

Winter/Spring 2010

In this issue

- 1 Which way to turn?**
- 2 Pre-Budget report**
- 3 Cash cash cash cash**
- 4 Partners' retirement age**
- 5 SIPPs - How to choose a provider**
- 6 Financial healthcheck for partners**
- 7 VAT changes**
- 8 "Hands off, Darling"**

Professional firms insight

Which way to turn?

We hope you found the first edition of PFI interesting and helpful. In this second edition we have tried to focus on issues which we believe are currently crucial to our professional firm clients.

There have been few high-profile casualties in the wider economy in the past six months. Many indicators and the media would seem to suggest the worst of the recession is over; the banks are making money again and, in some cases, lots of it. Some recruitment agencies are recording new vacancies are being placed with them frequently and there are even signs that merger and acquisitions activity is returning. So can we all heave a sigh of relief that the worst is over?

Most people we talk to are actually more uncertain about 2010/2011 than they were about 2009. This is despite having reduced headcount, held or reduced salaries and cut costs wherever possible. This uncertainty is partly due to the upcoming election and concerns about what happens after that. The winning party (and there is always the possibility of no clear majority) will have to deal with the enormous debt we have accumulated and that means painful decisions.

The other major cause for concern and uncertainty surrounds the lack of available funds for capital projects and working capital. Many firms are concerned about their capital structure and cashflow in the face of continuing reluctance by the banks to lend.



We have therefore looked at the issue of cashflow later in this publication.

Although many partners who were around during the recession in the 1990s have expressed the view that this recession is not as bad, there is still no sign that many major property developments are moving forward. Although there are some who have started to invest in UK property, many are still sitting on their hands rather than making the decision to invest in either property or mergers and acquisitions.

As the effects of the last Budget start to take hold, we also look at how partners and directors can make the funds they earn work harder for them in terms of tax-planning ideas and, if you have a SIPP, making sure you are with the best provider. We have also put forward some thoughts on the latest position on partners' retirement ages.

We hope these ideas are helpful, but please let us know if there are other specific topics you would like us to cover.

Pre-Budget report

Speculation was rife about the measures that could be introduced in the Pre-Budget report to raise revenue to fund the country's current account deficit. As it turned out, there were few significant changes that will impact on professional practices and virtually no changes to the capital gains tax regime.

Doubling the National Insurance increase from 6 April 2011 to 1% on individuals' income over £44,445 will inflict further pain in respect of both individuals' own tax and the costs of employing high-income earners. However this will be somewhat insignificant compared to the previously announced suite of personal tax and pension relief changes that affect high-income earners from 6 April 2010. Full details of the Pre-Budget measures introduced can be seen on our website www.kingston-smith.co.uk/kingston-smith/news/pbr_2009/

Cash cash cash cash

The unprecedented turmoil in the financial markets is continuing to impact on most professional firms. It has become evident that however much attention has been applied to maintaining revenue streams, developing new business and cost cutting, cash is becoming the key issue as we all attempt to weather the ongoing storm.

New business is only of immediate benefit if it generates cash quickly and, conversely, cost-cutting measures are only of immediate benefit if they conserve cash quickly. By way of example the immediate cash outlay required for redundancy payments can, in the short term, be more damaging than the longer-term savings in employee costs.

The banking sector has probably been the most high-profile sector in this period of turmoil and the fallout from the customer's perspective has been the complete change in the way banks now review, monitor and consider both existing and new funding arrangements.

Security is no longer top of the list with bankers as the uncertainty of valuations in all markets, not least property, raises doubts as to the validity and merits of valuations. What value is a property that cannot be sold? Banks are applying considerable discounts to valuations in their determination of the security an asset provides. They are paying far more attention to the business model generating the cashflow to service any borrowing and, as part of this process, considering areas that previously were intentionally or otherwise unvisited. How reliable are income streams? What is the history of a particular professional practice in achieving its budgets and projections? How strong is the management of cash collections and cashflow?

It is generally not the right time for customers to consider changing banks with a view to improving the facilities available to them. However, we are finding that the biggest issue with our clients' banking relationships is the unwillingness of some clients to accept that the past availability of excessive borrowing is



over, for the time being and probably forever. It is now time to accept, however reluctantly, that a time of responsible borrowing and lending has arrived.

A brief checklist of tips, which should be considered as part of your cashflow management are as follows:

- Work closely with your existing bank wherever possible.
- Liaise with your bank to establish the degree of flexibility in any lending covenants.
- Ensure you can demonstrate a responsible level of management and control over your cashflow.
- Ensure you have a sound plan for at least the immediate and medium-term future, and monitor your actual results and cashflow based on that plan.
- React to changes that occur, be they positive or negative, to show you are in control of the position.
- Consider the availability of personal guarantees and/or funds by using personal assets as a source of equity or loans, so that you are clear of your position when, as is likely, the bank raise the issue.

Keeping control of your own finances within bank facilities will hopefully prevent any bank intervention in your business affairs beyond the increased monitoring of lending covenants.

Partners' retirement age

Many firms have partnership or members' agreements which set a compulsory retirement age for partners. However, a recent court case has cast doubt over whether such clauses can be enforced.

Legislation enacted in 2006 protects individuals from discrimination on the grounds of their age unless there is reasonable justification for this discrimination. Within the legislation there is an exemption which enables employers to compel their employees to retire once they reach 65.

Many professional firms also require partners to retire at 65 or other, similar, age. However the exemption within the legislation does not apply to partners and a recent case has questioned whether this can be justified.

The firm argued that the retirement clause limited the need to expel partners through performance management. However, a tribunal found that there is no evidence that performance "dropped off" after the age of 65 or, indeed, any other age. The firm also argued that the clause facilitated succession planning and assisted in retaining associates, as it increased partnership prospects. No ruling has yet been handed down as to whether these secondary arguments are sufficient to support the clause.

So where does this leave professional firms? There remains much uncertainty as to whether partners can be compelled to retire at a set age, as this is yet to be properly tested in court. Fortunately the vast majority of partners are likely to seek to retire at or before their agreed retirement age, but forcing out a partner may prove difficult.

We will continue to watch this case closely but, in the meantime, we recommend that you consider carefully the grounds for setting any compulsory retirement age for partners in your firm and ensure that these are agreed by all partners.

SIPPs – How to choose a provider

The last Budget introduced significant restrictions for high earners obtaining full tax relief on pension contributions. Therefore pension scheme investors need to maximise the effectiveness of their SIPPs by selecting the right provider.

Why does someone have a SIPP? There are usually three categories of SIPPs members:

- Those wishing to carry out their own selections, transactions and management.
- Those wishing to appoint a professional investment manager, either on an advisory or discretionary basis.
- Those wishing to hold commercial property, either on their own or in conjunction with others, for own occupation or investment.

When choosing your SIPP provider, it is important to have access to key decision-making personnel who enjoy dedicated administrative support. This enables fast response times, resulting in the delivery of efficient and accurate reporting to clients.

We only select providers that give a clear and competitive charging structure, and who don't impose unexpected and unreasonable fees for routine processes.



Financial health-check for partners

Congratulations on making partner – your life is about to change! For one thing, you'll have less time to manage your own finances, at a time when they may require careful consideration. For example:

- Your earnings may increase, but become unpredictable.
- Your employment status, tax and financial liabilities may change.
- You may lose employee benefits and become responsible for your own pension provision.

This makes it an ideal and necessary time to take a look at your financial planning to ensure you're on the right track.

Kingston Smith has extensive experience of working with partners of professional firms. We understand the career paths and issues involved. We encompass tax, legal, mortgage and financial planning advice to ensure that guidance is dovetailed. Our Financial healthcheck for partners is one example of our approach to providing straightforward, seamlessly integrated advice. It works like this:

- You provide information about your assets, liabilities, income and expenditure, tax position, family circumstances, aims and objectives.
- We arrange a meeting with you to ensure that we fully understand you and your objectives.
- We provide a bespoke report summarising your position and addressing areas of risk, liability and opportunity. We provide a broad recommended strategy and identify areas requiring more in-depth attention.

For £950 (+ VAT), there are a few things our healthcheck won't do, which you may find refreshing depending on your previous experience. It won't sell products, it won't treat you like a commodity, and it won't swamp you with unnecessary paperwork generated at an hourly fee rate.

It will give you a clear and sensible analysis of where you are and how to get to where you want to be. It will give you peace of mind and possibly food for thought. It may be a one-off event, or it may be the beginning of a long journey in conjunction with dedicated fellow professionals.

VAT changes

A number of important changes to the VAT system have recently come into effect or will do so in the next few months.

Restoration of the 17.5% VAT rate

The VAT rate reverted to 17.5% on 1 January 2010, following the 2.5% cut in the standard rate that had been in force for the past 13 months. The original cut caused some confusion among businesses and the reversion to the standard rate will again be an administrative nightmare for some.

The rate of VAT charged depends on the date when the goods or services are supplied. For VAT purposes, this means the date on which the goods physically change hands (or a service is completed) or the date an invoice is issued, or the date payment is received, whichever is the earlier. As of 1 January 2010, businesses should use the old rate of 15% if they have provided goods or services before 20 December 2009 or if they have been paid before 1 January 2010 but have not raised an invoice within 14 days. In specific circumstances, Customs allows 45 days for a special credit note to be issued for the 2.5% and, of course, there are anti-avoidance provisions to consider.

Whether a service is single or continuous, HMRC will allow 15% to be charged if you can demonstrate that the service was performed in 2009, e.g. through time-recording records.

Cross-border supplies

On 1 January 2010, changes to VAT rules came into force that are intended to simplify cross-border supplies of services and recovery of input tax. The change means that in business-to-business transactions, the services are supplied where the customer is established, with the customer accounting for VAT under the reverse charge procedure. Intra European Union (EU) business-to-consumer supplies are subject to VAT in the country of the supplier as they are currently. As with most systems the problems arise with exceptions to the general rules.

EU VAT refund procedure

A new electronic VAT refund procedure has been introduced throughout the EU with effect from 1 January 2010, replacing the old paper-based system. From this date, UK businesses will need to submit any claim for VAT incurred in other EU countries on a standard form through the UK Government Gateway rather than direct to the relevant member state.

Online filing of VAT returns

From 1 April 2010, businesses with annual sales of more than £100,000 and all newly VAT-registered businesses will be required to file their VAT returns online. HM Revenue & Customs points out that filing VAT returns online brings some benefits, including, for many businesses, a seven-day extension to the filing deadline and an extra three working days before payment is taken by direct debit from the taxpayer's account (although a vast majority will not want to give HMRC the authority to direct debit their bank account!). HMRC is asking anyone who will be affected by the change to register for online filing as soon as possible.

For more advice on any of these VAT changes and how they will affect your business, please contact Adrian Houstoun on 020 7566 4000.

“Hands off, Darling”

With a new 50% top rate of income tax, the loss of personal allowances, restrictions on pension contribution tax relief and higher National Insurance Contributions (NIC) being introduced, it feels like the tax net is getting ever tighter.

Below is a list of recent measures introduced by the Treasury that will result in reduced income for partners in professional firms.

- New 50% rate of income tax from 2010/11 on taxable income over £150,000 (42.5% for dividends).
- Tapering personal allowances for “adjusted net income” over £100,000 means earnings between £100,000 and £112,950 will suffer tax at 60%.
- The main rate of employee NICs will increase from 11% to 12% from 6 April 2011 and the additional rate on earnings above the upper earnings limit will increase to 2%.
- Employer NICs increased to 13.8% from 6 April 2011.
- The main rate of class 4 NICs will increase from 8% to 9% from 6 April 2011, with the additional rate increasing from 1% to 2%.
- Restrictions on higher-rate relief for pension contributions from 2011/12.
- Limitations on relief for pension contributions for 2009/10 and 2010/11, including anti-forestalling measures.

- Pension reform from 6 April 2012 – compulsory employer pension contribution of 3%.

It is more important than ever for professional firms to consider their structure and profit extraction methods to ensure they are tax efficient.

Tax-efficient profit extraction post 5 April 2010

Below is a list of strategies to consider:

- Restructure from a limited company to an LLP.
- Consider bringing profits and/or earnings into 2009/10.
- Change your accounting year end (as discussed in our last edition of “Professional Firms Insight”).
- Ensure you are maximising your entitlement to claim expenses.
- If your spouse performs a service for the business, ensure that he/she is remunerated accordingly.
- Consider other income sources, e.g. rent, interest on non-capital loans to save on National Insurance.
- Maximise your pension contributions.

Depending on your particular business, there are more complex strategies that will result in bigger tax savings, usually at the expense of a greater administrative burden. Please call us if you wish to discuss your individual circumstances.

More information about Kingston Smith LLP and our services for professional firms can be found at www.kingstonsmith.co.uk/professionalfirms

Kingston Smith LLP
Devonshire House
60 Goswell Road
London EC1M 7AD
T 020 7566 4000

City
Julie Walsh
jwalsh@kingstonsmith.co.uk
T 020 7566 3800

John Staniforth
jstaniforth@kingstonsmith.co.uk
T 020 7566 3644

Mark Twum-Ampofo
mtwum-ampofo@kingstonsmith.co.uk
T 020 7566 3648

Offices also in:
Hayes
Jonathan Seymour
jseymour@kingstonsmith.co.uk
T 020 8848 5500

New Malden
Chris Bruce
Blacktower Financial Advisers Ltd
cb@bfa-uk.com
T 020 8336 6350

Redhill
David Montgomery
dmontgomery@kingstonsmith.co.uk
T 01737 779 000

Romford
David Benton
dbenton@kingstonsmith.co.uk
T 01708 759 759

St. Albans
Nigel Birch
nbirch@kingstonsmith.co.uk
T 01727 896 006

West End
Julie Walsh
jwalsh@kingstonsmith.co.uk
T 020 7304 4646