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Making Tax Digital.

for VAT - May 2019



Making Tax Digital

In 2015, the Government announced ambitious plans to modernise the administration of the UK tax system through its Making Tax Digital initiative. The intention is that individuals and businesses will have a single digital tax account that will bring together all their relevant information in real time. Ultimately, this will change the way in which taxpayers communicate with HMRC and remove the requirement for taxpayers to complete tax returns.

Concern about the scope and pace of the reforms means that MTD will now not come into effect for personal tax or corporation tax until 2021 at the earliest. However, plans to bring in digital VAT accounting were not delayed and MTD for VAT is now a reality.

Who is affected by MTD for VAT?

Businesses with a taxable turnover below the VAT registration threshold (currently £85,000) are exempt from MTD, although they may opt in if they wish.

All compulsory VAT registrations will be subject to MTD requirements unless HMRC are satisfied that any of the following apply:

- It is not reasonably practicable to use digital tools to keep business records or submit VAT returns for reasons of age, disability, remoteness of location or any other reason, or
- The business is subject to an insolvency procedure, or
- The business is run entirely by members of a religious society whose beliefs are incompatible with the requirements of the regulations

A business will remain within the MTD regime, even if its turnover subsequently falls below the VAT registration threshold.

When does MTD for VAT commence?

The vast majority of affected taxpayers will be within MTD for VAT from their first VAT returns beginning on or after 1 April 2019. For those with more complicated affairs the new regime will begin with effect from the first VAT return period beginning on or after 1 October 2019.

The six month deferral applies to:-

- trusts
- 'not for profit' organisations that are not set up as a company
- VAT divisions
- VAT groups
- public sector organisations having additional reporting obligations (Government departments and NHS Trusts)
- local authorities
- public corporations
- overseas traders
- those required to make payments on account
- annual accounting scheme users

What does MTD for VAT mean?

MTD for VAT is the creation of a '**digital journey**' whereby data from core records flows digitally into the VAT return. Once approved by the taxpayer, software will submit the VAT return directly to HMRC systems via an **Application Programming Interface (API)**.

MTD for VAT introduces a significant level of automation into the VAT reporting process with changes in two areas. The first is the way in which a business holds information; certain core data must be held as **digital records**. The second is the way that specific data (most notably the VAT return) is sent to HMRC. This is **digital submission**.

Software that is able to communicate with HMRC's systems via the API is known as API enabled or 'functional compatible software'. Software that is unable to fulfil this function is known as 'non functional compatible software'.

Businesses with non-functional compatible software will have to use **bridging software**. This is an API enabled digital tool that can connect non-functional compatible software to HMRC's system, thereby allowing the required two-way digital transmission of data.

What must MTD functional compatible software do?

This software must be able to:

- keep and preserve records in a digital format
- create a VAT return from the business's digital records and use the API platform to submit the return to HMRC
- provide supplementary data to HMRC on a voluntary basis
- receive information from HMRC via the API platform.

HMRC do not provide API enabled software or bridging software for taxpayers to use and so businesses need to obtain appropriate products from commercial software providers.

HMRC is maintaining a list of suppliers that have tested their products in HMRC's environment and demonstrated a prototype of their service to HMRC: **MTD compliant software providers**. This list is continually updated.

What records must I keep digitally?

The following records must be maintained and preserved in a digital form:

Designatory data

- business name
- address of the principal place of business
- VAT registration number
- a record of any VAT accounting schemes used

Supplies made

- time of supply
- value of the supply
- rate of VAT charged
- a record of the income for each period split between standard rated, reduced rated, zero rated, exempt and outside the scope (to the extent that the outside the scope income is required for the VAT returns)

HMRC has confirmed that multiple supplies made at the same time do not have to be recorded separately. It is acceptable to record the total value of supplies on each invoice provided that the supplies are subject to the same rate of VAT and have the same date of supply. Where an invoice includes supplies that have the same VAT liability but have different times of supply, these can be recorded as being at the same date if they are within the same VAT period.

Supplies received

- time of supply
- value of the supply including any VAT that is not recoverable
- amount of VAT recoverable

There is no requirement to record inputs for the period split by VAT rate.

Where a third party agent is responsible for managing or handling supplies, those supplies do not fall within the record keeping requirements until the information is received from the agent. This removes the obligation to include each individual supply separately in the electronic account. For example, if a business receives a monthly summary of rent collected and VAT charged from its letting agent, it can treat this summary as a single invoice.

Summary data

- output tax owed on sales
- output tax owed on acquisitions from other EU member states
- the tax that needs to be reported on a purchase under the reverse charge procedure
- the tax payable / claimable under an adjustment or error correction
- the input tax recoverable on business purchases
- the input tax recoverable on acquisitions from other EU member states

The summary data is the audit trail between the business records and the VAT return and is effectively an electronic VAT account.

It is not necessary to produce or store invoices or receipts digitally as part of this process. However, if the business's software scans and retains suitable images of invoices received, the business does not then need to retain the originals.

Can I hold information in more than one place?

It is permissible to keep records in a range of digital formats. For example, a business may record its sales and purchases within accounting software but then transfer the data into one or more spreadsheets in order to calculate its VAT return. Together these form the digital records of the business.

However, if multiple software programs, products or applications are used, there must be a **digital link** between these pieces of software. It is not acceptable under MTD to transfer data manually between different parts of the digital records system.

What is a digital link?

A digital link is one where data is transferred or exchanged electronically between software programs without manual intervention or transposition. Linked cells in spreadsheets would be one example of a digital link.

Data transfer between software programs, applications or products must be digital where the information continues to form part of the digital records. Information from records that are not required to be kept digitally can be transferred manually into the digital records. However, HMRC encourage digital links here too on the basis that the chances of error are reduced.

For the first year of mandation, HMRC will apply a **'soft landing'** and will not seek to apply record keeping penalties. Businesses will not be required to have digital links between software programs and the manual transfer of data will not be contrary to the regulations during this period.

Where bridging software is used to transmit the VAT return to HMRC, it is mandatory for a digital link to exist between the records and the bridging software from the MTD commencement date.

What about adjustments?

There are a number of VAT adjustments that are required under the VAT rules. Examples of these include partial exemption adjustments, fuel scale charges, bad debt adjustments and capital goods schemes adjustments. These adjustments do not relate directly to a transaction and are therefore not automatically captured by the primary sales and purchases records.

VAT adjustments are reported on the VAT return and must therefore be recorded in the software. However, only the total for each type of adjustment is required to be kept digitally, not the calculation that underlies them. If the adjustment requires a calculation, it can be performed offline in spreadsheets. The total adjustment can then be entered manually into the digital records.

Similarly, where an error is corrected on an error notification form, a business is not required to amend the digital records.

Will HMRC have access to additional information about my business?

Businesses are only required to submit the entries for the 9 boxes required for the VAT return. However, they will have the option of providing supplementary data at the same time.

If a business chooses to provide supplementary data, it will submit information that broadly aligns with that held in the electronic VAT account e.g. the outputs split between different tax rates and the total adjustments that are declared on the return. It is possible that this would give HMRC sufficient information to answer any questions it would have regarding an unusual VAT return that might otherwise trigger an enquiry.

Businesses are also able to provide this information to HMRC outside of a VAT return by voluntarily submitting an update. Updates would be drawn from the digital records and submitted through the API enabled software in the same way as a VAT return. There is no limit to the number of times this can be done during a VAT period.

Can I still use an agent?

A VAT registered business affected by MTD can still authorise an agent to keep records on its behalf and/or to create, view, edit and send data to HMRC. However, it will only be possible for an agent to undertake some of these functions if they have access to the API enabled software that holds the digital records.

Where data is sent between the business and the agent, the digital links must be preserved. HMRC suggests that this might be achieved by emailing a spreadsheet containing digital records to the agent or by downloading the records onto a memory stick to import into the agent's software.

MTD is intended to provide additional flexibility to taxpayers in that they may authorise multiple agents and manage different levels of permissions for each of them.

Can I still use VAT schemes such as cash accounting or the flat rate scheme?

Yes, there are no plans to withdraw any schemes as a result of MTD.

Will MTD necessitate substantial changes to my VAT processes?

This largely depends on the complexity of the business and the nature of the current processes.

Micro businesses that exclusively use spreadsheets for their VAT accounting may find that the only noticeable change is that they need to have bridging software in order to submit their returns. Businesses that use a single accounting package may not see any changes at all in the operation of their package, although behind the scenes the software provider would have made significant changes to the functionality and capability of the software in order for it to become API enabled.

However, businesses that hold information in multiple formats or systems may find the creation of the necessary digital links to be difficult. This is likely to be true for VAT groups and large businesses that run divisional accounts.

What should I be doing now?

Businesses must ensure that they sign up for MTD via HMRC's website in good time so that they can comply with the new rules.

If they have not done so already, most VAT registered businesses will soon need to submit their first VAT return under the new regime.

Those on the deferment list should consider joining HMRC's pilot scheme. The pilot launched in a limited scale in April 2018 and is now opened to all businesses other than overseas traders. Under MTD for VAT, a taxpayer must have software that can transfer data directly to and from HMRC's systems. We can help clients make the necessary changes to ensure compliance with the new regime. We can also provide a bridging solution to taxpayers wishing to use spreadsheets to work their VAT out.

PEM Virtual Finance Office (VFO)

We offer a fully bespoke, outsourced bookkeeping and accounting service, to support clients in converting to MTD compliant software, and providing advice on the optimum software solution to benefit their business.

For further information on the full range of services, please use the link below.

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