Costs Law Brief

The costs team at **Kings Chambers** in Manchester and Leeds focus on VAT and costs

VAT is a recoverable cost. This month we consider the way in which VAT should be dealt with on a between-the-parties assessment.

Liability for VAT

The extent to which a paying party is liable for VAT will depend on a number of factors, namely whether:

- VAT is chargeable by the receiving party's lawyers for the work that they have done;
- VAT is chargeable on expenses and disbursements;
- VAT (or any part of it) can be recovered by the receiving party from HM Customs and Excise; and
- it is reasonable for the receiving party to claim VAT from the paying party.

Whether VAT is chargeable by the receiving party's lawyers

Most lawyers will be VAT registered, and as such, their services will be subject to VAT at the standard rate (unless, of course, those services are zero rated or exempt). Some lawyers, however, will not be VAT registered, a common example being very junior counsel.

If a solicitor instructs a barrister who is not registered for VAT, that barrister's services will be deemed to be part of the service provided by his or her instructing solicitor, and as such, VAT will (in theory) be payable. In practice, however, the HM Customs and Excise permit the solicitor to "re-address" the barrister's fee note such that it is payable directly by the lay client. The effect of this is that if a non-VAT registered barrister renders a fee note, the receiving party can reasonably be expected to avoid paying VAT on his or her fees, and as a result, on a between-the-parties basis the paying party will not be liable for VAT on the barrister's fees.

Not all services provided by lawyers will attract a standard rate of VAT. Services relating to land outside the UK, for example, will not be subject to VAT. Moreover, services provided to non-UK business clients or to non-EEC private clients will also not be subject to VAT.

If there is a dispute as to whether a service is zero rated or exempt, Costs Practice Direction s 5.6 provides that the receiving party is to obtain the view of HM Customs and Excise, and that that view should be made available to the court at the hearing at which the costs are assessed.

Government departments who use their own staff to provide legal services (such as the Treasury Solicitor) cannot claim from the paying party VAT relating to those legal services (see Costs Practice Direction s 5.20).

If a lawyer is acting on his or her own behalf, he or she is not treated for the purposes of VAT as having supplied a service, and as such, no VAT would be chargeable.

Expenses and disbursements

HM Customs and Excise use the word "disbursements" in a different way to the way in which lawyers use the word. Broadly speaking, for VAT purposes a disbursement is an amount of money paid to a third party by the solicitor acting as agent of the client, but only where the client's account is debited for only precisely the same amount as was paid to the third party. If, however, these monies have been paid in order to allow a solicitor to provide a service to his or her client, then (for VAT purposes), those monies are not regarded as being a disbursement.

A solicitor may treat a payment to a third party as being a disbursement for VAT purposes if all of the following conditions are met (see para 25.1.1 of Notice 700):

- the solicitor was acting as the agent of the client (this condition will almost always be met);
- the client actually received and used the goods or services provided by the third party (this condition usually prevents the solicitor's own travelling and subsistence expenses, telephone bills, postage, and other costs being treated as disbursements for VAT purposes);
- the client was responsible for paying the third party (examples might include estate duty and stamp duty payable by the client on a contract to be made by the client);
- the client authorised the solicitor to make the payment on his or her behalf, and the client knew that the goods or services would be provided by a third party (if there has been compliance with the Solicitors Costs Information and Client Care Code 1999, this condition will usually have been met.);
- the solicitor's outlay is separately item-

DISBURSEMENT VAT is not chargeable (unless, of course, VAT is charged by the third party)	**EXPENSE** VAT is chargeable
Photocopying bureau charges (unless the copying is done to allow the solicitor to provide a service)	Photocopies made in the office
Counsel's fees (but only where the fee note is re-addressed)	Counsel's fee (where the fee note is not re-addressed)
Courier charges (but only where the service is provided to or for the benefit of the client)	All other courier charges
Oath fees	CHAPS/TT fees, and bank charges for supplying a bankers' draft
Search fees relating to searches carried out by post and supplied directly to the client	Search fees relating to searches carried out personally (including online searches)
Fees for police reports	Travelling expenses, hotel and accommodation expenses
Fees for medical reports	Telephone call charges and postage (these would usually be absorbed within the solicitors' overhead in any event)
Court fees	Telephone conference fees
Insurance premiums (IPT is, however, payable)	Lexis (and similar) charges (again, these would usually be absorbed within the solicitors' overhead)

ised when the client is invoiced;
- the solicitor recovers only the exact amount which he or she paid to the third party;
- the goods or services are clearly additional to the supplies which the solicitor makes to his or her client on his or her own account.

Examples of what are and are not disbursements are given in the table on p 539 (the examples are necessarily very general, and the classification may vary from case to case).

> *"If VAT can be recovered by the receiving party as input tax, it ought not to be claimed from the paying party as he or she has suffered no net loss in respect of that VAT"*

It can be seen that the classification of monies as disbursements or non-disbursements is not wholly intuitive. For example, if company search is made personally by the solicitor, it is the solicitor rather than the client who receives the supply and the fee cannot properly be regarded as being a disbursement. If, on the other hand, exactly the same search is requested via post and the results are then passed on to the client for his or her own use, then the fee can properly be regarded as being a disbursement.

If the third party charges VAT, then (for obvious reasons) this can properly be passed on to the client and will in principle be payable by the paying party. Thus, if an accountant prepares an expert report, the VAT charged by the accountant will in principle be recoverable from the paying party irrespective of whether accountant's fees are to be regarded as a disbursement.

The VAT status of one particular class of third parties is likely soon to change. At present, the services of medical and dental experts are exempt from VAT if the following conditions are met (see para 2.2 of Notice 701/57):
- the services consist of care, diagnosis, treatment or assessment of a patient;
- the services are within the discipline in which the expert is registered to practice; and
- performance of those services requires the application of knowledge, skills and judgment acquired in the course of the expert's professional training.

Up until recently, the provision of medical or dental reports has been regarded as fulfilling these criteria. Only work which was predominantly legal (such as arbitration, mediation, negotiation, etc) would attract VAT at the standard rate. In *Peter d'Ambrumenil, Dispute Resolution Services Ltd and Commissioners of Customs and Excise* (C–307/01), however, the ECJ has ruled that where a medical service is supplied, the supplier must look to the purpose of the service in order to decide upon the correct VAT treatment. If a medical practitioner supplies a service which does not go to the "the protection, maintenance or restoration of health", that service might well be subject to VAT. HM Customs and Excise are in discussion with the BMA in order to establish precisely which medical services will be affected, but it is not unlikely the medical experts will shortly begin to charge VAT.

A further area of uncertainty is where a solicitor uses a medical agency to obtain a medical report. At present, for the reasons set out above it would seem that that part of the fee which relates to the medical report itself might not attract VAT, but the part of the fee that relates to the agency's administrative work appears not to be a disbursement. It is curious, therefore, that VAT is rarely sought on medical agencies' fees.

Whether VAT can be recovered by the receiving party

If VAT can be recovered by the receiving party as input tax, it ought not to be claimed from the paying party as he or she has suffered no net loss in respect of that VAT. The Costs Practice Direction makes it clear that it is the receiving party who is responsible for ensuring that VAT is claimed only in so far as the receiving party is unable to recover VAT as input tax.

Where there is a dispute as to whether (or to what extent) VAT can be recovered as input tax, s 5.5 of the Costs Practice Direction provides that the receiving party must provide a certificate as to recovery of VAT. This must be signed either by the receiving party's solicitors or by the receiving party's auditors who must certify the extent to which the receiving party is able to recover VAT as input tax. Whilst the Costs Practice Direction lays down no hard and fast rules in this regard, it is clear from Precedent F (ie the model certificates annexed to the Costs Practice Direction) that the receiving party's solicitors or auditors are expected to base their opinion on the receiving party's most recent VAT return.

Whether it is reasonable for the receiving party to claim VAT from the paying party

It will rarely be the case that a receiving party has the option of avoiding paying VAT, so the issue of reasonableness will arise only very infrequently. That said, if in the future the rate of VAT does change, solicitors will (in certain circumstances) have a choice whether to charge VAT at the higher rate or at the lower rate. If this happens and if VAT is charged at the higher rate, the court will order the paying party to pay that rate only if the receiving party is able to justify the decision not to elect to charge at the lower rate (see Costs Practice Direction s 5.8).

Other issues concerning VAT

Generally speaking, VAT ought to be disregarded for the purpose of considering whether the costs are proportionate.

Unless stated otherwise, a Part 47 Offer will be deemed to be inclusive of VAT (see Costs Practice Direction s 46.2). If recoverability of VAT is in dispute, it would be sensible for parties to make it clear beyond doubt whether their offers include or exclude VAT.

Finally, we have dealt with between-the-parties costs and VAT rather than solicitor-and-client VAT, but it is worth mentioning one recent development which will be of interest to solicitors who carry out 'back office' functions for insurers. In *Staatssecretaris van Financien v Arthur Andersen & Co* Accountants cs ECJ (First Chamber) C–472/03 3 March 2005, it was held that 'back-office' functions performed by a firm of accountants under a contractual arrangement with an insurance company were services that were chargeable to VAT. The case has important implications for firms of solicitors who provide a claims handling service on behalf of firms of insurers. Presently, such a service provided by solicitors will not be chargeable to VAT as the solicitors will be acting as intermediaries. However, domestic law may well be changed in the light of this authority and those providing such services ought to keep a close eye on developments.

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