SKELETON ARGUMENT CONCERNING CORRECT VAT RATE TO APPLY

1. The following is based on the assumption that the following documents correctly summarise the law:

- HM Revenue & Customs' *VAT – Reversion of the Standard Rate to 17.5%: A Detailed Guide for VAT-Registered Businesses* ("The Guide")

- Law Society's VAT change practice note *VAT change: Reversion of the standard rate to 17.5% - 15 December 2009* ("Society Guide")

- Bar Council's guide *Standard Rate VAT increase – 1 January 2010* ("Bar Guide")

2. The Society Guide and Bar Guide have been available since the beginning of the year. If these guides contained basic inaccuracies it is safe to assume those inaccuracies would have been identified and corrected by now.

3. There are currently three relevant VAT periods where different rates apply:

- 17.5% - for the period before 1 December 2008
- 15% - for the period from 1 December 2008 to 31 December 2009
- 17.5% - for the period from 1 January 2010 onwards

4. CPD 4.2(4) reads:

"Where value added tax (VAT) is claimed and there was a change in the rate of VAT during the course of the proceedings, the bill must be divided into separate parts so as to distinguish between;

(a) costs claimed at the old rate of VAT; and

(b) costs claimed at the new rate of VAT."

5. CPD 5.9 mirrors this:

> "All bills of costs, fees and disbursements on which VAT is included must be divided into separate parts so as to show work done before, on and after the date or dates from which any change in the rate of VAT takes effect."

6. This is a mandatory requirement. The bill here fails to comply with that requirement and is therefore defective. Whether the correct rates have nevertheless been claimed is a matter for the Court.

7. The starting point is explained on page 10 of The Guide:

> "Under the normal rules, standard rated supplies with tax points created by payments received or VAT invoices issued on or after 1 January 2010 will be liable to the 17.5% rate."

8. The problems that have been experienced in relation to the correct rate to apply appear to stem from a failure to do more than understand the starting point. Where there are changes in the rate of VAT special rules apply. This is explained in section 3, at page 10, of The Guide:

> "However, there are **optional** change of rate rules that you may be interested in applying. You can apply the rules selectively to different customers. Also, you can adopt them without notifying HMRC."

9. For present purposes we are concerned with services which were ongoing when the rate change occurred. These rules apply where there is a continuous supply of legal services either because the substantive claim was still ongoing on 1 January 2010 or because the detailed assessment proceedings had not yet concluded by 1 January 2010.

10. The Guide explains this at section 3.4, at page 10:

> "It will happen that a service commences before 1 January 2010 and is still in progress after that date. The normal rule is that where an invoice is issued or a payment received after 1 January 2010 VAT is due at 17.5% even if part of the supply was undertaken before that date. However, the special rules also apply here both in relation to continuous supplies of services and to single supplies of services carried out over a period of time."

11. The option to choose which rate to apply is dealt with at section 3.4.1 on page 12:

> "If you make a continuous supply of goods (gas, electricity or water liable at the standard rate) or services (e.g. leasing equipment) and are currently applying the tax point rules at paragraphs 14.3 and 30.10 of the VAT Guide (Notice 700) you may account for VAT at the 15% rate on that part of the supply made before 1 January 2010. This is the case, even if the normal tax point occurs later (for example, where a payment is received in arrears of the supply).
>
> If you decide to do this, you should account for VAT at 15% on the value of the goods actually supplied or services actually performed before 1 January 2010, and at 17.5% on the value of the goods actually supplied or services actually performed after."

1.2 The position concerning work done by solicitors is expressly dealt with at section 9.5 on page 30:

> "If you are a solicitor most of your supplies are covered by the normal tax point rules including a tax point on completion of the work. Where you issue a VAT invoice or receive a payment on or after 1 January 2010 for work that was completed before 1 January 2010 you may use the special rules and account for VAT at 15% (see section 3.3). Where work commenced before 1 January 2010 but will not be completed until on or after 1 January you can

apportion the supply between that liable to 15% and that liable to 17.5% (see section 3.4)."

13. The Society Guide mirrors this. Section 3.3 states:

"The normal rule is that where an invoice is issued or a payment received after 01 January 2010 VAT is due at 17.5 per cent even if part of the supply was undertaken before that date. Where work commenced before 01 January 2010 but will not be completed until on or after 01 January you can apportion the supply between that liable to 15 per cent and that liable to 17.5 per cent."

14. The Bar Guide also mirrors this at paragraph 10 on page 3:

"Where a supply of services spans the change of rate (i.e. some services are performed before and some after 1st January 2010), it is possible to apportion a fee received after 1st January 2010 so that so much of the fee as relates to work done before 1st January 2010 is charged at 15%."

15. The Society Guide gives the following example:

"You have been instructed by your client to undertake court proceedings to recover damages for clinical negligence. Instructions were received and your retainer commenced in early September 2006. The case is settled in December 2009 on the basis that the opposing party pay your client's costs and a bill of costs is drawn up. The amount of the costs are not agreed or assessed until March 2010. How do you calculate the VAT?

Under the normal VAT rules, where one party is ordered to or has agreed under a settlement to pay the other's costs, the settling of the costs in these circumstances is part and parcel of your overall supply to your client. In such circumstances, the basic tax point arises when the costs have been agreed between the solicitors or the assessment of costs procedure is complete and the costs will be liable to VAT at 17.5 per cent. Under the special rules, provided that that no interim invoices have been raised or payments received over the

entire course of the supply, which would be the case if there was a conditional fee agreement, then you should apportion your costs so that:

• 17.5 per cent VAT is charged in relation to your costs for the period being due from September 2006 to 30 November 2008
• 15 per cent is charged for the period from 1 December 2008 to 31 December 2009, and
• 17.5 per cent is charged for the period from 1 January 2010 to March 2010.

If you have issued interim invoices to your client during the course of the supply, then the rate you charge to the other party will be the same as that on the invoices you have issued."

16. It is therefore clear beyond doubt that the legal representative can elect to apply 15% in relation to work performed between 1 December 2008 and 31 December 2009. This is by virtue of the special rules and is regardless of when the normal tax point arises and regardless of when payment is received. Given the legal representative can elect whether to apply the old or new rate, how should that decision be exercised when dealing with a party and party detailed assessment?

17. The CPD deals with precisely this situation:

"5.7 Where there is a change in the rate of VAT, suppliers of goods and services are entitled by ss.88 (1) and 88(2) of the VAT Act 1994 in most circumstances to elect whether the new or the old rate of VAT should apply to a supply where the basic and actual tax points span a period during which there has been a change in VAT rates.

5.8 It will be assumed, unless a contrary indication is given in writing, that an election to take advantage of the provisions mentioned in paragraph 5.7 above and to charge VAT at the lower rate has been made. In any case in which an election to charge at the lower rate is not made, such a decision must be justified to the court assessing the costs."

18. Other than the defectively drawn bill, there is no indication in writing that an election has been made to apply the higher rate. If such an election were to be made it would need to be justified. No such justification has been put forward here. It is hard to conceive on a standard basis assessment what satisfactory justification could be put forward for applying a higher rate than was necessary.

19. The rate should accordingly be limited to 15% for any work undertaken between 1 December 2008 and 31 December 2009.

For CFA cases

20. This matter was funded by way of a Conditional Fee Agreement ("CFA"). This CFA incorporates the *Law Society Model CFA Agreement* wording:

> "We add VAT, at the rate (now[……..]%) that applies when the work is done, to the total of the basic charges and success fee."

21. Therefore, in so far as the solicitor has the right to elect which rate to apply under the special rules above, the solicitor is contractually obliged to elect to apply the rate applicable when the work was done.

22. Even if the solicitor does not have the power to elect what rate to apply, this term in the CFA acts as a cap as to what the solicitor can charge the client. This term amounts to an agreement by the solicitor not to pass on to the client any increase in the VAT rate that may take place between when the work is done and when a tax point arises. The fact that the solicitor may have to account to HM Revenue & Customs for any increase in the VAT rate does not alter the effect of this term. Under the indemnity principle the paying party therefore cannot be required to pay a higher amount.

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