

MTD for VAT - Update

(Lecture B1223 – 23.29 minutes)

Making Tax Digital has been heralded by HMRC as both offering significant administrative savings to businesses and in addition considerable additional tax take for the exchequer – the latter claim based mainly on the reduction of errors but also the opportunity for HMRC to police the tax system more effectively.

From 1 April 2019 all businesses with taxable supplies in excess of the VAT threshold have been required to submit returns through MTD enabled software. For businesses using accounting software this has been possible through their accounting software, but for many smaller businesses this has been through the medium of what is known as “bridging software”, which provides a link through spreadsheets from basic record keeping functions to filing the return.

From April 2021 the mandation of digital links, which was planned for 1 April 2020 will be implemented, and from April 2022 all VAT registered businesses must file their VAT returns through the MTD process, and keep digital records in accordance with the legislation.

What are the requirements – who and when?

Businesses with taxable supplies in excess of £85,000 in a 12-month period must join MTD from 1 April 2019 onwards.

Businesses that are not yet mandated but are registered for VAT need to check their turnover monthly and join MTD from the next quarter after they meet the threshold.

For example, a business with VAT quarters ending in February, May, August and November should check the value of their supplies each month, and if they exceed £85,000 in September 2020 then they are mandated into MTD for VAT from 1 December 2020.

Voluntary application of MTD for VAT

A business which is registered for VAT can elect to keep records and file according to the MTD rules and is also free to choose to leave MTD and file under the old rules should they wish to.

Accounting software

Businesses within the new regime must keep digital records. However, HMRC uses the term “functionally compatible software” to specify how digital records must be kept and returns submitted to HMRC. Here is some guidance on that issue.

Example 1

A business receives an invoice and types selected data contained in the invoice into functional compatible software. They must still keep the invoice in its original form as the data in the functional compatible software is not a copy of the invoice.

Example 2

A business has functional compatible software that scans the invoices received and puts the information in its ledger. If the image is retained and contains all the detail required for VAT purposes then the business does not need to keep the original invoice unless it is required for another purpose.

If you deregister from VAT you will no longer need to keep digital records in functional compatible software, but you must retain your VAT records for the required period.

Functional compatible software is a software program, or set of software programs, products or applications, that must be able to:

- record and preserve digital records;
- provide to HMRC information and returns from data held in those digital records by using the API platform;
- receive information from HMRC via the API platform.

HMRC expects that there will be software products available that will perform all of the functions listed above. Some software programs will not be able to perform all of these functions by themselves. For example, a spreadsheet or other software product that is capable of recording and preserving digital records may not be able to perform the other 2 functions listed above, but can still be a component of functional compatible software if it is used in conjunction with one or more programs that do perform those functions.

The complete set of digital records to meet Making Tax Digital requirements does not all have to be held in one place or in one program. Digital records can be kept in a range of compatible digital formats. Taken together, these form the digital records for the VAT registered entity.

“End to end digital” – digital links

The expectation is that transfers of data between elements of the software systems will be achieved by digital links and not retyping or cut/copy and paste. This aspect is the subject of a “soft landing” allowing businesses an extra 12 months to create the necessary digital links between their functional software. Here is the guidance on that topic:

Digital links

Data transfer or exchange within and between software programs, applications or products that make up functional compatible software must be digital where the information continues to form part of the digital records.

Once data has been entered into software used to keep and maintain digital records, any further transfer, recapture or modification of that data must be done using digital links. Each piece of software must be digitally linked to other pieces of software to create the digital journey.

It follows that transferring data manually within or between different parts of a set of software programs, products or applications that make up functional compatible software is not acceptable under Making Tax Digital. For example, noting down details from an invoice in one ledger and then using that handwritten information to manually update another part of the business functional compatible software system.

A 'digital link' is one where a transfer or exchange of data is made, or can be made, electronically between software programs, products or applications. That is without the involvement or need for manual intervention such as the copying over of information by hand or the manual transposition of data between 2 or more pieces of software.

A digital link includes linked cells in spreadsheets, for example, if you have a formula in one sheet that mirrors the source's value in another cell, then the cells are linked.

HMRC will also accept digital links as:

- emailing a spreadsheet containing digital records to a tax agent so that the agent can import the data into their software to carry out a calculation (for instance, a Partial Exemption calculation);
- transferring a set of digital records onto a portable device (for example, a pen drive, memory stick, flash drive) and physically giving this to an agent to import that data into their software;
- XML, CSV import and export, and download and upload of files;
- automated data transfer;
- API transfer.

However, as this aspect may prove very challenging, HMRC announced a 'soft landing period' for businesses to action the full digital links requirements. This was extended as a result of Covid and now ends on 31 March 2021.

You should, however, be aware that the soft landing for digital links only applies to data moved within the functional software. When a separate package is to be used to submit the return figures prepared within the software, the transfer of data at this point **MUST** be by digital link from the start of MTD. This will most generally apply to spreadsheets used with bridging software to submit the return.

Manual calculations and input

The guidance does accept that some specific calculations will need to be manually input into software to prepare the figures for the VAT return. This is acceptable – the example given is capital goods scheme adjustments, but this could equally apply to fuel scale adjustments and partial exemption calculations.

What are the requirements for digital records?

The records listed in the following paragraphs must be kept, maintained and preserved in digital form. The regulations refer to this information as your 'electronic account'.

The exact way you must enter the information will depend on the software package you have. Contact your software provider if you are unsure how to enter information into your software. HMRC can only provide advice on the legal requirements of Making Tax Digital.

You will need to keep additional records, such as invoices. You do not have to keep these digitally but you may choose to do so. For more information on the additional records that must be kept for VAT purposes, see VAT Notice 700/21: keeping VAT records.

Supplies made

For each supply you make you must record the:

- time of supply (tax point);
- value of the supply (net value excluding VAT);
- rate of VAT charged.

This only includes supplies recorded as part of your VAT Return. Supplies that do not go on the VAT Return do not need to be recorded in functional compatible software. For example intra-group supplies for a VAT group are not covered by these rules.

The time of supply is the date that you must declare output tax on. Typically this is when you send a VAT invoice or, if you are on cash accounting, when you receive payment for the supply.

Where more than one supply is recorded on an invoice and those supplies are within the same VAT period and are charged at the same rate of VAT you can record these as a single entry.

Example 1

You sold 10 standard rated items and 15 zero rated items on a single invoice then you would only need to record the total figures for each of the VAT rates.

Example 2

You are on standard accounting and a customer makes a part payment before you send out an invoice. If the payment and invoice were received and sent in the same period, you can record the supply as one transaction with one transaction date. Otherwise, where one supply needs to be recorded in different periods the precise manner will depend on the software. This could be done by splitting the amounts out, or the software may allow one line to show different periods for the VAT to be recorded.

You must also have a record of outputs value for the period split between standard rate, reduced rate, zero rate, exempt and supplies which are outside the scope of UK VAT. However, you only need to keep a digital record of 'outside the scope' supplies that you are required to include in your VAT Return.

The following rule has the force of law:

Where you need to apportion the output tax due on a mixed rate supply with a single inclusive price you do not have to record these supplies separately. You can record the total value and the total output tax due.

Not all software will allow you to record a rate of VAT other than the standard, reduced or zero/exempt. If this is the case, this mixed supply should be recorded as either one standard rated supply and one zero rated supply or you can record the sale at one rate and correct the VAT through an adjustment at the end of the period. You will also need to do this if you are using a margin scheme or the flat rate scheme.

Supplies received

For each supply (my emphasis) you receive you must record the:

- time of supply (tax point);
- value of the supply;
- amount of input tax that you will claim.

This only includes supplies recorded as part of your VAT Return, supplies that do not go on the VAT Return do not need to be recorded in functional compatible software. For example, wages paid to an employee would not be covered by these rules.

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

The time of supply is typically the date on the VAT invoice or, if you are on cash accounting, when you pay for the supply. However you must also hold the associated evidence to claim deduction of input tax.

If more than one supply is on an invoice you can record the totals from the invoice. Where the amount of input tax that you will claim is not known at the time you record the supply you have received, you can record:

- the total amount of VAT and adjust for any irrecoverable VAT once calculated;
- no VAT and adjust for any recoverable VAT once calculated;
- VAT recoverable based on an estimated percentage and adjust for any VAT once calculated.

Commentary

The very light requirements make keeping records on a spreadsheet for those who have previously kept manual records a sensible option, but may encourage businesses to seek the “minimum viable” requirement as opposed to changing the business records completely. This will make the transition to MTD for income tax much more challenging.

For very small businesses using the bank as a source of data for transactions this presents a potentially major change in record keeping. Most small businesses will not keep a purchase ledger and enter payments only as they are made, based on the payment from the bank records. The requirement that each supply be recorded separately means that payment of a batch of invoices all of which are standard rated and all of which have tax points in the same VAT period cannot be recorded as a single item but must be spilt into the individual supplies.

Where a client runs a purchase ledger it is likely that the transactions are entered invoice by invoice so that the requirement is already met.

Adjustments

Where you are allowed or required to adjust the input tax claimed or output tax you owe according to the VAT rules you must record this adjustment in functional compatible software. Only the total for each type of adjustment will be required to be kept in functional compatible software, not details of the calculations underlying them.

If the adjustment requires a calculation, this calculation does not have to be made in functional compatible software. If the calculation is completed outside of functional compatible software then digital links are not required for any information used in the calculation. However using software for all your calculations will reduce the risk of errors in your returns.

The following rule has the force of law:

Where the input tax claimed or output tax due on a supply has been changed as the result of an adjustment you do not need to amend the digital record of the supply.

Flat rate scheme

The following rule has the force of law:

If you account for VAT using the Flat Rate Scheme:

- you do not need to keep a digital record of your purchases unless they are capital expenditure goods on which input tax can be claimed
- you do not need to keep a digital record of the relevant goods used to determine if you need to apply the limited cost business rate

If your software does not include a Flat Rate Scheme setting, and does not allow you to include a rate of VAT other than standard, reduced, zero/exempt, then you will need to record the supply as either one standard rated supply and one zero rated supply. Alternatively, you can record the sale at one rate and correct the VAT through an adjustment at the end of the period, using the same method HMRC will allow you to use to correct the VAT on a mixed supply.

Margin schemes

You are not required to keep the additional records required for these schemes in digital form, nor are you required to keep the calculation of the marginal VAT charged in digital form. These records must still be maintained in some format.

If you do keep a digital record and your software does not allow you to record the VAT on the margin, then you will need to record the supply as either one standard rated supply and one zero rated supply. Alternatively, you can record the sale at one rate and correct the VAT through an adjustment at the end of the period, using the same method HMRC will allow you to use to correct the VAT on a mixed supply.

Returns

The requirement is that returns are submitted through functional compatible software. The return consists (presently) of the nine boxes submitted under the general VAT regulations, boxes one to five dealing with the VAST element of supplies and boxes six to nine dealing with the value of transactions in the VAT accounting period.

Bridging software has been developed to provide a link from records based in simple spreadsheets to the VAT submission architecture.

Next steps

From April 2021 the digital links soft landing comes to an end but given that an extra 12 months was allowed for this, it should not present any particular problems for most businesses.

So the next step is the mandation of the remaining VAT population with effect from 1 April 2022.

Businesses which are VAT registered but keeping manual records will have to move to digital records over the next 18 months and it is wise to start planning for implementation now. It is also worth taking into account what the requirements for bookkeeping are likely to be under making tax digital for income tax, as that will follow quite quickly after.

Firms will need to make decisions about what software they will be encouraging their clients to use and supporting the move to more sophisticated digital records for those who need it.

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