



Making Tax Digital

The Basics

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A brief guide to new requirements to keep business records in a digital format, and how that information must be transmitted to HMRC.

WHAT IS MAKING TAX DIGITAL?

The Government wants all taxpayers to communicate with HMRC digitally. The long-term project to achieve this aim is called Making Tax Digital (MTD). Telephone and postal communications will not disappear, but digital channels will gradually become the normal way to transmit information to and from HMRC.

MTD started with the introduction of real time information (RTI) reporting of payroll data by employers at every payday. Employers can see how much PAYE they have paid and are due to be pay, as reported using RTI, by viewing their online business tax account on gov.uk. This account also displays the business' liability to corporation tax, VAT and any other taxes which are administered by HMRC.

Individuals can view their personal tax account on gov.uk. This account is regularly updated with net salary, benefits or pension as reported under RTI. The personal tax account can also provide the taxpayer with an estimate of their tax liability for the year, and access to lots of other services, such as checking entitlement to the state pension. The business tax account and the personal tax account are key parts of MTD for businesses and individuals.

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The next stage of MTD will be to require VAT registered businesses to report figures relevant to VAT to HMRC every quarter, starting from VAT periods beginning on or after 1 April 2019. Once that system has bedded in, MTD will be extended to all businesses and landlords, with an exemption for very small businesses.

WHY MTD?

Digital communications are cheaper for HMRC to process and transmit than those made by telephone or post, as digital services can be largely automated. The Government believes that it will be cheaper and easier for businesses to submit their accounting data to HMRC on a quarterly basis instead of just once a year on an

annual tax return. However, this apparent efficiency saving has not been proven.

HMRC wants each business to submit regular quarterly updates of its accounting data. The reason is that when transactions are recorded at or near the time the transaction occurred, fewer mistakes of omission or duplication are made. HMRC also believes that if accounting software is used to record transactions, and transmit the data to HMRC, human errors introduced during the accounts preparation process are minimised.

HMRC firmly believes that the combination of the use of accounting software, and quarterly reporting of accounting figures transmitted straight from the accounting software, will

improve the accuracy of business accounts. HMRC also think that this will increase the tax payable, on the basis that businesses tend to make mistakes in their own favour rather than to their detriment.

The core of MTD for business is thus based on these two requirements: use accounting software to record transactions, and to submit the accounting data to HMRC with little or no human interaction, on a regular and frequent basis.

When MTD is fully in place HMRC will be able to analyse the accounting data from each business more easily, and seek out anomalies which may indicate that expenses have been over-claimed, or sales have been under-declared.

WHEN WILL MTD APPLY TO YOU?

The next stage of MTD will come into effect for VAT periods beginning on or after 1 April 2019..

VAT registered businesses which have an annual turnover of £85,000 or more will be required to maintain digital accounting records, and use accounting software to report VAT-related accounting data each quarter to HMRC.

Other businesses will be able join the MTD project on a voluntary basis, but quarterly reporting of figures under MTD for income tax and corporation tax won't be a requirement until April 2020 at the earliest.

WHAT WILL YOU NEED TO DO?

There are two parts to complying with the MTD regulations:

1. Keep business records in a digital format.
2. Submit accounting data to HMRC using MTD compliant accounting software.

The MTD for VAT regulations will require businesses to report exactly the same data as is submitted on the current VAT return. The MTD quarterly report will effectively replace the VAT return.

When MTD is expanded to other taxes, the quarterly MTD reports are expected to replace the annual corporate tax return and the business pages of the self-assessment tax return. However, each business will have to submit a quarterly

MTD report for each tax it pays. Thus, a VAT registered company will submit four quarterly reports for VAT and four quarterly reports for corporation tax.

In addition, there will be an opportunity for the business to make an annual check on the data it has submitted under MTD, and make any accounting adjustments necessary. This will effectively be a fifth report each year for each business, for each tax it pays.

What are digital records?

Businesses will be expected to maintain their accounting records using MTD-functional software. This is a software package, or set of compatible software tools (see examples), which can be connected to the HMRC system via an application programming interface (API).

As the next stage of MTD is focused on VAT reporting, the MTD regulations only require the business to keep digital records of information necessary to complete the quarterly VAT reports. However, as that VAT data comprises all of the business sales and all of the purchases (unless the flat rate scheme is used), the digital records requirement will cover most of the accounting records of the business.

The MTD regulations specify that the following must be recorded digitally:

- identification details: name, address, VAT number and VAT schemes used;
- VAT account: totals of input and output tax and any adjustments;
- for each transaction: date, invoice totals and VAT charged, with some exceptions for businesses which use special schemes.

How is the submission made?

HMRC would like the business to make the submission of VAT information to HMRC directly from the accounting software that is used to maintain its accounting records. However, that won't be a legal requirement.

Businesses will be permitted to use several different software tools to undertake calculations needed to reach the VAT return figures. These permitted software tools will include spreadsheets.

Example 1

Golf Ltd is a partially exempt business, as some of its sales are exempt from VAT. It records all its transactions in accounting software A. The internal accountant for Golf Ltd uses a spreadsheet to calculate the adjustments needed to the input VAT under the partial exemption rules. The accountant then makes a journal entry into software package A to amend the VAT input tax that will be claimed.

The adjusted totals of input VAT and output VAT are exported digitally from software A to software C, which uses an API link to transmit the final totals to HMRC's systems. If the transfer of data between software A and software C is performed digitally, the MTD requirements are met. The use of a spreadsheet to undertake the partial exemption calculations is acceptable, even if the data is transferred to and from the spreadsheet manually.

Example 2

Mr Small is a VAT registered sole trader. He records all his transactions in a spreadsheet. Each quarter he emails this spreadsheet to Ann, his accountant.

Ann imports Small's transaction data electronically from the spreadsheet into her commercial MTD-functional software. Ann checks that VAT has not been claimed for purchases which are blocked under VAT law, such as for cars or entertaining. Ann then uses her MTD-functional software to submit Small's VAT data to HMRC each quarter, and tells Small what VAT he must pay.

What will be submitted?

The VAT data submitted under MTD will be exactly the same as that provided in the nine boxes on the current VAT return. Only the totals of sales and purchases, imports and exports will be submitted in the VAT report, not the detail of each transaction. However, see below regarding supplemental information.

The current interactive VAT form does little more than add up figures from some of the boxes. It doesn't prompt for missing information, or make a sense-check for a pattern of returns made by that business. The MTD-functional software will be able to perform such checks on the figures

submitted. For example, the MTD functional-software could compare the current figures to totals submitted in earlier periods for consistency, and thereby spot errors or omissions.

At present it is very difficult for a business to send additional information to HMRC to explain an unusual VAT return, such as a one-off repayment claim. Such additional information could head off an unnecessary enquiry from HMRC, or speed up a VAT repayment. Under MTD the business will have the option of submitting supplementary data to support the VAT figures. However, once the business has committed to providing supplementary data, it will have to provide that extra data with every subsequent VAT report.

When will the submission be made?

The VAT reporting dates won't change under MTD. Businesses will report their VAT information by the same deadlines and for the same VAT periods as they do currently. There will be no requirement to change VAT quarters to align with the company's accounting period or with the tax year, if the business' VAT quarters do not already align.

Businesses which submit monthly or annual VAT returns will continue as they do now. Those businesses won't have to move to quarterly VAT reporting, although they will need to comply with the digital record-keeping requirements.

WHO IS EXEMPT FROM MTD?

If one of the following circumstances applies to the business, such that it is exempt from MTD reporting, it will have to contact the VAT helpline to discuss alternative arrangements to submit its VAT figures.

A business can't simply choose to be exempt from MTD reporting. If the facts make it exempt, it can still elect to submit MTD reports using suitable software before the start of the next accounting period.

Ability to use technology

Where a business owner is unable to use computers or other digital tools due to reasons of disability, age, or remoteness of location of the business (e.g. no broadband access), that business will be exempt from MTD reporting requirements. However, where the business is a

partnership, every partner in that business must qualify for an exemption for the whole business to be exempt from MTD reporting.

HMRC has not indicated how old a person must be in order to qualify for an MTD exemption on the basis of age.

Religion

Where all the business owners are practising members of a religious society, whose beliefs prevent the use of computers, that business will be exempt from MTD reporting.

Insolvency

While the business is subject to insolvency procedures it will not be required to submit MTD reports.

Low turnover

Where a business has registered for VAT on a voluntary basis, as its turnover is less than £85,000, it won't be required to make MTD reports, but it can choose to do so.

This also applies to an overseas business which is required to register for VAT in the UK as it makes some sales in the UK. If its UK turnover is less than £85,000 per year, it won't be required to make MTD reports, but it also can choose to do so.

Not VAT registered

Businesses which are not registered for VAT do not have to submit MTD reports, yet. This is the case even where the annual turnover exceeds £85,000 but it is not VAT registered because its sales are exempt from VAT, such as for a residential landlord. When MTD is extended to include reports for income tax and corporation tax, such a business will be required to make regular MTD reports.

Charities

A charity which is registered for VAT because its turnover exceeds the VAT registration threshold of £85,000 will be required to make MTD reports.

DEREGISTRATION FROM VAT

Once a business is drawn into the MTD reporting regime, because it is VAT registered and its

annual VATable turnover exceeds £85,000, it remains within the MTD regime until it deregisters from VAT.

A business can deregister if its VATable turnover is expected not to exceed £83,000 in the next 12 months. The deregistration threshold has been fixed at this level until 31 March 2020.

MTD-FUNCTIONAL SOFTWARE

Currently only 12% of VAT returns are submitted directly to HMRC from accounting software. If your accounting software has the ability to do this now, talk to your software provider about how and when future versions will be MTD-compliant.

HMRC will not provide software to enable businesses to make MTD reports for VAT. Each business which is required to make MTD reports for VAT will have to purchase MTD-functional software, or use the services of an accountant to submit their VAT report.

HMRC has asked businesses to apply to take part in a pilot to submit MTD reports for VAT from April 2018. The number of businesses chosen for the MTD pilot will be limited, as HMRC wish to give each of those businesses personal support throughout the trial period. Those businesses will have to use commercial software to take part in the pilot, so if you wish to be one of those pioneers, talk to your software provider.

HOW WE CAN HELP

The first step towards complying with MTD will be to get all your accounting records into a digital format. You may need to buy or upgrade your computer systems, and consider what sort of software you require.

We can help you with the initial transition to digital records, and to set up software to submit reports to HMRC. Alternatively, we can help you transfer your VAT data to us so we can submit MTD reports on your behalf.