

The latest VAT developments that could affect you or your clients' businesses

Solicitors, disbursements and VAT

Where can I find the VAT rules on disbursements?

The rules governing disbursements are set out in the Principal VAT Directive. While the provisions in question do not appear to have been transposed into UK law, HMRC have set out their views of the conditions that need to be met for treatment as a disbursement in Notice 700 at 25.1.1.

What's the issue?

Those who supply services, such as solicitors, will often pay out sums to third parties in the course of providing their services. Sometimes those payments are supplies to the solicitors that they use in providing their own services. In those cases, if the solicitor is VAT-registered and recharges the expense, then the recharge is subject to VAT. The most commonly cited example is that of travel expenses. A solicitor based in London who takes a train to see a private client in Manchester, and recharges the cost to her client, would need to add VAT to the recharge. Although the train travel is a zero-rated supply, the recharge is regarded as part of the consideration received by the solicitor for her standard-rated supply of legal services.

On the other hand, if the same solicitor pays court fees on behalf of the same client and recharges that cost to the client, then the recharge can be treated as a disbursement for VAT purposes. This is because the court fees are for a service that is provided to the client, not to the solicitor. The solicitor simply pays them on behalf of her client as a matter of convenience. As the court fees are not subject to VAT and the private client would be unable to claim any VAT charged by the solicitor, everybody is happy.

Periodically the dividing line between disbursements and other recharged expenses can create difficulties for a wide variety of businesses. Why is it a line that particularly causes difficulties for solicitors?



Why disbursements cause particular difficulties for solicitors

In addition to the more general guidance in Notice 700 (which itself includes examples involving solicitors), HMRC's VAT Taxable Persons Manual contains two special sections on the subject. The need for such extensive guidance reflects the way that solicitors operate, for example:

- (a) Solicitors often meet the cost of statutory charges on behalf of clients;
- (b) Solicitors often act as co-ordinators in relation to client transactions (such as the purchase of a house); and
- (c) Along with other professionals, they incur costs in running their businesses that they can sometimes attribute and recharge to specific clients. Some of these they may nonetheless use to deliver their own services, such as some search fees.

These difficulties have increased following a couple of recent judgements. Neither are binding as precedents but they have been sufficient to exacerbate the uncertainties that can arise.

The cases

In *Brabners LLP* (2017), HMRC had decided that the appellant law firm should not have treated the cost of obtaining online searches as a disbursement. The Tribunal rejected the firm's appeal and its argument that "the act of obtaining the search results is separate from the provision of advice". The Tribunal arguably went further than some of HMRC's guidance and rejected any distinction between those cases where the solicitor passed the searches on without comment or analysis and those where the solicitor used the information to give advice or in a report. The Tribunal

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took the view that most clients would take silence as an “all-clear”.

Earlier this year, in *British Airways PLC and John Prosser*, the Court of Appeal had to consider whether the cost of obtaining medical reports by a solicitor could be treated as a disbursement. Lord Justice Newell took the view that to do so would be to regard the solicitor's role as that of a “postbox”. In his view the reality was somewhat different:

“The solicitor will have obtained the reports/records in order to advise the client on the merits of the claim and/or facilitate his pursuit of the client's claim. Consideration of the report/records will have been part of the solicitor's broader supply of legal services to his client. The solicitor's role will not merely have been to forward the report/records to the client”.

Using our examples at the start of this article, these judgements placed online searches and the obtaining of medical reports in the same category as travel costs rather than court fees: VAT had to be added to any recharge.

Law Society guidance

On 8 October 2019 the Law Society published some very helpful guidance to assist solicitors in finding their way through the published HMRC guidance following the above judicial decisions. The guidance comes with the caveat that

“...it has not been discussed or agreed with HMRC and is not binding upon HMRC”.

While this is a subject of great importance to solicitors, it is not surprising if the Law Society has had difficulty getting HMRC's full attention in a year which has seen the introduction of Making Tax Digital for VAT returns, the deferment of a domestic reverse charge for construction services and a continually moving Brexit day. In the absence of a comprehensive HMRC response, the Law Society should be commended for seeking to fill the gap as best it can. The guidance notes that they

“... are aware of the difficulties this has caused many firms. Firms may have taken a variety of positions for entirely honest and justifiable reasons. Many firms will want to take a conservative approach to classifying items as disbursements going forward, and in many cases we think that is likely to be a sensible approach.”



What should solicitors do at this point?

To quote the Law society:

“Unfortunately, the case law and guidance make it difficult to interpret and apply the rules to many situations that arise in practice... In the end, it is up to each individual firm to apply the law in deciding whether to invoice an item of expenditure as a disbursement for VAT purposes.”

Without doubt, each and every law firm needs to examine its policy and procedures in relation to recharged third-party costs and how it determines which are disbursements and which form part of its turnover subject to VAT. Such reviews will need to involve VAT specialists, whether in-house or from outside the firm. While HMRC may be preoccupied at the policy level, they are continuing to carry out visits. Now that the Law Society has called upon its members to address these issues, the scope for resisting HMRC VAT and penalty assessments is likely to reduce over time. Act now.

To discuss how this may affect your clients or your business, or to talk about a VAT issue in general - contact:

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