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MAKING TAX DIGITAL FOR VAT – DETAILED INFORMATION

1. The Principles of Making Tax Digital (MTD)

1.1 The principles of MTD are essentially threefold:

- a) records must be retained digitally;
- b) the VAT return must be submitted digitally direct from your accounting system into HMRC's systems. This means no manual entry or transmission of the data: and
- c) there needs to be digital links between all parts of the accounting system giving rise to the final VAT return data.

1.2 Items a) & b) above apply from April 2019 whilst item c), the need for digital links between your accounting systems, is mandatory from 1 April 2020.

1.3 The deadlines in 1.2 are 6 months later, namely 1 October 2019 and 1 October 2020 for “more complex” businesses including:

- Trusts
- ‘Not for profit’ organisations that are not set up as a company
- VAT divisions & VAT groups
- Public sector entities required to provide additional information on their VAT return (Government departments, NHS Trusts)
- Local authorities & public corporations
- Traders based overseas
- Those required to make payments on account; and
- Annual accounting scheme users.”

2. Liability to MTD

2.1 All businesses whose taxable turnover is above the VAT registration threshold (currently £85K) will be required to use MTD compatible software with effect from their introductory date.

2.2 VAT filing will have to be done via HMRC’s new online portal. We will be advising all affected businesses soon what you will need to do to assist us with this process.



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- 2.3 Businesses trading below the VAT threshold will not be required to submit VAT figures to HMRC by way of MTD - the existing portal will remain open for use by you if you are in this category.
- 2.4 If your business is VAT-registered but trading below the VAT threshold (nearly half of all VAT registrations in the UK), you will not be required to participate in MTD unless and until you exceed the threshold. Once the threshold has been exceeded and MTD implemented, there is no way back - if turnover drops below the threshold, the new obligations remain (unless of course you deregister your business from VAT completely).
- 2.5 If your business is VAT registered and your taxable sales exceed £85K at some time after 31 March 2019, MTD commences from the beginning of your first VAT period following the month in which your sales exceed this level. For example, if a business on calendar quarterly VAT returns exceeds £85,000 taxable turnover on a rolling twelve-month basis (or any revised VAT threshold figure by then relevant) in July 2020, their liability to MTD commences on 1 October 2020. Thus, where you are VAT registered but your taxable supplies are below £85K, you will now have to monitor ongoing sales at the end of every month to check that you have not exceeded £85K.
- 2.6 Since the test for compulsory participation in MTD for VAT is based on taxable turnover, you/we will need to separately identify the nature of the sales you make between:
- a) Taxable Supplies
These are essentially “standard rated” supplies of:
- (i) Sales to UK based customers, whether the customer is a business or an individual.
 - (ii) Sales of services to individuals (not businesses) based in the EC
 - (iii) Zero rated supplies (see immediately below)
 - (iv) Reduced rated (5%) supplies (for property development/energy suppliers)

If you provide “zero-rated” supplies (such as certain supplies of residential land / buildings, certain foods, books, transport, drugs or clothing), you will be within MTD for VAT if you are VAT registered, despite you not having to become VAT registered even where your sales exceed £85K (though it is generally beneficial becoming VAT registered, so you can claim back VAT each quarter/month).

- b) Non-Taxable Supplies
The following are not considered part of taxable supplies:
- (i) Sales of services to EC based business customers
 - (ii) Sales of goods or services to customers based outside the EC

Both are called “Outside the scope of VAT”

- (iii) “Exempt” supplies which include:
 - Certain supplies of land
 - Insurance services
 - Postal services
 - Betting& gaming
 - Finance

- Education
- Health & Welfare
- Burials

- 2.7 For example, a consultancy business with a turnover of £150,000 p.a., where £80,000 is derived from supplies to overseas businesses (EC or rest of world) will have a taxable turnover in UK terms of only £70,000. Therefore, it will not need to abide by the new MTD rules.
- 2.8 We believe that HMRC won't be able to distinguish between taxable and non-taxable sales shown within Box 6 on your VAT returns. So we expect quite a few letters/enquiries from HMRC asking why you are not filing your VAT returns using MTD software where your sales exceed £85K.
- 2.9 Businesses not liable to use MTD may opt to do so, and such businesses, if they remain below the VAT threshold, may opt back out again later. However, we don't recommend this as we see little benefit from this.
- 2.10 There are limited exemptions for certain businesses from these new MTD rules. The exemptions only apply for those with a religious objection to the use of computers, for those for whom it is not reasonably practicable to use digital tools for reasons of age, disability, remoteness of location or other reason, and for those subject to an insolvency procedure. You need to apply for exemption and this is subject to HMRC's acceptance.

3. Digital Retention of Records

- 3.1 MTD requires that all businesses liable to participate maintain electronic records. *This means that manual-only recordkeeping will no longer be permissible, as a matter of law.*
- 3.2 Spreadsheets are regarded as digital records for the purpose of the regulations but will still require some form of bridge to HMRC's systems.
- 3.3 The specific records which must be maintained digitally are as follows:

Designatory data:

- Your business name
- The address of your principal place of business
- Your VAT registration number
- A record of any VAT accounting schemes that you use

For each supply (sales), you make you must record;

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

If you make multiple supplies at the same time these do not have to be recorded separately.

You can record the total value of supplies on each invoice or receipt that have the same time of supply and rate of VAT charged.

You must also have a record of;

- Outputs value for the period split between standard rate, reduced rate, zero rate,
- Exempt and outside the scope outputs.

For each supply you receive (costs) you must record;

- The time of supply
- The value of the supply including any VAT that is not claimable by you
- The amount of input tax that you will claim.

If more than one supply is on an invoice, you can record the totals from the invoice.

- 3.4 There is no requirement to issue sales invoices electronically, nor to process them electronically. Each sales invoice can be an item of prime (manual) entry into the accounting system.
- 3.5 Retailers using the retailer's VAT scheme are required to maintain a digital record of Daily Gross Takings (as defined for VAT already), but not of each individual transaction adding up to the total. Amongst other things, this means that an EPOS till system does not have to link digitally with the main accounting system; daily figures may be manually input into the latter. Retailers who keep simple cash book records in a spreadsheet form we believe will be permitted to have a single entry covering the daily sales.
- 3.6 Where an agent is involved in arranging transactions on behalf of you, the principal (who is the VAT-registered person) and the agent produces a summary record of all transactions arranged for their client, this record may or may not have been compiled digitally. However, HMRC has stated that the summary figures from the agent's report may be entered directly into your own digital records as a single entry - there is no need to enter each transaction arranged by the agent individually into your digital accounting records.

This covers for example sales made via the Amazon or Ebay platforms.

This has been allowed as it is not practical to expect the accounting software systems to link electronically when the two parties are completely independent entities.

- 3.7 Any records not mentioned in HMRC's list above do not need to be digitally maintained. This includes detailed computations, such as partial exemption calculations, margin scheme calculations and other data (HMRC give the example of a register of company cars maintained for fuel scale charge purposes), and the source figures for error corrections. *However, any journal required to give effect to an adjustment of this kind will now need to be made before the return is submitted, rather than being input after the event.*

4 Digital Submission of Returns

- 4.1 This link in the "digital journey" (as HMRC have dubbed it), must be the submission of the data to HMRC. The old interface for submission of VAT returns will not be available for those liable to MTD (although it will remain for those not liable).

- 4.2 This link is required to transfer to HMRC only the same data already submitted – i.e. the same nine boxes on a VAT Return. HMRC are not currently expecting us to transmit to them any further underlying data from our accounting systems (though we expect this may well become mandatory too over the next 5-10 years)..Depending on any Brexit transitional arrangements or lack of them, the number of boxes may possibly reduce from 9 to 7 by the time MTD is introduced.
- 4.3 The piece of software (the bridge between a taxpayer's records and HMRC's systems, or API, standing for Application Program Interface) must be capable of both transferring data to HMRC and receiving certain data back, such as details of the next VAT return period. Only packages approved by HMRC will be permitted. HMRC has an online list of all approved MTD software and their respective capabilities - see here: <https://www.gov.uk/guidance/find-software-thats-compatible-with-making-tax-digital-for-vat>.
- 4.4 There will be an option to submit more information than is mandatory, but we don't think that a business would wish to take advantage of this facility.
- 4.5 Where businesses use accounting software packages other than Xero, Sage, QuickBooks or Iris, you will need to establish from the provider the functionality and cost of their product. If you use spreadsheets, assessment will be needed to ensure they are "automated" as far as possible and thus suitable for linking with an external software link between the spreadsheets and HMRC's new VAT filing system (N.B. we have software which will ensure spreadsheet data can be submitted under MTD).

5 Digital Links

- 5.1 From the point of prime entry, whether that entry is an invoice or the result of some form of specialised calculation, at the latest from April 2020, all links between any parts of the accounting system must be digital, right up to the point where the figures are digitally and automatically input into HMRC's system.
- 5.2 This delay until 1 April 2020 gives more time for businesses with multiple or complex accounting systems to link the various parts digitally. Manual extraction of figures into a summary document (e.g. a spreadsheet) will also remain permissible until April 2020.
- 5.3 Every link between any part of the accounting system, between different accounting packages and /or between pages in an electronic spreadsheet, must be "digital". If data is transferred from one form of digital record to another (for example totals from one spreadsheet need to be entered in another spreadsheet), there must be a digital link between the two. It will not be permissible to copy a figure manually from one to the other. From the point of prime entry (invoice, journal, etc) to the submission of the return figures to HMRC, there must be no manual intervention of any kind. Noting a figure from one digital source and recording it manually in another digital record is not permissible.
- 5.4 Given how central this concept of "digital link" is, it is typical of HMRC that there is no definition of the term in the guidance or legislation. HMRC regard the use of the "copy/cut and paste" function as not being a digital link. This is debatable since that function is merely another way of linking two cells or defining the content of a given cell, by use of a digital instruction to the computer. HMRC no doubt thinks that to qualify, a link must be

both digital and automated. But even automated digital links require human intervention at the point of inputting a formula or instruction.

6 MTD for VAT and Accountants/Agents

- 6.1 Where we already act as your agent for VAT, we submit VAT returns for you and where you use Xero, we will continue to be able to submit your VAT Returns after April 2019. We have already identified or are in the process of identifying whether your business will be within or outside MTD and will contact our clients accordingly.
- 6.2 We are recommending Xero cloud accounting as the best accounting package available. We know it is already MTD compliant. We have already submitted our own David Beckman & Co Ltd VAT return for the quarter to December 2018 using Xero, via HMRC's MTD Advance Trial. It was as simple as a push of a button (after the signing up process). We will also be submitting the Jan-March 19 return via Xero.
- 6.3 Where you have been submitting VAT returns yourself, you will need to let us know ASAP if you would now like us to take over this responsibility from you. We will need to check our current authorisation with HMRC and, if necessary, get your authorisation for us to act for you in connection with VAT.
- 6.4 Where you use computerised accounting software other than Xero, together we will need to assess the software's readiness for MTD for VAT.
- 6.5 Where you use spreadsheets, you will need to consider how automated/digital these sheets are and whether the spreadsheets will work for MTD.
- 6.6 Xero cloud accounting software offers huge time-saving benefits. It automates a lot of the mundane bookkeeping work. For example, it automatically pulls the bank details straight into the software – so you don't need to enter each transaction one by one.

The system can also:

- Post items to the correct account
- Intuitively match sales receipts to customer invoices and bank payments to supplier invoices
- Easily issues sales invoices which can be emailed to customers and are then directly shown in the system – you won't need to manually enter them any more
- Get supplier invoices straight into your accounts and posted to the right account without lifting a finger.

Please talk to us if you are interested in moving to Xero and we can send you a separate information detailing what is involved and the likely cost.

7 MTD & Penalties

- 7.1 HMRC has indicated that they would go easy on penalties for the first year or so of the new arrangements. This "soft landing" only seems however to apply to the failure to ensure digital links exist at every stage in the chain. We are unclear as to HMRC's light touch with other aspects of MTD.

- 7.2 The default surcharge will still apply for late payment of VAT return liabilities. HMRC will also be able to call on the existing penalty legislation for failure to keep adequate accounting records. This we believe will be used in cases where businesses fail to maintain digital records.
- 7.3 The penalty regime which is currently being looked at across all taxes is proposing a penalty points system – akin to the penalty point system which applies to driving, i.e. you get more penalty points the more contraventions you have and you pay the fine once a certain number of penalty points have been amassed.

8 Why MTD?

8.1 HMRC, in their published guidance, have stated that their ambition is to become one of the most digitally advanced tax administrations in the world and MTD is making fundamental changes to the way the tax system works - transforming tax administration so that it is:

- 8.1.1 more effective
- 8.1.2 more efficient
- 8.1.3 easier for taxpayers to get their tax right

8.2 HMRC has also said that the purpose of MTD is to "reduce the amount of tax lost through error and failure to take reasonable care".

8.3 Whilst most within the accounting & tax profession think the concept of MTD is good and will bring benefits to businesses and the economy in the long run, we have protested about:

- a) The fact it is being made compulsory, rather than voluntary; and
- b) It is being introduced (in our view) too soon, before the systems have been fully tested and at a time to coincide with Brexit.

However, HMRC & the Government have ignored most representations & insisted on this timetable regardless - so we should look at the benefits of using digital cloud-based software such as Xero and we'll need to abide by the new VAT laws.

8.4 As mentioned above, it is probably HMRC's longer term intention to be able to digitally receive underlying transaction details for all businesses, so they can carry out analytical checks of data and recover underpaid taxes.

If you would like to discuss this factsheet in more detail, do contact us.

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