

BAR STANDARDS BOARD (B.S.B)

AND

INCORPORATION OF BARRISTERS

1. LATEST POSITION

In January 2015 the B.S.B confirmed that from it will be accepting applications from Barristers who seek to practice through a separate legal entity, thus paving the way for barristers to operate through a limited company.

Initially only companies where all of the share capital is owned by practising barristers will be approved.

Applications will be accepted for consideration later this year once approval of the Legal Services Board (LSB) has been obtained.

The proposals to allow barristers to be regulated by the BSB for Alternative Business Structures (ABS) are still awaiting approval and will then need to be accepted by the LSB.

This means that barristers are still unable to practise using a limited company which has non barrister shareholders such as senior clerks or their non qualified spouses.

2. POSITION OF CHAMBERS

Before barristers can practise using a limited company they will need to ensure that they have the approval of Chambers.

It is likely that this will require a change to the Chambers Constitution to allow the limited company itself to be classed as a member of chambers.

Chambers will also need to consider obtaining a personal guarantee from the practising shareholder to ensure that they are not disadvantaged, should the limited company become insolvent.

Chambers will treat the member as having ceased to practise and all outstanding fees will need to be separately accounted for.

The new company will be treated as a new member with a new VAT registration and all fee notes issued will be in the name of the company.

This may cause administrative difficulties in ensuring that fees collected on cases that are incomplete at the date of the change in status are properly accounted for.

Chambers may also need to consider issues arising where a shares in the chambers buildings are currently owned by the individual who will no longer be a direct member once operating via a limited company.

Chambers will need to be satisfied that each limited company:-

- Has the approval of the B.S.B.
- Pays all registration and ongoing licence fees to the B.S.B.
- Carries approved professional indemnity insurance

3. THE BARRISTER

- a) The barrister will become the sole director of a limited company and will need to ensure:-
- Agreement is reached with chambers to admit the limited company as a member.
 - Carry out all obligations in respect of registration with the B.S.B.
 - Ensure that the company meets all its obligations to register with HMRC for Corporation Tax, VAT and PAYE if appropriate.
 - Put in place professional indemnity insurance
 - Ensure that a Service Contract is drawn up between the individual and the company to regulate the duties and remuneration of the individual in their capacity as director of the company.
- b) Cessation of practice
- The status as a self employed barrister will cease and final accounts will need to be prepared to that date.
 - This may accelerate tax liabilities if the individual currently has a year end other than 31 March.
 - Outstanding work in progress will need to be billed up to that date.
 - The existing VAT registration will need to be terminated and in most cases VAT on outstanding fees will need to be accounted for as and when received using the barrister deferment scheme.

- Income tax will be due and payable on post cessation receipts in the tax year of receipt (to the extent that they exceed the value of debtors included in the cessation accounts).
- The leasing of any assets, such as a car, currently financed on a fixed term agreement must be terminated since the agreement will be in the name of the individual who will no longer be operating a business.

c) The new Entity

The barrister will need to operate the company at arms length, meaning that the assets of the company are separate from the individual.

This represents a major change in thinking since most barristers do not currently use a separate bank account for their business activities.

The company will need:-

- To be incorporated and register with Companies House and meet its obligations to file an Annual return of its directors and shareholders and to file accounts in accordance with company law within nine months of its year end.
- To keep accounting records in accordance with company law.
- To operate a separate bank account in the name of the company and ensure that all fee income is paid into that account.
- To meet its obligations to file a Corporation Tax return within twelve months of its year end and to pay corporation tax on its taxable profits within nine months of the year end.

The Director will need to:-

- Ensure that all of the above matters are addressed.
- Ensure that only funds that are due to the director/shareholder by way of salary or dividend are paid out.
- Ensure that the company trades in a position of solvency and is able to pay its debts as they fall due.

4. TAXATION

a) The company will pay

- Corporation Tax at the rate of 20% (from 1 April 2015) on its taxable profits, payable nine months after the year end.
- PAYE being income tax, employees and employers National Insurance Contributions based on any salaries paid by the company on a monthly basis (due on 19th of month following)
- Pay VAT on a receipts basis on fee income received less VAT on expenses incurred. VAT Returns and the payment of VAT will be due on a quarterly basis as per existing arrangements.

b) The individual will pay

- Income tax and national insurance on final profits from self employment.
- Income tax on post cessation fee receipts to the extent they exceed the value of the debtors included in the final accounts.
- Tax and national insurance as an employee on any salary paid by the company to the extent it exceeds the current (2014/15) personal allowance for income tax of £10,000 and for national insurance of £7,955.
- Higher rate income tax on any dividends paid by the company once income from all sources exceeds £41,865 (2014/15 band) at the rate of 25% for income between £41,865 and £150,000 and at 30.56% (2014/15 rate) on above £150,000.

5. THE PITFALLS OF INCORPORATION

- The current proposals will not enable a non qualified or spouse or civil partner to become a shareholder until full ABS is available.

This restricts the ability to utilise more than one personal tax allowance and basic rate band. The tax advantages of incorporation are restricted to the savings in national insurance since most barristers will still need to draw the post corporation tax profits as dividends.

- The cost to the company of the director drawing out funds in excess of available profits which will be treated as a directors loan when it cannot be repaid to the company within nine months of its year end.
- The inability of the company to be able to estimate its likely annual profits to ensure that dividends can be legally voted on a regular basis without becoming insolvent, especially where much of the income is derived from conditional fee cases.
- The company cannot purchase and provide the director with a motor car without creating a taxable benefit in kind based on the original cost and CO2 emissions of the vehicle. This is expensive and inefficient meaning that the director must own the car personally and can only claim mileage rates for business use of the vehicle at 45p for the first 10,000 miles and 25p thereafter.
- The ability to charge the company for the provision of a study at home will need to be re-examined since HMRC will deem the company to have leased the room from the home owner who will need to account for the income as rent and claim for specific running costs.
- The costs of administration (see below)

6. THE ADVANTAGES OF INCORPORATION

- The ability to control the level of income that is drawn from the company and therefore the amount of tax payable from year to year (subject to the payment of corporation tax at the rate of 20% on the company profits).
- The ability to make pension payments directly out of the company on behalf of the director, thus saving national insurance.
- The saving of national insurance Class 4 contributions of £3,052 (being 9% on income between £7,955 and £41,865) plus a saving of 2% on all income above £41,865. (2014/15 rates)
- The future tax savings resulting from transferring shares to spouse and civil partners.

7. COSTS

- Regulatory fees as required by the B.S.B.
- Advice and cost of establishing a limited company.
- Drafting of directors service contract.
- Preparation of cessation accounts.
- Ongoing costs of dealing with post cessation VAT Returns and income.
- Bank charges.
- Company Annual Return.
- Administration of PAYE scheme.
- Company bookkeeping and annual accounts prepared to company law requirements.
- Preparation of directors personal tax return

8. SO SHOULD YOU INCORPORATE?

This is the opinion of Jack Ross Limited based on the information available to us and tax legislation applicable as at 12 February 2015. This opinion should not be relied upon as the basis for your decision to incorporate. The decision is dependent on personal circumstances and we recommend that professional advice be sought in all cases.

In our opinion incorporation as currently proposed by the BSB should only be considered if:-

- You are earning sufficient to allow surplus funds to accumulate in the company bank account enabling you to plan your personal monthly cash requirements accordingly.
- You are able to allow funds to accumulate in the company which can be drawn out as dividends in future years at lower tax rates.

- You believe that you may be able to liquidate the company on retirement and take advantage of capital gains tax entrepreneurs relief enabling accumulated profits to be taxed at 10%.

In our opinion you should not incorporate if:-

- You will be doing so on the understanding that you can transfer shares to your spouse/civil partner when the rules change. We suggest that you wait until that option is available.
- You need to extract all available fee income for personal expenditure as soon as received and are in arrears with current income tax liabilities.

Here at Jack Ross we consider ourselves to be expert at providing accountancy and taxation advice to the Bar.

We will be pleased to meet with you on an individual basis to discuss any issues you have arising out of this paper.

Peter Black
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Jack Ross Chartered Accountants