

SHERIFFDOM OF LoTHIAN AND BORDERS AT EDINBURGH

[2017] SC EDIN 76

SC336/16, SA1856/16, SG69/17
SG104/16, SG65/16, SG13/17 &
SG15/17

NOTE BY SHERIFF KATHRINE EC MACKIE

In the causes

MRS YUK CHAM AGAINST DAVID STONE

SONUI NICOLSON AGAINST MEWA SINGH

ERICA BROCK & OTHERS AGAINST CHRISTOPHER MCMAHON & OTHERS

ANDREW BEST AGAINST CRISTIAN LOAIES & FLORIN LAOIES

KRISHNA BANAVATHI & OTHERS AGAINST MARCIN HAJNYSZ & OTHERS

JAMES WATSON AGAINST EMEKA OKARO

MILYN MAGTANG AGAINST MACIEJ SURMACKI

Act: Walker, Solicitor, Gilson Gray Solicitors, Edinburgh

Edinburgh, 26 May 2017

Introduction

[1] These actions called before me on 27 April 2017 for determination of a claim by the pursuers' agents that Value Added Tax (VAT) should be added to the judicial expenses to which the respective pursuers were entitled. All actions were undefended. To date in this court VAT has not been added to such expenses. Following initial submissions on behalf of the pursuers, the hearing was continued to allow the pursuers' agent to present further submissions. It was agreed that such further submissions should be in writing. The written submissions lodged on about 11 May 2017, together with authorities produced then, are

comprehensive and incorporate and expand upon the initial submissions made at the hearing on 27 April 2017. I am grateful to the pursuers' agent for these.

The Statutory Scheme for VAT

[2] VAT was introduced by the Finance Act 1972, following the United Kingdom (UK) becoming a member of the European Economic Community (EEC). It is now regulated primarily by the Value Added Tax Act 1994 (the 1994 Act).

[3] Put shortly, the 1994 Act provides that VAT is to be charged on the supply of goods and services in the UK where it is a taxable supply made by a taxable person in the course of his business.¹ A taxable supply is other than an exempt supply but not anything done otherwise than for a consideration.² Legal services are not an exempt supply.³ A taxable person is someone who is required to be registered under the Act and whose supplies are or are anticipated to be at least £85,000 per annum.⁴ The taxable person is liable to account for and pay the VAT to Her Majesty's Revenue and Customs (HMRC) and a system of administration, collection and enforcement is provided for.⁵

[4] The pursuers' agents provide services in the UK in the form of legal services. The value of the services exceeds £85,000 per annum. The services are provided in the course of their business as Solicitors. Accordingly the pursuers' agents are a taxable person and are liable to be registered under the Act. They are so registered. Unless they provide legal services without any consideration the services supplied by them attract VAT.

¹ Section 4 of the 1994 Act

²² Sections 4(2) and 5(2) of the 1994 Act

³³ Section 31 and Schedule 9 of the 1994 Act

⁴ Section 3(1) and Schedule 1 of the 1994 Act

⁵ Schedule 11 of the 1994 Act

[5] The 1994 Act provides for a system of offsetting VAT where two taxable persons are involved.⁶ In essence a taxable person who pays VAT on goods purchased or services received by him (input tax) may offset that amount against his liability for VAT on goods he sells or services he supplies (output tax). In these circumstances where the pursuers' agents supply services to a taxable person the VAT on the cost of their services is regarded as input tax for the purpose of the client's VAT accounting. The client may deduct that amount from his liability for output tax. Any balance of output tax will be due to be paid to HMRC although if none is due at the relevant time credit may be given and held over until the end of the next accounting period.⁷

[6] Where the pursuers' agents supply services to a non-taxable person, or to a client who has not received the services in the course of his business, their services still attract VAT but the client is unable to offset the amount of the VAT and is liable therefor.

Judicial Expenses

[7] A party who resorts to litigation requires a service which must be paid for. Expenses are the charges exigible from a party to a process including the court fees, fees to solicitors and counsel and other liabilities incurred in the prosecution or defence of an action. Court fees are regulated by statutory instrument. A party may be liable not only for his own expenses but also, by virtue of an award by the court, for certain of his opponent's expenses.⁸

⁶ Sections 24 and 25 of the 1994 Act

⁷ Section 25(3) of the 1994 Act

⁸ Macphail para 19.01

[8] Expenses awarded whether in absence or in *foro contentioso*, unless modified at a fixed amount, shall be taxed before decree is granted for them.⁹ Taxation of accounts of expenses is carried out in accordance with the General Regulations and Table of Fees set out in Schedule 1 of the Act of Sederunt (Fees of Solicitors in the Sheriff Court)(Amendment and Further Provisions) 1993 (the Act of Sederunt). Therein it is provided that the Table of Fees “shall regulate the taxation of accounts between party and party”. Thus, where a party is entitled, by an award by the court, to recover some or all expenses from an opponent the amount recoverable is governed by the Table of Fees as taxed. The Table of Fees is divided into Chapters, and then subdivided into parts, dealing with different types of action, whether defended or undefended and detailed charges.

[9] Paragraph 3 of the General Regulations provides that “where an action has been brought under summary cause procedure only expenses under Chapter IV of the Table of Fees shall be allowed unless the court otherwise directs”. Paragraph 3A provides that “in a simple procedure case, unless the Sheriff orders otherwise (a) only expenses under Chapter V of the Table of Fees shall be allowed”. Modification of those expenses is provided for depending upon the total value of the claim.

[10] The Table of Fees does not refer to small claims. A small claim is a form of summary cause¹⁰ which would suggest that the General Regulations still apply. However, expenses in a small claim are governed by orders of the Secretary of State.¹¹ Until the introduction of simple procedure on 28 November 2016 no expenses could be awarded in a small claim in which the value was less than £200. The sheriff, where the value of the claim was £1500 or less, could award expenses not exceeding £150 and, where the value of the claim was more

⁹ Rule 32.1 OCR

¹⁰ Section 35(2) Sheriff Courts (Scotland) Act 1971

¹¹ Section 36B of the Sheriff Court (Scotland) Act 1971

than £1500, a sum not exceeding 10% of that value.¹² The order was revoked on the introduction of simple procedure.¹³

[11] Where an action is undefended and decree in absence is granted with expenses¹⁴ a pursuer may seek expenses as taxed but usually elects for the appropriate inclusive fee and outlays in which case taxation is unnecessary.¹⁵

[12] In terms of Regulation 7 of the General Regulations an account of expenses may be drawn either on the basis of inclusive fees, otherwise referred to as block fees, of Chapters I and II or on the basis of detailed fees of Chapter III. Such an option is not available in respect of expenses in summary cause procedure where the fees are governed by Chapter IV or in simple procedure where they are governed by Chapter V. In each Chapter there are block fees for each item of chargeable work. Where the actions are undefended, or in simple procedure admitted claims, the fee allowable is referred to as “inclusive”. From the narrative in each Chapter it is clear that this is intended to be a single fee to cover all work undertaken from taking instructions to obtaining decree. In each Chapter there are fees allowed for additional steps required to serve proceedings and in Chapter IV for an additional attendance at court.

VAT on Judicial Expenses

[13] Regulation 13 of the General Regulations provides that “where work done by a solicitor constitutes a supply of services in respect which VAT is chargeable by him there may be added to the amount of fees an amount equal to the amount of VAT chargeable”. As

¹² Small Claims (Scotland) Order 1988/1999

¹³ Schedule 1 Courts Reform (Scotland) Act 2014 (Relevant Officer and Consequential Provisions) Order 2016/387 (Scottish SI)

¹⁴ Rule 7.4 OCR

¹⁵ Macphail para 7.11 and 19.32 note 81

indicated above the pursuers' agents are required by reason of the 1994 Act to charge VAT in respect of the supply of legal services unless the work is done for no consideration. The taxation of accounts of expenses is governed by the General Regulations and the Table of Fees which is applied to all forms of procedure. As Miss Walker submitted accounts of expenses lodged for taxation routinely include VAT. However, despite the generality of Regulation 13, VAT is charged on accounts of expenses only where the party entitled is not a taxable person. If a taxable person, being entitled to offset the VAT paid to the pursuers' agents, recovered expenses from his opponent including VAT the amount of VAT recovered would be a windfall.

[14] Following the introduction of VAT in the Finance Act 1972 the Auditor of the Court of Session issued a Practice Note for the assistance of the legal profession.¹⁶ Therein he advised that if VAT was being claimed by a person engaged in business and the expenses were to be charged as a business expense then, unless there was agreement, a certificate would require to be produced to confirm that the party was not entitled to offset the VAT.¹⁷ Thus it would appear to have been recognised that in normal circumstances a taxable person would not recover VAT from his opponent.

[15] In the third edition of Macphail on Sheriff Court Practice published in 2006 it is stated "Where the solicitor's charges are taxable supplies in terms of the Finance Act 1972 and the solicitor is a taxable person within the meaning of that Act authority is given to make an addition to the fees in the table of such an amount as is equivalent to the rate of value added tax (VAT) at the date of supply and that additional sum is so described in the solicitor's account. Thus if the party found entitled to expenses is a taxable person and the

¹⁶ PN 14 April 1973

¹⁷ Paragraph 2(b) of PN

legal services have been supplied to him for the purpose of his business the tax which he pays to his solicitor will be an input tax which he may recover by deducting it from his output tax. Accordingly his account should not include any element of VAT. If on the other hand the party is not a taxable person or if the legal services have not been supplied to him for the purposes of his business he cannot recover the VAT but must bear it personally. In either of the latter cases accordingly an amount equivalent to the VAT should be added to the account to be paid by the other party.”¹⁸

[16] While it must be borne in mind that the rules and procedure in the Sheriff Court can often be very different from the rules and procedure in the Court of Session it can sometimes be instructive to compare the respective positions. Chapter 42 of the Court of Session rules essentially represents the General Regulations and Table of Fees applicable in this court. Rule 42.12(1) is in very similar terms to Regulation 13. In terms of rule 42.12(2) an account of expenses or a minute of election to charge an inclusive fee “shall contain a statement as to whether or not the party entitled to the expenses is registered for the purposes of VAT”. This is particularly helpful because firstly it appears to confirm that an inclusive fee may still attract VAT and secondly it emphasises the importance of clarifying for the purpose of taxation whether the party entitled to expenses from an opponent is registered for VAT and thus able to offset input and output tax. There is no requirement in the General Regulations, and in particular Regulation 13, for the production of any certificate or statement confirming the status for VAT of the party entitled to expenses. No reason or explanation for such omission was offered by Miss Walker. Given that it is still considered appropriate to include such a provision in the Court of Session rules it cannot be suggested that after some forty-five or so years since the introduction of VAT that the practice is so well understood as to

¹⁸ Paragraph 19.58

render a certificate or statement unnecessary. Miss Walker informed me that the requirement to produce a certificate or statement was honoured more in the breach than the observance. A party's designation and the subject matter of the cause may offer clues as to whether the expenses formed services for the purposes of the business but that in itself would not establish that the party was a taxable person and registered for VAT. It may be that if there was any doubt about a party's status as a taxable or non-taxable person, or challenge raised, a certificate could be produced.

[17] Miss Walker informed me that there was a complete absence of reported authority in relation to the issue. That may suggest either that the point has not been taken before, and that would certainly appear to be the case in this court, or that the point is so well understood that it need not be. The only authority which Miss Walker considered to be of passing relevance was *The Commissioners for Her Majesty's Revenue and Customs v Simpson & Marwick* [2013] CSIH 29. The case was not concerned with when VAT might be recovered in judicial expenses but rather illustrated the circumstances in which a recipient of legal services could offset VAT as a taxable person. The particular circumstances in the case involved an analysis of the arrangements where an insurance company exercised its right of subrogation. The decision emphasised the need to consider not the status of the insurance company but that of its policyholder. In the decision it is stated "The procedure for UK solicitors' services will depend on whether or not the policyholder is registered for VAT and whether the claim appears to relate to his business or private activities. If the policyholder is registered and can recover VAT from Customs the solicitor is obliged under the VAT regulations to address a tax invoice to him. This will request payment of an amount equal to the VAT and it will state that the balance of the account will be settled by the insurance company.....If the policyholder is not registered for VAT and/or cannot recover the VAT

from Customs for example because the claim does not relate to his business then the solicitor will address his invoice to the policyholder and send it to the insurance company for settlement.....care should be taken at (sic) VAT on supplies to policyholders is not counted as input tax by the insurance company.” While the decision confirms the attention to be paid to the status for VAT of a party it does not, in my view, advance an understanding of the position in issue in these cases.

Decision

[18] As indicated above, in litigation expenses, or costs, are incurred. The court may make an award entitling one of the parties to recover all or some of the expenses. Usually, but not always, such an award would be made in favour of the successful party. The taxation of accounts of expenses in the Sheriff Court is governed by the General Regulations and the Table of Fees. Regulation 13 recognises the requirement for VAT to be charged for services supplied in the UK including legal services. The Table of Fees provides in the different Chapters and parts thereof the amount of expenses which may be claimed in different types of actions. The parts are also divided between undefended, or admitted, and defended, or disputed, claims. Although in the majority of undefended actions no taxation takes place, where there is an election to accept the inclusive fees, there is no reason why VAT is not added to the amount of those expenses as it is added in an account of expenses in a defended action. This would of course be subject to whether VAT could be recovered because of the status of the party entitled to the expenses. In my opinion inclusive fees are descriptive of the nature of the work done and are not to be considered to mean inclusive of all charges. Were that the case outlays such as warranting dues or sheriff officers’ fees would not be recovered in addition to the inclusive fee. VAT is a charge imposed by statute

upon the cost of legal services supplied in the UK. It should therefore be recoverable, where appropriate, whether or not the action is defended.

[19] There is no requirement in either the rules of the various forms of procedure in the Sheriff Court or in the General Regulations for the lodging of a statement or certificate as to whether the party entitled to expenses is or is not able to recover VAT. It may be that that is an issue to be addressed elsewhere. If as submitted by Miss Walker the Practice Note of the Auditor of the Court of Session is not being observed it is not clear why that should be the case. No information was presented about the practice of the Auditors of the Sheriff Courts. In my opinion it would be at least good practice for such a certificate or statement to be produced when an election or minute is lodged in an undefended action and when an account of expenses is lodged for taxation.