April 2021 Changes to VAT Making Tax Digital (MTD) procedures

From 1 April 2021, UK VAT registered businesses faced more Making Tax Digital obligations. These obligations were due to be implemented on 1 April 2020 but they were postponed by the COVID-19 pandemic. For the first time, the obligations are accompanied by the threat of penalties. The following notes explain who will be affected and what the obligations are…

What are digital links?

HMRC have defined these as a digital means of transferring VAT information from one software programme to another. This could include running a VAT report in your accounting system with automatic extraction to your calculation tool. HMRC have confirmed that these software processes constitute digital links.

“Digital gaps” occur when manual intervention is required, for example copying information from VAT output files across to a VAT return spreadsheet. Businesses will need to find alternative solutions to avoid such manual interventions.

For example, a business may record income and purchase transactions in its accounting system, transfer the totals to a spreadsheet in which it calculates the UK VAT return figures then send the information to bridging software, which submits the return to HMRC via an online portal. The new law requires these three pieces of software to be ‘digitally linked’.

The outcome of this is that HMRC has provided more time for all MTD businesses to put digital links in place between all parts of their functional compatible software. Businesses now have until their first VAT return period starting on or after 1 April 2021 to put these links into place. The first of these being for the vat quarter ending 30th June 2021 and to be submitted by the 7th July 2021.

Who is affected?

VAT-registered businesses, individuals and charities with a taxable turnover above the VAT registration threshold (£85,000) are required to follow the MTD rules by keeping digital records and using compatible software to submit their VAT returns. Where taxable turnover is below the VAT threshold they can voluntarily join the MTD service now but from April 2022 all VAT returns will need to be completed and submitted using compatible MTD software.

What are the new rules?

1. Digital records

Under the MTD rules, UK VAT registered businesses with turnover above the VAT registration threshold must keep and maintain VAT records digitally in "a compatible software package that allows you to keep digital records and submit VAT Returns" or use "bridging software to connect non-compatible software (like spreadsheets) to HMRC systems".

This digital record keeping requirement is compulsory for all VAT periods beginning on or after 1 April 2021.

Records included under this requirement include sales and purchase invoices with VAT. Accounting records not specific to VAT return requirements are not included.

The data that must be stored digitally includes:

- your business name, address and VAT registration number
- the VAT accounting schemes you use
- VAT on goods and services you supply (everything you sell, lease, transfer or hire out)
- VAT on goods and services you receive (everything you buy, lease, rent or hire)
- any adjustments you make on a VAT return
- the 'time of supply' and 'value of supply' for everything you buy and sell
- the rate of VAT charged on goods and services you supply
- reverse-charge transactions – where you record the VAT on both the sale price and the purchase price of goods and services you buy
- total daily gross takings if you use a retail scheme
- items you can recover VAT on if you use the Flat Rate Scheme
- total sales, and the VAT on those sales, if you trade in gold and use the Gold Accounting Scheme

2. Digital Links

If more than one software package is used the packages need to be linked digitally. The links can involve:

- using formulas to link cells in spreadsheets
- emailing records
- putting records on a portable device to give to an agent
- importing and exporting XML and CSV files
- downloading and uploading files.

Digital should NOT involve:

- ‘cut and paste’ manual adjustments to move data; and
- any manual adjustments and consolidations of group returns in spreadsheets.

In practice

HMRC has recognised that there are circumstances during the preparation of a VAT Return when calculations have to be made outside software or is a need to enter data into software from other sources. It therefore continues to allow the use of manual calculations for special VAT schemes including the partial exemption and capital goods scheme calculations.

The digital links between the software packages need to be in place before the business’s first full VAT period after the 1 April 2021. However HMRC has offered an extension to the 1 April 2021 deadline if there is no solution to IT issues and the operation of an uninterrupted ‘digital journey’. Anyone wanting an extension must apply to HMRC as soon as possible and provide the following information:

- An IT map of the current accounting software showing where the digital journey fails, why it is “unachievable and not reasonable” at this time to export data via digital links.

- Reasons why the business is unable to meet the 1 April deadline.

- An action plan, with IT confirmation and timetable, to resolve the matter. This cannot take longer than the 1 April 2022.

- Details of controls that ensure that any manual data transfer will be performed without errors.

HMRC have made it clear that cost alone will not be an acceptable reason for an extension to be granted.

Penalties

From 1 April 2021, HMRC is introducing a penalty system for failing to meet MTD obligations. These penalties, or surcharges, will apply to the first completed VAT return on or after this date.
The penalties will be applied as follows:

- A default is recorded for a failure to observe the MTD rules or missing a filing. In this case a surcharge period lasting 12 months applies.
- If there is another failure a surcharge % applies to the VAT due on the latest return.
- If there are additional failures within 12 months a point system applies.
- The points result in % surcharges, starting at 2% and increasing to 15%, for each accumulated failure.

  There will also be fines and interest charges if there are errors in the VAT return. Fines may be 100% of the VAT due or over-claimed if returns include careless or deliberate inaccuracies or 30% if the taxpayer does not inform HMRC that their assessment is too low. Interest will be charged at 3% of the VAT due.

Updated 19th May 2021