

Legal Insight

AUTUMN 2017

HAWSONS CHARTERED ACCOUNTANTS



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Introduction



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WELCOME TO OUR AUTUMN 2017 LEGAL NEWSLETTER.

As the days become shorter and the evenings draw in, we are left in little doubt that winter is just around the corner.

More significantly is that Christmas is rapidly approaching and we will soon be saying farewell to 2017.

I think it is fair to say that it has been an eventful year. We had a new president inaugurated across the North Atlantic along with a snap general election resulting in a loss of the Conservative majority. On top of all this, the Brexit negotiations continue to ebb and flow in the background. Finally, and perhaps most significantly in the short term, we have just seen the first rise in interest rates in over a decade.

You may have noticed a change in presentation and format of this newsletter which we hope will resonate with our readers. We hope you enjoy our final newsletter of 2017, and as always, please get in touch if you would like any further information.

Hawsons are specialist legal accountants

Hawsons is one of the few accountancy practices with a dedicated team specialising exclusively in the need of solicitors and legal professionals. We act for a large number of law firms across all three of our offices and offer a wide range of services which are tailored to meet their individual needs. Our legal client base consists of a multitude of firms of varying structure and size, from sole traders to limited companies and LLPs with corporate members.

Our specialists offer an all-encompassing service to sole traders, partners, partnerships, companies and LLPs. We are able to offer all types of compliance work and advice on non-routine issues, including personal and business planning.

For more information on our legal expertise, including the services we offer and our experience, please visit: www.hawsons.co.uk/solicitors

Solicitors "SEARCH"ing for answers

The *Brabners LLP v HMRC* First Tier Tribunal (FTT) case involved whether electronic, local authority search fees paid to Searchflow (a specialised online search agency) by Brabners were to be treated as disbursements.

It had been standard practice since September 1994, after HMRC agreed with the Law Society that local authority postal search fees could be treated as disbursements for VAT purposes.

The judge agreed with HMRC's view that the electronic search fees had been incurred by Brabners "in the course of making its own supply of services" to its clients. The Tribunal dismissed Brabners appeal as it was satisfied that they had obtained the search records as an integral part of the legal services that it provided, and that the conditions in Notice 700 Para 25.1.1 (which relate to disbursements) were not satisfied.

The judge states "In my view, wherever searches are obtained, the payment is part of the overall consideration which the client pays for the service supplied by the solicitor".

This decision is at odds with that in the earlier case of *Barrett, Goff and Tomlinson v HMRC* (FTT). In that appeal the Tribunal came to a different conclusion when considering the treatment of fees paid by the appellant firm of solicitors for medical records and reports obtained in connection with personal injury claims. The Tribunal allowed the appeal and the medical records and reports were allowed to be treated as disbursements.

However, in *Brabners*, the tribunal commented that in *Barratt*, the tribunal was dealing with a different scenario. He said that in *Barratt* the medical records were confidential but the searches of property records were in the public domain.

The treatment between the historical postal searches concession and the types of electronic searches mentioned in the *Brabners* case are clearly inconsistent. It needs noting that the *Brabners* case is just a First Tier Tribunal and as such is not legally binding.

However, the fact that HMRC took the case to tribunal is probably an indication of how they see the VAT treatment of searches going forward. They could even remove the original concession.

Most solicitors have followed the Law Society's Practice Note on VAT and disbursements – 10 March 2011.

It states "Land Registry Fees – Following agreement with HMCE in September 1994, when a seller's solicitor obtains an office copy entry and recharges the exact fee to his client he may treat it as a disbursement and outside the scope of VAT.

It is now common practice for official copies to be obtained on behalf of any party to the transaction; seller, buyer or mortgagee. It is the Society's view that this may be treated as a disbursement, provided you recharge the exact fee."

In the light of the *Brabners* decision we believe that solicitors have two options. The first is to hold off taking any action until the Law Society has updated its guidance note on VAT and disbursements and/or an Upper Tier Tribunal has made a ruling on this matter and/or HMRC has updated its guidance.

The second option is to add VAT to all recharges of costs for searches going forward. This will protect the solicitors VAT position for the future. If the *Brabners* decision is overturned, this VAT will be reclaimable from HMRC within a four-year timeframe, as long as it is paid back to the client. Both options can be sustained as taking a reasonable approach, but option two does pass the risk onto the clients so may be more attractive commercially.

The *Brabners* decision appears to focus on local authority search fees via agencies such as Searchflow, rather than HM Land Registry fees. But it is difficult to see that there is any substantial difference between HMLR search fees and local authority fees.



Ransomware - is your legal firm protected?

We've all heard stories about firms who've been hit by a ransomware attack. They've suffered days of downtime while the firm recovers, and not been able to service clients as well as they would have liked to. Obviously it won't happen to your firm, but it just might.

THE RISE OF RANSOMWARE AS A SERVICE

The chances of being hit by a ransomware attack are significantly higher year on year. IBM research suggests the increase in 2016 compared to 2015 was 6,000% and with all the well publicised attacks in 2017 it looks like there has been no let-up in the rate of increase. It's easy to understand why the rise is so steep since, as ever, it's all about the money.

Ransomware encrypts your data and you have two options, revert to backups, or as a last resort pay the money, although there's no guarantee the criminals will give you the decryption keys. Typically the ransomware spreads like wildfire across the network, taking advantage of shared drives we normally use to locate and save our documents.

The criminal gangs involved are now so sophisticated there is a ransomware 'industry' which even offers ransomware as a service. The ransomware code writers provide their code via a portal and typically have a profit share agreement with the criminals who use it.

WE HUMANS ARE THE WEAKEST LINK

Two of the main options open to the criminals to inflict ransomware on us are to 'unlock' the door to our network, or to fool us into opening the door for them and letting them in. Hacking into corporate

networks is often done by criminals using programs which effectively check to see if you've left the door unlocked, hence the need for regular penetration testing of networks.

However, hacking is nowhere near as easy or as fruitful as simply getting us humans to open the door for the criminals and let them in. Sending out thousands of emails aimed at getting us to click on links or attachments in emails is now an even easier route. Once we have been duped into clicking, a 'payload' is silently dropped onto the computer.

This program may start encrypting the data immediately or alternatively it may just collate data from the network so the criminals can choose the most inconvenient time to catch you out and then encrypt your data.

We've all had the emails that are obviously not genuine. This used to be spam, but today it could easily be ransomware. Examples are where you are offered a voucher for 50% off your supermarket shopping or the email telling you that you need to change the password on a service you don't even have an account for.

Of course, we wouldn't fall for that would we? Well you just might fall for it if you are expecting some information from a client and you receive an email from Microsoft Office which says:



"An important document has been shared with you. You may need to sign in with a Microsoft account to view the secured document."

How do you know if that's a genuine email or ransomware? It all depends upon the context of your working day. You can't just assume IT will have sorted it out or that the spam filter should have done its job, because with the volumes involved they won't get it right all of the time.

SIMULATED PHISHING ATTACKS AND TRAINING

You need, and probably already, have several layers of cyber defences. The reason for the layers is that none of them are infallible. I repeat, none of them are infallible. Defences include email filters, web content filters, application installation blockers (ransomware can be disguised as software on internet downloads), security patch updaters and ransomware protection software running on all PCs and servers.

The last line of defence is your staff. Your staff need to be given anti-ransomware training. You should also invest in software to send regular spoof phishing emails to your staff.

This software typically allows you to select spoof emails from a pool, schedule emails to your staff and track who the clickers are and on what email and at

what time. When staff click on spoof emails they shouldn't have done, they are immediately taken to a web page and reminded of key things to look out for.

These include hovering over links and checking the path is where you would expect to be taken or spotting that security-update@Hotrnail.com is not actually from Hotmail as the letters 'r' and 'n' are used together to fool us into thinking we are seeing an 'm'.

BACKUPS, BACKUPS AND MORE BACKUPS

The final layer of defence, if all else fails, is your backups. They will take some time to reinstate so you need to have your other defensive layers in place as well. You need to be absolutely 100% certain your backups are being taken and just as importantly the data can be restored when it needs to be. Regular restore tests should be carried out and best practice is to have a simulated disaster recovery test day, typically annually.





SRA Sets Out Corporate Strategy for Next 3 Years

The SRA has recently laid out its three-year strategy that will establish its core areas of focus right up to 2020.

The current three-year strategy finished in 2017 and saw the regulator take the initial steps toward achieving outcomes focussed regulation, reducing bureaucracy and enabling a more efficient level of responsiveness and customer service.

One of the main steps to be taken in the forthcoming strategy is to ensure that above all else, regulation is proportionate and justifiable. The provision of legal services is changing and the SRA recognise that they need to evolve to be able to remain relevant and effective.

At the very core the SRA has stated it needs to 'make sure that our regulation helps, rather than hinders, an open, competitive and growing legal market that meets people's needs at affordable prices'.

The SRA has set itself five new strategic objectives to develop in its three year plan

- Set and apply consistently high professional standards for the individuals and firms it regulates.
- Ensure regulatory requirements are proportionate,

providing solicitors and firms with the flexibility to innovate and better meet the needs of members.

- Increase availability of relevant and timely information.
- Ensure regulatory arrangements work as effectively as possible for the public, businesses, solicitors and firms in the context of constitutional developments within the UK and any new relationship with the EU.
- Work better together and with others to improve overall effectiveness and the delivery of regulatory functions.

Overall the SRA acknowledges the increasing diversity within the sector since the provisions of the Legal Services Act 2007 and the environment it now regulates is very different to that of even five years ago.

They regulate a broad range of businesses that have changed massively since the last three year plan including leaps forward in the use of technology.

The SRA recognise that, in particular with the technological advancements, businesses have a far greater expectation when it comes to speed and quality of services provided.



Making Tax Digital faces even more delays

In the most recent update of the Finance Bill 2017-19, the government have announced a delay in the timeline for Making Tax Digital after concerns were raised, and the changes were put on hold due to the snap election back in June.

UNDER THE NEW TIMETABLE:

- Only businesses with a turnover above the VAT threshold (currently £85,000) will have to keep digital records

- Even then, this will only be for VAT purposes

- This will only be mandatory from 6th of April, 2019

- Businesses will not be asked to keep digital records, or update HMRC quarterly, for taxes other than VAT until April 2020 at the absolute earliest.

This means that any businesses and landlords with a turnover below the VAT threshold will be able to choose if they will move over to the digital system, but will not be compelled to do so.

For businesses over the threshold, they will have to provide digital tax records for VAT to HMRC from 6th April 2019, but not for any other taxes until at least a year after this point, maybe even later.

However, businesses above the threshold will be mandated to record VAT digitally from April 2019 in order to send HMRC standard quarterly updates.

Those businesses that are VAT exempt won't have to change to digital tax until all tax moves online

- which will be Spring 2020 at the soonest. This includes health and education services.

The first businesses that have already started keeping digital records, and providing updates to HMRC digitally will continue, and this pilot will be extended.

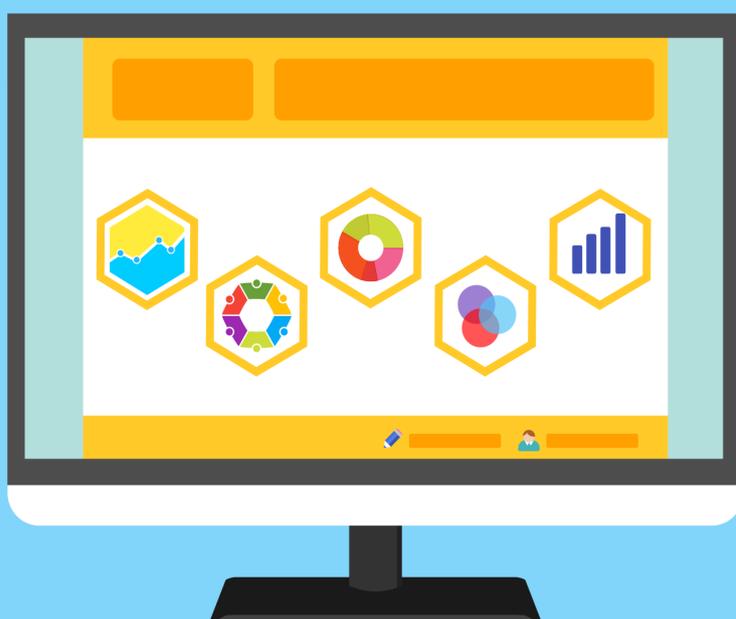
By the end of the year, HMRC plan to turn this into private, small-scale testing, which will then be followed by wider, live pilot testing starting in Spring 2018. This gives just over a year for testers before businesses over the VAT threshold have to change over to digital records for VAT purposes from April 2019.

Most businesses will not feel any change, as they do not need to provide information to HMRC under Making Tax Digital for business any more regularly than they do now. VAT has been available online since 2010, and over 98% of VAT registered businesses already file electronic returns.

Despite these clear delays, concerns are still being raised about the pace and scale of the change. How can we help?

With our knowledge of dealing with SMEs and of dealing with various accounting software packages we can help you cope with and plan for the forthcoming changes and provide a range of tools to help with the crossover to digital.

Please feel free to get in touch with us to discuss what this means for your business



Preparing for succession

In larger law firms, the changing of the guard is a well-practised art. In smaller firms, however, succession planning is often not seen as much of a priority. The call to action tends to be the retirement of a partner, an inevitable event, which is generally disregarded until it confronts the partnership. But, it is never too soon to start considering the options for this unavoidable occurrence.

WHAT SUCCESSION OPTIONS ARE AVAILABLE?

In terms of a (relatively) straightforward succession, it can only be advised to consider who will eventually inherit responsibilities very early on. This allows plenty of time for hand over to occur incrementally.

However, a straightforward succession is not the only exit strategy to deliberate. There is no “one size fits all” in terms of small practice progression. Mergers have been increasingly more prevalent in recent years. These bring with them their own challenges, not least of which the issue of partner integration. Problems can vary from cultural differences to financial issues such as profit sharing arrangements. It’s important to ensure you know all the details prior to a merger taking place to avoid problems down the line.

One final option not to be disregarded is shutting up shop altogether. Although, it is understandable why many smaller firms are deterred from this as an exit strategy. A controlled closure still requires run-off cover, and the premiums can range from anywhere from 2, to 4 times the annual premium.

TRANSITIONING

Both the succession process and transition itself need careful thought. Put bluntly, the departing partner needs to hand over the reins in a way that passes on wisdom, goodwill and trust. A manageable method is to pass on responsibilities gradually to the successor, and therefore focus on long term aims like maintaining the brand, culture, and reputation of the firm.

Moreover, a straight transfer of all responsibilities from one person to another is not always the answer. It’s rare that someone in their 60s can be effectively and instantly replaced by someone 20 years their junior. Finding one person to replace the partner who is leaving is, more often than not, hard to achieve. A more fitting method can be to assess the different roles the exiting partner fulfils, and find how each of those roles can be occupied effectively. Put people in the right roles.

Furthermore, it’s important that, while internal changes are hugely distracting, clients still remain at

the forefront of your mind. It’s recommended that you only let clients know about upcoming events once the solution has been agreed. If a departing partner is remaining in the firm through a consultancy role, this will keep clients at ease, and enable a seamless transition, but that consultancy role should be clearly defined with a timescale for full handover in mind.

Never underestimate the value of the young talent growing and developing in the firm. If their wants and needs are not addressed or their expectations managed, then you run the risk of losing them, which can dent the succession plan.

THE COST OF CHANGE

Valuation is a difficult matter for small businesses, especially in professional services. When it comes to external financial advice, a fresh and objective pair of eyes to look over accounts can ensure that the best decisions for the firm can be made, and any potential problems can be dealt with before they emerge. An external adviser can, and will, safeguard your sights for the future, alongside bringing perspective to the situation the firm is facing.

NEXT GENERATION

Aspiring for equity partnership is no longer a given in the younger generation. There are multiple risks in owning a business, and firms planning for succession should acknowledge that uncertainty over the future of the profession stops the younger salaried partners and associates from stepping into those roles. They may not want the risks and responsibilities that come with being an equity partner.

Clearer thinking is needed when considering the future of a business, and the aim of succession should not be forgotten: to ensure that the business keeps running, and that staff are happy and fully informed about what’s coming next.



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