
Making Tax Digital for VAT

Over the coming years, the government will phase in its landmark Making Tax Digital (MTD) initiative, which will see taxpayers move to a fully digital tax system.

This factsheet outlines some of the key issues for businesses.

Making Tax Digital for Business

Making Tax Digital for Business (MTDfB) was introduced by then Chancellor, George Osborne, in the 2015 Spring Budget. The government's 'Making Tax Easier' document was published shortly after, and outlined plans for the 'end of the tax return'. It also set out the government's vision to modernise the UK's tax system, with digital tax accounts set to replace tax returns for ten million individuals and five million small businesses.

Revised timescales

However, industry experts and those within the accountancy sector expressed concerns over the proposed pace and the scale of the introduction of MTDfB, and, as a result, the government amended the timetable for the initiative's implementation, to allow businesses and individuals 'plenty of time to adapt to the changes'.

MTDfB, starting with VAT, took effect from 1 April 2019, as summarised below.

Making Tax Digital for VAT

From 1 April 2019, businesses are mandated to use the MTDfB system to meet their VAT obligations. Under the rules, businesses with a turnover above the VAT threshold (currently £85,000) must keep digital records for VAT purposes and provide their VAT return information to HMRC using MTD functional compatible software.

The rules took effect from 1 April 2019, where a taxpayer has a 'prescribed accounting period' which begins on that date, and otherwise from the first day of a taxpayer's first prescribed accounting period beginning after 1 April 2019. The exception to this is a small minority of VAT-registered businesses with more complex requirements who were mandated to comply with MTD for VAT (MTDfV) for their first return period starting on or after 1 October 2019.

The six-month deferral period applied to businesses who fall into one of the following categories: trusts; 'not-for-profit' organisations that are not set up as a company; VAT divisions; VAT groups; those public sector entities required to provide additional information on their VAT return (government departments, NHS trusts); local authorities; public corporations; traders based overseas; those required to make payments on account; and annual accounting scheme users. HMRC estimates the deferral will apply to around 3.5% of mandated businesses.

VAT returns

Those businesses that fall within the scope of MTDfV are required to submit their VAT returns using software compatible with the MTDfV regulations. Information will be extracted from the digital records in order to populate the VAT return.

There are no changes to the statutory VAT return or payment dates. In addition, businesses who choose to submit VAT returns monthly or in a non-standard fashion are able to continue to do so.

Using third party software and keeping digital records

Under MTDfV, businesses must make use of functional compatible software to meet the requirements. VAT returns will be calculated and submitted to HMRC via an Application Program Interface (API). Submission can be from software, bridging software or API-enabled spreadsheets.

HMRC acknowledges there are different ways to do this. However, the transfer of data to HMRC, from the mandatory digital records to the filing of the return, must be entirely digital. HMRC has published VAT Notice 700/22: Making Tax Digital for VAT, setting out requirements in more detail.

Under MTD, manual record keeping is not acceptable. Specified records have to be kept digitally, using 'functional compatible software'. This means a 'software program or set of compatible software programs which can connect to HMRC systems via an API', which must be capable of:

- keeping records in digital form as specified by the MTDfV rules
- preserving digital records in digital form for up to six years
- creating a VAT return from the digital records held in compatible software and submitting this data to HMRC digitally
- providing HMRC with VAT data on a voluntary basis
- receiving information from HMRC via the API platform.

Records to be kept digitally are specified in the VAT Notice. They include 'designatory data'; the VAT account linking primary records and VAT return; and information about supplies made and received. Requirements are more extensive under MTDfV, for example in relation to supplies made, where it is necessary to record the different rates of VAT applicable. For supplies received, the amount of input tax to be claimed is also needed.

MTD is not completely paper-free, and it does not mean businesses are mandated to use digital invoices and receipts. Some records will still be kept in hard copy, such as the C79 import VAT certificate. However, the actual recording of supplies made and received must be digital. Where invoices and receipts aren't held digitally, they should be kept in hard copy as usual for VAT purposes.

Software issues

The digital records required for MTD don't have to be held in one place or one program. Businesses can keep digital records in a range of different compatible digital formats. The use of spreadsheets is allowed, in combination with add-on MTD software.

If the information is prescribed as part of the 'digital journey', the mandatory submission process, it must be transferred via 'digital link'. The VAT Notice defines these.

Digital links

A digital link is a transfer or exchange of digital data between software programs, products or applications. Where a set of software products is used, there must be digital links between them, and once data is entered into the software, any further transfer or modification must be via digital link.

Manual data transfer is not allowed under MTD. An example would be noting details from invoices in one ledger, then using that handwritten information to update manually another part of the functional compatible software. Copying by hand or manual transposition of data between two or more pieces of software and 'cut and paste', or 'copy and paste', will not be acceptable in the long-term. There are, however, some transitional arrangements (see below).

The VAT Notice outlines acceptable digital links, including:

- linked cells in spreadsheets
- emailing a spreadsheet with digital records to an agent for the agent to import data into software to make a calculation, such as a partial exemption calculation
- transferring digital records onto portable devices (pen drive, memory stick) and giving these to an agent
- XML, CSV import and export, download and upload of files
- automated data transfer
- API transfer.

Transition: soft landing penalty period

For VAT return periods beginning between 1 April 2019 and 31 March 2020, penalties will not be charged if businesses don't have digital links between software programs. This means 'cut and paste' will be acceptable while businesses update their systems. However, from 2020, HMRC will penalise non-compliance.

The transfer of VAT return data to bridging software to make submission to HMRC must always be digital, and is excluded from the soft landing provisions.

Exemptions

Under MTDfV, only a small handful of businesses are exempt. Please contact us if you believe your business may be exempt. Businesses will be able to make a right of appeal against a HMRC refusal of exemption.

How we can help

No matter if your business is big or small, MTD will undoubtedly affect you. As your accountants, we can help you to stay compliant with the MTDfV rules.

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