



Barristers & Incorporation

[www.pkwaccounting.com](http://www.pkwaccounting.com)



## Regulators – Where are they now?

### ***Bar Standards Board (BSB)***

From 5 January 2015 the BSB will accept applications for Barristers to operate as “Barrister only entities”. With the first applications expected to be accepted by April 2015. An interesting development is that, if you decide to work via an entity you can continue to work as a self-employed practice by obtaining a *dual capacity practising certificate*.

The BSB anticipate that the single person entity will be the most popular of the available options. However there is scope for more complex entities.

Details of the application process and requirements can be found in the BSB Handbook Part 3 Section E. With a brief summary below.

It is believed the BSB will seek designation as a licensing authority for Alternative Business Structures (see below), with the application being submitted to the LSB within the first quarter of 2015. This will allow Barristers to practice through a limited company where some shares are held by a lay person (E.g. non-earning spouse).

### ***Solicitors Regulatory Authority (SRA)***

The SRA can authorise ABS (see below) now. It is possible to set up an ABS with a barrister and a non-lawyer regulated by the SRA. However the procedure is bureaucratic and the professional indemnity insurance can be more expensive.

### ***Barrister Only Entities***

A new type of legal service business recently emerged called “an entity”. These Entities are companies or partnerships that provide advocacy, litigation and expert legal advice services.

A barrister only entity could take the form of a traditional partnership, a Limited Liability Partnership (LLP) or a limited company. A brief summary of each form are as follows:

- Traditional Partnership
  - *No limited liability* – Partners are jointly and severally liable.
  - *No tax advantage* – Partners will be taxed on their individual share of the partnership profits as per a self-employed individual.
  
- LLP's
  - *Limited liability* – Partners/members are protected by the limited liability nature of the entity.
  - *Partnership Accounts submitted to Companies House* – Accounts must be produced in accordance with LLP regulations.
  - *No tax advantage* – Partners/members will be taxed on their individual share of the partnership profits as per a self-employed individual.

- Limited Company
  - *Limited Liability* – Directors/Owners are protected by limited liability
  - *Taxed as separate entities* – A company and its directors are separate legal entities and are taxed as such. Resulting in potential tax advantages with regards to profit extraction.
  - *Corporation tax* – a limited company is subject to corporation tax rates which can result in tax advantages.

### Summary

From the above it is reasonable to conclude that a Limited Company offers more advantages with regards to limited liability and potential tax advantages (discussed later).

By using a limited company the traditional chambers structure can also be maintained as the limited company can become a member of chambers, retaining the “Chinese walls” therefore removing any conflict of interest that may arise if members of chambers were all involved in one company or partnership.

As mentioned above the BSB should be able to regulate ABS’s once obtaining LSB approval. This would allow a non-earning spouse to be included as a partner or shareholder. This would give the opportunity for further tax savings.

## The Application Process?

The first step in the application process would be to contact the BSB for an informal talk regarding your plans. They recommend contacting them via the following email:

[entityregulation@barstandardsboard.org.uk](mailto:entityregulation@barstandardsboard.org.uk)

After the initial informal chat the application process will be via an online portal on the BSB website. It will consist of 5 parts:

- a) Entity and eligibility details.
- b) Management and Governance processes.
- c) Suitability of HOLP (Head of Legal Practice) and HOFA (Head of Finance and Administration).
- d) Declaration of truth.
- e) Litigation Extension – only if entities want to conduct litigation.

All the information regarding the application and requirements can be found in Part E of the BSB Handbook with guidelines on the BSB website. However below is a summary of the requirements:

### **Mandatory Requirements**

The mandatory requirements can be found in section rS83 and rS84 on pages 116-117 for the BSB Handbook. A summary of key points can be found below:

- BSB's regulatory arrangements, including its rules and disciplinary arrangements must be complied with.
- Any other statutory obligations are complied with.
- Must have, at all times, appropriate individuals appointed to act as HOLP (Head of Legal Practice) and HOFA (Head of Finance and Administration). The same individual can be both (section E5 p124).
- Must have appropriate insurance arrangements.
- Must not, directly or indirectly, hold client money.
- Must ensure any individual appointed as HOLP, HOFA, manager or employee have not been disqualified from acting as such by the BSB or any approved Regulator.
- Must have a practising address in England or Wales at all times.
- At least one manager/e'ee is an authorised individual in respect of each reserved legal activity the company provides.
- Must pay annual fees when they fall due.

## **Discretionary Requirements**

If the mandatory requirements are met the BSB may, in its discretion, refuse your application for authorisation if (section rS101 page 122):

- It is not satisfied that managers and owners meet the relevant suitability criteria.
- It is not satisfied that managers and owners are a suitable group to operate and control a practice providing services regulated by BSB.
- It is not satisfied that the appointed HOLP and HOFA meet the relevant suitability criteria.
- It is not satisfied that management or governance arrangements are adequate.
- It is not satisfied, if authorisation is granted, the BSB's regulations will be complied with.
- Inaccurate or misleading information has been provided in the application or responses to requests.
- If you fail to notify the BSB of any changes in the information provided in the application.
- If the BSB concludes that it may require the intervention powers allocated to it.
- If, for any reason, the BSB considers it would be inappropriate to grant authorisation.

## **Other useful information:**

- Fees – There will be application fees and authorisation fees payable to the BSB totalling £365 for a single person entity and up to £2,900 for a 15+ person entity.
- Chamber Name – you can keep the same name as you currently operate under however clients must not be confused on whether they are instructing an individual or an entity.
- Practising Certificate – you will still need an individual practising certificate as an employed Barrister if you want to provide legal services through an entity. Alternatively you can apply for a dual capacity practising certificate allow legal service to be provided, though an entity or as a self-employed individual by the same person.
- Insurance – there will need to be an entity risk analysis performed in order to determine the level of cover needed. But insurance required should be broadly similar to that currently provided to the self-employed.
- How Long? – The BSB expect the process to take no longer than 6 months from application to authorisation, if successful.

## Incorporation – Practicalities

### ***Setting up a Limited Company***

- *Incorporation* – The process of setting up a company. This can be done via Companies House. However it may be worthwhile using a specialist firm to form the company.
- *Choosing a name* – This cannot not be the same as an existing company on the register. This will be checked upon formation.
- *Directors and Shareholders* – appointing directors and share structure will need to be considered.
- *Registered Office* – This will be where all official correspondence will be sent (E.g. Registrar of companies, HMRC etc.)
- *Business Stationery* – must contain certain details of the limited company on business stationery, such as company letterheads.
- *Registering with HMRC* – For Corporation Tax, VAT and PAYE (if necessary).
- *Company Bank Account* - A separate bank account will need to be set up.
- *Professional Indemnity Insurance* – under guidelines from BSB an annual risk assessment will have to take place to ensure entities have adequate insurance. It is envisaged that the insurance required for entities will be broadly similar to that of self-employed Barristers.

### ***What happens to the self-employed individual?***

This will depend on whether the individual would like to continue working in a self-employed practice and therefore require a dual capacity practising certificate. If the individual opts to trade as a limited company only, then the following actions would be required:

- *Cessation Accounts* – A set of self-employed accounts to cessation will need to be complete. With the cessation date being that of transfer of business into the limited company. Depending on your accounting year-end you may be eligible for overlap relief.
- *VAT* – As an individual you will need to deregister for VAT. Depending on individual circumstances (cash or earning basis) and whether you would want to use the “Barrister Deferment scheme” or pay the amount up front will determine how this will be complete.
- *Class 2 National Insurance* – should be cancelled as these payments are no longer required.

### ***Other points***

A limited company is a separate legal entity and therefore:

- *Fee income* - belongs to the company



- *Company assets* - belong to the company and cannot be taken from the company other than by way of a salary or dividend. This includes cash in the company bank account.
- *Director & Shareholder* – you will be both a director and shareholder and therefore can be remunerated via salary and/or dividends. Dividends are generally preferred as it is more tax efficient.
- *Dividends* – can be paid providing there are sufficient profits after tax. It is only possible to withdraw sums from the company after taking into account expenses payable and tax due.
- *Documentary Procedures* – Each dividend payment should be accompanied with a dividend voucher and board minute. This ensures the correct audit trail exists for dividend distributions.

### ***Disadvantages of incorporation***

- *Statutory Accounts* – A company must prepare accounts in accordance with the Companies Act. This will include a Balance sheet, profit and loss account along with detailed notes to the accounts.
- *Accountancy fees* – Increased compliance work and a higher level of bookkeeping needed will inevitably result in a higher annual accountancy fee.
- *Companies House* –
  - Statutory accounts must be filed with Companies House 9 months and one day after the company's year-end. These accounts will be in the public domain. However you are able to file abbreviated accounts (mainly a simple balance sheet) which do not contain as much detail as those presented to shareholders or HMRC.
  - Annual Return must also be filed with Companies House each year. This confirms Directors and Shareholders details along with registered office. A fee of £13 is charged by Companies House on submission (online).
- *Expenses* – some expenses will be treated differently through a company compared to being self-employed. However these changes are not always detrimental. Examples can be found below:
  - Motor expenses
  - Capital items – such as laptops, iPads etc.
  - Mobile phone
- *Pension contributions* – based on tax efficiency the majority of income will be taken from the limited company as dividends with a small amount as salary. As an individual you can only claim tax relief on personal pension contributions up to the amount of earned income (salary). A potential solution is to make employer's pension contributions on behalf of the director. These will be deducted from the income of the company when calculating corporation tax.

## Transferring assets from the individual to the company

It has been suggested that there would be some benefit from transferring assets from an individual to a limited company in order to pay a lower rate of capital gains tax opposed to the higher rate of income tax. Most notably goodwill and trade debtors.

### **Goodwill:**

- By transferring goodwill the individual would pay capital gains tax, at a lower tax rate, on disposal. Similar to a loan the value of the goodwill would sit in a director's current account that can be extracted from the company with no tax consequence.
- Personal goodwill – the profitability of a barristers practice is down to the knowledge, experience and reputation of the particular individual. A company cannot own this type of goodwill and therefore it is difficult to value and cannot be sold. Therefore the value of goodwill in relation to a barristers, that is transferrable, will be minimal.
- From 03 December 2014 entrepreneurs' relief will be denied for disposal of goodwill to related companies. This results in capital gains taxed being paid at a higher rate of 28% or standard rate of 18% as opposed to 10% with entrepreneurs' relief.

### **Trade Debtors:**

- A trade debt can only be created by recognising turnover at the same time. Therefore the individual would have already suffered personal tax on any trade debtors still remaining on cessation.
- Therefore we believe no real tax advantage can be gained by transferring aged debt from an individual to a limited company.

### **Fixed assets:**

- Fixed assets such as laptops, office furniture etc. can be transferred at the market value or an election can be made to transfer at TWDA (tax written down value).
- If transferred at market value, it will likely result in a capital allowances balancing charge for the assets in the individuals cessation accounts that will be taxed at the individuals effective rate. This is due to the likelihood AIA (Annual Investment Allowance) will have previously been claimed on the asset. Subsequently, the value of the assets would then be available for extraction from the company through the director's loan account.
- If transferred at TWDV there will be no capital allowances balancing charge. The TWDV of the assets (likely to be £0 if AIA claimed) would then be available for extraction from the company through the director's loan account.



## Potential Tax Savings

### ***Points of note:***

As mentioned previously, incorporation offers limited liability along with potential tax savings. The table below details tax rates and tax bands applicable for the 2014/15 tax year for both self-employed individuals and limited companies:

Self-Employment Tax Rates				Limited Company Tax Rates			
Income Tax		Class 4 NI		Corporation Tax		Personal Tax on Dividends	
Income bands	Tax Rate	Income bands	Tax Rate	Income bands	Tax Rate	Income bands	Tax Rate
£0-£10,000	0%	£0 - £7,955	0%	£0 - £300K	20%	£0 - £41,865	0%
£10,001 - £41,865	20%	£7,966 - £41,865	9%	£300K - £1.5M	21.25 %	£41,886 - £150K	25%
£41,886 - £150K	40%	> £41,865	2%	> £1.5M	21%	> £150K	30.56 %
> £150K	45%						

### Points to note:

- *Profit extraction* - A director/shareholder, as a separate legal entity, will look to extract the profits from the company by the means of salary and dividends.
  - Salary is generally not tax efficient (Class 1 E'ee and E'er NI), however salary is a deductible expense for corporation tax purposes.
  - Dividends are preferred as no national insurance is paid on dividends.

Therefore Corporation tax will be paid on company profits and then Income tax will be paid by the individual's profit extraction.

- *Profits retained in company* – Other than corporation tax no further tax will be due on profits retained in the company. This can give rise to potential tax planning opportunities.
- *Future corporation tax rates* – it is proposed from the 2015/16 tax year there will be a flat rate of corporation of a flat rate of 20% for all levels of profit.

**Potential tax savings for a Barrister only single entity:**

Based on the 2014/15 tax rates, a comparison between the tax liabilities of a self-employed Barrister and a Barrister only limited company with one shareholder, with a salary of £10,000 and the remained of profit extracted through dividends, can be found below:

Profit	Tax due Self-Employed	Tax due Limited Company	Tax Saving
£ 50,000	£ 12,985	£ 9,076	£ 3,909
£ 150,000	£ 58,985	£ 53,326	£ 5,659
£ 250,000	£ 105,985	£ 96,992	£ 8,993
£ 500,000	£ 223,485	£ 209,753	£ 13,732
£ 750,000	£ 340,985	£ 323,034	£ 17,951
£ 1,000,000	£ 458,485	£ 436,315	£ 22,170

**Potential tax savings - ABS:**

As mentioned earlier as an ABS the entity can permit a non-barrister to be a shareholder in the limited company. This may be a non-earning spouse that could hold shares and receive some of the dividends, which will be assessed on their personal income tax return.

It is expected that the maximum percentage shareholding a non-barrister/authorised individual will be permitted to hold in an ABS is 25%. The tax saving, based on both director shareholders receiving £10,000 salary each with the remainder extracted through dividends, using the 2014/15 tax rates would be:

Profit	Tax due Self-Employed	Tax due Limited Company	Tax Saving
£ 50,000	£ 12,985	£ 6,491	£ 6,494
£ 150,000	£ 58,985	£ 38,821	£ 20,164
£ 250,000	£ 105,985	£ 83,068	£ 22,917
£ 500,000	£ 223,485	£ 196,404	£ 27,081
£ 750,000	£ 340,985	£ 308,828	£ 32,157
£ 1,000,000	£ 458,485	£ 422,110	£ 36,375

## Is it legal?

### ***Using a limited company as opposed to a sole trader:***

With the recent introduction of the General Anti-Abuse Rule (GAAR) there has been concern HMRC may attack the use of a limited company as described above.

HMRC have confirmed in their official guidance on GAAR that it is not targeting this type of arrangement. Please find an extract of the guidance below:

*“B4.3: To take an obvious example, a taxpayer deciding to carry on a trade can do so either as a sole trader or through a limited company whose shares he or she owns and where he or she works as an employee. Such a choice is completely outside the target area of the GAAR, and once such a company starts to earn profits a decision to accumulate most of the profits to be paid out in the future by way of dividend, rather than immediately paying a larger salary, is again something that should in any normal trading circumstances be outside the target area of GAAR.”*

### ***Transferring shares to a spouse:***

As seen in the ABS example above there are potentially greater savings to be made by transferring shares to a non-earning spouse. It has been questioned whether this could be attacked by HMRC. The current situation is as follows:

- Jones v Garnett (Arctic Systems Case) – provided shares being transferred have rights to both capital and income there should be no difficulties. When the gift is of income only then settlements legislation will come into play.
- *Voting rights of shares* – it is important that shares being transferred are ordinary shares having exactly the same voting rights and rights to capital on a winding up.

## Chambers

It is up to Chambers to decide whether or not single-person entities can be members of chambers. There is no regulatory reason preventing you from continuing to work from chambers.

It is believed that the limited company will be treated as a new member of Chambers with separate aged debt reports and payment summaries being prepared. Depending on whether you decide to act in dual capacity or not will determine what happens with individual members aged debt. If opting for dual capacity everything will continue to run as usual. If you decide trade as an entity only the aged debt of the former individual member will run down as “post cessation” receipts that will feature on the individual’s tax return.

Chambers constitution may need to be amended to reflect the different legal status of the relevant member of Chambers.



## Summary

Incorporation had been a strategy that countless businesses have adopted through varying industries over the years. This is due to the clear advantages in terms of tax and limited liability. There are however complications and consequences to be considered to come to an informed conclusion. Everybody's individual circumstances are different and need to be taken into account. It is important that advice is taken on how the change may affect you before taking action.

## PKW Accounting, Chartered Accountants

### ***Why PKW Accounting?***

- *Bar Specialists* - Previously employed by the market leader and recommend service partner of The Bar. Learned from the best.
- *Chartered Accountants deals with all your affairs* – unlike some competitors, at PKW Accounting an experienced Chartered Accountant will deal with your affairs from start to finish. There are no bookkeepers or trainees completing the bulk of your affairs. Resulting in a higher level of service.
- *Very competitive rates* – We may not be the cheapest but we most certainly provide the best value. We like to provide high level service without the high level fees.
- *Minimal inconvenience* – we understand you are busy, which is why we look to make things as easy as possible for you. From obtaining information directly from your clerk (permission required) to meeting you at chambers at a time that suits you.
- Please see our website for more information [www.pkwaccounting.com](http://www.pkwaccounting.com)

