

The introduction of Making Tax Digital for VAT

August 2018

1. Introduction

Next year will see an important landmark in the development of the UK VAT system: the introduction of Making Tax Digital for VAT. This new requirement will mark a large upheaval in the way businesses comply with their VAT reporting obligations.

This guidance is based on Regulations¹ and a new HMRC Public Notice. This is an updated version of our note dated 1 May 2018. The changes reflect primarily information contained in the HMRC Notice published in July and which can be seen [here](#). We strongly suggest that this note is read in conjunction with the HMRC guidance.

We will update this note further as more information becomes available.

HMRC believe that MTD will make a large contribution to reducing the “VAT Gap” by helping to eliminate taxpayer error. It is widely anticipated that this is just the first step towards the real time filing of individual transactions with HMRC.

MTD is a complex subject. The purpose of this note is to summarise what we consider to be its main aspects with a particular emphasis on how it may affect those within the travel and events sectors. There has been great uncertainty about how TOMS VAT can be accommodated within MTD. Some questions have now, we believe, been answered and in section 9 below we consider how TOMS accounting can be incorporated into MTD.

2. What is changing?

MTD introduces a requirement that businesses keep certain records in digital form and file VAT returns using “functional compatible software” (see our section 5). For those affected (see below), manual records will no longer be acceptable and returns will cease to be submitted via the HMRC portal. The software used must be able to provide information digitally to HMRC and to receive information from HMRC via HMRC’s API platform.

3. Who is affected?

VAT-registered businesses with a taxable turnover above the VAT registration threshold (currently £85,000 a year) will be required to comply with these new obligations. There are few exemptions from this requirement: broadly, only those businesses which are currently excused the online filing of returns (for example on religious grounds or where there is poor broadband connectivity) can be exempted from MTD. Any businesses registered voluntarily (i.e. those with a taxable turnover below the threshold) can opt into the arrangements.

¹ The Value Added Tax (Amendment) Regulations 2018, SI 2018/261

A taxable supply is a supply of goods or services made in the UK other than an exempt supply. As above, a business is only compulsorily subject to MTD if the value of its taxable supplies exceeds the registration threshold. This raises an interesting question for many travel and events businesses. The value of a TOMS supply is the margin. Therefore, it appears that a business making TOMS supplies is only liable to use MTD if its margin, plus the full value of any other UK taxable supplies, exceeds the threshold. Furthermore, many non-TOMS supplies may not count towards the threshold. For example, in-house supplies, packages supplied on a wholesale basis and non-UK standalone services supplied on a wholesale basis are often not UK supplied services and therefore do not appear to count towards the MTD threshold. However, the HMRC Notice (para 2.1) states that taxable turnover “is the total value of everything you sell that is not exempt from VAT”. This is not the same thing and suggests that services supplied outside the UK *should* count towards the MTD threshold. We do not think this is a proper interpretation of the Regulations. We wrote to HMRC on this point in May but have not had a reply. We are following up on this. If we are correct, many travel and events businesses may be able to achieve total turnover well in excess of £85,000 before becoming liable for MTD.

The rules apply equally to UK and overseas businesses. Therefore, any VAT-registered business, no matter where it is conducted, will need to comply with the MTD regulations if it has UK taxable turnover above the threshold.

4. When do the new rules start?

The rules apply to VAT return periods starting on or after 1 April 2019. There will, therefore, be a staggered introduction. Businesses which submit returns on a calendar quarterly basis, and those with monthly returns, will need to comply from 1 April 2019; those which have January, April, July and October quarter ends will be required to comply from 1 May 2019 and those with February, May, August and November quarter ends from 1 June 2019.

5. What is functional compatible software?

As above, all businesses within MTD must keep records and file returns using functional compatible software. HMRC’s guidance (para 3.2) states that functional compatible software is a programme or set of programmes, products or applications which must be able to:

- Record and preserve digital records;
- Provide to HMRC information and returns from the digital records using HMRC’s API platform; and
- Receive information from HMRC again using the API platform.

Digital records can be kept in a number of compatible digital formats. A spreadsheet can be a part of a business’s functional compatible software. There is more detail on the use of spreadsheets below.

However, where two or more programmes etc are used, there will need to be a “digital link” between each item of software. A digital link involves a transfer or exchange of data electronically between software programmes without any need for manual intervention. Such transfers and exchanges of information between programmes will need to be made digitally. Examples of what HMRC will accept as a digital link are given in para 3.2.1 of the Notice.

Importantly, however, HMRC have announced (see para 3.2.1.1) that this digital link requirement only applies from VAT periods starting on or after 1 April 2020 – the so called “soft landing”. This gives businesses some leeway in the transition to MTD. For the first year of MTD, it is being proposed that businesses will not be required to have digital links between software programmes. Therefore, the manual transfer of the data will be acceptable, but only until the business’s first VAT return period starting on or after 1 April 2020. There is one exception to this: where a “bridging product” (see section 7 below) or similar is used to submit the VAT return detail to HMRC, the transfer of data to the bridging product must be via a digital link from the start of MTD in 2019.

HMRC recently published a list of software providers who are working with HMRC to make MTD compatible software. This list is available [here](#).

6. Spreadsheets

It is very common that businesses use a spreadsheet (or series of spreadsheets) to calculate their VAT return figures. This will continue to be acceptable, albeit subject to the existence of a digital link between the spreadsheet and the other software used (once the soft landing period is over).

Those within TOMS often calculate VAT due using a spreadsheet. HMRC’s guidance makes no reference to the application of MTD specifically to TOMS but it is clear that the use of spreadsheets as part of the functional compatible software will be permitted, subject to conditions. Some suggestions on the ways in which TOMS calculations may be completed within MTD are in section 9.

Where data is transferred from one spreadsheet to another, the requirement for this to be done digitally is satisfied where cells in the two spreadsheets are linked.

7. Submission of the VAT return

There will be no submission of the VAT return via the HMRC portal for those within MTD. Instead, the software will collate the information required, prepare the return and send the return to HMRC via the HMRC API. There are a number of ways in which this can be done:

- Via a commercial software package which will keep the required digital records and file the return detail;
- Using a bridging product which will connect digitally to the accounting software (including spreadsheets) and to HMRC via the API; or
- Using API-enabled spreadsheets in which digital records are kept and which submit the required data direct to HMRC.

Section 7 of the HMRC Notice contains useful examples of the different approaches.

8. Digital records

Whichever method is used, the MTD regulations require certain records and information to be kept digitally. Collectively these items are called the “electronic account” and they encompass a number of areas:

8.1 “Designatory information”

- The business name;
- The address of the principal place of business
- The VAT registration number
- Detail of accounting schemes used. This will presumably include TOMS, creating a new requirement that businesses in TOMS notify use of the scheme to HMRC.

8.2 Supplies made

- The time of supply
- The value of the supply
- The rate of VAT charged

8.3 Supplies received

- The time of supply
- The value of the supply (including any VAT that is not claimable)
- The amount of input tax to be claimed

8.4 Reverse charge transactions

8.5 Summary data

This is the link - or audit trail or VAT account - between the records and the VAT return. This is the information which will be used by the functional compatible software to complete the return. This must include:

- The output tax due on sales
- The output tax due on acquisitions from other member states
- Reverse charge VAT payable
- Any VAT payable or recoverable following an error correction
- The VAT due or recoverable on any other adjustment required or allowed by the VAT rules. This would include the annual TOMS adjustment
- The input tax to be claimed
- The input tax on acquisitions from other member states

Whilst the above transactional detail must be kept in digital format, the invoices themselves (both sales and purchase) need not be.

9. Calculating TOMS within MTD

Whilst there is no guidance specific to TOMS, we think the Notice does allow us to see how TOMS VAT can be accommodated within MTD. The way individual taxpayers will approach this will be determined by their circumstances and whether they calculate VAT due using the standard annual aggregated approach or separately for each TOMS supply. (If you would like to see our guidance on TOMS please click [here](#).)

From the HMRC guidance, we know that the records required for a margin scheme do not need to be kept in digital form (para 3.8) and that the margin calculation itself need not be in

digital form (paras 3.2.1.2 and 3.8). We also know that HMRC will accept, where VAT is payable at a rate other than one of the recognised rates of 0%, 5% or 20%, for example a “mixed supply”, that one of the recognised rates can be applied to the full sale value and the resulting output tax can then be adjusted at the end of the period (para 3.3.2). The value of the adjustment must be included in the functional compatible software but the calculation of the adjustment need not be (para 3.4).

The suggestions that follow are indicative of the approaches which may be available and are based on our understanding of the law and HMRC guidance. We have written to HMRC and hope to exchange views with them on how those in TOMS can comply with the MTD rules. We will update this note in due course.

A tour operator using the annual scheme needs to consider the recording of TOMS supplies during the year, the quarterly (or monthly) declaration of provisional output tax and the declaration of the annual adjustment. Let’s assume a provisional percentage of 12%, giving a provisional VAT percentage of 2% (assuming the standard rate remains at 20%). We think there are a number of ways in which the sales might be recorded. For example, if the accounting system allows for a VAT rate other than 0%, 5% or 20%, then a rate of 2% could be applied to all the TOMS supplies. Clearly, this would then calculate the period’s provisional output tax. Alternatively, if the system cannot accept a rate of 2%, a rate of 0% might be applied and then the output tax would be adjusted at the period end.

A variation of this would be to record TOMS sales within non-API enabled software and transfer the sales total (and all other detail required for the return) to a spreadsheet where the VAT return is calculated. The return would then be submitted via bridging software or direct from the spreadsheet if API functionality was built into the spreadsheet.

Another option would be to record all sales within a spreadsheet and to calculate the provisional VAT due on the TOMS supplies within the spreadsheet. The detail could then be transferred (digitally once the soft landing period is finished) to API-enabled software which contains the detail of non-TOMS sales and all purchases or, where all sales and purchases are recorded within spreadsheets, the return figures could be calculated within one of the spreadsheets and return information could be provided digitally to HMRC using bridging software (or again directly from the spreadsheet if it was API enabled).

Whichever approach is adopted, the provisional declaration must be adjusted at year end. As above, the adjustment calculation need not be a part of the functional compatible software so it appears that the year end calculation can be done in the way it is currently carried out but the resulting adjustment figure must be entered (via a digital link or manually) into the functional compatible software.

Where a tour operator calculates TOMS VAT separately for each supply, again a number of options seem to exist. One approach would be to import sales and purchase information into a spreadsheet which would calculate the margin and VAT due for each supply. The total output tax could then be transferred to a separate spreadsheet which prepares the VAT return.

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This note is intended only to be a summary of the main points arising and is only a general guide. It is not a comprehensive statement of the Making Tax Digital rules and no liability is accepted for any of the information it contains or for any omissions or errors. No-one should act upon this information without taking professional advice.