

SURVIVING THE CREDIT CRUNCH

The economic downturn is starting to have a dramatic effect on most businesses and law firms are no exception.

The decline in activity in the residential property market has had a knock on effect in conveyancing departments across the country, resulting in reduced working hours and job losses. Also corporate activity has been hit with much lower volumes of work available.

What can solicitors do to remain profitable?

Back to basics

It is important now more than ever, that the basics are not overlooked. There are some simple, practical improvements that can be made to improve a firm's working capital management by tightening controls on billing of WIP and collection of debtors.

Regular billing days should be established in order to catch up on outstanding bills. Ensure that all time is charged and fully billed and request prompt payment. Where possible, ask for up-front payments and ensure slow payers are chased without delay.

Monitor cash flow on a monthly or preferably a daily basis. If external borrowing is required, banks will require clear, detailed and relevant information.

Increasing revenue

With difficult times ahead, a number of firms may have decided to forgo expensive advertising campaigns in an attempt to reduce discretionary expenditure. However, if marketing does not receive sufficient attention, the firm's revenue streams will suffer.

If possible try to generate additional fee income from your existing satisfied client base. Research has shown that it is much easier and more cost effective to do this than to try and win business away from other providers.

Also make sure you have a good website which shows all the services offered by the

firm. This is often the way that new clients find a firm and is a cost effective marketing tool.

Analysis

At present, client money interest cannot be expected as a reliable income stream so it is now more important than ever to ensure that all areas of work are profitable in their own right.

An in-depth analysis of the firm's revenues and costs can help to identify which profitable areas are critical to the firm's success. If you require assistance with this analysis please do not hesitate to contact us.

A stronger financial knowledge of the business will provide a good basis for making strategic decisions.

Cutting costs

A crucial aspect of good management is knowing when and how to cut costs. Making redundancies is not always the best way as this will inevitably lead to low morale within the remaining staff and costly redundancy payments or gardening leave will have an impact on the firm's profitability.

Fee earning staff should be redeployed to busier departments if possible. Another option is to reduce their hours and pay to (say) a four day working week. Good two-way communication can often make the transition easier and staff are often more compliant if they understand the motives behind the decision.

If redundancies are necessary, it is imperative that the process is seen to be transparent and fair. When general trading conditions improve, key fee earners are much more likely to remain loyal if they believe the firm treats its employees fairly.

Additionally, concentrate on minimising large items of expenditure. Unless absolutely necessary, discretionary spending on items such as maintenance and decoration should be postponed until profits recover.

TAX CHANGES

In the Budget Report in April 2009 a series of proposed tax and NIC increases were brought forward and will start to affect higher earners from 6 April 2010.

Tax Year 2010/11

There will be a restriction on the basic personal allowance where gross income exceeds £100,000.

An individual's personal allowance will be reduced by £1 for every £2 of adjusted net income above £100,000 until it is reduced to nil.

Based on the current rates of personal allowance this will increase the tax liability of high earners by up to £3,238 per annum.

A new rate of income tax of 50% will be introduced where taxable income exceeds £150,000.

New tax rates of 42.5% will also apply to dividend income for higher earners and the trust rate will be increased by 10% to 50%.

Tax Year 2011/12

An increase in the rates of National Insurance is proposed from April 2011 of 0.5% for employers, employees and the self employed.

Removal of Higher Rate Relief on Pensions

In the Budget the Chancellor also announced the removal of higher rate relief on pension contributions.

Tax relief on pension contributions will be restricted from 6 April 2011 for higher earners with income exceeding £150,000.

The relief will be tapered until it is down to 20%.

There have also been anti-forestalling measures introduced from April 2009 to prevent higher earners with income exceeding £150,000 in the current or previous two tax years from increasing their pension contributions in excess of their normal pattern of regular contributions.

This proposal has been watered down somewhat in the Finance Bill and contributions qualifying for full relief in addition to the above can also include the average of irregular contributions paid in the last three tax years capped at £30,000.

For contributions to be classed as irregular they have to be paid less frequently than quarterly

Rent for Use of Premises

A partner who provides business premises for their firm may either receive rents or may take a larger profit share in lieu of the rent.

The benefit of taking rents is that they are not subject to NIC. However, if the property is sold on leaving/retiring it may not qualify for full Entrepreneurs' Relief from capital gains tax. To avoid this, rents should not have been taken from 6 April 2008.

Trading Structures

The Budget has significantly increased the marginal rates of income tax for higher earners. As a result, it is likely that although most professional firms will still include a controlling partnership or LLP, it will become increasingly common for there to be hybrid structures which may be able to reduce the tax liabilities of partners.

We have reviewed various tax planning opportunities available to partners in solicitors firms. These can deliver substantial tax savings although there are various commercial issues which need to be addressed, including the retirement and admission of new partners.

If you are interested in knowing more about these please contact us.

Contact Details

Brian Carruthers or Emma Kirton
Thomas May & Co
Allen House
Newarke Street
Leicester
LE1 5SG

Tel: 0116 233 5959

Email: briancarruthers@thomasmay.co.uk or emmakirton@thomasmay.co.uk

Disclaimer – for information of users

This bulletin is produced for information only and no action should be taken without seeking the appropriate advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this bulletin can be accepted by the authors or the firm.

July 2009