



# Making Tax Digital for businesses: phase 1

Making Tax Digital (MTD) is the most fundamental change to the administration of the UK tax system for a generation. Under MTD businesses will be required to use software to keep accounting records with paper records ceasing to meet the new digital requirements. The first phase of MTD is the digitalisation of the VAT return which came into effect from 1 April 2019.

## Key points

All VAT registered businesses with taxable turnover above the VAT threshold (currently £85,000) will be required to keep digital records and file their VAT return digitally using Making Tax Digital (MTD) compatible software from April 2019. This includes sole traders, partnerships, LLP's, companies, charities and landlords.

These businesses will remain in the MTD regime even if their turnover subsequently falls below the VAT threshold. VAT registered businesses with turnover below the VAT threshold will fall within MTD as soon as their turnover exceeds the threshold in a 12 month period and once within MTD a business stays in.

For businesses with turnover below the VAT threshold they will be able to opt in to MTD on a voluntary basis but otherwise they will continue to file VAT returns under the current system.

*The HMRC online VAT portal will not be available for businesses with turnover above the VAT threshold from 1 April 2019.*

## Digital records and compatible software

Under MTD businesses will no longer be able to use manual records and for VAT return periods starting on or after 1 April 2019 they must have compatible software in place to meet the new digital requirements. There will be no requirement to keep underlying records such as invoices and receipts in a digital format but transactional information will need to be stored digitally.

The record keeping under MTD will be more onerous than at present. For example, for supplies made and received the invoice total must be broken down into sub-totals for each rate of VAT chargeable and the VAT charged at each rate. HMRC state that in order to comply with MTD the 'compatible software' must be able to:

- Keep the required records in a digital form;
- Preserve those digital records for up to six years;
- Create a VAT return from the digital records;
- Provide HMRC with this information digitally;
- Provide HMRC with additional information on a voluntary basis;
- Receive information from HMRC regarding the business' compliance record.

For businesses that already use accounting software the transition to digital records should be relatively smooth as most software providers are already developing MTD compatible solutions to enable compliance. Both HMRC and the software developers are currently testing the software and HMRC will be publishing a list of available MTD compatible software providers later this year.

For businesses keeping their records in spreadsheet format this will still be permissible but third party commercial software will also be required to enable the flow of data from the business to HMRC.

For businesses using a combination of software and spreadsheets the links between them must be digital although HMRC will adopt a 'soft landing' approach for the first year of MTD to allow businesses to put the necessary digital links in place.

*HMRC will not be providing businesses with free software for MTD for VAT.*

## How will VAT returns change under MTD?

Under MTD the VAT return will be compiled by pulling the data from the business' digital records. The VAT return will then be filed with HMRC via compatible digital software and not through the VAT portal.

There are no current proposals to change the nine box VAT return however businesses will be able to voluntarily submit supplementary information which might for example explain the reasons for fluctuating profits. The VAT return frequency and payment deadlines are not set to change under MTD.

Also the rules for making amendments and correcting errors in the return will continue as now although HMRC is considering options for the electronic submission of form VAT 652 to notify errors in VAT returns.

## VAT accounting simplification schemes

Businesses will be permitted to use the existing VAT schemes under MTD including the flat rate scheme, retail scheme, cash accounting and annual accounting. It is expected that the requirements of MTD will also apply to other special schemes such as the second hand margin scheme.

## Exemptions from MTD

HMRC recognise that for some businesses the transition from manual record keeping to digital reporting will be a challenge. In order to assist these businesses with the move to digital reporting HMRC are offering a range of support which will include online guidance, a VAT helpline, webchat, webinars and online tutorials.

Where businesses are still unable to engage digitally, then it may be possible to claim an exemption from MTD. Businesses that are currently exempt from the VAT online filing requirements will also be exempt from filing VAT returns under MTD. An exemption can be claimed under the following circumstances:

- The business is insolvent.
- A business is a practising member of a religious society or order whose beliefs are incompatible with the use of electronic communications.
- It is not reasonably practicable to file online due to age, a disability or due to remoteness of location.

These exemptions must be claimed and there will be a right of appeal against HMRC's refusal of exemption.

There will be an automatic exemption for businesses which are registered for VAT but have taxable turnover below the threshold.

## Problem areas – business/non-business and partial exemption

We anticipate that businesses with exempt income and/or non business activities, including charities and other not-for-profit organisations, are likely to encounter issues in automating their recovery calculations. These calculations, known as 'business/non-business' and 'partial' exemption methods are used to calculate the appropriate restriction of VAT on expenditure which relates to exempt or non-business activities. They are often bespoke, relying on information such as floor area or staff numbers and thus accounting packages are unlikely to be able to manage this process automatically.

Businesses with these issues will need to consider how to comply with MTD and are likely to require specialist assistance and possibly specific agreement with HMRC.

## What next?

HMRC are due to start a trial of the MTD for VAT system in April 2018. This will enable HMRC to work with software developers and a number of small businesses to ensure that the system is working as expected before MTD for VAT becomes mandatory in April 2019.

For businesses already using accounting software we recommend that you check if your current software provider is developing MTD compatible software that will enable your business to meet the new record keeping and reporting requirements. For those businesses that currently keep manual records an online accounting solution should be adopted as soon as possible. Businesses with partial recovery methods will need to specifically consider how their system, including MTD compatible software, can cope with digital reporting and whether their methodologies require amendment and agreement with HMRC.

We anticipate that MTD for VAT will be followed in 2020 with the requirement for businesses to file their accounting results quarterly to HMRC using MTD compatible software.

At Kreston Reeves we have a team of online accounting and outsourcing specialists working in tandem with our VAT specialists, who are able to help you choose the most suitable accounting software for your business not only to enable you to comply with the new VAT filing requirements but also with the future requirement to file your business results digitally. If you wish to discuss the software options available to your business, which may also include configuring additional online applications (e.g. credit control apps) to aid you in the running of your business, please contact our Online accounting and Outsourcing team for a free consultation. If you have any VAT questions associated with MTD, or otherwise, please contact our VAT team.

## For more than accountancy, business and financial advice.

**Call:** +44 (0)330 124 1399

**Email:** [enquiries@krestonreeves.com](mailto:enquiries@krestonreeves.com)

**Visit:** [www.krestonreeves.com](http://www.krestonreeves.com)