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# Professional firms insight

## Economic overview

**Welcome to the first edition of our new publication specifically for the benefit of professional firms.**

The past year has seen unprecedented turmoil in the financial markets and the downturn in the economy has impacted on just about every professional firm. Many partners and directors of professional firms lived through the recession of the early 1990's, and have experienced difficult times before, but most commentators feel the speed with which this downturn gathered pace has made it much tougher for firms to manage.

We have all read about the huge impact on agencies due to the dramatic reduction in residential house sales which in turn has impacted on firms that are involved in this process, such as residential surveyors and lawyers. Commercial agencies have also recorded a huge fall in transactions as investors wait for the elusive bottom of the market.

Many architects and cost consultants are reporting little activity on large new build projects and while some are being kept busy on the 2012 Olympic project this is not a cure for all ills. Those firms that are heavily involved in public sector work still seem to be busy, but everyone is asking how much longer funds can be channelled into this sector.

The freezing of lending by the banks has meant very few merger and acquisition deals have completed which has led to redundancies at even some of the magic circle firms of lawyers as teams are sitting idle with no prospect of an upturn.

Many firms have already implemented redundancy programmes and for some there will undoubtedly be more to come. Firms have moved staff to other departments and are looking at developing new services more appropriate to the current climate. So much has already been done to deal with the economic situation.

The question no one is willing to answer is just when the green shoots of recovery will appear although just recently there are reports that some economic indicators suggest they are on the way. Let's hope so but most people we speak to feel 2010 will be just as tough as 2009 is likely to be.

We have therefore set out to provide in this new publication, some quick useful snippets of information that might help you in these trying times. Some of the matters we have addressed may help you to reduce your tax liability, and to see what options are available if you are trying to raise funds for your business. We have also included some news on changes in employment legislation from April 2009 and also some comment on the recent Budget.

We hope this is useful to you, please let us have any feedback you may have on the content and what you would like to hear about in the future.

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## Protection of client monies

**In this uncertain economic climate, we are often asked about the safety of clients' bank deposits. No longer are firms content for all of their funds to be held on deposit account at a high street bank. This could be of particular concern where you hold money on behalf of your clients. While the collapse of a bank used to be considered unthinkable firms are now asking just how safe are my funds and those of my clients.**

The Financial Services Compensation Scheme (FSCS) is the UK's compensation fund of last resort which covers consumers for defaults by banks on deposits held. The scheme covers deposits belonging to clients who are individuals or small businesses up to £50,000, per client, per authorised deposit-taking institution.

As long as the institution is aware that the account is designated as a client account, and each individual client and their balance is identifiable, then the client whose funds are held in that account would be eligible for compensation from FSCS. This would apply to general as well as designated client accounts as long as the FSCS can be satisfied of the entitlement of each individual client to funds held at that particular institution that failed. You, the deposit holder, would be able to make a claim with the FSCS on their behalf.

The £50,000 FSCS limit applies to the individual client and not to the specific deposit, so if your client holds other personal monies in the same institution as your client account, the limit remains at £50,000 in total even if held by a single institution that trades under different names.

If you hold more than £50,000 for one client you may wish to consider setting up accounts with different institutions to ensure the full amount is covered.

It would be helpful to inform clients of the name of the institution at which the account/ accounts are held and the fact that their balance would be considered to be part of their total £50,000 "allowance" to be held with that particular institution.

### Using foreign banks

If the deposits are held with a foreign institution the regulations will differ depending on whether the deposits are with a branch or subsidiary of the foreign bank. If the institution is a UK subsidiary of an overseas institution then the FSCS will compensate for loss in the same way as for UK institutions. However if the institution is a branch of an overseas institution then the compensation scheme of the home country of the bank is the one that would apply and not the FSCS regulations.

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## New procedures for disciplining employees

**We often hear that Employment Law is one of our clients' biggest headaches so here is some news of changes that became effective from 6th April 2009. Some of the procedures firms had to follow when dismissing an employee or dealing with a grievance have been changed and we set these out below.**

### So what has changed?

The main changes introduced are as follows:

- A need to deal with issues informally (as the first step of the procedure)
- No automatic unfair dismissal for a failure to follow the procedures
- No requirement for an employee to raise a grievance before making a tribunal claim
- No extension of time to raise a claim if they do raise a grievance
- The tribunal will only have the power to adjust awards for compensation up to maximum of 25%.

Tribunals will still expect employers to be fair and reasonable in dealing with issues, to use mediation to resolve issues if possible and for employers to deal with matters in a prompt and consistent manner.

### What do you need to do now?

If your disciplinary procedure complies with the ACAS Code no action needs to be taken. If it doesn't, your procedures need to be updated and we suggest you contact your HR adviser or our associated company HR Insight would be happy to advise you.

### Also, changes to flexible working legislation

As of 6th April 2009, the right to request flexible working was extended to all parents with children aged 16 or under. So, you can expect requests for flexible working to increase!

# Trading losses: carry back

**To help businesses that have recently become loss-making the trading loss carry back has temporarily been extended from one to three years, offering cash flow benefits to struggling businesses.**

Relief will be extended for losses incurred in companies with accounting periods ending in the period 24th November 2008 to 23rd November 2010, and for the 2008/2009 and 2009/2010 tax years for Limited Liability Partnerships ('LLPs') and unincorporated businesses, from the current one year entitlement to a period of three years, with losses being carried back against the later years first.

The amount of loss eligible to be carried back to the preceding year remains unlimited. A maximum of £50,000 of the balance of unused losses is then available for carry back to the earlier two years.

As with the current one year carry back, the extension to loss relief is limited to trading losses. For a company trading losses can be carried back against all trading profits of the earlier accounting period; for LLPs and unincorporated businesses losses can be offset against general income. See our budget commentary for news of an extension to this relief.

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### Example

Company A has a year end of 31st December 2008 and has incurred trading losses of £150,000 and prior year profits of:

2005	2006	2007
£30,000	£40,000	£90,000

Current rules allow £90,000 of the 2008 trading loss to be carried back to 2007. The extension to the carry back rules would allow £40,000 of 2008 trading loss to be carried back to 2006 and £10,000 of loss to 2005 – a total of £50,000. The remaining £10,000 of 2008 trade loss will be carried forward under the normal rules to offset against future years' income.

## Changing your accounting date to get a tax advantage

**Many professional firms choose an accounting date early in the tax year, often 30th April, in order to defer partners' tax payments on their share of taxable profits for as long as possible. This is beneficial when profits are increasing as the balance of tax does not become payable until 21 months after the year end.**

However many firms are now facing a sharp decrease in profits which may continue for sometime and may therefore benefit by changing the accounting date to, say, March in order to crystallise partners' overlap relief.

Overlap relief is given as a deduction in calculating the profits of the trade for the tax year in which there is a change of accounting date. Firms should review their expected profit for the current financial year and compare to overlap profits to identify if there is any merit in changing the firm's accounting date.

### Example

The effect of changing the accounting date from 30th April 2009 to 31st March 2009 is summarised in the following example:

Trade commenced 20th April 1998 and accounts are habitually drawn up to 30th April. The overlap profits available for relief relate to the period 1st May 1998 to 31st March 1999 and amount to £90,000. Profits for the year ended 30th April 2008 are £200,000 but for the 11 months ended 31st March 2009 are £40,000.

By changing the year end the profits for the periods ended 30th April 2008 and 31st March 2009 are both taxable in 2008/2009. However the combined profit figure is reduced by overlap relief resulting in lower assessable profits and a lower tax bill.



Year end	31 March 09	30 April 09
Taxable profits: Year ended 30th April 2008	£200,000	£200,000
11 month period ended 31st March 2009	£40,000	N/A*
Subtotal	£240,000	£200,000
Less: overlap relief	(£90,000)	–
<b>Total profits assessable 2008-09</b>	<b>£150,000</b>	<b>£200,000</b>

It is important to discuss this with your advisers to ensure there is a benefit but savings in immediate cash flow can be high. Please call us if you wish to discuss your individual circumstances.

You should note that HMRC restricts the number of occasions that a firm can change its year end and that overlap relief is restricted if the new year end is not 31st March.

\*Note: If the year end is not changed, the profit for the 11 months ended 31st March 2009 is included within the accounts for the year ended 30th April 2009 and taxed in the 2009/2010 tax year.

**Firms should review their expected profit for the current financial year and compare to overlap profits to identify if there is any merit in changing the firm's accounting date.**

## Deferring tax payments

**In these cash stretched times HM Revenue & Customs (HMRC) have already helped over 60,000 businesses defer their tax payments to aid cashflow. The Business Payment Support Service (BPSS) has been set up to assist businesses through the downturn by arranging a payment plan for any tax liabilities.**

Cases are considered on an individual basis with a decision given over the phone in the majority of cases. Sometimes this involves paying the full amount of tax a little late, but more often it is an agreement to make a number of payments over a period of time. We have agreed timescales for our clients of up to 36 months, though a shorter timescale is more usual. Where the debt is for PAYE or VAT, repayment within 12 months is required. Additional late payment surcharges on payments included in the arrangement will not be charged, although interest will continue to be payable on those taxes where it applies.

## When making a proposal, be careful not to offer more than you will be able to afford.

HMRC are unlikely to accept a lump sum of less than the tax due in full settlement. When making a proposal, be careful not to offer more than you will be able to afford. If you fall behind with an agreed scheme of payments, you may try to renegotiate, but you will have lost some credibility and HMRC may decide to proceed to enforcement. Offers must cover both arrears of tax and future liabilities, such as payments on account.

The service covers National Insurance, VAT and any other payments due to the Revenue. The Business Payment Support Line number is 0845 302 1435 and is open Monday to Friday 8am to 8pm, and at weekends 8am to 4pm. Further information is available on the HMRC website at [www.hmrc.gov.uk/pbr2008/business-payment.htm](http://www.hmrc.gov.uk/pbr2008/business-payment.htm).

## Access to funding

**Funding options available to SMEs struggling in the current economic slowdown.**

### The law

In the past the UK government has provided small businesses with financial incentives in recognition of their contribution to the economy. However, the recent economic meltdown and the part-nationalisation of several UK banks have led to a drop in lending.

Realising this, the government proposed a raft of initiatives in last year's Pre-Budget Report designed to help viable businesses with their short-term cash flow difficulties.

## The Working Capital Scheme is intended to boost bank lending for new and existing loans.

The Working Capital Scheme is intended to boost bank lending for new and existing loans by offering short-term funding to businesses with turnovers of up to £500 million. Subject to eligibility the Department for Business, Enterprise & Regulatory Reform (BERR) will guarantee 50% of the value of the loan portfolios submitted by banks.

The government will also support new lending by banks via the Enterprise Finance Guarantee (EFG). Loans are open to companies with a turnover of up to £25 million to secure loans of between £1,000 and £1 million. The government will guarantee up to 75% of the outstanding loan amount.

The Capital for Enterprise Fund allows businesses with a turnover of up to £50 million to sell debt in exchange for equity. Qualifying businesses can apply for investments of between £250,000 and £2 million.

Finally, the European Investment Bank will make an estimated £4 billion in business loans available to small and medium-sized enterprises through UK clearing banks.

### Applications

The introduction of these schemes is intended to reassure small businesses struggling to cope in the current economic climate, but it would be dangerous for applicants to view them as 'soft loans'. Each application is assessed using standard credit procedures and with financial information, forecasts and business plans reviewed with the same level of diligence as a bank would apply to a conventional loan facility.

The EFG scheme is not restricted to established businesses. Instead, if a new business with little or no available security meets the bank's credit policy criteria and has presented a solid business plan, the bank may still choose to support an EFG application.

Despite these new initiatives, there have been numerous reports about how small businesses are struggling to gain access to funding. In fact, BERR recently confirmed that just £40 million has been lent to businesses under the EFG since the £1 billion scheme was first introduced in January.

We are working with a number of our clients to obtain funding under these new schemes and regularly assist in putting together business plans. In our experience, the following points are key to maximising your chances of success:

### Check list

- Prepare cash flow forecasts to calculate how much you will need to borrow.
- Build a buffer into your forecasts so that you are covered for the unexpected.
- Arrange a meeting with your bank manager as soon as you have quantified your precise requirements.

### Beware

The government has been accused of moving the goalposts after encouraging banks to ask businesses applying for the EFG to provide security. All personal assets must be put up as collateral for banks to consider lending under the scheme and only the main marital home is exempt. Applicants who refuse to comply will fail to qualify.

## Residual client balances

**An increasing number of law firms are using the market downturn to address administrative tasks and we are starting to see more firms looking at the practicalities of withdrawing old client balances.**

It is essential that the following 5 conditions are met where the firm intends to withdraw amounts under £50:

1. The identity of the client is established or reasonable attempts are made to do so;
2. Adequate attempts are made to ascertain the correct destination of the funds and to return it unless the reasonable cost of doing so (i.e. attempting to ascertain the correct destination or owner) is excessive in relation to the amount held;
3. The funds are paid to a registered charity;
4. The solicitor must record the steps taken in 1-3 above and retain those records together with all relevant documentation (including receipts/acknowledgements from charities) for at least 6 years; and
5. A central register of all such withdrawals is maintained.

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The reporting accountant is not required to be involved in the process where the residual balance is below £50 however during the annual Solicitors Accounts Rules review, the accountant will have to perform some sample checks. This would typically involve checking that the appropriate procedural documentation exists, copies are on the relevant files, a central register of withdrawn residual balances exists and funds have been paid to a charity. It is beyond the reporting accountant's remit to judge how adequately the firm has taken steps to apply the rules, however the accountant will take a professional approach and can exercise their right to report where they believe the rules are not being followed.

From our discussions with the SRA, a number of practical points have arisen:

1. Simply writing to the last known address of a client is not deemed reasonable in terms of ascertaining the correct destination of client money;
2. Small amounts of a few pence or pounds should still be repaid by way of postage stamps or a postal order; it is not sufficient to say the cost of repaying small balances

is excessive;

3. Where the client and destination of small balances are identified, it may be possible to obtain the client's written permission to pay the funds directly to a charity as quite often a number of clients will not want their own administrative burden of processing small receipts;
4. The SRA would look for specific documentation and details for each balance and not generic statements when a solicitor records the steps taken; and
5. The notes to Rule 22 do allow for solicitors to apply for prior authorisation for sums under £50 but the SRA expects cases to be rare.

Where a residual balance is greater than £50, the rules remain unchanged and a firm must seek prior SRA authorisation before paying amounts over to a charity. In this case the rules are more stringent; a period of six years must have elapsed since the amount was due to the client and a confirmation letter from the reporting accountant is required.

## Budget Report 2009

### The main headline points for professional firms are as follows.

Many of the provisions are a draconian attempt to ensure that businesses and individuals file and pay their taxes on time thus generating cash for the Treasury.

Tax rises, withdrawal of personal allowances and restrictions to higher rate tax relief for pension contributions for those earning over £100,000 per annum will not be well received by many professionals.

Overall this is a very technical budget designed to close perceived loop holes, raise revenue and ensure that Cash is King. There is little of specific relevance to the UK property sector.

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### Income tax

- From 6th April 2010, there will be an additional higher rate of 50 per cent for taxable income above £150,000;
- From 6th April 2010 the basic personal allowance for income tax will be gradually reduced to nil for individuals with "adjusted net incomes" above £100,000.

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### Pension contributions

The Government has announced its intention to restrict, to the basic rate of income tax, tax relief on pension contributions with effect from 6th April 2011 for people with taxable income of £150,000 or more. There are some provisions to restrict contributions from the date of the budget to prevent large additional contributions.

### Extension of trading loss carry back for business

To extend the period for which trading losses (maximum £50,000) can be carried back against previous profits. This extension will apply to trading losses made by companies in accounting periods ending between 24th November 2008 and 23rd November 2010 and to trading losses made in tax years 2008/2009 and 2009/2010 by unincorporated businesses. Trade loss carry back will be extended from the current one year entitlement to a period of three years, with losses being carried back against later years first.

### Corporation tax

The main rate of corporation tax (CT) will remain at 28% for Companies with profits above £1.5 million. The small company rate will remain at 21% for Companies with profits below £300,000.

### Stamp Duty Land Tax

Stamp Duty Land Tax (SDLT) is in the main unaffected by the budget. A few relatively small amendments have been introduced that will impact on property purchases under £175,000, shared ownership schemes for social landlords and the acquisition under statutory rights of the freehold of a block of flats.

In particular the previously announced holiday from SDLT to 2nd September 2009 on acquisitions of residential property up to £175,000 has been extended to 31st December 2009. At that date the threshold at which the tax commences reverts to £125,000.

### Furnished holiday lettings

HRMC have recognised that the current legislation is contrary to EU law and propose that the advantages of the Furnished Holiday Lettings (FHL) scheme be extended to include all EU property. However they then propose that the FHL rules be repealed with effect from 5th April 2010.

The FHL rules allow owners of property operated as a holiday let to benefit from Entrepreneurs relief for CGT, which reduces the rate of tax from 18% to 10% on the first £1 million of life time gains. They can also roll over gains and the property can qualify for 100% inheritance tax relief on death. These were very valuable tax concessions however these will be withdrawn from 6th April 2010.

## The personal guarantee dilemma

**Businesses are facing unprecedented difficulties, with trading performance likely to be deteriorating as the economy shrinks. This creates a knock-on effect for business owners seeking finance.**

Nervous banks are scrutinising renewable, on-demand facilities such as overdrafts and are increasingly asking for personal guarantees where previously none were required. Many directors, however, are naturally unwilling to oblige.

For many it is important to maintain the separation between a business and one's personal wealth.

A case in point is Antony Worrall-Thompson, who quite publicly put his restaurant business into administration rather than give Lloyds TSB his personal guarantee.

For many it is important to maintain the separation between a business and one's personal wealth.

Many businesses are telling us the size of their overdraft facility has been reduced, or even withdrawn, and more tell of large increases in the cost of these facilities. For many, this is creating major cash flow problems that can quickly impact on trading.

One solution to this dilemma is to replace on-demand facilities with capital injections from directors/partners. By raising a mortgage, secured on their own home, with a third party lender, and then making a loan to the business, the cost of funding may be reduced and the individual can maintain a distinction between their business and personal assets. This may be a more prudent option than to offer a personal guarantee.

It is currently possible to raise residential mortgage finance for business purposes up to 85% loan to value, with rates and terms varying dependent on the percentage advance required.

We continue to provide a tailored service to business proprietors giving them support and advice in arranging bespoke finance to suit their needs.

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