

VAT UPDATE: Property searches & similar disbursements Brabners LLP vs HMRC [First Tier Tribunal] - what happens now?

In a recent VAT case, [Brabners v HMRC](#), a North West firm of lawyers were supported by the Law Society in an unsuccessful appeal against an HMRC assessment for output VAT on electronic property searches charged to clients as disbursements without any VAT being added. A Law Society Gazette [article](#) comments further on this.

The case primarily rested on whether such electronic search fees were properly disbursements for VAT purposes or instead were part of the service being supplied by the law firm.

We don't know whether Brabners LLP will appeal this decision but the Law Society have indicated that they will be considering the implications of the decision and updating their [practice note](#) on disbursements. So it's a "watch this space" warning as we are sure not to have heard the last of it.

In the meantime, what is the potential impact on your firm and what steps should you be considering now?

Any Input Tax offset?

Firstly, it appears that Brabners were not being charged any input VAT on the electronic searches which they usually obtained through Searchflow. As a result of that, they had no input tax to offset HMRC's claim for output tax on the "sale".

In our experience, for some time, many electronic search fees have been charged to law firms "plus VAT". If you are in the situation where for many years all of your searches have had input VAT added to what you are charged, you record the gross cost as a disbursement and then charge your client the gross cost without accounting for any VAT, then even if HMRC do claim you should account to them for output VAT on your charges to your clients, you would have an equal claim to input tax to offset that. Thus in theory no net financial liability.

However where this more common approach is adopted, it would be beneficial to make clear on the bill to the client the amount of the disbursement is the gross amount i.e. where applicable inclusive of VAT.

If you currently are charged input VAT but recover it on your VAT return and only treat the net amount as a disbursement then you should already be charging and accounting to HMRC for output VAT when you pass that charge on to your client.

What are Disbursements for VAT purposes?

HMRC successfully argued that such items can only be treated as a disbursement with no VAT charged on them by the law firm if it satisfies the 8 'disbursement conditions' in VAT Notice 700 Paragraph 25.1, being;

- You acted as the agent of your client when you paid the third party
- Your client actually received and used the goods or services provided by the third party (this condition usually prevents the agent's own travelling and subsistence expenses, phone bills, postage, and other costs being treated as disbursements for VAT purposes)
- Your client was responsible for paying the third party (examples include SDLT or other taxes, most court fees and Land Registry fees which are actually payable by your client for the purposes of their transaction, contract or legal action)
- Your client authorised you to make the payment on their behalf
- Your client knew that the goods or services you paid for would be provided by a third party
- Your outlay will be separately itemised when you invoice your client
- You recover only the exact amount which you paid to the third party

- The goods or services, which you paid for, are clearly additional to the supplies which you make to your client on your own account.

There are some exceptions to the standard position above including;

- There is a concession on postal property searches which would still appear to apply although few postal searches are undertaken these days.
- There are also concessions on counsel's fees and on most medical examination fees.

We can advise on these if you are unsure of the position.

Are search fees incurred merely as agent or as part of your service?

In the Brabners case HMRC contended, and it was upheld, that when clients engage a lawyer in property transactional work the solicitor is not "simply a conduit or post-box for search results". The client has an expectation that the lawyer will use their knowledge and experience to obtain such searches as are reasonably required and use the results of such searches to advise their client on any issues arising. In such cases the cost of the searches is part of the service being provided and thus not a disbursement for VAT purposes.

Payments direct from the client bank account

If the decision on the Brabners case stands, that search fees are not disbursements but part of the firm's service, does this change the fact that such amounts can be paid direct from funds held on the client bank account for the client? This would appear to be the position under the SRA Accounts Rules 2011 and would require some thought into changing the related systems and procedures to ensure payments are made from a firm's office bank account, etc.

Does it make a difference whether searches are made by post or electronic?

Although there may not be any apparent difference in principle or practice between how postal and electronic searches are utilised or otherwise by law firms, there does exist a long-standing concession granted by HMRC that does allow postal search recharges to be treated as disbursements.

This is actually reflected in the current Law Society guidelines (although these themselves are not formally agreed with HMRC). One of Brabners arguments was that this concession applying to postal searches should equally be applied to electronic searches. That argument may still run further in that the Tribunal indicated that such matter was outside the case they were considering and would be outside their jurisdiction. This might be the basis for some further appeal. See the actual case for details.

Does this only affect property searches?

Whilst this case related to property searches, unless there is a specific concession, the general disbursement rules for VAT treatment apply to all other disbursements. Therefore other items generally treated as disbursements such as locators fees or credit checks should also be considered.

What should you do now?

1. Ascertain what searches or similar you are obtaining on which you are not charged VAT. Do they quantify to a significant value per annum as that gives an indication of your possible exposure?
2. Review your procedures for accounting for such costs and VAT thereon. We would expect that where you are charged VAT and recover that as input tax then you should only be treating the net as a disbursement and should generally be applying output VAT when you charge it to your client.

As indicated above, if you are charged VAT but do not recover the input tax, treat the gross as a disbursement and then charge on the gross disbursement, making it clear it is the gross amount in the bill, your financial exposure should be minimal even if challenged by HMRC.

3. If the postal search concession does not apply then from the Brabners case, and subject to any appeal or new Law Society guidance, it would appear that you should be charging output tax on any disbursements for property, people locators, solicitor or bank searches/ checks or similar where they are used as part of the service or advice you give to your client. If you are to treat these as taxable supplies then you would be entitled to recover any input tax charged to you. Then input tax = output tax and no net cost to you or your client.
4. Watch the Law Society website and other services for further developments on this.