AUDIT • TAX • ADVISORY

# The Roadmap to your Financial Future

## Partners' Financial Planning Guide

Now, for tomorrow

mha

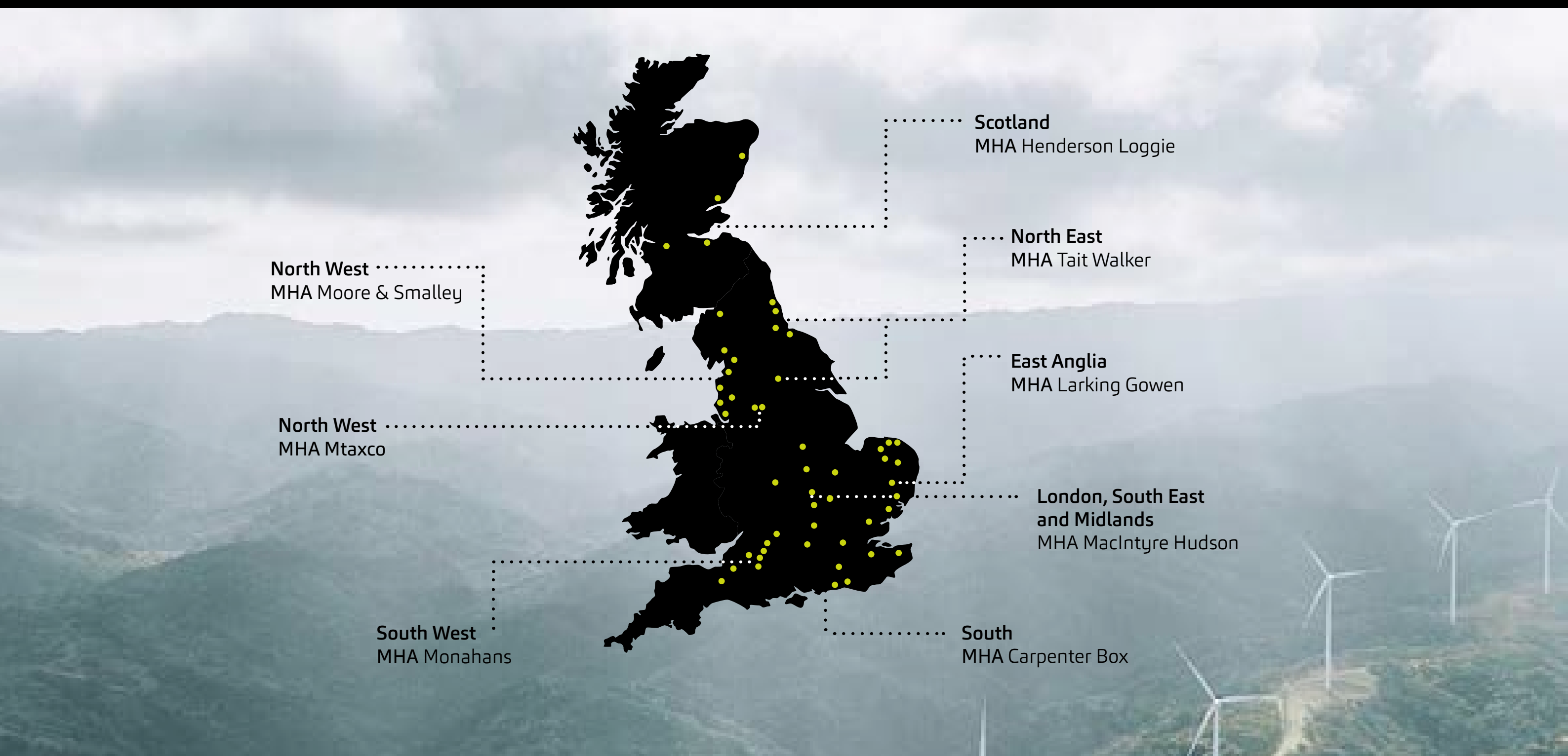
# About MHA

MHA is an association of progressive and respected accountancy and business advisory firms with members across England, Scotland and Wales. Our member firms provide both national expertise and local insight to their clients. MHA members assist clients with their needs wherever they are in the UK, as well as globally through our membership of Baker Tilly International, which has a network of trusted advisors covering 145 territories worldwide.

## Our Sector Approach:

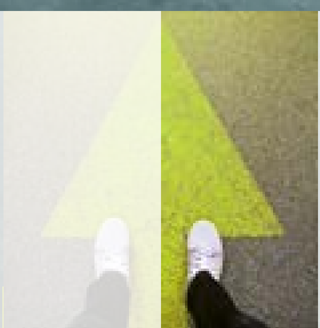
MHA allows clients to benefit from our in depth sector knowledge, which adds value to the specialist services that we can provide in accountancy, audit, tax, regulatory and expert business advice. Professional Practices is a key sector for MHA.

We act for over 400 professional practices, including over 200 legal firms. We are committed to assisting both our clients and the sector as a whole and this report is just one of the tools we use to give our clients insight into issues affecting the sector, to give them a head start when it comes to mitigating risks and exploiting opportunities.




## National Reach

**50+** Offices nationwide



## International Reach

**125** Member firms in 145 territories

**8** Independent accountancy firms

Combined turnover of **£143m**

**10th** Largest network in the world by combined revenue

**US$3.6bn** Combined member firm revenues

# Introduction

Our "Roadmap to your Financial Future" will help you to focus on the key issues, challenges and opportunities throughout your career, to ensure your affairs are managed in the most efficient and effective manner.

Our guide to your financial future has been developed by specialists at our member firm MHA MacIntyre Hudson, for partners at all stages of their life as a business owner, concerned with understanding the financial and legal obligations of partnership, whilst managing both their day-to-day finances and long term strategic financial planning.

The guide is intended to give some insight into becoming a partner and self-employment in the UK, whilst focusing on key personal and professional life stages; highlighting important considerations throughout your career, with suggestions to help ensure you make the most of your financial future.

We understand the value of sound financial planning and how it can translate into future financial success. Many of the points covered in our roadmap continue to apply throughout your whole professional life. It is worth taking the time to revisit different sections in the future to ensure your affairs continue to be managed in the most efficient and effective manner; especially if you may have overlooked any areas early in your career.

Please don't hesitate to get in touch with your local office if you would like to discuss any of the issues raised throughout the guide.

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## What's inside...



This guide is for general information only and does not constitute financial advice. You should ensure you take professional advice, tailored to your individual circumstances before acting on any recommendations or suggestions.

# Becoming a Partner

**Congratulations on your admission to partnership. If you have not already, get ready to receive your P45; it's probably the only time in your career when promotion results in the termination of employment!**

Becoming a partner shouldn't be the pinnacle of your career aspirations; it is the start of the next chapter of your professional life. Are you fully prepared for the additional responsibilities, liabilities and reduced statutory rights? The potential for reward is far greater, but so are the risks and it is important you are fully prepared.

As a shareholder, stakeholder and business owner, your day to day life will focus on a unique blend of professional expertise, employer responsibilities, business development acumen and entrepreneurial spirit.

## Key Considerations

- Understand what you are signing up for and the financial implications
- Know your legal and financial responsibilities
- Keep good records from the start to ease future compliance
- Plan for the future and protect your assets from the outset
- Ensure you focus on maintaining a good work, life balance
- Get good advice from your peers and from professional advisors

## Types of Structure

From the outset, make sure you fully understand how your firm is structured and the associated risks.

| | LLP | Traditional Partnership | Private Limited Company |
|---|---|---|---|
| **Legal Entity** | Distinct from members and partners. Ability to buy or sell property. Ability to enter into contracts. Can instigate legal proceedings or be the subject of legal proceedings in own name | Not a Legal Entity | Distinct from shareholders and/or directors. Ability to buy or sell property. Ability to enter into contracts. Can instigate legal proceedings or be the subject of legal proceedings in own name |
| **Limited Liability** | Liability of members of the LLP is limited to their capital contribution. Note: if it goes into liquidation, current accounts and tax reserves are also at risk | Joint and several unlimited liability | Liability of shareholders of the company is limited to their subscription to shares and potentially amounts advanced by way of loans |
| **Status** | Lifetime existence unless liquidated | Death, incapacity or insolvency of the partner results is partnership dissolution, unless elect to continue | Lifetime existence unless liquidated |
| **Tax** | Individual partners or members are liable to income tax on their share of taxable profits as dictated by the partnership agreement | Individual partners are liable to income tax on their share of taxable profits as dictated by the partnership agreement | Liability of the company to corporation tax and liability of individuals to income tax where salary or dividend is taken |
| **Compliance** | Greater requirement. Drawings and benefits dictated by internal governance | Lower requirement. Drawings and benefits dictated by internal governance | Greater requirement. Much more complicated rules regarding drawings and benefits in kind |

In a traditional firm, partners are jointly liable for losses, but even with the protections afforded to an LLP partner or a limited company shareholder, you could still be liable for any of your mistakes not covered by your Professional Indemnity (PI) insurance.

# Employed v Self-Employed

Depending on the structure of the firm, employment status can be a contentious issue, especially for junior partners who do not always have a guaranteed profit share and may have minimal voting rights.

Partners need to satisfy at least one of three tests below to prove they are true partners in a business, and retain the tax advantages the self-employed have over employees:

## For LLP's

- At least 20% of their remuneration must be directly dependent on the profit made by their partnership
- The partner must have at least 25% of their "disguised remuneration" at risk as part of the firm's capital
- They must be able to prove that they have significant influence on the overall partnership.

Without meeting one of the criteria stated, you would not be treated as self-employed for tax purposes, nor would you be entitled to the employee law protections of ordinary employees, such as statutory redundancy pay. However, you would still be covered by anti-discrimination laws, working time legislation and whistleblowing policies.

"Salaried Partner" or "Income Partner" denotes a partner who is employed by the firm under an employment contract and paid a salary subject to PAYE in the UK.

"Equity Partner" denotes a partner who is self-employed.

"Consultant" can indicate a partner employed by their own Personal Service Company (PSC).

### Differences: Employee vs. Self-Employed

| Employed | Self-Employed |
|---|---|
| Tax deducted at source | Earnings potential |
| Employee rights protection | Financial & legal responsibilities |
| Fixed income & minimum pay | Claim for professional expenses |
| Employee benefits including pension | Keep compliance records |
| Holiday & sick pay | Recognition & reputation |
| | Greater control over work environment |
| | Business development & fee generation |

## Tip

Life insurance, private medical or other insurances may have been provided as part of your remuneration package as an employee. Make sure you consider what level of cover you may want in the future, as some insurance providers may give you the option of continuing cover at a preferential rate.

# Funding of Partners' Capital

## Traditional Partnership or LLP

Your capital contribution is a significant investment in your professional future, which should be treated as any other investment; you need to believe in the strategy and ethos you are buying in to and expect a return on your investment.

Joining a professional partnership is a large financial commitment, but the loan is fairly tax efficient, with tax relief on the interest paid at your marginal rate.

There are a variety of ways to fund the initial equity stake: by a lump sum cash payment, a personal loan, or a loan arranged by the firm. Firms may also have a centrally organised loan if they have access to preferential rates, which also ensures the firm retains some control and confidentiality over financial matters.

## Key Considerations

- How much is required, both on initial admission to the partnership and in the future?
- Where can the money to fund the required contribution be sourced?
- What are the arrangements to recover the capital on retirement or other exit from the partnership?
- Is interest payable to you on the capital contribution?

## Risks

Historically, the capital invested is repaid when a partner exits the partnership, but obviously this is subject to risks, such as insolvency. It can also be a lengthy process to retrieve capital as partnership agreements are usually drafted to ensure firms are not plunged into crisis if a partner, or a number of partners leave unexpectedly.

It is important to note, that if you were to leave the partnership, you would no longer be eligible for the tax relief in respect of the borrowing. If the firm does not retain tax on your behalf, you may receive a tax bill whilst waiting for your invested capital to be returned. This can have significant cash-flow implications if you are not able to repay the original loan and could also affect any buy-in requirement from a lateral move to another firm.

Funding loans for partners' capital often include a clause that requires the firm to repay the loan directly to the bank, so it is important you are aware of your position.

## How we can help

If required, MHA MacIntyre Hudson's commercial funding solutions service can provide you with access to a bespoke lending solution suitable for your needs, or we are able to recommend suitable bank contacts who would be delighted to discuss your needs in more detail. Please get in touch if you would like further information.

# Partnership Agreements

The basis for your future partnership will be set out in the firm's partnership agreement, this agreement forms the contract between you and your firm.

It sets out the relationship between the individual partners and their obligations and contributions. It is important that you fully understand what you are signing:

## Key Considerations

- How much will it cost you, both now and in the future?
- What are the tiers of partnership and what are the steps to full equity?
- Which covenants and policies are likely to affect you? e.g. pension, statutory maternity / paternity pay (SMP/SPP), statutory sick pay (SSP) etc.
- Does it match with your own goals and aspirations for the future?
- What are the implications throughout your career?
- What level of financial information about the firm is available to you?
- What are the profit share and extraction arrangements
- Who pays your tax and on what basis of earning? Will the partnership hold back some of your profits to pay for tax

Make sure that your interests as an individual are fully considered and keep in mind how well matched the firm and partnership agreement is to your attitude to risk, your life stage and any agreements related to holiday, maternity, paternity pay etc.

## Profit share

- What will your profit share be and how is it calculated?
- How are drawings calculated (i.e. how and when can you access your share of the profits)?
- What can you take home each month and is it even across the year or are there bonus distributions?
- When is profit allocated?
- What (if any) are the clawbacks?

## Restrictive covenants

As a partner, you are there to represent the firm as an agent of that firm. As such, most partnership agreements include clauses for a specified period of time to restrict business interests partners may wish to enter in to without agreement of the board, and to prevent soliciting clients and / or poaching staff or other LLP members on exiting the partnership. There are usually specific rules for retirement as well.

## How we can help

Partners at MHA member firms have a wealth of experience in this area and can answer any questions you may have about your Partnership Agreement, or offer confidential advice if you have any concerns.

# Legal Responsibilities

## You can delegate many of the responsibilities of a business owner that we have outlined, but the personal liability remains with you as a partner.

Compliance with laws and regulations such as the General Data Protection Regulation (GDPR) (Regulation (EU) 2016/679), anti-money laundering laws and other regulatory requirements (such as the SRA, RICS etc) are all crucial, and you must be confident you and your firm are managing the responsibilities appropriately. Make sure you are aware of who is responsible for each matter and address any gaps you may find.

### Individual responsibilities

- Practicing certificates
- Internal declarations and filing of declarations confirming conflicting interests, shares, independence and integrity
- Continuous professional development

### Responsibilities as an employer

- Understanding of, and compliance with employment law
- Employee pay, taxes, incentives and benefits packages
- Management of staff, performance, attendance, discipline and grievances
- Motivate and engage staff

### Partnership responsibilities

- Understanding of, and compliance with, company law
- Full and proper accounting records
- Professional Indemnity (PI) Insurance
- Compliance Officers for Legal Practice (COLP) and Finance and Administration (COFA) responsibilities (Legal sector only)
- Client money
- Regulatory compliance
- Joint and severally responsible for compliance by authorised body, other parties and staff under 2019 Accounts Rules
- GDPR compliance
- Anti-money laundering compliance and client care letters
- Cyber security
- Business continuity protection, such as key man insurance

### How we can help

We are here to help with regulatory compliance, GDPR assistance, sourcing PI cover, outsourcing of accounting records, cyber security and HR solutions. Please get in touch for further information.

# Financial Responsibilities

As a self-employed individual, you and your business partners will share responsibility and profits. Each partner is responsible for their own self-assessment tax return and paying National Insurance and income tax, but a nominated partner will be responsible for the submission of a tax return for the partnership as a whole.

As a self-employed individual, there is an element of personal financial management required at a business level – you will be personally accountable for chargeable hours, recovery of your own time and the hours of your staff as well as overall productivity.

## Key considerations

- Who is going to be doing your tax return?
- How expenses work and what you can claim for
- What claw backs are possible or likely?
- Understanding of partnership financials
- History or future expectation of capital restructuring, cash calls and deferred drawings

## Financial stability of the firm

Professional firms are regulated and have an obligation to run their business in accordance with sound financial principles. It is key for the partnership group to understand the finances of the firm and to be able to properly assess these on an ongoing basis.

We would recommend that firms should have a comprehensive monthly management reporting pack to ensure the partners have a full picture of the firm's financial position available to them.

**Consider what questions you and your fellow partners should be asking to interrogate the data you have access to:**

- Look at the accounts - do you understand the operating financials, lock up, work in progress (WIP), profit and loss, cash-flow etc?
- What has the profitability been over the past few years?
- What is the firm's borrowing position?
- What are the liabilities?
- Have additional capital calls been made in the past? If so, how much?
- What is the firm's professional indemnity (PI) cover and claims record?
- Who does the accounts and is the firm reputable?

## How we can help

We can assist the firm and individual partners to effectively manage their financial responsibilities, working in-house with finance teams or individuals. We can also provide training at individual partner level or for the partnership as a whole to ensure a full understanding of the financial information.

We would typically expect partners to have access to a number of pieces of financial information and it is likely that you will have some responsibility for the monitoring and preparation of some of them yourself. A selection of these, and what your responsibilities are likely to be, are shown below.

| | Description | Responsibility |
|---|---|---|
| Management Accounts | The regular source of financial information for the business, typically prepared monthly. Management accounts are vital in the monitoring of overall business performance and should show a profit and loss and a balance sheet. | You will have a responsibility to review and understand the management accounts, asking questions where appropriate. These are the best indicators throughout the year of your likely profit share. |
| Cash-flows | A cash-flow should typically be provided as part of the management accounts. This additional source of information detailing the cash inflows and outflows of the business in a particular period is a good monitoring tool to assess the future viability and requirements of the business. | As above, the main responsibility here will be to review and understand the information presented. The cash position is important because although your profit share may be good, if the business does not have sufficient cash to support drawings you may find you can not extract your money. |
| Budgets | A budget is an educated estimate of the future performance of the business, typically prepared for the year ahead but sometimes for longer periods. | You may have some input into the budgeting process in the form of setting financial goals for your teams. These goals, for example a certain level of billing, will feed directly into the budget. |
| Forecasts | Similar to a budget but typically prepared for a longer period of time and based on some more general assumptions in relation to the growth of the business. | As above, your monitoring and goal setting for your team will likely feed into the forecast. Your bankers are likely to require forecasts to support borrowing requirements |
| Productivity measures | A typical key performance indicator (KPI) in a professional practice is productivity, or chargeable hours. Your business may monitor this and produce regular reports on the productivity of the staff and partners. | You will take responsibility for your team's productivity so you should be reviewing this information to ensure they are performing as expected. It will also allow you to benchmark against other departments. |
| Recoverability measures | Going hand in hand with productivity is recoverability. It is one thing having lots of hours on the clock, but recovering them from the client is just as important. If your business is producing reports on productivity then they should also be reporting on recoverability, as without the latter, the former is meaningless. | As above, you will take responsibility for the recoverability levels achieved by your team. This is a good performance indicator for use in the appraisal of fee earning staff as it really is a measure of the quality of hours they are charging to clients. |

# Tax Basics

As a self-employed partner, you will be required to submit an annual tax return and keep your financial records up to date.

Most partnerships appoint the firm's annual statutory auditor to look after the annual tax returns of partners, and as such, you would be required to authorise them to act on your behalf in order that any tax issues that arise or payments that become due are dealt with in a timely manner. If this is not the case, you will be required to prepare and submit your tax return personally or appoint your own advisor to assist.

## Drawings, profit and tax

Depending on how your partnership is structured, certain aspects may be dealt with by the partnership. One area is how a partner receives their share of the profits. The most common method is by using drawings. Drawings are payments made to each partner, usually on a regular monthly basis, on account of their final share of the net income (or profit) of the partnership.

They are not wages or salary and are themselves, not subject to tax (see below for tax implications). Each partnership will have their own rules regarding drawings which should be explained to you.

Income tax is the individual liability of each partner. It is the liability arising on the partner's profit share for a relevant tax year, plus any other income sources (such as rent from an investment property or interest on bank savings).

Whether you draw all of the profit or none of the profit out of your partnership, your tax liability is still the same.

## How are profits assessed to tax?

Each partner must submit a self-assessment tax return by 31 January following the tax year ended 5 April. The return should contain details of all sources of taxable income and allowable reliefs. For a continuing partner their share of partnership profits taxable in the tax year to 5 April will be those that arise in the accounting period ending in that tax year.

There are complicated opening and closing year rules to be looked at when an individual becomes partner or when they cease to be a partner.

The main methods of allocating profit are shown in the table and are generally set at partnership level:

## Income tax

Some firms save for their tax bills within the partnership so that individual partners do not have any concerns or responsibilities saving for these themselves, or making payments over to HM Revenue & Customs. The advantage of this is that partners have the convenience of somebody else managing the cash-flow. Although tax liabilities are an individual responsibility, i.e. there is no joint and several liability for the other partners, if a partner does get behind with their tax payments it can cause problems within the partnership.

Alternatively, partners can save for their own tax liabilities personally. This gives the individual ultimate flexibility in managing their own affairs and where to save or invest the money prior to payments being due.

This is an area that is usually confirmed at partnership level and is generally the same treatment for all partners.

| Drawings Method | Pros | Cons |
|---|---|---|
| Distribute to partners, in their profit share, the amount available in the bank account at the end of the month | Simple to calculate & avoids borrowings | Not geared to profitability & can lead to over drawing & amounts may fluctuate |
| Fixed monthly draw plus a quarterly bonus draw based on estimated net income earned per partner for that quarter | More scientific approach & limited to available net income | Short term profit fluctuations can lead to over drawing under this method |
| Project drawings for the full financial year ahead based on budgeted profit and available cash-flow, pay out over twelve equal monthly instalments with a final balancing up after the annual accounts are agreed | Involves total financial management and demonstrates good financial control, eliminates peaks and troughs, assists partners with their own personal financial planning, amounts drawn are correctly based on available profit | Takes up management time, depends on an accurate forecast, need to ensure sufficient working capital is retained |
| Notional salary & irregular 'dividend' (in the case of a Director / Shareholder of a Limited Company) | As above | As above |

## Allowable expenses – what can you claim for?

Partners are required to nominate one of their members to complete and file a partnership tax return and to sign the declaration that, to the best of their knowledge, it is correct and complete.

It is not possible for individual partners to make supplementary claims in their own tax returns for practice expenses incurred personally. Partnership expenditure incurred personally, including capital allowances on assets such as motor cars, must therefore be claimed through the partnership tax return. It is important to note that deadlines are usually set for personal information to be included within the partnership tax return in order that the return itself can be submitted in a timely fashion.

All of the following expenses are subject to any rules set out by the partnership regarding claiming expenses and this should be clarified before making any additional claims.

## Use of home office

HMRC allow individuals to claim an expense for using their home outside of work hours. There is a formal calculation that can be undertaken based on number of rooms, number of hours worked, and actual expenses incurred, which can be supplied upon request.

## Office expenses

Expenses not already reclaimed from the relevant partnership, such as stationary and printer consumables can be claimed, as well as the business use element of costs associated with telephone, mobile, computer and internet.

## Capital allowances on motor cars

These are allowances for assets that reduce in value over time and a proportion is allowed each year, not the full cost of the asset.

## Car

In order to claim capital allowances and car expenditure (e.g servicing) you will need to keep a mileage log as the allowance will be restricted to business use only. The partnership may have an agreed ratio with HMRC that is used for all partners.

## Work related travelling expenses

A record of other travel expenses (e.g. parking, hotels and reasonable subsistence costs) incurred whilst on work related journeys should be kept to support any claim.

## Professional fees, courses and conferences

Can be claimed in full if no social or holiday element is included. Whilst training undertaken to update skills and professional expertise is normally an allowable expense, training or courses which result in a new qualification or specialisation are unlikely to be allowed.

# Personal Tax Services

The typical personal tax services MHA member firms provide for partners and the documentation required is outlined below. Please be aware that even if your firm pays for your annual tax return, in the event of your exit from the partnership or the firms liquidation, you would become personally liable for the cost of your tax return.

## Documentation required

- **HMRC registration:** You will be required to submit form SA401 within three months of becoming a partner to HMRC.
- **National Insurance:** Your class 2 and 4 national insurance liability is calculated each year along with your tax liability for the year.
- **Authority to act on a personal basis:** With regards to agent authority to act for you personally, this is requested automatically on the date that you complete the engagement letter if we have received details of your Unique Taxpayer Reference (UTR) and HMRC will issue a letter with a code that should be forwarded to your MHA member firm as soon as it is received. If you have not been given a UTR then a paper 64-8 will be issued. You will also receive an engagement letter to sign should you wish to take advantage of the tax team completing your tax returns.

  This service is only available to partners and may contain restrictions on the services we are authorised to provide by the partnership. Any fees for services not covered by the partnership agreement would be agreed with you personally before any work is undertaken.

## Tax calculations

**Drawings:** Should a drawings model be prepared by your firm, it should include a tax calculation based on your estimated profit in the first instance.

The tax 'withheld' via the drawings model is not charged to your account; it remains as 'withheld profit' until the tax return and supporting tax calculation for the year is prepared.

Drawings figures should not be used to complete your tax return or if calculating possible pension contributions. Final figures will be available following the year end upon completion of the accounts.

## Tax payments

Tax payments by your firm will be charged to your account and any repayments similarly credited shortly after they are made/received.


## Timetable

| | |
|---|---|
| **April:** | You will be asked for details of your personal income and reliefs of the relevant tax year. |
| **August:** | Deadline for receipt of your personal details. |
| **By December:** | Your tax return will be completed using actual taxable profits and be issued to you via e-mail. |
| **January:** | Submission of your tax return. |
| **Following January:** | HMRC have until the following 31 January after the submission deadline (i.e. 12 months) to make any enquiries into the return, and assuming there are none, the liability will become final at that time.<br><br>When it comes to partnership profits and your share, it is important to understand accounting profits reported in the accounts are not necessarily the same once non-tax allowable expenditure is accounted for. It is the post-tax profit, rather than profit in the accounts which becomes relevant.<br><br>For example, accounting profit of £150k could end up as £170k in your account because of disallowable expenses for tax purposes, or should capital allowances be available, it may reduce to £130k. The other major difference is that accounting year ends may differ to tax year ends and can cause confusion.<br><br>**Example tax calculations for reference, are available online at:** www.macintyrehudson.co.uk/professional-practices-personal-tax-services |

# Life as a Partner

As a partner, your approach to work will be focussed on more of a commercial perspective, whilst balancing your professional and personal life.

Managing your business, tax and personal affairs in the most efficient and effective manner to ensure your long term financial security requires sound planning and advice that looks at the big picture; finding a balance between your current obligations and future goals.

As a partner, there are likely to be opportunities throughout your career to progress in seniority, to take on further responsibilities for the management of the professional practice or perhaps to work internationally; all of which should be the catalyst to revisit your financial planning matters on a regular basis.

## Key Considerations

- Good practice management to ensure ongoing financial stability
- Planning for upcoming life events
- Tax efficient financial management
- Ongoing management of personal finances and tax
- Implications of working internationally

# Partnership Financial Stability

## The importance of working capital

One area that can dramatically improve the stability and success of a firm is developing and managing an effective working capital strategy.  Cash-flow and working capital represent two critical measures of a firm's ability to meet its financial obligations and is the life blood of every business.

### Examples of specific areas to focus on:

- **Accounts Payable:**
  Central procurement
  Payment terms between competing suppliers
  Standardised terms across all suppliers
- **Accounts receivable:**
  Develop optimised client payment terms
  Dispute management to quickly resolve barriers to on-time payments
  Develop credit control procedures to reduce late payments
  Review credit risk policies
- **Work in progress:**
  Optimise the balance between cash, costs and services
  Focus on accurate forecasting to manage cash-flow
  Identify opportunities to reduce lead times

## Control of overheads

If overheads are treated as a central expense, rather than allocated to individual departments, it is important to factor in overheads and operational costs when billing.

### Areas to consider:

- Keep a tight control of overheads and question expenditure, in particular in areas of rent and premises costs
- Review charge-out rates to ensure they account for their share of overheads
- Ensure any fixed fee services, such as conveyancing, accurately reflect the whole costs of doing the work.

## Profitability

Not all clients are equal and not all work pays off; it is important for firms to understand which clients provide the highest profit. Does the firm's management information give an accurate understanding of which clients create the highest profit and those who produce a loss? The outcome of such analysis will provide a clear understanding of who the firm should do more or less business with.

Clearly there may sometimes be a business case for selling some services as a 'loss leader' if you are confident that you can sell other more profitable services to a client, but this should be monitored closely to ensure it continues to pay off.

Another threat to profitability comes from "scope creep". This occurs when the scope of services expands beyond the initial engagement. Firms must have a process to manage scope creep, from getting the original fee quotation right; monitoring the progress of all assignments; timely communications in writing to clients where potential overruns are identified; and documentation of agreed variations to ensure fees for additional services can be recovered.

## Understanding financial statements & management accounts

Financial statements are produced on an annual basis and include the balance sheet and the profit and loss statement that shows what the historical performance of a business has been.

Management accounts are the ongoing process of measuring performance on a regular basis. Instead of just producing historical results, management accounting statements include other financial data to assess the performance of a business, such as cash-flow, performance against targets and benchmarking data.

### How we can help

It can be difficult to truly understand your firm finances in order to make the right commercial decisions for your organisation. In order to bridge the knowledge gap, we have developed an "Understanding Finance" workshop offering personalised training on your firms accounts so that you have all the facts and figures in order to drive your future strategy. Please get in touch for further information.

# Life Events

## Key considerations

### Buying a home

- **How much can you borrow?** If you have only recently become self-employed, you may struggle to secure a mortgage with high street lenders as you will not have two to three years of records for a lender to review. It will usually be your share of the partnership profit (taxable income before personal allowances), averaged over three years on which the mortgage lender will assess your affordability. Often it is advisable to use a recommended independent mortgage broker who specialises in mortgages for partners as they are likely to have relationships with specialist lenders who can offer more favorable rates.
- **Insurance cover:** As well as ensuring that your mortgage product is suitable, it is important to ensure that all your insurance and protection arrangements are in line with your repayments and liabilities.

### Marriage, cohabitation & divorce

- **Protection of assets:** Consider the types of risks you may become exposed to and how to arrange your assets to protect them in case of a professional liability claim not covered by your firms indemnity insurance, or a claim based on employment practices, such as alleged discrimination or even the liquidation of the firm. Ownership of assets can be shared with your spouse or held in trust for your children and certain personal insurances may be advisable depending on your attitude to risk.
- **Pre-nuptial or cohabitation agreements:** An agreement that sets out exactly what each person brings to the relationship and what happens to assets should they need to be divided can be useful when planning for the protection of assets; especially if marital assets are predominantly held in a spouse's name.
- **Wills:** Your will should be reviewed at each change of life stage, especially as marriage automatically revokes a will made previously, leaving it invalid. It should set out how you would like your assets to be divided in the event of your death and should include details of your business interests.

### Children

- **Maternity / Paternity pay:** Employees are afforded a statutory right to maternity or paternity leave, which is not available to self-employed partners. Many partnership agreements do make provisions though and it is worth making sure you are aware of them from the outset. As a self-employed partner, paying class 2 national insurance (including voluntary national insurance), you would be entitled to claim maternity allowance. Further information on eligibility, rates and how to claim can be found online at www.gov.uk/maternity-allowance/eligibility. There is currently no equivalent paternity allowance for self-employed fathers.
- **Childcare:** Childcare vouchers (which were only available to employees) were replaced by Tax-Free Childcare (TFC) from 2018. TFC is available to both employees and those who are self-employed, earning less than £100,000 and covers the cost of childcare with a registered provider through an online account. Under TFC, the government will top up 20p for every 80p you pay in, up to a maximum support of £500 per quarter or £2,000 per year, per child, up to the age of 12 (exceptions apply).
- **School fees:** There are a number of tax efficient ways to prepare for and fund school fees, such as utilising trusts and the personal allowances of children. It is well worth considering your options at the earliest opportunity. We have vast experience in this area and can advise you according to your circumstances.

## Retirement planning

- **Pensions:** It's never too soon, or too late to start saving for retirement. It can be easy to put off in favour of meeting more short term financial commitments, but starting early can ensure you make the most of any allowances
- **Estimate your anticipated expenses in retirement:** Think about whether you would like to travel, buy a second retirement home, move closer to family, take up a new hobby etc
- **Investment options:** Consider a range of investment options; a second property for example could provide a reliable income in the future
- **Retirement planning:** Seek specialist retirement planning advice and revisit your plans regularly to ensure you are on track
- **At retirement:** There is a lot to think about as you approach retirement. A retirement specialist can help you navigate through all the complexities and options that may be available to help you establish how best to draw an income.

## Long term care needs

(you or your spouse)

- The cost of a care home place in the UK can be in excess of £30,000 a year, and over £40,000 if nursing care is required
- Going into care can be traumatic but planning ahead can ease the transition and reduce financial concerns; consider the support available, what you may be entitled to and any potential short-fall. Take specialist advice to address any issues
- Take advice to make sure you make the best use of your income, savings, investments and assets, particularly if you own your home. Consider if investments can be used to generate additional income and what the options are for the family home
- Are wills up-to-date and is a power of attorney required?

## End of life

(your own, your spouse or your parents)

- **Financial impact of death:** This is a difficult time, when it is important to consider the financial impact of the death on remaining family members, ensuring they have sufficient income and protection, any funds are invested appropriately and any future inheritance tax liability is mitigated. If assets are held in trust additional action may be required
- **Coming into an inheritance:** This can be an opportunity to review your financial planning needs, repay any debts, invest a lump sum and review your own inheritance tax planning
- **Inheritance tax planning:** There are many options to consider regarding inheritance tax planning, including gifting assets, gifting money, investing in businesses or certain types of shares and charitable giving. The rules are complex and specialist advice is recommended.

# Tax Efficient Financial Management

## Making use of offset mortgages

With an offset mortgage, you use the money in your savings and current accounts to help to reduce your monthly mortgage repayments or your mortgage term, whilst retaining instant access to your savings. You won't pay tax on your savings as they won't be earning interest and you can still access them when you need to, i.e. when the income tax payment is due to HMRC!

Whilst not all partnership agreements will allow for partners to take the maximum level of drawings available, holding them personally until such time as the tax is due in an offset account, can provide significant savings on borrowings.

## Making use of ISA allowances and spouses allowances

Maximisation of cash ISA allowances provides tax savings whilst the funds are held personally as the interest is paid gross.

The maximum cash ISA deposit for the 2019/20 tax year is £20,000 per person and funds can be held in a spouse's or partner's name. Again, the tax saved on the interest paid will maximise the returns on the funds. Where funds are available, it is also possible to gift funds into your partner's ISA.

## Maximising interest on cash deposits

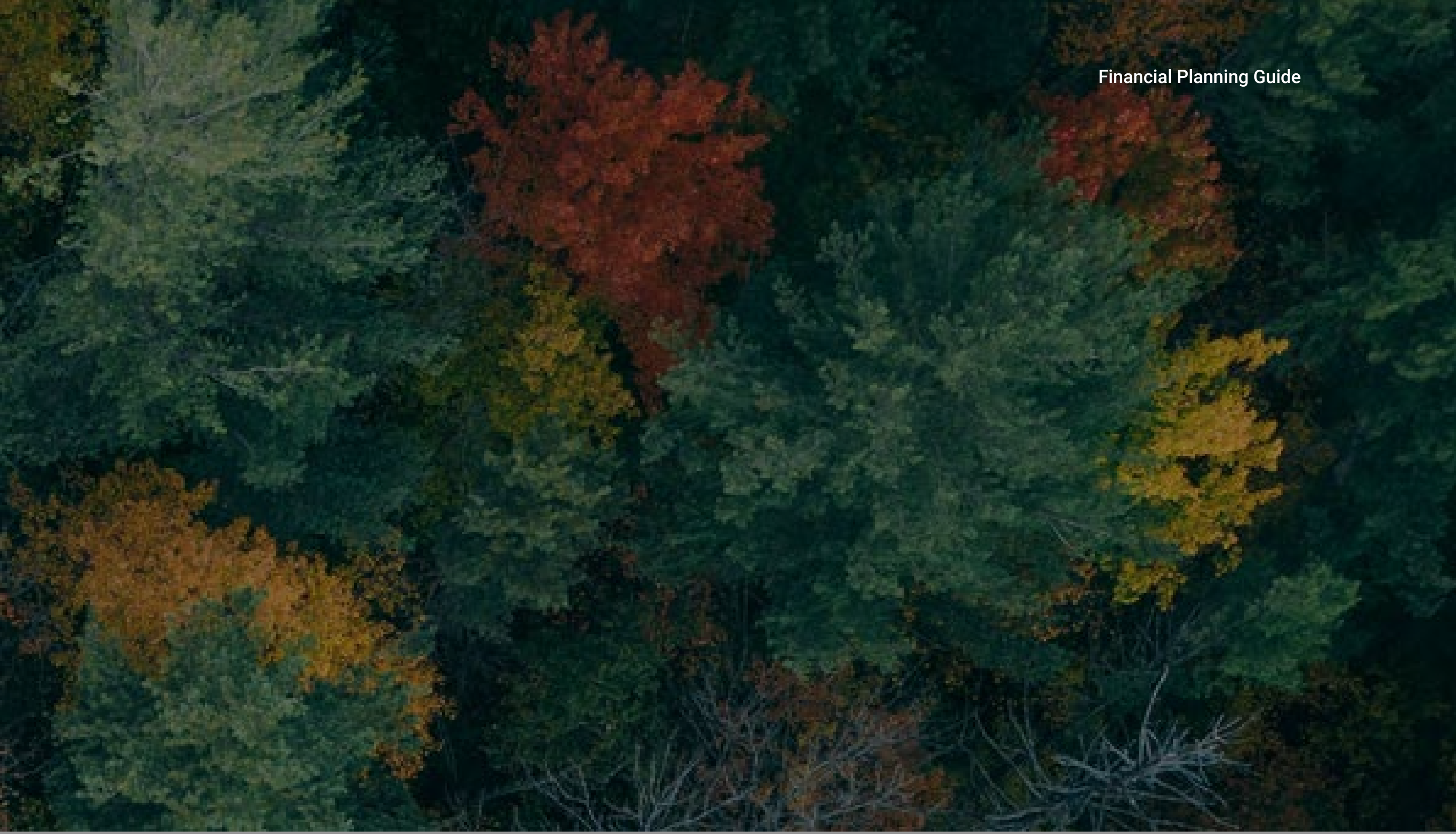
The use of fixed term cash deposits and notice accounts to maximise the rate of interest paid on savings is particularly useful. In general, you will know when the payments, and approximately how much, are due to HMRC. It is therefore possible to hold the required level of funds in term or notice accounts until the funds are needed to pay over to HMRC. Whilst interest rates are relatively low at the moment this strategy would maximise the interest you receive.

## Pensions

Pensions can be one of the most tax efficient investments you can make and can allow for effective tax planning throughout your career to ensure you do not inadvertently exceed certain tax thresholds. For example, currently every £2 of income over £100k reduces your personal allowance by £1 and there are further restrictions for individuals earning over £150k.

There is currently a maximum annual pension contribution allowance of £40,000, however you can use any unused allowance over the past three tax years. The lifetime allowance for 2019/20 is £1,055,000.

Many partners do not have their own personal pension, anticipating that they will be in a position to maximise contributions later in their career. However, annual and lifetime allowances are not guaranteed, nor is investment performance.



## Other investment options

Other saving and investment options are of course available, but these must be considered carefully before proceeding, especially where there is a level of investment risk.

Investments such as Venture Capital Trusts and Enterprise Investment Schemes do provide income tax reliefs but are subject to minimum holding periods of five and three years respectively and, in general, do carry a high degree of investment risk.

## Insurances

Some insurances may have been provided as part of your remuneration package as an employee, which may be overlooked on becoming a partner. It is worth considering what cover you may require in the future, as some insurance providers may give you the option of continuing the cover you enjoyed as an employee at a preferential rate.

## Types of insurance you may require

- **Income protection:** designed to support you with a monthly income until your normal retirement age if you are unable to work due to sickness or injury.
- **Critical illness:** designed to pay out a tax-free lump sum if you are diagnosed with a specified serious illness covered by your policy (usually some cancers, heart attack and stroke). Critical illness may be more relevant to you when you have a younger family as it can pay off any debts such as a mortgage or pay for alterations to your home in case of disability.
- **Life insurance:** designed to pay your dependent a lump sum or regular payments if you die.
- **Private medical insurance:** designed to offer swift access to private medical treatment if you or your family are faced with illness.

Check any other policies you may already have too, as your self-employed status may affect them.

## How we can help

We can guide you through changing circumstances and identify what 'Efficient Financial Management' means for you. Please get in touch to find out more.

# Plans for Exit

If your exit isn't properly planned the value of your hard work may not be fully realised.

## Exit planning and career change

Leaving a partnership for reasons other than retirement or death will need to be negotiated, with differing processes for contentious and non-contentious situations. Most partnership agreements will dictate matters such as notice period and restrictive covenants, as well as rights and liabilities on leaving.

### Main exit routes

- Resignation
- Retirement
- Forced exit / expulsion
- Members Voluntary Liquidation
- Court petition and winding up
- Striking LLP off Companies House register

### Key considerations

- Confirmation of restrictive covenants
- Return of capital contribution, including agreement on timescale
- Sharing of income and gains on leaving
- Settling liabilities arising after leaving
- Confirmation of your insurance cover and notification to providers of your departure
- Potential indemnities to protect against personal liabilities

Your capital contribution is usually repaid on exiting the partnership, however it can be a lengthy process as partnership agreements are usually drafted to ensure firms are able to manage their cash-flow and finances when a partner leaves.

If however, drawings have exceeded your profit share on a cumulative basis over the duration of your partnership, you could potentially find that you owe money to the partnership.

It is also important to note, that if you were to leave the partnership, you would no longer be eligible for the tax relief in respect of any borrowing. If the firm does not retain tax on your behalf, you may also receive a tax bill covering a period of 18 months, whilst waiting for your invested capital to be returned; which can have significant cash-flow implications if you are not able to repay the original loan and could also affect any buy-in requirement from a lateral move to another firm.

### How we can help

If required, MHA MacIntyre Hudson's commercial funding solutions service can provide you with support accessing a bespoke lending solution with preferential rates suitable for your needs. Please contact your regular partner to discuss your needs or visit our website for further information.

# Succession Planning

Succession

*"A number of people or things of a similar kind following one after the other"* Oxford English Dictionary

The succession we are considering here is that of a partner who, having served his or her clients for many years, now finds it time to hand them to a new custodian. With careful preparation and planning, succession cannot only be a means of exit but also a great opportunity for the next generation of partners.

### Succession takes a number of forms

- Passing clients on to another partner
- Merging the practice with another firm
- Passing the clients to another firm

### Plan ahead

Considering your succession up to five years beforehand will give you the opportunity to optimise your financial position and negotiate any future relationship you would like with the firm / partnership. If structured appropriately, certain options for succession could enable the exiting partner an opportunity to work on a consultancy basis if that should be desirable by all parties.

Consider internal succession versus external candidate recruitment and what options there may be to secure a buyer for either the firm as a whole or a particular client base.

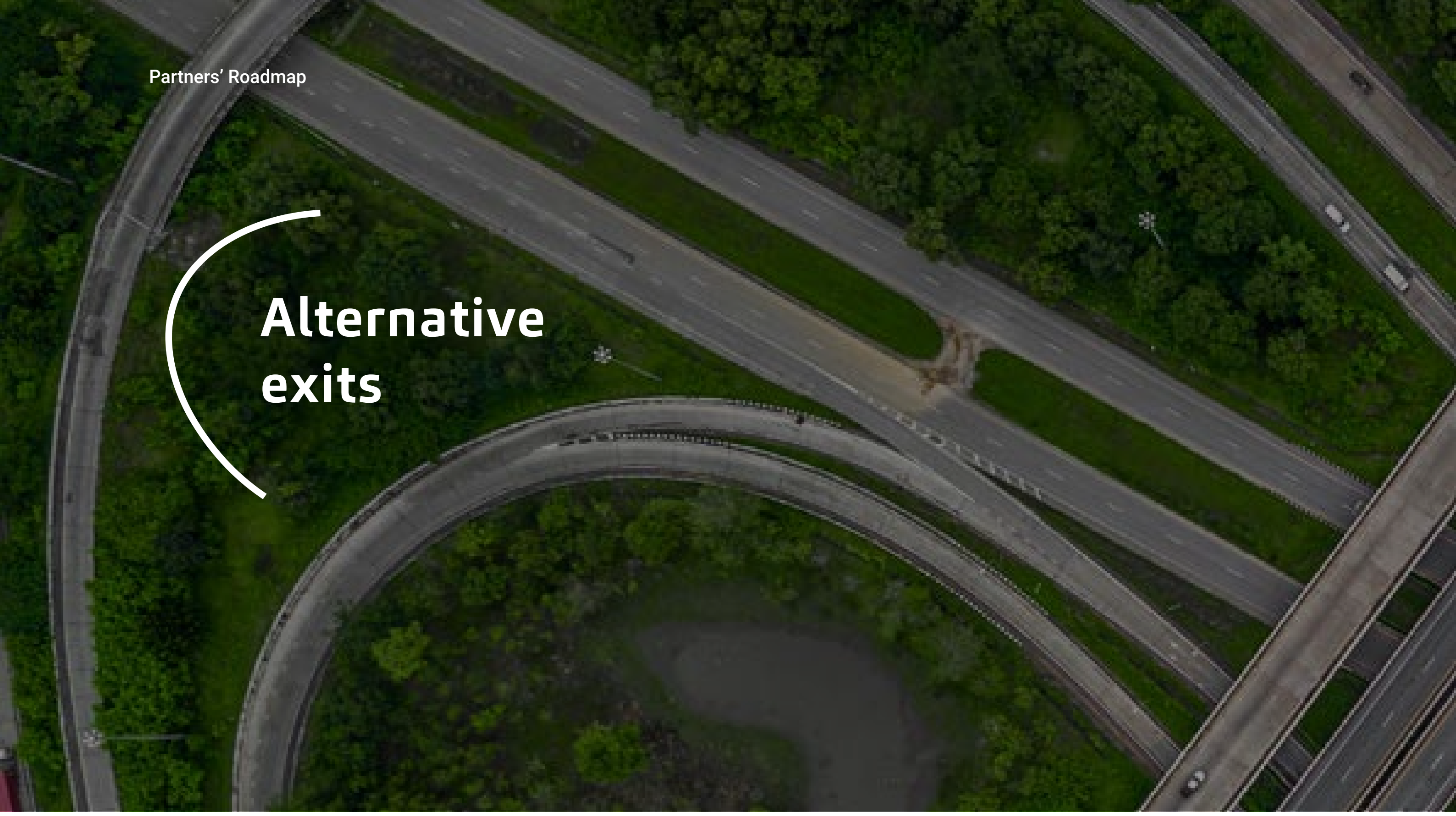
### Key considerations

- Start preparing your finances
- Refine your tax planning to avoid unnecessary tax traps
- Review your pension performance and anticipated retirement income
- Manage any transition for your clients
- Manage any transition to retain staff

### How we can help

We can support your succession planning in many ways, including:

- Lifestyle and estate planning
- Structuring your firm to maximise tax opportunities now and in the future
- Ring-fencing your assets and protecting you from liability
- Incentivising key staff
- Tackling cash-flow issues and improving profitability



# Alternative exits

## Mergers & Acquisitions

The whole professional practices sector continues on a path of consolidation, with plenty of merger and acquisition activity. The partnership you sign up to today could potentially go through many mergers, completely transforming the firm and the culture. It may also be your preferred route for succession.

### The main catalysts for M&A usually focus on

- Financial difficulties
- Practice growth
- Diversifying into new markets
- National expansion
- Global expansion
- Partnership succession

### Opportunities and upheavals

- Understand what the merger means to you and your clients
- Carefully consider the culture and ethos of the other firm and how it aligns with your personal and professional goals
- Ensure effective due diligence is undertaken
- Undertake financial modelling to identify potential synergies, cost savings and importantly how the profit share and capital accounts might look
- Understand the potential tax implications for both the partnership and you individually

## How we can help

Our specialists are uniquely placed to advise you in the area, with industry leading expertise and experience. To discuss mergers and acquisitions, financial modelling or succession planning, please contact your regular partner in confidence.

## Restructuring or Liquidation

Should the partnership fall into financial difficulty, seek financial advice at the earliest opportunity. There are often far more options open to your firm at the early stages, than there are on the day the bank calls in its loans.

Your firm may also have responsibilities to inform your professional body if in financial distress.

Our business strategy or restructuring and recovery specialists can draw upon our deep experience and sector expertise to provide clear and concise advice under the pressurised circumstances commonplace during difficult situations. Constructing a plan to secure the survival (or sale) of the business or options to protect the financial position of partners would be the primary objective, however, when cash-flow pressures are too great, or turnaround options have been exhausted, your firm may face a formal insolvency process.

### Our corporate services include:

- Administration
- Receivership
- Partnership Voluntary Arrangements
- Company Voluntary Arrangements
- Creditors Voluntary Liquidation
- Compulsory Liquidation
- Members Voluntary Liquidation

Our personal services also include bankruptcy, and Individual Voluntary Arrangements.

If you have any concerns in this area, please contact your engagement partner in strictest confidence. Alternatively, find out more about our restructuring & recovery services on our website:

www.macintyrehudson.co.uk/services/restructuring-recovery

## Death

It has long been said that there are no certainties in life, except death and taxes.  Having covered everything else, the death of a partner at your firm or indeed your own, should be well planned for; not least to protect the interests of your dependents or beneficiaries, but to ensure the ongoing viability of the partnership you have helped to build.

Most partnership agreements will set out details of what happens on death, but if no partnership agreement exists, the death of a partner would result in the dissolution of the partnership.

**For example:** Andrew, Brenda and Claire establish a general partnership called ABC Partners, with each contributing a third of the start-up capital. Without a partnership agreement Claire dies, which dissolves the partnership.  Andrew and Brenda each get a third of the partnership capital, and Claire's estate receives her portion.  Andrew and Brenda use their capital to form a new partnership – AB Partners.  The risk here is that Claire's spouse requires her money immediately, which may require assets to be sold.

A partnership agreement will generally have provisions to allow to the continuation of the partnership and will specify what happens to the deceased partners interests.  It would usually confirm the procedures on how the firm will pay out.

# Glossary of Financial Terms

| | |
|---|---|
| Accounts payable/trade creditors | Amounts due for payment to suppliers of goods or services, inclusive of VAT. |
| Accounts receivable/trade debtors | Amounts due from customers, inclusive of VAT. |
| Accounting period | Time period for which financial statements are prepared, usually one year for statutory purposes but probably shorter for internal reporting. |
| Accruals basis | Generally accepted accounting method whereby transactions are recorded when they occur, not at the point cash moves. For example, an expense for rent may be accrued every month but not paid until after the end of the month. The accounts for such a month would still reflect a rent expense. |
| Amortisation | The expense incurred in the process of writing down intangible fixed assets. |
| Articles of association | Document setting out the relative rights of shareholders in a limited liability company. |
| Assets | Something a business owns or is owed, e.g. equipment or amounts due from customers. |
| Audit | An audit is the independent examination of, and expression of opinion on, financial statements of an entity. |
| Balance sheet | A snapshot of the financial position of an entity showing assets, liabilities, and equity at a specific date. |
| Capital | An amount of finance provided, generally by the owners or shareholders, to enable a business to acquire assets and sustain its operations. |
| Capital expenditure | Spending on non-current assets of a business such as fixtures and fittings. |
| Cash-flow projections | Statements of expected cash movements into and out of a business over a period of time. |
| Cost of sales | Costs directly related to the services provided, such as fee earner costs. |
| Credit note | A document summarising a reduction in charge on an invoice. |
| Credit sale | A business entity sells goods or services and allows the customer to make payment at a later date. |
| Creditor | A person or organisation to whom money is owed by the business. Also used to describe other credits on the balance sheet arising from accounting entries such as accruals. |
| Current asset | An asset that is expected to be converted into cash. |
| Current liability | A liability which is expected to be settled within 12 months after the balance sheet date. |
| Debtor | A person or organisation that owes money to the business. |
| Deferred income | Income invoiced, or paid for, in advance of providing the service resulting in the income being deferred to a later accounting period, to when the service is provided. |
| Depreciation | The expense incurred when writing down tangible fixed assets over their useful economic life. |
| Director | Person appointed by shareholders of a limited liability company to manage the affairs of the company. |
| Dividend | Amount paid to a shareholder, out of a company's retained profits, as a reward for investment in the company. |
| Drawings | Cash taken for personal use, in sole trader or partnership businesses, treated as a reduction of ownership interest. |
| Financial statements | Documents presenting accounting information which is expected to have a useful purpose, commonly known as 'the accounts'. |
| Fixed asset | An asset that is for use in the production or supply of goods or services, for rental to others, or for administrative purposes on a continuing basis in the reporting entity's activities. Examples include land and buildings, vehicles and fixtures and fittings. |
| Fixed cost | A cost which is fixed regardless of the level of outputs of a business. An example being accountancy costs. |

| | |
|---|---|
| Forecast | An estimate of future performance and position based on stated assumptions and usually including a quantified amount. |
| Going concern basis | Financial statements are prepared on this basis assuming that the business will continue operating for at least 12 months after the signing of the accounts. |
| Goodwill | An accounting asset which arises when a business is purchased for more than the value of the assets it holds. |
| Gross profit | Sales minus cost of sales before deducting administration and selling expenses. |
| Intangible fixed asset | An asset, such as a right, that cannot be touched (e.g. a patent or Goodwill). |
| Invoice (bill) | A document from supplier to buyer summarising goods or services supplied and the price payable, usually including VAT. |
| Leasing | Acquiring the use of an asset through a rental agreement. |
| Liabilities | Debts owed by a business. |
| Limited liability company | Company where the liability of the owners is limited to the amount of capital they have agreed to contribute. |
| Limited liability partnership | Commonly abbreviated to LLP, a legal entity in which the partners have limited liability, being the amount of fixed capital invested in the business. |
| Liquidity | The extent to which a business has access to cash or items which can readily be exchanged for cash. |
| Lock up | The period of time it takes from completing chargeable time to converting this time into cash for the business. This is a key measure in almost all professional practices. |
| Materiality | Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. |
| Net assets | Assets minus liabilities. |
| Net book value | Costs of non-current assets minus accumulated depreciation or amortisation. |
| Nominal value (of a share) | The amount stated on the face of a share certificate as the named value of the share when issued. |
| Ordinary shares | Shares in a company which entitle the holder to a share of the dividend declared and a share in net assets on closing down the business. These may also give the holder the right to vote on company matters. |
| Partnership | Two or more persons (or companies) in business together. |
| Prepayment | An amount paid for in advance for and benefit to the business, such as insurance premiums or rent in advance. |
| Profit | Calculated as revenue (income) minus expenses. |
| Profit and loss account | Financial statement presenting incomes and outgoings, coming down to a profit or loss position. Also called income statement. |
| Provision | A liability of uncertain timing or amount. |
| Provision for doubtful debts | A provision made where the recoverability of a debtor is in doubt. |
| Registrar of Companies | An official authorised by the government to maintain a record of all annual reports and other documents issued by a company. The UK version is Companies House. |
| Reserves | The claim which owners have on the assets of a company. |
| Retained earnings | Accumulated past profits, not distributed as dividends. |
| Secured loan | Loan where the lender has taken security on particular assets of the company to give extra protection in the event of default. |
| Share capital | Total nominal value of the shares in issue paid in by the shareholders. |
| Share premium | The total amount paid above the nominal value for shares in a company. |
| Shareholders | Owners of a limited liability company. |
| Sole trader | An individual owning and operating a business alone. |
| Tangible fixed assets | A fixed asset which has a physical existence. |
| Turnover | The sales, net of VAT, of a business. |
| Working capital | Finance provided to support the short-term assets of the business (stocks and debtors) to the extent that these are not financed by short-term creditors. |
| Work-in-progress | Cost of partly completed goods or services, this term is usually used to describe the time costs built up on a particular job or matter. |

# Contact Your Local MHA Office

### MHA MacIntyre Hudson
macintyrehudson.co.uk

London
2 London Wall Place
London, EC2Y 5AU

**T:** 020 7429 4100

**Additional Offices:** Bedford, Birmingham, Canterbury, Chelmsford, High Wycombe, Leicester, Maidstone, Milton Keynes, Northampton, Peterborough & Reading

### MHA Larking Gowen
larking-gowen.co.uk

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Norwich, NR3 1RB

**T:** 01603 624 181

**Additional Offices:** Colchester, Cromer, Dereham, Diss, Fakenham, Holt & Ipswich

### MHA Mtaxco
mtaxco.com

Manchester (Head Office)
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**T:** + 44 (0) 7760 166 802

### MHA Tait Walker
taitwalker.co.uk

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**Additional Offices:** Durham, Leeds, Northumberland & Teesside

### MHA Carpenter Box
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monahans.co.uk

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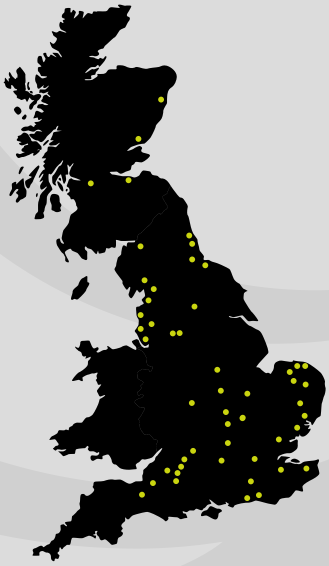



To find out more about the services MHA can offer, please contact

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