

Legal Focus

DRIVING LIFELONG PROSPERITY

Autumn 2019

SPOTLIGHT ON YOUR EMPLOYEES

Welcome...

Welcome to the autumn edition of our Legal Focus. In this edition, we focus on your employees, explore how to attract and retain staff, and we take a look at employee ownership trusts (EOTs).



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HOW TO ATTRACT AND RETAIN STAFF – IS MORE MONEY THE ANSWER?

We are often asked by owners of law firms how to retain, as well as attract new, members of staff. The market seems to be more competitive than ever, with bidding wars over salaries meaning that firms are often gazumped by the current employers whenever they think they have found a new recruit.

SALARY VS TIME

Speaking to one of our clients last year, we discovered that whilst they were often outbid in terms of salaries, they had extremely generous annual leave and flexible working policies.

The demographic of current work forces is shifting to include more millennials and generation Z-ers who want to work hard for their contracted hours, and leave on time. This is quite often unusual in the law firm setting, and particularly for larger law firms. If your staff are out of the door at 5pm most days, this might be a huge selling point for you.

Most businesses offer 20 days annual leave per annum, plus bank holidays. If your annual leave policy is more generous than this, or your offices operate Christmas closure (in addition to the standard annual leave days), highlight this.

Do you allow your staff to regularly work from home? Allowing staff to save valuable commuting time, or complete their work around childcare, is invaluable for some individuals.

SALARY VS CULTURE

Some individuals are more likely to work for a firm that they feel shares the same values that they do.

If your firm is actively involved in charitable fundraising (and we don't just mean donating your residual client balances to charity!) then make sure this is mentioned on your website.

As people are becoming more aware of the environment, make sure you have an environmental policy in place. Does your firm actively encourage recycling? Do you ensure all lights are switched off when the office is closed each day?

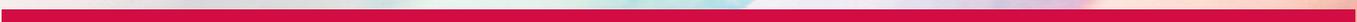
Most firms will offer a Christmas party as standard. If you believe your social offering is particularly strong, or you have an active social committee organising regular events, then make sure this is highlighted to any applicants.

SALARY VS BENEFITS

Have you considered all of the benefits that you offer, or might consider offering, that could stand you apart from other employers. Examples include:

- Onsite or nearby car parking, provided by the firm
- Pension contributions over and above levels required by auto-enrolment
- Corporate discounts with local restaurants or gyms
- Contributions towards personal health insurance or critical illness policies

Are your maternity, paternity and sick pay policies more generous than statutory requirements? Do you offer dependents pay? These things can be fundamental in staff deciding which firm to apply to, or whether to leave an existing employment.



FIXED SALARY VS INCENTIVES

Whilst the basic salary might be lower, consider whether an individual's earning potential is higher where you have a bonus scheme in place.

There are many different types of bonus schemes out there, some more successful than others, and if you need any advice on what might work for you, then please get in touch.

GET THEM WHILST THEY ARE YOUNG

Another thing that we are seeing work really well in some law firms is the offering of apprenticeship schemes. Provided you find the right candidate, bringing in employees straight from school or university whilst they complete a qualification guarantees two things:

1. They are great value for money; and
2. They are tied in for a defined period of time.

The cost of recruiting and training staff is significant, so it is important to highlight your additional benefits and promote your core values to attract and retain staff.

EMPLOYEE OWNERSHIP TRUSTS

Nowadays, with retention and succession being a major concern for many practices, we are seeing more and more law firms considering employee ownership as part of their future plans.

During the last recession, many professional services firms struggled, experiencing a decline in profits. Over the last few years, partners have been keen to hold on to improving profits, not wanting them to be diluted, which has limited the entrance of new partners. As that peer group of partners edge closer towards retirement, there is a gap of individuals willing to contribute capital, allowing those partners to be repaid.

With competition for talent high, firms are looking for ways to differentiate themselves from their peers. Employee ownership has become a marketing tool, as it attracts individuals who want to have a say in the business they work for. It is also a way of incentivising staff, as the performance of the business will have a direct impact on their remuneration, which in turn improves their productivity.

Employee ownership trusts (EOTs) were introduced in the Finance Act 2014, and are being mentioned more regularly in the press. In reality, there are very few (if any!) law firms going down this route at the moment.

WHY?

Whilst there can be definite benefits to EOTs, such as capital gains tax relief for owners who sell their shares to their employees, and income tax-free bonuses of £3,600 for each member of staff, it requires the existing owners to part with a controlling interest of the business. The majority of the practice then sits in the hands of the employees, who are ultimately able to decide how everyone in the firm is remunerated, and how the business is run.

A more attractive model for existing partners might be that used by Stephens Scown LLP, who have maintained the traditional LLP structure, but with a corporate partner that is owned by the employees. This means that the members of the LLP maintain control over profit allocations and business management decisions, whilst being able to 'sell' the business as employee-owned.

Some firms may feel it is more appropriate for them to introduce a profit share or bonus scheme, which is based upon staff receiving a top slice of the profits once their target has been exceeded, and for others it may be as simple as opening the dialogue with potential future partners earlier.



ENTREPRENEURS' RELIEF: ALL'S WELL THAT ENDS WELL

The final few months of 2018 saw a fair amount of uncertainty around the availability of entrepreneurs' relief (ER) for some shareholders. Thankfully, common sense has prevailed.

PREVIOUS CONDITIONS

By way of background, the longstanding conditions for ER to apply to the sale of a company's shares are that the company must be a trading company and the vendor must be an officer or employee of the company and hold at least 5% of the company's ordinary share capital, entitling them to at least 5% of the voting rights.

PROPOSED CHANGES

In the 2019 Budget, the Government announced two additional conditions that had to be met in order to claim ER. The new conditions were that the shareholder also needed to be beneficially entitled to at least 5% of the profits available for distributions, and 5% of the assets available on a winding up of the company.

Uncertainty arose in situations where a company had more than one class of shares and where the entitlement to dividends of each share class was decided by the directors as and when they saw fit. In that situation, it was questionable whether a shareholder had an entitlement to at least 5% of the distributable profits at any given time, as the entitlement to a dividend was at the discretion of the directors.

COMMON SENSE...THANKFULLY

Concerns about the impact of this change were raised with members of Government, our professional bodies and Tax Counsel, and this resulted in an important amendment. The conditions relating to distributable profits and assets on a winding up were retained, but an alternative condition was introduced. The legislation now permits a claim for ER where the longstanding conditions are met and where:

- a) The shareholder is beneficially entitled to 5% of the distributable profits and 5% of the assets on a winding up; or
- b) The shareholder is beneficially entitled to at least 5% of the proceeds in the event of sale of the whole company.

This alternative test re-opens the door for ER claims by shareholders of companies with multiple share classes, which is a victory for common sense.

Finally, it is important to remember that for disposals made after 5 April 2019 the qualifying period throughout which the conditions must be met is increased from 12 months to 24 months.

IS INCORPORATION DEAD IN THE WATER?

Transferring an unincorporated business (or LLP) into a limited company can offer a number of advantages. Some of the tax benefits have been curtailed or abolished in recent years, but with the corporation tax rate still low and set to reduce further, incorporation may still be worth considering.

ENTREPRENEURS' RELIEF

Probably the most significant tax benefit of incorporation was the ability to sell the business goodwill to a company and claim entrepreneurs' relief (ER). With a capital gains tax (CGT) rate of just 10%, the owners could then live off the sale proceeds, alongside a modest income from the business, minimising personal tax liabilities.

The Government ended this in December 2014, when ER was blocked on goodwill sold to a company connected with the vendor. At that time, the absence of ER meant the CGT rate jumped from 10% to 28%, making it prohibitive in many cases.

From April 2016, the main CGT rate reduced to 20%. Whilst this is still double the rate payable in the 'golden days', it is an easier pill to swallow for some. Coupled with the ability to spread the CGT liability if certain conditions are met, selling the goodwill might still be an attractive option.

EXTRACTIONS OF PROFITS

Another advantage of operating through a company is the ability to draw profits out as dividends. Unlike a salary or partnership profit share, dividends attract no national insurance contributions.

The Government clamped down on this from April 2016, when the rates of tax on dividends were increased. However, where the company's profits are being used to repay debt, reinvest in the business or the shareholders do not need to draw out the profits, the higher rates of tax on dividends can be avoided.

Therefore, in certain circumstances, incorporation may still be beneficial, despite recent tax changes.

BENEFITS OF INCORPORATION

In addition, there are some practical advantages to operating as company:

- Obtaining funding is generally easier (although not all banks are prepared to lend to owners of a limited company).
- It lends itself to management through a board as opposed to a fully democratic partnership.
- Separation of ownership and management is easier to achieve, facilitating ownership by family members or third parties (subject to SRA approval).

Practice structure should not be driven by tax savings alone, but the savings can be significant.

Any decision about the structure of the firm should be carefully considered, and we can advise on and assist with all aspects of the process.



First 100 years

Hazlewoods has provided specialist accountancy, tax, audit and business advice to individuals and businesses of all shapes and sizes ever since the practice was founded by Marcus Hazlewood in 1919.

In our centenary year we are pleased to announce that we will be holding an event to celebrate this, alongside the First 100 Years project, celebrating 100 years of women in law. Guest speaker Dana Denis-Smith will join us for an evening of discussion on changes in the industry, the power of role models, focusing on diversity and changes in attitude.

JOIN US!

Thursday 17 October 2019, The Old Courthouse, Cheltenham GL50 1ND.

If you would like to hear more or sign up to this event, please email marketing@hazlewoods.co.uk



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JON CARTWRIGHT

Partner

01242 237661

jon.cartwright@hazlewoods.co.uk



PATRICIA KINAHAN

Partner

01242 237661

patricia.kinahan@hazlewoods.co.uk



ANDY HARRIS

Partner

01242 237661

andrew.harris@hazlewoods.co.uk



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Windsor House, Bayshill Road, Cheltenham, GL50 3AT

Tel. 01242 237661

www.hazlewoods.co.uk / @Hazlewoods

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