

Disbursements – practical tips

(Lecture B1145 – 12.34 minutes)

What is a disbursement?

The basic principle to consider is whether a charge to a customer relates to a recharge of the supplier's own expenses (e.g. his motor and travel costs) or is a cost that belongs to the customer i.e. a disbursement.

To give an easy example, when a solicitor deals with a house purchase on behalf of a client, he will often pay for expenses that belong to the client e.g. local authority search fees, Stamp Duty Land Tax, land registry fees. These expenses will eventually be paid for by the house buyer so they are clearly the buyer's expenses and not the solicitors. As long as the solicitor adopts certain procedures on his sales invoices, these disbursements will not be subject to VAT.

However, if a consultant based in Scotland does some work for a client in London, and the client agrees to pay her train fare, mileage expenses or hotel accommodation, this is not a disbursement situation – it is effectively an increase in her standard rated consultancy fee to cover her out of pocket expenses.

Key point – a recharge of expenses will follow the same VAT liability as the work being carried out i.e. standard rated in this case but outside the scope of VAT if her work had been for an overseas based customer (general B2B rule – place of supply is customer's country).

Example - architect charging expenses

Jane is an architect based in Manchester and she is registered for VAT as a sole trader. She is working on a property development in London and her client has agreed to pay for her rail travel, accommodation and photocopying costs as well as £30 per month for her telephone costs.

When Jane invoices the client, she will charge 20% VAT on all of these expenses, as they are her own business expenses and not those of the client.

Note - although the rail ticket will be zero-rated when purchased by Jane from the rail company, she will still charge 20% VAT on the recharge to the client because it forms part of her overall fee, just like the other expenses.

Reference: VAT Notice 700, para 25.1

Conditions for disbursements

Going back to the solicitor acting for a house buyer, he needs to be strict as far as his procedures are concerned to ensure there are no VAT problems in relation to disbursements charges:

He must ensure that all relevant costs belong to the buyer rather than his own business and he must have acted as an agent for the buyer when he paid the various third parties e.g. local authorities, land registry office etc.

The buyer must have received and used the goods or services provided by the third parties and the buyer was responsible for paying the third parties and authorised the payments to be made.

The payments must be itemised separately on the solicitor's invoice(s) and he will only recover the exact amount paid to the third parties.

HMRC VAT Notice 700, para 25.1.

As far as record-keeping is concerned, the business charging disbursements without adding VAT must be able to satisfy HMRC on two issues, if so requested:

Evidence of the actual payment made to the third party supplier, with a document confirming the detail and amount.

HMRC must be satisfied that no input tax has been claimed on the disbursement by the business recharging it to his customer. There might be scope for the final buyer to claim input tax (if the expense relates to taxable supplies etc) because the goods or services belong to that person or business.

Case law example - MoT testing fees

The priority is to ensure that a business only charges its customers the exact cost of a disbursement and does not apply a mark-up or profit margin. So if our solicitor pays £80 for a land registry fee but charges his client £100 on his sales invoice, HMRC will usually seek to assess tax on the £20 profit margin and, in some cases, the full £100 fee. It would not be a problem if he charged £80 as disbursement and then a separate fee of £20 for an administration charge – the latter would be standard rated but not the disbursement.

This was the problem in the case of Ellon Car Clinic Ltd (TC5813) concerning MoT recharges. The company was not licenced to carry out MoT tests on customers' vehicles, so subcontracted these tests to other garages, paying between £40 and £54.95 per test. It charged its customers a standard fee of £49.95 (no VAT), which HMRC assessed as being subject to 20% VAT i.e. the disbursement conditions had not been met. However, the tribunal supported the taxpayer on the basis that an agency arrangement was evident and the supply was clearly between the testing garage and the customer, a fact of which all parties were aware. The company was only subject to output tax on the profit margin i.e. for those tests that cost less than £49.95. No output tax was due on deals where the company made a loss.

VAT registration

It is important to note that the expenses recharged by an unregistered business form part of the 'taxable turnover' test for registration purposes. So, if a consultant has annual UK fees of £80,000 plus travel and hotel recharges to customers of £10,000, then his total taxable sales are £90,000 i.e. greater than the registration threshold of £85,000. This could be a big issue because HMRC has the power to backdate a late registration by up to twenty years.

Final challenge

If a business pays £100 + VAT for an overnight stay in a hotel, and this cost will be recharged to a customer, then it would be correct to charge £100 plus VAT to recover the cost incurred by the business, on the basis that input tax has been claimed on the hotel bill. But what about if the business uses the flat rate scheme and cannot claim input tax on the hotel bill? It might then be appropriate to charge the customer £120 + VAT to recover the cost. This issue is not a VAT problem – it is a commercial dilemma. As long as HMRC gets output tax on the amount charged (be it £100 or £120 + VAT), it will not be concerned how the figure was established.

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