Helping Law firms survive COVID-19

The legal team at PKF Francis Clark are helping their law firm clients address the current challenges they face. In this email we have included a range of practical tips and actions firms might want to consider as part of their current strategy in managing the economic effects of COVID-19.

If you would like to talk to us about any of the issues raised in this email or any other matters you are facing more generally in respect of COVID-19 please do get in touch.

1. **Cash - not profit - is key**

   In the short term for most law firms cash will be the most important consideration as it is likely that for most firms incoming cash will decline rapidly – as other businesses and individuals consider how they spend their cash, it is less likely that settling outstanding legal fees will be at the top of the list!

2. **Remember 2008 and 2009**

   A common feature of law firms that suffered longer term financial challenges and even failure was a reluctance to take early action in reducing costs (primarily people costs). Taking action too late in the cash flow position for a firm can increase the redundancy and longer term financial implications. There is a risk for some firms that if they leave important decisions too late that the subsequent actions available to them may be more limited in nature and also less effective.

   There are lots of different ways that firms can look at reducing people costs in the short and medium term; whilst one of these is redundancies this is certainly not the only option and the Government appear at this point to be supportive to employers in terms of keeping the workforce in employment for as long as possible. However changes within firms such as reduced working weeks, unpaid leave, accelerated holidays, reduced pay and many others will all be things that law firms should be considering as options to preserve cash.

3. **Major cash outflows – VAT, PAYE, Income tax & Corporation Tax**

   Think very carefully before you make these large payments at present; it is going to be much easier to keep hold of cash than get it back – and remember some of these items can often be set up for automatic payment from your bank unless you cancel the arrangements.

   There are potential options around time to pay (TTP) arrangements with HMRC and these can alleviate short term cash flow pressures for firms. Our experience of TTP arrangements so far include:-

- HMRC teams do not appear to have been briefed as to how to deal with tax payments of significant size, the advice has all been for much small amounts to be spread over 3 months
- TTP arrangements may only be for one month's payment not for future monthly payments otherwise the arrangement has to be cancelled
- You may not be able to enter a TTP if there are already amounts outstanding
- They need to know that the law firm has been impacted by Corona Virus and that it will have difficulties paying PAYE & VAT – this will avoid late payment penalties
- Avoid using the COVID phone line, instead use the large debts phone numbers as below:
    - PAYE 0300 3229243
    - VAT 0300 2003830

4. **Management of payments / cash out**

Early review of the following areas may help firms in their effort to safeguard cash levels over the coming months:-

- Avoid prepayments arising e.g. any rentals paid quarterly in advance, consider renegotiation to monthly in arrears
- Explore expenses that can be spread over a longer period e.g. insurance, monthly rather than annually in advance
- For key suppliers consider whether it is important to continue with prompt payment or whether settlement times could increase; or even potentially maintained in return for a discount
- Review direct debits and automated payments and consider whether the basis needs to change – once the cash is gone its gone; may be better to have specific authorization for many more payments than is currently the case.

5. **New matter starts**

Clients engaging new matters at this point naturally are doing so with a genuine need for support and legal advice. Whilst having due regard for longer term business relationships with clients it would be prudent to consider asking for considerably higher levels of payments on account from clients at present to ensure the cash is available to transfer from client to office account when the work is completed.

6. **Offer discounts for upfront / prompt payment**

In many firms we are expecting to see lower productivity or in some cases activity will be directed at areas that are not likely to be cash-generative in the short term. Firms may want to consider offering discounts to clients for either upfront or prompt payment in an effort to bring in cash and to ensure fee earners are working on matters that can bring in cash at the earliest point.

7. **Financial forecasting**

Many law firms continue to find financial forecasting, particularly cash flow forecasting, a challenge but it is crucial that firms can model their future cash flow at this time with some degree of reliability. Firms should be ensuring they have this capability in place so they can quickly adapt to changing positions and information in their business so they can make decisions.

Preparing a detailed monthly cash flow for the next 12 months is the priority here for firms along with actions to stress test any assumptions that are being used in preparing the forecast.

8. **Credit limits**

There is a balance to be struck here in professional firms who often have long term relationships with their clients. However being more stringent about setting and applying credit limits to clients at this point will be an important consideration for firms.

Credit limits for these purposes should include WIP levels as well as fees outstanding (i.e. lockup). Better control systems for setting and enforcing limits in many firms will be an important matter to deal with here.

9. **VAT on bad debts**

Firms may find some cash flow savings by being more diligent in reviewing bad debts (both fee and disbursements) and considering whether any VAT can be reclaimed.

It's worth remembering that VAT on bad debts can be reclaimed once the debt is over six months old (from the date the payment was due) and is less than four years and six months old. In order to reclaim you must have: Paid the VAT over to HMRC, and. Written off the debt in your accounts.

10. **Provisions affecting partners**

Many firms will be considering options surrounding partners to preserve cash as well as including reductions to monthly drawing levels, postponement of capital / current account draws.

It is likely that many lenders will be expecting partners to share in the pain of the additional funding needs for their business over the next few months and early discussion with partners on this subject could be an important aspect.

11. **Changing your financial year end**

Firms may wish to consider whether a change to their financial year end could be appropriate in order to accelerate the point at which they experience reduced payments on account as a result of declining profits. For example firms with a 30 April financial year end may benefit cash flow wise from earlier reductions to their income tax payments if they change their year-end to 31 March.

12. **Accounting provisions – accelerating tax relief on future costs**

In an effort to reduce reported profits in the 2019/20 financial year and reduce tax payments firms may benefit from looking closely at accounting standards and the ability to make provisions for future costs in the 2019/20 financial year in order to get tax relief a year earlier (and reduce tax payments).

13. **Asset protection – individual partners**

Aspects such as partners taking charges over their capital account in an LLP and director's loan accounts in a Limited Company may be worth consideration, again taking into account insolvency legislation in the process of doing so.

Many firms carry surplus reserves to make income tax payments on behalf of their partners. In most firms these reserves in effect represent the working capital of the firm. However the tax liabilities remain a personal liability of the individual partners regardless of whether the firm is able to make the payments. Whilst we are not specifically advocating that these funds should be removed from firms at this point it is important that firms consider the ability to make these payments in the short to medium term and consider the potential impact on individual partners if it becomes impossible for the law firm to fund such payments.

14. **Incorporation as a limited company**

Many law firms will remember the high volume of incorporations as limited companies which took place bank in 2008 after the financial crisis. This may be relevant for consideration again for LLPs or unincorporated partnerships / sole practitioners.

The key thing to remember with incorporation is that at a basic cash flow level it provides an income tax holiday i.e. whilst the owners are being repaid their directors loan accounts in the new company (i.e. their current accounts, capital accounts and tax reserves) the company is earning profits and paying only 19% on those profits as opposed to say up to 47% (including National Insurance) in an unincorporated structure.

So, this eases cash burdens (often very significantly) on the business in the meantime. It needs to be kept in mind that there are longer term implications of incorporation and of course the income tax holiday ultimately does end when the director's loan accounts have been exhausted.

15. **Losses and reducing future tax payments**

Firms who are projecting short or medium term losses in their business need to consider the quickest and best way to access relief for those losses.

Law firms trading as a limited company have the option to carry back losses 12 months and recover Corporation Tax payments made in that period.

For LLPs, partnerships and sole practitioners there is an ability to carry back losses to the prior year (12 months) and this can then potentially reduce future tax payments on account or obtain some recovery of Income Tax paid.

For unincorporated partnerships that incorporate, if losses exist there is potential to claim terminal loss relief which can enable losses to be carried back for over 12 months potentially enabling income tax to be recovered from earlier years.

16. **Furloughed Workers Scheme / Job Protection Scheme**

Some more detail that's been obtained overnight from one of my tax partners, John Endacott, which I thought would be useful for you:

I managed to speak to H M Treasury and HMRC this afternoon on the Furloughed Workers or Job Protection Scheme. I'm told that I'm the first practising accountant to speak to HMT/HMRC on this which is possible as it is only the first working day after the announcement. I was part of a joint Institute of Chartered Accountants in England & Wales and Chartered Institute of Taxation team that we've got together on this.

The key points as I understand them:

- Only the bare bones of the scheme have been worked out. HMT/HMRC are working night and day on this. I'm trying to keep myself in the communication channel with HMT/HMRC.
- Furloughed is being interpreted as redundant (but in limbo). An employee who is furloughed can do no, repeat no work. I would interpret this as meaning that they can't even look at or respond to an email. Just think zero. Anything more and you're missing the point of the scheme. That's the message from HMT.
- The 80% is going to be computed by reference to a previous period. The previous reference period hasn't been worked out yet. They want to help seasonal workers. Possibly an average of past months or year but what about new seasonal workers? HMT are still working on it. What is clear is upping wages now is irrelevant.
- It is a grant paid to the employer. Grant is 80% of the reference period wage plus employers NIC and it seems the legal minimum pension contributions. That last bit is hard to achieve. So if wages in the reference period are £1,000 a month and employers NIC was £115 and pension contribution £30. So the total is £1,145. At 80% that is £916. So, the maximum grant is £916 pm. If during the next few months the amount paid to the employee is £916 pm then there is no cost to the employer. In fact the figure would probably be £911 because of the way the employers NIC calculation works.
- The employee is taxed as normal. Whether the grant is taxable or not will be irrelevant as the treatment will be consistent so it will net off.
- I think some flexibility on a furloughed worker returning to work and then going back on furlough is possible, but if there is any, it probably won't be much. They can definitely come back to work but can they be furloughed again. No decision on that yet. I think it was said that

that is a decision for the Chancellor (note not the Chief Secretary to the Treasury but the Chancellor), so these decisions are at the highest level.
- National minimum wage is not an issue because they're not allowed to work. So an employee on NMW being paid at 80% whilst furloughed is permitted. The individual should be eligible for universal credit.
- The desire is that employees made redundant but no change in the law so I think they keep their redundancy/pay in lieu (ask a lawyer).
- More guidance is promised by the end of the week.

More general commentary on measures available:-

PKF Francis Clark have a dedicated area on our website outlining some of the latest government support an information available to businesses at this time; you can use the following link to access this:-

https://www.pkf-francisclark.co.uk/coronavirus-updates/.

- **Coronavirus Business Interruption Loan Scheme ("CBILS")**

  Latest position on CBILS is summarised in my colleague's blog:-

https://www.pkf-francisclark.co.uk/blog/coronavirus-business-interruption-loan-scheme-cbils-what-we-know-so-far/

- **Other support for business in connection with impact of Coronavirus announced by the UK Government (as at 17 March 2020 – at 8pm)**

  • For businesses with fewer than 250 employees, the cost of providing 14 days of statutory sick pay per employee will be refunded by the government in full.

  • A dedicated helpline has been set up to help businesses and self-employed individuals in financial distress and with outstanding tax liabilities receive support with their tax affairs. Through this, businesses may be able to agree a bespoke Time to Pay arrangement. If you are concerned about being able to pay your tax due to COVID-19, call HMRC's dedicated helpline on 0800 0159 559.

  • Grant of £10,000 funding for small businesses that pay little or no business rates and are eligible for Small Business Rate Relief (SBBR) or Rural Rate Relief will be contacted by their local authority - they do not need to apply. (*)

  • Grant of £25,000 to retail, hospitality and leisure businesses operating from smaller premises, with a rateable value over £15,000 and below £51,000.(*)

  • All retail, hospitality and leisure businesses in England a 100% business rates holiday for the next 12 months.

  (* = we understand the funding will be provided to local authorities in early April.)

We are all facing uncertain and difficult times and hopefully the above comments and ideas provide some support at this time to you and your firms in making future plans.

Best wishes

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