ICAS comments on the draft VAT Notice for Making Tax Digital for VAT

24 April 2018

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

General Comments

3. ICAS welcomes the opportunity to comment on the amended draft VAT Notice for Making Tax Digital for VAT, issued by HMRC to interested stakeholders in April 2018.

Specific Comments

Section 1.2

4. The VAT Notice should be explaining the legal requirements for MTD for VAT and providing guidance on how to meet them. Section 1.2 should give a brief overview of the requirements. The first paragraph of this section is a reasonable opening.

5. However, it is irrelevant whether it is 'common' for business records and accounts to be kept digitally etc. It is also very common for businesses to use spreadsheets which is not mentioned. The sentence which begins "The difference under MTD", is potentially very misleading given that only 12% of businesses currently submit their returns direct from software.

6. Therefore, the sentence beginning "It is now common" should be omitted and the remainder of this paragraph should be rewritten. Possible wording would be: *"The MTD for VAT regulations require businesses to record and keep specific information digitally. Businesses must also use software which is capable of providing information to HMRC and receiving information from HMRC digitally via HMRC's Application Programming Interface (API) platform. Additional information about software is provided later in this notice."*

Section 2.2

7. The section heading should be "Exemptions" rather than "Other Exemptions". The previous sections explained businesses within scope; this section gives details of exemptions for some businesses which would otherwise be included.

8. The meaning of the sentence "These may apply even if you are not exempt from online filing for VAT" is not clear and should be deleted – or alternatively the meaning needs to be clarified. The bullet points appear to be taken from the exemptions for online filing for VAT so as it stands it does not appear to make sense.

9. The intended meaning of the sentence which begins with the words "If an exemption is not appropriate" is not clear. Is this referring to cases where HMRC disagree that an exemption under the second bullet point (not reasonably practical) applies? Is the suggestion then that digital assistance may be provided by HMRC (perhaps via the NES service)? If so the sentence needs to be rewritten to make this clear. Alternatively, if this refers to a taxpayer who could be exempt, but chooses not to be, it should be deleted – because it duplicates and confusingly overlaps with Section 2.3 which specifically deals with taxpayers who fall within one of the exemptions but choose to adopt MTD for VAT on a voluntary basis.

Section 2.3

10. it might be clearer to business users if the sentence about the election/withdrawal of an election referred to HMRC rather than 'the Commissioners'. There should also be guidance (or a link to guidance) on how to make the election/withdrawal – by email/online/by post? Is there a form to be completed and submitted?

Section 3.1

11. The meaning of the second paragraph and the examples needs to be explained more clearly. For example, it is not clear which records have to be kept and preserved in their original form by law (final sentence of the second paragraph). Example 1 refers to C79s and seems to suggest that they must be retained in their original form because the law requires this. However, example 2 suggests that the only reason for retaining the original C79s in the first example is that they have not been scanned. Is this the intended meaning? This requires more explanation. Depending on the intended meaning, the interaction with VAT Notice 700/21 may also need clarification.

12. We have raised concerns before about cost issues arising from the need to retain records for 6 years after deregistration (which will often mean the business has ceased to trade) – paying for ongoing access to software programmes would be expensive. The suggestion that records must be kept in 'some format' but not necessarily in software may not actually assist many businesses. Is HMRC expecting a business to print out all its records for the last 6 years on deregistration? This is unlikely to be feasible for businesses of any size or complexity. If a business has disposed of records because it has scanned them (as set out in example 2) it will be unable to recreate them. The VAT Notice needs to explain how businesses can realistically retain records for 6 years after deregistration without incurring significant costs for maintaining software/cloud access.

Section 3.2

13. The description of 'spreadsheet program' might be very hard to follow for some users of spreadsheets. It is also inconsistent with references to spreadsheets elsewhere in the Notice and hence likely to confuse. Why not just say 'spreadsheet' here as elsewhere?

14. We welcome the inclusion of the 'soft landing' until April 2020 for some aspects of MTD in part of the Notice which has the force of law. However, given all the preceding references to April 2019 the rule with the force of law in Section 3.2 does need some introductory explanation. The explanation currently appears in section 3.2.2 but should appear next to the text which has the force of law.

15. We consider that the 'soft landing' should also apply to problems with the transfer of data from spreadsheets to bridging software and to scenarios where API enabled spreadsheets fail to connect with HMRC's APIs. At present we are not aware that any bridging software for spreadsheets exists and we have had reports that some software providers will not be developing such software (preferring to sell software packages for MTD). There is therefore a strong possibility that not all businesses using spreadsheets will be able to comply with MTD requirements by April 2019; this should be addressed by expanding the scope of the soft landing.

16. If the scope of the soft landing is not extended to all types of software availability and functionality issues this needs to be made explicit. Currently, the wording of the opening of section 3.2.2 seems to suggest a transition period for all businesses. This appears to be restricted by the wording of the section with the force of law and by careful reading of the examples in section 8 - but some businesses may not appreciate this. Given the large number of businesses which currently use spreadsheets to keep their records (and will need to use bridging software or API-enabled spreadsheets) it needs to be explicitly stated that they are excluded from the soft landing with an explanation of why this is the case.

Section 3.2.1

17. The paragraph opening with the words "There may be points during preparation of your VAT return" needs clarification. It seems to mean that the calculations do not have to be digitally linked to software or carried out in software. A similar point is made in section 3.4 about calculations underlying adjustments – but in section 3.4 it is made explicit that the calculations do not have to be made in software. A similar approach needs to be adopted in section 3.2.1 – and we suggest that this paragraph about non-digital calculations should be moved to the end of the section. Currently, it is confusing that the following paragraph in the section opens by saying that 'a digital link would also be linked cells in spreadsheets' – suggesting that the previous paragraph covers digital links when in fact it does not.

Section 3.2.2

18. See our comments on Section 3.2 above. The order needs to be changed so that the soft landing rule with the force of law (currently in 3.2) appears alongside the explanation which is currently in section 3.2.2. As also explained above, the scope of the soft landing should be expanded – but if it isn't the exclusion of users of API-enabled spreadsheets/bridging software from the soft landing needs to be explicitly stated.

Sections 3.2.3 and 3.2.4

19. The introduction of references to 'non-functional' compatible software in both these sections is extremely hard to understand. At the very least an explanation of the meaning of 'non-functional' compatible software needs to be given. As noted in section 3.2 spreadsheets are acceptable as part of 'functional compatible software' – the sudden introduction of the idea of 'non-functional' compatible software without any explanation does not make sense.

20. A close study of the examples in section 8 reveals that 'non-functional compatible software' means "non-API enabled software (accounting systems/general ledgers)" and non API-enabled spreadsheets. It would be preferable to use these terms rather than the highly confusing 'non-functional compatible software' so that users of the Notice are clear what is being referred to.

Section 3.3.2

21. This section refers to having a record of outputs for the period split between standard rate, reduced rate, zero rate, exempt and outside the scope outputs. However, the regulations refer to *"the proportions of the total of the VAT exclusive value of all outputs for the period which are attributable in each case to standard rated, reduced rated, zero-rated, exempt or outside the scope outputs."* The difference in wording should be explained – or the notice should be amended to reflect the regulations.

22. The section states that HMRC will provide guidance for charities at a later date on supplies by charity volunteers. This additional guidance needs to be provided as soon as possible and certainly before the implementation date for MTD. Clarification has also been requested on other scenarios involving charities – use of event organisers, for example. Will guidance also be provided on these?

23. This section also states that for supplies received the business 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.

    This needs further clarification. For partially exempt businesses, at the time of recording the purchase transaction in the ledger, the amount of input tax recovered may not be known and a partially exempt business may adopt any one of these approaches:

    - Record VAT as fully recoverable and adjust for any irrecoverable VAT once calculated

- Record VAT as fully irrecoverable and adjust for any recoverable VAT once calculated
- Record VAT recoverable based on an estimated percentage which may then be adjusted as part of the annual adjustment process

The wording in this section needs to be amended to make clear that any of these three approaches will be acceptable.

Section 3.3.4

24. We have been asked about the meaning of the bullet point in the summary data section which reads “the tax that needs to be paid following a correction or error adjustment”. Does this bullet mean that VAT adjustments falling under the voluntary declaration thresholds, previously incorporated in the next VAT return, must now be ‘declared’ because 3.3.4 of the Draft VAT Notice requires these errors to be separated out in the records? We understand that the rules on corrections remain unchanged, but clarification would be helpful.

Section 3.4

25. As noted above section 3.2.1 refers to performing adjustment calculations manually with the resulting adjustment then input into the software. Examples 7 and 8 in section 8 also refer to the option of making adjustments by manual intervention. However, the VAT Notice does not explain how businesses can be certain that their use of manual interventions for adjustments will be acceptable to HMRC. This needs to be clarified and the section should also include a list of examples of calculations which would be covered: a starting point might be the examples mentioned in the legislation overview published last year.

26. The meaning of the final line of example 2 is not clear and needs to be clarified or amended. In the first line of example 2 the reference should be to ‘a business’ not ‘a businesses’.

Section 4

27. Many businesses will wish to keep a record of their submission. The mechanism for doing so will presumably vary according to the software being used. However, it would be useful for the software to include a prompt to print or save the submission before sending.

Section 5

28. Voluntary updates are only likely to have any real purpose at a future date – as explained in the sentence beginning “In the future….”. This should be made clear at the beginning of section 5 rather than in the penultimate paragraph, so that businesses understand that there is currently no benefit to submitting voluntary updates. They will require extra work, particularly if they turn out to require correction but, as noted, will not discharge the VAT return obligation.

Section 6

29. We have suggested before that there should be more flexibility around the additional data to be submitted. This would allow the additional data to be tailored to different types of businesses with different risk areas – and make it more likely that the suggested benefit of submitting supplementary data (reducing the risk of a compliance check) would be achieved.

30. This suggestion has not been adopted so we remain concerned that the real intention behind the option to submit supplementary data is that the submission of the supplementary data listed should rapidly become mandatory. If so this should be made clear to businesses – with the proposed timeframe – so that they can take it into account when selecting software and making their preparations.

Section 7

31. It would be less confusing if the section was divided into two parts – one dealing with agents keeping and maintaining digital records and submitting the VAT return for clients and the other covering agents who only submit the VAT return. The paragraph beginning 'agents will not necessarily have access to your source data' presumably only relates to agents who are not keeping and maintaining the client's digital records. It would be useful to set out the process separately and clearly for the two different agent scenarios.

32. The list of actions agents will be able to take by 1 April 2019 is useful but is not in the style of the remainder of the VAT Notice and is likely to change before April 2019. We suggest that this information should appear somewhere else with a link from the VAT Notice. This would also allow it to be updated as the information is superseded by events.

Section 8

33. We consider that it is essential to incorporate the illustrative scenarios into the VAT Notice itself. We understand that it is HMRC's intention to do this. It would be helpful to cross refer to relevant examples where appropriate.

34. In example 7 we do not think the reference to 'non-functional compatible software' is helpful without further explanation and examples. This is a similar issue to that raised in our comments on Sections 3.2.3 and 3.2.4 above. As noted above it would be clearer to refer to 'non-API enabled software' and/or non-API enabled spreadsheets (or at least give these as examples of what is meant by 'non-functional compatible software').

35. Our request for an additional scenario to address complex non-corporate entities not in a VAT group has not been taken up. Whilst we understand that the scenarios are not intended to be exhaustive we consider that a scenario addressing such entities is essential. It is not clear how the scenario involving corporate entities in a VAT group would 'carry across' to non-corporates not in a VAT group. The additional scenario should cover a large non-corporate group of entities – for example a large estate - involving different (but linked) entities (partnership, sole trader, trust), several activities and using multiple accounting systems.

Additional content which should be included in the VAT Notice

36. The Notice currently contains no information about how the TOMS scheme will work under MTD. We understand that there is currently no software which can deal with TOMS. It would be helpful for the Notice to include a section on TOMS with an explanation of any relaxation of the 'mandatory digital' approach which may be required if a range of software which can deal with TOMS is not available by April 2019.

37. The Notice also makes no mention of VAT Cash Accounting (other than in an example) or the VAT Annual Accounting scheme. We have been told that users would find it helpful for these to be explicitly mentioned in the VAT Notice with an explanation of how they will work under MTD.

38. The VAT Notice should include a section about security. Many smaller businesses will not have the expertise to assess whether third party software products provide adequate security. We have raised concerns before that HMRC does not appear to have any mechanism for enforcing minimum standards for security (or for other aspects of products, such as functionality).

39. The VAT Notice should explain clearly who will be liable for any security breaches or loss of data – HMRC or third-party software providers? This is particularly important, given that businesses are required to allow HMRC to push information to them: we have already received feedback that some large businesses will be ensuring that the information for the return will be ring-fenced to prevent potential security flaws outside the business' control providing access to business' accounting systems to hackers. The same option will not be available to smaller entities using 'off-the-shelf' software.

40. The VAT Notice needs to explain that HMRC will be providing a list of 'approved software' for MTD for VAT and provide a link to this list. A range of software suitable for MTD needs to be available as soon as possible. Businesses were promised 'well over a year of testing' before any businesses were mandated to use the system. This will not be delivered (even the very small number of simple businesses permitted to join the pilot in April will have barely a year). Businesses and agents are already looking for software so that they can start to prepare but cannot currently find any information and no products are available.

41. The 'approved list' needs to cover software which meets all the requirements for MTD ie the record keeping requirements as well as filing the VAT return. We understand that HMRC's original intention was that the list would only cover software which could meet the filing requirements. We understand that this is under review following feedback at recent meetings that this would be unacceptable. Most businesses will have considerably less than a year to find and implement software, so they need assurance that software on the list will meet all the requirements. Many businesses will also lack the expertise to assess whether a product meets the record keeping requirements before purchasing it.