Making Tax Digital for VAT

Main issues for consideration

Businesses whose taxable turnover exceeds the VAT registration threshold will need to keep their records digitally, using MTD functional compatible software, and create the VAT return from that (or a combination of) software, for return periods starting on or after 1 April 2019, unless the mandation deferral period of 6 months applies. For the minority of businesses to which deferral applies, the MTD for VAT obligations commence for return periods starting on or after 1 October 2019.

Key documents / announcements include:

- The announcements in July 2017 around Making Tax Digital, placing VAT firmly at the vanguard of the proposals.
- Finance (No. 2) Act 2017 includes legislation providing for the introduction of MTD for VAT (section 62 – as well as other clauses for income tax).
- Regulations were laid in relation to the VAT requirements in February 2018.
- Notice 700/22: *Making Tax Digital for VAT* provides further explanation of the requirements and was published in July 2018.
- HMRC also released a stakeholder communication pack for advisers, software developers and professional/trade bodies to use with clients, customers and members. This includes the list of deferred businesses.
- The list of MTD for VAT software suppliers which is updated regularly as new software suppliers complete the testing process.
- HMRC opened the VAT pilot in October 2018 and now all taxpayers, with the exception of overseas businesses, can join the pilot (as well as agents acting for such businesses). It is anticipated that the pilot will be opened to overseas businesses by April 2019.

We continue our engagement with HMRC, both directly, and within the various MTD forums.

Here we look at some of the issues faced by businesses and their advisers, and the changes MTD will require.

Headline issues

1. ***Changes to record keeping*** – Businesses in scope will no longer be able to keep manual records. Digital records must be maintained in what is defined as 'functional compatible software' – broadly, software or spreadsheets (or a combination thereof) which can connect to HMRC via an Application Programming Interface (API) – and these must capture more information than is currently required to be recorded.

2. ***Changes to VAT return calculation*** – When calculating the VAT return, the figures from bookkeeping / accounting software should not be manually rekeyed into another package (say) a spreadsheet, which would ordinarily deal with VAT adjustments or combination of data sources. Information will need to be transferred digitally. However, there will be a "soft landing" in the first year of MTD, allowing more time for these digital links to be put in place, during which manual transfer or 'cut and paste' (and 'copy and paste') can still be used . For businesses mandated from 1 April 2019 that

soft landing period will end for VAT periods commencing on or after 1 April 2020, for businesses mandated from 1 October 2020 will end for VAT periods commencing on or after 1 October 2020.

3. ***Changes to VAT return submission*** – VAT returns must be submitted to HMRC by means of a business's functional compatible software communicating digitally via HMRC's API platform, and not by manually entering the VAT return figures onto the HMRC portal. It is understood that the HMRC portal will be 'switched off' to businesses mandated into MTD, after a short period of time.

4. ***Timing*** – MTD for VAT is still expected to commence from 1 April 2019 for the majority of affected businesses, which is the same time as the UK leaves the EU. Notwithstanding the proposed EU Exit transitional period to 31 December 2020, uncertainty around the VAT treatment of transactions between the UK and EU will inevitably arise, and businesses will need to both understand any tax-technical changes to the rules, and ensure that their accounting systems deal with such transactions correctly. In any event, April 2019 remains a challenging time frame, particularly as the public pilot has only operated for a short period.

Delving deeper into the detail

The table below delves a little deeper into the types of issue that MTD for VAT will create.

This table is a living document and we will update it as our understanding of MTD for VAT develops.

Current position / approach	***Expected* position under MTD**	**Likely problem areas / challenges**
Maintaining your business records		
Business can use manual records, spreadsheets, accounting software, or a combination of all three.	Businesses will no longer be able to use manual records, subject to limited exemptions for some taxpayers set out in the row below (Exemption from MTD for VAT). Businesses must use 'functional compatible software' (digital records) to meet the new requirements. Digital records means a software programme or programmes which can connect to HMRC's systems via an Application Programming Interface (API). The software must be able to: • Keep the required records in a digital form;	As with the original MTD proposals, transitioning businesses from manual to digital records will be challenging. Business will need advice selecting appropriate software Spreadsheet users will need bridging software or API-enabled spreadsheets to digitally submit the VAT return data to HMRC.

	• Preserve those records in digital form for up to 6 years; • Create a VAT return from the digital records; • Provide HMRC with this information digitally; • Provide HMRC with additional data on a voluntary basis; and, • Receive information from HMRC about the business's compliance record.	Larger businesses using complex / bespoke software will need to ensure that it is or becomes MTD compliant. Businesses should start planning the move to digital records sooner rather than later, getting advice from their agent where appropriate. HMRC has published a list of software developers who have gone through successful testing. The list includes developers that provide bridging software / API-enabled spreadsheets.
Exemption from MTD for VAT	The following are exempted from MTD for VAT: a. The person / business meets one of HMRC's MTD exemptions: - Religious beliefs incompatible with the use of electronic communications - Not reasonably practical due to age, disability, remoteness of location or other reason - Subject to an insolvency procedure b. The business is voluntarily registered for VAT and trading under the VAT turnover threshold. No other exemptions are currently available, so (for example) charities, local authorities, trusts etc, are all within the scope of MTD for VAT if their taxable turnover exceeds the VAT registration threshold.	Taxpayers who already hold an exemption from online filing will be automatically exempt from MTD. No action is required. Exemptions under a. must be applied for, with the application being made to HMRC via the VAT helpline or by letter. The standard of evidence to support the exemption application for 'not reasonably practical' is anticipated to be the same as the current exemption for online filing of VAT returns. It is likely that more businesses will fall within this exemption for MTD for VAT as compared to online filing of returns. A business that is exempt from MTD for VAT under b. may elect not to be exempt and therefore file its returns digitally in accordance with MTD. It may also withdraw its election at a later time, providing it still fulfils the criteria for exemption. If a VAT registered business's taxable turnover falls below the VAT registration threshold after

		previously exceeding it (i.e. the time when threshold was exceeded was post 1 April 2019), it must still comply with the requirements of MTD for VAT until deregistration.
Information / records to be reported / maintained		
VAT-registered businesses must currently keep records of sales and purchases, a separate summary of VAT called a "VAT account", and issue VAT invoices if necessary.	The Regulations set out the required content of digital records. These require more information to be captured than at present. For example: a. Sales and purchases need to be recorded on a supply-by-supply basis, rather than simply on an invoice, statement / or payment basis. b. For supplies made, the Regulations require businesses to record the different rates of VAT applicable, and the amounts chargeable at those rates. c. For supplies received, the Regulations require businesses to record the amount of input tax that will be claimed. d. It is necessary to capture the proportions of the VAT-exclusive values of outputs, split across the various different VAT liabilities. However, there are relaxations in Notice 700/22, for example: a. For supplies made, example 1, para 3.2.2 of Notice 700/22 states that for sales with multiple items at the standard and zero rates only require the total at each rate. b. For supplies received, para 3.4 of Notice 700/22 states that where the input tax claimed has been changed as the result of an adjustment you do not	Whilst Notice 700/22 provides some relaxations from the requirements in the Regulations, many businesses will not currently capture the level of detail required, and so additional work / new processes will be necessary. Indeed, some of the information might not be available at the point of capture eg the amount of input tax to be reclaimed on an expense, and will therefore require subsequent adjustment. We are in discussions with HMRC to see whether some of the requirements can be relaxed on the basis that they are be *impossible, impractical or unduly onerous* – such as where a business makes payments against supplier statements, and just records the statement amounts – or petty cash (see below). More information in relation to specific matters is set out below.

	need to amend the digital record of the supply (this has the force of law).	
VAT return calculation and submission		
Prior to MTD, whilst 99% of VAT returns were filed online, only around 13% of VAT returns were filed direct from software. For the remaining 87%, the VAT return figures were typically entered manually into the HMRC government gateway page and submitted to HMRC that way ie requiring manual input / intervention.	VAT returns must be filed directly from the digital records, such as from the record keeping software, an API-enabled spreadsheet, or bridging software. *Subject to the soft landing below*, the transfer of data between digital records (including spreadsheets) must be digital, with no manual transposition of figures. These digital links must be in place where the data that is being transferred represents that which is mandated to be captured in digital records (as set out above). For example, the transfer of input and output VAT amounts between digital records must be done digitally as those values are required to be captured in the digital records. Information which is not required to be captured digitally, such as adjustments to those figures because of partial exemption or fuel scale charges etc, do not need to be undertaken digitally (see below).	Many businesses use spreadsheets or manual calculations to compile the VAT return figures. This process will need to be reviewed, and digitised where necessary, to comply with the requirements. This might involve creating or purchasing new software or developing functionality to enable this automatic linkage to take place.
Soft landing period and other penalties	For VAT return periods commencing between 1 April 2019 and 31 March 2020, HMRC will not enforce the requirement to have digital links between software programs. This easement is referred to as the 'soft landing period'. For VAT returns commencing after this time, all transfers of data between digital records must be done digitally. There is no soft landing period for the digital submission of the VAT return. For those businesses subject to the six month deferral period, the soft landing period will apply for VAT return periods commencing between 1 October 2019 and 30 September 2020.	During the soft landing period, the use of 'cut and paste' (and 'copy and paste'), or manual transposition, is acceptable as set out in paras 3.2.1 and 3.2.1.1 in Notice 700/22. After the soft landing period ends, the use of cut and paste (and 'copy and paste') will not be compliant with MTD for VAT. The ICAEW sets out the penalty position for MTD on its webpage here.

Adjustments are often required prior to submission of the VAT return, such as for fuel scale charges, partial exemption, and so on. These can currently be done in a variety of ways, prior to submitting the VAT return.	There are two main ways in which VAT adjustments can be made under MTD: 1. The business undertakes the calculation outside of software (e.g. on a spreadsheet or manually), and journals the effect of the calculation back into the software. The VAT return can then be submitted directly from the software. 2. The business exports data from the software into a spreadsheet. A digital link will be needed (see above) because the data represents that which must be kept digitally. The adjustments and VAT return calculation are undertaken in the spreadsheet. The business then uses bridging software or an API-enabled spreadsheet (ie a digital link) to extract the VAT return figures and submit them to HMRC.	This is one of the more complex areas of MTD for VAT. Examples are set out in part 3 of Notice 700/22 to illustrate where digital links are required, and where adjustments can be made outside of functional compatible software.
VAT return content		
There are nine boxes on the current VAT return. There is no easy way to provide additional information to HMRC alongside the VAT return.	There is currently no proposal for the number of boxes on the VAT return to change. Depending on the position for a no-deal Brexit outcome, boxes 2, 8 and 9 may change with the move to postponed accounting and acquisitions/dispatches becoming imports/exports. In the future, businesses will be able to voluntarily submit a specific data set of supplementary data. Part 5 of Notice 700/22 confirms that full details will be published in due course, but are anticipated to include the proportions of the Box 6 outputs value between the various rates of VAT, and any adjustments made to input or output tax figures. Functionality for provision of supplementary data is not expected to be available for some time.	If the business is selected for a compliance check, HMRC will review any supplementary data to see whether it provides sufficient assurance that the return is correct. Other than this supplementary data, we do not expect it to be possible to provide other information, such as copy invoices or written explanations. Whether provision of this information can be done on an ad-hoc basis is something we have asked HMRC to confirm. Also, the legal status of this supplementary data is currently unclear (eg for compliance / disclosure purposes etc). Errors in

		supplementary data must be corrected, but will not be subject to a penalty.
Amendments and error corrections		
Amendments and error corrections below certain thresholds can be amended on the next VAT return. Otherwise, a disclosure must be made on a form VAT 652.	These rules will continue as now, although HMRC is considering options for non-mandatory electronic channels for submission of a form VAT 652. Errors in voluntary updates or supplementary VAT data (when these go live in due course) can simply be corrected through the digital records (irrespective of the value) as these are not VAT adjustments under the regulations.	Businesses will need to ensure that any adjustments which must be separately disclosed are excluded from the VAT return prepared by the digital records.
VAT groups / organisations with multiple accounting systems		
Individual entities / divisions etc can maintain their own records in whatever form they choose, and those figures are consolidated each period for the preparation and submission of the VAT return by the representative member.	As outlined above, these records must be kept digitally and there needs to be a digital link from the various digital records held by VAT group members / divisions etc, through to the submission of the VAT return to HMRC. The six month deferral period applies to VAT groups/divisions trading in the UK, so the date of MTD mandation will be for VAT returns that commence on or after 1 October 2019. Note that the soft landing period for digital links is also extended until the first VAT return period commencing on or after 1 October 2020. The MTD for VAT pilot opened in January 2019 to VAT groups meeting the entry criteria and entry to the pilot for VAT divisions opened in February 2019.	VAT groups / complex organisations will need to create or purchase new software or functionality to enable this digital linkage to take place in order to enable the VAT return to be submitted from the digital records.
Overseas businesses trading in the UK		

As with UK businesses, overseas businesses have flexibility in how they maintain their records, and can submit returns through the HMRC portal.	Overseas businesses that have UK taxable turnover in excess of the UK VAT registration threshold will be subject to the requirements of MTD for VAT as outlined above. Overseas businesses registered for UK VAT but whose UK taxable turnover is below the UK VAT registration threshold are not mandated, but can opt in to MTD for VAT if they so wish. The six month deferral period applies to overseas businesses trading in the UK, so the date of MTD mandation will be for VAT returns that commence on or after 1 October 2019. Note that the soft landing period for digital links is also extended until the first VAT return period commencing on or after 1 October 2020. The MTD for VAT pilot is not yet available to businesses based overseas. HMRC anticipate that this will be available by spring 2019.	It may be more difficult for overseas businesses to comply with MTD for VAT as their UK activities are likely to be just a part of a larger whole. Further, the record keeping may be undertaken in the business's 'home' country and the submission undertaken from there. It may be possible to apply for exemption on the grounds that it is "not reasonably practical", but such applications will be considered on a case by case basis. We understand that overseas agents will be able to access MTD for VAT (see 'overseas agents' section below).
Annual Accounting		
Under the Annual Accounting Scheme businesses submit just one VAT return a year, and make advance VAT payments based on the last return submitted.	Annual Accounting will be retained with the current conditions. However, the MTD requirements will otherwise apply, ie digital records must be maintained, and the annual VAT return must be filed through API-enabled software. The six month deferral period applies to annual accounting businesses, so the date of MTD mandation will be for VAT returns that commence on or after 1 October 2019. Note that the soft landing period for digital links is also extended until the first VAT return period commencing on or after 1 October 2020.	See comments elsewhere.

	The MTD for VAT pilot opened to taxpayers using annual accounting in February 2019.	
Retail schemes		
Retail schemes have their own special rules, both around record keeping requirements and calculations of VAT due.	Retail schemes users will be permitted to electronically record sales transaction data based on daily gross takings, rather than recording details of each individual supply. However, the MTD requirements will otherwise apply. More information is set out in in para 3.5 of Notice 700/22.	Some businesses that are not strictly retailers may not realise that they are already using a retail scheme for part or all of their income eg bed and breakfast accommodation, restauranteurs etc. The relaxation on reporting daily gross takings (DGT) rather than the individual transactions in the DGT may be missed by these businesses.
Flat Rate Scheme (FRS)		
Businesses eligible to use the FRS account for output tax as a specified percentage of turnover and don't claim input tax on most purchases.	Digital record keeping requirements will broadly mirror current record keeping requirements, ie FRS users must keep digital records of sales, but only need to record purchases of capital goods costing £2,000 or more including VAT – see para 3.6 of Notice 700/22. 'Relevant goods' used to determine if the limited cost business rate applies do not need to be kept digitally. However, the MTD requirements will otherwise apply. The pilot opened to flat rate scheme users in December 2018.	See comments elsewhere.
Petty cash and other small value items		

Because there is currently no stipulation as to how a business maintains its records, small value purchases are often 'batched' or recorded in a petty cash book etc.	Other than a few limited exceptions (such as for employee expenses – see para 3.3.3 of Notice 700/22) all purchases need to be captured in the digital records on a supply-by-supply basis. This includes low value items that might be paid out of petty case etc.	We are in discussions with HMRC to see whether the requirements can be relaxed as they appear to be *impossible, impractical or unduly onerous*.
Cash Accounting		
Businesses typically enter the amounts received or paid as single items, even if they represent payments for one or more supplies / invoices (although there is a requirement to cross-refer to the individual invoices). Further details are set out in Notice 731	Businesses can use the date of receipt or payment as the 'time of supply' for the purposes of recording their transactions. However, HMRC stipulate that businesses will otherwise need to follow the rules for recording sales and purchases on a supply-by-supply basis; this increasing and complicating the entries in the business' records.	We are in discussions with HMRC to see whether the requirements can be relaxed so that they are more consistent with the current rules.
Second hand margin scheme, and global accounting		
The current requirements of the second hand margin scheme / global accounting are set out in VAT Notice 718. There are particular record-keeping requirements eg keeping a stock book.	Whilst the requirements of MTD will apply to these businesses, not all records will need to be maintained digitally. For example, the stock book will not need to be kept in digital form. However, complex record keeping entries will be needed if the software does not automatically calculate the VAT on the margin. Para 3.8 of Notice 700/22 refers.	We have raised these complexities with HMRC, along with questioning how businesses that use global accounting should record their transactions. We will share more detail as it becomes available.
Other special schemes		

There are a number of other special schemes within VAT, such as margin schemes etc (see below), each of which have their own record-keeping nuances.	The requirements of MTD apply to businesses who use these special schemes, but the requirements of MTD are adapted to facilitate the particular nuances of those schemes. More information is available in [Notice 700/22]().	See comments elsewhere.
Businesses that are voluntarily registered for VAT because their turnover is below the VAT threshold		
They have the same record keeping and reporting obligations as businesses that are compulsorily registered for VAT.	These businesses will not be required to comply with the MTD record keeping and reporting obligations. The existing method of online filing of VAT returns with HMRC will be retained for these businesses. However, these businesses can choose to enter MTD for VAT on a voluntary basis if they so wish. If they do elect to use MTD, they have the option to withdraw at a later time (unless the position changes as MTD is rolled out to other taxes – see right) provided they continue to quality for exemption.	We do not know when (or if) these businesses will have to comply with MTD for VAT, although if businesses are mandated into income tax in April 2020 (or later) it is possible that the VAT requirement will be extended to voluntary VAT registrations at that stage. In the meantime HMRC will have to run two systems, and at some point they will wish to "turn off" the VAT portal.
Brexit		
Sales / purchases from the EU are fairly straight-forward and understood. Whilst there are some administrative obligations (Intrastat, EC Sales Lists), the VAT and customs position is greatly simplified.	The position is currently unclear (which itself presents challenges). Sales and purchases of goods to and from the EU could become exports and imports and subject to VAT and duty if there is a 'hard' Brexit, although postponed accounting should be introduced. The VAT liability of some transactions might change (eg financial services). Reporting obligations will change.	Again there are many, including: • Making sure businesses / relevant personnel understand the tax-technical and administrative changes caused by leaving the EU. • Software will need to be developed and implemented to deal with the changes, which could be challenging because a) it might not be until much nearer March 2019 or into the proposed transitional period ending on 31 December 2020, when it is known what the actual requirements are and b) it takes time to develop and roll-out new software.

UK Agents/Overseas Agents		
UK agents: At present, UK agents can maintain the accounting records, submit the VAT return data to HMRC etc.	An agent's abilities should be mirrored with their clients under MTD. MTD for VAT functionality is part of the new Agent Services Account. For an existing agent, the client authorisations can be linked to the agent's ASA where an existing online filing authorisation is in place.	Agent functionality has been tested with volunteers in the MTD for VAT private pilot for agents with clients meeting the entry criteria. The public pilot is open to agents whose clients meeting the entry criteria. Agents can also change their clients' details digitally if both the agent and their clients are in the public pilot. Part 6 of Notice 700/22 provides brief information around agents and MTD for VAT and HMRC has published a communications pack for stakeholders including agents on GOV.UK.
Overseas agents: At present, overseas agents are in the same position as UK agents, i.e. they can maintain the accounting records, submit the VAT return data to HMRC etc.	Overseas agents are able to sign up for an agent services account (ASA), which has the same functionality as UK agents above.	If an overseas agent completes VAT returns for UK businesses that are mandated into MTD for VAT for VAT returns commencing on or after 1 April 2019, an ASA will be required.
Engagement letters may require updating	The scope of the services should be agreed between agent and client. The CIOT has template engagement letters including MTD on its website.	
Non-VAT / other reporting		
For indirect tax, only VAT is within the scope of MTD at present, so other indirect taxes (IPT, MGD etc) will continue as at present, as does the current	No change, although it may be that some elements become increasingly digitised (e.g. Intrastat). The form VAT21 is also understood to become within the scope of MTD.	Businesses may have to cope with two types of accounting records / reporting, if VAT becomes digital, but other taxes / aspects are not.

method of reporting statistical VAT information (Intrastat, EC Sales Lists etc).		
Other comments		
VAT pilots / software testing		
The private pilot of MTD for VAT started on 11 April 2018. The pilot built on the small-scale technical testing HMRC started at the end of 2017, and HMRC invited a small number of businesses with the simplest VAT affairs first. The public pilot was opened up to more simple businesses meeting the entry criteria in October 2018 once testing had been successful and the functionality was available. The pilot is now open to all taxpayers other than overseas businesses. The pilot should be available to deferred businesses in spring 2019, though HMRC announced in January 2019 that it was open to VAT groups meeting the entry criteria. If a business' software provider is not yet on HMRC's published list, they should ask their software provider when their product will be updated for MTD. We understand that there are some software providers whose products are customer ready, but nobody in their client base meets the entry criteria for the pilot, hence they are not able to complete all testing and do not yet appear on HMRC's list. See above re availability and choosing software.		
Costs		
Businesses that do not currently use software will need to buy software (and possibly hardware) to be MTD compatible. Other businesses will need to upgrade or develop bespoke systems. Some software developers have free bridging software available. Businesses may also require further help from their agent, or additional internal resource, at least initially to transition to digital records, and create the digital flow of data to HMRC. We understand that at least one provider will make its bridging software available to taxpayers for free. In a Technical Note published on 1 December 2017 HMRC estimated the average transitional cost for businesses to become MTD compliant was just £109. They also estimated (net) additional ongoing additional costs on average of just £31 per annum. These estimates seem surprisingly low as compared with the requirements outlined above.		
Simplification		

The Office of Tax Simplification published its report Value added tax: routes to simplification on 7 November 2017, and considers how MTD interacts with several of its suggestions.

The VAT registration threshold: call for evidence and the summary of responses recognise that MTD could add to the bunching effect of businesses which trade just below the VAT registration threshold.