

# DRAFT LEGISLATION: THE VALUE ADDED TAX (AMENDMENT) REGULATIONS 2018

Response by the Association of Taxation Technicians

## 1 Introduction

- 1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to comment on The Value Added Tax (Amendment) Regulations 2018 ('the Regulations'), the Draft VAT Notice on Making Tax Digital for VAT ('the Notice') and its accompanying Addendum ('the Addendum') published on 18 December 2017 (together 'the MTD for VAT documents').<sup>1</sup>
- 1.2 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations. This response is written with that background.
- 1.3 We have split our comments into sections. Sections 2 to 5 set out our main comments on specific areas of the Making Tax Digital (MTD) for VAT requirements, with reference to the content of the Regulations, the Notice and the Addendum. Sections 6 to 8 set out our further observations on each of the MTD for VAT documents in turn.

## 2 Consistency of terms, definitions and provisions with Making Tax Digital for Income Tax

- 2.1 One of our main observations is that wherever possible definitions, terms and provisions should be consistent under Making Tax Digital (MTD) for both VAT and Income Tax.
- 2.2 In our comments on the Income Tax (Digital Requirement) Regulations ('the Income Tax Regulations') submitted on 10 November 2017<sup>2</sup> we noted a lack of consistency between the terminology used in the primary legislation for Making Tax Digital for Business (MTDfB)<sup>3</sup> and the Income Tax Regulations, in particular with regard to *recording*, *keeping* and *preserving* records.

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<sup>1</sup> <https://www.gov.uk/government/consultations/draft-legislation-the-value-added-tax-amendment-Regulations-2018>

<sup>2</sup> The income tax Regulations can be found at <https://www.gov.uk/government/consultations/making-tax-digital-reforms-affecting-businesses> and our comments at <https://www.att.org.uk/technical/submissions/mtd-reforms-income-tax-att-comments>

<sup>3</sup> New Schedule A1 TMA 1970, as inserted by s60 of Finance (No. 2) Act 2017

- 2.3 This same inconsistency continues in the MTD for VAT documents. Regulation 32A states at paragraph (5) that the electronic account must be *kept and maintained* using functional compatible software. This can be contrasted with the primary legislation for income tax, which refers to the *keeping and preserving* of records and the Income Tax Regulations and the VAT Notice which refer to *recording and preserving* digital records.
- 2.4 More consistent language would help to clarify obligations under MTD regarding digital records. Whichever terms are adopted, these should be applied consistently across primary, secondary and tertiary legislation for both income tax and VAT. Otherwise there is a risk that the requirements of MTD could be interpreted differently between the two taxes.

### 3 Digital exclusion: consistency between MTD for Income Tax and VAT

- 3.1 A further area of inconsistency between the MTD legislation for VAT and income tax relates to the exemption for the *digitally excluded*.
- 3.2 For income tax purposes, paragraph 14 of Schedule A1 TMA 1970 specifically states that a partnership will only be exempt if all partners are digitally excluded. This specific reference to the digital capability of individual partners is not mirrored in the VAT Regulations. Whilst the exemption in Regulation 32B of the VAT Regulations may have the same effect (in that the partnership as a whole is the person to whom the digital exclusion test must be applied) this difference could, potentially lead some taxpayers to conclude that they are digitally excluded for one tax but not the other.
- 3.3 As stated in our response on the Income Tax Regulations<sup>4</sup> and our previous formal submission to the Public Bill Committee<sup>5</sup>, we do not believe that the focus in Schedule A1 on the digital capabilities of all partners is appropriate. Instead, it would be more appropriate for both income tax and VAT purposes to focus on the capability of the partner who usually files the returns and keeps the records of the partnership business.
- 3.4 Finally, the Income Tax Regulations provide at Regulation 24 for a specific mechanism by which those who believe they are digitally excluded can give written Notice to HMRC and receive confirmation from the Commissioners. There is no equivalent provision in the VAT Regulations, which merely state that the Commissioners must be satisfied that a person meets qualifying conditions.

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<sup>4</sup> <https://www.att.org.uk/technical/submissions/mtd-reforms-income-tax-att-comments>

<sup>5</sup> <https://www.att.org.uk/sites/default/files/171013%20Written%20evidence%20from%20the%20ATT%20-%20Digital%20Exclusion%20of%20Partnerships%20-%20Final.pdf>

- 3.5 In the interests of simplicity and certainty, it would be helpful to provide a single legislative mechanism which would allow businesses to claim exemption from both the VAT and income tax requirements of MTD at the same time. Having different mechanisms for the two taxes may cause confusion, and could expose taxpayers to penalties if they claim exemption under one tax but fail to realise this does not extend to the other. A single legislative mechanism would also have the added benefit of removing any doubt that the treatment of the digitally excluded may differ between taxes.

#### 4 **Restricted scope of first year *soft landing* for record keeping penalties**

- 4.1 The Addendum and Notice set out that transfer of information between different interfaces (e.g. different accounting software, spreadsheets etc) must be digital where the information in question falls under the MTD digital record keeping requirements. However, to allow legacy systems to be updated a *soft landing* period will apply in the first year. During this period, record keeping penalties will not be charged in certain scenarios where a manual transfer of data is made.

- 4.2 The Addendum sets out examples of where this *soft landing* will apply, including:

- Transfers from non-API enabled software (e.g. accounting systems / general ledgers) into a spreadsheet to calculate the VAT return. (Example 4)
- Combining different digital records of members of a group into a spreadsheet. (Example 5)

The Addendum indicates that these transfer should ideally be made digitally, but they will benefit from a *soft landing* if made manually during the first year.

- 4.3 By contrast, the following transfers are identified in the Addendum as mandatory digital links where there will be no *soft landing*:

- Between different spreadsheets which are used to maintain records and calculate the VAT return. (Example 3)
- From a spreadsheet used to calculate the VAT return to bridging or linking software for submission to HMRC. (Example 4)
- From a spreadsheet used to collate figures for a VAT group to bridging or linking software for submission to HMRC. (Example 5)
- From a client's non-API enabled digital records to an agent's API enabled software. (Example 7).

- 4.4 It is unclear what the basis is for restricting the *soft landing* in this manner. The current approach of applying it in some cases of manual transfer, but not all, will make it difficult for businesses to understand its application and for HMRC to assess and enforce penalties, especially where a business has a fact pattern which falls outside the examples set out in the Addendum.

- 4.5 It would be easier for businesses to understand the application of the soft landing, and ensure they are compliant, if the soft landing were to be extended to cover all aspects of the move to digital record keeping for VAT in the first year of MTD.

## 5 Use of examples to illustrate the practical application of MTD requirements

- 5.1 The examples in section 3.2 of the Notice regarding the use of spreadsheets are not very clear. Our understanding is that:
- Spreadsheets can be used to calculate an adjustment such as partial exemption, capital goods scheme which is then manually entered into accounting software.
  - However, spreadsheets cannot be used to calculate the full VAT return, or compile a group return, unless they are linked 'digitally' to the functional software.
- 5.2 For simplicity and to better help businesses understand the complexity around digital links, it would be preferable to set these rules out clearly in the Notice, rather than relying on examples and the Addendum.
- 5.3 A similar concern applies to the examples in section 4.2 of the Notice which set out a number of examples regarding whether an agent can be used to submit a VAT return.
- 5.4 Whilst we agree that examples can be helpful in understanding the practical application of requirements, they should always be accompanied by a full statement of the underlying principles. If not, businesses with a fact pattern that does not neatly fit into the examples used may have difficulty assessing their position.

## 6 Regulations: further comments

- 6.1 Regulation 31AA *Preservation of records* states that VAT records must be *preserved* using functional compatible software. It is unclear how this will work in practice where a business uses a cloud accounting package. Will it restrict the ability to change suppliers or packages? Will data storage fees have to be incurred after deregistration or even cessation of a business? What happens in the event of a cloud-based service going out of business? The position is similarly unclear if a business chooses to use a smart phone or tablet application for record keeping. How will they preserve their records if they no longer have access to the application, for example because it is withdrawn, or the taxpayer no longer has a current subscription? More guidance on these points would be welcomed.
- 6.2 Regulation 32A states at paragraph (2)(d) that the information to be kept and maintained electronically includes "*any VAT accounting schemes used by the taxable person*". Presumably this merely requires identifying any such scheme which applies, but it would be helpful to confirm this.
- 6.3 Regulation 32A(8) states that the information to be maintained in an electronic form must be entered into the *electronic account* by the date the return is required to be filed. We would query whether this requirement needs to be stated in law, as presumably this information must be entered into the functional compatible software in order for the return to be calculated and filed?
- 6.4 Regulation 32B deals with exemptions from the MTD for VAT requirements. The exemption for the digitally excluded is defined by reference to it not being "*reasonably practicable to make a return using a compatible software return system*". No reference is made in this definition to the possibly different inability to keep records digitally. It may be the case that certain businesses can, with the

help of an agent, file a return from software but would be unable to keep their underlying business records digitally. To ensure that these businesses are not disadvantaged, the exemption should be extended to cover those unable to either make a return or keep records digitally.

6.5 We understand that Regulations 32B(2) to (4) exempt businesses from the MTD requirements until their taxable turnover exceeds the registration threshold. We believe that the effect of this exemption could be clarified by changing the wording of these Regulations, for example to read *“Regulation 32A shall not apply unless or until a taxable person’s taxable turnover exceeds the registration threshold. If at the end of any month the taxable turnover for the period of 12 months or less then ending is more than the registration threshold, Regulation 32A shall apply from the first day of the next accounting period.”*

6.6 Regulation 32B(4) establishes that businesses will be subject to the MTD requirements from the beginning of their next accounting period once their turnover exceeds the VAT threshold. In certain circumstances this could result in a business having less than one month to make the changeover to MTD. For example, a business with mainly zero rated sales of £80,000 is likely to be making monthly returns. If their turnover rises to £90,000 in the year ending 31 August 2018, MTD will apply with effect from 1 October 2018. Similarly, a registered business making quarterly returns on 31 March, 30 June etc. may find their turnover exceeds the registration limit in the year ending 31 August 2019. MTD then applies from 1 October 2019. It will be extremely difficult for such businesses to ensure they are compliant with the requirements of MTD in such a short period of time. This situation could be addressed by specifying that affected business have at least two months before they are subject to MTD.

As noted in our press release dated 18 January 2018<sup>6</sup>, where a business has an accounting period which spans their first MTD VAT quarter, they will have to ensure they have appropriate software in place at the start of that accounting period or risk having to change accounting software mid-year. This risk could be removed by altering the MTD for VAT commencement provisions so that the requirements apply from a business’s first accounting period (and not VAT quarter) starting on or after 1 April 2019. If the commencement provisions are to be kept as currently drafted then it should be confirmed as soon as possible which accounting packages be MTD for VAT compatible. Guidance should also be provided to businesses on what they should do if they discover in the middle of an accounting period that their software package is not likely to be MTD compliant.

6.7 Regulation 32B confirms that, once a business is subject to the MTD requirements by virtue of having turnover above the VAT threshold, they will remain subject to those requirements even if their turnover subsequently goes below the threshold. The only way for a business in this position to no longer be subject to the MTD requirements would be to deregister for VAT. We note that this would be inappropriate for a small business that voluntarily registers for VAT and then goes over the turnover threshold due to an exceptional increase in business. To address this situation, we wonder whether consideration might usefully be given to a provision enabling businesses to be exempt from the MTD requirements where they can satisfy the Commissioners that their taxable

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<sup>6</sup> <https://www.att.org.uk/technical/news/press-release-businesses-face-major-headache-without-clarity-digital-tax-software>

supplies in any period were over the VAT threshold solely due to an exceptional event which they do not anticipate will recur in future periods?

- 6.8 Regulation 32C provides for businesses that would otherwise be exempt from the MTD requirements (for example due to turnover being below the VAT threshold) to elect for exemption not to apply. It is not clear what would be the consequences of not making this election, but nevertheless using functional compatible software to file a VAT return in the same way as if the MTD obligations applied. Would HMRC reject such a return if no election was in place? Could HMRC seek to impose MTD-compliance penalties if in this situation there was a subsequent failure to voluntarily comply with the MTD obligations?

## 7 Notice: further comments

- 7.1 Section 2.1 of the Notice addresses the application of the turnover test. We find the second paragraph of this section slightly confusing and believe the position would be clearer if this were revised to read along the following lines *“You should check your taxable turnover at the end of each month. If in the 12 months then ending it is over the VAT registration threshold you are subject to MTD rules from the start of your next accounting period. If the registration threshold is changing from the first day of the next month you should apply that threshold rather than that which applied on the last day of the 12 month period then ending.”*
- 7.2 The Notice states at section 3.2, with force of law, that *“If a set of compatible software programs is used there must be a digital link between the pieces of software”*. It would be helpful to include at this point a precise definition of what a *digital link* is.
- 7.3 The examples in section 4.2 of the Notice regarding the use of agents to submit a VAT return do not address what happens if the business and their agent use different software systems. Presumably these systems will need to be compatible, as, if they are not, our understanding is that a manual transfer (e.g. printing out a client’s trial balance and keying this into the agency software) will not be permitted.
- 7.4 Section 5.1 ‘*Voluntary updates*’ states that *“If you are an unincorporated business and are subscribed to Making Tax Digital for both VAT and income tax, you may find the VAT update facility useful to submit update information for both taxes simultaneously”*. However, it also states that a voluntary update will not discharge the VAT return obligation or affect the payment position. It is therefore unclear what the benefit of this would be for businesses.
- 7.5 Section 6.2 sets out what supplementary information will be sent by software. As set out in our comments on the *Making Tax Digital for VAT: legislation overview* submitted on 10 November 2017<sup>7</sup> it would be beneficial for both taxpayers and HMRC for a wider variety of information to be accepted, for example the facility to explain a variance in a figure from the previous return. It is also unclear from the wording used in this section whether it is possible to submit some of the information identified, or if it all has to be submitted.

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<sup>7</sup> <https://www.att.org.uk/technical/submissions/making-tax-digital-vat-legislation-overview-att-comments>

## 8 Addendum: further comments

- 8.1 The Addendum indicates that digital transfer includes “... options such as XML import / export, macros or linked cells, but does not allow manual transfer or transposition of data”. Our understanding is that this means it is not permitted to manually copy and paste data between spreadsheets / software packages. However, it is not clear what the situation will be where a spreadsheet is emailed, for example from a business to their agent, who then imports this into their software. Presumably this is acceptable if export / import is controlled by the software and not manual, but it would be helpful for this to be confirmed.
- 8.2 Example 7 in the Addendum, which deals with the use of an agent, states that “Any correction of mistakes must be made by the agent back into the client’s digital records”. It is more common in practice for business records to be maintained by the business itself and not an agent. It may therefore not be possible for an agent to make such corrections, for example where an agent does not have direct access to a client’s software, but instead takes data from their client which is digitally transferred into their software for the purposes of the VAT return.

## 9 Contact details

- 9.1 We would be pleased to join in any discussion relating to this consultation. Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Emma Rawson, on 07773 087111 or at [erawson@att.org.uk](mailto:erawson@att.org.uk)

Yours sincerely

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## 10 Note

- 10.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and

knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 8,000 members and Fellows together with over 5,700 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.