Making Tax Digital for VAT

Indirect Tax **Management of taxes**

01 February 2018

The VAT requirements become clearer as draft regulations and guidance are published, but do the numbers stack up?

VAT update

On 18 December 2017 HMRC published a number of documents in relation to MTD for VAT. These documents can be found on GOV.UK and were:

1. Draft Regulations: these Regulations are relatively brief, and include matters such as the commencement provisions (1 April 2019 or the first VAT return period starting after that date), the requirements (such as to use 'functional compatible software' to record transactions and to submit the VAT return), and relevant exemptions (broadly speaking, the same exemptions as now for online filing of VAT returns, together with a turnover threshold to exempt voluntary registrations).
2. Draft Explanatory Memorandum to the Regulations: which provides some background information and context to the proposals.
3. Draft VAT Notice: which seeks to explain the MTD requirements, such as who is in scope, what is meant by 'functional compatible software' etc, and how VAT returns, voluntary updates, and supplementary data should be submitted.
4. Draft Addendum to the VAT Notice: which explains, and illustrates using 'customer journeys', the extent of the digital links between software and spreadsheets, the process of submitting VAT returns in different scenarios, and how the first year 'soft landing' will operate in practice.

We will be providing HMRC with comments on the above documents by the deadline of 9 February 2018 (so if you have any comments, please be quick!), but in the meantime some of the headline points are:

- The requirements of MTD will apply to VAT return periods ('prescribed accounting periods') beginning on or after 1 April 2019. So, if you or your clients have VAT quarters ending March, June, September and December (stagger 1), then the April to June 2019 VAT return period will need to comply with the MTD requirements. Thought will need to be given to which software businesses will need to be using, and when. For example, if a business on stagger 1 has a 30 June 2019 year end, it will really need to be using the right MTD-compatible software from 1 July 2018, to ensure it can use the same software package for its entire accounts period, without having to change software from 1 April 2019.
- As expected, the only exemptions are (i) those which currently apply in relation to online filing of VAT returns and (ii) those businesses with a taxable turnover below the VAT registration threshold. But beware, the latter exemption needs to be monitored on a month-by-month basis, so businesses who are currently (say) voluntarily VAT registered will need to monitor their taxable supplies, because if those supplies go over the VAT registration threshold, the requirements of MTD apply from the start of the next VAT return period. And such businesses will then remain within the requirements until they deregister.
- HMRC has listened to feedback and relaxed the level of detail they require to be recorded in relation to each individual transaction. Their original proposal was particularly onerous (such as requiring the invoice

total to be broken down into sub-totals for each rate of VAT chargeable, and recording the VAT charged at each rate on the invoice). That proposal has been relaxed and the requirements now broadly reflect the existing record keeping obligations.

- Perhaps the largest 'concession', albeit a result which was clearly the most practicable from the outset, relates to the extent of the digital links between types of software and spreadsheets, and this is helpfully illustrated in HMRC's draft 'customer journeys'. In general, MTD will require a digital (that is, not manual) link between the source records (maintained in software or on a spreadsheet), and HMRC, where the information being transferred is the data which is mandated to be kept digitally. So for example, if a business has recorded output VAT of £10,000 and input VAT of £6,000 in its digital records, those amounts must flow digitally to HMRC (either directly from the software or spreadsheet, or via some form of bridging software) because those output and input values are required to be kept digitally. If that business is partially exempt, and needs to restrict (say) £2,000 of its input VAT, it has broadly two options. One option (example six in HMRC's customer journeys) is to journal the £2,000 adjustment into the record keeping software, which can then digitally submit the VAT return showing output VAT of £10,000 and input VAT of £4,000. The second option (example four in HMRC's customer journeys) is to digitally export the £10,000 output VAT and £6,000 input VAT into a spreadsheet, undertake the partial exemption calculation in the spreadsheet, and submit the VAT return digitally from the spreadsheet, showing output VAT of £10,000 and input VAT of £4,000.
- So where is the 'concession'? HMRC recognise that software is not widely available to digitise some of the VAT return 'journeys', especially where this involves exporting data from software to spreadsheets, and it is those links (and those alone) which will benefit from a 'soft landing' in the first year of MTD – allowing businesses more time to adapt their systems to make the VAT return journey an entirely digital one. Notwithstanding this proposed 'soft landing', businesses should start planning now how they will make their VAT return process an entirely digital one in the future.

Costs and revenue benefits

It is also worth focusing briefly on the revised costings for MTD, which were published by HMRC in a technical note on 1 December 2017. These are the first costings which have been published since the revised MTD timetable was announced on 13 July 2017. Headline points from these HMRC figures, which now reflect only the MTD for VAT requirement, are:

HMRC have calculated a transition cost of £131m in total, across a mandated population of 1.2m businesses. This averages at just £109 per business; a surprisingly low figure, considering the level of change and familiarisation needed for the new regime.

HMRC recognise that there will be net additional ongoing costs for businesses of around £37m per annum in total, represented by additional software costs of around £52m, offset in part by administrative savings of around £16m (subject to roundings). Time will tell whether these costs are in the right ballpark, but again we believe they are rather low.

Identifying the expected revenue benefits from the revised timetable/ requirements is not easy, as they have not been published in a single place, but require a series of calculations based on Budget/ Autumn Statement documents. Our calculations, based on these published figures, show a revenue yield of around £400m per annum once MTD for VAT is fully embedded and a 'steady state' is reached. These figures are surprisingly high, considering the 'steady state' revenue benefits for the original MTD proposals were around £900m per annum, included income tax, and that around 80% of the tax gap in relation to error and failure to take reasonable care (which MTD is intended to address) is said to arise in the business population which trades below the VAT registration threshold (and so therefore not within the current scope of MTD for VAT).

We will continue to provide updates on MTD through Technical Newsdesk, and on the CIOT website MTD pages.