



MAKING TAX DIGITAL FOR VAT: LEGISLATION OVERVIEW

ICAEW welcomes the opportunity to comment on the [Making Tax Digital for VAT: legislation overview](#) published by HMRC on 13 September 2017.

This response of 10 November 2017 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world.

Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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Key point summary

1. ICAEW welcomes the opportunity to comment on the [Making Tax Digital for VAT: legislation overview](#) published by HM Revenue & Customs on 13 September 2017.
2. ICAEW is supportive of HMRC's digital transformation. For the tax system to be fit for the 21st century, a 'digital first' approach has to be the right way, but it must not be rushed.
3. We have yet to be convinced that MTD will reduce the administrative burdens of business, particularly the smallest businesses. **Businesses and individuals should be encouraged to adopt digital reporting as a benefit to their business and not as a forced change.**
4. We welcome the assurance from the Financial Secretary to the Treasury, Mel Stride, that income tax and corporation tax will not be mandated until it is clear that the programme has been shown to work well.
5. The criteria for measuring the success of MTD for VAT, for business and for HMRC, will be an important element in directing the next steps in the development of the MTD programme.
6. We are concerned that MTD for VAT in 2019 will coincide with Brexit.
7. MTD requires a fundamental change to the way that many businesses keep their accounting records. We do not think businesses should be mandated to make changes for VAT alone as the same accounting records will form the basis of MTD for income tax or corporation tax in due course. Not all software will be suitable for all taxes.
8. While we understand that spreadsheets with suitable Application Programming Interfaces will be acceptable records for MTD purposes, the full extent of their use has yet to be clarified and should be incorporated in secondary legislation.
9. Sufficient time must be allowed for adequate consultation on the detailed requirements of MTD for VAT once these are known, before moving to secondary legislation.
10. The complexities of VAT, such as partial exemption, group registration, time of supply rules, and multiple special schemes, make it difficult to see how economical software can be designed to suit VAT reporting.
11. Our detailed comments below expand on these and other important aspects of MTD for VAT which need to be resolved.

Implementation of Making Tax Digital

12. We note the recent comments made by Jon Thompson, chief executive of HMRC, made to the Public Accounts Committee, who said that HMRC is to undertake a full review of its transformation plans, including moves to digitalise tax and its programme of office closures, to reassess how many of these proposals can be completed alongside Brexit.
13. We have welcomed the pause in the implementation timetable for Making Tax Digital (MTD) for income tax and corporation tax which will now begin in 2020 at the earliest and only after MTD for VAT is shown to have been a success. The Financial Secretary to the Treasury, Mel Stride, is reported in Hansard, on 12 September 2017, saying that 'We will not mandate other taxes until we are clear that the programme has been shown to work well'.
14. The criteria for measuring the success of MTD for VAT, for business and for HMRC, will be an important element in directing the next steps in the development of the MTD programme.

General comments

15. In 2016 HMRC published six consultation documents, but we note that there has been no formal consultation specifically on VAT. We are concerned that businesses have not had the opportunity to be involved in the detailed design of MTD for VAT.
16. The VAT legislation overview provides a summary of how MTD will work for VAT but a lot of the detail is missing. We are concerned that there may be insufficient time to consider fully the feedback from this overview before the government proceeds to secondary legislation. For a change of this magnitude, there must be adequate time allowed for consultation to be an iterative process. Draft legislation is expected to be available before the end of 2017 (and by April 2018 at the latest). Professional bodies and other trusted stakeholders will need time to digest the legislation and comment accordingly.
17. MTD requires a fundamental change to the way that many businesses keep their accounting records. Businesses maintain only one set of books, and MTD for VAT will necessitate a fundamental change to the way in which virtually all VAT-registered businesses keep these books. These form the basis of their unincorporated business or corporate statutory accounts, management accounts, direct tax computation and from which figures will be extracted for their VAT returns. Any change to record keeping software or the processes by which accounting information is used, should be undertaken with all these uses in mind, yet without knowing the MTD for corporation tax or income tax requirements, businesses are being told to implement software for VAT reporting first. This is not a good approach to managing the move to digital and is likely to lead to additional – and possibly abortive – costs for both HMRC and businesses.
18. We understand, from meetings and discussions with HMRC, that using spreadsheets with suitable Application Programming Interfaces (APIs) incorporated to feed the totals into MTD enabled software will meet the requirements of MTD for VAT. This should be made explicit in the regulations as, for many businesses, this will be the only means of filing a VAT return. Our members have told us of difficulties with partial exemption calculations, group VAT registrations, UK members of international groups, incompatible internal accounting systems and foreign currencies, all currently requiring spreadsheets to compute the figure to enable VAT returns to be completed.
19. Due to the number and complexity of the many VAT schemes permitted by legislation, a large proportion of businesses use spreadsheets to make manual adjustments to calculate their VAT position. We would welcome a conversation between HMRC, the Office of Tax Simplification and other trusted stakeholders to discuss sensible areas of the VAT system which could be simplified. This would in turn reduce the need to make manual adjustments to accounting figures on a spreadsheet and ultimately make the transition to MTD easier. Unfortunately, having Brexit, implementation of MTD for VAT and changes (even those simplifying VAT) all in 2019, may just be impossible to manage.
20. We understand the policy behind MTD is to close the tax gap which is created through failure to take reasonable care and errors made by small businesses. We have over many years worked with the former Inland Revenue and HM Customs & Excise on this and welcome the opportunity to continue to work with HMRC to try and reduce these errors. We recommend that HMRC publishes a list of commonly made errors so that agents and businesses can work together to reduce them going forward.

Legislation overview – specific comments

Application and start date

21. It is possible that the UK will leave the EU in April 2019. VAT derives its rules from the EU and is therefore most susceptible to change following Brexit. Whilst some simple changes to VAT could help smooth the transition to digital, we would not recommend 2019 as being a good time to make fundamental changes to the way that VAT is recorded and reported.

22. The draft primary legislation released to date would require digital reporting and record keeping for VAT from 1 April 2019. Clearly it would be impractical for a business to change its accounting software mid accounting period. No announcements have yet been made about if, when and how MTD will be introduced for income tax and corporation tax, but the same accounting system will be needed for all reporting purposes. A business needing to upgrade its accounting software or to buy new software would need to know the full extent of its own requirements as well being able to consider the products available from a relatively mature market place. It is becoming increasingly difficult to see quite how this can be managed to the proposed timetable.
23. There have been suggestions that the start date for VAT might be the first VAT quarter starting after 1 April 2019. If so, this would be mid-way through an accounting period for many businesses. The start of the first accounting year beginning on/after 1 April 2019 would be more practical.
24. The legislation overview states that 12 months will be sufficient time for businesses and software developers to prepare for MTD. In our opinion the timetable does not allow sufficient time for software companies to build appropriate MTD compliant software which can be tested before the start date in April 2019. As VAT filing software is not currently used widely, spreadsheets can easily be tailored to specific business requirements, software companies will need at least 18 months from when HMRC provides detailed IT specifications based on enacted legislation and compatible with HMRC's own IT, to design (often from scratch), build, test and amend if necessary the software. In business there will also be challenges, for example, UK subsidiaries of overseas groups will often be told what accounting software they must use and this is unlikely to be MTD compatible.

Scope

25. MTD requirements will apply to businesses with turnover above the VAT registration threshold. For those businesses needing to register for VAT for the first time, there will also now be a need to start keeping digital records, providing two reasons for some to keep their turnover below the limit.
26. The Office of Tax Simplification has recently published its report [Value added tax: routes to simplification](#). One of the key areas the OTS has looked at is the VAT registration threshold. Although the OTS has not recommended that the threshold should be reduced, it urges the government to examine the current approach to the level and design of the VAT registration threshold, setting out a future direction of travel for the threshold. The link between digital accounting requirements and the VAT registration threshold is an additional and unwelcome complexity at this time.

Exemptions

27. The digital exclusion exemption mirrors the current exemption for VAT. The MTD requirements are more onerous than the current requirement to file VAT returns quarterly online. MTD will involve much more regular online access and, therefore, the exemption will need to be applied much more flexibly.
28. The draft income tax regulations require a digitally excluded taxpayer to apply for the exemption. No details of how this application process would operate have been made available but we presume that MTD for VAT will be the same. It is not clear how an incapacitated taxpayer who cannot communicate would make the application. A simple method to define an excluded population would be by reference to the State retirement age. This would allow those with businesses in a run down to retirement, to complete the natural life cycle of their business without having to cease trading prematurely just to avoid MTD.

29. We would welcome clarification of how digitally excluded taxpayers will comply with their VAT obligations in the future.
30. It is not clear whether or how the digital exclusion exemption applies to agents. We have received conflicting information about whether provision will be made for digitally excluded agents. We would also welcome confirmation that a digitally excluded taxpayer can retain their exemption if they appoint an agent.
31. We note the intention to exempt a business on a rolling turnover basis for the previous twelve months and that this has to be monitored every month. When a business exceeds the annual turnover limit for the first time, it may take several months for it to create digital records. Accordingly, we recommend that the requirement to maintain digital records should begin twelve months after the limit is first breached.
32. Given that HMRC wants as many businesses as possible to maintain digital records, we do not see why it should be necessary for businesses that qualify for exemption from maintaining digital records to notify HMRC that they actually do wish to keep them digitally, or to do so at a later date if they wish to cease keeping them.

Third party software

33. Functional compatible software is described as being a software program or set of compatible software programs which can connect to HMRC systems via an API. It must include certain functions such as the ability to provide HMRC with VAT data on a voluntary basis and also to receive information from HMRC in relation to the compliance of the business.
34. We have discussed the importance of spreadsheets for preparing VAT returns at length with HMRC. Information is extracted from the accounting system, entered into a spreadsheet and then manipulated by reference to, for example
 - The VAT scheme used by the entity, flat rate, special retail scheme
 - The partial exemption method used by the entity
 - The figures extracted from the different computer systems used by companies included in a group registration
 - Foreign currency adjustments.
35. APIs could indeed take the 'nine box' information generated in the spreadsheet into MTD compatible software' and then on into HMRC's system, but it is difficult to see how sufficiently targeted nudges could be sent back on the basis of this information. We do not see how this would be any more beneficial for business than the current nine box system.
36. The requirements of the software suggest that there will be no basic, cheaper product available for the smallest VAT registered businesses, many of which may have income sufficient to require VAT registration, while generating very low profits.

Digital record-keeping

37. Digital records must be preserved for six years following deregistration. This means that businesses will presumably need to continue to pay software license fees for up to six years after deregistration and even retirement if trading ceased at that time. If the software is able to produce a pdf summary of the records, will this meet the requirements?

Content of digital records

38. The overview of MTD for VAT suggests that the regulations will specify the information a business needs to keep and preserve digitally. This includes the VAT account which is described as the link between the primary records and the VAT return. For a group registration, there will be more than one such account.

VAT returns

39. We welcome the statement that there will be no change to the statutory VAT return or payment dates. The additional seven days will be particularly useful as businesses become familiar with the new requirements.

Monthly, non-standard and annual returns

40. We welcome the statement that there will be no change to the availability of monthly and non-standard VAT return periods and that the annual accounting scheme will continue.

Periodic updates (voluntary)

41. The information that may be submitted by way of voluntary updates is currently unclear. Given the amount of software development that will be required to prepare this data and the time and cost that such development is likely to take, we believe that the take up of this voluntary information will be very low, particularly in the early days of MTD.

Supplementary data

42. The information that may be submitted by way of supplementary data is currently unclear. Given the amount of software development that will be required to prepare this data and the time and cost that such development is likely to take, we believe that the take up to submit this voluntary information will be very low, particularly in the early days of MTD.

Amendments to previously submitted returns and updates (error corrections)

43. We welcome the option to submit non-deliberate error corrections through MTD on the VAT return following their discovery. Where such corrections are made, we would recommend and welcome confirmation that they will be treated as voluntary disclosures for penalty purposes, thereby resulting in no penalties being applied.

Annex 1: electronic record-keeping requirements

VAT account

44. The nine box VAT return was introduced when the EC single market was created on 1 January 1993. Prior to this date, it only had five boxes, because transactions with other EU Member States could be identified through import and export procedures.
45. The currently proposed timing for the introduction of MTD for VAT is very shortly after Brexit. From this date, it is likely that information relating to acquisitions and despatches with other EU Member States will become obsolete, reverting to the pre 1 January 1993 status. This will depend upon the Brexit negotiations and whether such transactions will be treated as imports and exports after Brexit.
46. Given the time and cost to develop computer software to identify this information, the rules for which are likely to have changed before the introduction of MTD, we do not believe that around 210,000 affected businesses should be required to incur these costs unnecessarily. We therefore suggest that the requirement to separately identify transactions with other EU Member States be withdrawn for VAT return purposes and that the five box return be reinstated.
47. We note the requirement separately identify partial exemption annual adjustments. These are usually relatively small amounts when compared with the reductions in input VAT resulting from the quarterly partial exemption calculations. Such calculations are invariably made outside the accounting system, usually be spreadsheet. Is it intended that these quarterly adjustment calculations should also be separately identified?

Other information

48. We note that HMRC is expecting output and input values to be split between standard rate, reduced rate, zero rate, exempt and outside the scope outputs. This may be difficult, if not impossible in some cases, particularly where the accounting system does not have this information. For example, this may be the case where manual adjustments are required to account for output VAT on transactions that the accounting system treated as not being liable to VAT. It would be rare for input values split by VAT rate to be available from an accounting system.
49. The increased level of data capture for individual transactions, referred to as Further information required in addition to the VAT account, will impose a greater administrative burden on businesses and is an additional element for software to include. We urge HMRC to reconsider introducing this at this time.
50. Outside the scope output and input values, such as those relating to statutory charges, have always been specifically excluded from box 6 on the VAT return, because they do not relate to a supply for VAT purposes. We therefore question why this new information is now required, or does it only relate to supplies that are outside the scope of UK VAT due to them being supplied to overseas customers?

APPENDIX

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://www.icaew.com/-/media/corporate/files/technical/tax/tax-news/taxguides/taxguide-0499.ashx>).