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VAT treatment of disbursements and expenses

8 October 2019

Foreword

This guidance is for law firms that frequently make decisions about whether items may be treated as disbursements for VAT purposes.

The difficulties solicitors encounter in making those determinations have come into sharper relief following developments in case law.

The decision of the First-tier Tax Tribunal in *Brabners LLP v The Commissioners for her Majesty's Revenue & Customs* [[2017](#)] [UKFTT 0666](#) and the *obiter* comments of the Court of Appeal in the recent case of *British Airways v J. Prosser* [[2019](#)] [EWCA Civ 547](#) have interpreted the concept of disbursements narrowly. This has cast doubt on some established practices of solicitors around client invoicing.

The tribunal judge in *Brabners* concluded that the electronic property searches in question were supplied to the law firm which used them as part and parcel of its own overall supply of legal services to the client. That meant that those costs could not be treated as disbursements for VAT purposes.

It is difficult to discern the correct limits of the reasoning in *Brabners* and to determine how it should be applied in real situations.

A non-binding Court of Appeal analysis in the *BA v Prosser* case of 2 April 2019 also supports a narrow interpretation of when disbursement treatment is available, which could have significant implications for established disbursements practices. Although we consider that there remains scope for criticism of such narrow interpretations, these judgments cannot be ignored.

We 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.

We regret the continuing lack of clarity resulting from these decisions and would welcome guidance from the courts and an approach from HM Revenue and Customs (HMRC) that recognises and addresses it.

This guidance does not aim to set standards for the profession. Its purpose is to set out the changes in case law and to consider what they mean for the profession, based on the information available to date.

We acknowledge that this guidance might not be able to answer all the legitimate questions practitioners may have. However, it aims to set the context for the decisions that law firms must take on how they treat disbursements.

This guidance replaces our former practice note on VAT on disbursements. It offers less detailed guidance on specific areas of legal practice, due to the challenges resulting from these decisions. However, it provides some more detailed practical guidance on VAT and disbursements in a real estate context.

Gary Richards

As chair of and on behalf of the VAT on Disbursements Working Group

Introduction

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This guidance is aimed at all solicitors and their legal cashiers who have to deal with invoicing, making and receiving payments which include VAT. You are not required to follow it. It is not legal advice, nor does it necessarily provide a defence to complaints of misconduct or of inadequate professional service. The Law Society will not accept any legal liability in relation to it.

What is the issue?

When invoicing clients, it can be difficult to identify which items of expenditure incurred by a solicitor in the course of acting for a client can be classified as disbursements for VAT purposes, and which cannot.

Solicitors generally use the term ‘disbursements’ to refer to money which they have to pay to third parties in connection with the matter they are dealing with on behalf of the client. Section 67 of the Solicitors Act 1974 refers to disbursements as “costs payable in discharge of a liability properly incurred by him on behalf of the party to be charged with the bill”. These may include court fees, fees for medical or other expert reports or search fees in a property transaction.

For VAT purposes you are required to charge VAT on all amounts which constitute consideration obtained by you in return for the supply of services to your client. The rules for determining whether an item qualifies as a disbursement for VAT purposes are set out in the 2006 VAT Directive (2006/112/EC) which is covered under [The basic rules](#) below.

A cost for which you seek reimbursement from a client can only be a disbursement for VAT purposes if the reimbursement from your client does not constitute consideration for your supply of services to the client, but is simply the reimbursement of a payment which you made on your client’s behalf for goods or services supplied to the client by a third party.

The defining factor for determining whether a payment qualifies as a disbursement for VAT purposes is therefore whether its reimbursement by the client is part of the consideration for the “service supplied by you”, or whether it is made for third-party services supplied to your client.

It is important to note that if you are not charged VAT by a supplier on an item or an expense it does not necessarily mean that you do not need to charge VAT to the client. The description given to a payment is not relevant for determining whether it can be treated as a disbursement for VAT purposes. The key question is whether the reimbursement forms part of the consideration for the “service supplied by you”. This is discussed further below.

When is the issue most significant?

Where a cost qualifies as a disbursement for VAT purposes it is eligible for VAT ‘disbursement treatment’. It is important that firms pay close attention to whether an item qualifies as a disbursement for VAT purposes and ensure that they apply the correct treatment. Firms should be particularly mindful of the following:

- Where a client incurs expenditure as a business, provided it is registered for VAT, it will in most cases be entitled to recover any VAT incurred on fees for goods and services supplied to the business. However, where the client is an individual and is not obtaining goods or services in the course of a business, the individual will not be entitled to recover any VAT charged for the supply of goods and services to that individual. Any VAT charged will therefore represent an additional cost to the client.

- Disbursement treatment is beneficial to the client only where the third-party provider of the goods or services does not charge VAT on the fees. In circumstances where the provider does charge VAT on the fees, disbursement treatment will produce the same overall result as where the solicitor treats the fees as part of his or her costs of providing services to the client.
- If HMRC were to successfully challenge a firm on disbursement treatment then the firm may have to bear the additional VAT, interest and any penalties found to be due out of its own resources.

You should carefully consider these three points in assessing the potential costs and benefits of applying disbursement treatment in cases where there is any uncertainty. In particular, you should be aware that clients will only benefit from disbursement treatment where the following three conditions are met:

1. the client cannot fully recover VAT charged to them
2. the service from the supplier can properly be treated as a disbursement (that is, the service is not supplied to the firm)
3. that supply does not attract VAT

Approach of this guidance

This guidance aims to clarify this issue and help you identify what is or is not a disbursement for VAT purposes. It complements [HMRC Guidance](#) and sets out the Law Society's comments. This guidance has not been discussed or agreed with HMRC and is not binding upon HMRC.

The section on the basic rules sets out EU law. The following section reviews UK law and practice. The guidance also includes practical examples covering property matters.

The section on how to treat qualifying disbursements deals with accounting practices.

The basic rules

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The starting point for deciding whether an expense incurred is a disbursement for VAT purposes is Article 73 of the 2006 VAT Directive (2006/112/EC) which provides that:

“...the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party”.

Article 79 of the 2006 VAT Directive provides:

“The taxable amount shall not include the following factors:

(c) amounts received by a taxable person from the customer, as repayment of expenditure incurred in the name and on behalf of the customer, and entered into his books in a suspense account.

The taxable person must furnish proof of the actual amount of the expenditure referred to in point (c) of the first paragraph and may not deduct any VAT which may have been charged.”

If the conditions laid down in Article 79(c) are met, and the requirements as to proof in the final sentence of Article 79 are met, the amounts falling within Article 79(c) do not form part of your “supply” to your client and therefore can be treated as disbursements for VAT purposes.

The House of Lords in *Nell Gwynn House Maintenance Fund Trustees v C & E Commissioners* [1999] STC 79 confirmed that VAT law therefore draws a clear distinction in principle between:

- i. expenses paid to a third party that have been incurred by you in the course of making your own supply of services to your client and which are part of the whole of the services rendered by you to your client; and
- ii. expenses for specific services that have been supplied by the third party to your client and you have merely acted as your client's known and authorised representative in paying the third party.

Only in case (ii) can the amounts of the payments to the third party qualify for treatment as disbursements for VAT purposes, on the basis that they do not form part of the consideration for your own services to your client.

When can payments/expenses be treated as a disbursement for VAT purposes?

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Practical examples

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These practical examples cover the VAT treatment of certain common property transactions.

We emphasise once again that this is not a straightforward area of VAT law. It can require very finely balanced judgements. The conditions set out in HMRC guidance (section 25 of VAT Notice 700) may help you in determining the VAT position but as the Barratt and Brabners cases illustrate, the guidance may not provide a definitive answer and you should exercise your own judgement.

Many queries arise about the expenses incurred when acting for clients on property transactions.

In property transactions, property is sold on a *caveat emptor* basis. The onus is on the buyer to find out as much as possible about the property.

Normally a buyer would instruct you to undertake the necessary searches on their behalf, but increasingly, a seller may instruct you to obtain searches on their behalf to include in a sales pack or on an extranet to be provided to a buyer, to speed up the transaction process, or searches may be carried out for use in a finance transaction.

Ordering searches using online search providers

Searches may still be done by post or in person but in most situations they are done online. References in this section to a copy of the search results include an electronic as well as a paper copy.

Many solicitors obtain searches online through the National Land & Property Information Service (NLIS) or other online search providers. NLIS (via the licensed NLIS channel providers) and other providers facilitate electronic access to the official sources of land and property information in England and Wales.

When you order searches online through an online search provider, for example a water and drainage search, an administration fee will be charged in addition to the utility provider's search fee. If you use an NLIS channel provider you may also be charged the NLIS Hub fee.

You will be charged VAT on the NLIS Hub fee and any administration fee. No VAT is currently charged on LLC1 search fees or Land Registry fees but VAT will be charged on most other search fees. Some channel providers itemise each item separately, while others group them by category. You

should therefore account for input tax in the normal way on any VAT you pay (see [How to treat qualifying disbursements](#)).

If you charge your client the cost of the hub fee and/or administration fees then these should be treated as items of expenditure and not as disbursements. The net amount of the fee must be included in your invoice as part of your professional charges on which VAT is charged at the standard rate. The amount your client pays in total will be the same as that charged to you.

Where you have been charged VAT by the channel provider in relation to any search, such as a mining search, then (assuming non-disbursement treatment) this should be treated as your input for VAT purposes. The search fee (i.e. the net amount) should be treated as part of your professional charges, although these fees will be itemised separately on the invoice and should bear VAT at the standard rate. In these circumstances the amount the client pays for the search will be the same as that charged to you.

The searches that are carried out by you on behalf of your client may include the following (available through NLIS and other online sources):

- Local Land Charges (LLC1)
- enquiries of the local authority (CON29, CON29O)
- Land Registry (a whole range of searches and copy documents are available for registered land and land charges (searches for unregistered land)
- water utilities (drainage and water CON29DW and commercial drainage and water searches)
- Mining Search (CON 29M)
- Environment Agency (flooding and environmental)
- Forestry Commission
- Highways Agency (road building and maintenance)
- electricity (national grid)
- gas (pipelines)
- telecommunications (cabling)
- London transport (London Underground and Docklands Light Railway), Crossrail and High Speed Rail 2
- Civil Aviation Authority (airports)
- Canal and River Trust (canals)
- Ordnance Survey (maps and plans)
- waterways
- probate and administration searches
- specialty searches, including Cheshire Salt Search, radon, clay, tin mining, limestone, gypsum, chancel repairs
- company/individual insolvency searches and K16 bankruptcy only searches

The search results would show whether there is anything which adversely affects the property and may impact on a client, buyer or bank's decision about whether to proceed with a transaction.

You may need to consider the search result and advise your client of the result in layman's terms (for example in a report on title), or perhaps certify title to your client's bank.

Based on the *Brabners* and *BA v Prosser* decisions, HMRC may argue that the fact that you have made use of the search results or copy documents obtained to provide advice or give certifications means that the supply of the search result is a supply to you and therefore that the cost must be treated as a charge for part of your legal services and subject to VAT at the standard rate, rather than treated as a disbursement, whether or not VAT has been charged by your supplier.

VAT position for most common property searches

Whether the expenditure on search fees can be treated as a disbursement for VAT purposes only has a financial impact on your client where the supplier of the search result has not charged VAT. The fact

that such expenditure can be treated as a disbursement means that the cost to the client will not be increased by the standard rate of VAT.

For there to be any possibility that such search fees may be treated as a disbursement, you should ensure that the conditions set out under [Criteria for qualification as disbursement](#) are met. Therefore, you should:

- give or offer to provide the original search report to your client. If you must give this to the mortgage company, you should give a copy to your client and explain to them that the original search report has been provided to their mortgage company
- tell the supplier the identity of your client (although it should be noted that in *Brabners* the tribunal expressed the view that identification of the client was less to satisfy the conditions for disbursement treatment but more for convenience and/or client accounting). You can do this by including in the standard search forms sent to the supplier some identifying feature such as a client and/or file reference number

It is considered good practice to retain the original search results/report with the title deeds or with other information stored (whether in hard copy form or electronically) on behalf of the client and therefore you should in all cases give your client a copy of the search results. Failure to provide your client with at least a copy of the search results will very likely mean that the fees cannot be treated as a disbursement.

However, firms should be mindful of HMRC's position (set out in VTAXPER 47000) and of the *Brabners* and *BA v Prosser* cases in deciding whether to apply disbursement treatment on searches undertaken during the conveyancing process.

HMRC is of the view that where a solicitor has used the search to provide further advice to the client, it is considered integral to the solicitor's legal supply and therefore cannot be treated as a disbursement. This means that you will have to charge VAT when you charge this cost to the client. This increases the cost to the client where the search fees are not subject to VAT.

Where the subject matter of the legal services related to the client's business (such as the purchase of business premises) and the client is VAT registered, the client may be able to recover the VAT that you charge them, but in other cases the client must bear the additional cost.

Land Registry fees

Land Registry fees can be broadly divided into three categories:

- fees for registration applications
- fees for carrying out searches
- fees for obtaining copy documents

The Land Registry does not charge VAT on its fees.

It is our view that it should ordinarily be possible for registration fees to be treated as a disbursement.

Where searches are carried out or copy documents obtained, based on the *Brabners* and *BA v Prosser* decisions HMRC may argue that the fact that you have made use of the search results or copy documents to provide advice or give certifications means that the supply of the search results is a supply to you and therefore that the cost must be treated as part of your overall legal services and be subject to VAT at the standard rate, rather than treated as a disbursement.

Following agreement with HM Customs and Excise (HMCE – the predecessor to HMRC) in September 1994, when a seller's solicitor obtains an office copy entry (now known as an official copy) and recharges the exact fee to their client they may treat it as a disbursement and outside the scope of VAT. We believe that this exception will only still apply in limited circumstances, especially as it is now common practice for official copies to be obtained on behalf of any party to the transaction.

In relation to the historic agreement, where the seller's solicitor also uses the official copies as part of their advice (for example, to obtain the title number to insert in the transfer or to ascertain what restrictions are on title), then, based on the *Brabners* and *BA v Prosser* decisions HMRC may argue that the fact that you have made use of the official copies to provide advice means that the supply of the information is a supply to you and therefore that the cost must be treated as part of your overall legal services subject to VAT at the standard rate, rather than treated as a disbursement.

Local Land Charge Search Fees (LLC1)

Prior to 2017, the CON29, CON290 and LLC1 were ordered together from the local authority and known as the 'local search'. No VAT was charged on any of those searches.

Since March 2017, local authorities were required to charge VAT on the CON29 and CON290 elements of the search, but not the LLC1 which remains outside the scope of VAT. In addition, from 2018, provision of the LLC1 is being moved to the Land Registry.

HMRC's view is that fees for 'local authority' searches that you have used as part of your advice in a transaction are subject to VAT when you charge them to your client. But, historically **by concession**, HMRC has been prepared to allow solicitors to treat **postal** search fees as disbursements so that VAT will not be payable on the amount of the fee which should thus be shown separately on your invoice.

It is now very uncommon to obtain a LLC1 by post, and, in any event, following the *Brabners* and *BA v Prosser* decisions HMRC may argue that the fact that you have made use of the search results to advise your client or give certifications means that the supply of the search results is a supply to you and therefore that the cost must be treated as part of your overall legal services subject to VAT at the standard rate, rather than treated as a disbursement.

Enquiries of local authorities (CON29 and CON290)

As mentioned above, from March 2017 local authorities were required to start charging VAT on CON29 and CON290 searches, so these no longer need to be considered in detail.

Since these changes have come into effect, you should be charging your clients VAT (output tax) and recovering the VAT paid on the CON29 and CON290 search fees (input tax).

Personal searches

Where a local authority search is carried out personally either by your firm or, as is more common, by a personal search agency, VAT must be charged on the fees. This is because the fee charged by the local authority for a personal search is for the supply of access to the official record and this is a supply that is made to you or the personal search agency, rather than your client.

Personal search agencies will charge you VAT on their fees and expenses for carrying out a personal search. The VAT element of the fee should be treated as an input for VAT purposes. The search fee (i.e. the net amount) should be treated as an item of expenditure (not as a disbursement) and added to your invoice on which VAT is charged. The amount your client pays in total will be the same as that charged to you.

If you undertake a personal search without using an agency, the local authority's fee will be treated as part of your professional charges (although itemised separately on the invoice) and you should charge VAT on these fees at the standard rate.

Highways searches

Where these searches are requested directly from a highways authority, VAT may or may not be charged by the relevant highways authority.

If VAT is not charged, then based on the *Brabners* and *BA v Prosser* decisions HMRC may argue that the fact that you have made use of the search results or copy documents obtained to advise your client or give certifications means that the supply of the search results is a supply to you and therefore that the cost must be treated as part of your overall legal services subject to VAT at the standard rate, rather than treated as a disbursement.

Bank transfer fees

HMRC's views on the VAT treatment of telegraphic transfer fees (as bank transfer fees used to be called) were set out in a letter from the VAT Administration Directorate published in the Gazette on 18 November 1992. This letter confirmed that telegraphic transfer fees are not disbursements for VAT purposes and must be subject to VAT when passed on to the client.

However, the letter also acknowledged that there had previously been uncertainties, and where HMRC staff had provided incorrect advice no action would be taken to recover VAT on past transactions.

In the tribunal case of *Shuttleworth & Co v Commissioners of Customs and Excise* (LON/94/986A) it was held that the transfer of funds by a solicitor was part of the overall conveyancing service provided by a solicitor to their client. Therefore, a CHAPS fee paid by a solicitor to the bank could not, for VAT purposes, be treated as a disbursement in the solicitor's invoice to their client.

How to treat qualifying disbursements

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Non-qualifying payments or expenses

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Professional conduct

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In addition to considering whether costs are disbursements for VAT purposes, you may need to consider whether a payment is a disbursement, and if so, the type of disbursement, for the purposes of the SRA Accounts Rules 2011.

Resources

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Legal requirements

Articles 73 and 79(c) of the 2006 VAT Directive, 2006/112/EC

[Value Added Tax Act 1994](#)

Practice Advice Service

Our [Practice Advice Service](#) provides support to solicitors on a wide range of areas of legal practice. The service is staffed by solicitors and can be contacted on 020 7320 5675 from 9am to 5pm on weekdays.

Law Society publications

[Solicitors' Accounts Manual, 12th edition](#)

[Lexcel Financial Management and Business Planning Toolkit](#)

Law Society practice notes

[Client care information](#)

[Price and service transparency](#)

HMRC guidance

[The VAT Guide \(Notice 700\)](#)

Acknowledgements

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The Law Society acknowledges the contributions of members of our Working Group on Disbursements in producing this guidance.

Amendments

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This guidance is based on a previous practice note and reflects the developments following *Brabners v HMRC Commissioners* and *BA v Prosser* decisions. We will update this guidance when we have further clarity from HMRC or the courts on this subject.

The previous practice note was extensively amended in March 2011 from the version previously published on 19 February 2009 with clarifications in sections 1-3, and additional examples provided throughout. Section 4.1 was further updated in 2015 and minor other updates were made at the same time.