinary Practices (LDPs) are already with us and Alternative Business Structures (ABSs) are on the horizon. The Legal Complaints Service is drawing towards the end of its life to be replaced, possibly by late 2010 by the Office for Legal Complaints (OLC). In effect the Law Society will have three divisions – Solicitors Regulatory Authority, Office for Legal Complaints and the Law Society itself, each with separate functions

and powers. The Legal Services Board is already established and the profession will doubtless rise to the challenges and the new environment.

These significant changes may mean additional paperwork and the related headache to complete it. The message in the short term is watch this space!

For further information please speak to your usual WK contact or email Kevin Walmsley, kevin.walmsley@wilkinskennedy.com.

“Should we be interested in Legal Disciplinary Practices?”

What is a LDP?

From 31 March 2009, the Legal Services Act 2007 permitted a new type of practice to be set up – a Legal Disciplinary Practice or LDP. An LDP can be owned not only by lawyers authorised by the Solicitors Regulatory Authority but also a combination of other lawyers and up to 25% of non-lawyers.

‘Other lawyers’ include barristers, notaries, licensed conveyancers, legal executives, law costs draftsmen, patent and trademark agents.

There can however be no external ownership of an LDP. Non-lawyers must be a manager in the business. This is defined as either as partner in the partnership, member of a limited liability partnership or a director of a company.

The non-lawyers must not make up more than 25% of the ownership of the firm or of the number of managers.

How can a non- manager be a partner?

A non- lawyer manager will need to be approved by the SRA which will require a Criminal Records Bureau check which costs £250 and completion of form NL1 which can be found on the SRA website.

What are the benefits of setting up an LDP?

- > **It allows different lawyers to join together which can give a firm a strategic advantage.**
- > **It is a way of rewarding and retaining valued employees by giving them the opportunity to participate in the equity of the firm**
- > **The firm could opt to be regulated by the Council of License Conveyancers instead of the SRA, particularly if their main source of revenue is from conveyancing.**
- > **A LDP can only provide services that a solicitors firm can provide and therefore a financial advisor or an accountant who advises on tax could become a partner.**

Time to commit?

Given the current economic climate, it is not surprising that the initial take-up of LDPs is slow.

For people considering whether to become partners in an LDP, they will have to look closely at the financial information because equity brings with it risk.

The flexibility afforded by LDPs and the potential tax advantages will make this an attractive alternative type of practice.

For further information please speak to your usual WK contact or email Jemima Jones, jemima.jones@wilkinskennedy.com.

Orpington
Greytown House, 221-227 High Street, Orpington, Kent BR6 0NZ
Tel: 01689 827 505 Fax: 01689 831 478 Email: orpington@wilkinskennedy.com

Reading
6c Church Street, Reading, Berkshire RG1 2SB
Tel: 0118 9512 131 Fax: 0118 9512 161 Email: reading@wilkinskennedy.com

Romsey
3-4 Eastwood Court, Broadwater Road, Romsey, Hampshire SO51 8JJ
Tel: 01794 515 441 Fax: 01794 830 705 Email: romsey@wilkinskennedy.com

Southend-on-Sea
1 Nelson Street, Southend-on-Sea, Essex SS1 1EG
Tel: 01702 348 646 Fax: 01702 330 148 Email: wk@wkonline.co.uk

Winchester
Parmenter House, 57 Tower Street, Winchester, Hampshire SO23 8TD
Tel: 01962 852 263 Fax: 01962 841 197 Email: winchester@wilkinskennedy.com

Falkland Islands
Globe Offices, Philomel Street, Stanley, Falkland Islands FIQQ 1ZZ
Tel: 00500 22 918 Fax: 00500 22 918 Email: admin@wilkinskennedy.co.fk



To LLP or not to LLP, that is the question...

The current economic downturn has impacted significantly on professional practices over the last 18 months with many experiencing reduced profits, particularly through a decrease in conveyancing fees, and bank interest received on client accounts plummeting due to a fall in bank base rates.

Firms that previously had thought themselves economically sound have had to critically review how they approach practice management, resourcing, and the financial benchmarks they employ when assessing performance both within departments, and for the firm as a whole.

One of the options is also now to consider whether incorporation to a Limited Liability Partnership (LLP) would be beneficial, particularly in view of the attraction of having limited liability not afforded to unincorporated firms.

The option to setup a LLP in the UK has been available since April 2001 and the number of solicitors' firms opting for incorporation has risen by 21% (182 firms) over the 9 month period to June 2009. Whilst the current trend is for a decline in the number of traditional partnerships, LLPs still only represented 10% of the total number of firms.

Apart from the obvious attraction of limited liability in today's increasingly litigious society, what other factors are being considered?

For tax purposes LLPs are still treated as if they were partnerships with each member accounting for tax under the self-assessment regime, and making payments on account of their tax liability each January and July. On a practical basis this is a big advantage for partnerships who want limited

liability without the stress and complication of converting to a limited company.

The change to an LLP could mark the change for an existing firm from a traditional partnership to a more corporate culture. Re-branding the firm could lead to marketing opportunities and the cushion of limited liability may encourage some firms to tender for new work that they may previously have declined as being too "risky". There is an argument that a more corporate structure is a better way of organising a firm than that demonstrated through a traditional partnership.

There is also the impact of incorporation on the Solicitors Accounts Rules to consider. In an unincorporated partnership the duty to remedy any breaches rests not only with the person who caused the breach, but also on all of the principals in the firm. This duty extends as far as replacing any missing client monies. In the case of an LLP this duty falls on the firm itself as a separate legal entity, but does also still extend to the members.

One of the biggest perceived disadvantages of incorporating is the disclosure of information. LLPs are required to file statutory accounts at Companies House, which are then subsequently publically available. Key disclosures include net profit generated and the highest profit entitlement for a member. Who would be interested in the figures? Potential/existing clients, competitors and employees...

For financial years starting on or after 6 April 2008, (unless you are filing the first accounts), the time normally allowed for delivering accounts to Companies House will reduce from 10 months to 9. Filing penalties start at £150 and rise to

£1,500 if accounts are delivered more than 6 months after the filing date. In addition LLPs that consistently file accounts late would have these penalties doubled. The doubling of penalties for late submission will apply for two successive late filings of accounts for financial years beginning on or after 1 October 2008.

For further information please speak to your usual WK contact or email Tommy White, tommy.white@wilkinskennedy.com.

Points to consider:

- > Key difference from other corporate bodies is that an LLP retains the tax status afforded to unincorporated partnerships
- > Disclosure requirements
- > Cost of incorporation
- > Cost of statutory audit (if audit thresholds exceeded – gross assets greater than £2.8m, turnover greater than £5.6m)
- > Conversion of partnership agreement to detailed members agreement required
- > An LLP is liable for all of its debts up to the value of its assets. Members of an LLP have limited liability to the extent in which they have contributed to those assets – each member therefore risks losing that amount should creditors claim those assets (although exposure is likely to be considerably less than if subject to a claim in an unincorporated partnership)

And finally...

We have included a Key Performance Indicator (KPI) questionnaire with this newsletter which, if completed and returned to us, will allow you to benchmark yourself against other local practices. The KPI questionnaire is entirely confidential and those who complete it will receive a written benchmarking report. There will also be an opportunity to view the report at a Breakfast Seminar in mid 2010.

If you have any queries regarding the completion of the questionnaire, please email wklaw@wilkinskennedy.com.

Please send completed forms to:

Professional Services Group, Wilkins Kennedy, Gladstone House, 77-79 High Street, Egham, Surrey, TW20 9HY

A questionnaire form titled 'Key Performance Indicators Questionnaire' from Wilkins Kennedy. The form is designed for benchmarking and includes sections for 'Name of Practice', 'Structure of practice (please tick)', 'Select your role (tick)', 'Number of staff (please tick)', 'Number of clients (please tick)', 'Number of enquiries (please tick)', 'Number of other services (please tick)', 'Number of other locations', 'Business type', 'Number of staff (please tick)', 'Number of enquiries (please tick)', 'Number of other services (please tick)', 'Number of other locations', 'Business type', 'Number of staff (please tick)', 'Number of enquiries (please tick)', 'Number of other services (please tick)', 'Number of other locations', 'Business type'.

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