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Legal Bulletin

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LAW SOCIETY GUIDANCE ON VAT TREATMENT OF DISBURSEMENTS AND EXPENSES

The Law Society has issued new guidance on the VAT treatment of disbursements and expenses.
https://www.lawsociety.org.uk/support-services/advice/articles/vat-treatment-of-disbursements-and-expenses/

The guide not only sets out the likely VAT treatment of several types of searches, but also makes a number of key points:

- You will often need to add VAT when passing disbursements on to your client, even where you are not charged VAT by the disbursement provider. VAT will normally need to be charged whenever you use a report or a search to advise your client. This is because HMRC might argue this to be part of your legal service.
- Your clients will only benefit from VAT disbursement treatment where each of the following conditions are met:
  1. The client is not VAT registered (or cannot recover in full the VAT they are charged),
  2. The disbursement is of a type eligible for VAT disbursement treatment, and
  3. The third party provider of the disbursement does not charge VAT.
- Where there is uncertainty as to whether VAT disbursement treatment can validly be used, you should weigh up the potential costs and benefits. If HMRC successfully challenge your firm, you will have to bear the cost of the VAT, interest and penalties.
- The Law Society's view is that **firms should be charging VAT on land registry search fees, and also adding VAT to charges for office copy documents.** Only registration application fees will qualify for VAT disbursement treatment.

This advice is contrary to an agreement with HMRC September 1994 which allowed OCEs to be passed on without adding VAT.

The guidance note is not mandatory, but the Law Society anticipates many firms "will want to take a conservative approach to classifying items as disbursements in going forward". They note that "in many cases we think that is likely to be a sensible approach."

New Accounts Rules: Client's own accounts

We have known for a while now that client's own accounts operated as Court of Protection Deputy, or as donee of power of attorney, will from 25 November 2019 become "subject to reconciliations".

Barely one month away from the introduction of the new Accounts Rules, we are still waiting for more advice in this area. The SRA promise that guidance will be forthcoming, but this "may not be finalised by 25 November 2019." In the meantime what should firms be doing to prepare for the change? Here are our responses to some commonly asked questions.

Which accounts should we include?

In the absence of detailed guidance, our view is that firms should include all accounts from which cash can be withdrawn without notice, and exclude all accounts that are types of investment.

We believe that the new rules are intended to catch no-notice accounts, rather than money which cannot easily be accessed. Until more detail is known, firms can validly set their own definitions and boundaries as to what should and shouldn't be included. We would suggest:

Include	Exclude
Instant access accounts	Term deposits, savings bonds
Cash ISAs	Stocks and shares ISA
NS&I no-notice accounts	NS&I premium bonds, savings certificates
	Cash held by investment fund managers

What about accounts I can operate jointly?

We believe that if you operate a client's own account jointly (either with the client, or with someone else), that account will not be subject to reconciliations. In our opinion, the "joint" status of the account takes precedence over who the account might originally have been intended for.

Normally those named on a joint account have equal access to it. It might be argued that if you are the only person who in practice can operate the account, you should include it in the reconciliation system. We appreciate this can be a grey area, but suggest that all accounts on which you are named as joint operator should be treated as joint accounts.

You are still advised to keep a register of these accounts and must under rule 9.1 obtain statements at least once every five weeks.

Do I need a cashbook and ledger card?

There is no explicit requirement, but if you don't maintain either, what will you reconcile your bank statement or building society balances to?

Your cashbook and ledger cards can be prepared manually (outside of any computerised accounting system) or via your computer system. Software suppliers might at some point offer better functionality. Balances on all relevant accounts will need to be introduced on 25 November 2019.

We see no harm in using a "deposit ledger" column to record transactions on client's own accounts, but if your firm also maintains any Separate Designated Client Accounts, you will need to ensure you can distinguish between these and any client's own accounts. This is because client's own accounts are not "client accounts".

How often do I need to obtain statements or update passbooks?

At least once every five weeks. At present no concessions are apparent. If you are unable to obtain statements or update passbooks with that frequency, you are likely to find yourself in breach of the Rules.

Do I need a separate reconciliation for each account? Do I need to show all accounts on an overall reconciliation?

The Ethics guidance, "Helping you keep accurate client accounting records" (issued 4 July 2019), uses the plural throughout, referring to "reconciliations of accounts" and the production of "formal statements".

Having said that, the answer as to whether a single summary or individual reconciliations are needed depends on how many accounts you are operating, and how you operate them (manually or via the computer). Again, to an extent you are free to design your own systems and procedures.

Our advice is that a single, overall reconciliation is likely to be desirable, so that the COFA has an awareness of the aggregate total of client money controlled by the firm at each month end, and whether that money is held in a client account (general or separately designated) or a client's own account.

In practice if you operate a handful of client's own accounts, you will probably be able to squeeze each of these into the single page summary most firms prepare at present. If you operate tens or even hundreds of accounts, the summary page would be clearer if it cross-refers to a separate summaries which themselves aggregate account balances for different types of account where "client money subject to reconciliations" is held.

The Ethics guidance anticipates firms should be able to produce lists of all general client accounts, separate designated client accounts, third party managed accounts, clients own accounts or joint accounts operated by you, and business accounts. These lists should show the current status of each account and include any closed during the accounting period. We will ask you for a list of these accounts before or at the start of our next visit.

Banking facilities

The prohibition on providing banking facilities to clients remains a major topic for the SRA.

We understand more case studies are on the way – watch this space for more details.

New Accounts Rules: To bill or not to bill?

The New Rule 4.3 requires firms who want to settle their "costs" from money held in client account to first give the client a bill or other written notification. Previously this requirement applied only to "fees".

This subtle change has caused some controversy. Should firms be raising a bill every time they want to take money from client account for a disbursement?

The answer is perhaps more complicated than had been intended.

In one respect there is no requirement to raise a formal bill. You could instead send the client an email, or even a text message to tell them you are taking the cash.

However, withdrawing cash in respect of a disbursement for which you would be expected to charge VAT will create a tax point. If you take the money before raising a VAT invoice, you will need some method of accounting to HMRC.

Unless you are taking money for disbursements you don't need to charge VAT on, our advice is that you either raise formal bills each time you take disbursements, or wait for your money until you are next ready to bill.

When is a rule not a rule?

The answer is when it is a "Prescribed Statement".

The SRA have released a statement setting out what firms must do when donating residual balances after 25 November 2019:

https://www.sra.org.uk/solicitors/standards-regulations/withdraw-client-money/

Happily the requirements will already be familiar as they are the same as apply at present. Firms will need prior SRA permission before they can donate any balances of more than £500.

The statement is "mandatory", and therefore has the same status as a Rule. We suspect it has been issued as a "Prescribed Statement" to allow it to be amended at some point in the future, without the need for a detailed consultation or Legal Services Board approval.

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