HMRC - VATSC92000 - Note Published In The Law Society’S Gazette (July 1983)

This is the wording of the first of the two articles published by the Law Society referred to in VATSC91600.

Payment of another party’s costs: VAT implications

Enquiries being received by The Law Society indicate that a restatement of the principles governing the payment of value added tax on legal costs by any person other than a solicitor’s own client would be of use to practitioners. This note sets out therefore the rules which apply whenever a solicitor’s costs are paid by a party (“the paying party”) other than the person to whom the solicitor’s services are supplied. The person to whom the solicitor’s services are supplied will normally, but not necessarily, be the solicitor’s client (see paragraph 3(c)), for convenience referred to in this note as the client.

General principles

The principal guide-lines are as follows:

a. the solicitor whose costs are to be paid should deliver a bill to his own client if he is a taxable person;

b. if that solicitor’s client is a registered fully taxable person, and the supply of legal services is obtained for the purpose of the business, there is entitlement to an input tax credit;

c. the liability of the paying party is one of indemnity only and, accordingly, if the client obtains a credit for input tax in respect of the VAT included in the client’s own solicitor’s bill, the paying party should only pay the costs exclusive of the amount of the tax, unless the arrangements for indemnity provide otherwise (see paragraphs 8 and 9 below);

d. if, on the other hand, the solicitor’s own client is not a registered fully taxable person, and cannot obtain input credit in respect of the VAT included in the client’s own solicitor’s bill, then the paying party is liable to pay the costs and VAT as well;

e. where the solicitor’s client is a partly exempt registered taxable person, sub-paragraph (c) applies only to the extent that the client can obtain credit for input tax and sub-paragraph (d) applies to the balance;

f. under no circumstances should a tax invoice be delivered to the paying party who is not, in law, entitled to receive a credit for input tax as the services have not been rendered to the paying party. The paying party should therefore receive a note of the other party’s costs in such terms that it cannot be mistaken for a tax invoice. This may be done eg by clearly marking the copy of the bill sent to the paying party with the words. “This is not a tax invoice”, or it may be done (if acceptable to the paying party) by issuing a summary of the bill without a VAT registration number and without the tax element identified

Practitioners must remember that the issue of a tax invoice in favour of any person other than the person to whom the solicitor has supplied services is likely to constitute a criminal offence for which the solicitors of both parties could be prosecuted, together, possibly, with their clients.

Costs of employed Solicitors

Where the party whose costs are to be reimbursed has been represented by a solicitor in personal employment, the principles are as follows:

a. Where an employed solicitor is carrying out work for the employer there is no supply subject to VAT because the services of an employee do not attract the tax.

b. Because the employer of the employed solicitor suffers no VAT in respect of legal expenses, there is no occasion for the employer to seek reimbursement of VAT on legal expenses from the paying party. The account of the legal expenses of the party being indemnified should therefore make no mention of VAT and should, for preference, be marked “This is not a tax invoice”. The paying party will therefore pay a sum which, on normal principles, is properly due in respect of the legal costs and disbursements of the party being indemnified, as though value added tax did not exist, save that the employer may have to give credit for input tax on the other disbursements as described in 2 (c) and (e) above (but see 5 below).

c. An in-house solicitor is not always an employed solicitor; occasions may arise on which an in-house solicitor is in effect in the same position as a solicitor in private practice but has a single client in whose premises the practice is conducted. In this type of case, the general principles described in 2 above will apply if the solicitor’s practice is such that the solicitor is registered for VAT. This will be apparent from the existence of a VAT registration number on the bill paper.

d. Sometimes, an employed solicitor is permitted by the terms of employment to conduct what is, in effect, a private practice alongside the regular duties to the employer. Such a situation will arise eg where an employed solicitor is permitted by the employer to act for fellow employees in domestic conveyancing matters, and to charge them a fee for doing so. Should an occasion arise for the reimbursement of the costs of a solicitor acting in this situation, the general principles stated above again apply. In particular, if the fee income of the solicitor from the private practice does not entitle the solicitor to be registered for VAT, no question of VAT on the fees will arise; subject to that consideration, the solicitor’s activities as a private practitioner should be kept quite separate, for VAT purposes, from those which are undertaken as a salaried employee, and the normal rules should be applied. Thus, if the employer allows the employed solicitor to act for a fellow employee in a domestic conveyancing matter, and agrees to reimburse the charge made by the solicitor to the fellow employee, the fact that the paying party is also the solicitor’s employer must be disregarded, subject to 7 below.

Special cases

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