



The Institute of
Legal Finance
& Management

ILFM DIPLOMA - Part Two (D2)

Legal finance compliance & accounts rules

TUTORIAL SEVEN



KNOWLEDGE CONFIDENCE UNDERSTANDING

Legal Finance Compliance & Accounts Rules

Tutorial 7 – Disbursements v Recharges

The aim of this tutorial is to provide you with the knowledge and ability to distinguish between a non-professional disbursement, professional disbursement and a recharge. You may find it useful to consider purchasing a current copy of the ILFM's 'VAT for Legal Professionals' as additional reading for this particular tutorial.

In simple terms, a disbursement is any sum spent, or to be spent, on behalf of the client or trust (including any VAT element). Within the legal industry it is common for any sum which is not fees or VAT to be referred to as a disbursement. This generic use of the term disbursement can make it difficult for you to ascertain what type of disbursement it is, or if in fact it is a true disbursement at all.

It is hoped that this tutorial will help you to unravel the mysteries of the subject.

So what do our regulators say?

For firms regulated by the Solicitors Regulatory Authority, the Glossary defines a disbursement as "any costs or expenses paid or to be paid to a third party on behalf of the *client* or trust (including any VAT element) save for office expenses such as postage and courier fees".

For firms regulated by CILEx Regulation, the code of conduct – (3.1) requires you to be honest in all your dealings and in all financial matters.

Professional Disbursements

It is particularly important that professional disbursements are understood, as regulations exist around this. Professional disbursements are fees of counsel or other lawyers, or of a professional or other agent or expert instructed by the fee earner, to include:

- Interpreters
- Process servers
- Surveyors
- Estate agents etc.

Professional disbursements could be recorded through a purchase ledger system where there are many invoices attributed to a particular supplier. Such a process could enable you, through the assignment of a supplier nominal ledger, to easily distinguish between those professional fees paid and those unpaid.

Counsel's fees

The previous point made in relation to the use of a purchase ledger system can be particularly useful when dealing with counsel's fees. It is not unusual, on matters where counsel have been instructed, for the transaction to span many years. Counsel regularly use proforma invoices (i.e. a written request for payment) and, therefore, will use the same proforma number over multiple dates - all relating to the same matter as additional work is carried out during the life of that matter.



Counsel's clerk will update the original proforma invoice with any further legal advice or attendance – this can create confusion. You could put a system in place which allows you to prefix or suffix the invoice number with a letter to provide an identification process for new entries added to the original proforma.

PROFORMA INVOICE

Logo (press profile) Your company name here
Your company address line1 here
Your company address line2 here
Your company address line3 here
Your ZIP code here
Phone: 12345678 Mobile: 12345678

Number: A000000
Date: 2010/7/27
Page No. 2

Customer Information:

Billing Address:		Shipping Address:	
Company:	Sample customer name 001	Company:	Sample customer name 001
Name:	C0001	Name:	C0001
Address:	Sample address line1 Sample address line2 Sample address line3	Address:	Ship to address line1 Ship to address line2 Ship to address line3

Shipping Method: Courier Services
Currency: Dollar

Order Information:

Qty	Product Description	Amount Each	Amount
1.5	Stock item example description 001	1,000.00	1,500.00
1	Stock item example description 002	2,000.00	2,000.00
2	Service charge invoicing item 001	100.00	200.00
3	Service charge invoicing item 002	200.00	600.00
Additional line 1 for this item			
Additional line 2 for this item			
Subtotal:			4,300.00
Tax:			430.00
Shipping:			0.00
Grand Total:			4,730.00

Notes:
Your self-defined note1 here
Your self-defined note2 here

Additional Information: For contract job ABC etc.

This is what a proforma invoice will typically look like.

This entry will be the original entry relating to the initial instructions provided to Counsel.

Any further work for the same case will be added underneath the original entry. A further 'updated' version of the original proforma would be re-issued to you.

Counsel would typically use the notes section to advise you of the dates that each amended proforma had been re-issued to you.

So to differentiate one part of the invoice from another you could have a system that places a prefix of A, B, C etc. So if the proforma number was 11456, the first proforma received would be 11456A followed by 11456B for the issue of the second proforma, and so on.

Occasionally counsel may amend the amount charged for a previous part of their work and therefore you ought to be meticulous in reviewing the previous proforma entries.

Concession on counsel's fees

A concessionary treatment for counsel's fees paid into and kept in client account was agreed between HMRC, the Bar Council and the Law Society at the time VAT was first introduced and was published in the Gazette on 4th April 1973.

There are two ways in which you may treat counsel's fees:

4.1 Option A

You may treat the fee as your own expense and thus reclaim the VAT element as input tax. When you deliver your own bill of costs to your client, the value of the supply for VAT purposes is the value of your own costs, plus the tax **exclusive** value of counsel's fees.

Example

Assume your professional charges are £1,200 plus £240 VAT (assuming a rate of 20%), and the bill includes incurred unpaid counsel's fees of £800, plus £160 VAT. The £160 VAT on counsel's fee note is treated as your input tax and can be reclaimed by you from HMRC. Your bill should show:

Legal Services	£1,200.00
Counsel's fees	<u>£ 800.00</u>
	£ 2,000.00
VAT @ 20%	<u>£ 400.00</u>
TOTAL	£2,400.00

When the payment of £2,400 is received, the SRA Accounts Rules provide that the sum of £2,400 must be paid into an office account at a bank or building society in England and Wales.

You must have a policy in place that states when you will discharge third party liabilities that you have been paid for. Historically, under the SRA Accounts Rules 2011, a solicitor was required to discharge the third-party liability by the end of the second working day following receipt. It is good practice to continue to use this time frame. Discharging liabilities in a timely fashion is indicator of good financial management.

CILEx Accounts Rules provide that the sum of £2,400 may either:

- be paid into an office account at a bank or building society in England and Wales; by the end of the second working day following receipt, the amount due to counsel should be paid

from the office account, or the net amount of counsels fees being £800 transferred to client account pending payment. In this particular scenario, VAT is office money under the accounts rules and therefore remains in the office account; or

- be split between client account and office account as appropriate, £800 into client account and the remaining £1600 into the office account; or
- be paid into client account with a transfer out of client account of office monies (£1,200 costs and £400 VAT) within 14 days of receipt.

Because counsel's fee is being treated for VAT purposes as an expense of the fee earner and the VAT element is being reclaimed by you, payment, when it is made, must be from office account (so that the appropriate entry can be made in the VAT ledger account).

4.2 Option B

You may treat counsel's advice as supplied directly to your client and the settlement of the fees as a disbursement for VAT purposes. Counsel's VAT invoice (receipted fee note) may be amended by

- inserting on the fee note your client's name and the word 'per' immediately preceding your own name and address; or
- crossing out your name and address and replacing it with the name and address of your client.

The fee note from counsel will then be recognised as a valid VAT invoice in the hands of your client (who can reclaim the VAT if registered) and no VAT record need be kept in your account's ledgers. You should keep a photocopy of the VAT invoice.

Where you consider that the services of counsel, if supplied directly to the client, would be outside the scope of UK VAT, you must **not** certify counsel's fee note to this effect and pay counsel only the fee net of VAT. You may advise counsel that VAT is not due on their services because of the place of belonging of the client. You may provide them with appropriate commercial evidence of the client's place of belonging.

Where the client is in business in other EC Member States, this evidence could be the client's EU VAT registration number, but if no EU VAT number is provided and the client is in business in the EU, counsel should obtain commercial evidence to this effect. A statement from you that the client is in business would not be sufficient. Where the client belongs outside the EU and Isle of Man, counsel should obtain commercial evidence to confirm the place of belonging. Where no evidence of belonging is obtained, counsel should charge VAT on their services.

Example

Assuming the same level of professional charges and counsel's fees as above, your bill should show:

Legal Services	£1,200.00	
VAT @ 20%	<u>£ 240.00</u>	
		<u>£ 1,440.00</u>
Counsel's fees (including VAT)		£ 960.00
TOTAL		£ 2,400.00

VAT and counsel's fees

A fee note issued by a barrister is not normally a VAT invoice, and does not become one until it is paid. The proforma invoice usually states 'This is not a VAT invoice', and then upon receipt of payment the barrister issues a receipted fee note, which should now include the VAT registration number. This process will then allow you to reclaim the VAT paid over to counsel. It would be wise to ensure a system is in place to enable you to clearly identify those proforma's which you have paid out on but have not yet received a receipted invoice in return.



As indicated earlier, so long as the client is given a properly amended receipted fee note they may treat it as a valid VAT invoice. The client must be given the original receipted fee note and NOT a copy.

However, if you alter the fee note so that it is addressed to your client, and input tax credit can be taken by your client, you should keep a photocopy of the VAT invoice, passing the original amended receipted fee note to your client. This is in case the fee note needs to be dealt with on an assessment of costs.

CILEx Accounts Rule 2.1.2 does not permit unpaid professional disbursements to be held in office account. Any unpaid professional disbursements which have been inadvertently paid into office account must be;

- transferred to client account by the end of the second working day following receipt, or
- paid out to the professional who provided you with the supply (i.e. pay the disbursement) by the end of the second working day.

Anticipated disbursements

Some computer systems allow you to record anticipated disbursements (i.e. disbursements which have been incurred but not yet paid). You must be vigilant when using such systems where part payment of an anticipated disbursement takes place. Many systems do not trigger a payment out of office unless the anticipated disbursement has been paid in full. The consequences of this could result in an office in credit balance being masked as payment is not subsequently made within the appropriate time frame (by the end of the second working day following receipt).

Needless to say, if you receive client money on account of disbursements, such as counsel's fees which have not yet been incurred or paid, then this should be paid into client account.

If you choose to send out to the client your bill of costs which includes incurred counsel's fees which have not yet been paid and the client subsequently pays the full value of your bill, under the SRA Accounts Rules you pay the full amount into office account and discharge the counsel fee proforma from office account in accordance with time frame set within your accounts policy i.e. the same day or the next working day.

Under CILEx Accounts Rules, you either;

- pay the full amount into client account and transfer the profit costs and VAT element within 14 calendar days, or
- pay the full amount into office account and discharge the counsel fee proforma from office account that same day or the next working day, or
- pay the full amount into office account and transfer the element that relates to net counsel's fee into client account.

The requirement to transfer costs out of client account within a set period of time is intended to prevent costs being left in client account to conceal a shortage on a client account elsewhere.

Non-professional disbursements

Non-professional disbursements relate to payments which are incurred whilst acting on behalf of your client in relation to the progression of a legal transaction. You can include these disbursements on a bill of costs as long as they have been properly incurred. As with professional disbursements, these disbursements should also be described on the bill as unpaid where appropriate.

Below is a sample of some non-professional disbursements;

- companies' house search fee
- court fees
- coal mining search
- land registry

- stamp duty fees

It would be wise to have a policy in place which encourages you to receive money on account of fees and disbursements prior to incurring any liabilities on a file. This can aid cashflow as well as reduce any debt recovery work your firm will need to undertake after the matter has been concluded.

Money received on account of specific liabilities, such as a land registry fee or stamp duty land tax (SDLT) fee, is client money and therefore should be held in client account. It is standard practice, as the money is in client account, to pay either of these disbursements straight from client account.

Whilst it is possible to pay these disbursements from office account this is only usually done where a shortfall of the entire fee exists. For example, if the land registry fee is £90 and you only have £80 in client account. It would be common practice to withdraw the £90 from office and then perform a client to office transfer for the £80 held in client account. You would subsequently write to the client for the remaining £10 which remains outstanding in office account.

It is common for land registry fees to be paid by direct debit out of office account. It is permissible for the direct debit to be set up against client account. However, you are not directly in control of direct debit payments and, therefore, this could put you at risk of an overdrawn client balance if anything went wrong.

Disbursements incurred by way of a credit account, such as land registry fees or companies house fees, become office money at the point the liability has been incurred/spent **and** included on a bill or other written notifications of costs sent to the client. So, although the direct debit may not have been debited from your bank account, because it has been put onto your credit account for that organisation, you can transfer this payment over to office account once you have issued the client with a bill or other written notification of costs for the same. Theoretically on the day of requesting a search you could post this to the ledger. If you had funds in client account and you had sent the client a bill, you could then transfer sufficient money from client to office to cover the search fee.

As mentioned in earlier tutorials, the above scenario is an exception to the accounts rules which permits office account to be in credit. There is little appetite for applying this exemption for a number of reasons but not least because it dilutes the value of running an exception report which would allow you to identify office in credit balances.

Money which is received for disbursements that have already been paid from office account is office money once you have issued a bill of costs or other written notification of costs to the client.

If a client pays their bill by credit or debit card, or using the bank details provided on the reverse of their bill, then you would need to consider;

- It would be reasonable to say that a misdirected electronic payment, assuming the correct bank account details had been given and robust systems are in place, would not result in a breach where client money is inadvertently paid into office account. Needless to say, this ought to be rectified on the same day the payment has been received. Many large organisations retain the original bank details and, therefore, if your original account number related to your office account, despite advising them that the next payment must be made into your client account, all future payments are defaulted into your office account.

Principal and Agency method

In the principal method you are treating the third party supply as having been received by you and supplied by you to the client. Therefore, you should process the cost of this by splitting the net cost and re-claiming the VAT. You would then re-charge this onto the client in the same way.

[illegible][illegible]

 DRAPER LAW Suite 404, 100 Canada Place Vancouver, British Columbia V6C 2A6 Canada	Invoice # 6 - 03/09/2009 INVOICE Invoice # 6 Date: 04/09/2009 Due On: 04/08/2009
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Simplifile Client

315 Bachelors Street
Etobicoke, ON L2B 4G6
United States

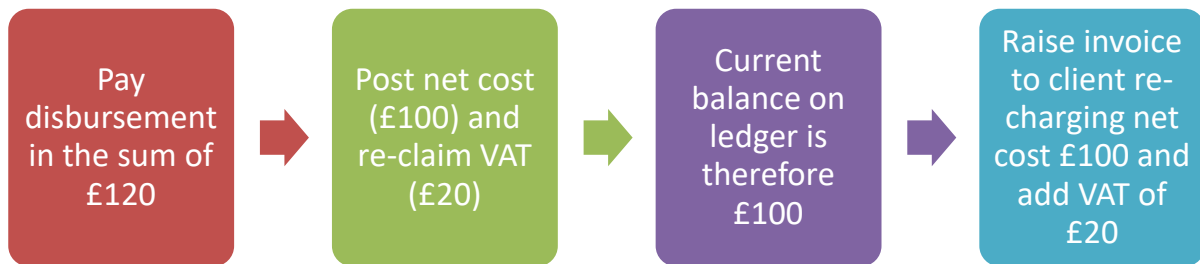
01029-Client

Bankruptcy

Attorney	Date	Description	Quantity
JN	03/09/2009	Called Client	2.0
JN	03/09/2009	Reimbursable expense: Photocopies	2.0
JN	03/01/2010	Affirmed Court	5.0
JN	04/10/2010	Cat Case	1.0
JN	04/21/2010	Prepays Pleadings	1.0
JN	07/28/2010	New Line Item: Testing adding a new line item.	1.0
			Total
			\$895.00
			Payment (01/21/2010)
			\$ -64.00
			Balance Owing
			\$791.00

Detailed Statement of Account

(Other Invoices)



The third party invoice should be addressed to your firm (and not the client) otherwise you cannot reclaim the VAT element. The firm may then treat the payment as though it had been the VAT registered organisation who received the goods or services. The fee earner accordingly re-claims the VAT as input tax. The fee earner would then include the disbursement onto their bill to the client showing the split between the net amount and the VAT. This then becomes part of the firm's output tax for their overall bill. The original invoice from the third party should be held with the accounting records for evidence.

Example: John, a fee earner, instructs Jim Smith, a Surveyor, to inspect a property on behalf of his client, Fiona Jones. Jim Smith does this and sends a bill for £80 plus VAT. John pays this using the principal method, and then bills Fiona with Profit Costs of £200.

Office Cash Book

		Office		
Date	Details	Debit	Credit	Balance
June 10	Jim Smith Survey Fee		80.00	80.00CR
June 10	VAT thereon		16.00	96.00CR

Fiona Jones - 76 Highfields

		Office			Client		
Date	Details	Debit	Credit	Balance	Debit	Credit	Balance
June 10	Jim Smith Survey Fee	80.00		80.00DR			
June 20	Invoice	200.00		280.00DR			
June 20	VAT	56.00		336.00DR			

Sales Day Book

Date	Client/Customer	Invoice Number	Gross Total	VAT	Net
June 20	Jones Invoice	M001	336.00	56.00	280.00
			336.00	56.00	280.00

VAT Input

Date	Details	Debit	Credit	Balance
June 10	Jim Smith Survey Fee	16.00		16.00DR

General Ledger – not required for exam, provided for information purposes only.

Office Bank

Date	Details	Debit	Credit	Balance
June 10	OCB		96.00	96.00CR

Unbilled Disbursements

Date	Details	Debit	Credit	Balance
June 10	OCB	80.00		80.00DR
June 20	SDB		80.00	0.00

Input Vat

Date	Details	Debit	Credit	Balance
June 10	OCB	16.00		16.00DR

Sales Ledger Control Account

Date	Details	Debit	Credit	Balance
June 20	SDB	336.00		336.00DR

Output Vat

Date	Details	Debit	Credit	Balance
June 20	SDB		56.00	56.00CR

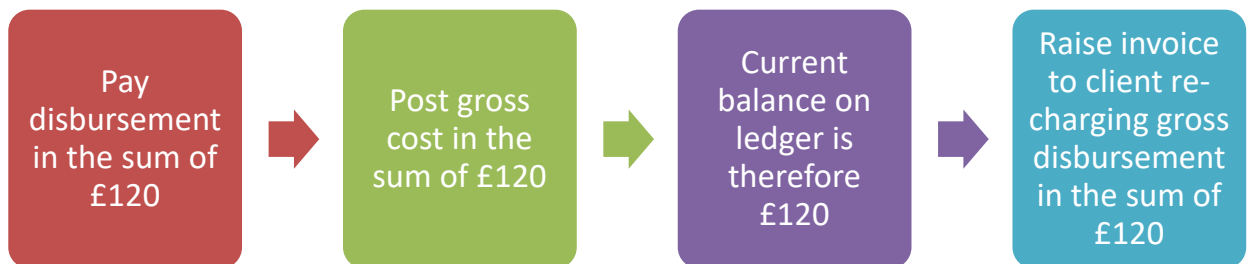
Sales/Fees Delivered

Date	Details	Debit	Credit	Balance
June 20	SDB		200.00	200.00CR

Agency method

When using the agency method you are treating the supply as if your client has received it. Therefore you should treat the charge as gross (do not split the net and VAT element) when processing it through your accounts. You then charge it on to the client in the same way, as a gross payment.

In essence, the fee earner will treat the payment as though they were the agent of the client and, therefore, it is a VAT inclusive amount (assuming the disbursement included vat in the first place!). The fee earner must not claim the VAT as input tax and does not take the VAT into account as output tax on the invoice to the client. For payments dealt with in this manner the fee earner must keep records to show his ability to do so.



Example: John, a fee earner, instructs Jim Smith, a surveyor, to inspect a property on behalf of his client Fiona Jones. Jim Smith does this and sends a bill for £80 plus VAT. John pays this out of office account on behalf of Fiona.

Office Cash Book

		Office		
Date	Details	Debit	Credit	Balance
June 10	Jim Smith Survey Fee		96.00	96.00CR

Fiona Jones - 76 Highfields

		Office			Client		
Date	Details	Debit	Credit	Balance	Debit	Credit	Balance
June 10	Jim Smith Survey Fee	96.00		96.00DR			
June 20	Invoice	200.00		296.00DR			
June 20	VAT	40.00		336.00DR			

Sales Day Book

Date	Client/Customer	Invoice Number	Gross Total	VAT	Net
June 20	Jones Invoice	M001	336.00	40.00	296.00
			336.00	40.00	296.00

Note the differences from the principal method shown above:

1. The amount of £96 is not split in the office cashbook and this is the amount shown on the client's ledger being inclusive of VAT on the date it was paid out.
2. The output VAT charged to the client is reduced, it does not include any VAT charge for the disbursement.
3. The Sales Day Book includes the total disbursement amount in the net value.

Input VAT may only be claimed by the person to whom the invoice is addressed to. There is one exception to this which has already been covered under counsel fees.

General Ledger – not required for exam, provided for information purposes only.

Office Bank

Date	Details	Debit	Credit	Balance
June 10	OCB		96.00	96.00CR

Unbilled Disbursements

Date	Details	Debit	Credit	Balance
June 10	OCB	96.00		96.00DR
June 20	SDB		96.00	0.00

Sales Ledger Control Account

Date	Details	Debit	Credit	Balance
June 20	SDB	336.00		336.00DR

Output Vat

Date	Details	Debit	Credit	Balance
June 20	SDB		40.00	40.00CR

Sales/Fees Delivered

Date	Details	Debit	Credit	Balance
June 20	SDB		200.00	200.00CR

Disbursements v recharges

A fee earner, in the course of acting for his client, is often required to pay for goods and/or services supplied by others. How these costs are passed onto the client has always caused confusion within the profession, especially when it comes to charging VAT.



As indicated in the opening paragraphs of this tutorial, it is common practice for all payments incurred in the course of acting for your client to be referred to as a 'disbursement'. Some firms do make a distinction between disbursements and expenses (an older more traditional name for recharges) although few actually get it 100% right.

Broadly speaking this terminology is not incorrect - as the definition of the word 'disbursement' is defined in the Oxford dictionary as 'to pay out'. However, from a regulator and HMRC (VAT) point of view the word disbursement has a very specific meaning.

The SRA AR defines a disbursement as;

"means any costs or expenses paid or to be paid to a third party on behalf of the client or trust (including any VAT element) save for office expenses such as postage and courier fees".

In other words you simply act as an agent by making payment *on behalf of* your client. It is the client that has received and used the third party supply/goods and **not** your firm. The

suppliers invoice should have been addressed to your client and in the instance where it has not, you should insist the supplier re-issues the invoice in the name and address of your client.

Now ignoring the regulatory requirements of where or how it should be listed on an invoice we come to HMRC's criteria!

HMRC have a very specific definition of a disbursement and this could affect whether you charge VAT or not.

The VAT guide – Notice 700 section 25.1 states that you may only treat a payment to a third party as a disbursement for VAT purposes if;



- a) you acted as an agent for your client when you paid the third party; and
- b) your client actually received the goods or services provided by the third party; and
- c) your client was responsible for paying the third party; and
- d) your client authorised you to make the payment on his behalf; and
- e) your client knew that the goods or services for which you paid would be provided by the third party; and
- f) your goods and services are separately itemised when you invoice your client; and
- g) you recover only the exact amount which you paid to the third party; and
- h) the goods or services for which you paid are clearly additional to the supplies which you yourself make to your client.

Again, if a fee earner purchases something in their capacity as an agent for the client they must only pay for this on behalf of their client - the client **must** be the person who receives the goods or services. The fee earner is, therefore, only acting as the middleman. An example of a disbursement for HMRC purposes would be patent fees, stamp duty or court fees.

If all of the criteria as set out in Notice 700 section 25.1 has been met, you may treat your payment as a 'disbursement'. Where these are included on the invoice to your client, you must itemise these types of payment under a disbursement header. You should also indicate whether or not the payment has been made at the time of the invoice being issued in accordance with the accounts rules (i.e. unpaid).

So now we have established what a true disbursement is for VAT purposes - what are our options?

Well there are two options and if the charge is a true disbursement, you can use either the principal or agency method. These were detailed above and are also outlined in more detail in VAT notice 700 section 23.1.

In the ILFM's opinion, best practice would be to use the principal method where your client is VAT registered (as this enables your client to re-claim the VAT) and then the agency method in all other situations.

Recharges

Any costs (overheads) that your business incurs itself in the course of supplying goods or services to clients are **not disbursements** for VAT purposes. These are likely to be incidental costs which a fee earner will incur during the life of a transaction which you may, or may not, choose to recharge onto your client. It's you, and not your client, who purchased or used the goods or services in order to *better* provide your own service to your client.

Typically these tend to be travelling expenses, postage costs, conference calls etc. These aren't normally treated as disbursements for VAT purposes. In these circumstances the third party supply is provided and used by you and/or your business. Such expenses may or may not be vat-able. The original status of the supply does not determine the vat-able status upon recharging.

It's up to you whether or not you choose to itemise these additional costs separately from your profit costs. If you do show them separately when you invoice your clients then these are known as 'recharges' (and not disbursements for VAT purposes). You must charge VAT on them whether or not you paid any VAT or not to the original supplier. These now form part of your overall legal supply to your client.

Example; the special delivery service provided by Royal Mail is exempt from VAT where it is being supplied to you or your business. Assume this has cost £15 and you wish to recharge this onto your client. Despite the fact it cost you £15; when recharging this onto your client you would need to charge a further £3 = £18.

Unfortunately, it's not always straightforward when it comes to drawing up a list of what are recharges and what are disbursements. This is mainly due to the fact some payments can be either. The ILFM always advise before you determine whether or not a payment is a disbursement or a recharge, you must ascertain the circumstances in which the payment was incurred and more importantly, who received and used the third party supply.

VAT Notice 700 Section 25.5 says:

"If you obtain a fiche or hard copy of data from a source such as Companies House, the item you obtain should be regarded as a piece of information rather than a tangible object. When you recharge the search fee to your customer, you may treat it as a disbursement and outside the scope of VAT, provided you pass on the information without analysis or comment, and all the conditions outlined in 25.1.1 are met".

It is worth noting that there is a concession for Local Authority Search fees where they have been carried out as a postal search, a fee earner may treat this as a disbursement regardless of whether he uses it to advise his client or not.

Some examples of payments which could be either:

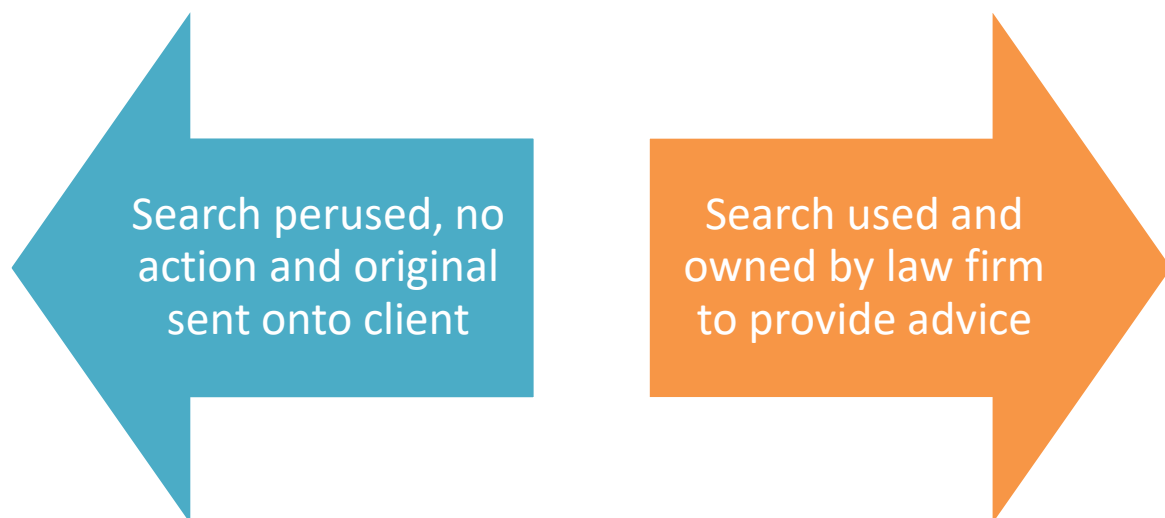
Train fares which are used by the fee earner to attend or represent their client ought to be treated as a recharge (assuming this has not already been absorbed in the fee earner's hourly

rate). It is the fee earner of the firm who has used the services of the rail company, in order to fulfil their service to the client. In contrast, if the fee earner had purchased two train tickets, one for the client and one for themselves, the client's train ticket would be a disbursement and the fee earners train ticket would be a recharge.

Search fees can also be treated as either a disbursement or a recharge depending on the circumstances in which they were incurred.

A recharge could occur where a fee earner pays for various online property searches (invoice is in firm's name) and discovers there are adverse entries within the results and the report belongs to the firm. Where the searches have VAT added onto their net value, the fee earner would process this through the office side of their accounts (claiming the input VAT). As you have adopted the principal method you would then recharge this onto the client in the same way (breaking up the NET and output VAT) as a recharge.

If the searches did not have VAT included in the invoice to you - you would process these through the office side of your accounts as a vatable supply and would then have to charge VAT on top of the searches.



However, if the fee earner simply had a cursory look at the search results and the third party supplier invoice is addressed to the client (and is owned by the client) the fee earner may treat the payment as a disbursement for VAT purposes. As a matter of practice, the fee earner should also send the original search results (as it is owned by the client) and copy of the supplier invoice directly to the client.

When using an online search provider, it is worth noting, there may also be an admin fee and in the instance when the search is obtained via NLIS channel provider, there may also be a hub fee. In this scenario, the search provider's supply is to the firm and *not* the client and this element of the search fee must always be treated as a recharge regardless of whether the actual search fee qualifies to be a disbursement for VAT purposes.

Medical records/reports can also be treated as either depending on the circumstances in which they were incurred.

In the recent tribunal case of the Commissioners of HMRC V Barratt, Goff and Tomlinson (BGT), the decision was made that medical reports may be treated as a disbursement for VAT purposes on the basis that BGT argued that obtaining and providing them to the client, and its own perusal of them to determine the legal position, were two separate acts. This was strongly supported by the fact that the documents remain the property of the client. Should a client wish to disengage a firm and take their custom elsewhere, they take the bundle of evidence with them.

The Law Society advise in order to treat payments that HMRC in the past have considered to be recharges as disbursements, the following conditions must be met:-



- a) Your client should have either requested that you obtain the service on their behalf or authorised you to do so; and
- b) In the case of a report or a search result, the final report should be sent to your client either by you or the supplier. You can retain a copy; and
- c) The amount you charge your client should be exactly the same as the amount charged to you by the supplier; and
- d) The expense should be separately itemised on the invoice you send to your client; and
- e) The supplier should be aware that the service is being provided to a third party, i.e. your client.

To comply with (b) you should give the original report to your client. Where this is not possible, for example the original search report must be provided to a mortgage provider or an original medical report must be available to the court in a personal injury action, you just give a copy of the report to your client.

To comply with (e) you should tell the supplier the identity of your client. Where your client does not wish their identity to be revealed or the process involved (such as electronic form submission) does not enable your client's identity to be communicated to the supplier, you should provide the supplier with some identifying feature such as a client and/or file reference number.

Many firms now use **medical reporting agencies** to obtain health records and/or medical reports. These medical reporting agencies commonly charge a global fee for their services and do not set out separately the element of the fee that is charged by the medical expert they instruct. The medical reporting agencies normally charge VAT at the standard rate on the entire fee. It is unlikely that these fees can be treated as a disbursement since the medical agency is acting on your behalf to co-ordinate obtaining the medical records and any medico legal report. Their supply will have been received and used by the firm and not the client and the medico legal report should be treated as a recharge.

Electronic payments are regularly used by legal entities to facilitate the provision of legal services. This could range from sending the purchase price for a property to another legal practice or it could form part of the distribution of an estate.



The firm may instigate the electronic payment, either through the completion of a hard copy form which is subsequently handed to the bank, or it could use the bank's on line website to send a transfer on behalf of their client. The bank will subsequently charge the firm for the use of its



banking services.

When charging the bank transfer fee onto the client, the fee earner must charge VAT on top (regardless of whether they charge the actual fee the bank has charged or if a 'mark-up' is incorporated). These must be itemised as a recharge and not a disbursement. Further information on this can be found by downloading from The ILFM's website a copy of the 'Billing Guide'.

If a fee earner pays for a train or taxi fare and recharges it onto the client, again it is the fee earner who has used the service of the train or taxi, not the client and it therefore does not qualify as a disbursement. The firm must charge VAT on top of the original cost and itemise it as a recharge on their invoice to the client.

Other examples of payments that could be a recharge:

- Postage and courier fees
- All travel expenses
- Hotel expenses
- Fax and telephone charges
- Conference calls

Remember, where a payment is a recharge and the fee earner does not have a valid VAT invoice from the supplier, they will not be able to claim the input VAT. You would need to post the entry onto the client's ledger gross (inclusive of VAT). The firm must still continue to charge VAT on top of the gross amount, in the same way as you would if there hadn't been VAT (because you can't prove there was VAT in the first place - otherwise you would have been able to claim it!). Valid VAT invoices must be obtained.

This is why you would not (assuming you have an appropriate VAT invoice) post a recharge as gross through the office side of your client's ledger as it results in the client being charged VAT twice – this is not in the client's best interest.

Tutorial 7

Self-Test Questions

1. What is a disbursement?
2. Are Estate Agent's fees professional disbursements?
3. What is meant by the term agency method of VAT?
4. Give 4 examples of recharges?

Tutorial 7

Answers to Self-Test Questions

1. Disbursements are sums spent or to be spent on behalf of the client or trust (including any VAT element).
2. Yes, if the estate agents were instructed by the fee earner.
3. The fee earner deals with the invoice gross. The fee earner does not claim the VAT as input tax and does not treat the VAT as output tax on the invoice to the client.
4. Postage and courier fees
All travel expenses
Hotel expenses
Fax and telephone charges
Conference calls

Tutorial 7

Assignment

1. Evelyn instructs the firm to deal with her late mother's estate, Mrs Joy Sprigg deceased. Record the following transactions:
 - May 6 Proceeds received from the auctioneer on the sale of Mrs Sprigg's personal assets amounting to £2,630.00.
 - May 7 Paid funeral expenses of £1,140.00.
 - May 10 Paid Accountant £200.00 (plus VAT) for final tax settlement. Invoice addressed to the client.
 - May 10 Paid by cheque £50.00 (plus VAT) for statutory notice. Invoice addressed to the client.
 - May 21 Issued invoice for work done £400.00 (plus VAT).
 - May 27 Paid Legacy to Justin £500.00 by cheque.
 - May 28 Transferred costs from money held in client account. Paid balance to Evelyn by cheque.
2. What is the difference between the Agency and Principal treatment of Vatable disbursements?
3. Record the following transactions in the appropriate books of the account of Settle and Co:

Where allowable use the principal method on vatable disbursements.

	Office columns	Client columns
May 2 Balances brought forward:		
Ralph	136.00DR	5,000.00CR
William	555.00DR	1,600.00CR
Cash Book	741.00CR	6,600.00DR
Petty Cash	50.00DR	

The office balances for Ralph and William are unpaid bills not yet settled by the client.

- May 3 Received a cheque from Jay on account of work to be undertaken on his behalf in connection with a breach of contract for £500.00.

Paid petty cash £15.00 (inclusive of VAT) for advertising in the local paper for the matter of William, the newspaper invoice is addressed to William.

- May 4 Ralph instructs the firm to transfer the amount owing to the firm from the funds held on his behalf. The transfer was completed on the same day.
- May 7 Ruth instructs the firm to deal with a motor accident claim.
- May 8 Ruth requests the firm obtain copies of road plans in respect of her accident from the local council, paying £2.00 from petty cash. These plans are passed to Ruth without comment from the fee earner.
- May 10 Paid agent's fees to Grouse & Co who have been instructed by the firm for the matter of William. Their invoice is for £200 (plus VAT) and is addressed to the firm. Paid £150 (plus VAT) to P J Engineering for an engineer's report on the condition of Ruth's car. The invoice is addressed to the firm.
- May 12 Work on William's affairs is now complete and the firm issues an invoice for profit costs of £500.00 plus any disbursements that have been incurred (plus VAT).
- May 13 Paid agent's fees to D S Law who has been instructed by the firm for the matter of Jay. Their invoice is for £600.00 (plus VAT) and is addressed to the firm.
- May 17 Received a cheque for £15,000.00 being compensation due to Jay.
- May 18 Sent invoice to Jay, profit costs of £350 and any disbursements incurred (plus VAT).
- May 23 Transferred costs for William and Jay from client account to office account. William asks for the balance held to be sent to him. Jay asks for the balance held to be sent to him.
- May 30 Ruth's matter is completed and the firm invoices Ruth, profit costs of £150 and any disbursements incurred (plus VAT).