

# Costs Law Update

17<sup>th</sup> November 2010



- The Defendant Costs Specialists

## Post Jackson, Post Young

What does the *Young Report* mean for defendants?

Lord Young recommends the implementation of Lord Justice Jackson's *Costs Report*:

“It is my firm belief that the government should adopt Lord Justice Jackson’s proposals as soon as possible”

The Government has approved the *Young Report* with the Prime Minister saying:

“Lord Young has come forward with a wide range of far reaching proposals which this Government fully supports”

Lord Young has also proposed the extension of the RTA claims process into other personal injury and lower value clinical negligence claims. Separately, the Government has advised it wants to press ahead with Lord Justice Jackson's proposals to end the recoverability of success fees and ATE insurance premiums as a matter of urgency and has just launched a consultation on implementation. April 2012 is being talked about as a target date for the changes.

It is not quite clear how extension of the RTA claims process would tie in with Jackson's proposal to introduce fixed fees for all stages of fast-track matters. The Government is still considering this issue but presumably there would be a different fixed fee system for those cases which fall outside the extended claims process.

Defendants will hope that the proposed increase in general damages will be more than off-set by the savings to be made from an end to recoverability of success fees and ATE premiums.

Defendant lawyers will hope that these changes do not significantly reduce the amount of litigation such as to adversely impact on work volumes.

The biggest impact is likely to be experienced in the legal costs profession. An end to recoverability of success fees and ATE premiums will reduce the relative importance of costs in many disputes (by more than 50% in some cases). An extension of the claims process, with fixed fees, in all fast-track personal injury matters is likely to catch 90%+ of such claims and possibly 80% of costs claims by value. Although there will be the inevitable problems and satellite litigation to begin with, the end result will be a massive reduction in work volumes. This is likely to lead to a number of things:

- Those solicitors and insurers with in-house costs departments will carefully consider whether the reduced work volumes continue to require in-house expertise.
- A large number of the sole practitioner law costs draftsmen, the traditional backbone of the costs industry, will not have sufficient work volumes to survive.
- The volume costs businesses will not survive in their present form, if at all. Mergers and management buy-outs are inevitable.

The costs work that will survive is the higher-end more complex claims. Defendants will be reviewing carefully where to place this work.

## **The Great VAT Swindle**

Are you paying VAT at too high a rate on third party legal costs claims? VAT may not be the most exciting topic around but the amounts at stake run into £millions for defendants.

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

- 17.5% - for the period from 1992 to 30.11.08
- 15% - for the period from 01.12.08 to 31.12.09
- 17.5% - for the period from 01.01.10 to 03.01.11

Since VAT reverted to 17.5% a very large number of claimant lawyers have been claiming 17.5% on all work, regardless of whether some of the work was undertaken between 01.12.08 and 31.12.09.

The starting point for understanding the correct rate to apply can be found in HM Revenue & Customs' *VAT – Reversion of the Standard Rate to 17.5%: A Detailed Guide for VAT-Registered Businesses* ("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.”

Claimant representatives routinely argue that where the costs are not settled until after 31.12.09, then because an invoice will not be raised or payment received until after 31.12.09, that is when the tax point will arise and therefore all work attracts VAT at 17.5%.

Initially it seemed possible that claimant representatives were acting under a genuine misunderstanding of the rules based on the above. Now that we are almost a full year after the change happened, this continued insistence that 17.5% is appropriate is beginning to look disingenuous.

The “normal rules” are no more than 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.”

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 01.01.10 or because the detailed assessment proceedings had not yet concluded by 01.01.10.

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.”

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.”

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).”

The Law Society’s VAT change practice note *VAT change: Reversion of the standard rate to 17.5% - 15 December 2009* 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.”

Unless, which would be unusual in personal injury claims, interim invoices have been delivered to the client, the rates that should be claimed from defendants are those in force at the time the work was undertaken.

The added importance of this is that VAT is about to increase to 20% from 04.01.11. Claimants will no doubt start to claim VAT at 20% on all work regardless of the fact that much of the work may have been undertaken when the rate was 17.5% or 15%. This is wrong.

Links to the relevant information and a detailed skeleton argument from Gibbs Wyatt Stone can be found at: <http://www.gwslaw.co.uk/legal-costs-central/vat/>.

## **Legal Costs News and Information**

Up to the minute news and commentary on the world of legal costs is available from GWS's hugely popular [Legal Costs Blog](#) and access to legal costs information across the internet is available via [Legal Costs Central](#).

## **Complimentary Costs Training**

GWS are currently arranging a limited number of complimentary in-house costs law training sessions for defendant panel solicitors and insurers. These typically focus on the proactive steps that can be taken during the life of a claim to control third party costs but can be tailor-made to your requirements. We will also be covering the impact of the *Jackson Report*, the *Young Report* and their implications.

Please contact Simon Gibbs if you would like to find out more.

## **Contact**

If you wish to discuss the contents of this update in more detail contact:

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### **Gibbs Wyatt Stone**

Dedicated to providing the level of expertise expected from specialist costs counsel and the range of services provided by traditional costs draftsmen.