Making tax digital for business - VAT

In a nutshell

April 2019 is likely to be a busy time for businesses. We will, if the current timetable applies, just have left the EU and the first phase of Making Tax Digital (MTD) for Business goes live. That first phase is VAT.

From April 2019 all VAT registered businesses with a turnover in excess of the VAT registration threshold (taxable supplies of £85,000 per annum, frozen for two years) will have to maintain digital records for VAT and submit their VAT returns digitally. There will be some limited exceptions – in line with the current exceptions for businesses that are unable to submit returns electronically (whether due to religious beliefs, lack of internet access etc). However there will be no general exceptions for overseas businesses or charities. Once a business is covered by MTD it will remain within the regime even if its turnover later goes below the threshold. Businesses for whom it is not mandatory can option into MTD if they wish.

Businesses will not be asked to keep digital records for other taxes until at least 2020 so as to give HMRC a chance to assess how the VAT regime is working. However as businesses do not tend to keep wholly separate records for the different taxes this timing concession probably means little in practice. MTD will undoubtedly come for income tax and corporation tax further down the line and any software investments/changes made for MTD VAT should bear that in mind.

Purpose of MTD

As well as showing that the tax regime is moving with the times, HMRC envisage that MTD will have a positive impact on the tax gap as it should remove the mistakes that arise when VAT figures are wrongly entered because of manual intervention in the return submission process.

VAT errors and mistakes by taxpayers account for around £3 billion of the tax gap according to HMRC (this is about a third of the total for taxpayer errors/mistakes) and most of these are likely to be made by smaller businesses hence, no doubt, why MTD will apply from the outset to all VAT registered businesses that are over the threshold, and not to just the larger ones first. Even a small reduction in this £3 billion will be worthwhile for HMRC.

Simple mathematics though tells us that two thirds of taxpayer errors will be wholly unaffected by MTD VAT as they are not VAT errors made by businesses over the threshold. The Chancellor decided in the 2017 Autumn Budget not to reduce the VAT registration threshold and simply to freeze it for two years – thus keeping many smaller businesses out of the MTD net, for now.

What does MTD VAT mean for business?

MTD Vat involves three things:

- Maintaining details of the business transactions that directly lead to the creation of the summarised VAT return figures due for periodic submission to HMRC in digital form within a software package or packages.
- Information transfer between each software package that is directly used to produce the taxpayer's VAT return must be digital (non-manual with a digital link).
- VAT return information can only be submitted to HMRC via a software package compatible with HMRC's Application Programming Interface (API) standard. An API is a set of clearly defined methods of communication between various software components.

For some of the larger businesses who already keep digital records and have automated VAT compliance processes that comply with the first two requirements mentioned above, MTD may only require investment in some bridging software to allow the business's software package(s) to talk to the HMRC systems and enable them to comply with the third requirement. For others rather more action may be needed, depending on how they arrive at their VAT return figures at present and how digital their current records are, if at all. Complying with MTD may be much more onerous for those, generally smaller, businesses who will first need to transition to digital records as well as submitting the return differently.

HMRC would like a seamless digital link from the recording of transactional data in the digital records through to the submission of the VAT return from the functional compatible software. However many businesses have complex VAT accounting (Partial Exemption Special Methods (PESMs), business/non business apportionments, overseas transactions and so on) where some manual intervention is essential to arrive at the correct VAT figures because the software that can do it all simply does not exist. A spreadsheet is a digital record but API enabled software will be needed to extract the data from the spreadsheet and transmit it.

As part of the release of the draft legislation HMRC has issued some examples for businesses with different digital record-keeping options to outline where mandatory digital links will be needed. The transfer of data from the mandatory digital records (see below) to HMRC must be digital. The mandatory digital records can be kept in different places as long as transfer between those places is also digital. However there will be an additional year during which the digital link from non API enabled software/legacy systems to a collating spreadsheet, while desirable, will not be mandatory and no record keeping penalties will be applied in that year either.

What should businesses do now?

The draft legislation and guidance has now been released and while it is still open for consultation we now have a better idea of what will be mandatory and where there is some flexibility (or a transitional period to allow businesses longer to comply).

The digital records will include designatory data about the business, the VAT account, the totals of any adjustments like credit notes etc and transactional data (time and value of each supply made and received, the rate of VAT charged on supplies made and deductible input tax on supplies received) together with a record of outputs (supplies made) in the period, broken down into totals for each different VAT rate. This is less detailed than the previous overview intimated. Users of retail schemes will need to record their Daily Gross Takings (DGT) digitally. One useful point is that where adjustments require a calculation (like partial exemption) that calculation does not have to be made in software though HMRC stress more digital links should mean less potential for error.

Businesses should consider their UK VAT audit trail and what VAT complexities apply to them, how they collect the VAT return information and how they currently submit the return, to identify how much of a behavioural and accounting shift MTD will impose. Early discussions with software providers about the software compatibility with HMRC MTD requirements may prove useful. MTD software trials will begin imminently.

What else should I know?

As part of HMRC's plan to de risk businesses MTD allows for additional information to be submitted as the nine boxes on the return in isolation will not explain why sales have gone down, or purchases have gone up, or the pattern of UK and non UK transactions has changed. This additional information is envisaged as purely voluntary at the moment but may be useful if a business wishes to speed up processing of a repayment for instance.

Contacts

Frankie Devlin
Partner
VAT
t: +44 (0)28 9089 3753
e: frankie.devlin@kpmg.ie

John Curry
Director
Tax Technology
t: +353 1 700 4242
e: john.curry@kpmg.ie

Andrew Egan
Director
Tax Technology
t: +353 1 700 4120
e: andrew.egan@kpmg.ie

Jennifer Upton
Director
VAT
t: +44 (0)28 9089 3761
e: jennifer.upton@kpmg.ie

Senan Kavanagh
Manager
Tax Technology
t: +353 1 700 4742
e: senan.kavanagh@kpmg.ie

kpmg.ie

Produced by: KPMG's Creative Services. Publication Date: May 2018. (3619)